BAWAG P.S.K.

H1 2016 results

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Transcription

Key Speakers

Byron Haynes
Enver Sirucic

Operator: Good day, ladies and gentlemen, and welcome to the BAWAG P.S.K. first half 2016 earnings call. Throughout today's recorded presentation all participants will be in a listen-only mode. The presentation will be followed by a question and answer session. If you'd like to ask a question, you may press star followed by one. If any participant has difficulty hearing the conference, please press star followed by zero for operator assistance. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Byron Haynes, Chief Executive Officer. Please go ahead, sir.

Byron Haynes: Thank you. Good morning, good afternoon, everybody, and welcome to our first half 2016 earnings call. I'm joined by Enver Sirucic, our Deputy CFO, as well as members of the Board of BAWAG P.S.K.

BAWAG P.S.K. has delivered strong first half results. A net profit of 284 million, up 25%. Return on equity stands at 19.3%, that is a 1.2 point improvement. Return on tangible equity stands at 21.8%, that's a 2.9 point improvement.

So, what has driven this increase in operating results? There are higher core revenues (net interest income, net commission income) in excess of 470 million, up 2%. There's been core product growth, pricing initiatives and lower funding costs.

Stable net interest margin has been maintained at 2.1%, and of course this is despite the significantly low interest rate environment that we operate under. Of course there's been continued focus on efficiency and operational excellence. Operating costs are down to 215 million. Our cost-income ratio has been further improved by 2.3 points and now stands at 42.6%.

There's been lower risk costs. Lower risk costs by 36%, down to 16 million. Our NPL ratio remains stable at 2.3%, and of course this reflects the low risk business model and conservative risk profile that we operate under.

At the same time of improving operating results, we further strengthened the capital and liquidity position of the Bank. The CET1 fully loaded ratio now stands at 15.1%, that is up 2.2 points, and the total capital ratio, fully loaded, stands at 18.1%, and that is up 2.3 points compared to the year-end. We run a healthy liquidity coverage ratio in excess of 140%, and our regulatory leverage ratio has further improved by 40 basis points and now stands at 6.6%.

As it relates to capital, we have favorable stress test results from the ECB banking supervision. The adverse CET1 ratio of 9.7%, and that's only an adjustment of 330 basis points. This compares very favorably to the 51 bank results which were published, which represents 70% of banking assets across Europe. There the average adverse CET1 ratio was 9.4% and the average adjustment was in excess of 380 basis points, independent confirmation of the strength of our capital position as well as the low risk balance sheet and business model that we operate.

Now, let's look at some of the business highlights. Of course I will go into more details when we look at the individual business segments.

Our investments in retail franchises continue to pay off. Consumer lending market share is up 80 basis points and now stands at 11% compared to the year-end. 20% of these consumer lending sales are now through digital channels and mobile banking usage is up 22% on an accelerated basis over the last 12 months. We have an average seven million customer log-ins per month. Of course this reflects the rapidly changing customer behavior.

On the M&A side the intent to acquire the start:bausparkasse and IMMO-Bank will grow our domestic platform, will extend our expertise in building society and savings & loans and will result in significant financing opportunities for real estate, financing and social housing associations. The transaction is expected to close in the fourth quarter 2016.

If I look to Moody's. Moody's has upgraded BAWAG P.S.K. the second time in 12 months. The long-term deposit, senior unsecured and issuer rating now stands at A3 with a continued positive outlook. BAWAG P.S.K. is the highest-rated Moody's Bank here in Austria and we're one of the few A-rated banks across Europe.

And, finally, it's nice to receive some awards. *Euromoney* have just awarded us Austria's Best Bank 2016, and this fully reflects the successful strategic transformation that the Bank has undergone over the last recent years. This is the second international award that we've received following the *The Banker* award in December 2015.

What you can see is impressive strong results, and this confirms the sustainability of the business model of BAWAG P.S.K. We will continue to maintain our Austrian and Western market focus, our low-risk strategy, and we'll continue to provide our customers with simple, transparent, best-in-class products and services.

