BAWAG P.S.K.

Q1 2017 results

4th of May 2017 at 15:00 CEST

Transcription

Key Speakers

Anas Abuzaakouk
Enver Sirucic

Operator: Good day, ladies and gentlemen, and welcome to the BAWAG P.S.K. Q1 2017 Earnings Call. Throughout today's presentation all participants will be in a 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 star, followed by zero, for operator assistance. As a reminder, this conference is being recorded. I would now like to turn the conference over to Anas Abuzaakouk, Chief Executive Officer. Please go ahead, sir.

Anas Abuzaakouk: Thank you. Good afternoon, everyone. Just to go ahead and get started, I'm on slide 2. Before we talk about the first quarter results, we wanted to update you on the change in management.

So, what we've done is we've made a few management changes. I've taken over the role of Chief Executive Officer during the first quarter. In addition, we have promoted Enver Sirucic. He was our Deputy CFO and has been with the Bank for over 11 years, as Chief Financial Officer. We have promoted David O'Leary as a Management Board member as well, Head of our retail banking franchise, the BAWAG P.S.K. franchise. David has been with the Bank for the better part of three years. And we've promoted Andrew Wise. He was formerly our Chief Investment Officer and Head of our international business, continuing in his role as CIO as well as Head of all non-retail lending, and Andy's been with the Bank for the better part of five years.

The reason I wanted to share this page with you is to give people a sense of the stability of the leadership team and really talk about the way forward for BAWAG P.S.K. We have an incredibly strong foundation in terms of leadership, we promote from within. This is really in large part driven by the culture that has been created here at the Bank over the past five years, one which really focusses on establishing a meritocracy, and we take great pride in really promoting from within and ensuring that we put people into the right leadership positions. So, this really is the foundation for the next years to come and we're excited about all of the developments and opportunities that the Bank has.

So, with that, we'll get into the first quarter results. I am on slide 5. So, on the back of the record 2016, we actually had a really strong first quarter. Pre-tax profit came in at 123 million, return on tangible equity, assuming a 12% level of capitalization given our overall high levels of capital, is around 17.2%. This was driven in large part by an increase in operating income of 6%.

From a cost standpoint, it's really more of the same, Enver will talk about the details in terms of the quarterly development. Our cost-income ratio is down to 40.5%, under the 43% cost target that we had communicated at the end of 2016.This also, by the way, factors in regulatory costs which were unusual in the first quarter just given the accounting treatment, so our regulatory costs were front-loaded and really took into account about 80% of our full regulatory expenses for the full year.

From just a business standpoint, we had about 900 million of new business customer originations. 50% of that was driven by our retail franchise, both BAWAG P.S.K. as well as easygroup. The other 50% was driven by our non-retail lending, primarily our international business.

From an overall risk standpoint, NPL ratio at 2.1%, just another confirmation in terms of the high credit quality of the balance sheet, a very low NPL ratio. Risk cost ratio at around 14 basis points. I think historically we've communicated this range is effectively from 10 to 20 basis points and we don't see any deviation on that front.

From a capital standpoint, the CET1 ratio came in at 15.7%, so for the quarter up 60 basis points in terms of capital accretion, and the total capital ratio was up 50 basis points.

And just in terms of developments from an external perspective, we were upgraded yet again by Moody's, and we take a lot of pride in that. We had a one notch upgrade in April on our senior unsecured to A2 and our sub-debt rating to Baa2, while still maintaining a positive outlook over the next 12 to 18 months, and Fitch initiated coverage in February of this year effectively with an A- on senior unsecured and BBB+ on the sub-debt ratings. So, we take a lot of pride in that.

In addition, we were awarded the "Austria Bank of the Year" for 2017 by *Global Finance,* which the leadership team takes a great deal of pride in, but more importantly, our customers as well as our employees. It's a real source of pride for everyone.

