EARNINGS CALL
TRANSCRIPTION

Q1 2023 RESULTS

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SPEAKERS:
ANAS ABUZAAKOUK
ENVER SIRUCIC

Anas Abuzaakouk:

Thank you, Operator. I hope everyone is keeping well this morning. I am joined by Enver, our CFO. Let us start with a summary of the first quarter results, on slide three.

We delivered net profit of €167 million, earnings per share of €2.11, and a return on tangible common equity of 24% during the first quarter. The operating performance of our business was very strong, with pre-provision profits of €258 million and a cost-income ratio of 33%.

Other income of -€9 million related primarily to other operating expenses, tied to legal, tax and transactional advisory costs on M&A deals. The bulk of these costs will be capitalised when deals are closed. Total risk costs were €30 million, translating into a risk-cost ratio of 28 basis points.

We did not release any credit reserves, with an ECL management overlay of €80 million. We have a low NPL ratio of 1% and continue to see solid credit performance across our businesses.

In terms of our balance sheet and capital, average customer loans were flat, and average customer deposits were up 1% quarter-over-quarter. Our CET1 ratio was 15.6%, up 90 basis points from year-end 2023 after considering the first quarter dividend accrual of €92 million, and we paid the dividend for the financial year 2023 of €5.0 per share, or €393 million, on 15 April.

We have a fortress balance sheet with excess capital now at €623 million, approximately €12 billion of cash, an LCR of 217% and overall strong asset quality.

We continue to see a market where customers are cautious in slowly adjusting to higher rates as we maintain our outlook for static-to-modest customer loan growth. We have earmarked our excess capital for the acquisition of Knab Bank, which we signed earlier this year. In addition to other strategic M&A that we are at an advanced stage, we have purposely maintained dry powder to pursue these strategic M&A opportunities that will be highly accretive to the franchise in both earnings as well as allowing us to grow our Retail & SME franchise and our footprint in the DACH/NL region.

Today, our franchise is approximately 70% Retail & SME-focus, with 70% of our customer business in the DACH/NL region. In the mid-

term, we see this migrating to 80-90% Retail- & SME-focus, with 80-90% of our customer business in the DACH/NL region.

The first four months of this year have been defined by M&A and integration planning, ensuring constant dialogue with regulators, targets and laying out our detailed day-two plans. There has been a great deal of work taking place behind the scenes. We are excited about the opportunities ahead and will provide more details as the year progresses.

Moving to slide four, we delivered a net profit of €167 million, up 20% versus prior year and a record first quarter result.

Overall, strong operating performance with total pre-provision profits of €258 million, up 4% versus prior year. Tangible book value per share was €36.33, up 16% versus prior year and 3% versus prior quarter. This assumes the deduction of the first quarter 2024 dividend accrual.

On to slide five, at the end of the first quarter, our CET1 ratio was 15.6% after deducting the first quarter dividend. For the quarter, we generated approximately 90 basis points of gross capital through earnings.

We also executed a corporate securitisation transaction, which accounted for the majority of lower RWAs in the quarter. Our excess capital of €623 million, or 340 basis points, provides us with enough dry powder for strategic M&A opportunities, both signed and in the pipeline.

On slide six, our Retail & SME business delivered first quarter net profit of €134 million, up 14% versus the prior year and generating a very strong return on tangible common equity of 36% and a cost-income ratio of 30%.

Pre-provision profits were €208 million, up 9% compared to the prior year, with operating income up 7% and operating expenses up 4% versus prior year.

Risk costs were €26 million. The retail risk costs run rate has now returned to pre-COVID levels, as multiple stimulus and government support programmes have now expired. However, we continue to see solid credit performance across the business, with an NPL ratio of 1.8%. We expect solid operating performance across the Retail & SME franchise in 2024, but muted customer loan growth, given the overall economic environment.

On slide seven, our Corporates, Real Estate and Public Sector business delivered first quarter net profit of €39 million, up 5% versus prior year and generating a strong return on tangible common equity of 22% and a cost-income ratio of 27%.

