EARNINGS CALL
TRANSCRIPTION

Q1 2023

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SPEAKERS:
ANAS ABUZAAKOUK
ENVER SIRUCIC

BAWAG Group

Anas Abuzaakouk: Thank you, operator. I hope everyone is keeping well. I am joined this morning by Enver, as usual, our CFO.

Let us start with a summary of the first quarter results on slide 3. We delivered net profit of €140 million and EPS of €1.69 and a return on tangible common equity of 20.5% during the first quarter. The normalised return on tangible common equity was 23.5% when pro-rating the front-loaded regulatory charges in the first quarter.

The operating performance of our business was very strong with pre-provision profits of €248 million and a cost-income ratio of 32.5%. Total risk costs were €21 million, translating into a risk cost ratio of 19 basis points.

We did not release any credit reserves, with an ECL management overlay of €100 million that was built up over the past few years and equal to almost a full year of risk costs. We have a low NPL ratio of 90 basis points and continue to see solid credit performance across our businesses. Regulatory charges for the quarter were €41 million, equal to approximately 80% of full year charges.

In terms of our balance sheet and capital, average customer loans were down 3% quarter-over-quarter and up 1% year-over-year. Average customer deposits were down 2% quarter-over-quarter and down 6% year-over-year. Average customer funding, which is made up of our customer deposits and AAA-rated mortgage and public sector covered bonds, was up 2% quarter-over-quarter and up 6% year-over-year.

We generated approximately 70 basis points of gross capital from earnings during the quarter. Our CET1 ratio was 14.1%, up 60 basis points from year-end 2022, after considering the first quarter dividend accrual of €77 million. We have a fortress balance sheet with excess capital of €365 million, €8.5 billion of cash, which excludes the TLTRO funds, and this accounts for 16% of our balance sheet, an LCR of 215%, and overall strong asset quality.

We are targeting a buyback of up to 100 basis points, which we hope to execute during the second half of 2023, subject to regulatory approval. When we reported our year-end 2022 results in February, we were purposely maintaining dry powder for organic opportunities and potential M&A in the coming quarters. Our outlook still assumes overall static loan growth this year, but M&A opportunities have taken longer to materialise than we initially anticipated. With this size buyback, we will have more than enough dry powder for both organic opportunities as well as potential M&A if this should materialise.

Three of the past four years have felt like the first quarter has introduced a new crisis and, more broadly, required banks to address unique risks and volatile market conditions. As a Management team, we have embraced the fact that the only constant is change and the only way to manage risk, both known and unknown, is to take a prudent and conservative approach to how we run the business. Time and time again, we stress the merits of being a conservative commercial lender focused on risk-adjusted returns. This means our underwriting takes a 'through-the-cycle' view and does not allow for credit drift or overextending ourselves during a benign credit environment.

Although we never complained about negative interest rates that lasted eight years, we were sensitive to the underlying interest rate risks that lurked beneath the surface and always focused on being a credit spread lender. Ultimately, we focus on the things that are within our control: our risk appetite in underwriting, the operations of the Bank, managing our cost base and being good stewards of capital.

What the most recent banking crisis has highlighted is that not all management teams and banks are the same. It is a fallacy to think that banks operate as utilities. The reality is the exact opposite.

We have been a patient and disciplined commercial lender over the years, dealing with negative interest rates, credit risk being mispriced and excess liquidity, driving irrational behaviour in the pursuit of growth. We have been consistent in our approach to how we run the bank. We have a resilient business across all cycles with consistent earnings and capital generation that should serve us well in the quarters ahead. We have a fortress balance sheet with ample capital and liquidity and we will be ready to support our customers as well as take advantage of dislocations should they arise.

Our performance over the past decade reflects these basic principles. With our strong operating performance during the first quarter, we are reaffirming our full-year targets for 2023: a profit before tax greater than €825 million, a return on tangible common equity greater than 20% and a cost-income ratio under 34%.

Given the current environment, we have provided additional pages on our commercial real estate portfolio, our investment portfolio and the evolution of our funding stack.

Moving to Slide 4. We delivered a net profit of €140 million, up 26% versus prior year. Overall, strong operating performance with operating income of €367 million and total expenses of €119 million, up 13% and down 1% respectively, versus prior year.

Total pre-provision profits were €248 million, up 21% versus prior year. Risk costs were €21 million and regulatory charges were €41 million. Tangible book value per share was €33.55, up 6% versus prior year and 2% versus prior quarter. This assumes the deduction of the first quarter 2023 dividend accrual of €77 million.

Moving on to Slide 5. At the end of the first quarter, our CET1 ratio was 14.1% after deducting the first quarter dividend accrual. For the quarter, we generated approximately 100 basis points of gross capital, with approximately 70 basis points coming from earnings and approximately 30 basis points from lower RWAs, which resulted primarily from executing a securitisation transaction and lower volumes.

