ALIOR BANK S.A.

ALIOR BANK Q1 2016 RESULTS ANNOUNCEMENT

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Edited transcript

Speakers:

- Wojciech Sobieraj, CEO
- Witold Skrok, CFO

Host: Good morning, everyone. Welcome to Alior Bank's Q1 2016 results presentation. Today, our speakers are Wojciech Sobieraj, CEO, and Witold Skrok, CFO. Gentlemen, please start the presentation.

Wojciech Sobieraj: Welcome, everyone, we will walk you through a short presentation on Q1 2016 results of Alior Bank, and then we hope to get some discussion during the Q&A session.

So, briefly, Q1 2016 for Alior Bank was a little bit unusual – for the first time since 2008, Q1 2016 was better in terms of loan and deposit growth than Q4 of the previous year.

Alior is maintaining its balance between the small business and retail clients, 43% of small retail companies and 57% of retail clients. Therefore, we are also subject to seasonal movements in retail banking.

This was, quite honestly, for the first time on the Polish market that the first quarter of the year was better than the previous quarter.

Capital position has strengthened as we promised. We used these three methods. At the end of Q1 2016, we got the portfolio guarantee from PZU. For Q2 2016, after gaining the approval of shareholders last week, we are in full speed going to the capital markets. We hope to finalise the transaction between 7–15 June, so the capital will be registered by the end of Q2 2016.

One important phenomenon in the life of Alior in Q1 2016 was signing the SPA and all the other contracts with GE for the acquisition of the Core Bank BPH.

We are happy with our C/I development. There were some seasonal movements, but at the end of the day, for the first time, we achieved our annual targets. By the end of Q1 2016, we were already below 48%, which makes us believe that by releasing the merger-related costs and benefits, Alior is on the way to achieve a C/I ratio below 47%, or even 46%.

CoR is now at a comfortable level of 2.1%, again the lowest in the history of Alior. Usually, our CoR guidance is somewhere between 2.2–2.3%.

Our income from fees and commissions has increased. I believe that the highest quarterly result from net fees and commissions for Alior was at a level of PLN 93 m, and with this quarter it was PLN 87 m. Looking at the composition, regardless to the bancassurance, the Recommendation U, and all these issues are gone. It was a particularly slow quarter for the brokerage. We hope to get back to the PLN 90+ m per quarter level in fees and commissions quite soon.

So, this is Alior in a nutsell, these are the highlights for Q1 2016, and now I am passing to Witold.

Witold Skrok: Good morning, slide 5. I thought it's important to highlight is growth of loans which we achieved in Q1 2016, our record quarter ever. Usually, as you remember, we percieved the last quarter as the harvest for the banking sector. But looking at the Q1 results, these show that we have achieved the best quarter in sales and production of cash and loan products. This is important, and we are very proud of the results.

Our net profit was PLN 80 m, slightly lower than last year, but the circumstances are completely different. If you multiply this quarterly net profit by four,[you will see that we are almost done in terms of the guided net profit for the entire year.

The main coefficient Wojciech has already mentioned, C/I, is below 48%. L/D is 91%, capital adequacy ratio and Tier-1 - at the safe level.

On page 6, you have our loan book split. We grew by 19% q-o-q, and 13% in Q4 2015 vs Q1 2015. If you look at quarterly development, please bear in mind that Q2 2015 was flat, so if you compare Q1 2016 vs the end of June, this growth is close to 20–25%. What is important is that we are growing in all our products and segments at the same pace. We are a stable universal bank; we are staying on very favourable terms with business customers and intermediary bank borrowers.

Slide 7, deposit base. L/D is 91%, and I would not call it as our success, but our medium-term target for this ratio is close to 95%. So, it means that we are overliquid in Q1. We will use this liquidity buffer to fuel the growth of the loans in Q2.

When we met last time, we discussed a lot our interest rate prospects. I think that now our expectation that market interest rates remains as flat as in the bank, so I believe that we will be able to increase our share of retail term deposits in the deposit base.

On slide 8, you can see credit risk overview. I would sum up this quarter as very boring quarter: we are almost at the level of the previous quarter. Retail growth of the NPL portfolio is in line with our expectations and our CoR development.

Slide 9, net interest margin. You can see that we experienced quite a drop in NIM in Q1 2016 vs the previous one. At the same time, CoR was significantly reduced, so NIM after CoR remains flat. One of the reasons was that we allocated sales to our existing customers. We know their risk profile, so we offer lower margins bearing in mind that CoR will be at the same time lower.

