BAWAG Group

H1 2018 Results Call

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Transcription

<u>Key Speakers</u>:

Anas Abuzaakouk

Enver Sirucic

Operator	Good day, ladies and gentlemen, and welcome to the BAWAG Group first half 2018 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 * followed by 1 on your touch-tone telephone. Please press the * key followed by 0 for operator assistance. As a reminder, this conference is being recorded and a replay as well as a transcript thereof will be available on BAWAG Group's website. I would now like to turn the conference over to Anas Abuzaakouk, Chief Executive Officer. Please go ahead, sir.
Anas Abuzaakouk	Thank you, operator. Good morning, everyone. I hope everyone's doing well. I'm joined this morning by Enver Sirucic, our CFO. Let's just jump right into it. So I'm on slide three. Related to the financials the second quarter profit before tax came in at €153 million. This is up 21% from the second quarter 2017 and results in a return on tangible equity of 18.3% when we apply a 12% CET1 ratio to adjust for excess capital levels. Pre-tax earnings per share came in at €1.50. We also generated 120 basis points of capital accretion during the second quarter, landing at a fully-loaded CET1 ratio of 15.2%. On a half-year basis profit before tax came in at €269 million. This is up 9% versus prior year and results in a 15.8% return on tangible equity. Again this is applying a 12% CET1 ratio to adjust for excess capital levels and generates pre-tax earnings per share of €2.66 for the first half. Also for the first half of the year we generated in aggregate 170 basis points of CET1, driven by strong capital accretion and lower RWAs. I just want to remind everybody that this actually takes into account fully IFRS9, which had an impact of negative 10 basis points during the first quarter. As far as the development of our customer franchise we continue to shift the overall asset mix to our core retail products of consumer loans, housing loans, auto leasing, credit cards and current accounts through both our physical and digital channels. Also at the same time, we've maintained our disciplined underwriting as we continue to focus on risk-adjusted returns across all of our business segments. Just as a reminder for everyone, this means focusing on good pricing and solid asset quality versus taking on more volume with increased risk. In terms of capital optimization, we executed the main elements of our capital optimization plan for 2018 during the first half of the year.

We've completed our inaugural €300 million AT1 issuance in April. We also completed our Tier 2 buyback in early July, which was very successful. Investor take-up was very strong with a total principal amount of €268 million, which represented about a 90% take-up rate. Outside of our capital optimization plans, we also launched a small share buyback of around 1.3 million shares, which will run through the end of the year.

As far as strategic initiatives: We've continued to make very good progress across the board and have good momentum going into the second half of the year. Specifically as it relates to Südwestbank our integration is ahead of plan with our initial areas of focus centered around cost and capital efficiency. The benefits from the restructuring program will become much more visible for Südwestbank going into the second half of the year. We are also in the process of expanding our retail and SME product offering and leveraging new distribution channels across Germany through the Südwestbank platform.

On the BAWAG P.S.K. front, we continue to make very good progress with our retail transformation roadmap, which we refer to internally and externally as *Concept 21*. The separation from the Austrian Post is on track as it relates to customer migrations, identifying branches and our redesign as well as moving our financial advisors into our target branch network of up to 100 branches by the end of 2019.

As far as easygroup: The PayLife integration is ahead of plan. We have fully integrated PayLife into *easybank* and are focused on driving revenue and cost synergies across our retail franchise. We are also planning for the launch of *Qlick* as we leverage the Südwestbank platform and provide an integrated front and back office across easygroup and Südwestbank for consumer loans.

As far as overall business segment performance: We continue to see a shift towards our retail business with strong performance from both the BAWAG P.S.K. and easygroup segments. Our International Business segment had another strong quarter of originations although redemptions remained high. We see a strong pipeline of opportunities during the second half of the year as well.

As far as the DACH Corporates & Public Sector business: Pricing remains challenging and we continue to focus on risk-adjusted returns versus just focusing on driving volume. Also we proactively derisked our treasury portfolio during the first half of the year and remain patient and disciplined with overall liquidity and capital management.

Lastly our overall strong capital generation provides us with a number of opportunities as we focus on organic growth in our core retail and SME products across the DACH region.

On the M&A front we continue to pursue a number of deals that we think will complement our retail strategy. However, we will only pursue deals if they are the right strategic fit, come at the right value and are earnings-accretive, generating returns consistent with our overall return on tangible equity group targets.

In the event we are unable to deploy our capital to organic and/or inorganic opportunities that generate returns greater than 15% from a return on tangible equity standpoint we're absolutely committed to returning capital to shareholders, be it through dividends and/or share buybacks.

Moving on to slide four, we have outlined the customer franchise development, what we call internally the strategy gameboard. The focus here is on the overall growth in core retail products across both BAWAG P.S.K. and easygroup and the overall shift of our business to the retail segments.

