EARNINGS CALL
TRANSCRIPTION

Q2 2023

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SPEAKERS:
ANAS ABUZAAKOUK
ENVER SIRUCIC

BAWAG Group

Anas Abuzaakouk:

Thank you, operator. Good morning, everyone. I hope everyone is keeping well, I'm joined this morning by
Enver, our CFO. Let us start with a summary of the second quarter results on slide three. We delivered a very strong set of results with net profit of €181 million, earnings per share of €2.19 and a return on tangible common equity of 26%. The first half return on tangible common equity was 23%.

The operating performance of our business was very strong with pre-provision profits of €262 million and a cost-income ratio of 31.5%. Total risk costs were €20 million, translating into a risk cost ratio of 19 basis points. We did not release any credit reserves with an ECL management overlay of €100 million that was built up over the past few years and equal to a full year of risk costs.

Credit performance remains solid across all businesses with a low NPL ratio of 90 basis points. We look forward to publishing the results of the EBA stress test on 28th July, which will provide greater insights into asset quality, capital and overall balance sheet resilience.

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

We generated approximately 90 basis points of gross capital from earnings and landed at a CET1 ratio of 14.8%, net of the first half dividend accrual. After deducting the proposed €175 million share buyback, our CET1 ratio would be 13.9%. We have a fortress balance sheet with excess capital post €175 million share buyback of €330 million, ample liquidity with cash of approximately €11 billion, equal to almost 20% of our balance sheet, an LCR of 207% after having paid back €2.8 billion of TLTRO during the second quarter and one of the lowest NPL ratios across European banks of 90 basis points, reflecting the strong asset quality. This will allow us to eventually play offence as we stay patient and liquid in the current market environment.

With our strong operating performance during the first half of the year and despite an overall cautious consumer and muted loan growth, we are updating our full year targets for 2023. We are now targeting a profit before tax of greater than €875 million, earnings per share of greater than €8.20 and a dividend per share of greater than €4.50.

We have a resilient franchise across all cycles with very strong earnings, strong capital generation, conservative and disciplined underwriting in a granular retail deposit and robust covered bond franchise that is the foundation of our funding. These factors will allow us to consistently deliver quality results. We continue to remain vigilant in managing risks, requiring us to be patient, always focused on risk-adjusted returns, not be distracted by irrational lending or short-termism.

We focus on the things that we can control: our investments, our risk appetite, the operations of the bank and being good stewards of capital. After the €175 million share buyback programme, which will take a few months, we plan to address further capital distributions around year-end results based on M&A prospects, market developments and subject to regulatory approvals.

Okay. Moving to slide four. We delivered net profit of €181 million, up 35% versus prior year. Overall, strong operating performance with operating income of €383 million and total expenses of €121 million, up 16% and 2%, respectively, versus prior year. Total pre-provision profits were €262 million, up 23% versus prior year. Risk costs were €20 million, down 32% versus prior year.

Tangible book value per share was €34.36, up 8% versus prior year and 2% versus prior quarter. This reflects the deduction of the first half dividend accrual of €176 million.

Moving to slide five. At the end of the second quarter, our CET1 ratio was 14.8%, up 70 basis points quarter-over-quarter after deducting the second quarter dividend accrual. For the quarter, we generated approximately 90 basis points of gross capital from earnings.

Net of our proposed €175 million buyback, our CET1 ratio would be 13.9%, which represents €330 million of excess capital above our stated target of 12.25%. We are well positioned to address multiple market opportunities, given our earnings, capital and funding base. The acquisition of Peak Bancorp in the United States is still pending regulatory approval. However, we've been pleased with the business performance despite the challenges experienced across US regional banks in the past few months.

On slide six, our Retail & SME business delivered net profit of €134 million, up 45% versus the prior year and generating a very strong return on tangible common equity of 38% and a cost-income ratio of 31%. Total assets for the quarter were €22 billion, down 1% versus prior year and down 1% versus prior quarter.

Customer deposits were €27.3 billion, down 3% versus prior year and up 1% versus prior quarter.

Total retail customer funding, which is a combination of customer deposits in AAA-rated Austrian mortgage covered bonds, were €37 billion, up 9% versus prior year and up 3% versus prior quarter. Pre-provision profits were €198 million, up 17% compared to the prior year with operating income up 12% and operating expenses up 2%. Risk costs were €20 million, reflecting normalised risk costs with no management overlay build or releases.

The trend in asset quality remains strong across our customer base, with a low NPL ratio of 1.7% and a risk cost ratio of 36 basis points. We expect continued earnings growth across the Retail & SME franchise in 2023, driven by strong operating performance, but muted customer loan growth, given the overall economic environment and overall cautious consumer sentiment.

On to slide seven, our Corporate, Real Estate and Public sector business delivered net profit of €50 million, up 19% versus the prior year and generating a very strong return on tangible common equity of 26% and a cost-income ratio of 23%. Total assets for the quarter were €13.7 billion, down 4% versus prior quarter. Customer deposits were €5.5 billion, up 2% versus prior quarter.

Total customer funding, which is a combination of public sector and corporate deposits and AAA-rated Austrian public sector covered bonds was €7.2 billion, up 1% versus prior quarter. Pre-provision profits were €66 million, down 1% compared to the prior year and up 13% versus prior quarter. Risk costs were effectively zero with no management overlay build or releases. The trend in asset quality continues to be solid with our NPL ratio at 70 basis points.