Our excess capital of €365 million above our CET1 target of 12.25% provides us with the opportunity to pursue a buyback now and still have enough dry powder for potential M&A. Net of our targeted buyback of up to 100 basis points this year, our CET1 ratio will be at a minimum of 13.1%.

On to Slide 6, our Retail & SME business delivered a net profit of €118 million, up 19% versus the prior year, and generating a very strong return on tangible common equity of 35% and a cost-income ratio of 31%. Average assets for the quarter were €22.3 billion, up 5% versus prior year and down 1% versus prior quarter.

Average customer deposits were €26.8 billion, down 5% versus prior year and down 2% versus prior quarter. Average retail customer funding, which is a combination of customer deposits and AAA-rated Austrian mortgage covered bonds, were €36.5 billion, up 8% versus prior year and up 2% versus prior quarter. This provides a more comprehensive view of overall customer funding and allows us to match fund longer-dated mortgage assets against longer-dated funding.

Pre-provision profits were €191 million, up 19% compared to the prior year, with operating income up 12% and operating expenses flat versus prior year. Risk costs were €20 million, reflecting normalised risk costs with no management overlay build or releases. The trend in asset quality remains strong across our customer base with a low NPL ratio of 1.7% and a risk cost ratio of 35 basis points.

We expect continued earnings growth across the Retail & SME franchise in 2023, driven by strong operating performance, but muted customer loan growth, given the overall economic environment.

On to Slide 7. Our Corporate, Real Estate & Public Sector business delivered net profit of €37 million, down 3% versus the prior year, and generating a solid return on tangible common equity of 19% and a cost-income ratio of 24%. Average assets for the quarter were €14.4 billion, down 2% versus prior year and down 5% versus prior quarter.

Average customer deposits were €5.1 billion, down 9% versus prior year and down 1% versus prior quarter. Average customer funding, which is a combination of public sector and corporate deposits as well as AAA-rated Austrian public sector covered bonds, were €6.7 billion, flat versus prior year and up 2% versus prior quarter. Pre-provision profits were €58 million, down 7% compared to the prior year. Risk costs were essentially zero, with no management overlay build or releases. The trend in asset quality continues to be solid, with our NPL ratio at 70 basis points.

We pride ourselves on disciplined underwriting, focusing on risk-adjusted returns across all cycles and avoiding blindly chasing volume growth. We will continue to be disciplined and have the capital and liquidity to support customers and capitalise on dislocations, should they arise, as we see a potential repricing of credit risk more broadly across various asset classes.

On slide 8, given the overall focus on the commercial real estate sector, with a particular focus on US commercial real estate, we wanted to provide more insights into the portfolio and why we feel confident about our overall Real Estate Lending business.

As a reminder, we focus on senior secured loans to high-quality counterparties. We do no mezz financing, no pure land financing, and we avoid markets and asset classes where we see froth and irrational behaviour. The team is quite experienced, with senior members having worked together for over a decade.

As we have consistently said year in and year out, we do not place volume targets on the business. If we find attractive places to lend, meeting our risk-adjusted return thresholds, then we will pursue them. If not, then we will hold back and keep searching until we find something that fits our risk appetite. We are patient lenders who do not let our credit standards drift. This has benefitted us over the years with limited losses in a stress resilient portfolio.

Our portfolio has increased its focus primarily towards residential, industrial and logistics assets over the past few years; asset classes with positive secular trends since the pandemic. Conversely, we have done very limited new lending in Retail and have become much more cautious with office post-pandemic, given the negative secular trends. If you look at our portfolio growth since 2020, you see the shift in focus on underlying asset composition. The growth in the portfolio has come almost exclusively from residential, industrial and logistics assets, which comprise 65% of the total Real Estate portfolio.

In terms of our underwriting approach, we are a senior secured lender against diverse properties that produce strong cash flows. Our weighted average LTV is below 60% and has consistently been at this level as the portfolio has turned over the past few years. We primarily finance granular multi-asset portfolios, often with multiple collateral types. The asset class diversity provides an additional margin of safety. The portfolio is primarily floating rate loans. However, as part of our underwriting process, risk mitigation measures were put in place as part of loan agreements. Examples include interest rate hedging requirements, interest reserves and sponsor guarantees.

Our US real estate exposure, which accounts for 40% of the total Real Estate portfolio, has since grown over the past few years, mainly from residential, industrial and logistics assets. These asset classes account for 70% of our US commercial real estate exposure. The office portfolio, which is equivalent to €490 million, accounts for 1.4% of total customer loans, 9% of total real estate loans and 22% of total US real estate exposure. The US office portfolio has its geographic footprint solely in major cities and is comprised of Class A buildings.

The portfolio has an average senior debt yield of over 9%, has a comfortable weighted average lease term of approximately six years, solid tenants with average occupancy levels at approximately 75% and LTVs in line with the broader portfolio under 60%. Given the underlying credit performance, we feel confident that we will address any severe downturn that may materialise.