If you go back to 2012 - referring now to the top right-hand side of the page. If you go back to 2012, the retail segments of what is today BAWAG Group accounted for about 40% of pre-tax profit. Today that figure stands at 70% and we anticipate this will go to approximately 80% in the near future as we continue to grow our retail projects across the DACH region.

This takes into account the planned run-off of our international mortgage portfolios in easygroup. A key driver for the growth of retail's contribution is the continued organic growth of consumer loans, housing loans and autoleasing products. Additionally, we plan for strategic partnerships in digital platforms to augment existing retail distribution channels that will drive growth across our retail segments.

As far as the non-retail business, the International Business is flat for the half-year despite €1.5 billion of originations during the first half. However we have built a strong, solid pipeline for the second half of the year and anticipate net asset growth in this segment. On the DACH Corporates & Public Sector business the focus has and will always be on risk-adjusted returns, never overextending ourselves. We'll emphasize price and asset quality over volume and we will continue to do this despite a challenged pricing environment.

As far as our treasury portfolio, we will remain patient and disciplined as we deploy our liquidity and capital on the back of de-risking measures during the first half of the year.

Moving on to slide five, the BAWAG P.S.K. Retail segment had another strong quarter. In terms of financials, second quarter profit before tax came in at €62 million, which is flat year over year and up 13% versus the first quarter.

The first-half profit before tax came in at €117 million. This is up 13% versus prior year with a cost-income ratio of just slightly under 44%. We see risk costs improving since the first quarter and benefiting from an overall benign credit environment.

As it relates to just the asset and liability development, new business asset originations of €300 million were driven by consumer and housing loans. Overall customer loans are flat since year-end but this actually doesn't really provide the right picture as we continue to change the asset mix with net asset growth of 2% in both consumer and euro housing loans, which are offset by a proactive reduction of Swiss franc housing loans and that's down 5% since year-end 2017. Our focus continues to be on running off the Swiss franc housing loans and driving euro housing consumer and SME financing. On the liability side of the house, customer deposits were up 2% versus year-end 2017.

In terms of operational and strategic developments, over-the-counter transactions were down 19% year over year. These over-the-counter transactions account for only 10% today of our overall transaction volumes. Historically this was a core offering of our branches. However, this has been replaced by e-banking, mobile banking and self-service terminals as we see the migration away from the physical footprint to more online.

We've also signed a strategic partnership with MediaMarktSaturn Austria during the second quarter which we hope will allow us to provide point-of-sale financing starting in 2019, when we'll hopefully represent the first of a number of strategic partnerships that we execute on.

Moving on to slide six, we wanted to provide you with a more detailed update on *Concept 21*, which is our retail network transformation. Let me start by stating that *Concept 21* has been in the works for actually quite some time now, probably the better part of two to three years. The separation agreement from the Austrian Post, which we actually signed earlier this year, provided us with a chance to accelerate our retail transformation plans and work towards a preferred stand-alone network.

If you think about the opportunity set for us, this has been pretty compelling. It provides a chance to a), enhance the overall customer experience; b), reduce inefficiencies within the network; c), invest in a digitally integrated omni-channel distribution; and last but not least, maintain our high-touch advisory, which ultimately is what our customers want and expect from us.

The target network we communicated is up to 100 branches and this will hopefully cover over 85% of the Austrian population. This will cover 92% of our existing customer base. This will be comprised of 74 high-performing branches that today we own or lease within the BAWAG Group and this will ultimately be augmented with up to 26 new branches that we'll be able to launch.

To date we have only financial advisors in 111 post offices, which we will exit by year-end 2019 as we stand up our own network of up to 100 branches. Of the 26 new branches that I've mentioned we've already signed 12 branches and are confident that we'll be able to be fully operational with the whole network of up to 100 branches by year-end 2019.

Ultimately, *Concept 21* provides us with the client-focused advisory centers, self-service enhancements and improved customer service workflows, integrated with our digital platforms. As it relates to just the benefits of *Concept 21*, by 2020 our targets for the BAWAG P.S.K. Retail segment are really threefold: a) is to have a stand-alone network of up to 100 digitally integrated branches; b) to have a cost-income ratio of under 42% at the segment BAWAG P.S.K. level versus at the total group level of under 40%; and lastly we expect the separation from the Austrian Post to generate pre-tax earnings per year of greater than €30 million. This is resulting directly from the network optimization and not factoring in any other organic growth in the segment.

On slide seven, easygroup had another strong second quarter as well. On the financials: pre-tax profit came in at €40 million. This was up 25% versus the first quarter and down 7% versus the prior year. First-half pre-tax profit came in at €71 million, down 6% versus prior year with a cost-income ratio of 31%. We continue to see risk costs improving versus the first quarter and really benefiting from a continued overall benign credit environment.