Pre-provision profits were €58 million, down 1% versus prior year. Risk costs were €5 million. We continue to see solid credit performance across the business with an NPL ratio of 80 basis points. We pride ourselves on disciplined underwriting, focusing on risk-adjusted returns and not blindly chasing volume growth, as we continue to remain patient and disciplined. We have the capital and liquidity to support our customers as we expect markets to normalise in the next few quarters.

On slide eight, an update on the real estate portfolio. We experienced a 2% reduction quarter-over-quarter in our real estate portfolio, the bulk of which was related to US office. The portfolio continues to perform well, reflecting the underlying exposure to residential, logistics, industrial and hospitality assets, which make up 75% of the total real estate portfolio and 85% of our total US exposure.

Our office exposure in the United States stands at €371 million, down 19% versus prior quarter due to refinancings. The performing US office portfolio represents less than 1% of total customer loans and 6% of our total real estate exposure. This remaining portfolio has a debt yield of approximately 9%, occupancy levels of approximately 80%, a weighted average lease term of six years with solid tenants, and an LTV under 75%.

We believe the worst is behind us in terms of stress on our portfolio, with our US office portfolio reducing in size and other asset types continuing to perform well. For our remaining office portfolio, in certain cases, we have been able to negotiate equity contributions resulting in deleveraging and/or additional equity to improve the properties and attract additional tenants. As I have stated before, the stress we are seeing, particularly in commercial real estate, will differentiate banks in terms of underwriting and asset quality as we see greater dispersion across lending portfolios.

With that, I will hand over to Enver.

Enver Sirucic:

Thank you, Anas. I will continue on slide ten.

A strong quarter with net profit of €167 million and a return on tangible common equity of 24%. While net interest income was

down 1% versus prior quarter, the net commission income was up 4% in the first quarter. Year-over-year, core revenues were up 7% and flat versus prior quarter, operating expenses up 2% in the quarter and cost-income ratio now at 33%.

Risk costs were €30 million in the quarter, stable versus the prior quarter. ECL management overlay remained at €80 million.

On slide 11, key developments of our balance sheet, a few things I will highlight here.

Customer deposits were down 3% in Q1 and flat year-over-year. This was largely driven by seasonally high deposit balances at year-end versus first quarter. Our average deposits were actually up by 1%. Customer loans went up 1% while our risk-weighted assets came down by 4%, and this is largely due to a corporate securitisation transaction that was executed in the first quarter.

Our cash position came down to €12 billion this quarter, also driven by the full pay-down of the remaining TLTRO tranche. Cash and cash equivalents make up approximately 22% of the balance sheet, leaving us with a very comfortable liquidity buffer to address potential organic and inorganic market opportunities in the coming quarters.

Next slide, our customer funding, which is made up of customer deposits and AAA-rated mortgage and public sector covered bonds, grew by 1% since year-end, and 5% year-over-year, to around €46 billion. Cash position now at €12 billion.

In terms of customer deposits, no relevant structural changes in the first quarter. Repricing continues in line with our expectations. Overall deposit betas now at around 29%, expected to grow to 30-35% and peak in the coming quarters.

With that, moving on to slide 13, core revenues.

Net interest income was down 1% versus prior quarter, with a net interest margin of 296 basis points. Overall, we have seen stable margins and volumes in the business with a pickup of deposit betas from 25% to 29% and a lower day count, leading to a slightly lower net interest income.

In terms of net commission income, up 4%, with an overall good performance across securities and payments in our Retail & SME segment.

For 2024, our guidance remains unchanged. We expect core revenues and net interest income to grow by 1%.

On slide 14, operating expenses are up 2% versus prior quarter, largely driven by a full quarter of Idaho First Bank in the numbers and some inflation effects. The cost-income ratio increased slightly to now 33%.

In March, the collective bargaining agreement for banking was finalised with an agreed 8% wage increase in Austria, which is in line with our expectations. That will be partly offset by our ongoing optimisation programmes, mostly through further simplification and standardisation across the Group, leaving us with an expected cost increase of around 3% for 2024 before any M&A.

Our expectation for regulatory charges in 2024 remains at around €16 million, or €4 million per quarter, for the remainder of the year.

Moving to slide 15, risk costs. Overall, continued strong asset quality with a low NPL ratio of 1%. We booked €30 million of risk costs in the first quarter, which was in line with prior quarter.