We pride ourselves on disciplined underwriting focusing on risk-adjusted returns, which factor in losses across all cycles and avoiding blindly chasing volume growth, specifically during a benign credit cycle over the past few years. We will continue to be disciplined to have the capital and liquidity to support our customers and capitalise on dislocations, should they arise as we see a potential repricing of credit risk more broadly across various asset classes.

On slide eight, an update on the real estate portfolio. We experienced a 6% reduction quarter-over-quarter in our real estate portfolio. The portfolio continues to perform well, reflecting the underlying exposure to residential, logistics and industrial assets, which make up 65% of the total portfolio and 72% of our US exposure. Our office exposure in the United States stands at €470 million, down 4% quarter-over-quarter. This represents less than 1% of total assets, 1.3% of total customer loans and 9% of our total real estate exposure.

We are confident that we will be able to address any potential issues in the total real estate portfolio and believe the stress test results with a cumulative loss rate under 2% over a three-year period is a good proxy for stressed loss assumptions across the portfolio, which is less than the €100 million management overlay.

More than ever, the stress we are seeing in certain asset classes, commercial real estate being one, will differentiate banks in terms of underwriting and asset quality.

With that, I will hand it over to Enver.

Enver Sirucic:

Thank you, Anas. I will continue on slide 10. Again, a very strong quarter with core revenues up 6% versus prior quarter with continued strength in net interest income up 7% and better net commission income.

Compared to prior year's first quarter, core revenues were up 18%. Strong core revenues and largely stable operating expenses, our cost-income ratio further came down and stands at 31.5% for the quarter.

Risk costs of €20 million are in line with prior quarter with a risk cost ratio of 19 basis points, which is very comparable to the underlying trend over the last couple of quarters. And that is without any releases of our management overlay that still stands at €100 million. We had a reversal of regulatory charges of almost €3 million, which was a result of lower than expected resolution fund contributions.

On slide 11, we show key developments of our balance sheet. In terms of our balance sheet and capital, customer loans were down 3% quarter-over-quarter and down 8% year-over-year. We continued to improve our customer funding through high customer deposits that were up 1% quarter-over-quarter and further issuances of covered bonds of around €1 billion in the second quarter.

Our position of cash and cash equivalents stands at €11 billion or 20% of our total balance sheet. This is after we repaid another €2.8 billion of TLTRO in the second quarter, leaving a small tranche of €0.6 billion that will be redeemed next year. We generated approximately 90 basis points of gross capital from earnings and another 30 basis points from lower risk-weighted assets, which were down 3% versus prior quarter, in line with the overall loan and asset development.

CET1 ratio came in at 14.8%, net of the first half dividend accrual. After deducting the planned €175 million share buyback, our CET1 ratio would be 13.9%, leaving us with an excess capital of €330 million.

On slide 12, our customer funding, which is made up of customer deposits and AAA-rated mortgage and public sector covered bonds and represents around 94% of our total funding. The split between customer deposits and covered bonds is about 75%, 25%.

On the deposit side, we have €27 billion of very granular Retail & SME deposits with an average size of €12,000 and 80% are insured by depositing guarantee schemes. €6 billion of public sector and corporate deposits are largely with long-term relationship customers and mostly from transactional current accounts.

In terms of deposit betas, year-to-date trends are in line with our expectations, and our overall deposit beta was around 15% in the second quarter. Based on current rate forwards, we expect deposit betas to grow to below 40% by 2024.

Prior to the sudden rise in interest rates of past year, we've lived in a period where banks were in search of yield. This was a period that combined excess liquidity with negative interest rates and extremely tight credit spreads. We consciously made the decision to sit on the sidelines, have our securities portfolio run off, de-risk where it made sense and make very few investments, given we did not see attractive risk-adjusted returns.

We issued almost €10 billion of covered bonds, taking advantage of securing long-term funding at very attractive pricing. This decision to go long liabilities was to match fund our longer duration mortgage portfolio, while also locking in long-term funding during a period of excess liquidity that presented both very attractive pricing and duration.

Again, our cash and cash equivalent position, which includes money held with central banks was €10.8 billion at the end of the second quarter with an LCR at 207%. This represents around 20% of our balance sheet. We have purposely maintained an excess liquidity position to address potential market opportunities over the years, which have yet to materialise. Year-to-date, we have repaid €5.8 billion of TLTRO funds with €600 million remaining.

Enver Sirucic: With that, moving on to slide 13, core revenues. Strong net interest income trend continues in the second quarter, up 7% versus Q1 despite lower customer loans. Net interest margin of 291 basis points for the quarter improved by almost 20 basis points.

In terms of net commission income, overall stable with better performance in payments due to seasonal effects and slightly lower advisory business. For 2023, we expect core revenues to grow by more than 14%, mainly driven by an increase of net interest income to over €1.2 billion, while we assume customer loans to be static to declining for the rest of the year.

Slide 14. Operating expenses were up 1% in the quarter as a result of the new Austrian banking collective bargaining agreement. With strong operating leverage, revenues were up 7%. Our cost-income ratio continued to improve and stands at 31.5% for the quarter, which is well on track to meet our 2023 target of below 34%.

