BAWAG Group

Q3 2018 Earnings Call

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Transcription

Key Speaker:

Anas Abuzaakouk

Enver Sirucic

Anas Abuzaakouk Good morning, everyone. I hope everyone's doing well. I'm joined this morning by Enver Sirucic, our CFO. Let's jump right into it, on slide three. We delivered very strong results during the third quarter, with profit before tax of €160 million. This is actually up 24% versus the prior year. Net income is up 27% versus the prior year, at €125 million, a return on tangible equity of 20.2%, this is when we apply a 12% CET1 ratio, and earnings per share for the quarter of €1.22. We also generated 10 basis points of CET1, landing at around 15.3% fully loaded CET1 ratio, and this is net of the capital actions that we took during the third quarter. On a year to date basis, profit before tax was €429 million, this is up 14% versus prior year, generating 16.8% return on tangible equity, again when we apply a 12% CET1 ratio to adjust for excess capital levels.

Given the strong performance over the first three quarters, we're on track to exceed all of our 2018 targets. As far as executing on our operational road map, we continue to make really good progress across the board and have good momentum as we look to close out the remainder of the year.

On *Concept 21*, the separation from the Austrian Post is on track as it relates to customer migrations, branch transitions and hiring of advisors. We've completed 85% of the branch transition and migrated 55% of the impacted customers to date, with the retention ratio of over 95%.

We've also added another retail partnership during the third quarter, providing new customer acquisition channels to offer full scope of retail banking products. The Südwestbank restructuring is ahead of plan, and we've planted the seeds for growth in 2019, expanding our retail and SME offering and leveraging new distribution channels across Germany.

We also closed the Deutscher Ring Bausparkasse acquisition in the third quarter. Mind you, this is our first German M&A bolt-on acquisition, and this will complement our German mortgage channel. As far as business development, we saw favorable trends during the third quarter, however we continue to stay patient and disciplined, focusing on risk-adjusted returns versus absolute volumes.

Overall, we've had year to date new business originations of €4.7 billion, this is up 28% versus prior year, and primarily driven by our core retail product growth as well as our international lending business.

Our overall strong capital position and generation provides us with a number of opportunities as we focus on organic growth across our multiple business lines.

On the M&A front, we are evaluating a number of opportunities, however we will only pursue deals if they are the right strategic fit, come at the right value, are earnings accretive and generating returns consistent with our Return on Tangible Equity group targets.

We're absolutely committed to total shareholder return and being good stewards of capital. In the event we are unable to deploy our capital to organic and/or inorganic opportunities that generate returns greater than 15%, we are committed to returning capital to shareholders through dividends and stock buybacks.

Moving on to slide four, we've outlined the quarterly financial development and per share performance metrics. Third quarter profit before tax came in at €160 million, up 5% versus the prior quarter. This was driven by higher NII and other income, staying disciplined on costs by keeping expenses almost flat and maintaining low risk costs.

The third quarter earnings per share increased by 7% to €1.22, and tangible book value per share increased 3% to €31.90. Core revenues were up 2%, driven by NII growth of 5% and NIM increase of 13 basis points. This was mainly driven by balance sheet optimization measures and converting our strong pipeline in the international lending business, which we had alluded to in prior quarters.

NCI was seasonally lower than anticipated, which is in line with prior years. Overall, operating expenses were up 1% versus the second quarter. This takes into account the acquisition of Deutscher Ring Bausparkasse and the increase in our branch network, however the overall cost-income ratio decreased 1.5 points to 42.4%.

The risk cost ratio was 12 basis points, and the NPL ratio decreased 10 basis points to 1.7%. The low risk costs for the quarter reflect the ongoing benign credit environment we're experiencing, solid asset quality in the stable developed markets that we continue to operate in.

On slide five, the customer business development has been led by BAWAG P.S.K. Retail, easygroup and our international lending business.

The BAWAG P.S.K. Retail segment continues to deliver core net asset growth, with €900 million of originations year to date, we're really focused here on consumer and housing loans, and this is offsetting the proactive run-off of our Swiss franc mortgages. Our focus is on delivering on *Concept 21*. Additionally, we've been growing partnerships in our digital platforms to augment our existing retail distribution channels.

At easygroup, our year to date performance has been really solid as the organic and inorganic growth from *easybank*, *easyleasing* and start:bausparkasse are replacing the run-off of our international mortgages. We're also positioned for the launch of *Qlick*, which is our digital German brand, during the fourth quarter, which will drive consumer loan growth in Germany.

Our International Business segment had another solid quarter with strong originations and year to date net asset growth of 9%, while maintaining a disciplined approach to underwriting and focusing on risk-adjusted returns.

