BAWAG P.S.K.

H1 2017 results

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Transcription

Key Speakers

Anas Abuzaakouk
Enver Sirucic

Operator: Good day, ladies and gentlemen and welcome to the BAWAG P.S.K. first half 2017 earnings call. Throughout today's recall presentation, all participants will be in listen-only mode. The presentation will be followed by a question and answer session. If you would like to ask a question, you may press star followed by one on your touchtone telephone. Please, press the star key followed by zero for operator assistance. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Anas Abuzaakouk, Chief Executive Office. Please, go ahead, sir.

Anas Abuzaakouk: Good afternoon, everyone. This is Anas Abuzaakouk. I'm joined here today by Enver Sirucic, our CFO, as well.

For those on the webcast, let's just jump right into it. I'm on slide 3, first half highlights. I'm proud to say we delivered a pre-tax profit of 251 million for the first half of the year, up 3% versus prior year. This translates into a return on tangible equity of 18.3%. We do this measurement assuming a 12% CET1 ratio, given the level of overcapitalization, which I'll address later in the presentation. Net interest income is up 5% versus prior year, operating income up 3%.

From an overall cost efficiency standpoint, cost-income ratio down 90 basis points to 41.7%. It's also important to note we've frontloaded the regulatory charges during the first half of the year, so 90% of our regulatory charges have been consumed up until this point. Enver will walk you through the specific details.

From an overall customer business development standpoint, we had originations of 2 billion; that's pretty much broken up between our retail and our non-retail business, it's about 50% / 50%. Customer loans are pretty stable at 28 billion with a balance sheet of around 70-75% customer loans to date. From an overall asset quality standpoint, NPL ratio is slightly under 2% at 1.9% with a risk cost ratio of 17 basis points on a half-year basis, and we continue to focus on really maintaining a conservative risk profile and maintaining a fortress balance sheet.

From a capital standpoint, our CET1 ratio stands at 16.5%, up 140 basis points since year-end 2016, total capital ratio of 19.3%, up 130 basis points.

And last but not least, and I'll touch on this later in the presentation, we're proud to say that we signed on the acquisition for Südwestbank; this is our foray into the German market. Südwestbank is a platform or franchise in South West Germany; over 7 billion of assets, over 100,000 retail and corporate customers, and I'll talk more about that in detail later in the presentation.

Moving on to slide 4, just at a high level, positive developments across the entire P&L as you go up and down the P&L. NII for the first half was up 5%, as I had previously mentioned; NCI up 3%; our operating expenses are up 1%, but this is really just a reflection of having fully absorbed the acquisitions from the fourth quarter of 2016. What I'm referring to, specifically, is the start:bausparkasse and the IMMO-BANK acquisition. We fully expect the operating costs to improve in the second half as our integration efforts are fully realized and come to fruition.

Pre-tax profit up 3%. All of this translates into, as I mentioned before, a return on tangible equity of 18.3%. Net interest margin is stable at 2.23% and cost-income ratio slightly under 42%. From an overall balance sheet standpoint, we're pretty stable. From year-end, around 40 billion or so of total balance sheet size. RWAs are slightly under 17 billion with an RWA density of 43%, coupled with 2 billion of asset originations that we experienced in the first half. So, all in all, pretty stable on the financial front.

Moving right now on to slide 6, for those on the webcast. What we do here is just an intro to our various business segments. What we wanted to highlight is really the shifting composition of our business segments between retail versus non-retail. So what you see is based on the BAWAG P.S.K. Retail brand as well as the easygroup brand, that accounts for about 56% of our total customer loans. The customer loans are about 71% of the total balance sheet, which I had mentioned before. From a customer deposit or deposit franchise standpoint, it's about 86% retail versus non-retail, and the pre-tax profit as well as core revenues are around 70–75% composition in terms of our retail business.

The theme here is really the retail business continues to grow in terms of its overall footprint, both organically as well as inorganically. It makes up a larger percentage of our core revenues as well as our pre-tax profits. This will be a continuing theme. The non-retail business is pretty steady. One of the things I'll touch upon is just some of the challenges or headwinds that we see from a corporate lending standpoint, in terms of overall pricing. It's been a pretty challenged market, so we are not volume-driven. We try to focus on risk-adjusted returns and stay disciplined in both our DACH Corporates & Public Sector business as well as our International Business. So those are the highlights in terms of just the overall segmentation of our businesses.