Wojciech Sobieraj: If I can drop in… Last year, if you probably remember, we invested more than PLN 36 m in a new CRM platform. We did not want to test it during the Christmas peak, but from 1 January 2016, we started to offer to our clients. That is how growth of our loan portfolio was mainly done. This is also a new phenomenon for us in making a better use of our client base. I will come back to this issue later.

Witold Skrok: The second part that we show on the slide is growth of the AFS portfolio, from PLN 4.2 bn at the end of the last quarter to almost PLN 6 bn this month.

Next slide, fees and commissions. We are on track to our plan towards quarterly fee and commission income, i.e. PLN 90 m q-o-q. This is a baseline. What is important to highlight is that we cover all negative factors, and we are able to offset a lot of income from this line. However, there is a lot of potential, especially in the brokerage fee, Q1 - as you know, was the best quarter for our exchange.

What is important to highlight in this respect is that we enjoyed a drop in fee and commission expenses from PLN 61 m to 51 m. You remember that when we met last time, we explained that we had booked the cost of acquisition of the T-Mobile customers and recognised this cost in Q2 2015. So, that was a one-off, and in Q1 2016 there is no such one-off.

Next slide, slide 11, capital position. When we met last time, we said that we expected to go through one of the three approaches. At the end of the day, it turned out that the best in terms of the profitability was to get a guarantee from our strategic investor. We signed the deal at the beginning of March, and after that we enjoyed very solid Tier-1 and TCR ratios.

Next slide, slide 12. Wojciech has just mentioned that we had already achieved our 2016 targets. What is important, if you look at our bank, we have three banks ahead of us, bank 2 and bank 3. The difference is just minor. So, our ambition is not to be a number four, but maybe, a number two or three. But it all depends on the cost associated to the transaction.

If you look at the cost in the financial statements, you will see that we showed growth of wages and salaries. This is explained by the increase of the FTEs in Romania. The Romanian project is going ahead, so we have people in our head office and in Romania allocated.

At the second point, we hired 130 advisors for the micro customers when we launched the new products. These are unique products which we just started marketing at the beginning of Q1 2016. Our customers can get four products in one process. So, we believe that it will bring revenue in the next quarters.

Wojciech Sobieraj: This is a simplest straight processing of credit loan for Polish small and mid-sized companies. We were developing this product through the whole 2015. The product has been tested and is now available in all our agencies. The branches started at the beginning of April, and we hired and trained 130 people to focus on small and mid-sized loans.

Witold Skrok: Slide 13, customer base. We cross-sell to over three million customers, so this is where we are now. It is important that we are acquiring customers through all channels, and we believe that this trend will be able to continue in the next quarters as well.

Witold Skrok: The next slide, slide 14. We ranked fourth largest distribution network among Polish banks. But this is the banking sector and the banking environment has been changing. So I think there is no competition to be the number one in this category. And I believe that in the light of the forthcoming integration with Bank BPH the number of combined entities will be different.

Wojciech Sobieraj: Thank you, Witold. We go to page 16 to comment on our T-Mobile cooperation. I think it goes quite well, and we are satisfied with the progress. Q2 2016 will be definitely the first one with more than PLN 2 m of loan sales per day. We were very close to this number, with a PLN 171 m increase in Q1. I think our cooperation works on all fronts. The financing of telecom equipment works particularly well. The last bullet point on this page is about credit cards. Actually, I forgot to mention it earlier, but we believe that net fees and commissions is another area for potential growth. We can beat PLN 90 m per quarter, or even get closer to PLN 100 m per quarter with our credit cards. We were not sure if the credit card business would be profitable considering the decrease in interchange fees. However, since we have noticed that the number of transactions among our clients grew by 87% y-o-y, including small ticket transactions, I think we will be pushing credit cards more to the clients in our channels, in Alior, and T-Mobile franchise.

Another important development is taking place in Romania this quarter. We are starting to hire Romanian people, as we mentioned. Our weekly letters that go to the employees are now being translated into Romanian, and I think that all the integration and IT works go quite well, and we will confirm the start of operations in Romania in Q2 2016.