As far as the DACH Corporates & Public Sector business, pricing remains challenging and we continue to focus on risk-adjusted returns versus just driving volume.

At Südwestbank, we're building on the early momentum from our transformation roadmap. The primary focus here to-date has been really on the operational restructuring, however we've already planted the seeds for 2019 as we expand our product and channel offering across Germany.

Overall, we feel very good about the customer business development during the first nine months of the year. Growing in our core retail products, continuing the shift of our customer franchise to retail and SME, and executing on various operational initiatives, be it the Südwestbank restructuring or the BAWAG P.S.K. Retail *Concept 21* network transformation. We also believe focusing on risk-adjusted returns, not chasing volume, and staying patient and disciplined in deploying our liquidity and capital will serve us well over the long haul.

I'm on slide six, now. The BAWAG P.S.K. Retail segment had another strong quarter. As it relates to financials, third quarter profit before tax came in at €60 million, this is up 24% versus prior year. Year to date profit before tax came in at €177 million, up 17% versus prior year with a cost-income ratio of 44.5%.

The business continued its trend of driving positive operating leverage. This is really best demonstrated through the reduction in costs on a year to date basis of 8%, while growing our operating income by 5%. As far as business development, new business asset originations of €300 million during the quarter were driven by consumer and housing loans. Year to date, we've had core net asset growth of 3% in consumer and euro housing loans, which is offset by a proactive reduction of Swiss franc housing loans, which are down 5% year to date.

In terms of operational and strategic developments, we also signed a strategic partnership with Metro Cash & Carry, which is the leading SME-retailer in Austria, on the heels of the partnership we signed with MediaMarktSaturn Austria in the second quarter. This will allow us to provide current account products and credit cards for entrepreneurs as well as SMEs. The collaboration will allow us also to provide tailored financial products and services to their more than 500,000 customers, so we're really excited about this partnership.

On slide seven, we wanted to provide a more detailed update of *Concept 21*. Again, this is our retail network transformation. *Concept 21* has been in the works for quite some time. The separation agreement from the Austrian Post we signed earlier this year provided us with the chance to accelerate our retail transformation plans and work towards our preferred stand-alone network.

The opportunities that brought were compelling and really a chance to, A, enhance the overall customer experience, B, reduce inefficiencies within the network, C, invest in a digitally-integrated omni-channel distribution and, D, maintain our high-touch advisory, which is really, at the end of the day, what our customers want and expect from us.

The target network we communicated is up to 100 branches, and this will cover over 85% of the Austrian population, over 92% of our existing customer base, and will be comprised of 74 high-performing branches that are today leased or owned by BAWAG, and that will be augmented with an additional 26 new branches.

The execution of the *Concept 21* roadmap has actually been going very well. To date, we've completed 85% of the branch transition, shifted over 55% of our 420,000 customers that are impacted in our target network. It's also important to understand and note that approximately 70% of the customers, or about 1 million customers, are not impacted by the branch transition.

We've maintained a customer retention rate on the transition customers of over 95%, which is consistent with past migrations. Over 50% of our newly planned branches have been signed with the opening of our first stand-alone branch that took place in October, and there has been really no significant complaint activity.

Ultimately, *Concept 21* provides us with client-focused advisory centers, self-service enhancements and improved customer service workflows integrated with our digital platforms. This is really the transformation of the future for us.

On slide eight, easygroup had another solid quarter. On the financials, third quarter profit before tax came in at €35 million, up 20% versus the prior year. Year to date profit before tax came in at €106 million, up 1% versus the prior year with a cost-income ratio of around 32%.

As far as business development, new business originations of €200 million during the quarter were primarily driven by autoleasing. We continue to see steady growth in our core products, which are up 3% year to date. Overall, customer loans were flat since year-end as we absorbed Deutscher Ring Bausparkasse. This had assets of about €400 million, and this was offsetting, in large part, the anticipated run-off of international mortgage portfolios, which are down approximately 15% year to date, in line with what we've guided historically.

Moving on to slide nine, in the non-retail segments, the International Business delivered a strong quarter with profit before tax of approximately €30 million. This is up 11% versus the prior year. Year to date profit before tax came in at €88 million, up 45% versus prior year, driven by the release of provisions from the sale of a non-performing loan in the second quarter. Asset quality remains high, with an NPL ratio of 20 basis points.

Overall, new business origination of approximately €1.4 billion during the third quarter helped drive net asset growth of 10% from the prior quarter. Additionally, we have a solid pipeline in the fourth quarter that we hope to execute on.