As far as the asset and liability development, new business originations of approximately €200 million were driven primarily by autoleasing, by the autoleasing product. Overall, the customer loans were down 5% since year-end and this was driven primarily by the anticipated run-off of our international mortgage portfolios, which are down 10% year to date. However, we continue to see steady growth in our core products, which are up 2% year to date and this is primarily the *easyleasing* and consumer loans. On the liability side, overall customer deposits were up 1% versus year-end 2017.

In terms of operational and strategic developments, the PayLife acquisition has been fully integrated into *easybank* and the teams are now focused on driving revenue and cost synergies across the group and we continue to make progress on that front. We're also proud to note that *easybank* received the Recommender Award from the Austrian Financial Marketing Association for having the highest NPS or net promoter score of 52% across any bank in Austria, which is a great accomplishment for the *easybank* team.

Moving on to slide eight as it relates to non-retail segments, let's start off with the International Business. The International Business segment delivered a very strong second quarter with pre-tax profit of approximately €36 million. This is a threefold increase from the prior year and a 58% increase versus the first quarter.

Results were driven by lower costs and a significant reserve release of €9 million tied to the sale of an oil & gas loan that we conservatively provisioned during the second quarter of last year. We see risk cost continuing to benefit from proactive derisking of positions and the overall high asset quality of the business, which we believe is best reflected in an NPL ratio of 20 basis points.

Overall, new business originations of approximately 1.5 billion in the first half of the year was offset by high redemptions, which you see in customer loans being flat since year-end. However we've built a solid pipeline of lending opportunities in the second half of the year and anticipate a few points of net asset growth.

As it relates to the DACH Corporates & Public Sector segment we delivered profit before tax of approximately €10 million during the second quarter. This is a decrease of 32% from the prior year and a 22% decrease versus the first quarter.

Overall, we continue to experience muted loan corporate demand which is compensated by short-term public sector lendings. The overall DACH corporate lending market share continues to be challenging as it relates to price and risk-adjusted returns.

However, we'll continue to be patient and disciplined, focusing on risk-adjusted returns versus pure volume growth.

Moving on to slide nine, our focus on Südwestbank, which was an acquisition we closed in December 2017, continues to be on the transformation and repositioning of the business. Südwestbank delivered second-quarter profit before tax of approximately €7 million and half-year profit before tax of approximately €21 million. There are no comparisons to prior periods given the acquisition closed in December 2017.

Overall, revenue development has been in line with our expectations as part of the capital efficiency review and the financial benefits of the cost restructuring will become much more visible during the second half of the year. Core revenue development is in line with capital efficiency measures taken as we scale back low-margin, high-risk-weighted and/or low-returning businesses that do not meet our targeted risk-adjusted returns.

From an operational standpoint, the second quarter was a continuation of the transformation efforts that we launched at the beginning of the year. We will continue to focus on the operational transformation, which I'll get into in more detail on the next slide, and really planting the seeds for the business transformation.

The key focus from a product and channel standpoint will be augmenting our retail and SME products and channels, which will be accelerated with the closing of Deutscher Ring Bausparkasse on the housing loan front. Hopefully, that will take place in the third quarter or early fourth quarter, using *Qlick* as an integrated German consumer product channel, leveraging Spotcap technology to address parts of the SME market and migrating the credit cards portfolio to PayLife during the second half of the year.

Additionally we're looking to grow the securities AuM business both organically and inorganically and focus on growing our share of volume with established and profitable SME and corporate customers.

On slide ten we wanted to provide you guys with more detail on the Südwestbank integration and operational transformation. Specifically, we wanted to highlight the work that has been done to date and provide details about restructuring and projected cost-out. The integration leadership team has been in place since 2017 and really has worked closely with Wolfgang Kuhn, our CEO of Südwestbank, and the leadership team on the ground.

The transformation plan covers cost restructuring, product profitability reviews, process improvements across the middle and back office as well as trying to identify ways to leverage the broader group infrastructure. In terms of just staff or personnel, we project FTE reduction of approximately 40% versus year-end 2017 so this happens in two phases from the 540 FTE in 2017 all the way through the projected reduction of about 40% through year-end 2019.

To enable the restructuring we implemented a social plan that was agreed with the workers' council earlier this year in April. This social plan outlines specifics around the scope of restructuring, impacted functions and overall timing which really runs in two phases between phase one in 2018 and phase two in 2019. The good news is we've already completed the first phase and are ahead of plan in terms of overall restructuring.