We kept our management overlay at €80 million, and we expect risk cost in 2024, in the context of 25 to 30 basis points.

On slide 16, we reconfirm our outlook and targets for 2024. This is based on current interest rate expectations and assuming no M&A in 2024. We are targeting net interest income and core revenue growth in 2024 of 1%, while containing operating expenses to 3% growth. Foreseeable regulatory charges are expected at around €16 million in 2024.

Based on overall macro environment, the recent underlying trends and solid asset quality, the risk-cost ratio is expected to be between 25 and 30 basis points.

The financial target for 2024 is a profit before tax of greater than €920 million, return on tangible common equity greater than 20%, and the cost-income ratio under 34%.

And with that, let us open up the call for Q&A, please. Thank you.

Vishal Shah (Morgan Stanley):

Hi Anas and Enver, thank you so much for the call and hope you are doing well. My first question is on M&A. I understand that you may not be able to share many details, but on the second M&A transaction that you had mentioned earlier in Q1, that it was in advanced stages, now it seems like maybe something can materialise more likely in Q2. So any colour you can provide there

on the discussions, and what is affecting the timeline of announcement on this transaction?

And then secondly, on the risk transfer, clearly, that helped reduce the RWAs significantly in this quarter and provided a decent boost to the CET1. Could you comment on how you see the evolution of RWAs for the remainder of the year, and do you see any such further opportunities to execute SRTs? Thanks.

Anas Abuzaakouk:

Okay, thanks, Vishal, I will take the first on M&A. And, Enver, you want to take the SRT?

Enver Sirucic:

Yes.

Anas Abuzaakouk:

Okay. So, Vishal, you are right. Obviously, we are limited in what we can say with respect to M&A that is in the pipeline or that is being currently assessed. I will say that we are at an advanced stage.

I think I have said this before, as far as we like Retail & SME in the DACH/NL region, it is a product fit that we think is complementary to what we have in our existing product suite. And we hope that in the near future we will be able to hopefully communicate more details with respect to our pipeline.

I will say one thing, Vishal, and you saw it in the first quarter numbers, it was €9 million of 'Other operating expenses'. When you do deals, there is always a great deal of complexity, whether it comes in the form of legal work, tax work, just a whole host of other advisory transactional work that we need to account for. So that was reflective not just of the Knab deal, but of other deals that we are looking at. However, hope to come back in the near future.

I will pass it over to you, Enver.

Enver Sirucic:

Yes, so, Vishal, on the question of RWA trend, I think it is going to be very much in line with the overall asset development, which we said is going to be muted on this side of the year. So we said around 1%. So that is going to be very much in line with that.

In terms of potential further SRT measures, we are looking at different things in the existing book, but also we will consider it on

the future M&A as well. And then it is going to be an economic decision what makes more sense.

Vishal Shah:

Thank you so much.

Enver Sirucic:

Thanks, Vishal.

Gabor Kemeny (Autonomous Research):

Thank you. Hi, team. A follow-up from me on the synthetic risk transfer. Has any of this been factored into the Knab capital consumption guidance of 100-150 basis points, or could such risk transfers potentially lower the capital consumption? This is the first question.

My second question is on the deposit beta, which seems to be trending up. I understand your messaging that the increase from 25% to 29% mostly happened already in Q4, and this is just the averaging impact. However, how do you see the likelihood of the beta climbing above your target range of 30-35%? Maybe you can comment on the turning out behaviour you have observed.

And the final question would be on CRE. I noticed that your total US CRE book remained at €2.4 billion despite this refinancing transaction. Can you perhaps comment on, I think it is residential, why you decided to provide additional financing in that segment? Thank you.

Anas Abuzaakouk:

Gabor, let me start with the CRE, and then I will give it over to Enver on SRT and the deposit beta. All very good questions.

For the US CRE, Gabor, obviously the focus has been on office. I think the performance quarter-over-quarter down almost 20%, based on two refinancings, one which was expected, the other was not expected. However, I think it tells you a reflection on the strong position that our senior debt had in the capital structure – very positive signs.