In closing, I think we would like to maintain the 2016 outlook with some comments. The 2016 consensus is PLN 322 m. Last year, we grew by 10%. Here PLN 320 m is PLN 80 m times four quarters. For NIM, we confirm that 4.3—4.4% is not our level. 4.5—4.6% are the levels that we will achieve. The C/I ratio will be below 47%, it is our goal to go below 47% this year. CoR, again, we believe there is some room for improvement, especially if our cross sell client base expands. In consumer finance, we are strong number two in Poland, in instalment loans. We are building our strong position not only in electronics, healthcare and other products, but our position in furniture market segment increases and strengthens. We believe there is potential for lower risk credit financing in this segment. Loan growth in 2016 is another area where we can experience better than target results. All in all, I would like to get back to the 2016 guidance at the end of Q2, not to fall into a very positive mood after Q1. There are still some things to check and verify. If anything, we do not expect any deterioration from Alior after Q2. This is what I can say right now.

So thank you very much. We are now open for questions.

Host: Gentlemen, thank you very much for the presentation. We are now starting the Q&A session. We will take questions from the audience in the room and then we will follow to the remote audience. Please let me know if you would like to ask a question.

Marcin Jabłczyński / Deutsche Bank: Thank you for the presentation. My question is on T-Mobile clients. I think, in one part of the presentation you are stating that there are roughly 300,000 clients, and in another it is 600,000 clients. So what is the correct number of T-Mobile clients and why is there this difference?

Witold Skrok: You remember Alior Sync at the beginning of cooperation with T-Mobile, so we are calculating and showing stock and it is 500,000 including Alior Sync clients. The number of customers acquired only by T-Mobile is 300,000.

Wojciech Sobieraj: At the beginning of the cooperation we pushed about 250,000 Sync clients. Sorry about this, it should have been properly communicated. The true number that was acquired from T-Mobile is just about 300,000.

Marcin Jabłczyński / Deutsche Bank: Just for T-Mobile, could you share details about the P&L of the whole project, T-Mobile in Poland, so that we could get some flavor on how it goes in Romania in terms of the incremental additions to the business.

Wojciech Sobieraj: I think Q1 2016 was the first quarter when the project was fully profitable. As I mentioned, I think, since we are starting with a different product range in Romania and there is different pricing over there, we expect that gaining profitability on the Romanian market will take 12 months from the start. In Poland it took, I think, 16 months to get to the profitability. As to the overall impact for this year, the bottom line would be, I would say, low tens of millions zlotys of net profit per month. So it will be profitable and, if it is, it will be PLN 10—20 m for Polish operations. With such a strong growth in the last quarter, we were selling PLN 1 m per day. Two quarters ago it was PLN 1 m per day. In Q1 2016, we were selling PLN 2 m per day. If it goes in this state, it will be closer to […]. It is too early to give a forecast.

Marcin Jabłczyński / Deutsche Bank: Maybe just one last question from me. In terms of your production, core production, do you attribute this to your cross sell and to your CRM platform and if so what kind of percentage of the growth? Your cash loan grew basically by almost half million, so what percentage of that would be cross sell and what would be new clients?

Witold Skrok: Our target is to improve our cross sell operations because we are not satisfied with the current level. That is all that we developed previously in 2015, and we started to use the production scale in the last quarter. The last retention package for former customer from Q2 2015 - I strongly believe the production which we enjoyed in Q1 is at the level that we will be able to achieve in the next quarters as well.

Wojciech Sobieraj: I think it is fair to say we would like to maintain the balance between the channels and the products, so we will not be pushing one side. We see the increasing demand for corporate lending and consumer loans. We thought that Q1 would be worse for us in terms of mortgages, because of the higher loan payment combined with the end of the subsidised programme, and some aggressive approach by the market leader. Actually, q-o-q, this was a very, very good quarter: 450,000 new production in mortgages and new production in instalment lending. I think it's fair to say that it was good in all channels.

Dariusz Górski / BZWBK: BPH has reported for the first time their core business numbers. I am under the impression of the loan book growth. The question is, what are your thoughts on the development of the Core BPH, especially the loan book, in the interim period, with respect to the loan book? Does the agreement provide any size of the loan book at the exit or not?

Witold Skrok: A good question. There are two aspects here. When we signed the SPA, it was agreed among the parties that BPH will run a Remedy Programme update, and some business-related KPIs were incorporated in this agreement. So, in our valuation we estimated a slight development of the loan portfolio in the interim period, but this is a good sign, and it is above what we expected.

Wojciech Sobieraj: Yes - indeed, the size of the loan book is within the KPI parameters, directly and indirectly. So, we are looking not only at the execution of the Remedy Programme in the sense of cost cutting, but also at the revenue line and at the asset side.

Kamil Stolarski / Haitong Bank: I have a question on costs, a general one. Looking at your numbers y-o-y, the FTEs are down by 7% and the number of branches is down physically. If you put everything together, actually the cost went up by 7%. I wonder why we have different dynamics in the number of employment and branches, and why the cost is up.