The DACH Corporates and Public Sector segment delivered profit before tax of approximately €11 million during the third quarter, this is a decrease of 44% from the prior year. Year to date profit before tax came in at €33 million, down 39% from the prior year. In reality, from our perspective, the DACH corporate lending market continues to be challenging, as it relates to price and risk-adjusted returns, however we will continue to be patient and disciplined, focusing on risk-adjusted returns versus purely pursuing volume growth.

On slide ten, our focus on Südwestbank continues to be in the transformation and repositioning of the business. Südwestbank delivered third quarter profit before tax of approximately €13 million, and year to date profit before tax of approximately €33 million. There are no comparisons to prior years given the acquisition closed in December 2017. Overall, revenue development has been in line with our expectations, as part of the capital efficiency review taking place, and the financial benefits of the cost restructuring will continue into the fourth quarter with the full benefit being realized in 2019. The core revenue development is in line with our capital efficiency measures taking place as we scale back low margin, high-risk weight and low-returning business that do not meet our target risk-adjusted returns. From an operational standpoint, the third quarter was a continuation of the transformation efforts launched at the beginning of the year.

The key focus from a product and a channel standpoint will be augmenting our retail and SME products and channels, which were accelerated with the closing of Deutscher Ring Bausparkasse on the housing loan front, using *Qlick* as an integrated German consumer loan product, leveraging Spotcap technology to address parts of the German SME market, and leveraging PayLife for the issuance of credit cards.

Moving on to slide 11, we wanted to provide more detail in the integration efforts in Germany and focus on the operational transformation at Südwestbank and Deutscher Ring Bausparkasse. Specifically, we wanted to highlight the work that has been done to-date and provide details around restructuring and projected cost-outs. The transformation plan covers cost restructuring, product profitability reviews, process improvements across the middle and back office, and identifying ways to leverage the broader group infrastructure.

In terms of personnel at Südwestbank, we project a total FTE reduction of around 40% versus year-end 2017. To enable the restructuring, we implemented the social plan that was agreed with the workers' council earlier this year, in April. The social plan consists of two phases, split between phase I in 2018 and phase II in 2019. We've already completed the first phase and are in the process of accelerating phase II of the restructuring to focus the team on a number of growth initiatives going forward.

In addition to Südwestbank personnel restructuring plan, we also agreed on an optimized branch network and non-personnel cost-out; reflecting both the overall business needs and digital priorities. Our day 1 network consisted of 28 total branches. The social plan settled on a total of 16 branches, which is a reduction of around 40%, which we believe will preserve both regional coverage and core product services. At the end of the third quarter, we'd completed 100% of the branch closures that we had targeted.

With Deutscher Ring Bausparkasse, which is a building society bank with 85,000 customers, approximately half a billion of assets and 100 employees, this really represents our first bolt-on acquisition in Germany. The business provides a new mortgage product and channel for our German platform. We closed the transaction in September and agreed upon a social plan with the workers' council just last week. Our goal is to complete the restructuring and integration by the first half of 2019.

To-date, we've made very good progress with the German integration and expect the strong momentum to continue for the next 6 to 12 months. The cost benefits will become much more visible in 2019, and the retail and SME product and channel positioning will also start to take shape in 2019 as well. With that, I'll pass it over to Enver to go into more details on the financials.

Enver Sirucic — Thank you, Anas. I'm on slide 13 right now. Let me briefly reiterate some of the Q3 highlights. It has been a very good quarter, strong core revenues which are up 2% versus the previous quarter, despite the seasonal commission income softness. Net interest income is up 5% in the quarter, and the net interest margin improved by 13 basis points to 2.28%. Operating expenses were broadly flat and with growing revenues the cost-income ratio improved by 1.5 percentage points. The risk profile remained unchanged, with low risk costs, low level on non-performing loans and a very high asset quality. This all resulted in a profit before tax of €160 million for the quarter, which is more than 5% higher compared to the second quarter, and 24% better than last year's third quarter. The return on tangible equity at the target of 12% CET1 ratio was slightly above 20%, and the pre-tax earnings per share came in at €1.57. In terms of balance sheet developments, we had a strong growth in interest-bearing assets for the quarter of almost €1 billion, and with the Tier 2 buyback we completed we have done an important optimization measure in the third quarter.

On slide 14, you see the usual overview that we have on P&L and balance sheet and some of our key metrics. I think most of the numbers have been mentioned before. I would only highlight the further improvement of the tangible book value per share, which is up 3% versus previous quarter, or €1, and shows a very positive trend on the asset side, with growing interest-bearing assets of €1 billion in Q3 compared to the previous quarter.