Moving on to slide 7. Our BAWAG P.S.K. Retail franchise delivered 117 million of pre-tax profit in the first half, up 45%. This was obviously assisted by the acquisition of start:bausparkasse as well as the organic developments. Cost-income ratio for the segment at 48%, this is down 7 points in terms of overall cost-income ratio. A pre-tax RoE (@12% CET1) of 28%, and we see further improvement, in terms of overall asset quality with our NPL ratio down 30 basis points to

2.1%. From an operational standpoint, the business continues to make significant improvements. What we've done, as far as just new business originations, we had about 700 million; that's really a split between our mortgages as well as our consumer loans.

On the consumer loan front, we've actually made really good progress. We've increased our market share up to 12.4%, that's up 80 basis points versus year-end 2016. The acquisition of start:bausparkasse is way ahead of plan in terms of just our integration efforts. That was an acquisition which was earnings accretive day 1, and that really helps us, kind of, round up our mortgage offering on the front end. From a digitalization standpoint, the highlights that I'd like to mention is in terms of overall online payments, they're up 7%. We see a lot of activity in terms of mobile banking, up 55%, in terms of overall payments.

From a strategic standpoint, we were able to do two key things: we launched the video legitimation, as well as, we've launched a 100% automated brokerage process, which are two key developments that we were working on for the better part of a year. And just overall sales advisor productivity is up 11%, while we see over-the-counter transactions down 13%, which is really a reflection of the migration to digital.

On to the next page, on slide 8, pre-tax profit for easygroup of 71 million, that's up 59%. That's a mix of both organic as well as inorganic. We bought a mortgage portfolio last year, which is reflected in these numbers. Across the board, in terms of P&L metrics, easygroup had a very solid performance. Just overall business highlights: customer accounts up 8%, originations of over 220 million, this is primarily driven by our auto leasing business, deposits up 2% to 3.8 billion. From a strategic standpoint, we signed on the acquisition for PayLife; this is a commercial credit card issuing business, which we signed in the first quarter of this year. Hopefully, that closes during late third quarter/early fourth quarter of 2017. And from an organic standpoint, we received clearance, I think, I mentioned this during our last call, to open a branch office in Germany. We hope to be operational during the second half of this year in terms of originating our first consumer loan. So, a lot going on from a strategic standpoint.

On slide 9, if we go to our DACH Corporates & Public Sector business. Highlights there: 38 million of pre-tax profit, up 6%, NPL ratio is slightly under 1%, which, again, is a reflection of the strong asset quality of the business, and we had asset originations of 380 million, despite, really, a muted loan demand and a challenged environment from a risk-adjusted pricing standpoint. So we continue to be disciplined but we don't overextend ourselves.

As far as our International Business, 34 million of pre-tax profit; this is actually down 38%. The story here is twofold: the first is just muted loan demand, versus what we've seen in prior year. We had about 760 million of originations. We, again, don't look to overextend ourselves and really focus on risk-adjusted pricing and, secondarily, we took a precautionary measure in booking provisions in the oil & gas sector related to two exposures. That was about 16 million of provisions that we booked in the first half, and that's really the big driver in terms of the reduction of pre-tax profit.

Overall, the credit quality of the book remains incredibly strong. LTVs of our real estate assets are under 60%. I think, the overall leverage, in terms of our corporate business for the tranches that we lent to is under 3x, so we're really proud of the overall credit performance of the portfolio.

And lastly, Treasury Services & Markets: 27 million of pre-tax profit, up 28%. This is where we manage our excess liquidity as well as our securities portfolio. This is best reflected in the high credit quality with 97% of the securities portfolio being comprised of investment grade securities. With that, I will pass it over to Enver to go through the details of the P&L.

Enver Sirucic: Thank you, Anas. So I'm on page 11. I will give you some highlights on our P&L lines, starting with the core revenues. So, I think, Anas has mentioned most of the developments that we have seen in the first half.

I will start with the net interest income, which was actually a very good performance with up 5% compared to the previous year. This is driven by a couple of initiatives that we continue to execute on. The first one is that we have seen a further positive trend on the funding costs, so they have reduced from 28 basis points to, now, 19 basis points on our deposit base. The other one is also quite a good origination, primarily in our retail channel, it's very stable margins. And the third one I would like to mention are also the positive tailwinds that we have seen from the acquisitions that we have finalized in December of last year. So this, together, gives us also the NIM of roughly two and a quarter, which, I think, is now a quite stable level if I also see the trend from the past.

On the NCI side, actually we have seen some positive momentum and this is true for the last four quarters actually, especially from two product lines. One is the current accounts. We have talked about it in the previous earnings calls. We have launched last year, I think, it was February 2016, new accounts, or as we call it, KontoBox family, with now almost 50,000 new account boxes being sold since then, which is generating an uplift in our commission income line. And the other thing is that our securities business did very well in the first half where we had sales of almost 900 million, or 5% higher compared to the previous year. The composition of the balance sheet has not really changed, so we are still very focused on customer loans. The overall composition is still about 70% customer loans compared to total balance sheet.

