BAWAG Group

BAWAG Group Q3 2021

Earnings Call

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Transcription

Speakers:

Anas Abuzaakouk

Enver Sirucic

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

Let's start with a summary of the third quarter results on slide 3. We delivered net profit of € 123 million, earnings per share of € 1.38 and a return on tangible common equity of 16.4% during the third quarter. The underlying operating performance of our business was strong with pre-provision profits of € 187 million and a cost-income ratio of 39.2%. Total risk costs were € 22 million, with the ECL management overlay now at € 72 million. We continue to not release any credit reserves, although we see a substantially improved macroeconomic environment and continued positive developments across our customer base, in particular observing payment holidays falling to approximately 10 basis points across our total customer business.

In terms of customer loan growth and capital, average customer loans were up 4% quarter-over-quarter and up 7% year-over year. We continued to accrete CET1 capital, generating 60 basis points of gross capital during the quarter. Our CET1 ratio was 14.7%, up 70 basis points from year-end 2020 after all dividend deductions. As of third quarter, and after deducting year-to-date 2021 dividend commitments of €158 million, we have additional excess capital of € 500 million above our target CET1 ratio of 12.25%.

In terms of dividend distributions, we paid out the earmarked dividend of € 420 million from 2019 and 2020 profits in early October, which is following through on our commitment to distribute dividends post the ECB recommended dividend ban being lifted at the end of September.

We are on track to deliver on our 2021 targets, with return on tangible common equity ~15% and cost-income ratio ~40% for the full year. On the M&A front, we expect the closing of both Hello bank! Austria and Depfa bank, both signed earlier this year, to take place during the fourth quarter.

We recently held our first investor day in September, where we shared our new targets and 4-year plan through 2025. We updated our medium-term targets to a return on tangible common equity > 17% and cost-income ratio < 38%. Our 2025 financial targets aim for profit before tax > € 750 million, earnings per share > € 7.25, and dividend per share > € 4.00.

We also committed to a set of ESG targets for the first time by 2025, targeting a reduction of our own scope 1 and 2 CO_2 emissions of > 50%, from a baseline ~ 2,900 tons in 2020. We committed to annual new business green financing > € 1.6 billion, which is 2x from where we stand today. We also established a female gender quota of 33%, for both the Supervisory Board as well as the Senior Leadership Team. With the new composition of the Supervisory Board following the AGM, we stand today at a women quota of 44% on Supervisory Board Level.

In terms of capital distribution policy, we target a dividend payout of 50% of net profit for the financial year 2021 and will increase the dividend payout ratio from 50% to 55% starting from financial year 2022, resulting in a targeted dividend distribution of ~€ 1.4 billion for the financial years 2021 through 2025. In line with our capital management framework to distribute excess capital to our shareholders, we are also targeting a share buyback in 2022 in an amount above our CET1 target of 12.25%, which as of the third quarter 2021 equaled up to € 500 million. We plan to file the formal regulatory application in the coming days.

The past 18-months have been incredibly challenging and not without adversity; testing our collective patience and resolve. However, the COVID-19 pandemic truly highlighted the quality, resilience, and sustainability of our franchise. With everything we've gone through, the team is more excited than ever to address the many opportunities ahead of us and committed to delivering on our future plans.

Moving on to slide 4: We delivered net profit of € 123 million, up 57% versus prior year. Overall, strong operating performance with operating income of € 307 million and total expenses of € 120 million, up 6% and down 4% respectively, versus prior year. Total pre-provision profits were € 187 million, up 13% versus prior year. Risk costs were € 22 million, down 57% versus prior year and reflecting the normalization of risk costs. Tangible book value per share was € 34.43, up 5% versus prior year and 3% versus prior quarter. This reflects the recent dividend payment of € 420 million from 2019/2020 profits as well as the year-to-date 2021 dividend accrual of € 158 million.

Moving on to slide 5, at the end of the third quarter, our CET1 ratio was 14.7%. For the quarter, we generated 60 basis points of gross capital as we continue to consistently generate significant amounts of capital, averaging around 210 basis points annual gross capital generation over the past four years. As of third quarter and after deducting year-to-date 2021 dividend accrual of € 158 million, we have excess capital of € 500 million versus our target CET1 ratio of 12.25% and stand at 558 basis point buffer to our SREP of 9.14%. We are targeting a share buyback in 2022 in an amount above our CET1 target of 12.25%, subject to regulatory approvals.

