**ALIOR BANK S.A.**

**ALIOR BANK 2016 EOY RESULTS ANNOUNCEMENT**

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Edited transcript

**Speakers:**

Wojciech Sobieraj, CEO

Witold Skrok, CFO

**Wojciech Sobieraj:**

Welcome to our conference and let us start with page 3, the summary of 2016 for the Bank. It was a pretty busy year for Alior which we proud to end according to our plans for very solid base growth. Business as usual; on comparable terms grew by almost 60 percent, without banking tax and without any financial implications of the BPH transaction.

The BPH transaction itself has been concluded on the legal side in the fastest track on the Polish market and, on the top of that, we're having now the operational track as we promised. Over the weekend, March 25/27, we'll merge both banks on IT basis, which will be fastest banking merger on the Polish banking scene for years.

It was also very strong growth on our base business. Loans grew by almost PLN 7 billion year on year on Alior alone, and we also managed to improve the loan to deposit ratio to 90 percent. So the loan growth was fully financed by the growth from both Alior internal and the transaction with BPH.

We maintain high net interest margin, we slightly lower our cost of risk, and capital position has been enhanced due to the capital raised in the mid-2016.

On next page, some more details about the BPH merger because this is very important step in the history of Alior. The bargain purchase generated on the transaction after (all these reviews) amount to PLN508 million. We're on track to realize all the synergies that we promised. Actually, the good news is that the synergies after calculation will be PLN70 million higher than our previous forecast. The previous forecast was PLN160 million generated by the restructuring program by BPH alone plus PLN300 million of our own synergies. Now we are revising this to PLN370 million.

All this restructuring and synergies are as done. We've already started the restructuring of the whole company; 670 layoffs have been already concluded in January and February prior to IT merger. Now after the merger we (just counted) and we have the second largest numerical distribution network in the country with more than 1,100 outlets. It's clearly more than enough to play in the major league of the Polish retail banks.

We believe that the network can be restructured to roughly 880 branches, which still be one of the largest in top three, top four, in the country, and we are planning to accomplish this task by the end of 2017. There will be only two or three real estate (spaces) which would require slightly longer periods to exit. Most of this not only HR-related but real estate-related synergies will be realized in 2017.

In the meantime, as we promised, we are not just reducing our headcount left and right. We are doing this in a slightly different fashion, because, as a result of the merger, we would like to build very, very strong IT engineering, financial engineering powerhouse, not only in terms of the transactions but in terms of real coding and being able to be a major player in API based banking in the new generation of the developments that are about to come.

So now we have 700 people strong IT engineering platform. We do not have any intention to reduce them and the results of their work will be, I hope, very, very visible; first in this short and fruitful operational merger, that we will announce on March 25/27 as I mentioned, and then following by the new initiatives that we will cover later of these new initiatives. The most important, definitely, is the rolling of the new mobile and Internet platform that is currently in the last testing phase. Then, in March, we'll start with the friends and family and it will become live in May this year.

Next page, well, last sentence, which is somehow unusual, because usually the banks that are merging they are shutting down the development on the IT platforms for years. We will be able to come to the market with new solutions as early as two months, or even one month after the merger.

On page 5, this is the new Alior; the new basis. If you look at the bottom line, the net profit for this year from PLN309 million last year grew exactly by 100 percent to PLN618 million. I know, on the next pages, we are cleaning this out from the extraordinary events. Most of the Polish banks reporting their results they report the extraordinary event linked with the Visa payoff, but we haven't received PLN 1 from Visa transaction. But we have been through this complex transaction with BPH affecting the financial results of the Bank. So on this page, the overall new Alior net profit for 2016 is PLN618 million.

On next page, there were three blocks that we would like to cover to explain this PLN618 million. First, is Alior standalone on a comparable basis, where it's Alior comparing with Alior 2015. Then, it's the impact of BPH for the last two months of the year, where we consolidate them after the legal merger. Then it's the financial aspect of the transaction, this PLN508 million of gain of bargain purchase, of which, from this PLN508 million, we were able to create the restructuring provisions and reserves for integration costs for what we incurred in 2016. But also, what we will pay in form of redundancy packages for 2017.