So we will continue to focus on absolute cost targets and we are confident to manage operating expenses at +2% year-over-year.

Slide 15, risk costs. Overall, stable underlying trends and strong asset quality with a continued low NPL ratio of 0.9%. The risk cost run rate stands at €20 million for the quarter, which is in line with the underlying trend of the past couple of quarters. And with the risk cost ratio of 19 basis points, also on track with our full year outlook of being between 20 basis points and 25 basis points.

We did not release any credit reserves with an ECL management overlay of €100 million that we have built over the past few years.

Slide 16. We wanted to reiterate and update our 2023 targets. With our strong operating performance during the first half of the year and with that line of sight of core revenue trends, we are now targeting core revenue growth of greater than 14% with a net interest income of over €1.2 billion, while containing operating expenses to 2% growth.

Based on stable underlying trends and solid asset quality, the underlying risk cost ratio is expected to be between 20 basis points and 25 basis points. The strong operating leverage, we have also updated our profit before tax target to greater than €875 million, earnings per share of greater than €8.20 and the dividend per share of greater than €4.50, which considers our planned buyback of €175 million in 2023.

Our medium-term targets of a return on tangible common equity greater than 20% and the cost-income ratio under 34% remain unchanged.

And with that, I'll hand back over to Anas.

Anas Abuzaakouk:

Thank you, Enver. We wanted to provide everyone with a recap of BAWAG Group's franchise. We felt it important to recommunicate to our stakeholders who we are, what we stand for and highlight the franchise growth over the past decade.

The past decade is important as the strategic transformation of BAWAG Group was launched in 2012, which was led by the current senior leadership team. The transformation not only changed the fortunes of the bank at the time but positioned BAWAG as one of the most profitable and successful European banks in the years that followed and for many more years to come.

As part of our transformation, we embraced our long and rich tradition of representing the workers bank that serves all communities, from union workers to pensioners, to immigrant communities, a rich history and tradition that dates back over 100 years. We aim to provide our customers with simple, transparent and affordable financial products and services they need and that promote their financial health. This underpins our strategy, our growth and the investments we have made over the past decade.

On slide 18, an overview of the franchise. BAWAG Group is a multi-channel and multi-brand commercial bank with a strong focus on retail banking. We serve 2.1 million customers with Austria as our foundation. We offer basic banking products that our customers need from current accounts, payments, savings products, term loans and working capital facilities, leasing and factoring products, as well as distributing third-party insurance and investment products through our various channels.

Approximately, 80% of our customer franchise is Retail & SME-focused with approximately 75% of our customer business in Austria, Germany, Switzerland and the Netherlands. Our strategy has been consistent throughout the past decade. We focus on growing our franchise in core markets by serving the basic financial needs of our customers.

We differentiate ourselves through efficiency, technology, simplicity and operational excellence. And we operate a safe and secure business, maintaining a fortress balance sheet with strong asset quality and a robust funding stack. Our aim is to extend credit to customers while never overextending their ability to repay.

On slide 19, the consistently strong performance of our business in the past decade speaks to the quality of the franchise. We have grown pre-tax profits in every year since 2013 with the exception of 2020 when we booked significant management overlay provisions to address potential headwinds brought on by the COVID pandemic, of which we continue to hold €100 million on the balance sheet as a precautionary measure.

We delivered an average return on tangible common equity of approximately 15% over the past decade. Despite operating in a negative interest rate environment for almost eight years, our strategic transformation was the catalyst for sustainable growth and value generation for all our stakeholders. Our focus has been on developed and mature markets. Austria is our foundation, and we find the markets that resemble Austria are most westward, providing geopolitical stability, strong legal systems and solid macroeconomic fundamentals.

We focus on our core businesses and products that meet the needs of our customers. We believe in making long-term investments and not shying away from making tough business decisions. This, at times, may not be popular in rightsizing the business, exiting non-core businesses or loss-making partnerships.

We believe in simplicity and transparency, prioritising what really matters. We are disciplined and conservative lenders, never compromising our credit quality or blindly chasing volume growth. We are focused on disciplined long-term sustainable and profitable growth, which we assess not after one quarter or one year but over the long term to understand the underlying trends and impact of our actions and investments.

Slide 20. The importance of maintaining a profitable franchise. First and foremost, our profitability allows us to maintain a healthy capital position and capital buffers, which is the bedrock of any bank. Our profitability and capital generation have also enabled us to make significant investments for the benefit of all stakeholders, building a franchise that is positioned for success for many years to come.

Over the past decade, we averaged annual gross capital generation of 210 basis points. Because of this solid capital position and robust capital generation, we have been able to extend €68 billion of credit to our customers over the past decade, growing our customer loans and franchise by 62%, invest approximately €600 million in our technology platforms and branches and distribute over €2 billion of capital to shareholders since our IPO.

This was only possible because we fundamentally transformed the earnings power and capital generation of the franchise.

On slide 21. Since our IPO in October 2017, our absolute total shareholder return was 17%. Relative to the two largest and most representative European bank indices, we have outperformed the 7E and the 7P by 6 points and 10 points, respectively.