In addition to the personnel restructuring plan, we also agreed on an optimized branch network and non-personnel cost-out, reflecting both overall business needs and digital priorities. Our day-one network, just to kind of level-set everybody, consisted of 28 total branches. The social plan settled on a total of 16 branches, which is a reduction of over 40%, which will preserve both regional coverage and core product services. As of July, the good news is 75% of the branch closures were already completed and well behind us, so to date we've made very good progress with the integration and expect the strong momentum to continue for the next six to 12 months.

Our aim is to complete the transformation by year-end 2019 with cost benefits becoming more visible in the second half of this year and retail and SME product and channel positioning really starting to take form in 2019.

With that I'll pass it over to Enver to go over some more details on the financials.

Enver Sirucic

Thank you, Anas. I'm on slide 12 right now. It's been a very strong quarter in terms of financial performance, as Anas mentioned. Profit before tax came in at €153 million for the quarter, more than 30% higher compared to first quarter and 21% better than last year's second quarter. The return on tangible equity at 12% CET1 was slightly above 18% and we also saw a continued trend towards retail while core revenues developed in line with the balance sheet optimization of the last quarters. Overall, we had new customer asset originations of €1.3 billion for the quarter with a stable NIM of 215 basis points.

In terms of efficiency, opex improved €225 million for the quarter, which is 4% better than Q1, with a stable cost-income ratio of just below 44%, which is clearly better than our FY target of below 46%. On the risk side, just given our focus on stable economies, we have experienced a very favorable trend in the second quarter which is reflected in a risk cost ratio of 5 basis points and a very stable NPL ratio of 1.8%.

One of the highlights for the quarter as well as for the year to date was clearly our capital accretion in terms of CET1 ratio, which improved by 120 basis points in the second quarter to 15.2% CET1 ratio and with the AT1 issuance and the Tier 2 tender we also made significant progress in optimizing our capital structure.

On slide 13 you see the usual overview that we have on P&L and balance sheet; core revenue is up 8% compared to previous year, mainly driven by the performance of the retail segments and the integration of the acquisitions that were made in 2017.

Regulatory charges have been mostly booked in the first quarter, as we said on the Q1 call, so the €2.8 million for the second quarter is a good proxy now for the remaining quarters. As mentioned previously, we had low risk cost in the second quarter, coming in at just over €5 million. I will talk about it later on. Pre-tax EPS for the quarter was €1.50. Tangible book per share was close to €31 as of end of June.

The balance sheet remained largely stable compared to first quarter but also reflected the deleveraging that took place in the first quarter if you compare it to our year-end numbers. The AT1 issued in April is shown separately just to be consistent to how we present our common equity base in the past and also going forward. Our risk-weighted assets came down in the second quarter by more than a billion and I will provide more details about the overall capital development later on.

Now moving on to the development of core revenues on slide 14, net interest income and net interest margin were largely stable in the first half with expected impacts from derisking as well as strong core retail growth. Generally we see a continued shift to our core retail products and at the same time we stay patient and disciplined on the corporate and treasury side.

Just given the capital optimization that took place and the measures implemented as well as our new business pipeline we anticipate a bit stronger second-half performance for the NII. On the NCI side we saw a very strong first half which was driven by the reduction of commission expenses related to the Austrian Post Corporation and the integration of PayLife, which is mainly an NCI business, and Südwestbank, but also good core product development with some expected softness and seasonality in the second quarter.

Moving on to operating expenses on slide 15, we closed the quarter below €125 million of opex with a cost-income ratio just under 44%, quite consistent with what we had in Q1. As Anas pointed out earlier, a strong performance in Q2 with a number of transformative initiatives well underway across the group. Two key initiatives I would like to highlight; the first one is integration of Südwestbank is progressing ahead of plan with strong transformation momentum following the signing of the comprehensive social plan framework that we had in April and phase one of restructuring is mostly being completed this summer so we expect to see some cost benefits of this to materialize in the second half of the year.

If I come to our branch network transformation also, which we call *Concept 21*, we are making very good progress in terms of repositioning the network but we are also making investments and these measures may lead to an increase in staff costs in the coming quarters as well. All in all, I would say, a strong performance this quarter that puts us in a good spot as far as meeting or exceeding the 2018 guidance of the target cost-income ratio of below 46%.

Switching to the next page on risk costs, slide 16, this quarter has been a good example of how we are running our balance sheet in a safe and secure manner, ensuring proactive risk management and also maintaining a conservative risk profile. We closed the quarter with approximately €5 million of risk costs and the risk cost ratio was 5 basis points. Performance was driven by solid risk profile but also included a recovery from a sale of an exposure in oil & gas which we have provisioned for last year. I think it was pretty much the same time.

NPL ratio stands at 1.8%; if you exclude the litigation case with City of Linz it would be for the core business 1.2%, which is very consistent and stable over time, with existing NPL stock being provisioned at almost 84% in terms of coverage. We will continue to drive also provisioning adequacy to proactively address higher-risk exposures. We have all seen recent markets; you have political volatility across the market and we as a bank, we reiterate the importance of running a fortress balance sheet and prudent risk management and be it on the lending but also on the treasury business. That's why we will stay patient and stay disciplined.

