BAWAG Group

BAWAG Group Q2 2021

Earnings Call

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Transcription

<u>Speakers</u>:

Anas Abuzaakouk

Enver Sirucic

Anas Abuzaakouk: Good morning everyone. I hope everyone is keeping well and enjoying the summer months. I'm joined this morning by Enver, our CFO.

Let's start with a summary of the second quarter results on slide 3. We delivered net profit of € 119 million, earnings per share of € 1.34 and a return on tangible common equity of 16.3% during the second quarter. The underlying operating performance of our business was strong with pre-provision profits of € 181 million and a cost-income ratio of approximately 40%. Total risk costs were € 24 million, with the ECL management overlay now at € 70 million. We continue to not release any credit reserves, although we see a substantially improved macroeconomic environment from earlier in the year and continued positive developments across our customer base, in particular observing payment holidays falling to 20 basis points across our total customer business. We will reassess the management overlay during the second half of the year once we've seen greater normalization and stabilization of economic activity.

In terms of customer loan growth and capital, average customer loans were stable quarter-over-quarter and up 3% year-over year. We continued to accrete CET1 capital, generating 60 basis points of gross capital during the quarter. Our CET1 ratio was 14.4%, up 40 basis points from year-end 2020 after all dividend deductions. As of second quarter, and after deducting all current dividend commitments totaling € 515 million, we have additional excess capital of € 436 million versus our target CET1 ratio of 12.25%.

In terms of dividend distributions, we still have our earmarked dividend of € 420 million from 2019 and 2020 profits, which have always been deducted from CET1 capital and remain in profit reserves. Our plan is to pay the outstanding 2019 and 2020 dividend of € 420 million (or € 4.72 per share), subject to shareholder approval at the AGM on August 27, now that the ECB recommended dividend ban has been lifted, sometime in early October.

In terms of 2021 targets, given the strong business performance during the first half of the year, the improving macroeconomic environment we're witnessing, and the continued improvement in credit quality across the business, we are upgrading our targets for the full year. We now expect to deliver a return on tangible common equity of approximately 15% and a cost-income ratio around 40% this year.

On the M&A front, we signed the acquisition of Hello bank! Austria last week. Hello bank! Austria is the leading online retail brokerage platform in Austria and allows us to bolt-on an online brokerage product to our existing easybank offering, adding 80,000 new customers, which fits in nicely with our overall Retail & SME offering. We also expect the DEPFA Bank acquisition we signed during the first quarter, which is capital accretive Day 1, to close in the second half of the year. Both deals will have no impact on our overall capital distribution plans. I'll provide more details on both acquisitions later in the presentation.

Given the recent lifting of the ECB recommended dividend ban and the scheduling of our AGM for late August, we've decided to move up our investor day to September 20, 2021. We plan to share updated financial targets and will provide a new 4-year plan through 2025. We also plan to release the results of our stress test on July 30, shortly after the release of stress test results from the regulators.

The past 16 months have been incredibly challenging and not without adversity; testing our collective patience and resolve. However, the COVID-19 pandemic truly highlighted the quality, resilience, and sustainability of our franchise. With everything we've gone through, the team is more excited than ever to address the many opportunities ahead of us.

Moving on to slide 4: We delivered net profit of € 119 million, up 94% versus prior year. Overall, strong operating performance with operating income of € 303 million and total expenses of € 121 million, up 6% and down 3% respectively, versus prior year. Total pre-provision profits were € 181 million, up 14% versus prior year. Risk costs were € 24 million, down 68% versus prior year and reflecting the normalization of risk costs. Tangible book value per share was € 33.38, up 5% versus prior year and 2% versus prior quarter. This assumes the deduction of the earmarked € 420 million from 2019/2020 profits as well as the first half 2021 dividend accrual of € 95 million.

Moving on to slide 5, at the end of the first quarter, our CET1 ratio was 14.4% after deducting the remaining earmarked dividends from profit reserves of € 420 million and deducting the first half 2021 dividend of € 95 million. We look forward to finally distributing the remaining earmarked dividends of € 420 million, as we look to honor commitments to shareholders and believe the bank's continued resilience and overall strong capital levels position us well to resume ordinary capital distributions going forward.

For the quarter, we generated 60 basis points of gross capital as we continue to consistently generate significant amounts of capital, averaging over 220 basis points annual gross capital generation over the past four years. As of second quarter and after deducting all dividend commitments, we have excess capital of € 436 million versus our target CET1 ratio of 12.25% and stand at 528 basis point buffer to our SREP of 9.14%. To the extent that we are unable to deploy our excess capital in organic growth or M&A, we will distribute capital to shareholders through share buybacks and/or special dividends on an annual basis in a normalized environment as part of our ordinary capital distribution plans.