We pride ourselves on being good stewards of capital. Since the IPO in 2017, we have extended €42 billion of credit to our customers, meeting their daily needs in growing our franchise. We have self-funded seven acquisitions, and we have distributed over €2 billion since our IPO in the form of dividends and share buybacks with cumulative dividends of €14.7 per share. We have a pending €175 million share buyback and are targeting dividends over €4.50 per share for 2023, which represent at least a further €530 million in distributions and will take our total capital distributions, both paid and earmarked to approximately €2.6 billion by the end of the year since our IPO.

We have also worked hard over the years to build a strong core shareholder base and have always welcomed constructive dialogue with existing and potential long-term investors. The senior leadership team, both as fiduciaries as well as significant shareholders with a 4% shareholding in the bank are focused on delivering results for all stakeholders every day. The team's ownership reflects the deep commitment and investment in the long-term success of the franchise.

On slide 22, our strategy has been consistent throughout the past decade. Our three strategic pillars have guided our transformation over the past decade and will guide us over the coming years.

Our primary focus has and will always be on execution and doing our best to consistently deliver results for all stakeholders. We do not have a separate ESG strategy as ESG underpins our strategic pillars and is embedded in how we run the bank to ensure responsible, sustainable and profitable growth through robust governance structures.

Slide 23, the growth of the franchise, both in Austria and across all markets has underpinned our success. Our profitability has allowed us to pursue a dual growth strategy, both domestically in Austria as well as expanding our footprint into six new markets since 2013. This was a mix of organic and M&A growth, all self-funded and all adhering to the fundamental principle of pursuing disciplined, long-term, sustainable and profitable growth.

Over the last decade, we increased customer loans, customer deposits, retail assets under management and our core product offering. Most importantly, we have grown our foundation in Austria. We typically do not use product market share as a specific target in any given year because we believe this at times drives the wrong behaviour. However, over a longer period, this provides insights into the trajectory of a business, the impact of long-term investments, capital allocation and the underlying health of the franchise.

Over the past decade, we have increased our housing loan market share from 2.8% to 5.6%, up 2.8 points as we focused our franchise on more secured lending, serving the housing needs of our customers and deepening our customer relationships through a greater focus on advisory. We have also grown our share of consumer loans from 8.2% to 12.7%, up 4.5 points, reflecting our focus on local community banking and the success of initiatives around direct banking, which is more prominent with personal loans.

We have substantially grown our share of credit cards' transactional volume from 8% to 21%, up 13 points, benefiting from our bolt-on acquisition of Paylife credit cards. We have expanded our market share in auto leasing from 4.5% to almost 8.4%, up 3.9 points, building up our network of local dealers, digital capabilities and bolt-on acquisitions.

Our share of retail household deposits has held steady between 8-9% over the past decade. This considers several moving parts from a prolonged period of negative interest rates, shifting customers to current accounts with greater banking features looking to deepen relationship with customers through investment products and more recently focusing on primary banking relationships versus maintaining the last marginal deposit.

On slide 24, in addition to growing our market shares in Austria, we have gradually transformed the bank to more of a retail orientation. In 2013, our retail lending accounted for 41% of customer loans. Today, this accounts for 62% and we will continue to grow through our multi-brand and multi-channel Retail & SME business in Austria and abroad. This was only possible through a combination of organic growth initiatives and M&A, filling out our core product offering with factoring, leasing, credit cards and building society products.

We grew our Retail & SME customer loans from €9 billion to €22 billion, up 135% since 2013. Over the same period, we have held our Corporates, Real Estate and Public sector business relatively flat at

€13.7 billion, albeit, with a greater shift towards secured real estate lending.

As part of the strategic transformation of the franchise, we shifted the focus towards secured and public sector lending, which accounts for 77% of total lending, up 12 points since 2013.

On slide 25, over the last decade, we have invested significantly and consistently in transforming the franchise. We transformed the bank from a traditional savings bank, focused on transactions, to a more customer advisory-oriented retail bank. We digitise and modernise our products, customer journeys and how we work as a team using technology and collaboration tools.

We simplified our workflows, redesigned processes and streamline decision-making, and we divested from non-core businesses and products as well as loss-making partnerships. The impacts of our investments have been significant. We fundamentally bent the cost curve reducing our cost-income ratio by over 50% from a starting point of 68% to under 34%. This was only possible because of the long-term investments that yielded real productivity gains in permanent cost out. More than anything else, this has provided us with the sustainable profitability to support our customers, grow the franchise and continue making long-term investments.

A few examples of the specific actions taken and the resulting impacts are the following. We invested approximately €600 million, allowing us to upgrade our self-service e-banking, mobile banking and modernise the original BAWAG branch network, providing more capacity for customer advisory. We digitised approximately 90% of our core products, reducing friction in our sales process and allowing us to scale transactional banking. We completed nine migrations and consolidated 80% of our data centres. We reduced the number of headquarter sites from four to one. We have invested heavily in training our technology team in cloud fundamentals, effectively in-sourcing our technology capabilities.

Today, we spend approximately 26% of our operating expenses on technology, up from 13% a decade ago to provide our customers with simple, transparent and easy-to-use financial products and services across multiple channels and brands. We also discontinued the Austrian Post partnership, saving €50 million annually, exiting 400 post offices, taking full control of our branch network and sales advisors, and most importantly, allowing us to accelerate to a more advisory-focused retail banking business.

