Alior Bank S.A. Q1 2013 Financial Results Announcement Call May 9, 2013

Attendees:

Wojciech Sobieraj – Chief Executive Officer of Alior Bank S.A.

Witold Skrok - Deputy Chief Executive Officer of Alior Bank S.A.

Niels Lundorff – Deputy Chief Executive Officer of Alior Bank S.A.

Michał Hucał - Deputy Chief Executive Officer of Alior Bank S.A.

Please, if you have questions during our presentation, please feel free to ask them in this room and on the internet and we'll tackle them during the presentation and at the end. So first I think the highlights of the Q1 results are very simple. What we've told to the market in publishing of our prospectus last year and going to the IPO – once again thank you very much for your support during this process – we are just delivering. The strategy of Alior is very simple. We haven't stopped investing in expanding our distribution network and the new projects Alior Sync, Alior Expresses and then consumer finance in 2011/2012 and now we can have results of such a strategy. In the first part the revenues are up 32% year on year versus the cost increase that is only up by 11%. The situation will be similar in the future. Delivering to our published target which is 42% cost income ratio at the end of 2015. After the results of this quarter we feel more comfortable that this can be achieved. Net profit is at the 91 million level which is higher, much higher than first quarter last year. Loan growth in line with internal assumptions about 400 million net growth of the loan book per month. I think we are on target in our growth. The new client acquisitions is going ahead. Even we'll be faster than the expected. Because usually… Alior is now a big bank and we are going through the seasonality cycles if we want to get 400 000 clients of entire 2012 then gaining 100 000 clients the first quarter is not a bad result, knowing that this is the lowest period in the year – winter, winter holidays and so on. Pressure on net interest margin obviously coming from the changes in the macroeconomic environment but also our actions from last year when we ended up the year with huge buffer of highly paid by us, bearing high interest rates, deposits. We are… this period is over these deposits are gone, the ratio – credit to deposit is changing – however we're still maintaining our strategy which is to be self-financing and always have a buffer between the deposits and loans. Key financials here on this page comparing ourselves versus the first quarter 2012 and the fourth quarter 2012. The fourth quarter 2012 obviously it was a lot of distortions that were coming from events linked with the IPO. These events — good for us, because we had enough of IPO actions since

2011…ended in 2012 – we are focusing on the business this year. These are gone so the best way is to compare us versus the first quarter 2012. And if you look at the… I would like to draw your attention to three numbers here – net interest growth, loan book growth and fees and commission income growth. And the growth is bigger than our distribution network growth. We are bigger than last year – first quarter last year we are roughly 15% bigger in terms of our weighted distribution size. We have more people, more branches, more clients than last year so I would say half of this growth is definitely coming from the expansion but then we are very, very happy with the store by store growth which is well and above the market averages. Loan books I mentioned we are better than or roughly better than expected by some 400 million net in loan books growth per month. Here I think of what some of you call the positive jaws between the revenue and the costs and this will be the picture that we would like to show you quarter on quarter on quarter that our cost base will grow on a moderate level. This year we will not have a huge investment in Alior Sync but we are not stopping investing in branches, Alior Express branches, we are not stopping in expansion of our consumer finance. Consumer finance is a good example. Every week we are signing up new stores. In order to get into new stores you need some investments – IT linkages and so on. Then you start issuing the loans to the clients that are taking the installment loans for furniture, for electronic goods and so on. Only after the first cycle you are starting to cross selling them with new products. So obviously at the very beginning it's still an investment and we are not changing our policy to show you the positive results quarter on quarter, which will be based on moderate increase of the cost base and a faster increase of the revenue line leading us to as I mentioned earlier 42% cost income ratio at the end of next year. At the end of 2016 – sorry, but maybe we can reach it faster.

Net interest margin? Page number five. We're very pleased to show you that we are keeping NIM at 4.1 % despite the fourth quarter campaign we had for retail where we had more than two billion zloty at a very high promotional price which ran out in February and also the rate cuts in the fourth quarter had its effect because of the time delay between opening a term deposit based on the old rate, and keeping them till capable re-pricing on the new basis. We have also, as Wojciech mentioned, started the consumer finance entry – there's almost a 100 million zloty with a small negative margin in the first quarter. And we have in second half last year entered more and more into price sensitive cash loans because we have a very strong competence in retail collections so that we can predict what are the losses on various cash loans. We will have less campaigns going forward, we will reprise after these rate cuts now and we will see consumer finance cross selling and we will see a structure of more high margin loans in the whole book which in itself should push NIM up in the future. NIM is not our target, it's ROE that's our target so if we get some good business with good ROE we will still do that.

Page number six. Retails makes up roughly 2/3 of our profit and corporate 1/3 and we are still seeing very good growth in both segments. We had good volume growth on the lending side we now have 30% cash loans, high margin cash loans on the retail and we see a good structural growth of those loans in the whole loan book going forward. We have seen a very