On slide 6, a recap of the two M&A transactions signed this year. We signed the acquisition of Hello bank! Austria last week and are excited about the team joining, the business, and the many opportunities ahead of us. Hello bank! Austria is the leading online retail brokerage platform in Austria and allows us to bolt-on a brokerage product to our existing easybank platform, adding 80,000 new customers, which fits in nicely with our overall Retail & SME product offering. The deal is expected to close in the fourth quarter of this year or first quarter of 2022. We underwrote the deal to an RoTCE greater than 15% and will have a Day 1 impact on our CET1 ratio of low double digit basis points. The deal will add over € 10 million pre-tax profit post-transformation.

We also expect the DEPFA bank acquisition, which we signed during the first quarter, to close during the second half of the year. The DEPFA transaction represents an accelerated operational wind-down of DEPFA bank leveraging BAWAG's operational capabilities and infrastructure, while taking little to no credit risk. The deal is capital accretive with a Day 1 gain of over € 60 million, which will in turn be reinvested to accelerate our business transformation.

Both deals will have no impact on our overall capital distribution plans. More details will be provided during our investor presentation as part of our 4-year business plan.

On slide 7, our Retail & SME business delivered net profit of € 94 million, up 40% versus the prior year and generating a very strong return on tangible common equity of 25% and cost-income ratio of 38%. Average assets for the quarter were € 20.1 billion, up 10% versus prior year and 2% versus prior quarter, which is driven by continued growth in housing loans and a pick-up in consumer loans. Average customer deposits were € 26 billion, up 7% versus prior year and 2% versus prior quarter. Pre-provision profits were € 141 million, up 12% compared to the prior year, with operating income up 6% as we begin to see a gradual normalization of customer activity. Overall operating expenses were down 4% versus prior year, resulting from prior year operational initiatives with a continued focus on driving synergies across our various channels and products. Risk costs were € 15 million, down 58% versus prior year, reflecting a gradual normalization of risk costs without any credit reserve releases. The trend in asset quality continues to improve across our customer base, with payment holidays at 30 basis points as of the end of the second quarter (versus 1.2% at year-end) with a customer payment rate of 90% on all expired deferrals with an average of 9-months. Additionally, 87% of all customer loans that are either in active deferral or non-paying after deferral expiration, are already captured in stage 2 or stage 3 loans.

We've continued to execute on our various operational and strategic initiatives. We expect to see continued average asset growth and efficiency gains across the Retail & SME franchise as well as a shift to a greater percentage of secured housing loans for the balance of the year. We also expect the second half of the year to look very similar to the second quarter with normalization of customer activity continuing in the months ahead.

On Slide 8, our Corporates & Public business delivered net profit of € 35 million, up 149% versus prior year and generating a strong return on tangible common equity of 16% and a cost-income ratio of 22%. Average assets for the quarter were € 13.4 billion, down 4% versus prior year and 2% versus prior quarter, driven primarily by lower corporate and public sector cash advances as well as delayed funding on several loan commitments. Pre-provision profits were € 58 million, up 21% compared to the prior year. Risks costs were € 10 million, down 65% compared to prior year, reflecting positive developments across our customer base with no reserve releases taken as well. The trend in asset quality continues to improve with payment holidays at 10 basis points and a 100% paying ratio for customers that took up payment holidays over the last year. We've been pleasantly surprised with how our customers have responded and the overall credit performance of the business.

We continue to see solid and diversified lending opportunities as well as a greater normalization of customer activity and several commitments funding in the second half of the year. We will continue to maintain our disciplined underwriting, focus on risk-adjusted returns, and avoid blindly chasing volume growth.

With that I will hand over to Enver.

Enver Sirucic:

Thank you, Anas. I will continue on slide 10 - Overall strong results in the second quarter: core revenues up 1% versus Q1, with both better net interest income and net commission income. Compared to prior year, core revenues were actually up 6%. Operating expenses further came down as well as risk costs without releasing any credit reserves. This all led to a significant improvement of net profit by 62% versus Q1 and 94% versus prior year – as well as all key ratios improving.

On slide 11, an overview of our balance sheet: We saw a very stable level of average interest-bearing assets over the last few quarters, with a mix of growing customer loans offsetting lower securities and bonds, leaving us overall with a significant cash position – we believe that being patient at the current interest and spread levels will provide an interesting opportunity in the future to deploy our excess cash. On the funding side we see growing deposits and also, we continued improving our long-term funding profile through issuing the next € 500 million covered bond, first time at a negative spread.