In this context maybe just to highlight some themes, number one, we have no relevant exposures to Turkey, Russia or generally broader emerging markets. Number two, we have no relevant exposure also to Eastern Europe and also, to reiterate what we have said over the last couple of quarters, our customer loan franchise is focused on developed markets, of which 75% relates to DACH region and roughly 25% to Western Europe and the United States.

One thing that will continue in the future is their shift of the business model, more focused towards retail which will further diversify the portfolio growth and also will be subject to conservative client and as well collateral underwriting. And one thing that happened already in Q1; we derisked our treasury portfolio because we just saw some mispricing of the risk and dislocation in the market.

Overall we will remain patient, disciplined, as I said and will always focus on risk-adjusted returns. In terms of the full-year outlook and also on the back of the derisking efforts and the benign credit environment we expect the 2018 risk cost guidance to come in below the previously communicated range of 15 to 20 basis points.

On slide 17, capital, so we have two pages on capital prepared, one to show the overall development and key points and the second one is a more detailed walk of our capital ratios. So our fully loaded CET1 ratio came in at 15.2%, which is 120 basis points higher than Q1 and up 170 basis points YTD. The excess capital above our management target of 12% stands now at approximately €650 million, compared to the mid-term target of €2 billion excess capital that we have.

The second quarter was also transformational in terms of capital structure. We mentioned some of the highlights. We have issued the €300 million AT1 in April but also announced the tender of our €300 million Tier 2 that was issued back in 2013, which was then executed in July with a very strong take-up of 90% and with these measures we have made significant progress in optimizing our overall capital structure.

Moving to slide 18, what are the key drivers behind the significant capital ratio growth? It's really twofold. On the one side we have earnings that contribute around 50 basis points, which was in line with previous quarters, and another 70 basis points came from lower risk-weighted assets which then led to a CET1 ratio of 15.2%. Or if you accrue for the 50% dividend payout, the CET1 ratio would then be at 14.7%.

We have not yet finalized the PPA of Südwestbank, which will lead to a release of the prudential filter once completed. It's roundabout 20 basis points that we have still left for the PPA.

As we completed the Tier 2 tender in July and also launched a share buyback we expect some negative impact to come from that, which will then mainly be reflected in our Q3 numbers. On the total capital ratio we had a 120 basis point improvement from the CET1 side and on top of that the AT1 issuance contributed another 150 basis points, while the Tier 2 tender that we did, resulted in a reduction of roughly 100 basis points.

Overall, we see a big step achieved in terms of capital structure optimization and with that I will hand back to Anas. Thanks.

Anas Abuzaakouk

Thanks, Enver. For everyone, I'm on slide 20. We just wanted to recap our targets for 2018, which are comprised of pre-tax profit growth of greater than 5%, cost-income ratio under 46% in 2018, a return on tangible common equity greater than 15% - this is again when you apply a 12% CET1 ratio to adjust for the excess capital levels - and a CET1 ratio equal to or greater than 12%.

So as I stated earlier in the presentation, we're on track to meet or exceed all of our 2018 targets. We feel good about our operating performance during the first half of the year, growing in our core retail products, continuing the shift to our retail franchise, executing on various operational initiatives, be it Südwestbank's integration or the BAWAG P.S.K. *Concept 21* network transformation.

And we also believe focusing on risk-adjusted returns, not chasing volume and the patience and discipline in deploying our liquidity and capital will ultimately pay off over time. We have a solid M&A pipeline, but each deal, as we've said before, has to be the right customer franchise, has to be the right product offering, has to be the right market access, has to have the potential for operational improvement and ultimately has to come at the right price.

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

So as of the second quarter we've built up excess capital of around €650 million. Our primary objective is to deploy our excess capital into organic growth as well as M&A that generates returns consistent with our return on tangible equity target of greater than 15%.