So block number one, on page 7, is the Alior as it is, without any impact of the transaction with BPH. Total revenues grew by 18 percent; the total costs practically was at the same level. On the fourth quarter, you will see later, it's even lower than last year, so costs are strictly under control.

The bottom line on the comparable basis, excluding the banking tax, we are really pleased to see the 57 percent growth on comparable profit before banking tax. Even after the banking tax doesn't look very bad, the growth from PLN309 million to PLN360 million. So this is the Alior as you know it; Alior as it used to be.

Now, the next part is the two months of consolidated results for BPH. What I can say, BPH can do much better than that. This is just the beginning, so it's not a loss. But it's nothing for now; nothing to be substantially impacting the bottom line of the new larger Alior.

Page 3, this is the explanation of the PLN508 million. It's basically the four components, of which one is the gain on the transaction. Mainly, this is the difference between the book value and the price that we paid.

The second block, the PLN313 million, this is linked to the fair value, which is the difference between the book value and the net present value of the future cash flow mainly from credit operations. Then adjustment for tax and other adjustments adds together to this PLN508 million. This amount of money will help us in two ways.

First, due to this transaction, we were able to create this provision, that I will cover later, in 2016, which would allow us to have better results in 2017. Also, it helps in our capital position for the Bank. Obviously, the PLN313 million, because it's a difference between net present value of the future cash flows and the book value, this will be amortized over time, but it will be amortized over the period of five years. So it helps us in our capital position, whereas this PLN282 million, this is the impact without any form of amortization.

The last block, this is the level of restructuring provisions that we've created. Most of this, almost 80 percent/90 percent, is linked with our agreement signed and approved with the trade unions in the last weeks of 2016, on the basis that we know how much we're going to pay in restructuring costs and redundancy packages for the staff.

On page 11, you see the financial impact. Because of this PLN282 million bargain price that we've paid, we were able to cover the 2017 HR optimization cost. Then, integration cost that you will see in 2017, they're going to be much, much lower; they will amount to PLN195 million versus the PLN447 million that we planned previously.

So the previous version and the current version of the restructuring costs means that both in 2016 and 2017, we'll be able to report the results better than we anticipated prior to our transaction.

And last, but definitely not least, this is the difference of the PLN70 million that we believe that the synergy targets can be improved. So PLN160 million that BPH restructuring is done, finished, over. We're very happy that this restructuring program was concluded in a satisfactory fashion. And we believe that we can achieve more than we expected, looking at the line-by-line cost reduction facilities in both banks.

So this is the highlights of this pretty busy year, and for the operational performance measurements, let me pass to Witold.

**Witold Skrok:**

Thank you. Page 14. When we announced the deal, we mentioned that we will focus on two legs: the business as usual and transaction. And if you look at the growth of loan volume, we grew by almost PLN7 billion. We are number two among the Polish listed banks, so we delivered what we promised in terms of the development of the business. And, as Wojciech mentioned before, also the second target, the project and the transaction were delivered on time and the better results than we expected.

What is important, if you look at the split of the loan growth, you can see that we are very solid and we are standing under two legs, corporate and retail. Contribution of BPH to the loan portfolio is almost the same as we experienced in Alior, so there's a very good combination. And for us, it's important to explore the unused potential in terms of the profitability of the loans which we acquired from BPH.

Next slide, slide 15; Wojciech just mentioned that loan to deposit ratio, 90 percent, gives us enough liquidity buffer for loan growth in the course of 2017. What is also important, and it will have an impact on the net interest margin, that we are acquiring deposits with a lower margin. So gradually, the old Alior deposits will be replaced by cheaper deposits acquired from BPH.