Moving on to slide 6, you can look at our P&L. Just some key developments there. NII was up 6%, total operating income, as I stated earlier, was up 6%. We had some softness in terms of NCI down 2%, but that was really in large part driven by a one-off that we had taken in the first quarter of 2016. We've actually seen positive developments specifically as it relates to securities and current account development. Operating expenses were up 3%. This is inclusive of a restructuring charge of 3 million that we took in the first quarter, and this is really reflecting the absorption of the acquisitions of start:bausparkasse and IMMO-BANK, which we had closed in the fourth quarter of 2016. On that point, both acquisitions were accretive day one. We're actually ahead of plan in terms of overall realization of synergies and it's been a really nice state in terms of our retail product offering on the BAWAG P.S.K. side in terms of building society loans. So, very positive developments on that front.

When you look at the balance sheet on the right-hand side, customer loans are pretty much flat since the fourth quarter of 2016. It accounts for about 70% of our total balance sheet, so we kind of focus on the overall balance sheet efficiency. We participated in the TLTRO, which is why you see our liquidity reserves effectively larger than normal when you look at the year-end balances. So, overall, a positive balance sheet development, and we actually had a good start to the second quarter, so we're feeling good in terms of the overall customer franchise.

Moving on to slide 8, what we want to do here is actually give you some perspective on just how the overall customer franchise breaks out between our retail and our non-retail lending business. So, if you look at overall customer loans of 28 billion, 57% of this is driven by our retail franchise which is both BAWAG P.S.K. Retail as well as easygroup, which we'll touch on in a bit. And then the non-retail lending is comprised of the DACH Corporates & Public Sector lending as well as our International Business franchise.

What this highlights is really that we have a very strong customer franchise, both on the lending side as well as on the deposit taking side, where 85% of our customer deposits are generated through our retail franchise. And when you look at our pre-tax profit, effectively 60% of that is generated by our retail franchise. The way to think about it is really it's going to be 60 to 70% retail driven with the residual effectively coming from our non-retail franchise. So, that's the way we look at our business and we'll start to communicate that in the coming quarters in this light.

On slide 9, the actual development by individual business segments. BAWAG P.S.K. Retail had a fantastic first quarter. Pre-tax profit was up 11% to 43 million. This obviously factors in the acquisitions from start:bausparkasse and parts of IMMO-BANK. Just to recalibrate, the BAWAG P.S.K. Retail franchise comprises 1.8 million private and small business customers, which we service through our physical network in cooperation with a number of partners as well as through our offline channels, online and mobile sales. In terms of originations for the quarter, 350 million of new business originations, that's pretty much a split between consumer loans as well as housing loans, so positive developments on both fronts. From an overall return standpoint, the segment delivered pre-tax RoE of around 21%, cost-income ratio was down 6 points to 51%. We continue to see opportunities on the productivity front. I mentioned earlier the integration of start:bausparkasse is well ahead of plan. We feel good about that. There's a lot more in terms of our overall product offering that we think we're going to be able to capitalize on, and from a strategic standpoint we're doing a lot in the digital transformation. We've provided some metrics but I think some of the interesting developments are around video legitimation. We're the first bank in Austria to effectively offer that service and we hope to do a lot more around that front, so a very strong quarter for BAWAG P.S.K. Retail.

Slide 10, our easygroup franchise delivered 31 million of pre-tax profit in the first quarter, up 33%, again driven here by core revenues. This is a reflection of the mortgage portfolio that we had purchased in the fourth quarter. *easybank* customers were up 8% to 423,000 customers, yet just another positive development in terms of growing our overall customer franchise. Deposits are up 16% year over year in terms of just overall deposit base. And from a strategic standpoint, some really exciting developments. In the first quarter, we signed on the potential acquisition of the commercial card issuing business of SIX Payment Services. This is more frequently known in Austria as the old PayLife Bank. This will effectively make us the number one credit card issuer in Austria and really provide us with the foundation not only to provide credit cards here in Austria, but as we look across the DACH region. And, secondarily, we achieved regulatory clearance to be able to open a branch office in Germany during the first quarter. We've communicated historically that organic growth through easygroup was the channel effectively to address the German market and we hope to go live in the second half of 2017 in terms of issuing our first loan. So, the team's really excited, there's a lot happening on that front, so positive developments to come.

