Alior Bank S.A. 1H 2013 Financial Results Announcement August 8, 2013

Corporate Participants

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Presentation

Operator

Thank you for standing by, and welcome to the Alior Bank Financial Results Announcement call. At this time, all participants are in listen-only mode. There will be a presentation, followed by a question and answer session, at which time, if you wish to ask a question, you will need to press *1 on your telephone. I must advise you that this conference is being recorded today, 08/08/2013. I'd now like to hand the conference over to your speaker today. Please go ahead.

Wojciech Sobieraj

Welcome, everyone. It's Niels Lundorff, Wojciech Sobieraj, Witold Skrok and Fabiola Kolago-Winiarska. We would like, from the side of Alior, to welcome you at our half-year results presentation and let me start with the first pages overlooking our performance. Then Witek will go through financials and Niels with the rest of our story.

So the results of Alior, the summary, it's on page two. The long story short is that our fundamentals, we released looking at our number of customers, loan growth, deposits growth both quarter to quarter and half year - half-year they're showing significant increase and that would be from net income perspective the best quarter in Alior history, amounting roughly to 105 million net income, however, we clean up the bankassurance issue with a one-off net impact of 25 million. The gross impact on provisions in the third income that we did in the second quarter is roughly 30 million. All other issues – risk, cost control, trading results, even the interest margin in the environment of declining interest rates we guess are meeting our expectations in most of euro [?] short term.

If you look at the numbers, I would like to draw your attention on page three to the middle part of this column, of this table, where the bank is practically 50% bigger than it used to be at the end of June 2012, both on the loan deposits... On the other hand, the bank is stronger, looking at the capital adequacy ratio and is getting more profitable looking at the cost income ratios and other key performance indicators.

On page four, this would be the second quarter in our history where the cost income ratio would go below 50%, meeting our long term targets to go to the 42. That would be the case if our revenue line was not at 396 but 426, including all the way of calculating our insurance income. We've done the correction. We've changed our distribution agreements with our insurance partners, from now on, from the 1st of July. Absolutely no risk linked with the prepayment of loans is on our side. We will get slightly less compensation from the original level and, to reflect this compensation and to reflect to the bigger amount of prepayments that we expected done in 2011, 2012 and 2013, we created this deferred income with the provisions in the second quarter this year.

On next page, net interest margin, I think it's relatively stable. It's 4.1%. The negative impact on the rates cuts was still a factor, especially at the beginning of this quarter. I can say it's not as dramatic anymore. We reprised the majority of our deposit base and we believe that the net interest margin for the second part of this year can go to 4.2%/4.3%.

What helps us too, the fact the net interest margin level – it's on page six – where we feel we are showing that we are a universal bank, with roughly 60% of our revenue coming from retail clients and 40% from corporate but, if you look at our loan book portfolio, that grew by 44% half year on half year the majority of the growth comes from cash loans and from working capital financing for companies and these are the components that allow us to enjoy higher net interest margins.

We still maintain the policy of self-financing, I think, with a loan to deposit ratio on overall at the 93% level. Obviously, as can be expected, the retail ratio is much, much lower, versus the corporate. I think, Witold, if you can take this. Slide 7.

Witold Skrok

Slide 7. Fee and commission. Fee is driven by the new production. So I heard there are a lot of questions about the production. If you look at the second quarter, slightly below what we generated in the first one, however, what is important here is what Wojciech already mentioned, that we create additional provisions for the period remaining to the production which already took place in 2011 and 2012. According to IFRS, if we notice a change in the parameters, we have to adjust and create provision for the all production, give the maturity. This is why this 30 million zloty throughout, which we put the second component, is an adjustment to KNF requirements that is somewhere 11 million zloty for the first half of 2013.

If you look at the right hand side graph, it presents something which we find our target to concentrate on a life insurance. This is something which is treated as additional collateral in case of debt.

On the next slide, slight eight, right hand side, presented improvement on the cost to income ratio. We did a lot in the last 12 months, squeezing to get this ratio from 58% to 52%. We are still, I'd say we are still on the track to get 42 level in our midterm track.

If you look at the structure and the changes on the cost side.. Sorry, so slide eight. If you look at cost development, what is share of people perceived is that increase of HR costs is related, with this extension of our distribution network, especially in the form of the Alior Express plus the consumer finance, which if you look at the...

Niels Lundorff

Could we excuse for this little technical challenge? I believe that we can continue on page number nine.

We are very proud about our continued superior portfolio collection capacity. We have now a loss given default on the nonmarket retail of just 43% but we have 61% coverage with collateral, meaning we have almost 60% more coverage than we need, purely economically calculated, and this is in a very challenging market that we're continuing seeing this quality improvement in our collection because it looks alarming that we have 8.2% NPL on the retail, however, that is only because we did not manage to get that portfolio sale in June but have done it now in August. So we're going to see a drop in the NPL ratio for retail.