Our total loss rate since the inception of the business has been under 20 basis points, albeit the past decade has been primarily defined by a benign credit environment, excluding a few periods of stress. A good reference point for our existing portfolio under a severe stress scenario is the 2021 EBA stress test, which assumed approximately 30% reduction across all commercial real estate asset classes.

Our total Real Estate portfolio experienced cumulative losses of just 2% over a three-year period, reflecting the significant loss absorption and collateralisation levels and a good proxy for a severe stress scenario. It is important to note the portfolio composition has only improved, given our focus away from office and retail and shift to residential, industrial and logistics assets since the last stress test. This is all before accounting for €100 million of management overlay that would be used to address severe downturns in any potential stress across the balance sheet.

On Slide 9, an overview of our investment book and overall cash position. Our investment book, or Securities portfolio, at quarter-end was €5 billion, up 1% versus the prior quarter. The investment book is 100% investment grade, of which 70% is single A or higher and has a weighted average life of approximately 3.7 years, with solid diversification across both geography and issuers. Considering recent events and how banks manage interest rate risk, specifically in their securities portfolios, it is important to highlight that we take no interest rate risk in our AFS portfolio and almost no interest rate risk in our HTM portfolio.

Our AFS portfolio is €2.4 billion with a weighted average life of three-and-half years. The accumulated OCI in our AFS portfolio is negative €10 million, which is already deducted from both tangible equity and CET1 capital, a common sense and consistent regulatory approach across all European banks. Our HTM portfolio is €2.6 billion with a weighted average life of 3.8 years. The HTM portfolio has net unrealised losses of €30 million, or approximately 1%, a reflection of how we have managed interest rate risk in our Securities portfolio over the years.

Equally important to highlight is our investment book development since 2020, where the portfolio declined by almost a quarter from €6.5 billion to €5 billion. A period that combined excess liquidity with negative interest rates and extremely tight credit spreads, we consciously made the decision to sit on the sidelines, have the portfolio run-off, derisk where it made sense and make very few investments, given we did not see attractive risk-adjusted returns. Our cash position, which includes money held with the Central Bank, was €11.8 billion at the end of the first quarter, of which €3.3 billion were TLTRO funds. We have purposely maintained an excess liquidity position to address potential market opportunities over the years.

At its peak, we drew down €6.3 billion of TLTRO funds as we hoped to see interesting opportunities post COVID. That never materialised and we essentially had an inflated balance sheet the past few years. We paid down €2 billion of TLTRO during the first quarter, with another €2.8 billion targeted during the second quarter. This will leave us with approximately €8.5 billion of cash, with additional funding capacity of a few billion after paying back the TLTRO funds.

Today, our balance sheet is comprised of approximately 25% cash, or 16% when excluding TLTRO funds. We will continue to maintain excess cash and a liquid balance sheet to address lending opportunities, portfolio opportunities and potential M&A. Historically, this came at a cost of negative carry. It was something we were willing to accept, in terms of overall balance sheet management and ensuring we always have sufficient liquidity and capital for both opportunities as well as being conservative in managing liquidity in the event of severe downturns.

With that, I will hand over to Enver.

Enver Sirucic: Thank you, Anas. I will continue on Slide 11.

Overall, a very strong operating performance in the first quarter, with core revenues up 6% versus prior quarter, with continued strength in net interest income, which was up 8%, and good net commission income, which was up almost 2%. Compared to prior year's first quarter, core revenues were up 13%. With strong core revenues and almost stable operating expenses, our cost income ratio further came down and stands at 32.5% for the quarter.

Risk costs of €21 million show a more normalised picture with a risk cost ratio of 19 basis points, which is also in line with the underlying trend over the last couple of quarters and that is without any releases of our management overlay that stands at €100 million.

Regulatory charges for the first quarter were €41 million, equal to approximately 80% of the full year charges. With the return on tangible common equity of 20.5% during the first quarter, we are on track to meet our return levels of greater than 20%. When pro-rating for the front-loaded regulatory charges in Q1, our normalised return on tangible common equity was actually 23.5%.

On Slide 12, we show key developments of our balance sheet. In terms of assets and capital, customer loans were down quarter-over-quarter by 1% and stable year-over-year. On an average basis, customer loans were down 3% quarter-over-quarter and up 1% year-over-year.

We generated approximately 70 basis points of gross capital from earnings during the quarter, also supported by lower risk-weighted assets of 2%. Our CET1 ratio was 14.1%, up 60 basis points from year-end 2022, after considering the first quarter dividend accrual of €77 million.

On the funding side, average customer deposits were down 2% quarter-over-quarter, while our customer funding was up 2% quarter-over-quarter and up 6% year-over-year as we continued improving our long-term funding profile through issuing AAA mortgage covered bonds, in total approximately €5 billion since 2022.

On Slide 13, we added more information around our €43.6 billion of customer funding, which is mostly made up of customer deposits and AAA-rated mortgage and public sector covered bonds and also represents 95% of our total funding, excluding TLTRO. The remaining 5% is made up of senior funding - Tier 2 and additional Tier 1- mainly to address capital and MREL requirements.