Next slide, I'm on slide 11, I mentioned the non-retail segments between the DACH Corporates & Public Sector lending as well as the International Business, they accounted for about 43 million. If you actually split it up, the DACH Corporates & Public Sector lending contributed 21 million of pre-tax profit. 40 million of originations. What we still see is a challenged market in terms of risk-adjusted returns. We're going to be very disciplined in terms of the overall volume origination. We're not chasing volume but we're looking at risk-adjusted returns in terms of the criteria to take on new business in a challenged market, to be candid, but positive developments regardless. NPL ratio, which is really a reflection of the conservative underwriting in our corporate segment, our non-retail segment, 70 basis points, and this has been consistent throughout, and return on equity of 19% which is really a reflection of maintaining a low Opex base and managing overall efficiency.

In International Business, new business originations of 430 million in the first quarter. We had higher than expected redemptions, pre-tax RoE of about 20%, NPL ratio of 30 basis points. This has been a rock-solid business for a number of years now. I think it's best reflected in probably the credit metrics around, at least in our portfolio of real estate financing sector with an LTV on a blended basis of under 60% with the stock that we have. So, really solid credit metrics.

And in Treasury Services & Markets, this constitutes our financial securities as well as our liquidity reserve. I should highlight, and Enver will talk about this in detail, we participated in the TLTRO, which explains the increase in overall liquidity reserves. We participated to the tune of 2 billion, but the credit quality of the overall segment continues to remain the same, 96% investment grade, and really the same methodology or approach to how we invest. Obviously as we have more customer loan opportunities we'll recycle from our liquidity reserve in our financial securities book into our customer loans.

And with that, I will pass it over to Enver Sirucic.

Enver Sirucic: Thank you, Anas. So, on page 13, I would like to start with the core revenues, so with the top line. I think most of the topics Anas has already covered in the introduction, so if I start with the NII, we almost landed at 200 million for the quarter, on the NII side up 6% versus the previous year, even up 10% versus the previous quarter. There are a couple of things to mention. I think it's really threefold.

The first point, we had very strong originations with 900 million in our core businesses, which is really our retail segments and the international business. The second point is, we had a very good momentum out of the acquisitions that we completed in Q4 of the last year, and the third one is just a continued optimization of the liability side, which is also reflected in the blended deposit rate of 22 basis points, which came down from 29 basis points to the previous year.

If you look at NCI, it is slightly lower than we had it in the previous year quarter. It's down 2%, but this is really because we had a one-off booked in Q1 2016. If you look at the overall trend of the last three quarters, we see a very good momentum there, permanently increasing over time, and this is driven by two main products that we have. This is the current accounts with a very successful initiative that we launched last year on the current account boxes, and currently we stand at 40,000 pieces that we sold in that time.

Also, in the securities business we did very good sales with more than 500 million in sales in Q1 which is up 6%.

Going to page 14, operating expenses, this is really consistent with what we had in the past. So overall from a cost structure, you basically see it also in the cost-income ratio of 40.5%. This is a reflection of the investments that we have done consistently over the past years, significantly but also are permanently bending the cost curve. What you see, there is an increase in Opex of 3%, and this is really just a reflection of the newly acquired businesses that we have, and this will add the restructuring reserve that we also provided for the first quarter of 3 million.

Just giving a bit of outlook, because we see already the first integration efforts being in place, we expect over the next months that the cost line will further decrease.

One thing is important to mention, I mean on the restructuring program over the last years we spent more than 300 million but also on the digital front, our IT expenses. We continue to invest in digital and the IT investments, we plan to have more than 60 million spent on there.