Moving to page 12, operating expenses. I would say, the trend continues, but I will just explain some of the numbers that we see here. So the operating expenses are up 1%, but if you really peel back the onion, there are two things. The first one, we have fully absorbed the acquisitions that have taken place as of year-end, and the second part of it, we have actually booked restructuring expenses of 11 million in the first half. The majority of that, precisely 8 million, have been booked in the second quarter.

So if you just focus on the core OPEX which is actually moving down, and as Anas has mentioned, also the integration of the new businesses that we acquired is moving very well and is far ahead of the original plan.

Cost-income ratio on average was slightly below 42%, which is a further improvement of 90 basis points. I think, also, going forward, and that was a topic also of the past but more so in the future, we will continue to focus or also increase our focus on technology, and not only on the absolute spend but also how we spend this. So this is going to be one of the key pillars of our strategy going forward and also on our OPEX spend.

Moving on to page 13. I guess, the only thing to highlight here is you see on the one side an increase of the absolute risk costs and even on a relative basis, it seems very high with 68%, but the truth is we look at it more from a ratio perspective, which was quite stable with a risk cost ratio of 17 basis points in the first half. And even if you compare Q1 to Q2, it was quite stable between 15 and 20 basis points. And the increase that we show here is basically reflecting a precautionary measure that we have taken on the oil & gas exposure that we have in our International Business portfolio.

Everything else is stable, NPL ratio still below 2%. Our focus is unchanged. 70% of our book is still in the DACH region and 30% invested in Europe and the US. And going forward, of course, we will further continue to focus on risk-adjusted pricing and proactive risk management and keep our geographical split in the location.

Moving on to page 14. This is probably the most confusing one, so talking about regulatory charges and taxes. Let me just briefly explain the two parts of the P&L.

So on the regulatory charges, we have pretty much taken 90% of the full-year expenses already in the first two quarters, and the majority was taken actually in the first quarter.

This has to do with just the accounting principles that we apply, mainly reflecting the contribution for the deposit guarantee scheme and the single resolution fund, as well as the contributions to bank levy and the supervisory charges. So this will, basically, flatten until year-end and the expectation is for the full year around probably 32 / 33 million.

On the tax line, let me put it that way: our effective tax rate in the first half was around 19%. The volatility that you see compared to the previous year has to do with the deferred tax assets that we have booked in the previous year, especially in Q1 2016, which was a positive impact in the first half of 2016. So we had a net tax benefit or income of 39 million in the first half 2016, compared now with a tax expense of 47 million. So this is, basically, just a reversal of the previous year DTAs that is now shown in the tax expense line.

On page 15, a reflection of the capital base and how we stand in terms of leverage ratio. So, capital ratios, CET1 up 1.4% points and the total capital ratio went up 1.3 points. This is mainly driven, of course, by the year-to-date profit.

The risk-weighted assets as well as the density of the risk-weighted assets is almost unchanged. We stand quite stable at 17 billion of risk-weighted assets and a density of 43%, which we think is a quite conservative metric.

On the leverage ratio, we always present it two ways. The one is the regulatory perspective where we went up by 50 basis points, now standing at 7% leverage ratio on a fully loaded basis from a regulatory perspective. But also very relevant, from our perspective, is the economic leverage where we stand at 11.9x, as of half-year.

Funding & liquidity, nothing really changed. Maybe just to hit on two or three highlights. So we are still mainly customer deposits funded with a split of two thirds of our funding coming from these channels. One thing just to highlight, you see the LCR. This comes down a bit. The peak in Q1 was mainly driven by the TLTRO that we have taken. Now it has normalized back to the levels that we used to have around 130–150%.

And on the right-hand side, also from an issuance level, our redemption concentration levels remain very low and also our encumbrance levels, they are very low levels. I think, with that I'll pass on to Anas.

Anas Abuzaakouk: Thanks, Enver. I am on slide 18. So what we wanted to do was take you through just how we vet potential M&A opportunities. We've done five acquisitions over the past 18–21 months. This is reflected on the following slide, which I'll get to in a second in terms of what those acquisitions were, but we thought it was important to give you a sense of how we vet potential opportunities. And it's really very simple, so our strategic pillars at the bank, and we've been consistent on this front, are based on four pillars. That is to grow in developed markets, to make our customers' lives easier, that you focus religiously on efficiency in optimizing your processes and investing in technology and maintaining a fortress balance sheet. That's how we look at our potential M&A opportunities, and that's effectively the pipeline of potential deals, as based on these four pillars.

