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BAWAG Group Q3 2022
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.

Before we start with a summary of the third quarter operating results on slide 2, let me address the City of Linz legal case. In August, the Austrian Supreme Court ruled that the swap contract entered between BAWAG and the City of Linz almost 15 years ago was invalid. As a result of the ruling, we took a pre-tax write-off of € 254 million, equal to a € 190-million impact after tax related to the City of Linz receivable on the balance sheet.

As the write-off was fully absorbed in regulatory capital in prior years, this will have no impact on our capital distribution plans for 2022. The write-off also resulted in the reduction of 40 basis points to our NPL ratio as the receivables classified as an NPL in the past. For the remainder of the presentation, all earnings will be presented on an adjusted basis, excluding the City of Linz impact, as this provides a more meaningful presentation of our operating performance as well as capital distributions.

For the third quarter, we delivered net profit of € 132 million, earnings per share of € 1.49, and a return on tangible common equity of 19%. The operating performance of our business was very strong with pre-provision profits of € 218 million and a cost-income ratio of 35%. Total risk costs were € 35 million, inclusive of a € 12 million increase in our ECL management overlay, bringing our management overlay to € 82 million despite sound credit performance and a record low NPL ratio of 1%.

In terms of balance sheet and capital, average customer loans were flat quarter-over-quarter and up 9% year-over-year. We are seeing a slowdown in loan growth as customers grow more cautious and deal with the impact of inflation, repricing of loans, and uncertain economic environment.

Customer loan growth will continue to be subdued in the quarters ahead and offset with the build-up in our securities portfolio, as the widening of credit spreads provides for more attractive risk-adjusted returns.

In terms of capital development, we generated approximately 60 basis points of gross capital during the quarter. Our CET1 ratio landed at 13% after deducting the year-to-date dividend accrual of € 207 million and the € 325 million share buyback program.

Given the significant inflationary environment in rising interest rates, the bank is positively positioned for a rising rate environment with our retail deposit franchise. This will further add to our positive operating leverage and gradually materialize in the coming quarters.

With our strong operating performance during the first three quarters of the year and despite potential headwinds building up, we are on track to deliver on all 2022 targets; a profit-before-tax greater than € 675 million, return on tangible common equity greater than 17%, and a cost-income ratio under 38%. We plan to update our original 2025 targets at year-end as well.

In terms of our existing share buyback program of € 325 million, we have executed approximately 65% of the buyback and expect to have this completed by end of the year. We will address any further capital distributions around year-end results based on market developments and subject to regulatory approvals. Above all else, we want to make sure we are prudent in our capital distribution plans, always maintain our fortress balance sheet, and ensure we have sufficient dry powder to address potential organic and inorganic opportunities in the coming quarters.

Market downturns and dislocations present unique opportunities if you have capital liquidity and a fortress balance sheet with solid capital generation throughout all cycles.

Given the headwinds we see building up from volatility in the energy markets, persistently high inflation, subdued consumer sentiment, prolonged geopolitical conflicts in the repricing of credit risk, we have added to our management overlay, as we take a cautious and prudent approach to provisioning in the quarters ahead.

Our ECL management overlay, which now stands at € 82 million, is equal to almost a full year of normal annual risk costs. We will look to continue and build this up in the fourth quarter as well given the volatility and uncertainty ahead. The management overlay is specifically intended to address any severe downturn and heightened volatility in the quarters ahead, despite our very low NPL ratio of 1% and solid credit performance across the business to date.

As I've stated in the past, our actions are born out of an abundance of caution, no different than how we reacted during the early days of the pandemic or more broadly the conservatism that underpins how we run our business over the past decade.

Moving to slide 3. We delivered net profit of € 132 million, up 7% versus prior year. Overall strong operating performance with operating income of € 336 million and total expenses of € 118 million, up 9% and down 2% respectively versus prior year.

Pre-provision profits were € 218 million, up 17% versus prior year. Risk costs were € 35 million, up 64% versus prior year driven primarily by the build-up of our management overlay.