We also made strategic decisions to divest from non-core businesses and participations that were weighing down the franchise in terms of both cost and capital. And we simplified our Group structure reducing unnecessary management layers, hierarchy and bureaucracy.

On slide 26, the bank is in the business of managing risk. The entire management team prides itself on risk management. Our discipline and conservatism is best reflected in one of the lowest NPL ratios across Europe at 90 basis points, low balance sheet leverage of 13 to 15 times based on total assets to equity without adjusting for our excess cash position and low risk costs with an annual average risk cost ratio over the past decade of 23 basis points.

The principles, many of which I have touched upon, basically come down to focusing on mature, developed markets with strong macro economics, healthy fiscal positions and robust legal systems. We aim to focus on senior secured lending with solid collateral, being a credit spread lender, hedging interest rate risk and maintaining a securities portfolio comprised of 100% investment-grade credit.

The business that we do not offer is just as important and reflective of our risk management principles. We do not operate in the CEE, Russia, Ukraine or emerging markets as we believe these are at times more volatile markets with less robust legal systems and fiscal capabilities. We do not offer customer derivatives, no mezzanine financing, no capital markets business, no trading book, no exposure to high-risk AML countries, no market risk RWAs and very limited exposure to high-emitting greenhouse gas sectors.

Slide 27. We are primarily customer deposit funded. 90% of our deposits are from Austria, with 80% of our deposits being granular retail deposits across our customer base with an average size of €12,000 and 80% being insured. Just as important, we do not have any brokered deposits. €6 billion of public sector and corporate deposits are largely with long-term relationship customers and mostly from transactional current accounts.

Over the last decade, our customer deposits have been growing in the Austrian market and our deposit base moved in line with the overall market, maintaining a retail deposit market share of 8-9%. After years of low to negative rates, we have seen a shift of customer deposits from term to overnight.

To address that development of shortening deposit duration, we decided to increase our covered bond funding over the last couple of years. We issued over €10 billion of covered bonds since 2019, taking advantage of securing long-term funding at very attractive pricing. This decision to go long liabilities when others went long assets to generate extra yield is one that we see playing out across banks and will have significant impact on any given bank's profitability.

Our motivation was to match fund our longer-duration mortgage portfolio, while also locking in long-term funding during a period of excess liquidity that presented both very attractive pricing and duration. Our covered bonds had a weighted average life of nine years with almost no maturities until 2027. This provides us today with a structurally more balanced customer funding stack, nicely matches our mortgage loan book with a weighted average life of approximately eight years.

Our decision to go long liabilities is also reflected in our cash position, which includes money held with central banks, which is around €11 billion or 20% of our balance sheet at the end of the second quarter with an LCR of 207% after redeeming €5.8 billion of TLTRO over the last couple of months. This underpins our highly liquid balance sheet and our robust customer funding stack.

Lastly, on slide 28, over the past decade, we have made significant strides in delivering value for all our stakeholders. A few examples are the following. On the customer front, we saw the long-term trends in retail banking and proactively transformed our retail business to be focused more on advisory as transactional banking was slowly being displaced by digital capabilities. Our profitability allowed us to extend €68 billion of credit over the past decade.

We are also cognisant of to never pass on negative rates to customers and work closely to support our customers during the pandemic to ensure we provided financial relief and support.

On the investor front, we took the company public in 2017, representing the largest IPO in Austria's history in ensuring we listed in our home market. Since our IPO, we have delivered a total shareholder return of 17%, outperforming the relevant bank indices and distributing earmarking almost €2.6 billion of capital by the end of 2023.

On the employee front, we have firmly established the company's culture as one defined by meritocracy, accountability, fairness, diversity, promoting the well-being of our employees through various training and benefits programmes.

We were one of the first companies to embrace a hybrid home office model, providing our employees with the flexibility to strike a balance between the demanding work schedule and family and personal needs.

In terms of society, we have focused our resources in promoting social programmes focused on supporting underserved communities. Having mentioned the above, we still have a lot more to do. In cognisant of gathering the voice of all customers, our employees, our investors and broader society, we plan to engage more broadly and meaningfully to capture the voice of all our different stakeholders in the spirit of continuous improvement.

We have never taken our stakeholders or the success of the franchise for granted. We will continue executing our strategy, serving our customers, investing in our people and society and ensuring we stay ahead of the curve in a dynamic and changing banking environment.

Our transformation over the past decade has provided the foundation for sustainable growth and value generation for all stakeholders.

With that, operator, we will open up the call for questions.

Mehmet Sevim (JP Morgan):

I will have two questions. My first one will be on loan volumes. The momentum here looks relatively weak compared to all the other moving parts in the balance sheet and the P&L. How much of this would you say comes from lower customer demand and maybe higher repayments from customers in the environment of high rates? And how much on the other hand, from your lower appetite to deploy capital in the current market environment?

And going forward, how do you see the volumes, particularly, I would say, both in the second half but also beyond that, helping us maybe understand the implications of high for longer rates on the outlook for growth?

And my second question on the other side of it will be deposit behaviour broadly around betas, thank you for the disclosures here, but also deposit mix. What you're seeing here from customers in terms of behaviour? And maybe is it fair to say that so far, it is coming a little better than expected? And how has your pricing strategy currently in Austria compared to the rest of the market?

Anas Abuzaakouk:

Thank you, Mehmet. Very good questions. I will take the loan volumes question. Enver, you will take the deposits.