On slide 6, our Retail & SME business delivered net profit of € 95 million, up 21% versus the prior year and generating a very strong return on tangible common equity of 28% and cost-income ratio of 38%. Average assets for the quarter were € 20.6 billion, up 9% versus prior year and 3% versus prior quarter, driven by continued growth in housing loans and a pick-up in consumer loans. Average customer deposits were € 26.8 billion, up 10% versus prior year and 3% versus prior quarter. Pre-provision profits were € 143 million, up 8% compared to the prior year, with operating income up 4% as we begin to see a gradual normalization of customer activity. Overall operating expenses were down 3% versus prior year, resulting from a number of operational initiatives and a continued focus on driving synergies across the franchise. Risk costs were € 15 million, down 43% versus prior year, reflecting a gradual normalization of risk costs without any credit reserve releases. The trend in asset quality continues to improve across our customer base, with payment holidays below 20 basis points as of the end of the third quarter. Our customer payment rate continues to be around 90% on all expired deferrals with an average of 12-months.

We've continued to execute on various operational and strategic initiatives. We expect to see continued average asset growth and efficiency gains across the Retail & SME franchise, a shift to a greater percentage of secured housing loans, and greater normalization of customer activity in the quarters ahead.

On Slide 7, our Corporates, Real Estate, and Public Sector business delivered net profit of € 40 million, up 105% versus prior year and generating a strong return on tangible common equity of ~18% and a cost-income ratio of ~22%. Average assets for the quarter were € 14.1 billion, up 3% versus prior year and 5% versus prior quarter, driven primarily by real estate and corporate lending. Pre-provision profits were €61 million, up 27% compared to the prior year. Risks costs were €6 million, down 72% compared to prior year, reflecting positive developments across our customer base with no reserve releases taken as well. The trend in asset quality continues to improve with payment holidays under 10 basis points and a 100% paying ratio for customers that took up payment holidays over the last year. We've been pleasantly surprised with how our customers have responded and the overall credit performance of the business.

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

With that I will hand over to Enver.

Enver Sirucic: Thank you, Anas. I will continue on slide 9. Overall a strong third quarter: core revenues up 1% versus second quarter, with both better net interest income and net commission income. Compared to prior year, core revenues were actually up 3%. Operating expenses further came down as well as risk costs without releasing any credit reserves. Net profit up 3% versus Q2 and 57% versus prior year.

On slide 10, an overview of our balance sheet: In terms of customer loan growth, average customer loans were up 4% quarter-over-quarter and year-to-date - with asset growth across our customer segments, while we reduced our cash position by more than a billion in the third quarter but are still up 10% year-to-date; we believe that being patient at the current interest and spread levels will provide an interesting opportunity in the future to deploy our excess cash. On the funding side we continued improving our long-term funding profile through issuing the next € 500 million covered bond, first time in a green format.

On slide 11, core revenues. Net interest income up 1% versus Q2 with a slightly lower net interest margin of 224 basis points largely driven by asset mix. We continue to see a positive trend in NII for the coming quarters which is coming from continued asset growth. In terms of net commission income, positive trend continues, up 2% versus second quarter - we observed a continued overall improvement, especially with a stronger advisory business and improving payments business. For the full year, expectations are unchanged - we still see core revenues growing by at least 2%.

With that, moving on to slide 12. No changes here as well, operating expenses further coming down. Cost–income ratio was at 39.2% for the quarter. Absolute costs came in at € 120 million. For the full year we expect to be below € 485 million in absolute costs, and to be around 40% cost-income ratio.

Slide 13, risk costs. In general, unchanged conservative and prudent approach on provisioning with improving underlying trends and a strong asset quality performance. In Q3 we booked € 22 million of risk costs – mainly driven by a normal run-rate in Retail & SME of approximately € 15 million. Overall, we have not released any credit reserves and the ECL management overlay now stands at € 72 million versus € 38 million as of year-end. We have no plans to release any reserves this year and expect risk costs to come in below € 100 million for the full year.

Slide 14 provides more details on reserves. Overall reserves increased by 8% versus year-end, resulting in a total reserve ratio of 1.4% and a cash coverage ratio of 49% excluding City of Linz, which was fully provisioned through a capital prudential filter last year. Total ECL reserves now stand at € 148 million, up 13% versus year-end, of which almost 50% or € 72 million is comprised of management overlay reserves. Stage 2 assets are approaching pre-pandemic levels – while NPL ratio remains stable at 1.5%, considering that we have not executed any routine retail NPL sales since Q2 last year. Overall, we see both an improved overall macro environment and continued positive developments across our customer base and asset quality.