Tangible book value per share was € 31.40, down 9% versus prior year and down 1% versus prior quarter. This captures the deduction of the year-to-date 2022 dividend accrual of € 207 million, the € 325 million share buyback, and € 190 million after-tax write-off related to the City of Linz receivable.

Moving on to slide 4. At the end of the third quarter, our CET1 ratio was 13%, up 30 basis points from Q2 with approximately € 150 million excess capital above our CET1 target of 12.25%.

For the quarter, we generated approximately 60 basis points of gross capital from earnings, which was offset by negative OCI movements of 10 basis points, primarily driven by widening credit spreads and a positive impact of 10 basis points in regulatory capital stemming from the City of Linz write-off.

The dividend accrual for the quarter was equal to approximately 30 basis points. On a year-to-date basis, we have generated 180 basis points of gross capital, offset by growth in RWAs, which consumed about 50 basis points a negative OCI hit of 50 basis points primarily from widening credit spreads and FX movements.

Despite the overall volatility we are witnessing that can impact capital in many ways, we believe we are well-positioned to address multiple market opportunities given our earnings, capital, and funding base. Our total capital distributions for the year reflect deducting the year-to-date 2022 dividend accrual of € 207 million, which reflects a pay-out ratio of 55% of adjusted net profits in 2022, the € 325 million share buyback, and the acquisition of a consumer loan portfolio earlier in the year. Net of all M&A in capital distributions, we landed at a 13% CET1 ratio.

Following our capital distribution framework, our primary focus is to deploy our capital into organic growth and value-enhancing M&A. We currently see several potential organic and inorganic opportunities that we will be assessing over the coming quarters.

On slide 5, our Retail & SME business delivered net profit of € 111 million, up 17% versus prior year and generating a very strong return on tangible common equity of 33% and a cost-income ratio of 33%.

Average assets for the quarter were € 22.5 billion, up 9% versus prior year and 2% versus prior quarter. Average customer deposits were € 27.8 billion, up 3% versus prior year and down 1% versus prior quarter. RWAs in the segment were

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€ 9.5 billion, up 18% versus prior year and 1% versus prior quarter.

Pre-provision profits were € 172 million, up 20% compared to the prior year with operating income up 12% and operating expenses down 2%, resulting from prior year operational initiatives with the continued focus on driving synergies across our various channels and products.

Risk costs were € 23 million, up 51% versus prior year driven by an incremental € 6 million booking of the management overlay. The underlying core retail cost run rate is at € 17 million per quarter with the addition of the acquired consumer loan portfolio at the end of the second quarter. The trend in asset quality continues to hold across our customer base with a stable low NPL ratio of 1.9%.

Across the business, we will remain prudent and cautious as we've tightened our credit box, given the increasing headwinds. We also continue to maintain our pricing discipline as we focus on risk-adjusted returns and price against movement and swap rates across the curve. We expect continued earnings growth across the Retail & SME franchise for the remainder of 2022 and going into 2023. However, we see subdued loan growth in the quarters ahead, given the overall cautious consumer sentiment, impacts of inflation on daily spending, and a wait-and-see approach to new investments as well as the repricing of credit.

On slide 6, our corporate real estate and public sector business delivered net profit of € 35 million, down 12% versus the prior year due to the booking of incremental management overlay, but still generating a strong return on tangible common equity of 16% and a cost-income ratio of 23%. Average assets for the quarter were € 15.5 billion, up 10% versus prior year and down 2% versus prior quarter.

Pre-provision profits were € 60 million, down 2% compared to the prior year. However, core revenues were up 6%. Risk costs were € 11 million, up 93% versus prior year driven by the incremental € 6 million booking of the management overlay. The trend in asset quality continues to be solid with our NPL ratio of 70 basis points, down 30 basis points versus prior year and flat versus prior quarter.

We continue to see diversified lending opportunities with a solid pipeline and commitments that we expect to fund in the coming months. We will continue to maintain our disciplined underwriting, focused on risk-adjusted returns, and avoid blindly chasing volume growth. As the markets repriced credit risk, which we believe was long overdue, we have further tightened our credit box and adjusted our risk-return criteria,

given the uncertainty ahead and reflecting our disciplined approach to lending.