Wojciech Sobieraj: I do not want to go into the accounting issues: it is usually a little bit higher in Q1 because of the taxation, and the burden is 18% vs 14% for the entire 6,000 people of Alior's staff. The phenomenon is explained by employing people for the new push, which is SME, and the Romanian operations, plus people being hired for the T-Mobile operations. As we have mentioned earlier, the way that the Alior branch network evolves implies transformation of some smaller branches, which were particularly useful for the transactional purposes are being transformed into the agency network.

We are experiencing a 28% decline y-o-y in the number of cash and non-cash transactions at the branch level. And we are strengthening the staff for the advisory services called "the premium branches". Here the number of staff is higher. Our prime coefficient here is the productivity per PLN 1 of salary and non-salary for HR-related costs, and this coefficient increases and improves over time.

As to the Romanian project, we need to hire people first to train them to be able to sell in the Romanian market. I have mentioned it earlier that we are strengthening our IT capabilities in Krakow. Our plan is to hire at least 80 new employees this year, and 130 employees will go to SME and this branch restructuring that works in both directions. I think you will not see such a spectacular growth in HR costs over the course of this year. You can treat this Q1 as slightly unusual.

Witold Skrok: Yes, and just to provide the whole picture, the growth is 2% in Q1 2016 vs Q1 2015. So, during the last twelve months staff costs grew by 2%.

Kamil Stolarski / Haitong Bank: Yes, I meant the total cost. And a general question on the cost of risk in cash flow. If I look at the numbers for the banks that had shown this numbers. Actually, the cost of risk in non-mortgage retail loans is down by 60–80% in 2015, compared to what they reported in 2009, 2010 and 2011. The cost of risk of these banks is gradually going up. Looking at your numbers, I wonder why we cannot see a decline in the cost of risk.

And one more question. Some other banks comment that the cost of risk in the retail segment is at the level which is cyclically low. The comment that we have is that most likely, when the market cycle changes, it will go up. I wonder what your situation is and what you expect. Please, make a general comment on cash flow.

Wojciech Sobieraj: I think our cost of risk is not reduced by 60–80% because if we do that, you will ask us the same question: why our net interest margin is so low. So, I think what should be taken into account is the combination of these two coefficients. I think there is a number of things to be taken into account in the cost of risk for consumer finance. It depends on whom we sell the product to, through which channel, and on the composition of the product itself, because we can talk about a cash loan, a credit card, an overdraft, a cash instalment loan. These numbers are not really comparable.

Our business model is closer, probably, to the old portfolio of Santander Consumer Finance, which is now becoming part of the big BZ WBK. Looking at the differences and the developments on the markets for 2016, I guess we will have a big impact of the 500+ projects. On the one hand, there will be higher demand for consumer lending. On the other hand, we will see a huge number of families that will be moving from the para- or semi-bank segments into the bank segment. They will be eligible for loans. Then we will see some improvement in the short-term cost of risk for these credits because some of them will get out of [inaudible].

In the longer term, I think that is why we have the proper IBNR. I do not believe that now we are at the very bottom of the cycle, we are definitely on the right side of the cycle because the unemployment goes down. But you are right, if the market situation deteriorates, then the behaviour of the cash portfolio will be worse. That is why now is the right time to invest in the restructuring, recovering, and collection to improve the long LGD.

Kamil Stolarski / Haitong Bank: OK, thank you. And the last question is related to page 24, where you present the sales of retail loans. I wonder if there was some restatement for the last three quarters when it comes to cash loans.

Wojciech Sobieraj: Restatement? No.

Kamil Stolarski / Haitong Bank: So, can you comment on where was the growth in sales of cash loans coming from in Q3 2015?

Witold Skrok: Q3 2015?

Kamil Stolarski / Haitong Bank: Yes.

Witold Skrok: The loan production is explained by Meritum.

Kamil Stolarski / Haitong Bank: Thank you.

Wojciech Sobieraj: This was the first quarter when we had Meritum; then we had the Christmas quarter with 1.7 bn. We know that Q1, when people go for winter vacations, is usually horrible, however, to our surprise, this one was bigger. And Q3 was about the Meritum consolidation.

Kamil Stolarski / Haitong Bank: I was asking because the numbers for the last quarter were different from the historical ones, but I understand now. OK, thank you.

Host: We have one more question.