To wrap-up, on slide 15: unchanged 2021 forecast since our investor day: 15% RoTCE and around 40% cost-income ratio. In detail this is based on:

- Core revenues growing by 2%, while we expect other income to be at around € 10 million for full year

- Operating expenses to be below € 485 million

- Risk costs to come in below € 100 million

- And regulatory charges to land at € 65 million for full year, of which we have taken € 61 million year-to-date

In terms of full-year timeline, we plan to publish our financials on March 1 and to host our AGM on March 28 of next year.

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

Operator: Thank you. Ladies and Gentlemen, we will now begin the Q&A session. As a reminder, if you have any questions please press star one on your telephone and wait for your name to be announced. If you would like to cancel your request, you can press the hash key. Once again, please press star one if you would like to ask a question. And your first question comes from the line of Izabel Dobreva, your line is now open and you may ask your question.

Izabel Dobreva: Hello, good morning, thank you very much for taking my questions. I had 3 questions, and actually, they are all on the business outlook and net interest income. Firstly, I wanted to ask you a question on corporate volumes. If I look at the asset development this quarter, the assets in the corporate and the real estate segment were up quite substantially, about 15% q-on-q. And in your comments, you have highlighted the strong pipeline too. So I wanted to ask you, how much of that volume is pent-up demand from the pandemic. And would you expect this trend of volumes getting an extra boost to continue also into 2022 or by then easing that it will be more driven by the underlying demand? So that's my first question.

Then my second question is on the consumer segment. If I look at the loan growth there, it was up 3%. And I think that's the fastest growth we have seen since pre-pandemic. So what are you seeing when it comes to contributions? And is the demand back to the pre-COVID level?

And then my final question is actually on the treasury business. So I saw that you have given us a new disclosure on the book split, which is very useful. And in there, it looks like the cash portion currently is very high, about 70% of that book, where historically, it's been much lower. And I know some is still TLTRO, but still on my numbers, it looks like there is at least € 15 million of NII, which could be a tailwind if you were to normalize that cash position?

So my question is, how are you thinking about the timing of deploying that excess cash? Now that the 5-year swap rate is materially higher and actually close to breaking positive? So those are the 3 questions I had.

Anas Abuzaakouk: Thanks, Izabel, this is Anas, I hope you're doing well. I'll go ahead and take the first 2 questions. So just Izabel on your question, the real estate and corporate outlook, that was -- that's twofold. That's pent-up demand because you had a slowdown in 2020, where I think people are on the sidelines at least the number of customers that we had worked with and things are quite static. That's one explanation. But the other explanation, at least when you look at the quarter-over-quarter growth rates, is that you have a number of commitments and sometimes the funding gets delayed. And that, I think, is a bigger explanation for some of the growth rates. I think you're more focused on what is the long-term outlook. And as far as kind of the growth, we've always assumed things -- we don't put volume targets on the corporate, real estate and public sector. If there's great deals, we have capital and liquidity to pursue those deals. We're going to be disciplined in terms of our underwriting. But I think a lot of this was pent-up or a pipeline that we had built up over the past few quarters, and you start to see that pipeline executed on in the third quarter and hopefully in the fourth quarter. And we'll give outlook going into 2022 based on what the pipeline looks like at the end of the year.

And then as far as consumer loans, I think it's twofold. It's a resumption of customer activity, which we highlighted during the course of this year. We're seeing more of a normalization, and then just the number of initiatives that we have on the consumer loan front in terms of partnerships and the like, and that's why you're seeing to drive the growth rates in consumer and SME.

And I'll turn over to Enver for the treasury questions.

Enver Sirucic: Sure. So, Izabel, on the treasury side, I think the question was around the excess cash. You're right. So if you look at the numbers, it came down a bit versus June, but we still have a lot of excess cash. And obviously, we'll try to redeploy it into customer loans, which worked out well in Q3. So I think it's not going to happen overnight. It will just take time to deploy it. And if you just take out the -- as you pointed out, the TLTRO cash out of the position, you're kind of left with € 5 billion to € 6 billion, of which we would try to deploy as much as to customer loans. Then -- you mentioned the rate situation. Obviously, it's helpful that the 5-year and also the 10-year rates moved up a bit, but still is -- it's to be seen how long this will last and if you see further increases in the future. We really see it as just more potential for us, although it's now obviously a negative carry on our balance sheet.

Izabel Dobreva: Thank you very much.

Operator: Thank you, we will now be taking our next question that comes from the line of Mate Nemes, your line is now open and you may ask your question.