With that I will move on to the development of core revenues on slide 15. Strong growth of net interest income, which was up 5%, and net interest margin, again up 13 basis points. There are three main drivers behind that. Firstly, as announced in Q2, we finished the Tier 2 buyback in July, and this has a positive impact of approximately 4 million per quarter going forward. Secondly, we had a very good asset deployment in our retail segments, and a strong pipeline conversion in our international lending business that led to a 10% net asset growth in the segment. And last but not least, we also managed our excess cash position and deployed more liquidity into interest-bearing assets. As expected, the net commission income was seasonally lower and we also saw some weakness in securities sales and insurance products, just given high market volatility in Q3. Overall, I would say a very good development of core revenues, despite a seasonal headwind, and a very good momentum for the remainder of the year.

With that, moving on to operating expenses on slide 16, this will be a rather short update. Operating expenses are broadly flat versus Q2, with a cost-income ratio of 42.4%, showing a 1.5 percentage point improvement in the quarter. Our new bolt-on acquisition in Hamburg is already partly reflected in the numbers, where the closing took place in September. What are the further trends? We will continue to focus on efficiency, of course, and we should see the full benefit of the optimization measures of our acquisitions in 2019. On our branch network transformation, called *Concept 21*, it's progressing very well but we are also making investments and these measures will lead to an increase in staff costs in the coming quarters as well. All in all, I would say a solid performance for this quarter that puts us in a very good spot as far as exceeding the 2018 guidance of the target cost-income ratio of below 46%.

Switching to the next page, slide 17, very solid quarter on the risk side. The risk cost ratio was at 12 basis points and our NPL ratio actually improved from 1.8% to 1.7% reflecting our focus on developed markets with still 75% of our customers being in our home countries, in the German-speaking region, and 25% in Western Europe and the United States. In this context, maybe just to highlight some topics; number one, we have no relevant exposures to Turkey, Russia, CEE or generally broad, emerging markets. Number two, our business is mainly domestic mass retail banking, and we do not have any operations in countries with elevated AML risk and we also avoid certain asset classes just in general, such as construction financing. Overall, we will remain patient, disciplined and will always focus on risk-adjusted returns. We strongly believe that this approach will serve us well in the longer term and strengthen the resilience of our business model.

On slide 18, we again have two pages on capital, one to show the overall development and key points, and the second one is a more detailed walk of our CET1 ratio. So our fully loaded CET1 ratio came in at 15.3%, which is 10 basis points higher than Q2, and up 180 basis points on a year to date basis. The excess capital above our management target of 12% CET1 ratio stands now at approximately €660 million, compared to the mid-term target of €2 billion excess capital that we have. A brief update also on the recent EBA/ECB stress test. Our three-year cumulative CET1 impact in the adverse scenario would have been 240 basis points compared to the industry average of 395 basis points, and also in this scenario we would land at a CET1 ratio of 11% compared to the average of 10.1%. Overall, I think a good reflection of the resilience of our business model, and the strong asset quality with the focus on developed markets.

Moving to slide 19, what are the key drivers behind the quarterly CET1 ratio walk. It's really three elements. On the one side, we have earnings that contributed around 60 basis points per quarter, which is in line with what we have seen in the previous quarters. Secondly, we executed a Tier 2 buyback in July, that was a negative 30 basis points impact, and then we launched our share buyback program for roughly €1.3 million shares, which was completed by more than 70% at the end of the quarter, and actually was fully completed yesterday that was a 20 basis points negative impact. So in a nutshell, plus 60 basis points from earnings and minus 50 basis points from the capital buybacks, that is how we moved from 15.2% to 15.3%. If you now accrue for the 50% dividend payout, the CET1 ratio would then be at 14.5%. We have not yet finalized the PPA of Südwestbank, which will lead to a release of the prudential filter, once completed. It's round about 20 basis points that is still left. Overall, with the completion of both buybacks this was strategically a very important step for us. And with that, I would like to hand back over to Anas. Thank you.

Anas Abuzaakouk Thanks, Enver. So I'm on slide 21, everyone. We wanted to just recap our targets for 2018, which are comprised of the following: pre-tax profit growth of greater than 5%; cost-income ratio under 46%; return on tangible common equity greater than 15%, this is applying a 12% CET1 ratio to adjust for the excess capital levels; and a CET1 ratio of fully loaded equal to or greater than 12%.

As I stated earlier in the presentation, we feel very good about our operating performance through the first three quarters of the year and are on track to exceed all of our 2018 targets.