As for the other parts of our US real estate exposure, we are quite happy to build up our residential. 85% of the book is residential, industrial, logistics and hospitality, all asset classes that have performed very well. Quite frankly, it has been a challenge even to keep those levels, given just the level of refinancing activity as well as just the limited opportunities that we have seen over the past

BAWAG Group

18 months. So that is an area, at least residential, that we are very positive on, and that is where you have, kind of, seen the growth.

However, all in all, we are really positive as to the development, in particular with office, and as I mentioned, just going through the earnings, we do believe the worst is behind us, and we are in a good position vis-a-vis the US office.

However, Enver, I will go ahead and give it to you on SRT and betas.

Enver Sirucic:

Gabor, on the Knab transaction, the simple answer is no. The 100-150 basis points does not include any SRT transactions. That would be incremental benefit if you consider something, but as I said before, we will consider it in the overall context if it makes sense or not from an economic perspective.

On the second one, on the deposit betas, you are right. So we had an increase from 25% to 29%. As you rightfully said, it is an average effect. We have seen that towards the year-end, and it remained quite flat in the first quarter. So we feel quite comfortable – despite the changed short-term interest rate outlook, we feel quite comfortable to get into that range of 30-35% at a peak for deposit betas. On that, there is any significant change in the rate outlook on top of what you are seeing today, but otherwise we should be fine with 30-35%.

Gabor Kemeny:

Got it, thank you. A small follow-up. Can you comment, is there anything you can share on the cost of the synthetic risk transfer and how it impacts your P&L?

Enver Sirucic:

We do not give the specifics, but when we look at it, it is always how much is the cost per RWAs, if you like, because that is the only comparable metric. And that has been pretty much in line also with the prior ones, which is slightly above 100 bps per RWA relief.

Anas Abuzaakouk:

And it falls in the risk-cost line.

Enver Sirucic:

And it is in the risk-cost line the effect.

Gabor Kemeny:

Very clear. Thank you.

Anas Abuzaakouk:

Thanks, Gabor.

Mate Nemes (UBS):

Hi, good morning. Thank you for the presentation.

Two questions please. The first one is on still funding costs and deposits. I just wanted to ask you about the online retail savings product by the Austrian treasury, I think it launched about a week ago. What would you expect the impact to be on competition for depositors? What are the initial signs, interest that you are seeing in your client base? Any comments on that would be valuable.

The second question is on costs. I was wondering if you could provide some further details on the cost optimisation this year that you are pursuing in the context of trying to offset that 8% wage increase you mentioned for a good three-quarters of the year. That does not seem trivial, especially given the starting point in the cost-income ratio you are at. So any further colour on that would be helpful. Thank you.

Anas Abuzaakouk:

Thanks, Mate. To start off, it is absolutely not trivial. So you are spot on, that 8% on top of 8%, it starts to add up year-over-year and just from a compounding standpoint, but this is not a large-scale restructuring by any means. Enver had mentioned just that we see various operational initiatives. That is from your physical footprint to your G&A, which is your non-personnel cost, to your replacement ratio in terms of retirements as well as attrition.

We try to really manage that to the best of our abilities, keeping in mind that there is significant wage inflation that you have to address when you start the year. And 3% is no small feat when you talk about cost growth year-over-year, but I think having the discipline and having the operating plans in place day one allows you to be able to make those – to capture that cost savings. However, it is not something that happens overnight, it is something that has a significant lead time, and we will do our best to stay within the guidance, but it is definitely no small feat without a doubt.

Funding cost?

Enver Sirucic:

Yes, Mate, on Bundesschatz, launched last Monday, I believe, and we are looking at it from a daily perspective, just also interested to see how the customers will react. We have seen an uptick in activity the first two, three days. It slowed down towards the end of the week. It is really hard to judge after the first week. The first week

was probably stronger than what we are expecting in the coming weeks to come.

Overall, the fact is, right now, not relevant. However, I guess what could happen that it increases a bit, the competition across the banks for deposits. That could be a side effect of this, but again, too early to say.

Anas Abuzaakouk:

Thanks, Mate.

Mate Nemes:

Thank you.

Mehmet Sevim (JP Morgan):

Good morning, Anas. Good morning, Enver. I hope you are well.