With that, I'll hand over to Enver.

Enver Sirucic: Thank you, Anas. I'll continue on slide 8. Solid operating performance in the third quarter with core revenues up 2% versus prior quarter with net interest income being up 4% with first impacts from high-interest rates and net commission income down 4% due to overall market environment and a slowdown in the advisory business.

Operating expenses remain stable at € 118 million, while our cost-income ratio landed at around 35% for the quarter. Total risk costs were € 35 million inclusive of a € 12 million increase in our ECL management overlay, bringing it to € 82 million, which equals almost a full year of normal annual risk cost.

On slide 9, key developments of our balance sheet. Average interest-bearing assets and risk-weighted assets remained at the same levels as in Q2. Customer deposits were slightly up, while we increased our own issues by more than 11% through issuing € 1.25 billion covered bond and CHF 125 million senior preferred notes in Q3. CET1 capital and CET1 ratio improved by 2% and 30 basis points respectively, mainly coming from solid earnings generation post the dividend accrual.

On slide 10, core revenues. Stronger net interest income up 4% versus second quarter. Net interest margin improved to 231 basis points for the quarter driven by mainly increasing interest rates.

Our interest rate sensitivity remains unchanged with 200 basis points increase in overnight rates and three-month Euribor leading to approximately € 200 million increase in net interest income per year. Given the re-fixing structure of our assets, it takes around four to five months to see the full effect of a rate increase reflected in our run rate, which means that the NII improvement will gradually materialize in the coming quarters.

As mentioned before, net commission income was down 4%, as we see a slowdown in our advisory business, given the uncertainty and volatile market environment, which is likely to continue for the rest of the year. Having said that, we have a positive view on core revenues for the rest of the year, that is why we again updated our outlook from previously over 7% core revenue growth to around 9% growth in 2022.

Moving on to slide 11. We continue to maintain operating expenses at stable levels despite significant headwinds. Cost-income ratio continued to improve and stands around 35% for the quarter, which is well ahead of our 2022 target of below

38%. We'll also continue to focus on our absolute cost-out target, and we are confident to achieve a net cost-out of around 2% in 2022.

Slide 12, risk costs. Overall, unchanged conservative prudent approach from provisioning with stable underlying trends and strong asset quality with the NPL ratio of 1%. The underlying core retail risk cost run rate is around € 17 million per quarter, including the portfolio acquisition in the second quarter, and the total risk-cost ratio is around 20 basis points. We added € 12 million to our ECL management overlay, which now stands at € 82 million and is equal to almost a full year of normal risk cost.

For the rest of the year, we expect a stable underlying risk cost ratio of around 20 basis points. In addition, we will look to continue and build up the management overlay in the fourth quarter.

And on slide 13. So, we are confirming our 2022 outlook with our strong operating performance during the first three quarters of the year, we are on track to deliver all 2022 targets, a profit before tax of greater than € 675 million, a return on tangible common equity of greater than 17%, and a cost-income ratio of below 38%. As mentioned earlier, we have again upgraded our core revenue growth outlook from previously greater than 7% to around 9%. Everything else remains unchanged.

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

Operator (Operator Instructions) Our first question comes from the line of Mate Nemes from UBS. Please go ahead. Your line is open.

Mate Nemes: Good morning and thank you for your presentation.

I have a few questions, please. The first one is on corporate loans. It seems like corporate exposures declined by 4% sequentially. I'm just wondering if you could share any sentiment, any commentary on what's been driving this. Is it about a lower risk appetite on your side? Is it that the risk adjusted returns are not necessarily meeting your hurdle rates? Or is it simply just a matter of timing? And we could see perhaps an increase or better performance towards the end of the year.

The second question is on management overlays. Could you perhaps discuss how you assess the portfolio in Q3 that resulted in the € 12 million of additional overlay? And what shall we expect in the next few quarters? Should we expect similar top-ups as long as there's no market improvement in the macro environment?

And then, the last question would be on the TLTRO and the investment of excess liquidity. How do you think about your TLTRO balances and potential repayments in case the ECB changes the terms or the pricing of TLTRO? And what could that mean for reallocation of liquidity perhaps to secure this portfolio or other means? Thank you.