BAWAG P.S.K. now ranks as one of the most profitable, efficient and well-capitalized banks across Europe. We're well positioned to win in this evolving competitive European banking landscape. We're delivering results and we're well on track to outperform our 2016 targets, as you can see on the right-hand side of this slide.

If we now go to the next slide, our performance scorecard. As you can see, strong results across all key indicators, those same indicators I think I've discussed already.

Now let's turn to a review of the business segment performance, but before I go into the details, it's important to note that as of June 2016 we've changed the business segmentation and reporting. Why? It provides greater insight and transparency and it also better reflects our strategic focus and progress of our businesses now and going forward.

The former BAWAG P.S.K. Retail Banking and Small Business [segment] has now been split into two segments, BAWAG P.S.K. Retail as well as easygroup, and the former Corporate Lending and Investments business segment has also been split into two, the DACH Corporates & Public Sector segment as well as our International Business segment, and I will go through all the different business segments.

If we turn to slide 4, you can see here the BAWAG P.S.K. Retail business segment, a segment which serves 1.3 million private and small business customers, including real estate and social housing. We offer simple, fair, transparent products and services. The profit before tax stands at 80 million for the half-year, that is 3% down compared to the half-year 2015. However, it's important to note that included within that 80 million is the full year deposit insurance charge of 12.4 million. If you look at that on a six-month pro rata basis, the profit before tax is up 8.4% and stands at 86.3 million with a return on equity of 20.3%.

So, what has driven this improvement in operating results? We focus on four main value drivers. Growth in our core asset products. New business stands at 560 million, that's 50% from consumer lending and 44% from housing loans. If you look at our consumer loans, of course this excludes easygroup, which I'll discuss later, it's up 70 basis points and now stands at 10.6%. Net asset growth is 7.8% since the year-end. We continue to have the market ambition to grow our consumer lending, so it's the same market share as our current accounts, which is approximately 15%. So, as you can see, more growth to come in our consumer lending sphere.

Now let's turn to the second value driver. The second value driver is optimizing our product mix with a particular focus on value-added products. In February this year we launched a new generation of current account with enhanced features and services. This has been very much appreciated by our customers, and our customers have actually shifted from basic accounts to premium accounts because of those features. Some examples include our gold debit card with mobile functionality, SmartPay, or our DANKESCHÖN incentive program which incentivizes the use of products and payment card services. If I look on the liability side, there continues to be a shift from fixed savings to current accounts and savings cards. Of course this lowers funding costs but it also frees up sales capacity, provides our customers with greater functionality.

The third value driver is of course to continue driving transactional productivity. I've mentioned before that one out of every two customers now visits our branches. OTC transactions continue to shift to self-service, which of course allows our branch salesforce... frees up their time to focus on high value added advisory for our customers. Online transactions increased to 56% while OTC transactions have decreased, of course, down to 17%. In excess of 83% of all transactions are now completed online or through self-service.

In the first six months of this year we've also introduced a more modular system across our branch network. We have core branches which provide the full product and advisory services to our customers. We also have service branches which provide the basic services and transactions. This enhances our customer service quality, drives sales, lowers the cost to serve as well as optimizes our distribution capability. We continue to invest in our front-end “GATE” proprietary system.

And, finally, transformation to digital. Of course that continues as apace. We introduce new products and services. We have the full range of products and services online and in digital form, and we are the market leader in this respect in Austria. Examples include our “Einfach [Online]” current account, which is a 100% current account that can be opened by 100% digital mechanisms, including our online validation as well as digital signature. Or I can point to our SmartPay app via NFC smartphones. We've also redesigned and relaunched our website in the first six months of this year which improves usability, convenience and has a sharper focus on product sales.

Mobile banking usage, which I've already indicated, is up 22% on an accelerated basis. The increase in online services means higher interaction with our customers. We can better anticipate their needs and we, of course, continue to invest in data-based analytics as a key driver of future growth and cross-sell going forward. With all this focus on growth, it is important to note that we have not sacrificed risk and our risk framework. The NPL ratio has further improved by 40 basis points and now stands at 2.2%.