Just one follow-up on the US CRE portfolio, please. The refinancings that brought down your exposure there meaningfully, clearly a positive sign. Are you able to provide more colour on those transactions? For example, were these triggered by yourselves or by the debtors? Has there been any financial impact for you there? And would you see any further financings or any volume changes, so to say, in US office in the upcoming period?

Anas Abuzaakouk:

Thanks, Mehmet. One of them was an early refinancing redemption. Let me just start. Both strong sponsors. One was in Washington DC, an early refinancing. But, when you have a really strong debt yield, at some point for the sponsors, right, that becomes injecting equity or refinancing yield, is a good commercial decision. I think that was a good example of that.

And then the other one was New York, which the sponsor was able to execute a securitisation. And I think that was unique because of the quality of the asset, but also a positive sign that a securitisation was actually pulled off. And that securitisation obviously refinanced our debt position.

So two, I think really good signs, probably more idiosyncratic on the DC deal, to be honest. And I think the New York deal was one that was just a broader reflection of if you have a quality office asset, the markets are still open for business, but that is not broad-based. Right? And that is why I said I think this, the development on US commercial real estate, US office, when I say US commercial real

estate, will truly be, I think, a reflection of the dispersion in underwriting.

When we say being disciplined, being patient, risk-adjusted returns, I think this is a good proxy for that. And we will see how things develop in the coming quarters. However, I do believe the worst is behind us.

As far as refinancing or redemptions this year, it is fairly minimal, but we will see how the sponsors react. We have, I think, six years of weighted-average lease term. We like the quality of the tenants, so I think we are in a pretty good place for the remainder of the portfolio, the performing portfolio.

Mehmet Sevim:

That is super. Thanks very much. And just on Knab, is there anything additional you can share at this stage in terms of the timeline from here? Is everything going according to initial plans or any surprises you have seen, etc.?

Anas Abuzaakouk:

Still as positive as we were when we signed the deal. Obviously, spending a lot of time with the team with the target, working with regulators. There are a lot of different constituents. Hopefully, fourth quarter is, kind of, the planned timing, but we will see. And we are subject to regulatory process, and we have got to be patient. However, the idea is when we get close to closing or at closing, we will provide a lot more detail.

Mehmet Sevim:

Super. Thanks very much.

Anas Abuzaakouk:

Thank you.

Johannes Thormann (HSBC):

Good morning, everybody. Also some questions.

First of all, my usual one. On NII, we have seen a small decline due to probably less days and deposit beta. Is Q4 or was Q4 the peak, or do you expect an uplift in the next quarters again when business volumes normalise?

And secondly, on the risk cost side, normally we have a pretty seasonal risk-cost pattern, and now with this case in the corporates, probably there was some distortion. Should we expect still a

seasonal pattern for the rest of the year? And what will happen to the €80 million management buffer you have created? What do you think, as you sounded quite positive on US real estate as well, do you expect to use it in 2024, or will it rather be released at one point in time?

Anas Abuzaakouk:

Thanks, Johannes. I will defer to Enver on the NII and the risk cost.

Enver Sirucic:

Yes. Good questions, Johannes. On the NII, I think it would be fair to say that we have seen the peak of net interest margin in Q4. It was 300 basis points. It will slowly come down. I said on our full-year earnings call that we expect a very similar net interest margin for 2024, which was 290 in 2023. So it is going to be stable. In terms of peak, probably that was the peak NIM.

In terms of NII, still too early to say that. We will keep the NIM quite stable. And if you see more growth on the loan side, obviously, also the NII could be higher in the coming quarters. So that is how I would phrase it.

On the risk-cost side, the first thing is most of our risk costs are coming from retail, and most of that part comes from the unsecured part of retail. And what we have seen already over the last couple of months and quarters is that we are getting back to pre-pandemic levels. So, the fiscal support, the subsidies, less consumption that we observed during the pandemic time is just disappearing. And now we are just seeing back-to-normal scenario. That is why we guided to 25-30 basis points for 2024.