On slide 12, core revenues. Net interest income up 1% versus Q1 with a stable net interest margin of 228 basis points, which is in line with prior quarters. We see a positive trend in NII for the rest of the year which is driven by continued growth in housing loans and a pick-up in consumer loans as well as a greater normalization of customer activity and a number of commitments in Corporates & Public sector funding in the second half of the year. In terms of net commission income, recovery trend continues, up 4% versus first quarter, we observed a continued overall improvement, especially with a stronger advisory business, while we still see subdued activity in selected business areas compared to pre-pandemic levels. For the full year, expectations are unchanged - we still see core revenues growing by 2%.

With that, moving on to slide 13. Operating expenses further came down. Cost–income ratio was at 40.1% for the quarter. Absolute costs came in at € 121 million and we expect further gradual OpEx decreases over the coming quarters. For the full year we expect to be below € 485 million in absolute costs, and we updated our 2021 cost-income ratio target, which is now to be at around 40%.

Slide 14, risk costs. In general, unchanged conservative and prudent approach on provisioning with improving underlying trends and a strong asset quality performance. In Q2 we booked € 24 million of risk costs – mainly driven by a normal run-rate in Retail & SME of approximately € 15 million. Overall, we have not released any credit reserves and the ECL management overlay now stands at € 70 million versus € 52 million as of first quarter. We will reassess the management overlay during the second half of the year once we've seen greater normalization and stabilization of economic activity – without taking any releases into account we are updating our numbers and expect risks costs to come in below € 100 million for the full -year, again without releasing any ECL reserves.

Slide 15 provides more details on reserves. Overall reserves increased by 5% versus year-end, resulting in a total reserve ratio of 1.5% and a cash coverage ratio of 45% excluding City of Linz, which was fully provisioned through a capital prudential filter last year, therefore with no impact on our capital distribution plans, even in a worst-case scenario. Total ECL reserves now stand at € 147 million, up 13% versus year-end, of which almost 50% or € 70 million is comprised of management overlay reserves, which we will reassess during the second half of the year. Stage 2 assets continue to decline, approaching pre-pandemic levels – while we have not executed any routine retail NPL sales since Q2 last year. Overall, we see both an improved overall macro environment and continued positive developments across our customer base and asset quality.

To wrap-up, on slide 16: we updated our 2021 targets to approximately 15% RoTCE and around 40% cost-income ratio. In detail this is based on:

- Core revenues growing by 2%, while we expect other income to be flat for this year
- Operating expenses to fall below € 485 million
- Risk costs to come in below € 100 million
- And regulatory charges to land at € 60 million for full year, of which we have taken € 56 million year-to-date

We've decided to move up our investor day to September 20, 2021. We plan to share updated financial targets and will provide a new 4-year plan through 2025.

With that operator, let's open up the call for questions. Thank you.

Operator: Thank you. Once again if you have any questions please press star one on your telephone and wait for your name to be announced. If you would like to cancel your request, you can press the hash key. Once again, that is star and one if you would like to ask a question. Our first question comes from the line of Izabel Dobreva at Morgan Stanley, please ask your question.

Izabel Dobreva: Hello, good morning. Thank you very much for the presentation and for taking my questions. I have three questions for you. So the first one is on capital deployment. You mentioned in one of the slides that you now have nearly € 450 million of excess relative to your 12% target. And you have been very clear about potential future distributions, but I wanted to clarify the timing a little bit, regarding any potential buybacks. How should we think about the timing of any potential announcement, could the buyback be restarted already from January next year or would you think about it more as a year-end event towards the end of next year. So, that is the first question.

Then my second question is on DEPFA. In there, you mentioned a € 60 million Day 1 capital gain, which is going to be reinvested in the business. And I wanted to clarify does this mean that you can fund the structuring charges, which is gain to this degree and basically take out further costs? So, if we assume a three-year payback, does that mean that you can potentially strip out another 4% of the cost base?

And then my final question is just on the City of Linz. If you could remind us of the timeline there regarding the final decision.

Anas Abuzaakouk: Hi, Izabel. Hope, you're doing well. So, for your questions, I'll take the capital and then Enver will take the question on DEPFA and the City of Linz.

So, with regards to capital, I think it's best that for the Investor Day, we will provide greater clarity on the excess capital as well as capital distribution plans. So, it's not a year-end event, I think it's something in September hopefully, we'll be able to provide more clarity on. That's it.