On corporate, on the other side, we do continue seeing some challenges in the construction sector, nothing alarming, but enough to see a slight growth in the NPL ratio and also having significant provisioning coverage for those exposures, increasing there by the coverage ratio for corporate.

Going forward, we still believe that the 200 basis points we've seen so far is giving us very good comfort that the guidance we gave earlier of being below 250, we now believe that we will be below 210 basis points cost of risk for the year.

Page number ten, market risk, nothing new from that front. We are still very conservative. We still run no FX position risk and no commodities risk. On the interest rate, we have gone out and done some hedging of the reliable interest rates, especially on the cheaper consumer loans, to ensure that the margins we had calculated upfront are also secured for approximately two years going forward.

Page number 11; the key performance ratios, return on equity, return on assets, considering this 30 million pre-tax, roughly 25 million post tax, one-off correction, we are able to conclude here that we are doing better than we have done before. We are back at roughly 1.8% return on assets. The capital efficiency, there is still some space free for further growth. So we are very pleased with that development.

Page number 12, being pleased with a development is perhaps one of the strongest measures we can do in a market like we are in is a very good growth of the market share. If you look at over the last one year, we have grown 0.5% market share under deposits and 0.6% on the loans. When you look at the single months, we are constantly doing better than the market. We are over the deposit campaigns effect from last year, where we saw negative outflows in the first two months of this year. This element of doing well is, of course, coming from something. If you look at page number 13, you see that we have grown the number of clients by 151,000 in the second quarter, which is 50% more than we did in the first quarter. It is a record growth which we are seeing here. The capacity to do this growth is very much coming from good people in the existing branches, plus adding further outlets.

If you see on page number 14, you will see have grown almost 200 outlets over the last one year. That's a very, very significant challenge to manage, to ensure that staff is well motivated, but we are doing that at a very strong capacity and we are still having a lot of unused potential, unused capacity in those new outlets we have opened. We will continue opening outlets and will continue working on new business channels. If you look at page number 15, our three strategic initiatives, consumer finance only really starting out the beginning of this year with roughly 50 million. We now have 263. We believe we'll have 800 million at year end. We have very good growth on that and when Witek spoke earlier about the cost growth coming from HR, yes, 300 people have been hired this year, purely to work on the consumer finance, most of them sitting in a new contact centre we have set up in Lublin.

Also, we are growing the mini branches. We have now 142 of them. We have opened 33 in the second quarter. The deposit growth, the loan growth is up almost 50% quarter on quarter – very, very strong dynamics. We have long term plans for these outlets and the profitability of it, just as we have long term plans for Alior Sync, Alior Sync now having 252,000 customers after just one year of operations but most of these are relatively young and not yet classic banking protocol. We have this year a very, very good insurance that, when we have an aging population from our (unclear) that we have a lot of new and more bankable customer segments going forward in the next coming years.

But we are not looking only at the next coming years. We look also at what happens in 2013. Page number 16, three major elements. We are seeing good sustainable growth on the profitability, the lending. We see good growth on our deposit gathering capacity and we still have some outstanding issues on regulatory. The profitability of business, we are very disciplined. We have a very good risk weighted return on all our customer segments, including the higher risk consumer finance loans. We have, however, some potential support coming in the second half of the year from Macro. We have now, for the first time, seen some retail spending growths in the system happening in June. This, potentially, could mean that we have seen the bottom of unemployment. It could also mean we have seen that the market now will start seeing some more lending growth and we are very ready to take a significant part of that. With our preparation on the consumer finance point of sales, we are ready where most of that consumption is going to happen.

On the deposit gathering side, we are not changing our approach. Yes, we did issue 150 million zloty bonds to 17 different buyers, 130 basis points now in June but this was more to test our internal capacity to ensure that we are fit if we will go out and do some nonorganic growth. The ability to collect further deposits is partly shown in the fact that a significant part of our deposit growth in the second quarter are coming from current account deposits from private individuals.

The regulatory elements, we all have some understanding that there is a discussion about potential increase of bank guaranteed fund contributions. I guess this is the major element we have opened right now and we also do not have any real traction on the major shareholder, Carlo Tassara's, sale of, or committement to sell at least 30% of their holding in the bank.

So far, this is the presentation. I kindly invite to questions.

Questions and Answers

Operator

Thank you. As a reminder, if you wish to ask a question, please press *1 on your telephone and wait for your names to be announced. If you wish to cancel your request, please press the # key.