Moving to the risk costs on page 15, I think from an overall perspective, you'll see just an absolute increase of risk costs, which is basically because we extended our balance sheet by acquiring the new businesses. I would look at it on relative basis, which is best reflected in the risk cost ratio that we show, which stands at 14 basis points and that has been stable over the past couple of years and is within the range that we have always communicated of 10 to 20 basis points, basically.

The NPL ratio is very stable at 2.1%. Even if you look into the businesses, we would see an adjustment from a customer perspective and much lower NPL ratio across the segments.

Moving on to page 16, we wanted just to highlight two effects that we had in the first quarter, which makes a comparison to the previous year a bit difficult. That's why we put this page together just to explain it. So, you see the regulatory charges and the taxes here. From the regulatory charges, Anas mentioned it already, 80% we have covered basically in the first quarter of this year of the expected regulatory charges for the full year, which translates into 25 million of charges that we took. So, the expectation will be about 30 million plus that we will have to take for the full year compared to the 16 million that we had last year.

So, if you would normalize or do the P&L on a pro rata basis, the profit before tax would basically increase to 140 million. And this is really comprised of three elements. The biggest one is the deposit guarantee scheme, the second is the resolution fund, and the third, and that's now a minor position because we took the one-time charge in the fourth quarter last year, is the reduced bank levy going forward.

On the tax side, you see that we have tax expenses. This is not cash tax. This is really just tax expenses from an accounting perspective. This has to do with the DTAs that we have booked in the previous years and they are now being released, which leads to a tax expense. So, compared with the first quarter of the last year, we had a DTA booked of 90 million, which was on a net effective basis, a good guy in the tax line of 60 million. So, if you just normalize it going forward, we would expect to see the level that we saw also in the first quarter.

Going to page 17, capital, what we wanted to show here is basically on the left-hand side our requirement that we have, and this is basically split in two or three parts. The first one are requirements. If I would just add all buffers together and the Pillar 2 requirement, we stand at 8% CET1 ratio on a transitional basis. The guidance that was given to us is 1 percentage point, so it’s 9% and the implicit management buffer that we decided to have is another 300 basis points. That is just purely a decision by the bank to have this buffer, so we stand at 12%.

Compared to the actual numbers that you see in the middle on a fully loaded basis, we had an increase of 60 basis points, from 15.1 to 15.7%, so that gives an extra 370 basis points, even to the target that we set out at 12%. We believe that is not a natural level of capital and this is definitely something that we also communicated in the full year results. It’s something to have for further acquisitions or a potential dividend payment in the future.

From a leverage perspective, we present both numbers, so the economic leverage in a sense it’s very favorable at 12.6x, which was stable over the last couple of quarters, but also in terms of the regulatory leverage ratio, we are far beyond the regulatory requirement with 6.6%.

Coming to page 18, what we just wanted to reflect is also the funding position of the Bank which was always a key strength of our balance sheet. If you just look, there are a couple of numbers that you see on the page. If you just look on the top left side, there is the composition of our funding base, and this basically shows you that two thirds of our balance sheet is funded through customer deposits.

If I would look at the next layer, basically another 12 percentage points is really covered funding which comes from the customer businesses. So if you combine these two you can say 75% is kind of self-funded from a balance sheet perspective.

And the remaining part is equity and wholesale funding, and what we have showed on the right-hand side it is very diversified and we also take a great pride just from a concentration risk that we are taking, that we are running at very low numbers. Basically, for the next five years we don’t have a high concentration of repayment more than 900 million per year.

On the LCR, one thing to mention, this is a result also of the TLTRO that we have taken in the first quarter. You see a bit of an inflated LCR with 185% compared to 130%, 140% over the last couple of quarters. This will normalize as we will deploy this excess liquidity over time.

And to just close, also just from the overall encumbrance levels, a very, very favorable metric which stands below 20%.

With that, I would hand over back to Anas.

Anas Abuzaakouk: Thanks, Enver. So, now I'm on page 20. What we wanted to do different this time around was we've been quite active on the M&A front, so we wanted to recap the developments over the past 18 months and also shed some light in terms of our overall view as to how we approach M&A and just inorganic growth.