Anas Abuzaakouk: Okay. Thank you, Mate. All good questions. I'll take the corporate loans and the management overlay and then you want to address the TLTRO? So, Mate, on the corporate loans, really nothing to read into it, just kind of subdued demand in terms of at least how we price loans and just the decline that you see kind of sequentially quarter-over-quarter, that's just the maturities. But the pipeline in kind of traditional corporate lending is still pretty, I think, challenging. We are seeing, I think, more firm pricing in some of the indications, but you should assume it's pretty static. There's not going to be --when we talk about kind of a diversified opportunity or pipeline, it's more I think in the real-estate and the public sector side. The traditional corporates, I think, is more idiosyncratic, but we'll see. I think that's going to -- that's pretty fluid, but at least from what we see today is going to be pretty static.

In terms of the management overlay, so we're at € 82 million, that's almost 51%, I guess, of the total ECL. I would leave you with a few comments. The first is, if you take our ECL of € 160 million of which 50% is the overlay and you compare that to the asset quality pre-pandemic, you see an improved overall asset quality and I think it's best reflected in the NPL ratio, which is I think it's now at a record low of 1%, as well as if you look at the staging in terms of stage 1, 2, and 3, and that's probably at a steady state. And you don't see any deterioration there.

What goes into -- I think your question is, what goes into the actual assumptions. We can break that out at year end in terms of a formula, but I would tell you, when we look at the severe scenario in kind of calculating our overlay, our severe assumption is more severe than the ECB severe scenario for the euro area as well as obviously the IMF is less severe than the ECB's assumption. So, we tend to be pretty conservative in the assumptions that we put in to get us to our overlay to be able to build that up. And we'll continue to build that up in the fourth quarter.

I think we updated our core revenue guidance. I think what you should kind of take from that is we will continue - the third quarter is a good proxy probably for the fourth quarter in terms of what we will look to build up in the overlay. And again, we're just being prudent and cautious. We'll see what happens in '23, hopefully, nothing. At least from what we see today, nothing is - we don't see any concerns or facts in our book, but we just

want to act out of an abundance of caution as we go into '23 and beyond, so. Do you want to take the TLTRO?

Enver Sirucic: Yes. On the third question, Mate. So, the TLTRO, I think it very much depends what ECB will announce by end of the month. But asking about the asset side, so the excess liquidity what we are thinking is redeploying in shorter term assets, mainly on the securities side, we are quite under invested there. So, if you think after redeeming the TLTRO in such a situation, we are left with € 3 billion to € 4 billion of excess cash for the ECB. That's something that we are already proactively looking into. And as I said, that would be mainly in high-quality securities very likely.

Mate Nemes: Great. Thank you very much.

Anas Abuzaakouk: Thanks, Mate.

Operator: Thank you. We'll now move on to our next question. Please stand by. Our next question comes from the line of the Gabor Kemeny from Autonomous Research. Please go ahead. Your line is open.

Gabor Kemeny: Yes. Hi. A couple of questions from me. First one is on the Euro rate sensitivity where you have a useful guidance. Can you give us a sense of the impact of higher Euro rates on your Q3 NII? I mean if you could help us quantify the benefit you have from rising Euro rates. And if you could give us a sense of what is a reasonable assumption for the rate rise benefiting the fourth quarter, as I understand it takes a few months to reprice assets at higher interest rates.

And the other question would be, how do you see your M&A pipeline? And you've talked about slowing loan growth due to tighter credit underwriting. I wonder to what extent does this incentivize you to pursue inorganic growth opportunities? And perhaps in relation to that, where does the execution of the € 100 million share buyback, the second tranche of the share buyback currently sit in your pecking order? Thank you.

Anas Abuzaakouk: I think, Enver, do you want to take the sensitivity?

Enver Sirucic: Yes. Sure. So, I think, Gabor, for Q3, it's quite simple. I would take the € 10 million increase of NII, I would mostly put it on the interest rate sensitivity. From Q4, we don't provide single-line-

item guidance, but what we tried is by updating the core revenue growth target from 7% to 9% that should give you some guidance to what we expect for the NII in Q4.