Host

So I would like just to inform that first we will start from the questions from the audience present in the meeting room. Then we'll follow with the questions from the participants on the conference call.

So anyone willing to ask a question? I can bring the microphone.

Operator

Your first question comes from Ivan Bokhmat. Please ask your question.

Host

Apologies for this.

Ivan Bokhmat, Barclays

So how do you guys want to proceed? Will that be the first call from the audience or from the phones?

Niels Lundorff

First we're taking calls from the room and then we take from the remote audience. We have promised this is the way to do it so this is the way will do it.

Ivan Bokhmat, Barclays

Sure.

Unknown male speaker

We will say when we will open up for questions from remote audience. Please, first from the room.

Dariusz Górski, BZWBK

Okay, Dariusz Górski, I'm sure the bancassurance plan will probably be getting most of your attention so... We're working on a quarterly number basis but, from what I got here, your bank assurance fees were 113 last year, I mean previous quarter, 67 this quarter. So the drop is to the tune of 50 million. You said approximately 30 so could you explain the balance of 20 million, such a drop?

Witold Skrok

On the differences, it's coming from two items. The first is this slightest overproduction of cash loans second quarter versus the first one, which explained the difference of eight million zloty. The next component is more complicated but here we are talking about provisions which we created based on our own decision to anticipate behaviour of our customer which, sooner or later, they might come and they claim, in case of early repayment of cash loan or insurance contract, and this amount consists of 38 million zloty total. In this case, the majority comes from production contracts, which we sold in 2011 and 2012, and in the model, which we used when this sale came, we created provisions, but recently we observed increase of repayment, and based on that, and based on IFRS, we had to adjust this difference in valuation for the whole portfolio, which we sold. This is why this amount is significant comparing to what we observed in the past.

Host

We have a question from Marcin Jabłczyński, Deutsche Bank.

Marcin Jabłczyński, Deutsche Bank

I have a question. Starting from the second half of the year, you are going to have no risk of prepayments, right? But it still seems to be not addressing the KNF concerns, ie, you know, KNF wants to have most of the bancassurance provisions accrued over time, and this is the approach to cost efficiency from other banks operating in the market, ING Bank Śląski from yesterday. I guess most of them actually accrue most of the revenue. Do you plan to introduce further changes, to basically be more compliant, you know, so to speak, with the central practice of accruing more versus, you know, up fronting more. Because it seems to me if you are going to still, you know, collect up front, most of your provisions, and I think you said that your bank fee is 7.5%, which you collect up front, right?

Witold Skrok

Well, to make the whole bank insurance transparent and clear, and we enter into new contract with our issuers, so it means that the whole risk related to that early repayment post-production activities would be taken by the insurance company. Those two elements were addressed in the letter, which received the whole sector that this part of the revenue from the insurance is not certain. This is why KNF claim to spread over this part of the revenue accrued, because there is a risk, so if you have the risk according to IFRS, you have to exit this revenue.

If we take out this uncertain revenue and shift to the insurance company what left in Alior is only sure revenue and this is why it would be recognised fully, up front.

Wojciech Sobieraj

Would the (unclear) insurance companies are not doing this for free and taking this risk for production, so we receive slightly less money from them, and the slightly less money is expected to be at the level of 11 million per the revenue, if we are not growing the business.

Marcin Jabłczyński, Deutsche Bank

A quarter?

Wojciech Sobieraj

No, half year. And this reflects virtually the same 11 million that we created for the first quarter, and with this extra provision that Witek has mentioned. So there are two components for this extra provisioning: one is that growth in early repayments higher than we expected for the use in portfolio, and second component of this is to reflect on production that took place in the first quarter this year, as if we had had the new contracts with the insurance companies, and these are roughly 11 million for half a year.

We are not doing any work with this insurance contract, or the post-production or the risk of prepayment on the insurance side, and according to the auditors, according to the insurance company and us, and hopefully KNF. This addresses all the questions that we received from them in the letter. Because it fulfils all the criteria o IAS 18, and saying that this is… the revenue should be booked as fully at the time that it comes to the bank without any risk, so I think the money we receive are no subject to any risk of the… other than obviously the credit risk, which is the part that we are taking that the loan is not being replaced, but this is definition.

Witold Skrok

Maybe just one small comment, how this additional provision shall be interpreted, it doesn't mean… we put them as a cost, but it doesn't mean that fully and will be converted into cost, because we already launched some retention work, and if we improve this ratio of repayment, we will recalculate again this provision; it may happen, but I'm not going to make any promises, but it may happen that, let's say, in the future this repayment ratio will be lower. It would allow us to reduce this provision.