Okay. So Mehmet, the loan volumes: We mentioned that customer loans obviously are down quarter-over-quarter and on a year-to-date basis. This is a result of, I think, two factors: A cautious consumer. Obviously, loan volumes across the market are down. And I think just the high rising rates and that impacts the overall consumer sentiment.

What has been surprising from our standpoint is, at least when you look at credit spreads, given the velocity of increase in rates, I would have thought that there would be more of a repricing of credit risk and spreads would have widened. It has probably been the opposite. I do not think this is a long-term trend. I think this is more of an anomaly. What is the exact timing, whether it is one quarter or two quarters, we are not sure. We think there will be a lot more interesting opportunities. But as we have always said, we do not chase volume growth. It has to meet risk-adjusted returns, and we are going to be disciplined commercial lenders.

So even though it has been muted or static kind of volume growth to declining, and I think Enver gave that outlook for the second half of the year, we are in a good place. When the market reprices and when there is actual robust demand, we will be there to be able to serve our customers and deploy capital and liquidity. So you want to take deposits?

Enver Sirucic:

Yeah, sure. So on the deposit front, Mehmet. So you asked a couple of things. The deposit trends as we are seeing right now. So the market has been quite stable, the overall Austrian market. We have been up in the quarter. Month-to-date in July, it has been very stable, and we would expect a very similar trend to continue for the rest of the year just in terms of deposit volume trends.

In terms of the mix of deposits, we have seen early in the year, some shift into term deposits, but that has really happened just in the first quarter. We have not really seen anything happening in the second quarter. So right now, the split is probably 90% daily savings versus 10% term deposits, and it really did not change over the last couple of months.

In terms of pricing and betas, so I would say we are probably average of the Austrian market, where we price on the different products. Obviously, you have some nuances around special offers, fresh money, some features of the products. But overall, I would say we are a good proxy for the average pricing, which leads me to the betas, which grew from 10% that we have seen in Q1 now to 15%, which is perfectly in line, maybe a bit better than what we expected initially, and still completely in line with our projections to be below 40% until 2024.

Hugo Cruz (KBW):

I have three questions. First, on CRE. I have noticed that your volumes are down Q-on-Q for the overall portfolio, were stable for the US portfolio. So it sounds like you are still doing some business in US. If you could talk about a bit more granular what you are doing with CRE about maturities and new business?

Second, on your funding slide, where you talk about the average duration of your housing loans of eight years, which I thought is quite interesting, quite short. Is this something you are seeing changing in this rate environment? Are you seeing people actually doing less repayments or more repayments over time?

And then a final question on Ireland. I read in a press that you guys actually entered the market, bought a very small platform there recently. Can you tell us about your plans for this market?

Anas Abuzaakouk:

Thanks, Hugo. All good questions. Commercial real estate, what we call the real estate lending portfolio is down 7% quarter-over-quarter. The US exposure is primarily flat. I think the question we get a lot, obviously, is on US office exposure. That is down 4% quarter-over-quarter, normal amortisations. The reality is that we just do not see a lot of opportunities. We have always been cautious on office post-COVID.

I gave you just a sense of the overall exposure for US office. But given the current trends, just to give an environment, there is not a lot of new business. It is more just normal amortization, a few early redemptions. And we will see. We will be cautious in terms of how we lend. We tried to provide a little more disclosure on the real estate portfolio in terms of overall stress scenarios, using the stress test results that hopefully will be published next week with a cumulative loss rate of under 2% over a three-year period, which the management overlay more than sufficiently covers.

So we feel pretty good about where the portfolio is today. There is less new business opportunities. I think it goes back to my earlier comment of people are pretty cautious and things are a bit stuck. But look, we look at things on a risk-adjusted return basis, and we will be disciplined across asset classes. The opportunities we will probably see are in residential industrial logistics if they do open up. Enver, you want to take housing loans?

Enver Sirucic:

Yeah, sure. So, on the mortgages, you asked about the short duration of the mortgage loans. I think the main reason for that is almost all our mortgage loans are amortising loans. So we hardly do any interest-only of the likes, the bullet loans. So that is why the overall duration is lower than 10 years.

In terms of repayments, it is a bit mixed picture, if you see more or less. We have been doing mostly fixed-rate mortgages over the last couple of years. We do not see any increased repayments, which is kind of intuitively what you would expect. We see a bit of a shift from some of the vintage floating rate mortgages into fixed-rate mortgages these days, but nothing meaningful. So I would say it is kind of balanced in terms of repayments.

Anas Abuzaakouk:

And lastly, Hugo, the question on Ireland. MoCo is a small platform that we purchased that allows us to have origination capabilities. We like the team. We like the customer journey that was created. More broadly, we like the macro fundamentals of Ireland mortgages or housing loans as an asset class, we think is quite robust. There is acute housing shortage in Ireland. This is not any new news. And we like the risk-adjusted returns profile.

Ireland will probably be more into the Netherlands when we entered the Netherlands in terms of NHG Dutch mortgages. But that will take time. It is something organic and the platform is effectively a greenfield.

Gabor Kemeny (Autonomous):

Thanks for your additional insights on the franchise and your strategy. My question is about customer satisfaction here. Obviously, a long-dated, quite a lot in the last few weeks. My question is, how do you measure customer satisfaction? And what initiatives do you have in place to improve customer satisfaction?