Since 2020, we have been growing our customer funding by 23%, or 7% on average, and today it covers all our interest-bearing assets, including our investment book of €5 billion. Structurally, we saw a shift of deposits from term to overnight over the last ten years because of the negative or low interest rate environment. This will very likely reverse, at least to some extent, over the next couple of quarters.

To address that development of shortening deposit duration, we decided to increase our covered bond funding over the last couple of years. Our covered bonds have a weighted average life of eight years, with almost no maturities in the coming years. This provides us today with a structured, more balanced customer funding stack and nicely matches our overall customer loan book.

The split between customer deposits and covered bonds is about 80/20. On the deposit side, we have €27 billion of very granular Retail & SME deposits, with an average size of €12,000, and 80% are insured by deposit guarantee scheme. €5 billion of Public Sector & Corporate deposits are largely with long-term relationship customers and mostly from transactional current accounts. Over the last decade, customer deposits have been growing in the Austrian market and our deposit base moved in line with the overall market trend at a stable market share of 8%.

With that, moving on to Slide 14, core revenues. As mentioned before, strong net interest income trend continues, up 8% versus Q4, despite lower customer loans. Net interest margin of 272 basis points for the quarter improved by almost 30 basis points. Given the refixing structure of our assets, it takes around four to five months to see the full effect of the rate increase reflected in our run rate, which means that the NII improvement will continue to gradually materialise in the coming quarters. For the second quarter, we expect a similar pace of NII growth as in the first quarter.

In terms of net commission income, overall good and stable performance in Payments & Advisory business, with customers shifting more into fixed income products.

Our outlook for 2023 remains unchanged, and we expect core revenues to grow by more than 12%, mainly driven by an increase of net interest income to over €1.2 billion, while we assume customer loans to be static.

Slide 15. We managed to keep our operating expenses almost stable despite significant inflationary headwinds. This is a result of several initiatives we launched over the past two years that have allowed us to counter these significant inflationary pressures we are confronted with today, which otherwise would have led to a cost increase more in line with the overall inflation rate in Austria of 9%-10%.

Cost-income ratio continued to improve and stands now at 32.5% for the quarter, which is well on track to meet our target of being below 34%. We will continue to focus on absolute cost targets, and we are confident to manage operating expenses at plus 2% year-over-year after considering wage inflation of 8% to 9%.

Slide 16, risk costs. Overall, stable underlying trends and strong asset quality with a continued low NPL ratio of 90 basis points. The risk cost run rate stands at €21 million for the quarter, which is in line with the underlying trend of the past couple of quarters and with the risk cost ratio of 19 basis points also on track with our full-year outlook of being between 20 and 25 basis points. We did not release any credit reserves and we have an ECL management overlay of €100 million that we have built over the past couple of years.

On Slide 17, we wanted to reiterate and reaffirm all our 2023 targets. As you know, we are targeting core revenue growth of greater than 12% with a net interest income of €1.2 billion, while containing operating expenses to 2% growth despite significant inflationary headwinds.

Based on stable underlying trends and solid asset quality, the underlying risk cost ratio is expected to be between 20 and 25 basis points. With a strong operating leverage, we have set a profit before tax target greater than €825 million, return on tangible common equity greater than 20% and cost-income ratio of 34%. We are also targeting earnings per share of greater than €7.50 and a dividend per share of greater than €4.10, which excludes our planned buyback of up to 100 basis points in 2023. With that, operator, let us open up the call for questions. Thank you.

Operator: Thank you. As a reminder, to ask a question, please press star one, one on your telephone and wait for your name to be announced. To raise your question, please press star one and one again. Please standby while we compile the Q&A roster.

We will take the first question. One moment, please. It comes from the line of Mate Nemes from UBS. Please go ahead. Your line is open.

Mate Nemes (UBS): Yes. Good morning and thank you for the presentation with the additional details.

My first question is on deposits. Could you talk a little bit about what has been driving the non-immaterial drop in Corporate deposits? Also, on the Retail side, could you elaborate a little bit on the trends, including what sort of pass-through rates and what sort of shift you are seeing in your deposit mix?

The second topic I wanted to ask you about is the share buyback, the up to 100 basis points in CET1 capital. Could you give us a sense on the timing here? Have you already applied for an approval from the ECB? What sort of timing are we looking at here?

Then, lastly, related to that, could you perhaps give us a sense on the timing of a potential M&A transaction as well? Are we looking at perhaps the back-end of the second half of this year or this is more likely a topic for early next year? Thank you.

Anas Abuzaakouk: Thanks, Mate. Enver, do you want to do the deposits and I will do the M&A –

Enver Sirucic: Yes.

Anas Abuzaakouk: – and the buyback of shares?