And the second point important is that, in the course of last 12 months, contribution of the current deposits increased significantly, almost by one-third versus what we had one year ago. So it means that we are reducing the cost of funding, and these are the target for 2017.

On the next page, you can see the credit risk performance and this is just business as usual. We disposed significant NPL portfolio. This improved our NPL ratio and it had also impact on the coverage ratio. As I mentioned, there is no significant -- no risk and the portfolio which we acquire in 2017 is even better quality than the stock which we had at the beginning of 2016.

On the next slide, net interest margin development, and I'm pleased that, for the second quarter in a row, Alior kept a net interest margin of 4.5 percent. And this is bearing in mind potential reduction in the cost of funding, plus the certain speculation about market interest rate, I can see that the potential for net interest margin improvements.

On the next slide, fees and commissions. What is important that on this slide, but you remember the bars and the split, what is important that the provision of fees and commissions from banking transactions replaced the short of revenue from bancassurance. It is our policy to reduce this component in our revenue streams.

However, we already informed our customers about new fee and commission charges. It will be in force since March this year, so the full effect will be seen in the second quarter of 2017.

On the next slide, capital position. We are well above the level required by our regulator. Please remember that, at the end of last quarter, this year only profit retained earnings from the first half contributed, so there is still almost PLN400 million which will improve this ratio but we have to get approval from our regulators. We already filed the letter to get such approval.

On the next slide, cost development. Wojciech just mentioned that we are very disruptive in this aspect and the cost base, without one-off, quarter to quarter is even lower. We reduced the costs almost by 10 percent. Please remember that savings remedy plan launched by BPH, plus restructuring which we also announced and in Alior, will reduce the cost base in 2017.

On the next slide, number of branches, numerical distribution network, we are number two, but it's not our appetite and further reduction will be announced, will be seen.

So thank you from my side. Wojciech?

**Wojciech Sobieraj:**

Looking into the future, slide 23, 2017 outlook, I must tell you we have the problem with the slide because we have a long tradition, since 2012 when we were listed, to comment upon the consensus of the market. This year, when we look at the three latest, it's PLN360 million and for the first time, we will not say that we feel comfortable with the consensus. We believe that this is too low. We'll beat these expectations in 2017, for sure.

We will maintain the net interest margin at the 4.5 percent level. You can see we are struggling with the fees and commission, so we are not charging. In the course of 2016, we haven't charged clients extra for current accounts, for instance. On the other hand, as a result, we achieved a current accounts to total deposit ratio the 50 percent plus level, which is comparable with the largest banks operating on the Polish market. And we would like to maintain this very healthy net interest margin level, at the same time slightly improving our fees and commissions component.

You remember that we would like to get into this PLN100 million per quarter target. Now, with BPH, it will be easy because we're already at PLN91 million. So I believe that our target for this year for the combined Bank is PLN110 million of net fees and commission per quarter.

I must tell you that one of the most important tasks, and difficult ones to accomplish by the IT merger for March 25, is the IT platform for the business clients that was run and operated by BPH. We are expanding the platform to our clients and although it was created eight, nine years ago, it still is one of the most advanced platforms for cash management and transactional basis for these small and midsized companies. And we would like to switch these functionalities to Alior clients, counting that it's going to create us another flow of fees and commission.

As to cost/income basis, we don't need to prove that Alior is not really a big spender, so wherever we can save costs, we will, and we will achieve on a standalone basis. This year, our goal is 45 percent. Counting on all the restructuring costs, one-off and so on, it's going to be 60 percent for cost/income for 2017 goal.

Cost of risk will be reduced, not significantly because of our mixture, but I think the level of 1.9 percent is achievable. And the loan growth, we are expecting to be not lower than this year, to be on the safe side, for PLN6.5 billion is what we have in our budget.

So this is the outlook and we are really happy with the results of 2016. And we are open for questions from your side.

**Piotr Bystrzanowski:**

Thank you. Now it's questions from the audience in the room.