Lastly, on slide 21, we wanted to highlight the pace of capital accretion during the first three quarters against our stated target of generating over €2 billion excess capital through the end of 2020. Again, this is based on amounts greater than 12% CET1 ratio and how we ultimately plan to deploy our excess capital.

As in the third quarter, we built up excess capital of €660 million, this is net of the capital actions Enver mentioned. Our primary objective is to deploy our excess capital into organic growth, as well as M&A that generates returns consistent with our return on tangible equity target of greater than 15%.

To the extent that we are unable to deploy our capital in organic or inorganic growth at stated returns, we will be good stewards of capital and return excess capital to shareholders. We target an annual dividend payment in 2018 of 50% as well as pursuing stock buybacks. With that, operator, let's open the call for questions.

Operator Ladies and gentlemen, at this time, we will begin the question and answer session. Anyone who wishes to ask a question may press star followed by one on their touchtone telephone. To withdraw a question, please press star followed by two. If you are using speaker equipment today, please lift your handset before making your selections. Anyone who has a question may press star followed by one at this time. The first question comes from the line of Pawel Dziedzic of Goldman Sachs. Please, go ahead.

Pawel Dziedzic Good morning, and thank you for the presentation. The first question is just a follow-up on your dividend policy you just reiterated. How should we think about the timing of announcement if you are in a position to pay more than 50% for the current year?

The year is not over, but clearly you haven't closed any deals yet. Do you have enough clarity at this point in time to perhaps indicate that the higher payout is on the cards? And if not, at what point in time could this announcement come? So that's the first question.

And then, I have a more detailed question on your performance. The first one is on Südwestbank, so going back to slide 11. Your cost-income is still above 60% and I think you are showing that your costs are falling but so are your revenues, so I wonder if you can help us understand a little bit better the dynamics here, going forward?

On the slide, you mentioned 35% to 40% cost base reduction under the current plan. If I look at the change in your cost base between the first and third quarter, it's around 9%, so is it fair to assume that there is further 25% to 30% that could materialize by the end of 2019? And how should we think about revenue erosion as well, next year?

And maybe one very short question on International Business, so slide nine. Can you give us a little bit more detail on what drove this 10% increase, and how should we think about the level of NII, which is up 15% quarter on quarter, is it sustainable or not? Thank you.

Anas Abuzaakouk Thanks, Pawel. Let me just start by again apologizing to everyone on the phone for the technical issues that we experienced earlier on the call. So we apologize for that and if anybody has any items that we need to follow up on, obviously, follow up with our Investor Relations, and we should hopefully have a clean transcript.

So, Pawel, on your questions, let me go through it. Full-year dividend is the expectation, so that will be at the end of the year, in February will be the announcement in terms of the full-year dividend. We're still committing or sticking to the 50% dividend payout. I think you would ask the question with regards to are we going to increase the capacity or amount. We're still committing to the 50% payout.

As far as Südwestbank, I would look at it this way, Pawel, you're right, absolutely, there's revenue erosion; we've been focusing more on the operational restructuring. The cost-out will probably be about 40% to 45% from the day one overall cost base. The erosion that you're seeing today is more around the capital optimization, so I think you have to look at it in light of not just top-line overall gross revenue but also the return on tangible equity when you apply 12% CET1.

We don't give any specific targets in terms of top line versus OPEX. All we've said, and will be consistent in saying, is we'll hit the overall group targets. So we plan to, by 2020, be at a return on tangible equity of over 15%, and then obviously the cost-income ratio should be pretty much in line with the overall group.

And then, as it relates to the International Business, the 10% in asset growth, that was primarily driven by our real estate portfolio lending opportunities, which we had indicated in prior quarters in terms of having a solid pipeline, so we see good opportunities in that space. I hope that answered your questions.

Pawel Dziedzic: Very clear. Maybe just one follow-up on Südwestbank. You don't give guidance on top line, but the cost-income should gradually improve, let's say, until 2020? Is that a fair assumption?

Anas Abuzaakouk: Yes, that's correct. I think you mentioned 25% to 30% of incremental cost-out but without getting into specifics, yes, the cost-income ratio will improve.

Pawel Dziedzic: And I guess you gave a little bit of an indication about the timing of this cost saving, so you mentioned it will come really throughout 2019, so I think we can understand that when it comes to, let's say, the inflection point of revenues, is the heavy work done already? Will we see them stabilizing any time soon? Or perhaps not yet? How should we think about that?

Anas Abuzaakouk: I think you'll see as a whole, as a unit, you'll see '18 and '19 an improvement in the overall returns in the cost-income ratio, versus giving the individual P&L line. Thank you, Pawel.