Wojciech Sobieraj

There's one more sentence in our calculation. We… in the first quarter it was 113, 116. We believe that the revenue from the insurance for this third and the fourth quarter should be in the range of 90 to 100 million, including the effect of increase of sale that is expected in the second part of this year. So 90 to 100 is the overall income from the insurance that we believe it's possible in the first… in the next two quarters.

Host

Okay. So still opportunity to ask questions from the audience present in the meeting room.

Paweł Kozub, UniCredit

Paweł Kozub, UniCredit. I have a question about your provisioning in the second quarter, because as far as I remember, you did some 8-9 million zloty release on the IBNR, and can you explain why, given the fact that your portfolio and the coverage deteriorated in the second quarter?

The second question relates to your earlier statement related to your appetite for acquisitions, either portfolios or banks on the Polish market. Can you comment about your current state of any kind of discussions that relate to any acquisitions?

Niels Lundorff

Sure. If you go back to page number nine, you will see that the growth of NPL from 7.4 to 8.2, as I mentioned, is linked with the fact that we have not managed to sell out of the portfolio in June. We have done that in August. So we are not seeing any further deterioration of the portfolio.

On the opposite we are seeing a significant improvement, because as time is passing by we're getting more and more strong data to back test our models, and this back testing of the models now means that we have a provisioning model for the non-mortgage loans, where we in average have a loss given default of 43%, but we have 61% coverage ratio. So there's no deterioration in the portfolio.

In terms of appetite for acquisition, we have a good appetite, and we have a very strong capacity to take in further loans. We are in discussions with another little bank about buying a portfolio, even of non-performing loans, because our capacity is much stronger in the collection work than most other banks, even in Europe, but there's nothing specific I can tell at this stage. It doesn’t even mean that it's sure there will be a transaction.

Operator

Okay, from the audience, once again, if you want to ask a question, please press star one on your telephone.

Niels Lundorff

We will tell you when we have finished in the audience in the room first.

Wojciech Sobieraj

We were able… Oh. Okay. So far we were able to back test, and the… our… both IBNR and the actual provisions for one part of our portfolio, which was the non-mortgage retail. This portfolio is maturing now, so we can calculate loans given default behaviour, the vintages, and so on. We believe that we might have the same case in two other parts of our portfolio. One is micro and one is mortgage. We will do all the effort to prove that our provisioning for the micro is again too conservative, and we will probably try to do it in the second quarter of this year, second half of this year. The mortgage, unfortunately, must wait, because it is still relatively young, and so ..

Niels Lundorff

We do not have too many cases to bank.

Wojciech Sobieraj

And we don’t have too many cases. So there's one part that is still missing, which is the micro.

Host

So any following questions from the audience in the room?

Unidentified Male

If I may, on trading gains, I mean, again, we look on it from a quarterly perspective that in the past couple of quarters the plan is to bring 40, 50 million; all of a sudden it's 78. So if you could give us more colour as to what was driving such a good growth, or such a good result on trading, and, more importantly, the outlook for the line, going forward?

Niels Lundorff

The main element of the growth is coming from very strong the cooperation with mid and large cap customers, and a small part of it is also coming from hedging the interest rate on some of the variable interest rate consumer loans.

Going forward, we believe that the range we have seen now, we will not exclude that this is a level, which we could continue seeing, but we are also very pleased with the growth, which we have seen. The customer activity is spread out on a very large number of customers. There is very little concentration; so good guidance going forward is still seeing some very high levels. If it’s going to be 78 in the third quarter or a little bit lower, I cannot promise, of course, but there's nothing, which we would consider too much of one off in this position.

Host

So, any more questions?

Izabela Rokicka, BRE Securities

Iza Rokicka, BRE Securities. I just have one more question on the fee income and the insurances. You have mentioned that there's a lot of cash loans this quarter was lower. Could you share with us what was the volume of the sale? And the last, this guidance on the bank assurance fee for the third and the fourth quarter this year, what kind of sale of cash loans it assumes?

The second question would be more on the capital adequacy ratio. You were mentioning that you were considering the acquisition of the loan portfolio, and I believe you want to continue grow organically. For how long the current capital base will be enough, or basically we see that the capital adequacy ratio is dropping from the quarter-to-quarter, and how long you can maintain the current level of the growth of that portfolio?

Witold Skrok

The first part of the question; for the first time upon your request we put a number about new production in our report, so you will get in due days what was the number and volume of new productive cash loan. In the second quarter this slight decrease. It's not in the presentation but in the report, and this slight decrease is around 5% quarter to quarter.