**Dariusz Górski:**

Dariusz Górski, BZ WBK. Congratulations on your good score. I have a question relating to page 11, first. The PLN195 million in cost of integration that you expect to incur in 2017, will this be P&L or expense cost? Or will this show up in the balance sheet? This is the first question.

Second is, why not actually provision against it in 2016? You had room, given that how much badwill you had.

And if this is a capital reason which you have mentioned, the third question is about your capital, because I did a very rough calculation and it looks that, even if you include the remaining part of 2016 profits, you will only have room for 10 percent growth in RWA.

**Witold Skrok:**

Thank you for this advice. Let me start from the last of your questions. I also made very roughly a calculation and, our outlook for 2017, the loan volume is PLN6.5 billion. You should apply the average risk-weighted 85 percent, it gives you growth of risk-weighted assets by less than PLN5 billion, so it will require PLN500 million of the net profit.

So we finished the first quarter with PLN160 million net profit. We finish the year with PLN618 million. It gives us almost PLN50 million of net profit. If you add the profit for the first half of 2017 there is enough equity to grow as we announced.

So that is the third question. Now to the first one. Yes, we considered to do that but we cannot provision only this cost, which we can prove that will be materialized. So all lay-offs, all restructuring costs of the distribution network, when we reach the agreement with the trade union, we can say that it will happen. And there is no doubt that they would materialize; therefore, the condition for creating such a provision were fulfilled, and this is why we only, let's say, part of that we can recognize.

The remaining PLN195 million, unfortunately, we have to leave for this year. And this is the next answer to your question, is that PLN195 million is a profit and loss impact.

**Dariusz Górski:**

I will continue. I know this is a bit of a naive question, but this is the third round of estimates of synergy costs. And I know it's naive, but what are the odds of you again under-delivering? You already cut your estimate three times in a row, so maybe there is a chance that this will not be PLN195 million but less.

**Witold Skrok:**

It seems to me that there's a misunderstanding, because we are talking about synergies. So it means that we will deliver more synergies, more saving. There is, from saving synergies, PLN300 million to PLN374 million, so it will have the positive impact on the bottom line. At the same time, we're just shifting the integration costs because of the provision from 2017 to 2016, and it will improve the bottom line in 2017.

**Wojciech Sobieraj:**

The total cost of restructuring was never increased by a single PLN; it was maintained at the same level as we expected. It will not be higher than PLN500 million. On the other side, the synergies that we expect, the savings from this transaction has been improved by PLN70 million. So I think, calling this under-delivery is --

**Dariusz Górski:**

I basically thought that your early estimates of restructuring costs were higher and so they're basically coming down. These two figures are the same. So my question is, is there a chance that it will do better than PLN195 million?

**Wojciech Sobieraj:**

No, the costs associated with the restructuring, obviously, at the first stage were our estimates. Then we are getting into the two major components, which is the negotiations with the trade unions, so the package, and one by one review of the real estate. And the third component is the review of the service providers' contract, amortization and IT spending.

And two months after the legal merger, i.e., after we got the full access to the books of BPH, we can say now that we are comfortable with our estimate of PLN100 million and we do not expect this to go lower. To reduce the cost below PLN500 million would be difficult, although we will be trying, obviously.

**Marcin Jabłczyński:**

Marcin Jabłczyński, Deutsche Bank. I have a question on your cooperation with PZU on the operating side. Are you planning or maybe conducting now any participations together in innovations lab, or are you transferring products from the reinsurance side to your business or vice versa? Is there a transfer of your knowledge to what PZU is doing? How deeply is this cooperation going between you and your main shareholder?

**Wojciech Sobieraj:**

We have a number of initiatives launched between us and PZU. All the commercial initiatives are on an arm's length basis, so obviously we are selling some insurance, although not a lot. You see only PLN12 million revenue per quarter from this aspect. And here, we have PZU and other partners in this field. We are using the services of PZU to ensure our properties, people and clients.