Pawel Dziedzic: Thank you.

Anas Abuzaakouk: You're very persistent, though.

Operator: The next question comes from the line of Stefan Maxian of RCB. Please, go ahead.

Stefan Maxian: Yes, thank you. Just a few questions. First, on the acquisition of Deutscher Ring, can you refer to the one off that is triggered by that acquisition? I assume it's either €25 million or €22 million booked in the Corporate Center. So it seems you bought the bank for €1. Could you refer to why it was only €1 and what risks are attached to that bank if you can buy it at that price?

Then, why did you book it actually in easygroup segment and not under Südwestbank, which should be the hub for German operations?

And then, maybe you could refer a little bit to your further M&A ambitions,

	so if it's still the target countries, Germany and Austria mainly, or also Switzerland? And finally, on the *Qlick* launch, which you now flagged for the fourth quarter, what would be the launch costs that would be attached to that? Thank you.
Enver Sirucic	Thanks, Stefan. So, on Deutscher Ring, the one-time is booked in the Corporate Center, which was €25 million. That already considers all the costs attached to that, which is restructuring costs and also reflecting any potential liability, which we took out.
	On why we put it under easygroup, fairly simple, it falls under the non-branch channels and it's in the international retail, and also the Austrian building society is under easygroup, so to be consistent with that approach, we classified it under easygroup.
	When it comes to M&A focus, less Switzerland. I think the main focus is Germany, but we also look at Austria, so I would say Germany and Austria will remain the main focus. And on the launch of *Qlick*, we don't disclose any costs attached to that.
Stefan Maxian	But you will launch it in the fourth quarter, no?
Enver Sirucic	Yes.
Stefan Maxian	Thank you.
Anas Abuzaakouk	Thanks, Stefan.
Operator	Next question is from the line of Gabor Kemeny of Autonomous Research. Please, go ahead.
Gabor Kemeny	Hi, Gabor here. Firstly on NII, a decent performance in the third quarter, do you think we have seen the full impact from optimizing your liability structure and cash utilization in the third quarter, or shall we expect some further uplift here in the coming quarters? And turning to the International Business, you talk about a solid pipeline, a significant increase in the NII in Q3, could this NII growth turn into a trend here in the International Business, or has this actually turned a corner?
Enver Sirucic	On the first one, I think on optimizing the liability structure, yes, I think we will look into other options as well, but the Tier 2 buyback was definitely the most significant one. When it comes to cash deployment, this is still not over, so we are further looking into opportunities to deploy this excess cash, which was very successful in Q3 and we hope to continue that in the further quarters.
	I think you asked about the NII trend. We don't give any trends, as you know, on the top line. What we look at is not on a quarter to quarter basis but we also start looking on a multi quarter period internally to see where

the NIM is, and that was actually quite stable if you look at that number. But we don't give any further guidance.

Anas Abuzaakouk If I could just add to that, Gabor, when you think about the overall balance sheet optimization, that's not something that just happens in a few months, that's something that you chip away at slowly, and I think we've started doing a nice job of that in the third quarter but that will be a gradual process.

Gabor Kemeny Understood, thank you. And just to follow up on the excess capital distribution you talked about, how should we think about the magnitude of the possible surplus capital you would seek to distribute? You have this 12% CET1 target, would you want to pay out any excess above that or would you want to keep a buffer for potential acquisitions?

Anas Abuzaakouk So, Gabor, this is consistent with what we've said in terms of our annual and three-year targets. We run the business at 12% CET1 on a fully loaded basis. Any excess capital that we generate, obviously we'd like to put that into organic growth all day long; if we don't have the organic growth, it's M&A that provides a return on tangible equity of over 15%. In the absence of both of those items, we will be good stewards of capital and we're going to do the 50% payout in terms of a dividend, and stock buybacks is another capital tool to use. So I think to answer your question, 12% is where we see kind of running the bank at a stable level.

Gabor Kemeny Just to make sure I read this correctly, provided that you wouldn't see major M&A opportunities early next year and growth remains roughly where it is, would you want to distribute most of what you have? You would want to distribute most of what you have?

Anas Abuzaakouk We'd look at that on an annual basis. So that's exactly the point, we'll asses it against those criteria that I just laid out on an annual basis, correct.

Gabor Kemeny Got it, thank you.

Anas Abuzaakouk No problem.

Operator Next question is from the line of Giulia Aurora Miotto with Morgan Stanley. Please, go ahead.