Coming back to the corporate part, we have not seen a single case deterioration or any risk costs that we need to build for single cases in corporates. What happened there is, was really ECL-driven, so model updates. And one part of that was actually reflecting new macro parameters that drove a large part of that increase in Q1. So seasonality to some extent, you see seasonality towards year-end, obviously, but otherwise retail is more recurring risk cost line. So I would say, that should be fairly stable development for the rest of the year.

And you mentioned the management overlay. So I think probably 2024 is going to be the year where we will start, kind of, reviewing the overall management overlay setup and what we will do with that.

Again, it is a bit too early to decide what exactly is going to happen, but we will address management overlay very likely in 2024.

Johannes Thormann:

Okay, thank you.

Noemi Peruch (Mediobanca):

Thank you and good morning. I have a few questions from my side. The first one is on Stage 3, if you could give us a little bit of colour on the quarterly evolution there?

And then on CRE, so you gave a bit of colour on US offices, and that is appreciated. And here I would like to ask you about some insights on your strategy and also on the market trends that you are seeing in Europe, especially in Ireland, when it comes to office.

And then a follow-up on deposit in Austria. So, indeed, we see the competition is on, now we have a new product entering the market. And I was thinking just – I wanted to know how you are thinking about the trade-off between betas and outflows, if there is a certain maximum you can withstand on one hand or the other? Thank you very much.

Anas Abuzaakouk:

Hi, Noemi. All really good questions. I will take the Stage 3 and the US office, and then Enver can deal with the deposits.

The Stage 3, Noemi, nothing in the corporate, real estate, public sector. That is just your normal build of NPLs in Retail & SME, which we will do NPL sales. However, we typically do that at the end of the year. So you, kind of, see this build-up and then is absent if the markets are frozen to not sell the NPLs. However, that is normal course of business. And you see it in the NPL ratio for retail, it goes from 1.7 to 1.8% and nothing under corporate real estate and public sector.

The question on commercial real estate, obviously, really positive development, quarter-over-quarter. I think I addressed that with Mehmet's question on our own portfolio.

To the broader market question, if you had to differentiate between the stress that we see in US office versus the stress in Europe, I would say US office is more about vacancies and the permanency of cash flow, or lack thereof, because of just the secular change in terms of workers not going into the office. And that is a very unique dynamic to the United States.

You see less of that in Europe. In Europe, it is a different issue, which is commercial real estate loans that were originated at 2-3% cap rates, that is going to be a real issue for whoever originated at those levels. That was not our book. We have been pretty clear around being disciplined.

When we say risk-adjusted returns, that can manifest itself in a lot of different ways, but you do not lend at 2-3% cap rates. That is just, you are upside-down. And I think that is where the real issue is. The building is doing well, there is cash flows, it is just a matter of the capital structure, I think, will undergo change. And that is just borne out of really low cap rates, which were not, I think, sustainable in lending in that type of environment.

It is a good point that you bring up. There is really two different narratives in terms of the stress and what is driving that. The US is obviously more acute. Europe is, to some extent, for the lenders, self-inflicted with low cap rates.

Enver, I think the deposits?

Enver Sirucic:

On deposits, a lot has happened on the deposit side over the last 12 months. And I think the retail team has done a great job, finding the right balance between pricing, being competitive, and also keeping the deposits.

So if you look at the numbers, pretty much over the last three years, our average total deposits have remained very stable in a competitive market. Overall, the deposits in Austria have not really moved, just the total market has not really moved in the last 18 months. We are hovering around that €300 billion household deposit mark, and we do not expect that to change in the future.

So there is only two things that are still happening. Not so much on price points, more on structural changes, we have seen a bit of an uptick in terms of customers switching to term deposits, but still very low. And it has not really happened as much as we expected that to happen over the last 12 months. That is one.

And the other is what you mentioned before, is we are offering treasury savings for Bundesschatz, that was launched last week, which is definitely an interesting offer for the customers, but we also try to match that offer with certain campaigns, especially through our online banking channels.

So overall, as I said before, I think our assumption, 30-35%, still holds true, and we are quite confident to be in that range for the rest of the year.

Noemi Peruch:

Thank you.

Anas Abuzaakouk:

Thank you, Operator. Thanks, everybody. Thank you, everyone, for joining and look to touch base in the second quarter or earlier. So all the best. Have a nice week.