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

Operator	Ladies and gentlemen, at this time we will begin the question-and-answer session. Anyone who wishes to ask a question may press * followed by 1 on their touch-tone telephone. To withdraw your question please press * followed by 2. If you are using speaker equipment today please lift the handset before making your selection. Anyone who has a question may press * followed by 1 at this time. One moment for the first question, please.
	And the first question comes from Pawel Dziedzic from Goldman Sachs. Please go ahead, sir.
Pawel Dziedzic	Good morning and thank you for the presentation. Two questions from me, please. The first one is on cost - and your performance this quarter seems quite good - your cost base is now at around €125 million and I was wondering if, you know, if you could help us understand, how should we think about the run-rate from here on?
	You mentioned Südwestbank but to what extent benefits of the transformation plan are already in Q2 numbers if at all and, you know, if perhaps you can comment on your branch network roll-out post the separation from the Post; are we likely to see any cost pressures here in the second half?
	And finally, you know, if we look at the €125 million number, could you comment if there are any specific items, you know, in the second quarter that we should be aware of to understand the movement there? Some of that is for instance in the Corporate Center, if you could comment on that. So that was the first question on cost.
	And then the second question, just to come back on your point on capital deployment and M&A, you slightly changed the way you address M&A pipeline. In your presentation you removed the reference to the size of the pipeline, so I wonder if, you know, if it means anything and also, given you highlighted the strong pace of capital accretion already this year and perhaps without any deal materializing so far this year, are you leaning towards increasing capital returns, dividends or perhaps buyback this year? Thank you.
Anas Abuzaakouk	Thanks, Pawel, very good questions. I'll let Enver address the cost questions and then I'll take the question on capital deployment.

Enver Sirucic

Yes, Pawel, so on the cost base, so Südwestbank; almost nothing is reflected so far in the Q2 because we just started to execute the program so you will see an improvement in run-rate in Q3 and mostly in Q4 once it really feeds through the run-rate of the opex space, so that will be a positive.

On the Post, you pointed it out right, so the guidance that I gave is we will see costs going up in Post. Will it match with Südwestbank? Probably you will temporarily have a cost increase over the next quarters which will then offset over time. This is, I think, what we can say.

And I would say on the Q2, nothing specific that I would highlight that is in the €125 million.

Pawel Dziedzic

Okay.

Anas Abuzaakouk

So, Pawel, in terms of excess capital deployment - and then you asked a question on M&A - so on the M&A front we still have a robust pipeline. I think we've mentioned historically the pipeline was about €25 billion of customer loans. Directionally this is the same size, of course the mix has changed. This is primarily Germany and Austria opportunities that we're looking at. The important thing on the M&A front is we will be disciplined. It's got to be the right strategic fit, it's got to be the right value. I alluded to that earlier but we feel pretty good about the M&A but obviously that's something that you need to be patient on and you can never overextend yourselves and one thing we'll do is always be disciplined and patient when it comes to M&A as well as to lending.

As it relates to excess capital we haven't changed our approach. What we'll do at the end of the year, given our excess capital levels, is do a full assessment. We will always be good stewards of capital and act in obviously the best interests of shareholders. We've committed to a 50% annual payout in terms of net profit for 2018 and to the extent there's excess capital we will also be pursuing stock buy-back programs in the event that we build up these excess capital levels and I think you can see as of the first half you've got €650 million and if you measure that up against the €2 billion of excess capital generation I think we're on a pretty good pace so hopefully that answers your question.

Pawel Dziedzic

That does answer my question. If I can have one follow-up please and it's just on costs. So you mentioned you're on track to, you know, beat or exceed targets for this year, so for 2018. Now, you haven't changed your 2020 guidance at all but do you think you are in a position to perhaps achieve the levels of below 40% cost-income ratio sooner than 2020 and if not, you know, given the integration and cost savings go on a little bit better than expected, are you more cautious on the top-line outlook?

Enver Sirucic: I think on the cost side we'll stick to the same targets that we have for the three years. We just want to be cautious because there will be investment that we plan to do in the networks so I think it's not fair to say in the next 12 months you would see then the 40% cost-income ratio target being met so we would stick to what we said previously. Sorry, the last question you had, the additional one?

Pawel Dziedzic: No, I think that answers my question actually. Thank you very much.

Enver Sirucic: Okay, thank you.

Anas Abuzaakouk: Thanks, Pawel.

Operator: And the next question comes from Marcel Houben from Credit Suisse.

Marcel Houben: Good morning, gentlemen, thank you for taking my questions; there're two. The first one is on NII; it was a little bit light. We see some negative impacts from the Südwestbank deleveraging as well as on DACH and the constant drag on the Corporate Center. I think you guided for some improvement in the second half this year. Can you explain the drivers of this improvement, please?

Then the second one is on the branch network in Austria with the Post. Are you running on a much lower branch network of 185 on slide six? Can you tell us a little bit about the retention rate that you're having, is it somewhat similar that you expected, around 95%? Thank you.

Anas Abuzaakouk: Hi, Marcel. I think Enver will take the question on NII and then I'll address the question on the branch network.

Enver Sirucic: Yes, so the NII improvements; yes, we are guiding for a bit better NII in the second half. Couple of effects that we have there; so the one is obviously the Tier 2 tender which was a highly prized Tier 2, which will give us a reduced interest expense going into the second half.