Enver Sirucic: Mate, good questions. On the Corporate deposits, this is really more seasonal. We had very strong inflows just at the year-end numbers. If you look at the end-of-period numbers, that was a bit inflated at year-end. If you look at the average, which is the daily average of deposits, it was rather stable through the last couple of quarters. On Corporate & Public Sector deposits, it could be sometimes a bit more seasonal.

On the pass-through on overall deposits, it is still very low what we are seeing in Q1. It starts picking up. We are still below 10%, I would say, on average. Our expectation, as we also said on the prior calls, is it will go up to around 40% until 2024, which is in line with our expectations. It also is underlying our NII targets that we communicated.

Anas Abuzaakouk: Mate, on the share buyback, so what is the difference on this call versus our year-end results in February? The main difference is we have always said we are going to target up to 100 basis points of CET1, right, without giving a specific number.

The overall M&A landscape, in particular, one opportunity has not materialised as quickly as we anticipated. That is most likely, if it does materialise, if there is an opportunity, going to the second half of 2023-first half 2024 event, just given the nature and timing of these things. We are still looking at a few targets.

I should mention this is in core Continental Europe in our core DACH/NL region because we were asked before, in terms of where the opportunity is. This is not in the United States. This is something that we think could be potentially interesting, but we are going to have to be patient.

We have more than enough capital to be able to execute a buyback this year and potentially pursue M&A, again, if it materialises. However, we are going to be disciplined. Obviously, the market has changed and we need to make sure that we are vigilant in how we manage and underwrite risk. What was the other question?

Enver Sirucic: It was with M&A.

Anas Abuzaakouk: With M&A? Okay. As far as the overall, I think you said the process on the buyback, we have done this a couple of times. We can only say so much, I am sure you can appreciate that. We feel confident, hopefully, we will be able to execute in the second half of 2023 up to 100 basis points. We will hopefully provide more specificity in the months ahead. Thanks, Mate.

Mate Nemes: Thank you.

Operator: Thank you. We will now take the next question. One moment, please. It comes from the line of Gabor Kemeny from Autonomous.

Please go ahead. Your line is open.

Gabor Kemeny (Autonomous Research): Thank you. Hi, team. A couple of questions from me.

First one on the deposits. Thank you for the clarifications here. What trends have you seen in deposit dynamics so far in the second quarter for April? That would be the first question.

The second one is a broader one on whether the recent banking turbulence has created any business opportunities in your view? I am asking this in the context of your M&A plans seemingly less imminent and the Securities book, I think, remaining roughly flat over the first quarter. Thank you.

Anas Abuzaakouk: Thanks, Gabor. I will go ahead and take the second part of the question and Enver, just the deposit revenue, just the trend in April.

Gabor, as far as M&A, obviously, we look at things through an entirely different lens. However, the reality is the delay was completely divorced from what is happening in the overall market post Silicon Valley and just the banking crisis that witnessed for a few weeks. This is just something operational that is going to take a little longer.

As far as the opportunity set, in terms of dislocations, there was a period where you saw spreads widen significantly across certain asset classes. However, I think this is going to be one that is not going to be as abrupt and that you will see probably come in over the coming months.

That is why we tried to highlight during the call that we have ample capital and liquidity if these opportunities should arise. We tried to also highlight that if you look at the past three years, obviously, there was a period there in COVID, where we were able to be active. I think it was like one to two months and you saw us put on high-quality securities.

In reality, however, subsequent to all the stimulus that came in after the initial COVID period, the portfolio has deleveraged because we have seen spreads tighten negative rates, some irrational things taking place. If risk is repriced, we will be ready to be able to pursue opportunities, be it in the Securities portfolio or also lending opportunities. However, from what we see today, it is pretty static and pretty benign. However, I think we are going to be vigilant and ready to pursue things as they come along.

Gabor Kemeny: Okay. Thank you, Anas.

Enver Sirucic: Yes. Just in terms of April deposits, so I would say a bit more stable than what we have seen in the first couple of months. What we saw in the first quarter is just a continued trend in the market overall of high inflation, people saving less than before. That is still continued, but, as I said, at lower levels than what we have seen in the first couple of months.

Gabor Kemeny: Thank you, Enver. When you say 'stable', stable relative to the end of the Group first quarter roughly?

Enver Sirucic: Correct. Correct.

Gabor Kemeny: Got it. Thanks very much.

Enver Sirucic: Sure.

Operator: Thank you. We will now take the next question. It comes from the line of Johannes Thormann from HSBC.

Please go ahead. Your line is open.

Johannes Thormann (HSBC): Good morning, everybody. Some follow-up questions, please.

First of all, just on the deposits, is the fact that people probably save less than before in line with your previous expectations? This is just qualitative feeling.

Secondly, can you give us some more data how the current sight deposit mix is going towards term deposits or has this ratio stayed unchanged over the last quarters?

Then, last but not least, on the Public Sector deposits, could you explain a bit more what you mean with transactional accounts? What is driving those activities? Is this really stable Government money or is it coming from water companies, utilities – something more in this respect?