Marcin Jabłczyński / Deutsche Bank: BPH said today that they sold cash loans of PLN 540 m in Q1 in this part of the bank that you are buying. You sold PLN 1.8 bn. Should we assume that you are going to sell together PLN 2.3 bn of cash loans every quarter, or, maybe, in a good quarter? Thanks.

Wojciech Sobieraj: More than that, because we will really be the number two player in all fragments of consumer lending, not only cash loans, but cards, overdrafts, instalment loans. I think we publicly stated that our ambition was to be number two in the market, just after Santander Consumer Finance. GE invested in cash loans, in consumer lending, in Poland at least, so I think there is a lot to build on. Obviously, this is from the sales of this particular product. But as regards our merger plan, we believe there will be some dissynergies. When we merge the two networks, there might be some temporary decrease in income. Not all clients will stay with us, some of them will find the closed branches unacceptable, but we will be looking at this very closely. One of the areas where we do not expect any deterioration is cash loans. The other one is SME, where we believe our offers will be improved.

Marcin Jabłczyński / Deutsche Bank: And maybe the question should not be addressed to you, but I think there was some pushback among trade unions, and possibly also the regulator, in terms of the way BPH would like to structure their branch network going forward, i.e. kind of removing all the branches outside of the regulatory to basically the entrepreneurial base model. Do you see any kind of threat to this new model from either trade unions, or the regulator, or any kind of stakeholders involved? Thank you.

Wojciech Sobieraj: I think the process is being performed well by the current management of BPH; they know what they are doing. There was a transparent process of negotiations with the trade unions, concluded and publicly announced, with the terms and conditions of the process publicly known. I think everyone knows that this is not a nice process to go through. But to answer your questions, I have never heard of anything from the regulator's or stakeholder's side. I think the process has gone well so far. We have not received access to all the details yet, but to the best of our knowledge, it goes well.

Host: I see that we have no further questions. Is that right? OK, if we have no further questions from the audience present in the room, operator, please open the line for the Q&A for the remote audience. Thank you.

Operator: As a reminder, if you wish to ask a question on today's call, please press "*1" on your telephone keypad and wait for your name to be announced. Your first question comes from the line of Alan Webborn. Please, ask your question, your line is now open.

Alan Webborn /Societe Generale: Good morning, it's Allan Webborn from Societe Generale. Thank you for the call. Clearly, a good set of volume numbers in Q1 in a context where the broader Polish market is clearly stumbling, certainly on the corporate side. I know you are slightly isolated in terms that you are a small bank and you are growing, but how do you feel, particularly in the non-retail parts of the business, how the competitive environment is moving? And are you having to make any compromise on margins in order to grow your volumes, because it's something that some of the other banks appear to be alluding to? So a general view of how you are feeling in terms of the competition on that side of the business would be interesting.

And I think secondly, what is your opinion on how pricing trends in retail, and particularly on the unsecured side, are going to progress in the context of a banking sector that is under profitability pressure as a result of the extra burdens that have come on to profitability for the sector this year. And whether you feel it is rational that the pricing can improve and can stick, or do you think competition will prevent that? That would be really interesting to hear your views on that. Thank you.

Witold Skrok: […] the credit verification process for these companies is becoming easier and easier. I believe that with the e-government's program one day we, as the banks, will have access to those files for individual clients, for social security files for individual clients, as well as for the tax offices, which would streamline the whole process for corporates as well. So I am very positive on looking at the small and midsized companies.

The second part of your question relates to the price pressure in retail business. First, I do not know if this has anything to do with the change in macroeconomic environment but, for some strange reasons, I do not see any price competition or very little price competition on the Polish market in Q1 both on deposit and on the credit side.

Easier, if any, I think it is always linked with the risk. So, Alior was the first to offer a 30% – no asterisks, no gimmicks – 30% discount in the credit costs for the best clients. If they served their loans in other banks for one or two years, they would have the 30% discount coming and switching the volumes to Alior.

I think this campaign was a great success. I would not mark it as price competition because it was linked to price with a specific client segment. So the clients with group 1 and 2 on the credit portfolio scoring increased in Alior's portfolio a lot. This was improved by BZ WBK, who also offered some discount to the best performing clients. So it is always price vs quality of the loan book.

Last year, as you remember, some of our competitors were jumping to the market with a flat 4.99% rate. And I think these times are gone, so we do not see any more of this flat price competition regardless of the product, regardless of the segment.

Host: Operator, do we have any further questions?

Operator: No, we have no further questions at this time.

Host: All right, so I guess that we can finish our presentation today. Thank you very much for attending the meeting and see you at the next quarter presentation.