So, in terms of growing in developed markets, we really focus, first and foremost, on Austria and then we expand beyond Austria to Germany and Switzerland with a bias towards the DACH region. And then, more broadly, we look at developed markets across Western Europe.

When we say "making or customers' lives easier" we really try to target franchises, both on the retail and corporate side, that have an established customer base and that could really benefit from the infusion of technology, process optimization, big data analytics, where we think, from a customer-centric standpoint, we can make a difference. And that's effectively the roadmap that we applied here at BAWAG P.S.K. and we think that's highly replicable when you have a solid foundation to be able to work off.

From an efficiency standpoint, we try to look at operationally challenged businesses where there's an opportunity to drive efficiency, and this is really through process optimization, continuing to invest in technology, in terms of the right technology, streamlining processes and so on and so forth.

And lastly, I think, probably the most important thing is ensuring we buy platforms that have a solid balance sheet. The way we look at the world is, buying an impaired balance sheet really puts you behind a couple of years. So for us, looking at the overall asset quality is really twofold: we look at the macro conditions, which is why we have a bias towards the DACH region and, secondarily, we look at the underwriting standards, the credit profile of the potential acquired business. We look at the amount of leverage that's taken on, so we don't like to buy businesses that are wholesale funded or take on excess leverage. We look at the amount of capital to ensure that the business is well capitalized. We look at the overall funding stack to make sure that this is something that's sustainable. So this is, kind of, the prism that we vet our M&A opportunities.

On slide 19, these are the five acquisitions that I had mentioned before. We've talked about this, the most recent being Südwestbank, which we signed in mid of July. I'll talk about that in a second, but I think, more importantly on this page, what I wanted to highlight was the systematic approach that we take towards M&A, from sourcing to due diligence to integration. So it's a highly systematic approach. We rely on internal resources. We try to focus on process optimization, a swift onboarding process, and it's really all about integration, simplification, making efficient processes, process optimization, building up the retail and customer franchise, corporate customer franchise, and lastly, acquiring customers with better sustainable relationships as well as having the opportunity to cross-sell. So that's, thematically, how we look at M&A; those are the principles that we apply.

And last but not least, we wanted to give you just a primer on the recently signed acquisition for Südwestbank. There will be a lot more information to come on the acquisition in the coming quarters but what we wanted to do was just give a brief overview as to the bank itself.

So we're very excited about this opportunity. We're excited about the people that will be joining the BAWAG P.S.K. family, we're excited about the platform, we're excited about the region, in terms of this being our real, you know, first entry into Germany, and not only into Germany but into South West Germany, which we think is a phenomenal economic region and a great base to start from as we enter the German market.

Südwestbank, you know, just a little background: founded in the 1920s, a very well-recognized brand in the Baden-Württemberg region; over 7 billion of assets, 5.6 billion of deposits, customers loans north of 4 billion, well capitalized, 12% CET1 ratio; a low NPL ratio, so again, back to all the principles that I had mentioned before. Where they really distinguish themselves is really in what I'd call the SME space; very strong relationships with family-owned businesses within their region and they'd been able to grow both on the lending as well as the deposit side over the past few years, and they have a very stable operational platform that's in place.

From a strategic standpoint this meets all of our criteria in terms of setting up a Germany beachhead, and this will be the platform that, effectively, we look to grow, both organically as well as inorganically in Germany. It meets our criteria in terms of developed markets and really focusing on the DACH region, and we have a sustainable platform.

From an integration standpoint, you know, we look at both product and channel profitability; there will be something that will perform a deep dive and we think that we can make a lot of progress on that front.

We really want to re-energize and revitalize the retail franchise, and this means both organically as well as potential inorganic opportunities that we're looking at.

And lastly, as part of our pillars, from a strategy standpoint, focusing on efficiency and really infusing technology, digitalization, similar to what we've done here in BAWAG P.S.K. over the past years.

So with that, I think, we are ready to take questions.

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 on your touchtone telephone. 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 selections.

Anyone who has a question may press star followed by one at this time. And one moment for the first question, please.

Ladies and gentlemen, if you would like to ask a question, please, press the star followed by the one on your telephone.

The first question comes from the line of Gilles de Bourrousse of Octo Finances. Please, go ahead.

G. de Bourrousse: Yes, good afternoon. I have a couple of questions, please, on capital, notably. Maybe I missed it but I would like to know what is the impact of the acquisition of Südwestbank on your capital ratios.