The other one is we have - as Anas laid out, a cash deployment program in place now just to optimize the asset deployment but also maybe reduce something on the liability side and on top of that we still expect Q3 and Q4 - it's going to be small but a bit of an add-on from the closing of the books integrated - which is sorry, the Deutscher Ring Bausparkasse, that is about to close in Q3 and Q4.

So all these elements give us enough confidence to say that NII will be slightly better.

Anas Abuzaakouk	Marcel, in terms of the branch network, so just to kind of, just some key facts or data; the impact of customers are about 400 thousand plus customers when we talk about getting to a network of up to 100 branches. We've already done customer migrations on a third of that and when we look at just the retention rates, it think we mentioned before, historically when we closed branches we had a retention of over 95%. We're running at that clip and even better in terms of overall retention for high-value-add customers. So we feel pretty good. It's obviously a process that we're going to go through but if the early indications are any sign we're in a good place.
Marcel Houben	All right, thank you, guys.
Anas Abuzaakouk	Yes, thanks, Marcel.
Operator	And the next question comes from Gabor Kemeny from Autonomous Research. Please go ahead.
Gabor Kemeny	Hi, it's Gabor from Autonomous. Firstly, on the core revenues, I mean, looking at the volume dynamics, I think that your loans are flat or slightly down in most of the key segments. It's a combination of your foreign mortgages declining, Swiss franc loan portfolio coming off and, I guess, limited demand in the domestic corporate space. So the question is, how do you think about organic revenue growth in this environment when you face some volume headwinds? And the other question is on Südwestbank. I wondered if you had any significant seasonality in the second quarter so, I mean, I understand you had a derisking impact but looking out into the second half and possibly 2019 and 2020, I'd like to understand what makes you confident that the very significant cost savings at Südwest which you are already executing would not compromise your revenues.
Anas Abuzaakouk	Hi, Gabor. So I'll - I think the best page to refer to is what we call the strategy gameboard; that was slide four in the earnings presentation. I think this best addresses the question around volumes and the overall asset mix if you look at both the retail and the corporate franchise. So when you peel back the onion in terms of BAWAG P.S.K. Retail we actually have positive development on consumer and housing loans, which is up 2% YTD, so that is slightly above kind of where GDP is on an annualized basis and that's kind of where we've guided for our core retail products.

The same holds true for easygroup in terms of our autoleasing or *easyleasing* product, in terms of also consumer loans and housing loans, which is up 2% net asset growth YTD. So I think, you know, we don't give guidance for overall volume growth but in the core retail products we're kind of in that GDP to plus one or two points' growth from what you see domestically.

And the offset - we've talked about it before - is we're proactively reducing the Swiss franc mortgage portfolio in Austria. That's something that, to the extent we can move people into euro housing mortgages that are, we believe, less volatile that's a good thing for both the bank and the customers. And then we've anticipated the run-off of the international mortgage portfolios.

On the corporate side, as far as DACH Corporates & Public Sector lending, it's less so that there isn't as much demand; it's just the volume that we see out there doesn't meet our risk-adjusted returns so you'll see, I think, other banks demonstrate growth in the corporate segment or corporate area. Just when we see the pricing and we look at kind of the covenants, overall asset quality for us it doesn't meet the return thresholds that we require and we think being disciplined and patient will pay off over the long term as far as the corporate lending.

Our International Business actually had a really good first half. We just had higher redemptions and hopefully with the strong pipeline in the second half you'll see net asset growth in our international business.

That is, I think, addressing the overall volumes. What was the question on Südwestbank?

Enver Sirucic — Of course there will be a balance but what we always said; we'll focus on PBT accretion and also return on annual equity in terms of also how we look at Südwestbank. So yes, I wouldn't say that cost is really tied to the revenue line but I think the deleveraging that we are also doing in Südwestbank will have an impact on revenue but we think the cost reduction will outpace it, what we have on the revenue side as a potential loss so I think we will find the right balance to mitigate for that.

Gabor Kemeny — Okay, thank you.

Anas Abuzaakouk — Thanks, Gabor.

Operator — And the next question comes from Mate Nemes from UBS. Please go ahead, sir.