And then coming back to financials for a second. I think Enver mentioned that you expect further operating profit growth in Retail & SME, even though loan demand is weak, and you expect beta to increase. So can you elaborate on what you expect to drive that growth? And if it is NII, how do you think about the Group's NII dynamics for the rest of the year?

Anas Abuzaakouk:

Thank you, Gabor. Very good questions. So as far as customer satisfaction and what we do internally, obviously, we do not present a lot of this stuff externally. We get a voice of the customer. We do it through our local branches. We have almost 70 or so local branches in Austria. Through our branch managers, we do mystery shopping as well. There is a host of things that we do to better understand the customer needs, a friction that customers are experiencing in the process, primarily on OTC or transactional banking. And we look to improve that through a variety of measures through training, through our digital capabilities through store hours. And I think what we will do going forward is just be, I think, provide more information, more transparency around how we do those assessments and the results of those assessments as well.

So that was part of it when I said about the voice of the customer and the voice of stakeholders. Those are things that I think there is an opportunity for continuous improvement.

What was the second?

Enver Sirucic:

I think the second question, Gabor, was around retail, I think, operating profit, if we expect that continue to grow. And I think the overall NII trend was the second part of the question. So yes, we would expect retail to further grow because you have some long-term benefits on the deposit side from the deposit hedge that we put on. That is the main driver.

And also, if you look at the assets, they are quite stable in retail, not growing, but at least more stable than we see in the corporates, real estate and public sector side.

Overall, the NII trend, I would say twofold. The one is just deposits, deposit betas, interest rate curve. Still, we will see positive momentum in that. But on the other side, that is why we indicated more stable development for the rest of the year is the asset NII. We have seen assets coming down. And as mentioned, we want to be patient in this market environment. So the question will be how quickly will we see assets growing again? That is what drives then the overall NII trend in the outer quarters, I would say.

Gabor Kemeny:

Just a small follow-up to Anas' point, please. What is your branch strategy from here just in terms of the size of the network? Do you think what you have now is sufficient? Are you planning to close down more? What is the outlook there?

Anas Abuzaakouk:

No, Gabor, this is, I think, the ideal network size, you can be opportunistic in terms of certain branches and opening up branches in new areas or white spaces. But I would say this is the ideal network, given the current business model.

Marlene Eibensteiner (Deutsche Bank):

I would have two. Firstly, on the updated guidance going forward for 2023. Could you please elaborate a bit on the underlying drivers as most line items and expectations of which seem to remain unchanged? Would you expect a higher contribution from fee-income going forward?

And secondly, could you also please provide an update on potential M&A opportunities that you are seeing in the market currently?

Anas Abuzaakouk:

Thanks, Marlene. Enver, do you want to take that?

Enver Sirucic:

Yes, I will take the first one. Yes, I think on the outlook, Marlene, what we said on the call, it is mainly coming from the strong performance of the first half and having better line of sight of the revenue trends of the second half of the year, which is mainly to come from the NII.

So if you extrapolate just what you have seen in the second quarter, I think we feel very comfortable getting to the 14%-plus guidance.

NCI, I would say there is still positive momentum but stable, very stable development that we have seen in the last couple of quarters. I think will continue also for the next quarters.

Anas Abuzaakouk:

Marlene, in terms of the M&A, I mentioned earlier, with the full year results, we thought there was going to be things in the first half. That has been delayed to the second half. We have seen that reinitiated. I think we will get a better sense by end of year for the M&A prospects and the things that are tangible and the things that never materialise. And that is why in terms of capital distributions incremental to what we have already talked about. We will have a better sense because we will then know how the M&A prospects develop and then just the overall market environment and potential new opportunities.

Tobias Lukesch (Kepler):

My questions are mainly around the targeted bank acquisitions and holdings. First, in terms of the Idaho First Bank acquisition, to what extent have you revised your strategic thinking around the asset following the US regional bank crisis earlier in the year?

Secondly, on HCOB Holding, any strategic news regarding this one? There was this big special dividend, which you accounted for or where you adjusted basically only the carrying amount. Would be interesting like if there is a bit more of actionable things around that over the next one to three years, maybe?

And very lastly, did I just – I would like to understand that correctly around M&A, there will be an update with Q3 results? Or is that rather something we discuss next year basically when we have the year-end results ready?

Anas Abuzaakouk:

So thanks, Tobias. All good questions. M&A, I think is more realistic by year-end results. I do not foresee anything happening in 3Q. It is just the second half of the year. And I think then at full year results, we will be able to more I think confidently provide you with where we stand on M&A, if something is tangible or if things do not materialise. So that is the broader question.

On Idaho First Bank through Peak Bancorp. Look, we get a lot of questions on this. The community bank that we are targeting, which is Idaho First Bank. Let me start by saying we've been in close contact with the team. The operating performance obviously, in light of the market environment with US regional banks. We are very pleased with the development, both on a deposit as well as the asset quality standpoint. So we like that.

The process is still pending regulatory approval, so we cannot talk about the broader or more details in terms of just the overall acquisition. But hopefully, we will be able to come back shortly and provide more details on that.