Secondly, just a quick question on your CET1 target of 12%: I was wondering, at what horizon is this target and if you were to go to this target, how do you complement the, I would say, your ratios in order to reach your future MREL requirements?

And finally, just a quick question: I would like to know if you had anything new on the Linz case? Thank you.

Anas Abuzaakouk: So that were a lot of questions in that one question. Let me address it. So, we don't disclose the CET1 impact of Südwestbank, number one. Secondly, the target, effectively, we run the bank at 12% CET1 post-acquisition of Südwestbank or PayLife, organic growth; we will be above 12%, so I think, that answers that question.

The third question, I think, was with regards to MREL? What was the question?

G. de Bourrousse: Yes, considering when you reach the 12% CET1 ratio then, obviously, well, you don't have any AT1 for the moment, you have only one issue of Tier 2. I was wondering, how do you plan to reach the future MREL requirements, which, in my opinion, could be higher than the ratio with a 12% CET1?

Enver Sirucic: Let me, maybe, take that question. I think, on MREL, we have mentioned it also on the last earnings call, actually it's not defined in Austria yet, so first, we need to know our requirement and we expect that this will be probably more of a 2018 impact for us.

G. de Bourrousse: So you won't be a part, so you are not on the list of banks who would be, I thought maybe you're not regulated by the SRB but, I think, the SRB do disclose to each bank it's future MREL requirement by end of 2017.

Enver Sirucic: Our latest information is that this will happen in 2018. I think, how we treat it, we monitor it and we also have some assumptions. I think, before we have the requirement, we cannot really disclose what the impact will be, but, I think, what we can see is even if there is any impact, we will be able to cover it.

G. de Bourrousse: Okay. Just a follow-up, and it's on something very different, did you disclose anything about the future impact of IFRS9 on your CET1 ratio?

Enver Sirucic: Yes, we disclosed it; it's in our notes, and the impact is what we expect currently below 40 basis points.

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G. de Bourrousse: That's 40 or 14, sorry?

Enver Sirucic: 40; four zero.

G. de Bourrousse: Thank you very much.

Enver Sirucic: You're welcome.

Opertator: The next question comes from the line of Rod Neira of Citigroup. Please, go ahead.

Rodrigo Neira: Yes, good afternoon. Congratulations on the financials, and a couple of questions.

One is, regarding excess capital, is there any view of a potential dividend payment or is it more safe to say that the excess capital is geared more towards the acquisitions front?

And, part two of the question is, can you comment on the Reuters article regarding a potential IPO?

Anas Abuzaakouk: So let me start with the second one that's a lot easier. We can't comment, or we don't comment. I can tell you that Cerberus, GoldenTree and BAWAG P.S.K. are, obviously, pursuing strategic options, as we've stated, and that comes in a variety of forms. As far as the first question, what was that?

Enver Sirucic: Capital levels.

Anas Abuzaakouk: Oh, capital, yes. So, Rod, the way we look at just overall capital levels, you know, we were clear, in terms of our level of overcapitalization, which is purposely done to allow for the acquisitions that we've recently communicated. Look, the 12% is a good proxy or benchmark. What we'll do at the end of each year is take an assessment of what we've done for the year, the organic opportunities for the future year and we'll make a strategic decision in terms of any excess capital. So, I think, we really review it at this point in time anyway, on an annual basis, based on where things come out at the end of the year, both organically as well as inorganically.

Rod Nera: Okay, thank you.

Anas Abuzaakouk: Thanks.

Operator: Again, for asking a question, please, press the star followed by the one on your telephone.

And the next question comes from the line of Claus Mendler of J.P. Morgan. Please, go ahead.

Claus Mendler: Hi, and thanks for taking my question. My question is, are there any news with regards to the Linz 4175 swap that you can disclose?

Anas Abuzaakouk: Yes, so no news on the City of Linz. Look, we still maintain our position, which we've been consistent over the past years. We feel that our legal position is a strong one. Having said that, we are always constructively looking at finding a way to settle this situation. so, and we've communicated it as much as to the counterparty, so…

Claus Mendler: Perhaps a follow-up, if you permit: Has this claim been impaired in any way or do you carry that full phase.

Anas Abuzaakouk: So, we don't, at the moment, disclose the receivable that we have on our balance sheet, but we have measured it according to where we believe it is appropriately fair valued.

Claus Mendler: Okay.

Operator: As there are no questions at this time, I will now hand back the conference to Anas Abuzaakouk.

Anas Abuzaakouk: Okay. Well, thank you, everyone. Appreciate everybody attending the call and look forward to talking to you guys in the third quarter. All the best.

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