What is important for the future, this is a level which already Wojciech mentioned, we expect to have 90-100 million zloty revenue from the insurance, and as far as fee and commissions is concerned, I think that I covered all your question. So…

Wojciech Sobieraj

To be maybe more specific about the reason for decline, for slightly slower growth in volumes of cash loans in the second quarter of this year, we started… the first quarter of this year we had the good production. However, we ran the campaign that was called the Guarantee of the Lower Rate. The Guarantee of the Lower Rate we invented in the fourth quarter 2012. Then it was copied by our competitors here in the market, and then led to the client in the overall net interest market in this product.

We didn’t want to participate in this war, and we increased… that was one of the reasons why we defended our net interest margin, and with… at the cost of slightly decline in growth of the volumes, comparing with the first quarter. Obviously we expect the volumes… we promised the net production of the overall loan would be a level of 400 million. Currently we are 590. We will definitely meet the target of 400 maybe we go above that, and that the appetite for consumer lending and cash loans is linked with our distribution and also we believe that the fourth quarter, as usually, it will be very nice for us.

Now, covering the question about the capital adequacy ratio, the… I must a little bit correct what Niels has mentioned earlier. We are looking at the portfolios, but to tell that we are ready to acquire one, that we are in a negotiation room, that it’s gonna come, I think is not the case yet, so I would like to draw your attention to the base case scenario, which is basically the organic growth, without any other, other than testing any other bonds issued by Alior, and in this case I think the capital adequacy ratios and the capital in our calculations is enough.

Bear in mind that in previous years we did all this every quarter to, not to put more capital in every quarter. The net income for every quarter was added to our capital base. This year it’s not the case. This year we'll add the net income at the end of the year; that obviously improve our ratios.

It might happen; it might happen that our lending ability grow to the level of 590, as it is currently, not 400 that we expected. Obviously we like this business to be in a slightly bigger exposure, especially when it comes with the FX component that Niels was referring to earlier, but this is currently as unlikely as our acquisition of the portfolios, and it’s eager to above the volumes up to this 590, and 400 how much, it was produced in the cash loans.

Some of you say that I'm doing a lot of micro management. I can tell you that yesterday we sold four 10.8 million, so this… the net production, daily production of net loans is 10.8 per day, including all the channels. I think yesterday was slightly average day for the (unclear) for the third quarter.

Host

Any following questions? Then we…

Niels Lundorff

Then let us open up from the remote audience. There's still possibility to ask questions from the room here, of course, when they have finished their round. Please, Operator, open for questions from remote audience.

Operator

Okay, once again, if you wish to ask a question, please press star one on your telephone, and wait for your name to be announced. If you wish to cancel at any time, please press the hash key.

Your first question comes from Ivan Bokhmat. Please ask your question.

Ivan Bokhmat, Barlcays

Hello. Thank you for the presentation. My first question would be related to the outlook for 2013, which I understand from the press reports you are slightly bringing down from 414 plus to between 380 and 400. Can you elaborate a little bit on what is behind this decision, given that, for instance, growth or margin were quite favourable in this quarter? And secondly, would you be able to elaborate a little bit more on the bank assurance recognition, and the exact nature of why you think you will not have to accrue more proportion of your bank assurance income over the life of the contract? I'm sorry; I may have not heard that over the line.

Wojciech Sobieraj

Let me take the first part, and then Niels will take the second part of the question.

The reason why we are looking more conservatively at your forecast because we haven't done ours, but we acknowledge this for one part of the beginning of the year, and now we're saying it's going to be roughly 25 million net. It's linked with exactly what we've done in the second quarter, which is the extraordinary… which really leaves one off event linked with a different booking of the insurance linked revenue. I'm saying different booking, because this was deferred… the provisioning and the deferred income.

We believe that the expected 11 million lower revenues from insurance in this third quarter and the fourth quarter, as the 90-100, can be maintained, and we, as we have mentioned earlier, we started entire profits in all our branches to get the repayment levels at the level that we're achieving our original model, rather than one that materialised in our bank in the first half of this year. So all in all the impact of the insurance, which we've done in the second quarter of this year, is the only arithmetic reason 414 minus 25, somewhere in between 380 to 400. Why? Because all the other areas of our growth are roughly in line with the, you know, all our expectations.

Niels Lundorff

And the reason why we believe that we will have no issues any more with this IAS 18 discussion is that we are totally removing any discussion about do we have a very strong model to assess the future work we have with this type of insurance, so if the client changes that risk we have to inform the insurance company and we have to set our very advanced model to assess what is the work linked with that versus the revenue. This we are totally eliminating, because we have no further work with this. We're also eliminating the potential uncertainty of early repayment because, until now, we had a part of that if the client comes at an earlier stage than the finalisation of the loan, then we have to calculate a proportional part of the insurance to be resettled to the client. Also, this, we are totally eliminating from any model uncertainty, by handling in a new contract with the insurance company, where we do not have that… elimitation the risk on our side. It's fully on the insurance company.