In terms of just the strategy, it is a growth platform for us. It is Retail & SME, it is not commercial real estate. There are certain asset classes that we like. And we think it will be a new growth platform similar to the Netherlands, similar to potentially what we are doing in Ireland that adds to our geographic revenue and earnings diversity. That was always the thinking, and we like the overall market in terms of maturity and opportunities.

So you want to take HCOB?

Enver Sirucic:

Yes. So on HCOB, I think two things, Tobias. The first one is special dividend. As you mentioned, rightfully is, we have not taken it through the P&L. So you do not see any of that in our P&L statement. We have reduced our carrying amount by the exact amount of the dividend received, which is just being a very conservative balance sheet approach on our side.

And the second part of the question, it is not a strategic investment that we have. We only have 2.5% invested in HCOB.

Mate Nemes (UBS):

I have a couple of questions, please. The first one is on real estate lending. You had 6% decline from the previous quarter in real estate lending. Could you just clarify if this is all organic development or just amortisations or exposures rolling off? I think you mentioned specifically the US office portfolio that this was the case. Can you just confirm that this is also true for the entire real estate lending book?

And also related to that, if I am not mistaken, the average duration of that real estate lending book is just above three years, three-and-a-half years. Am I wrong to assume that in this environment and just referring back to your comments, saying you do not see such attractive opportunities. So am I correct assuming that in this environment we could see continued decline in this book that is perhaps similar pace that we saw in the second quarter?

And finally, a question on risk weights in the real estate lending book. Could you tell us what the average risk weight is? And in that part of the book, it is clearly higher than the 51% you have in the overall corporate real estate and public sector division. And then if that is the case, is it fair to expect a more pronounced RWA decline going forward even relative to the total asset decline?

Anas Abuzaakouk:

Thanks, Mate. Very good questions. In terms of just the amortisation, that was normal course amortisation. Every now and then, we will have an early redemption that happened in the first quarter, by the way, where the borrower refinances, which I think is contrary to a lot of the market sentiment. We are cautious in terms of risk-adjusted returns. We did see some opportunities in real estate lending with the resi as an underlying asset class. I think that is still pretty robust.

In terms of the US exposure, we don't really see much across industrial and logistics, things are pretty frozen. These are typically five-year term loans and cash flow, pretty quickly. We have not seen anything unusual in terms of overall amortisations. And I gave some guidance in terms of if you stress the portfolio under adverse scenarios not using our data points, but just using external data points, and we will be able to share more of this detail next week as we provide the details of the EBA stress test, I think that will give people a sense of comfort. And then there were some more questions.

Enver Sirucic:

Yes. I think duration three, three-and-a-half years.

Anas Abuzaakouk:

Yes, that is about right.

Enver Sirucic:

That is right assumption. And you asked about the risk weights, they are slightly above 60%, 60-65% on average.

Anas Abuzaakouk:

On the RWA, yes, it is higher than the 50% because obviously that is weighed down by the public sector.

Andrea Vercellone (BNP Paribas):

I have got two. The first one is on deposit hedging that you mentioned before. Can you elaborate a bit on what is the notional of the hedging?

What is the expected rollover and expected tailwind to NII coming from this component?

And the second question is on your strategy for deposit pricing for retail. You are guiding us to stable to down volumes. In the short-term, you don't see major really attractive investment opportunities on the securities book. So essentially, you do not need an incremental deposit funding, if that is the picture. So do you plan to price in line with the market? Or could you even be less aggressive because you are happy to let some deposit go if they want to?

Enver Sirucic:

Thank you, Andrea. On the deposit hedging, so most of our deposits, as you said, are daily, and we do hedge them. Directionally, I can tell you, 40% roughly of them are hedged on a 10-year rolling basis, which gives you an average duration of the hedge of two years for the overall hedge portfolio. But it is not a point in time. It is a rolling. So every year, one part will roll over. That benefit that you see from the role over of our hedges is actually offsetting right now the increasing betas. So it is kind of perfectly matching. And it is in line, again, with the expected beta to offset itself, which means depending obviously on the rate curve that we will see in one, two years' time, there is still tailwind benefits from that kind of rollover of the hedging, but depending on the rate structure then.

In terms of deposit pricing, very good question. I think our strategy is pretty much in line with the market. I said it before, a bit nuanced. So there are a few things that we are just not doing. We are not into brokered deposits. We do not think that is high quality, so we would not spend money on that. We do value more primary banking relationship deposits over hot money or marginal deposits. So we are a bit more defensive there than the market. But overall, I think it is fair to say that we are pricing in line with the overall market.

Simon Nellis (Citi):

Just one last quick one from me. Back in your 2021 Investor Day, you said that around €50 million of annual regulatory charges would run out. I think you have got a €15 million reg charge target in 2025. Can you just give us some guidance or look through to next year and 2025 on reg charges and update?

Enver Sirucic:

Yes. Sure, Simon. Good memory. So I think for 2024 is to be around €25 million. I think we still have a bit of remainder of the last payment in the deposit guarantee scheme. The contributions to the resolution fund are done with this year. So basically, this year I think we will be around 45, next year 25, and then after 25, 15 is the run rate. So that is kind of directional what we expect for the coming years.

Anas Abuzaakouk:

Thanks, everybody, for joining the call. I know this was a little longer than usual. I hope everybody has a great summer, and we look to catch up for third quarter results. Take care and have a great day. Bye.