Anas Abuzaakouk: And then, Gabor, on the M&A, let me first address. Irrespective of what happened with customer loan growth, whether it's at a high velocity growth or it's subdued, that does not - that's mutually exclusive from how we look at M&A. So, we'll never do a deal, because one part of the business is slowing down or cautious. We look at each deal on a mutually exclusive basis, and it has to hit our risk adjusted return criteria. I think we've laid that out before in terms of returns. And look, the reality is that the environment is, we're much more cautious on the overall environment. We've tightened our credit box on our own lending quite a bit from the pandemic, and we added to that earlier this year.

So, any deal that we do would have to really meet a lot of thresholds in terms of our conservatism. And the asset classes we are judicious, very selective, and what works and what doesn't. And the reality is anything we price will have to be reflective, if we do a deal, right? Would have to be reflective of the environment, we think potentially could materialize in the next 6, 12, 18 months with all the headwinds building up. And I think a good proxy of how we approach things was the consumer loan portfolio that we purchased in the second quarter. And that's the type of conservatism that we would probably be applying.

But as I mentioned during the call, when we were going through the results, market dislocations and downturns do provide unique opportunities, if you have capital, if you have a healthy return profile, if you're generating, if you have a strong funding base. And I think, we have that going into whatever might, materialize, so. Thanks, Gabor.

Gabor Kemeny: Okay. Thank you.

Operator: Thank you. We will now move on to our next question. Please stand by. Our next question comes from the line of Johannes Thormann from HSBC. Please go ahead. Your line is open.

Johannes Thormann: Good morning, everyone. Johannes here. Three questions from my side, please. First of all, regarding the management overlay, we don't know how long this crisis lasts, but is there any target volume? And probably looking at portfolios, what are the areas of special concern where you say this is the most -- if bad things

happen, this is the most likely outcome where we would use this management overlay?

Secondly, on your corporate loans pricing: Where do you think you differ from competition? Because other European banks are still talking about healthy demand. Is your pricing so much different? And last but not least, just on the tax rate for this year. Where do you expect us to be after the one-off in this quarter? Thank you.

Anas Abuzaakouk: Thank you, Johannes. All good questions as well. On the overlay, I would say, look, in the second quarter we booked € 6 million, we then booked € 12 million in the third quarter, that's probably a good proxy looking at the fourth quarter. We don’t have a target volume. I will tell you this. We intend that we have very good line of sight into delivering on our financial targets, a return on tangible common equity of over 17%. That’s what we said throughout, not just 2022, but obviously going into years ahead of us. So, whatever we do on the overlay, it doesn't compromise kind of our returns. So, I think that’s one way of looking at it, and we're just being overly cautious.

Your question about where do we see potential risk? I've always said this, or Enver has always said this as well. It's the unsecured portfolio. It's your consumer loans, Austria, Germany, right? That's the bulk of our consumer loans. In any downturn where you have unemployment kind of a GDP downturn leading or translating into unemployment -- higher unemployment, you'll have impacts on your unsecured. That's the one area. But look, I think our underwriting in that respect, how we look at risk adjusted returns, we've been pretty disciplined over the years, and I think we have a good sense of how the book would materialize. In the overlay, it's just again out of an abundance of caution, like we did in the pandemic, and we intend to be able to achieve or hit all of our targets irrespective of what we do in the risk side.

On the corporate side, look, we -- our risk-adjusted pricing is different from competitors - not to comment on what other people are doing. And I think also the price is one thing, Johannes, but also covenants and how we underwrite is also a factor, it's not always price. We’ve been pretty disciplined over the years, the impact of that is more subdued loan growth, but we're okay with that. We look at each individual loan at kind of an ROE basis and we try to price and think about risk throughout all cycles, not just any one particular point in time, so.

Johannes Thormann: Thank you.

Enver Sirucic: Yes. Tax rate is simple. 25%, I think, is a good proxy for a full-year tax rate.

Johannes Thormann: Okay, cool. Thank you.