The area of the closest cooperation with PZU so far is the area of asset management, where we have launched projects together. PZU is becoming an important provider of asset management products for our clients, and we are becoming more and more important for their distribution. But also, this is on the arm's length basis.

We have some initiatives announced on the cost side to share some costs with them, and what you've mentioned is the, first the relative, beyond the obvious. We are trying to work together with PZU on the more innovative side aspect. It will be a subject of our strategy day, which I already invite you for March 13 and 14, when we will talk more about the projects for the future. Some of them we are doing separately, some of them we are doing jointly, and some of them we're sharing the knowledge with them.

So I wouldn't say it's two separate units, but it's a peaceful cooperation, I would call it.

**Marcin Jabłczyński:**

And maybe my last question. On your M&A strategy, you were very close to acquiring an asset; the market was nervous because it would require another capital increase. Since you walked away from the deal, the share price obviously rebounded very, very strongly. What's your future approach to M&A? I think you've mentioned that you'll be ready operationally to conduct another deal sometime in late 2017. But what's your appetite, say, for more assets?

**Wojciech Sobieraj:**

To answer for your question, one is the business logic and the other one is the appetite. So from the business perspective, I would say nothing has changed. As we planned, as we announced earlier, we are ready. We will be ready as early as April 1 to go into another transaction, so from this aspect, from the technological and engineering management attention, we are ready.

It's not enough. We need to have also appropriate transaction on the table, which currently we are not looking at any transaction. We need to prove to the market that what we promise in capital raise in 2016 for the BPH transaction we deliver. And I think that the results so far, looking at the cost of synergies, the timing of the entire operations, the synergy delivered, prove that we are doing, in all the aspects, as we promised or even better.

Starting from the transaction itself, we never planned PLN508 million negative goodwill of the bargain transaction; it's better than expected. The cost of synergies are lower than the original plan, but at the PLN500 million, now looking at the overall synergies which is above in total PLN160 million plus PLN370 million, it's the level of PLN530 million which means that we achieved what we quietly counted on, which is to have the synergies bigger than the one-off cost.

So we hope that if market conditions, owners, allows us to go into other transaction, we'll conduct another transaction in the same smooth and profitable fashion as we are doing with BPH. However, I must strongly reinforce here that no transactions are on the table whatsoever and we are not looking at any targets at this point. It's probably the first time in the history of Alior that we are not in any data room.

**Michał Konarski:**

Michał Konarski, mBank. From outlook, we can see that you are expecting a net interest margin improvement. And if you could tell us what is the reason behind it? Is it all about the deposits cheaper funding or are you expecting some rate increases already in 2017?

And if you could present us some sensitivity for the rate hikes of net interest margin of the new Alior with BPH?

**Wojciech Sobieraj:**

In our forecast for 2017, we do not expect the interest rates going up, so if it goes up, it's going to be better. What I can promise you, in case of the sensitivity numbers we will deliver. There are two parts. We slightly can improve our net interest margin. We are very happy with the current 4.5 percent level; we can go to 4.6 percent, 4.7 percent maximum. Two reasons for that.

First is that, when we launch the new Internet and mobile banking, we believe that the proportion of current accounts to the total deposits can go even above the current 50 percent level. We are not dreaming to jump directly to the ING levels, but I think, over the course of time, we can enjoy cheaper funding from more balances in the current accounts.

We believe that we will maintain most of the current accounts and the cheaper funding from the former BPH part, because for all the former BPH clients, we are never cutting a single product that was supported by BPH that they will not be supported by us. So they receive the same or even more what they had in the past, which is also somewhat unusual in the merger side. So this is on a deposit side.

On a credit side, on the loan side, first of all, we would like to maintain our balance, 53 percent to 47 percent that is currently for this year. We will be balanced Bank. We don't want to boost our net interest margin to become a personal loan monoliner. We have no intention whatsoever to go into the mortgage price war. If it's not profitable for us, it's not profitable for us. We will not be obsessed with the league tables. We've seen, in the last quarters of 2016, some aspects of the price competition on the Polish market to with, again, margins going below 2 percent. It's not for us.