Now let's turn to easygroup, if you like, the new business segment. easygroup comprises our number one-rated direct bank, *easybank*, our number three auto lessor as well as the international residential mortgage portfolios. easygroup serves approximately 400,000 customers, and that is a 25% increase compared to this time last year. easygroup operates a lean, efficient business model, distributing products and services via the digital channels as well as via partner networks. If you look at the numbers, profit before tax of 45 million, a significant increase compared to the first half-year 2015, return on equity at 27.7% and an NPL ratio at 2.5%.

So, again, what are the key drivers of growth? Here, easygroup focuses on four strategic pillars, the first pillar being growing the customer base and market share in Austria. The customer base in Austria is 380,000 customers, that is an increase of 19%. Included within that number, of course, is the acquisition of Volksbank Leasing, which we completed in the fourth quarter of last year. But it's not all about inorganic growth. There has been strong organic growth of 6% across the online channel and through key partnerships like ÖAMTC, Shell and Energie Steiermark.

Strong origination in our auto lessor business. 187 million in the first six months of this year, is up 15%. And in July this year, last month, we entered into a strategic partnership with *Autogott*, Austria's leading online [auto] sales channel. We've combined the benefit of online sales with our leasing expertise, and this will be a great growth opportunity going forward for easygroup.

Of course we continue to drive efficiency across the organization. The Volksbank Leasing acquisition has been fully integrated into our leasing platform. As you can see, there's been a strong increase in sales while at the same time we've realized the synergies and we've realized the benefits from economies of scale.

The third strategic pillar is around building and maintaining loyalty. A good example of that in the first half of 2016 has been the 5% increase in current accounts and savings in *easybank*. At the same time as interest rates have decreased, we've also reduced our funding costs for savings and current accounts, which are now down to 44 basis points.

And, finally, the fourth strategic key pillar is expanding internationally into Western markets. As you know, we acquired a high-quality performing residential mortgage portfolio in December last year. This acquisition is very much in line with our strategy to expand in Western European markets. We will continue to look at inorganic opportunities, but in addition we are planning to offer direct banking services in Germany from the fourth quarter of this year.

Now let's turn to the other three business segments. Let me first start with the DACH Corporates & Public Sector [segment] on the far left-hand side of this slide. This incorporates corporate lending and public sector activities as well as fee-based financial services in Austria, Germany and Switzerland. What you can see is a profit before tax of 36 million, that is down 19%. That is principally driven by a reduction in core revenues, down 16%, driven by early redemptions, margin pressure and low new business volumes. We continue to focus on sustainable relationships while at the same time being disciplined on risk-adjusted pricing.

Commercial loan demand remains very weak due to the flat domestic output, due to the low corporate investment demand as well as due to other macroeconomic risks across Europe. Further margin pressure is being seen due to the excess liquidity that is on the market. Despite that, originations stand at 170 million for the first half and the credit quality of the book remains very high. As you can see, the NPL ratio has remained stable at 1%.

Now let's turn to the International Business [segment]. International Business profit before tax of 56 million, that is up 2%, return on equity of 19.5%. Core revenues, yes, are down due to early redemptions, but this has been compensated by positive risk costs. The focus continues to be on Western Europe and the US. International Business comprises international corporate, real estate and portfolio financing outside the DACH region. In terms of new originations, new originations of 1 billion in the first half 2016. Of course we continue to focus on high credit quality and strong cash flows. The average LTV remains less than 60% and the leverage of corporate assets remains less than four times. There's no risk cost and there are no non-performing loans in this portfolio.

And, finally, Treasury Services & Markets. Treasury Services & Markets manages the 5.1 billion securities book as well as the 1.2 billion liquidity reserve. As you can see, the profit before tax has remained stable at 21 million. Return on equity stands at 11.9%. The investment strategy continues, high credit quality, shorter duration, strong liquidity with some diversification provided by select sovereign purchases. The portfolio average is 3.9 years. 98% is investment grade, 78% rated single A or higher. We have no exposure to HETA, Hungary, Russia, China or other South Eastern European countries.