Anas Abuzaakouk: Thanks, Johannes.

Operator: Thank you. We'll now move on to our next question. Please stand by. Our next question comes from the line of Mehmet Sevim from JP Morgan. Please go ahead. Your line is open.

Mehmet Sevim: Good morning. Thanks very much for the presentation. I have just a couple follow-up questions, please. So first of all, can I please follow up on your NII sensitivities beyond the 200 basis points of level of guidance? Could you please help us understand maybe qualitatively, what trends you'd expect to see in terms of deposit betas and other funding costs, but also asset repricing once, say, rates reached 2% level and beyond that?

And my second question would be on the deployment of your excess cash position and securities as you highlighted and mentioned before. Is that something that we can expect will become visible in your balance sheet soon? Or is that, for example, depend on potential changes to remuneration by the ECB? Are you actually planning to start with that really soon? These would be my follow-ups. Thank you.

Anas Abuzaakouk: Thanks, Mehmet.

Enver Sirucic: So, on the deposit betas, the current assumption is around -- I would say around 40% deposit betas that we apply on the interest rate sensitivity. What we put in the presentation is new information of the re-fixing schedule. So, it takes a bit of time to get the full benefit to reflect it, which we said it takes four to five months.

We also gave a bit, you know, the structural measure on our deposits, which is most of it is still kind of overnight, right. So, what we would expect once rates go over 200 that there will be a gradual increase in the deposit betas. So, what we are observing right now, we are definitely below the 40% expectation, the € 200 million expects the 40%, and then after that, we would see a gradual increase of that.

And we just also want to wait for the -- the second question that you had, we also want to wait for the ECB to see what the outcome of that is, because that impacts our overall balance sheet position and would then give an update on that measure by year-end, which I think is more meaningful.

On the securities, yes, we already started deploying more cash into securities, but not to the full scale, right? And it will definitely depend on what the ECB decides on the remuneration, if you increase that or not.

Mehmet Sevim: Okay, great. Thanks very much. And then, maybe one final question, more general in Terms of the balance sheet and growth trends. Clearly, trends have slowed down this quarter and it was a lot faster in the second quarter, and I appreciate you always look at risk-adjusted returns and pivot the balance sheet accordingly. But if we were to assume that things stay as they are now or even maybe get worse, how should we expect a balance sheet composition to change, say, over 2023, if everything stays the same by the end of next year?

Anas Abuzaakouk: I think things will be pretty static. And when you think about subdued loan growth, and I mentioned that in the retail side, that will be a couple of quarters. That's not just one quarter, because you can see just the overall pipeline. How you're pricing versus where the markets pricing. But I think, it'll be fairly static, and I think proportional in terms of retail versus non-retail business. The one thing that will probably continue to grow as a percentage of your balance sheet will be your securities portfolio.

And I think the third quarter, if you kind of look at the development Mehmet, that's probably a good proxy and kind of the pace that we're looking in the securities investments, where we do see good opportunities. But I think it's fairly static, but it's not going to impact our returns. I think we feel fairly confident in different areas, we'll be able to deliver in'23 and beyond.

Mehmet Sevim: Great. Thanks. Thanks, Anas, for the colour. Thank you.

Anas Abuzaakouk: Thank you, Mehmet.

Operator: Thank you. We'll now move on to our next question. Please stand by. Our next question comes from the line of Magdalena Stoklosa from Morgan Stanley. Please go ahead, your line is open.

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Magdalena Stoklosa: Great. Thank you. Thank you very much. And I've got some questions really. One is around costs and inflation and another one on the real estate portfolio. So, let me maybe start with the real estate side. So, you've actually grown your loans in the quarter, so could you give us a sense of what sort of opportunities were out there for you to grow the portfolio? And the second just for us, can you just remind us of the kind of geographical mix of that portfolio kind of by sector and by, let's just say, LTVs, so that we kind of have a sense of how to look at it in more detail?

And the question number two really is on your cost, because you run this extraordinary cost-to-income ratio with also extraordinary targets. But of course, we are also operating at these serious … every month heightened to kind of inflationary times and seriously if they last for a little bit longer. So, as you look into 2023, how do you assess that inflation pressure versus your kind of more structural savings that you already kind of have in mind for the next, let's just say, two years? Thanks very much.