And the other aspect that we would be looking very carefully on is the corporate lending. And we would like to stress, again, that we have no intention of building out positions in the large corporate sector, which is characterized by lower margins. It's not a market segment for us. We believe that, for all our corporate clients, relationship by relationship we can maintain at least 14 percent ROE level for the segment. Obviously, much higher in small business and in micro companies a little bit lower in a middle large but all in all 14 percent after cost of funding, after cost of capital, after cost of risk is our goal for the segment.

**Witold Skrok:**

Let me add one sentence. There is also one aspect, because if you look at the profitability of the corporate customers on BPH side, this is slightly below our standard. Also re-pricing for the customers from the former BPH, it will bring additional positive impact. And as for our sensitivity, 100 basis points give us roughly PLN80 million bottom line on an annualized basis. So it depends also on timing.

**Kamil Stolarski:**

A number of questions. First of all, when it comes to this calculation of impact of BPH, you commented in your financial statement that you came up with some numbers which were denied by GE and I think it's about PLN92 million/PLN94 million. Is there a big difference between your estimates and GE estimates or what should be the --?

**Witold Skrok:**

I haven't heard about GE estimates, so it's difficult to comment.

**Kamil Stolarski:**

So they simply denied your calculations and now you are preparing the new one or what's the process now?

**Witold Skrok:**

Well, what calculation done by GE do you mean?

**Kamil Stoalrski:**

(inaudible - microphone inaccessible)

**Witold Skrok:**

In our financial statement there is information about further negotiation with GE. So yes, there is some element but it's immaterial.

**Kamil Stolarski:**

OK. My next question would be about synergies. You said that you will have more synergies; are those synergies more on the cost side or on the revenue side?

**Wojciech Sobieraj:**

In our calculations we never include the synergies on the revenue side. This is add-on, counting all the revenues on the synergies side which is very, very small. That would be add-on, for instance -- so long story short, this PLN70 million of additional synergies are coming from the cost side. If we are able to reprice, for instance, some of the unprofitable corporate relationships, or pass on the product of BPH the cash management product to our clients, it will be extraordinary on top of this expected PLN370 million.

**Kamil Stolarski:**

Thank you. On page 37 of the presentation you presented the details of this wind farm portfolio. My first question would be this 3 percent of loan book, do you mean your Alior standalone loan book or is it the loan book of the combined entities?

**Wojciech Sobieraj:**

Total, combined.

**Kamil Stolarski:**

Total. And you have made some --

**Wojciech Sobieraj:**

Sorry, the percentage is only for Alior alone.

**Kamil Stolarski:**

Only for the Alior. So it's like --

**Wojciech Sobieraj:**

It's 3 percent of the former Alior loan book, so combined.

**Kamil Stolarski:**

Combined.

**Wojciech Sobieraj:**

Combined.

**Kamil Stolarski:**

OK. So it's like PLN1.4 billion, more or less.

**Witold Skrok:**

Yes.

**Kamil Stolarski:**

And then you provided us with some guidance for the provisioning for 2017 and it's like PLN40 million to PLN60 million. I wonder what scenarios have you assumed? You assumed that there would be some further regulatory changes or you assumed nothing new will happen or --?

**Witold Skrok:**

We assumed that the scenario will continue in the course of this year and no negative changes in the course of 2017.

**Wojciech Sobieraj:**

Nobody had done worse.

**Kamil Stolarski:**

OK. My last question would be about the comments coming from PZU about dividends and whether you could be considering something?

**Wojciech Sobieraj:**

OK. Well, this should be on the last page. OK, on Monday, March 13, and on Tuesday, March 14, we'll be showing the strategy for Alior for 2017 to 2020. We will, I think, thoroughly review the (technical difficulty).

**Operator:**

Ladies and gentlemen, the conference has now ended. Thank you for participating, you may now disconnect.

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