So, just to recap, we've closed on three transactions over the past 18 months between the Volksbank Leasing platform, IMMO-BANK, and start:bausparkasse, which closed in the fourth quarter of 2016. Highly accretive, fantastic bolt-on acquisitions in terms of our retail franchise, and we're going to look at a lot more of those types of deals. We signed on the PayLife or the commercial card issuing business of SIX Payment Services. We hope that that will close in the second half of 2017. That will make us the number one credit card issuer in Austria. As I mentioned, that's a great foundation to go into the DACH region.

What we pursue from an M&A standpoint, and this is part of our overall strategy, complementing our organic growth in the market share growth that we've had with our retail franchise, is really finding niche bolt-on acquisitions or platforms that will augment what we've done from a retail standpoint. So, we're very keen in terms of growing our consumer loan franchise, we're keen on growing our mortgage capabilities, we're keen to grow our auto leasing and auto loan franchise. These are all very nice fits into our overall retail franchise. We've been doing that in Austria. We're looking to do that potentially in Germany.

We've also stated over the years, this has been a consistent theme that we think that consolidation will take place. We're predominantly focused on the DACH region where we think there is oversaturation in terms of banks. It's a highly competitive region but one that, when you look at the macroeconomic fundamentals and you look at the growth in just the overall customer profile, it's one that we think we have a competitive advantage in and we can deal with. So, our predominant focus is the DACH region.

We will look at things selectively in Western European countries. We focus our whole strategy around developed economies. In the DACH region, we are looking at both retail and corporate customer franchises. We have a well-established M&A process in-house in terms of just due diligence. We're very disciplined, we have a rigorous and systematic approach where we rely effectively on our internal teams. We have a very established integration effort where we're able to quickly onboard platforms and the customers, as well as realize potential synergies.

So, this all effectively comes together in terms of our overall inorganic strategy and one that hopefully we will be able to communicate good things to come in the coming quarters. So, we thought it was important to just give you guys a sense of how we look at M&A and just how that's effected within the Bank.

On slide 21, just to reiterate the 2017 targets. Pre-tax profit that we put out at the end of 2016, over 500 million. We're on target to exceed that potential target. Return on equity and return on tangible equity, using a capitalization level of 12%, over 15% and 16% we're well on target to exceed those targets.

Cost-income ratio under 43%, we feel good at that, we're already at 41%. And our CET1 ratio, as Enver mentioned, we have excess capital, we're well over the 12%. We're looking to effectively deploy that first and foremost organically but obviously also in inorganic opportunities. And our leverage ratio, we're well ahead in terms of meeting that target.

So, with that, I guess we can take 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. If you wish to remove yourself from the question queue, you may press star followed by two.

If you are using speaker equipment today, please lift the handset before making your selection. Anyone who has a question may press star followed by one at this time.

As a reminder, that's star followed by one to ask a question.

There are no questions at this time. I will hand back the conference to Anas Abuzaakouk for any closing comments.

Excuse me, we have had a question come in from Vincent Barea of MIF Insurance. Please go ahead.

Vincent Barea: Hello. Thank you for holding the call. I just wanted to know if you were happy with the current split of capital and getting to know more about your MREL strategy. Maybe can you develop more on that please?

Enver Sirucic: Sure. I mean, if you look at our capital levels, we are in a very comfortable position. We closely follow the MREL requirements. Unfortunately, there is no final definition of that for our Bank, so we'll look at that and if necessary, we will take measures to fulfil them. But currently we don't see any issues.

Vincent Barea: Alright. Thank you very much.

Operator: Ladies and gentlemen. If there are any further questions, please press star followed by one at this time.

There are no further questions at this time. I hand back to Mr. Abuzaakouk for closing comments.

Anas Abuzaakouk: I'll do it one more time. Thanks, everyone, and we look forward to talking to you when reporting our second quarter results. Have a good afternoon.

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.