Anas Abuzaakouk: Thank you, Magdalena. All great questions. Let me start, Magdalena, with the OpEx or the cost and then we will address the real estate. So, on the cost, just to remind everyone, our level of confidence in terms of delivering the 2% net cost out for 2022 as an example, we have that confidence because typically 12 to 18 month lead time to be able to really understand your cost base for that current year. So, a lot of the tailwinds are kind of the positive cost developments were born out of the fact that it's initiatives that we took during the pandemic as well as in 2021, which gave us a line of sight in terms of the overall cost base.

More importantly, and I think the topic you're addressing is the impact of this significant inflationary development and it hits you in a lot of different ways. You have the wage inflation that will be part of the collective bargaining agreement next year and that's something that we're working through and factoring in.

And then you have inflation with a lot of your non-personnel costs, what we call your G&A, which is tied to technology contracts, releases, I mean, everywhere that kind of has a CPI linked to it. And those are all things that people should consider in their overall cost basis. Those are pretty major headwinds.

But we're working through all of that, we'll give an update at year end, in terms of what the cost outlook is. But be rest assured, Magdalena, this is something that we've been

focused on from 2021 in terms of the overall cost element. We saw some of the inflationary pressures at the tail end of last year, so there were things that we were able to do that I think will provide a positive lift. But I think we'll have more clarity at year end. But you should see pretty consistent development on the cost base going into '23, despite all of the points that I just made in terms of the inflationary headwinds that we're seeing. And that is one of the things that we pride ourselves on, that we can truly control. But you do need a lead time. You need to have a viewpoint as to how things are developing, and I think that's something that we've done, I think, a decent job of.

On the real estate exposure, I'd say, look, we can come back to you on the split, I think, of the different underlying asset classes. But what we're seeing is primarily a multi-family lending as far as an underlying asset class ...

Enver Sirucic: On Page 17.

Anas Abuzaakouk: On Page 17, we have a split of the overall real estate portfolio of € 6.6 billion, but where we see opportunities is kind of multifamily. What we've done is we've adjusted our credit box or tightened our credit box in terms of advanced rates, debt yields, and the like. So, we've been pretty conservative prior to 2022, and I think we've tightened our credit box further and we have a different threshold on risk-adjusted returns. So, these are pretty idiosyncratic opportunities, mix of U.S. versus Western Europe. But we feel pretty good about the loans that we're putting on at this moment, so. The Page 17 has sort of, I think, the split of the € 6.6 billion.

Magdalena Stoklosa: Thank you very much.

Anas Abuzaakouk: Thanks, Magdalena.

Operator: Thank you. We'll now move on to our next question. Please stand by. Our next question Comes from the line of Simon Nellis from Citibank. Please go ahead. Your line is open.

Simon Nellis: Hello. Thanks very much for the opportunity. Yes, a quick question. If you could give an update on the Peak Bancorp transaction, how that's progressing? And then just maybe generally you have € 150 million of excess capital above your Core Tier-1 ratio, come year-end what should we expect? Are you going to do another buyback, maybe a special? What's the plan there? Thank you.

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Anas Abuzaakouk: Thanks, Simon. Capital distributions, you're right. We have € 150 million as of 3Q. We'll wait till end of year. Just I think we'll have greater line of sight and clarity as to how things are developing, and it will update on overall capital distribution plans going to '23.

On the U.S. acquisition, I think in the next quarter or two quarters hopefully, but that's -- the process is going well. I think we've said probably first quarter probably more likely, but we'll see. No issues so far in the process.

Simon Nellis: Thank you. And just on the buyback for next year, I think you were planning a € 100 million. When do you think you might apply for that?

Anas Abuzaakouk: Yes. So, Simon, on that, we just want to wait till year-end to see how things develop in the market, and then obviously, we'll give you guys an update with year-end results in terms of updated capital distribution plans, inclusive of buyback, special dividends, and the like, plus seeing what kind of -- what we see happen in the fourth quarter as far as inorganic opportunities.