Secondly, you said before, you expect NII to peak in Q3 this year. Is still your view or would you say probably due to the four to five months delay, that NII could only peak in 2024?
Last but not least, probably a bit more details on the US office exposure – which cities and how many properties you finance, how granular is this – would be appreciated. Thank you.

Anas Abuzaakouk: Enver, do you want to do the deposits and I will take the Commercial Real Estate?

Enver Sirucic: Yes. Spot on, Johannes. One trend that we are obviously seeing in the market is as well the shift into fixed term deposits, it has started picking up, if you look at the overall market, and we see that also in our customer base. However, we think there is more to come in the next couple of quarters. It is, I think, very early stages of that trend.

The earlier trend that we have seen at year-end and also in January-February was the people, our customers, moved into fixed income products than on the just advisory side, which is an early read of what is going to happen. If you go back a few years, you will see that the term deposits had a much larger share of the overall deposits in Austria than it is currently the situation.

Going back to your question on transactional accounts, just one step back. As you are familiar with, we are processing the Government payments in Austria, including social security, pension, any other subsidies. As part of that business, also we have a very strong long-term relationship with these customers, which is also the majority of the deposits that we have. It is tied to that processing payments business that we are having in the Public Sector and it is rather stable.

What I mentioned earlier on the call is it could be just seasonal. From time to time, you might have higher income in balances that are with us for a couple of weeks. That just happened at year-end, where you have seen actually a significantly higher deposit balance than in Q1.

Anas Abuzaakouk: Johannes, as far as just the Commercial Real Estate, this cuts across seven major cities, for the most part. In terms of diversity, there is bilateral loans as well as part of mixed use. You get cross collateralisation against different asset classes.

I think we have provided some details around just the debt yields of over 9% and LTV under 60%. The occupancy level is over 75%, on average. We feel pretty good about the portfolio. Obviously, this has been a point of reference for a lot of folks. It gets a lot of attention.

However, I go back to what I said during the earnings call, in terms of riska djusted returns through the cycle. There is nothing you really can do to mitigate that risk today. The only mitigation is what has been your underwriting over the years. We feel confident how we have been underwriting this asset class. Even with US office exposure, we feel that we are in a good place. Thank you.

Johannes Thormann: Okay. Sorry, just on the NII peak?

Enver Sirucic: Yes. Yes. It is hard to answer, to be honest, because rates are you know– if feels like they are changing daily. However, you are right, if you look at the expectations in the next 12 months, rates are shifting higher, which means there is going to be more benefit from rates in the coming quarters. We try to be a bit more precise, giving you also a bit of guidance for the second quarter. but, you are right, it could continue also going into 2024 – that positive momentum.

Johannes Thormann: Thank you, gentlemen.

Anas Abuzaakouk: Thanks, Johannes.

Operator: Thank you. We will now take the next question. It comes from the line of Tobias Lukesch from Kepler Cheuvreux.

Please go ahead. Your line is open.

Tobias Lukesch (Kepler Cheuvreux): Good morning. I would like to start on the fee side. I think a couple of Austrian banks are having indexed fees on inflation, increased rates. I think BAWAG is increasing by midyear – June or July, if I am not mistaken – and the biggest uptick potentially between Austrian banks.
I was just wondering, is that completely baked into the guidance of the core revenue development of the fee development, could it potentially have more upside also, with regards to upside on fees? How would you look at the Brokerage business, etc.?

Finally, potentially also the mix of, let us say, deposits going into securities, is there still a trend you can see, positive or negative? Is there a potential dynamic you might expect potentially for the second half of the year?

And secondly, on the Real Estate, again. You mentioned that you have over 75% occupancy rate on average. I was just wondering, is that giving you a lot of comfort? The yield on debt around 9% is quite comfortable.

Could you also potentially provide some interest coverage ratios or something like that in these class A buildings you have in the locations? I would guess from the confidence, you are trying to express basically that this is a very solid average underwriting that you did in the US. Thank you.

Anas Abuzaakouk: Thanks, Tobias. You want to go ahead, Enver?

Enver Sirucic: Yes, very detailed. Good question on the NCI indexation. You are right. We are indexing some of our products around mid-year, mostly on the current account side. The reason for that is we would do it annually. We paused last year because of the difficult situation and higher energy prices. We did not want to burden our customers. That is a bit of a catch up of combined indexation for this year and last year, which is in line with overall market.

In terms of the trend, yes, it will be probably some incremental positive to the NCI overall. However, it only applies to certain products. It is not applicable to the full €76 million or €75 million quarterly run rate.

Anas Abuzaakouk: As far as the Commercial Real Estate, I think Tobias, we do not get into the interest coverage. We look at debt yield, which is your NOI divided by just your loan balance. We think that gives us sufficient coverage where we underwrote the asset, how things are developing now, we are in touch with, obviously, the sponsors in active engagement.