Giulia Aurora Miotto Hi, good morning. Thank you for the presentation. A couple of questions from me as well. So if I can go back to the International Business, plus 10% asset growth, could you please give us some colour around what these assets were, where do you see the most interesting risk-adjusted pricing at the moment, and how the pipeline is looking here? So that's my first question.

And then, if I can just ask a clarification on slide seven? When you show the branch transition, so, for example, 141 branches as of September '18, does this mean that customers of the branches that have been closed cannot go to the branch anymore and ask for banking services, or does this just mean that you have stopped actively marketing any services but, on a reverse enquiry basis, those branches are still available? Thank you.

Anas Abuzaakouk Do you want to go with the branches and I'll take the international?

Enver Sirucic Yes, I'll take the branches. So what we show, you can still use transaction services, so we have an OTC business there as well, and self-service devices. When it comes to advisors, these customers have been shifted basically to our branch network. That's what this number shows.

Anas Abuzaakouk So, Giulia, on the International Business, we said it in the second quarter that we were building up a good pipeline, we were fortunate enough to execute on that pipeline. I think we still have a good pipeline here, as we stand, in the fourth quarter.

We don't give the details in terms of the breakout of the specific opportunities by country or what the actual transactions are, but we've indicated that we see good opportunities in real estate portfolio lending. We don't break out the specific pricing there but we think, on a risk-adjusted basis, these are very attractive lending opportunities.

As far as overall trends, we don't do that by individual business segment. Quite frankly, we don't do the volume trends across any of our business units because we don't want to fall into the trap of chasing volume. We want to make sure that we're patient and disciplined.

I know we say that very frequently, but that's really how we operate the business. If it's a good risk-adjusted return, when you look at the pricing, when you look at the asset quality, when you look at the credit environment of the country you're actually lending into, if all those factors look good, then obviously we'll pursue those transactions or lending opportunities. So we'll be disciplined and we're not going to put out any targets, just given the cyclical nature of the business, but things look good in terms of overall pipeline today. Thank you, Giulia.

Giulia Aurora Miotto If I can quickly follow-up on the International Business, you mentioned in the past that covenants you were being relaxed and, in some transactions, you weren't comfortable with not necessarily the yield per se but just the risks associated with it. Is this a trend you're still seeing, or perhaps you're just focusing on pockets where still the covenants makes sense and so you're happy to take the risk?

Anas Abuzaakouk It's a good question. When we see pricing challenges in the DACH Corporates and Public Sector, more on the corporate side for DACH, you also see, in terms of covenants, a loosening of standards. And it's not just specific to DACH, it's across any type of corporate lending or retail lending for that matter.

If you see a loosening of credit standards, that's an early warning sign, so we'll pull back and be patient. And it's got to be a good mix between price and overall credit quality, and credit quality is best reflected in the terms, the advance rates, the collateral, the various provisions that you have in your loan doc. So I hope that's helpful.

Giulia Aurora Miotto	Yes, thank you.
Operator	Next question is from the line of Simon Nellis of Citibank. Please, go ahead.
Simon Nellis	Hi, Anas, Enver, thanks for the call.
Anas Abuzaakouk	Hey, Simon, welcome back.
Simon Nellis	Thanks. Just on the Deutscher Bausparkasse transaction, can you tell us roughly how much risk-weighted assets and assets were added in the quarter? That would be my first question.
Enver Sirucic	Yes. So the risk-weighted assets were roughly €200 million. We had loans of €330 million and some securities of €200 million, so balance sheet, half a billion, RWA is €200 million.
Simon Nellis	The second question would just be on the French mortgage book. Can you give us an update on the risk weights and if there's any potential to lower that?
Enver Sirucic	It's in line, what you said in Q2, so we did the first step of optimization. At this point we will just let it run out, so it's still at, I think, 75% average, and now it's just running off, normal cycle.
Simon Nellis	So no change expected there?
Enver Sirucic	No.
Simon Nellis	And maybe just last, if you could give us an update on the City of Linz? I think there were rumblings that you might be able to go into out-of-court mediation, or is that not happening? Thanks.
Anas Abuzaakouk	So, Simon, consistent with what we've said, historically, I think every time this question is posed, we are in the business of looking to settle, if there's an opportunity. We're very pragmatic. We want to turn over a new leaf and focus on the future and put this issue behind us. So to the extent that we can pursue mediation talks or there's space available to get a deal done, we'll absolutely pursue that. And we've been pretty consistent on that.