Enver Sirucic: On DEPFA, Izabel, look, the € 60 million, it's a Day 1 impact after we have taken all future loss charges whatsoever associated with the transaction. The plan would be to share more details with you also at the Investor Day, but the idea is to reinvest it. You mentioned restructuring, but it will be a variety of measures with, actually, at the end probably very limited to no bottom-line impact.

On the City of Linz, we are now finally at the Supreme Court, we have filed the appeal, now we are waiting for the decision of the Supreme Court that could happen in the next couple of weeks, months or it could take longer. We don't really have a line of sight when the decision is being made.

Anas Abuzaakouk: I'll just add, Izabel, on the City of Linz, we provide in our supplemental information, a page just walking through the different scenarios and trying to explain what the decision at the Supreme Court now is with regards to the validity of the contract. It does not address damages and what we've tried to highlight is, obviously, there's no impact on capital as we've taken a full provision through the prudential filter, and I think that should provide some explanation in terms of how the receivable is treated from a balance sheet standpoint as opposed to from a capital standpoint. But hopefully we get a decision soon but that's obviously out of our hands, and we feel strongly about the case that's why we've stuck with it for the past decade, so. Thank you.

Izabel Dobreva: Thank you.

Operator: Next question is from the line of Mate Nemes from UBS. You may ask your question now.

Mate Nemes: Yes. Good morning. And thank you for your presentation. I have three questions, please.

Firstly, on the 2% core revenue growth guidance. Could you help us understand a bit better what is that predicated upon, especially after the second quarter now it seems already Q1, Q2 more together each one run rate will order be sufficient for hitting that to a 2% revenue core growth. Is there any negative item, is there any attrition on the loan book that you expect on the second half, perhaps something negative on fees that would make you come out with a reconfirmed conservative guidance?

The second question is on risk costs. The € 100 million risk cost guidance excludes any provision releases, I think that's what you commented. Nevertheless, do you see a scope for provision releases outside of guidance in the second half? And if so, could you comment how that could be done when and so on?

And thirdly, could you give us a timeline on Hello bank!, by when do you expect back to get to the € 10 million pre-tax profit mark and what sort of restructuring costs should we assume here? Thank you.

Enver Sirucic: Thanks Mate. I'll take the core revenue question. Look, I think you're absolutely right, if you think the run rate of first quarter, second quarter extrapolate will probably land a bit higher than that. We have just not updated every time the guidance but put it that way we are just very cautious on our assumptions, that's all.

Anas Abuzaakouk: Hey Mate, it is Anas. On the risk costs, it's good that you've clarified that it is under a € 100 million for the year, assuming no reserve releases, but our preference quite frankly is a) just to see the normalization of customer activity and I think that's best reflected in the payment holidays, which we mentioned is 20 basis points across the whole customer loan book. b) The stage 2 in % of our loans, which is 6% and probably migrating to pre-COVID levels of 4%. I think those are the best indications. As far as the reserve release, we want to be prudent and cautious. I think we've said that last year, we've said that in the first half of this year and we're going to continue, even in the second half to be prudent and cautious. So however, we treat that ECL management overlay of € 70 million and that'll probably be a growing balance. We're always going to be prudent and cautious.

As it relates to Hello bank! that is hopefully fourth quarter this year, first quarter of next year. The restructuring costs are embedded in the low-double-digit CET1 impact that I mentioned. So we don't disclose the actual numbers. Given that this is a domestic acquisition of € 10 million of pre-tax profit, I think on a conservative side, assume that's after two years. Hopefully sooner, I think we've had a track record of doing things a bit earlier, but just to be on the conservative side And more importantly, we underwrote it to a return on tangible common equity of greater than 15%.
Hope that helps Mate.

Mate Nemes: Absolutely. Thank you very much.

Anas Abuzaakouk: Thanks, Mate.

Operator: Our next question is from the line of Gabor Kemeny from Autonomous Research. Thank you.

Gabor Kemeny: Hi. Good morning. Couple of questions.
Firstly, another one on the share buyback. Have you requested approval for share buybacks from the ECB yet?

And the second one is on the DEPFA acquisition, you mentioned, € 60 million Day 1 gain. I mean, shall we read it like you are reinvesting the potential capital gain into the restructuring -- into group restructuring? And if so, we should not expect like a meaningful capital impact from this deal over the next year or so. Would that be a kind of fair interpretation?