Ivan Bokhmat, Barclays

Okay, and would that mean that your future recognition would move to 100%? Or stay at 87% up front?

Niels Lundorff

It will… Hello. It will be 100% of this significant reduced level. So arithmetically you will say it is a lower proportion, from the old level, but we're reducing the old level and converting that into 100%, based on having zero risk from model of early repayment and future work, and the only challenge we still have open, but there we have no problem as Alior Bank is that the underlying product still have to be profitable. This is the third requirement from IAS 18, but here we have no uncertainty, even versus any model verifier.

Ivan Bokhmat, Barclays

Okay, thank you. And maybe just one final quick question, you mentioned in your statements that you're using the new loan last given default model, and I think you've alluded that it was applied to consumer loans here in recall. Is it also applied to corporate loans?

Niels Lundorff

It is. Hello? It is potentially possible to have further data to do back testing of that model, also for micro customers, but we have not yet gathered sufficient data to have the back testing at a level, which both we and our auditors can be satisfied with, but there is a potential, going forward, with that as well.

Ivan Bokhmat, Barclays

Thank you very much.

Unidentified Male

(Overtalking) if I can …

Operator

Thank you. The next question comes from Daniel Cowan. Please ask your question.

Daniel Cowan, Morgan Stanley

Yes, hello. I wonder if you could give us an idea of the competitive pressures that you're seeing on the unsecured retail side? A number of the bigger banks in Poland now are talking more enthusiastically about cash lending, not only to existing customers, but also to new ones. Can you give us an idea of how competitive pressures might be changing, or not, and how you're responding to the?

Niels Lundorff

I will give you first some numbers. Wojciech will give you a little bit from his travel to see the branches.

On page number 12 you will see our monthly production of loans. We have absolutely no slowdown in the percentage growth, so… and we are continuing being bigger and bigger, so in terms of absolute total production of loans, this is retail in total, both mortgage and cash loans. As was mentioned earlier, we have seen a little slow down in cash loan production, from roughly 450 million in the first quarter to roughly 380 million in the second quarter, and it is nothing, which we are considering as a significant challenge from total numeric point of view, but perhaps a little bit from market presence, Wojciech?

Wojciech Sobieraj

It's… I think there are really two components. One is that everyone can claim that increased share of the product that is high margin, but there are two things that might be… must come with this statement. One is the increase in the distribution, and we are presenting ourselves as a bank with one, almost 200 more distribution places in Poland at the end of June 2013, versus June 2012. We are the bank with more than 1,200 more people, all of them client facing, sitting in physical branches and the headquarters, which is the guys in the headquarters are basically the call centre in Lublin, and this is one part of our advantage.

The second part of our advantage is the consumer finance model that's now required a really significant IT effort to get linked with the large retailers, and to tell you the truth, we haven't lost a single large retailer, and we haven't noticed anyone from our competitors coming and giving them sophisticated IT systems, which allows them, which allows to match the selling system of the large retailers with the credit assessments from the bank side. We can do that.

Now, the… Maybe… The third component is the ability to assess the risk, properly, and to get the vindication up and running. I've mentioned about our advantages a number of times on the collection system, central number of IT different portfolios, but we also, quietly, revealed our physical network of collectors in Poland, and I think that we… what we see here is the loans given default at a much lower level than provisioning for the retail. We believe this might be the case for the micro. It's still to be tested. No one developed this further. The Polish banks, our competitors, are mostly following the strategy of get a loan and then sell it to the specialised lenders.

Not to be overly optimistic, we've noticed that there's one very dangerous part, which is to get into the price war of net interest, of… because… of cash landing. And we've noticed some of this happening at the first quarter, and I think the… We set up the price control unit centrally, and we eliminated all the negotiation… We're still very competitive, but we don't want to add competitive pricing and the local ability to give even extra to the client, so either/or. And I can tell you that on this specific product we're able to improve our net interest margin, and if I'm looking forward to the competition, this is the only thing that worries me. That some of the competitors being able to fulfil better distribution, better risk assessment, and better collection, can also play with the price.

That's so far hasn't happened.

Daniel Cowan, Morgan Stanley

Excellent. Thank you. Just one more question, on development of costs, you've done very well to keep a lid on operating expenses in the first couple of quarters, but I think you have flagged that the roll out of the mini branches will pick up in the second half. Can you give us an idea of how that's going to impact the cost base in Q3 and Q4, please?