Simon Nellis	There's no new development on that front that you can share?
Anas Abuzaakouk	There have been discussions with the City. The judge had asked the parties to enter into mediation talks. It's something that we have more than happily obliged in terms of communicating our interest, and it's something we'll try to pursue.
Simon Nellis	Got it. That's all from me, thanks.
Anas Abuzaakouk	Thank you, Simon.
Operator	If you would like to ask a question, please press star followed by one. The next question is from Marcell Houben of Credit Suisse.
Marcell Houben	Good morning, gentlemen, thank you for taking my questions here. I have three left, if I may. The first one is the M&A. Could you talk a little bit about the pipeline there? It's been relatively quiet, recently, just wondering if anything changed regarding the opportunities. Potentially, Germany, do you still see a lot of mismanaged assets that you can buy there? Then, on the cost-income ratio target 2020, so the 40%, can you give us some dynamics or just a little bit of feeling regarding the revenue and the cost dynamics there? Is it more revenue-driven, is it more cost-driven? I don't expect any numbers here but just a feeling as to which direction I should look at. And the third one is on the branch optimization in Austria. Given that the Austrian Post is out, do you expect some inflation regarding a variable compensation as you replace Austrian Post members with your own employees, which obviously can be a little bit better, based on performance? Thank you.
Anas Abuzaakouk	Let me start with the last one, because that's an easy one. Actually, that's not the case if you think historically of the cost structure of the advisors we were paying for versus advisors that we would be bringing on, that you call our employees. There's actually a labour arbitrage, a benefit there, so we actually aren't seeing cost inflation on that front. On the M&A, we'll be patient, Marcell. We will evaluate a number of opportunities. We are evaluating a number of opportunities at the moment, some good, some not so good. Obviously, our focus, our bias, is on opportunities or platforms that require operational transformation. I think we do that pretty well and that's our focus area, but again, it's got to be the right strategic fit, it's got to come at the right price. You've got to price in the restructuring, you've got to price in any asset liability management. We tend to avoid platforms that have credit issues, significant credit issues, because those are just overwhelming, and we'll

be disciplined. We're not going to just chase deals for the sake of putting points on the board.

And it's only been almost a year or so since we signed and closed Südwestbank, it's actually even less, it's been ten months. We closed, then, the Deutscher Ring Bausparkasse, albeit a very small platform, so I always have to remind people, these things take time. But yes, we're evaluating a number of opportunities. I think you had a question on the cost-income ratio, which I'll pass to Enver.

Enver Sirucic — Yes, so, Marcell, we don't communicate the individual P&L lines, but I think it's fair to say it's going to be a mix of both. So it will be on the cost side but also the income side.

Marcell Houben — Excellent, thank you.

Anas Abuzaakouk — Thanks, Marcell.

Operator — And the next question is from the line of Christoph Blieffert of Commerzbank.

Christoph Blieffert — Yes, good morning. I have three questions on your retail segment, please. First of all, you mentioned that 420,000 clients are affected by the separation from the Post. What are your expectations with regard to potential client losses after you have completed the exit from the Austrian Post branch network?

Secondly, what will happen to the transaction service you are currently offering in Austrian Post branches, which you have already exited after the termination of the agreement with the Post? And thirdly, is there any penalty fee you need to pay to the Austrian Post for the early termination of the cooperation? Thanks.

Enver Sirucic — Thanks, Christoph. Let me start. What we offer in the Post branches that we left, as mentioned before, our customers can go to a Post branch and do their transactional services as well as using the self-service devices. All advisor services and a full banking spectrum is done in our branch network.

You mentioned a penalty. That's actually been reflected in our full-year numbers of 2017, so that was, if you want to call it, a break-up fee that was fully reflected and digested in the P&L of Q4 2017.

Christoph Blieffert — Can you remind us? Can you remind us of the amount?

Enver Sirucic — Yes, we disclosed, I think, €110 million, roughly, that was the upfront payment for the separation.

Christoph Blieffert — Thanks.

Enver Sirucic — And the first one, could you please repeat that question?

Christoph Blieffert	Yes. You said that 420,000 clients are affected, and what is your expectation with regard to potential losses?
Enver Sirucic	Yes, we don't give a forecast. So far, the progress was very good. As Anas said, we had a very high customer retention rate, which was 95% or higher. So far, we don't observe any relevant customer losses, but we don't give any forecasts.
Christoph Blieffert	Okay, thanks.
Enver Sirucic	Thank you.
Operator	We have no further questions, so I hand back to our moderator for closing comments.
Anas Abuzaakouk	Yes, thank you, operator. Again, thanks everyone. Apologies for the technical glitch earlier in the presentation. If you have any questions, reach out to our Head of Investor Relations, Jutta. And with that, hopefully, we hope to talk to you guys in February. Have a good day and we'll talk to you guys soon. Take care.