I hope I conveyed that we feel pretty good about the portfolio. This is a portfolio that was not recently underwritten. We saw these negative secular trends, in terms of just overall office development. We have been pretty negative on office for the past few years. I hope all of these points just highlight that we feel pretty good about where the portfolio is. It does not mean we are immune, but I think given how we underwrote these assets, we think we will be okay.

Tobias Lukesch: Okay. Maybe one follow-up? Given debt yield, etc., is the assumption right that you have not seen really strong shifts in the portfolio over recent quarters, i.e., that things are more or less at the levels where you have underwritten it?

Anas Abuzaakouk: Yes. In terms of the underwriting at Day One underwriting, correct. The one thing we have seen is we have had a few loans pay off early redeem. That was actually, I think, a good testimony to the quality of the loan and the opportunity of the underlying asset class in office, by the way, but yes, correct.

Tobias Lukesch: Thank you very much.

Anas Abuzaakouk: Thanks, Tobias.

Operator: Thank you. We will now take the next question. It comes from the line of Simon Nellis from Citi.

Please go ahead. Your line is open.

Simon Nellis (Citigroup): Hi.

Anas Abuzaakouk: Hi, Simon.

Simon Nellis: Thanks for the opportunity. Hey! I am not sure if you can actually answer at this point, but I was hoping you could give an update on the Peak Bancorp acquisition and a few comments on how that asset has been faring in the aftermath of the SVB collapse.

Anas Abuzaakouk: Yes. Simon, good question. People forget about that as well. That is still pending regulatory approval. Nothing out of the ordinary. It is just a prolonged process. Obviously, I think regulators have been probably busy. It is out of the San Francisco office as well. Then, we have been in touch with the management team almost daily. That is pretty robust and static, in terms of just the deposits and divorced from some of the issues you are seeing with the US regional banks. Those issues have not migrated to Idaho First Bank or Peak Bancorp. Good question.

Simon Nellis: Thank you. That is pretty much it for me. Thank you.

Anas Abuzaakouk: Thanks, Simon.

Operator: Thank you. We will now take the next question. It comes from the line of Mehmet Sevim from JP Morgan.

Please go ahead. Your line is open.

Mehmet Sevim (JP Morgan): Hi, Anas. Hi, Enver. Thank you very much for the presentation. I have, generally, a couple of follow-ups left.

First of all, maybe on the deposit base. Is the pass-through that you mentioned, which is still below 10%, is that similar across Retail & SME as well as Corporate & Public Sector or are you seeing any different trends there?

Are you seeing any incremental pressures on deposit pricing from your customers at all or is that basically more reactive at the moment still?

Do you have any views on the market share in the first quarter? I think the sector data is not out yet, but maybe you may have additional views here. That is on the deposit front.

Secondly, on capital, generation is very strong. You mentioned 100 basis points already in the first quarter, which is basically equal to the buyback that you want to do, and we still have three more quarters with higher expected profitability coming. I do appreciate your views on the M&A, but given that can be cyclical and should not materialise, how should we think about capital return over and above your 55% dividend payout beyond the 100-basis point buyback that you plan?

Finally, if I may, on the CRE portfolio. Thank you very much for the details that you provide. The US office occupancy levels of 75%, what has this been in the past? Do you have any information on the momentum of the occupancy rates there? Is it declining or is it fairly stable? That is all for me. Thank you.

Anas Abuzaakouk: Thanks, Mehmet. Do you want to take the office and I will take the share buyback?

Enver Sirucic: Sure. Okay. I think the first question was on the pass-through rates between Retail and Corporates. I would say, in general, it is a bit lower still on Retail & SME. That is still below 10%. Corporate is, I would say, around 20% to slightly below 20% – Corporate & Public Sector.

Pricing market has picked up. We have seen that over the last couple of months. It started with the online banks very early and now the more traditional banks are pricing as well. As I said before, we will start increasing the deposit pricing in the coming weeks and months as well. That is on track from that 10% deposits pass through to the 40% that we anticipate for 2024.

In terms of sector data, yes, you are right, it is not disclosed for the full quarter. What we can see is data until February, year-to-date, from the overall perspective. That has trended completely in line with our customer deposits, which was down 2% on a sectoral basis.

Anas Abuzaakouk:

Mehmet, in terms of the buyback, you are spot on. We are generating significant amounts of capital on a quarterly basis. You can do your extrapolation however if you want, for the full year. We are in a pretty good capital position. What we wanted to do with highlighting this particular buyback is to say we can do it in parallel to a potential M&A. Right?
The point you have raised is absolutely spot on, which is if the M&A does not materialise, obviously, we will come back for another round of buybacks. This is in the context of a potential

M&A. We just think we are in a pretty good position, as far as our overall capital position.

Then, I think – what was the last one? On the Real Estate? Yes.

Enver Sirucic: Occupancy rates.