I think with that I will now hand over to Enver who will provide us more details of the overall Bank's performance.

Enver Sirucic: Thank you, Byron. I'm now on slide 7. Just to reiterate, another great quarter for BAWAG P.S.K. 284 million net profit in the first half. As Byron mentioned earlier, up 25% year over year, a PBT of 244 million. So, if you go across the P&L lines, we basically saw positive performance across the board. If you look at the core revenues, up 2% to 473 million, driven in a large part by net interest income. Opex was down 3% to 215 million, risk costs down 36% to 16 million. Unfortunately regulatory costs more than doubled compared to the previous year. What we have done, we have booked full year costs for the deposit insurance and also for the resolution fund already in the first half. And we also had a net tax benefit of 39 million which we expect will be absorbed by year-end.

From a business standpoint, we saw new originations of total 2 billion of which 50% came from our international business, around 40% from our retail and easygroup business and another 10% from our corporate business. If you look at all our ratios, RoE of 19% and return on tangible equity of 22%. Cost-income ratio came in below 43% and our net interest margin was quite stable at 210 basis points, which we think is a great result, just given the headwinds that we see in the market. So, I would say, all in all we are very positive, feel good about the first half and we have a good line of sight that this will continue in the following quarters.

Now moving to slide 8, core revenues. This is really more of the same what we have seen in prior quarters. From a net interest income standpoint, it's up 2% to 370 million in the first half and close to 189 million for the second quarter, with an average NIM, as I mentioned, of around 210 basis points. This was driven largely by two things: first, we had a very stable performance on the asset side, and this is really across all business segments; and second, we had repriced our deposits. Our blended retail deposit rate came down from 39 basis points in the previous half-year to 27 basis points as of June.

From an NCI standpoint, overall stable development, up 1%. We have seen a very solid payments business. We have seen good fund sales which are north of 400 million. And also our new current account campaign that we launched in February 2016 was very well received and is going very well. So far we sold more than 15,000 additional boxes. One last point on this slide that I would like to mention, also comment on, is just the overall balance sheet mix. So, we continue, really, to run our balance sheet in a very efficient manner, and one of the examples is what you see on the bottom left side is that 70%, and this is very consistent over the last quarters, between 65% and 70% of our total balance sheet are customer loans.

If we now move to slide 9, operating expenses. Again, this is more of the same. The restructuring investments that we made over the last years continue to pay off. Our cost-income ratio is 42.6%, down 2.3 points, and operating expenses down 3%. What is, I think, important to mention, if you look on the second quarter, is that we booked 12 million of restructuring in the first half, and that was mainly in Q2. So, if you take this out, you would get a normalized run rate of around 100 million core operating expenses. We generally believe that in this environment of slow growth, negative interest rates and increasing regulatory hurdles, the ability to control cost is the key element. Saying that, we'll continue to invest in the shift to digital, which is part of our overall investment that we will make this year of about 60 million.

Moving to slide 10, risk costs. Again, same theme here. Our continuous focus on developed markets, first our core market Austria, which is around two-thirds of our book, and one-third being in Western countries, also reflects the excellent risk cost ratio which currently stands at 12 basis points in the first half, which is probably at the low end. We expect through the cycle probably a risk cost ratio around 15 to 20 basis points. Our NPL ratio is 2.3%, and one thing also to mention is that you see the coverage ratios across all business segments being between 95% and 100%, which again shows our risk-averse approach that we have.

Moving to slide 11, capital. Capital is a real source of strength for the Bank. You see that we accrued north of 200 basis points in terms of capital ratios in the first half, which also allows us to look at potential market opportunities. Just in terms of actual capital ratios, our CET1 ratio is up 220 basis points to 15.1% on a fully-loaded basis. The same applies, basically, to our total capital ratio which is up 230 basis points to 18.1%. Our RWA density remains very stable at a conservative level of 45%. On the transitional capital ratios you see that there is a natural distance of approximately 50 basis points higher than what we have on a fully-loaded basis.