Mate Nemes	Yes, good morning and thanks for the presentation. I have two questions, please, first of all on the net interest margin. Could you give us a better sense of actual NIM development across the group? Obviously group NIM is flat sequentially but if I am not mistaken apart from easygroup and Treasury Services & Markets the rest of the segments saw lower NIM quarter on quarter so if you could comment on this, whether this is competitive pressure, a reflection on market conditions or front book versus back book yields or does actually the treasury deleveraging have a spillover effect or impact on these other segments as well and if so can you discuss in what way this affects other segments? And secondly on International Business, if you could talk a bit about the opportunities you see in the International Business segments, the pipeline in the second half which you say is robust; what type of opportunities are these, are these NPL finance or other type of financing? What volumes should we expect here and also how should this affect actually net interest margin in the segment? Thank you.
Enver Sirucic	I'll take the first one. So thanks, Mate; very detailed. You know that we don't disclose all the details that you ask for but I think it is - yes, I think if you just look at the individual NIMs of the segment sometimes it's a bit distorted but I think the best way to look at it; the biggest impact really came from the Treasury divestment that we did in the first quarter and it had some spillover effects into the other segments as well. And then also what we see in DACH and Südwestbank, just low volume given low demand or the deleveraging exercise but the segment NIM, especially just for the quarter, is not really representative, we think, in terms of the metric. I think the second was on new business volume in IB.
Anas Abuzaakouk	Yes, so in terms of the International Business, Mate, the very strong pipeline and why we're comfortable on this front is these are deals that you sign and then the funding takes place at a later point in time, so we've signed a number of opportunities. This is portfolio financing, commercial real estate, NPL financing that we feel pretty good about; Western Europe, developed markets, Spain to a certain extent. We don't talk about the NIMs or the pricing on the deals but we feel pretty good and that was why I made the comment that we see net asset growth in the second half for the International Business.
Mate Nemes	Okay, that is helpful, thank you.

Anas Abuzaakouk	Thanks, Mate.
Operator	The next question comes from Giulia Miotto from Morgan Stanley. Please go ahead.
Giulia Miotto	Hi, good morning and thank you for your presentation. A couple of questions from me as well. So the first one, just a clarification on the International Business pipeline; so if I understand it right at the moment you've got this excess liquidity drag because, well, you see some opportunities coming up, mostly in the International Business and you're planning to deploy this excess cash there more than in the domestic markets where it seems like, sure, you're growing but perhaps it's more business as usual and steady 2% growth so that's the first question. Then, second question; so you mentioned that we will see a negative CET1 impact in Q3 coming from the Tier 2 and the share buybacks. Could you please quantify it? And if you have already done it, sorry if I missed it. And then, finally, thinking about the domestic Austrian market, so one of the points when we did the IPO was around consumer credit and BAWAG wanting to increase the market share in consumer credit given the better returns. How do you feel about your market share now and do you still see attractive pricing there? I see quite a high growth rate in easygroup, 58% in the first half 2018 so I was wondering if we can have a bit more color on this one. Thank you.
Enver Sirucic	Thanks, Giulia. I'll try to cover all the questions. So I think IB versus cash; this is not really tied to each other, so what we said; strong IB pipeline irrespective of the cash. On top of the strong IB pipeline we have a variety of measures also domestically where we want to just deploy it into cash and also to reduce the negative carry, but this is not really tied to each other. On the CET1 impact, I think a good proxy if you just look at the total RWAs that we have, which are around €20 billion, so each €20 million of earnings or €20 million of capital translates into 10 basis points impact, so if we look at the share buyback that we announced, was 1.3 million shares up to a purchase price of 70 million. Just given the recent share price - and I don't know what it will be over the next couple of weeks - let's call it, you end up with €50 to 60 million of share buyback. This would then translate to 25 to 30bps so it's quite mathematical. And in terms of Tier 2 you just take the fair value change that we had initially on the Tier 2, I think it tendered at 134, so this is then really translated as well in the CET1 ratio impact on the absolute volume. So this is, I think, on the CET1 impact.

	Consumer lending we feel very good about it, so since the IPO the market share further expanded and we currently stand, I think, at 13.1%; I'm just looking at then numbers and Q3 '17 we stood at 12.6% so 50 basis points accretion in terms of market share on the consumer lending side.
Anas Abuzaakouk	What, I think, Giulia, to remember is when we look at overall market share entitlements across the core retail products, our current accounts between BAWAG P.S.K. as well as easygroup is about 17%, is our market share entitlement. That's where we're at with current accounts which are golden bread or which is our key product that we have.
	If you look at the context of autoleasing, current accounts or consumer loans, mortgages obviously to a lesser extent, the goal is ultimately to grow into that market share entitlement of 17%, so we still have quite a bit of way to go.
Giulia Miotto	Thanks.
Anas Abuzaakouk	Thank you, Giulia.
Operator	The next question comes from Victoria Cherevach from Bank of America. Please go ahead.
Victoria Cherevach	Hi, thanks very much. Actually all my questions have been answered now. Thank you.
Anas Abuzaakouk	Thanks, Victoria.
Operator	All right. Since there are no further questions I would like to hand over the conference back to Anas Abuzaakouk.
Anas Abuzaakouk	Thank you, operator. Thanks, everyone, for joining the call and I hope to talk to you guys during the third quarter earnings call. Take care and have a nice day. Bye.
Operator	Ladies and gentlemen, the conference is now concluded and you may disconnect your telephones. Thank you for joining and have a pleasant day. Goodbye.