Anas Abuzaakouk: Yes, the occupancy rates. We do not disclose that specifically. Look, I think the more important thing, Mehmet, is it is 75% when we underwrite at Day One, a lot of those tenants are locked in. That is where you get the six-year average lease term.
You will see some fluctuation on different properties. Certain properties are not fully let out and that is because the sponsor wants to try to achieve a better price point. However, that is one I think that is pretty much in line.
I would focus more on the six-year lease term, which gives us confidence. This is something that we are in constant dialogue with, in terms of the sponsors and how the buildings are performing. We feel pretty good.

Mehmet Sevim: Thank you. That is great. Very clear. Thanks so much.

Anas Abuzaakouk: Thanks, Mehmet.

Operator: Thank you. We will now take the next question. It comes from the line of Johannes Thormann from HSBC.

Please go ahead. Your line is open.

Johannes Thormann: Hi, guys. Just a follow-up question from me.

Anas Abuzaakouk: You are back, Johannes.

Johannes Thormann: Yes, yes. Sorry, I have to pester you on the US real estate again.

Anas Abuzaakouk: Yes.

Johannes Thormann: You said the portfolio in office was not recently underwritten but covering US real estate for 20 years. It is more the stuff you have underwritten three or four years ago, where you did not know about rising rates and COVID-19 that caused the trouble. How is the NPL ratio? Or is there any default business in that part of the portfolio? Thank you.

Anas Abuzaakouk: Johannes, very good point. That also gives us more comfort because you obviously see the development and the trends in the underlying portfolio. There are zero NPLs, both in US as well as in Europe.

Our only NPL that we have across the entire Real Estate portfolio is actually a retail position, that was an asset class, I mentioned the loss rate of 20 basis points over the past decade, that was an asset class that we saw some stress in and even then, we were able to manage it. However, there is no NPLs.

This is something that because we have seen it over the past few years, we feel pretty decent about, in terms of just the LTV and some of the metrics that I mentioned. That is a good point that you brought up.

Johannes Thormann: If I may ask, can you say the region of the Retail NPL?

Anas Abuzaakouk: That is in Europe.

Johannes Thormann: Okay. Cool, thanks.

Anas Abuzaakouk: Thanks, Johannes.

Operator: Thank you. We will now take the next question. It comes from the line of Tobias Lukesch from Kepler Cheuvreux.

Please go ahead. Your line is open.

Tobias Lukesch: Yes. I am sorry, I think a part of my question on the fees with regards to brokerage was still open.

Any view on that development, basically? How was the catch-up in Q1? What are your thoughts about the rest of the year? Thank you.

Enver Sirucic: Yes, it was. Yes, sorry we missed that.

Yes, it was better in Q1, but again, still early. We will have to see how the full year will develop. What we have seen is a shift, actually, from more the fund business into fixed income, which is a bit lower margin. We might see growth in overall AuM, but it also could come in at expense with lower margin, which then again balances with that and should lead to a quite stable NCI development.

Tobias Lukesch: Do you think a push from customer deposits into securities is still possible – something we have seen a couple of years ago, basically – or is there no incremental new security business at the horizon currently?

Anas Abuzaakouk: Yes, it was quite strong, as I said, in the first quarter and also in the prior quarters. However, that also has to do with the fact that overall, banks have not offered fixed-term products. Now, banks, including us, are starting offering these. I think there is going to be more shifting to term deposits versus fixed-income products on the Advisory side.

Tobias Lukesch: Yes. Thank you.

Operator: Thank you. We will now take the next question. It comes from the line of Jovan Sikimic from RBI.

Please go ahead. Your line is open.

Jovan Sikimic (Raiffeisen Bank International): Good morning, guys. Thank you for the call.

I would just have one question on costs. In Austria, what we have here, collective bargaining is at nearly 8% salary hike. You, of course, still guide to 2% operating costs for this year. Can you maybe again provide some more granularity on staff and non-staff cost performance for the rest of the year, if possible, just to understand where the major savings should come from? Thank you.

Enver Sirucic: I am not quite sure, Jovan, if I got the full question right. I think you did say, 'Is the collective bargain agreement 8-9%?' Yes, that is true. That is a mix of both collective bargaining agreements that apply to our staff base. That, on average, is between 8-9%. It is fully factored into our OPEX target of up 2%.

In terms of staff and G&A, most will happen in the staff cost line because G&A got already indexed in most of the contracts over the last 12 months. It is fully considered in our run rate.

You will see a slight uptick in the second quarter because the collective bargain – the major one – only kicks in with 1st April. However, it is going to be still in the range of that 2%. We were able to absorb most of that uptick with the measures we put in place over the last two years.

Jovan Sikimic: Okay, thanks. I appreciate it, thank you.

Anas Abuzaakouk: Sure, thanks.

Operator: Thank you. I will now like to hand back over to the CEO, Anas Abuzaakouk, for final remarks.

Anas Abuzaakouk: Thank you, operator. I appreciate everybody's attendance this morning. Look forward to talking to you guys in the second quarter results. Take care. Have a nice day.

Operator: That does conclude our conference for today. Thank you for participating. You may all disconnect.