And then just finally on retail loan origination, we think to be trending pretty well, especially on mortgages if you can comment on the trends here and how your Dutch mortgage business is doing, how much are you originating there?
Thank you.

Anas Abuzaakouk: Hi, Gabor. Hope, you're doing well man. On the share buyback, nothing is formally applied. I think, we'll just wait till the Investor Day to provide greater clarity. In terms of overall capital distribution plans, which potentially could conclude on the share buyback. I think I'll leave it at that.

On the DEPFA aside, you're absolutely right € 60 million is the Day 1 gain, but effectively we're going to reinvest that, part of that is restructuring as Enver had mentioned there's going to be no P&L drag, post-closing and also that is going to be reinvested in terms of footprint optimization and a lot of other things we're doing from a transformational standpoint from a cost standpoint as well as in other areas of the business.

Then as far as the retail loan origination you are spot on, I think what you'll see in the first half of the year will continue in the coming quarters, in terms of asset growth on an average basis for both housing loans as well as in consumer and SME. So it's a good development on that front, we feel pretty -- we feel pretty positive on that front so. I hope that helps Gabor.

Gabor Kemeny: Yeah. It does. Just a quick follow-up. What the size of your Dutch mortgage book these days?

Anas Abuzaakouk: Did you say what's the size of that Dutch mortgage book? Yes, look at the total housing loans right now I think is around 15.5, oh sorry 18, what's the number 15.5 billion or so now in the housing loans. We just, we report as overall Austria, Germany, Netherlands, and Switzerland and so on, we don't break that up separately. I think € 15.2 billion, just telling you the exact numbers. Thanks Gabor.

Gabor Kemeny: Okay, thanks.

Operator: Next question is from the line of Mehmet Sevim from JP Morgan.

Mehmet Sevim: Yes, good morning. Thanks very much for the presentation and taking my questions. First question on dividends, please. Are the plans still subject to ECB approval, and if so could you please share whether you have received individual approval from the ECB on your dividend plans already? And I'm asking given the wording is vague when it comes to the process and it's stating that banks should seek ECB approval before market communication. So is there anything you can share beyond what we learned from the ECB on Friday?

And my second question was on Hello bank!, I mean, obviously a very exciting acquisition given the shift we also see in customer behavior in many other countries. Can I ask what kind of synergies do you expect from the business with your existing easybank franchise? And this -- you're saying this is the leading brokerage already, but 80,000 customers may be still some room for growth in a country like Austria. So would you see this as a high growth business in the mid-term? That will be my second question. Thanks very much.

Enver Sirucic: Hey, Mehmet. So on the dividend, we have not changed anything in our plans seems pretty much for the last 1.5 years, always announced the same number. We always deducted the dividends € 420 million outstanding from the capital. So, there is no formal approval needed to pay it out. We just wanted to wait for the new announcements from ECB that came out last Friday. So, we feel good from our perspective. The next steps are, as we said, is AGM. So, we need the AGM approval. And after that, we'll wait for the ban to formally expire at the end of September and then pay it out early October. So, we think that is in line with the recommendation from ECB.

And Hello bank! we feel very good about the deal. We like the team, we like the product. You're spot on. It's a growing business. In terms of synergies, it's a domestic play for us, which means obviously on the infrastructure side, there are certain synergies that we want to extract from the transaction but first and foremost, it's really the team and the product that we are excited about.

Mehmet Sevim: Okay, great. Thanks very much Enver.

Enver Sirucic: Thanks Mehmet.

Operator: Thank you. (Operator Instructions) Over the next question is from the line of (analyst). Thank you.

Analyst: Yes, Good morning and thank you for the presentation for the call. I had just a couple of questions. And the first one is on the NII and on the TLTRO impact. Is it correct that you booked around € 7 million of impact in the first quarter and around € 23 million for the second quarter?

And my second question related to the stage three loans. I was wondering whether there was a small increase in Q2 for amount to € 20 million. If you could elaborate on this?

And maybe, do you give any guidance on the NPL ratio for the full year? Thank you very much.

Enver Sirucic: I think, look on the first one it's very easy on the TLTRO no, it's not, right. So we booked the same amount for Q1 and Q2. There is no different number.

	And on the second one, we don't give any guidance on the NPL ratio for the full year.
Analyst:	Okay. Thank you very much.
Operator	There are no further questions on the line. Please continue.
Anas Abuzaakouk:	Okay. Thank you, everyone. I hope everybody has a chance to enjoy the summer holiday and get a chance to get some much needed rest and relaxation. Take care and look forward to talking to you guys at the Investor Day. All the best. Bye.