Simon Nellis: Understood. Thank you.

Anas Abuzaakouk: Thanks, Simon.

Operator: Thank you. We'll now take our next question. Please stand by. Our next question comes from the line of Tobias Lukesch from Kepler Cheuvreux. Please go ahead, your line is open.

Tobias Lukesch: Yes. Good morning. I would like to touch again on the commercial real estate portfolio. You just outlined a bit of the rational with regards to potential focus on multi-family business. Maybe you could again give us a bit of a flavour with regards to your geographical focus, like, where are the countries where you potentially do see most opportunities? And in general, I mean, given that the real estate sector has been quite under pressure and assessing your portfolio, would you think that there might be some rating migration likely in 2023?

Second question would be on the retail side, on the housing business here. We have especially seen price changes in the Netherlands and your recent focus basically. I was just wondering, if you see a particular country which would be

potentially most opportunistic for the next one or two years for you to target.

And finally, I mean, I appreciate your comment on the capital distribution, and I think you just mentioned that with regards to a special dividend. I was just wondering like if there would be a consideration or a chance that we might see a pay-out ratio increase if there was potentially the reasoning that you do not go for € 100 million share buyback, because this would have or would need an approval by the ECB, but rather increase the pay-out ratio and basically pay this out of adjusted net profits, basically. Thank you.

Anas Abuzaakouk: Thanks, Tobias. All good questions. Let me start with the capital distribution. Like I mentioned earlier, we'll wait till year-end and I think we'll give you guys more clear picture, because there's just a lot of developments that happen in the fourth quarter organically, inorganically in particular. And then, I think we'll have a better perspective as to what we can commit to. So, just, sorry on that you have to wait till year-end.

As far as the real estate, maybe I'll start with the mortgages or the housing loans. We actually added a page, which hopefully provides some greater colour on the overall portfolio on slide 16 just in terms of the composition of the housing loans, but I think your question was where do we see opportunities? I will tell you, across the different geographies, whether Austria, Germany, the Netherlands, where we reprice against the swap rates and maintain a certain margin, I think we are probably earlier to the game on that than others, and that obviously impacts demands. But you also have just a subdued demand as a whole in addition to the fact that we reprice probably sooner and trying to maintain that margin, so that will impact the volumes.

In terms of asset quality, we feel pretty good about the portfolio. Just in terms of fixed versus floating, ours is predominantly a fixed rate portfolio. We swap out the interest rate risk. Our LTVs on the whole portfolio is approximately 60%. It's been pretty seasoned, so we feel pretty good about the overall portfolio, but demand is subdued across all of the geographies, and that's what I mentioned earlier about kind of a static view.

And then the real estate, the commercial real estate, it's more U.S., Western Europe, less continental Europe as far as the opportunities. And I think the slide that we have provides a good break out. But we have tightened our credit box and adjusted pricing given just the unknowns and the headwinds that we potentially could develop.

Tobias Lukesch: And with regards to a potential, I mean, stress you see with regards to rating migration, is there something you could envisage for '23 already? Or do you think that the changes we have seen in the commercial real estate sector especially, do not indicate anything on the negative?

Anas Abuzaakouk: I would say, so that's one of the reasons we build out the overlay, Tobias, right, € 80 million probably to € 100 million, whatever the number is. But more importantly, if you look at the IFRS kind of staging, we're at pre-pandemic levels. I think that's a good proxy that you have on Page 15, if it's just slightly, I don't think it's going to be what we see today. Credit performance is pretty robust, but again, we are just acting very conservatively and being really prudent. We hope for the best obviously, but prepare for the worst and that's typically how we run the business. So, I hope that helps.

Tobias Lukesch: Thank you.

Anas Abuzaakouk: Thank you, Tobias.

Operator: Thank you. There are no further questions at this time. So, I'll hand the call back for closing remarks.

Anas Abuzaakouk: Thank you, operator. Thanks, everybody, for joining our 3Q call. Look forward to catching up with you at year-end results. Take care. All the best. Bye.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect. Speakers, please stand by.