Wojciech Sobieraj

If I'm looking at page 23 here and comparing the cost base for the first quarter with the cost base of the second quarter it's 5 million more. At the same time, if you look at the line which is HR costs it is 10 million so it explains more than the difference. We are really cost conscious on all other aspects. We were able to maintain the costs that are related with our real estate headquarters and the branches. I have to apologise to some of you that instead of Aleje Jerozolimskie you must travel to Łopuszańska. We develop our distribution base of not agencies but 100 more our own place, our own shops and there is a zero increase in the rent, in maintenance.

Why? Because our first branches are coming out of their five year cycle and we are renegotiating the real estate prices. I expect this cost development exactly the same way for the next two quarters of this year, ie, we will be able to maintain all our other costs at the decent level, at the same level actually and the only increase will come with the number of newly opened branches which we plan, there's now additionally 50 branches times, 5 employees so I think this is all what we plan in increase of our costs. No major significant investment also planned for the second part of this year, similar to Sync (unclear).

Daniel Cowan, Morgan Stanley

Thank you very much.

Operator

Your last question comes from Paul; Paul please ask your question.

Paul Formanko, JP Morgan

Good afternoon, Paul Formanko from JP Morgan, just on the costs how will this work with the stock options; how are you planning to expense that going forward? Where are we going to see it in a cost base?

Witold Skrok

Stock option which… It was a valuation made when the stock option was released and based on this valuation the costs are current on the quarterly… on the marketable basis. You had the chance to look at the volume on the quarter results. The overall impact at the valuation was intimated that 28 million zloty for three years. As you may know, these consist of three parts and for the first year we would book the cost for the first, second and third tranche, altogether it would be around 50 million zloty.

Paul Formanko, JP Morgan

And this will be done this year?

Witold Skrok

The valuation is accrued, as I said, on a monthly basis and one warranty will be granted based on the performance but the decision would be taken month April next year but it would have no impact assuming that the structure, so number of people and the number of shares allocated to the person is not changed. It would has no impact on the valuation and profit and loss above what is booked based on the valuation.

Niels Lundorff

Paul, to be very clear, the initial valuation of this Warrant Programme is not changing. There is a monthly periodization of each of the three tranches, one split over 36 months till 2015, one split over 24 months to 2014 and one split over 12 months to 2013, part of it. As you see, this year this is the largest year because we have allocation both of the 13, 14 and 15 part of it. And for the first half of the year it was 6.5 million, so for the whole year this will be 13 million for this year. Next year it will be lower, because that is only a 24th part and a 36th part which will be hitting next year.

Wojciech Sobieraj

What Witek was referring to is that accounting rules, the accounting rule that calls for change in this. These are the people that are currently part of the Warrant Programme they are changed are remunerated for their performance. And bear in mind, that Supervisory Board that needs to look at our performance, look at our performance versus the other banking stock in WIG Banki. And then they look at the individual performance of the person within this group of managers and if the person is given zero because she or he's not performing, there's no change at all in what we currently booking.

If the person is booked the same as it was planned there is no change in what we put in our portfolio. Only in the case where the Supervisory Board is so generous to increase the warrant to some of us then it will be the effect. I think this the situation for 2013 is very unlikely.

Paul Formanko, JP Morgan

Thank you and a follow-up question on the interest margin trends you have had a stabilisation quarter which seems more or less in line with the sector but we're also aware that you've booked some fairly expensive deposits in Q4. So are we still going to see some positive impact from a re-pricing of these deposits in the third and fourth quarters? And are we seeing now NIM actually arising as it's been the case for some of the smaller banks that have reported so far their second quarter numbers?

Niels Lundorff

It is very clear that there's still room for re-pricing of the term deposits both for private individuals and for corporate clients. We have in the note to the financial statements, we have a very detailed split of what is the average interest rate for that period in the different product segments per customer segment as well. And there you will see the term deposits for private individuals and corporates being relatively higher, even above the existing interest rate. So, yes there is still room for improvement there.

There's also room for improvement of the NIM based on getting more of our current account holders having their salaries paid to the accounts. We have seen a very positive development in the second quarter with that [unclear]. There's also room for improving the NIM by seeing a further strengthening of the non-mortgage retail loan growth and a significant part of that will come now in the third and fourth quarter when we're seeing the consumer finance picking up to the level which we are expecting and it's following very well our expected trajectory.

Paul Formanko, JP Morgan

Thank you, Niels for the answers.

Operator

There are no further questions at this time; please continue.

Niels Lundorff

Is there a question from the audience here?

Marcin Jabłczyński, Deutsche Bank

A very short question on your corporate business which got little attention so far in this meeting. You are reporting a lot of big tickets in the corporate side and I think, Mr President you mentioned that you would like to do a traditional asset business and no real lending commitment. How come that you do a lot of lending commitment and you plan to continue at the same pace? It seems to be like 200 million plus, you know, lending tickets these days.