Mate Nemes: Yes, thank you very much for the presentation. I have 2 questions, please. First of all, on net commission income. Clearly, we are seeing a good development sequentially there. Could you just give us a bit more color on what's been driving this? I think you mentioned the securities and insurance, but you also alluded to the fact that some areas are still showing some sort of subdued activity. What would be these areas? And when would you expect improvement here?

And secondly, clearly, volume growth has outpaced RWA growth. Could you give us some explanation around this? It seems like there's been a bit of a de-risking in treasury, but interested in your views on why the divergence? Thank you.

Anas Abuzaakouk: Thanks, Mate. Enver, you want to take the questions?

Enver Sirucic: Sure. So on the net commission income, I think it's just a continuation of what we have seen so far. So advisory is really doing quite well also in terms of insurance and as well as securities. And we see also a pickup in payments. That's still a bit bold to pre-pandemic levels, but it is probably -- has caught up most of the gap that we had during the pandemic. But the main driver is really the advisory business. On the RWA growth or development in Q3. So if you look across the segment, so retail was quite stable despite the asset growth. The reason for that is just on the new business that we are doing, it's more mortgages and lower risk weight versus the redemptions to runoff, especially the portfolios that we have bought a few years ago, carry a high risk weight, which pretty much finance all our new business in retail.

On corporate, real estate and public sector, that was just in line with asset growth. So RWAs just went up as assets went up. And then the offset was through Treasury Services and Corporate Center. And as you pointed out rightly, it's just de-risking, and we shifted some assets in the treasury book that provided the offset for the growth that we had in corporate and real estate.

Mate Nemes: Thanks Enver.

Operator: Thank you and your next question comes from the line of Gabor Kemeny. Your line is now open and please ask your questions.

Gabor Kemeny: Hi. Firstly, just a follow-up on the capital beat. So we've seen a combination of pretty solid loan growth and no meaningful RWA growth for the reasons Enver just mentioned. Do you think there is room to continue this trend in the next few quarters?

And then secondly, on the capital distribution. So just a clarification on the possible size of the buyback. So when you will talk to the ECB in the next few weeks about the possible buyback, the basis of the excess capital, would it the last reported, like the third quarter, which will be the basis for the possible size of the share buyback discussion?

And then just lastly, the full year core new guidance of 2% growth, I think it implies roughly flattening core revenues in the last quarter of the year. Can you elaborate a bit on why you would expect a change in the trend we have seen in the last few quarters of gradual growth?

Enver Sirucic: Thanks, Gabor. So I think on the capital side, this quarter, we managed kind of the balance of the RWAs overall. With increasing asset growth that we expect for the rest of the year, but also for the outer years, we would expect also that RWAs will move more in line with the asset growth. So I don't think it's realistic to assume that RWAs will stay flat with continued asset growth. In terms of size of the buyback what you said, we obviously didn't disclose the number, but we tried to give as much kind of guidance or to give you some idea of the size, the technical question around is it based on third quarter or any other date. So the idea was that we start with final Q3 numbers. That's why, as Anas said, we'll file the application in the next couple of days because it's only based on the reported numbers as of today. But what you then have to take into consideration is not just Q3 but also the outlook, right? So for full year, next year, the asset growth, the RWA growth, so it's a mix of starting point in Q3, but also you have to lay out the development of the future when you define the size. But it will be in the context of being above 12.25% or slightly above that.

And in terms of core revenue growth, I think the 2% number is just very conservative. In reality, I think the expectation is it will just continue as what we have seen so far year-to-date. And if you just extrapolate that in reality the number is going to be bigger than 3% in terms of core revenue growth.

Operator: Thank you and the next question comes from the line of Izabel Dobreva. Your line is now open.

Izabel Dobreva: Thank you. Yes, I wanted to ask a follow-up question if everybody else has already used theirs. I just had a small one, which is technical on the buyback. I wanted to clarify, do you have a preference as to how you conduct this buyback? Meaning do you have a preference that you do it in the open market? Or would you be open to participating in a placing if the opportunity was to present itself?

Enver Sirucic: So Izabel, we have not made a final decision, but I think as we laid out at the Investor Day our preference right now would to do an open market buyback in very likely safe harbor format.

Izabel Dobreva: Thank you.

Enver Sirucic: You're welcome.

Operator Thank you. There are no further questions came through, Sir. Please continue.

Enver Sirucic: Yes. So I think I'll take it over. I think Anas has some technical issues. So I guess we'll talk to each other with the full year financials, which will be on March 1, of next year. Thanks, everyone, for joining, and have a good day.