Compared to our SREP requirements, you see we are currently 580 basis points above these. And also, compared to our internal targets which we communicated earlier of 12%, we see a 310 basis points buffer. And, lastly, leverage, we are levered 11 times currently, roundabout, and our regulatory leverage ratio stands at 6.6%.

Moving to the last slide, page 12. Just to reiterate Byron's earlier comments, our targets for 2016 are unchanged and we are well on track to meet and also to exceed all of our targets that we communicated earlier. So, Byron, I'll pass on to you.

Byron Haynes: Yes, thank you very much, Enver. Operator, we're now in a position to take any questions the audience has on our results. Thank you.

Operator: Ladies and gentlemen, at this time we'll begin the question and answer session. Anyone who wishes to ask a question may press star followed by one. If you wish to remove yourself from the question queue, you may press star followed by two. If you are using speaker equipment today, please lift the handset before making your selection. Anyone who has a question may press star followed by one at this time. One moment for the first question, please. Your first question comes from the line of Johann Pötzelsberger of Wüstenrot. Please go ahead.

Johann Pötzelsberger: Hello. We have got two questions. The first one is concerning the exposure in the UK, about 3 billion, I think. How do you estimate the influence of the Brexit on the performance of these exposures in the UK, especially due to an assumed economic downturn or due to rising currency risks? And the second question is, we didn't understand why the international mortgage business is included into the *easybank* and not to the International Business segment.

Byron Haynes: I'll ask Enver to answer the first question and then I'll answer the second question.

Enver Sirucic: Yes. So, on the Brexit exposures, first thing maybe to mention, after the referendum our teams across Finance and Risk are monitoring closely the developments. So far we have seen a stable environment. Actually, we had even an uplift from the scenario, roundabout 15 basis points on our capital ratios. Coming back to our exposures, we don't see any issues in the short or mid-term. We cannot really say what the forecast looks like for the long term. Overall we have a very solid credit profile on our exposures with high coverage and a high collateral situation. On the FX situation, one thing to mention is that we 100% hedged our FX risks in the book, so we are not at all exposed to that.

Byron Haynes: Then in terms of your second question around the international mortgage portfolios. The simple reason is that this is on the retail side. They're residential international mortgages, and basically easygroup is the vehicle that we are using to expand our retail business internationally whereas on the international business, it's very much on the corporate side.

Johann Pötzelsberger: Okay, we understand. Thank you very much.

Byron Haynes: Thank you.

Operator: As a reminder, that's star followed by one to ask a question. The next question comes from the line of Thomas Marsoner at M&M Capital. Please go ahead.

Thomas Marsoner: Thank you. Just, firstly, congratulations. Another stellar set of results. The usual question, anything new in Linz?

Byron Haynes: Well, Thomas, thank you for the question. As usual, there is something new for a change. What is new is that we have the expert opinion published last week after 15 months. That expert opinion further increased our legal position and the strength of our legal position. Why? It confirmed the validity of the contract, it confirmed that the swap transaction was common practice in year 2006 to 2007. It actually significantly criticized the fact that the City of Linz had no risk strategy, no risk policy, had no stop-loss policy, and also confirmed that our claim of 417.7 million was reasonable and justifiable on the closeout. So, all those factors lead us to believe that our legal position vis-à-vis Linz has been further strengthened. There is lots of rumors in the market around settlement talks. Of course we've always indicated that we'll be ready to have settlement talks, but clearly, with our claim of 417 million, that's the basis of any settlement going forward.

Thomas Marsoner: Thank you.

Byron Haynes: Thanks.

Operator: There are no further questions at this time. I now hand back the conference to Byron Haynes.

Byron Haynes: Okay. Thank you very much and look forward to our earnings call for the third quarter, which I believe is going to be somewhere at the beginning of November. Thank you very much.

Operator: Ladies and gentlemen, the conference has now concluded and you may disconnect your telephone. Thank you for joining and have a pleasant day.