Wojciech Sobieraj

Don’t like large corporate. Don’t like this sector at all. I think my colleagues in the Board they kick me now under the table not to say (inaudible). I would be happy to continue growth in the mid and small sector but unfortunately, let’s face reality there is no demand for investment loans in the sector coming. So instead we look at the corporate sector but these clients that are giving us the small business and what you see now in our FX income it’s partly the reflection of both FX platforms but, for some of them are more sophisticated products that links this corporation with our treasury department. Our treasury department is now considered to be definitely in top ten, maybe in top five in Poland. So they are equal partners to large corporates.

I think over time I would be very happy to report the growth in both segments, in mid-size companies, basically the business that comes from the branches, as well as from CDS - Centrum Dużych Firm, the centre of large corporates. Centrum Dużych Firm currently in Alior is six times as big as it used to be before we IPO-ed. But every single client from this group is going through the same scrutiny, through the same profitability calculation, same calculator and we are not destroying our return on asset or return on equity going into the relationship with this client.

Our goal, again, in this sector is have the ROE above 20 all in, no definitely from the credit products. So, all in all our strategy is the same to maintain the well balanced growth retail, small and mid-size companies and the large corporate sector.

Niels Lundorff

Based on a 12% tier one ratio we have an average return on equity of 50% before cost allocation on the large corporates.

Wojciech Sobieraj

Which means that if the cost income ratios are 50% so the 50 goes to 25. This is very relatively.. this is to the segment but only for those clients that are not only pure lending but other services and I don't know practically of any pure lending clients from this group.

Niels Lundorff

We have only two participations in syndications where we do not have turnover. All other corporate client relationships are business, daily business where we have a significant cross-sale and a very strong understanding of the risk because we see the monthly inflows and the quality of these monthly inflows.

Host

Do we have any other questions from the audience in the room?

Kamil Stolarski, Espirito Santo

Kamil Stolarski, Espirito Santo. From the comments coming from the head office it seems you have another recommendation on bancassurance officially to be known in September and all the details will be known by the end of the year. And I just wonder do you see any risk coming from here and what is the worst case scenario for your fee and commission? And second question, any update in Polbita, do you still expect to sell this year?

Wojciech Sobieraj

On the bancassurance case I think… On the bancassurance case I believe that we are now seeing the worst case scenario. I can't imagine anything that can come but I'll answer first what is the proposal of the new regulations about to come to the market. I think that we've done all necessary changes to fulfil the requirement of KNF conservative requirements because, to clear the issue that are around bancassurance. On the other hand, Polbita I think we have first of all improvement of the daily results of Polbita and it's good.

I'm thinking of two or three potential scenarios, one is sale this year, one is sale after the fourth quarter results because in this business the results of fourth quarter are usually much, much better than all other quarters combined. The third option is part related. One, because we see the improvement of the Polbita rather than deterioration so I think too early a sale is not (inaudible) at this stage.

Niels Lundorff

Plus we are acting as collateral agent so it's true it looks in the commercial register we are 100% owner but we have loan agreements in consortium with another institution and we are taking such positions in corporations.

Wojciech Sobieraj

Let me reconfirm, it's not our intention to stay in Polbita, we want to exit the Polbita just what I'm referring to is on the timing of this; is it in the four quarter of this year or is it the first quarter of next year or is it a partial?

Male Speaker

Have you conducted more debt to equity swaps in your corporate loan book other than Polbita to last couple of quarters?

Niels Lundorff

No. No single.

Host

Okay, so still we can take the last question. Do we have question from the audience present in the room?

Marcin Jabłczyński, Deutsche Bank

Maybe just very brief… in your corporate business is 140% so it seems to be, you know, lending is much more important than deposit cash management. Do you plan to change; do you have like internal target for loan deposit in your corporate book?

Niels Lundorff

The whole sector has a loan to deposit of 240 so we're very pleased with the fact that we have such a low loan to deposit ratio. We try to present it as, kind of, clapping our own shoulder, but it's very, very clear that where the whole corporate sector is sitting on something like 60% plus of total loans in the whole banking sector this is only 30% of total deposit. So we have a very, very positive ratio here which is proving that we have major customer relationships with our corporate customers.

Host

Some last question? Maybe from participants on the conference call is there any other question on the conference call? Then thank you very much for attending our results announcement meeting. Apologies for the inconvenience caused by so little space in the room; next time we will have to potentially get a ballroom, I guess. Thank you very much.

Operator

This does conclude the conference; participants you may disconnect.