good growth in retail current account deposits, we are more and more being the bank number one from all retail customers, we're seeing the same on the corporate side as well, and we keep our policy of not being dependent on wholesale funding, we had loan to deposits 92% in the first quarter versus 83 end of last year.
Page number seven. Nothing new – insurance from… fee income from insurance distribution is still a relevant part of Alior's revenue and we're reconfirming that we are fully complying with our IAS 18. Page number eight. We are gaining more efficiency through our growth. Our operating platform can handle much more than we're doing right now and as Wojciech mentioned our target of getting below 42% is still a very realistic target as we are growing and going forward. We have seen HR cost now at 53%,however it has only grown 5% the HR cost versus year. Other operating cost have grown faster than that mainly because of now having a 109 Express branches in the distribution network, where we practically had only 20 for a month in March last year.
The next page – number nine. We are still very pleased with our quality of retail collection and with the capacity to grant corporate loans with significant collaterals, but we are not totally immune to macro, and we do see an increase in private individual NPL due to the macro, however we are improving and improving our collection so that we do not have to see so high loan loss provisions from that. We have 68% coverage with loan loss provisions on the retail non mortgage NPL. On corporate we have a macro situation where we have seen higher bankruptcies in total in Poland and we are hit by some of it, nothing very significant, we have a very good provision in policy and we believe that with the coverage rate of 54% on corporate is significant and sufficient for this.
Page number 10. Also nothing new – we stay conservative on the market risk. We have practically zero position on FX, on interest rate position due to the relatively large bank book now we have a sensitivity analysis saying up to 60 million if there's a 1% parallel rate cut on the valuation of the whole book. Witek?

Now we are on the page 11. ROE – 16% at the end of first quarter and we are very pleased with these results, because as you know we're going to…. next 12 months… previous 12 months we doubled our equity. So this is very satisfying what we did in terms of efficiency.

Next page – capital adequacy ratio. If you look at the 15% of CAR and Tier at the 13% we are very well equipped with equity and this is a good start for the further growth, so we have enough buffer for the organic growth in the next few years.
Next slide, slide 13 – if you look at the special deposit side, January and February – this is what Wojtek and Niels mentioned – the marketing campaign and deposit which we collected at the end of 2012 matured. So this is the ratio (deposit to loan) improved according to our expectation and will be sustained in the next month. On the credit side we are growing faster than the market and we are getting the market which is of course our target and in line with our strategy which Wojtek mentioned.

So at the beginning I should say what is my function – I'm Michael Hucał, I'm head of development divisions, it's my first time when I see with in my new role, so that's the introduction. What I want to say on slide number 14 that we is that we keep our policy of instant innovation. Innovation every quarter could give us opportunity to gain additional customers, that's why we introduced a new current account. It's smart account, we want to appeal to the customers that want to have smart savings. We see that the group of that kind of people is increasing in Poland, they are the middle class and upper mass and they want to have savings but in smart way. They do not want to decrease the level of their living but to have something additionally. That's why we introduce this smart account with small cash back. Second product that we want to reveal is our product designed for checking better possibilities to acquire cheaper current and term deposits. So we introduce the SME term deposit. It's combined with the relation with the bank. It's very small. In terms of duration it's short, so the main target is to keep the level of these deposits after this promotion period. Third thing is that we are happy to reveal that we are recognized as a finalist of retail banker. Especially we're happy because we are in the group of strong international players and that supports our… continues of our policy.
Slide number 15 – we are still on track in customer acquisition, we acquired 100 000 customers in first quarter. This new product and additional activities linked with our customers increase the level of acquisition per day up to 2300 customers that we acquired yesterday. So still the acquisition is key point of our development.
Slide number 16 – this acquisition is not based only on products and innovation of course. We should have huge distribution network, so we are on the third place in terms of the distribution network. After combining the network of Kredyt Bank and BZ WBK we will be fourth, however still on a very strong position and we are planning to build, to open additional 100 Alior express branches of the small concept that is with more cost efficiency and it will of course support our plans of development this year and next year. We are planning to open most of them in the second half of year so with the same story like in 2012 of course, when the time for construction is better. Slide number 17 – Wojtek?

the thing on slide number 17 what I'm trying to say is that we are in a top tier of the Polish banks in terms of the client recognition for good. I don't know if we are number 4, number 5, number 6, but clearly PKO SA, PKO BP, BZ WBK, Millennium, ING and then Alior is within the same group. Doesn't matter what we take into account, which quarter, so the message is that we are there for good. And Alior is becoming the household name, is already a household name and we see the net promoter score among the highest of the Polish universal banks. Only the internet base banks are slightly better in net promoter score.

On the next page the new strategic initiatives as we call them. We haven't stopped investment, consumer finances are mentioned both online and in real world we are signing up new partners, new clients, focusing on the most prospective segment which is the furniture and the household appliances. Good? Alior Express — I think concept is working. We've learned on our mistakes and on our positive experiences where to build these branches, where not to build the branches. The basic message is the same – we should be where the Poles are going for shopping. Some strengths – very easy to think about more difficult to execute. We are maintaining our target of building more than 100 of these branches by the end of this year. And the discussions with the retailers, with the retail centers, are well advanced. Alior Sync – well it seems that our competition is a little bit delayed in entering the market. We would like to see more virtual banks coming to this place, because we believe that in spite of Alior strength we are too weak ourselves to move the change, the shift to new internet or virtual banking segment. With the mBank coming to the market we believe that our growth may be even faster. 200 000 clients – nothing to be ashamed of at the end of first quarter 2013 with a very good deposit and slightly lower loan book that we originally expected but it's very realistic that first we need to learn about the clients, we need to see who they are, what they are interested in, in cyberspace and then to give them any loan. Summing up outlook macro as you know the rate cuts are not helping banks, it's not that with the rate cuts the next day the Polish enterprises are going to line up with our branches to beg for investment loans. I think we are… some of the analysts are claiming that the increase of the demand for the investment loans among Polish enterprises will come the second half of this year. We believe this gonna be late second half of this year, namely fourth quarter. Unemployment still a factor but I think here I'm more optimistic than the official numbers, because the recommendation T helped a lot for the Polish banks. These 28 billion of volumes that were over the last 2-3 years transferred by private individuals in lending to non-banking lenders to put it in general. I think some of these are coming back to the banking space. Real… construction sector it's still challenge – I think it's not the time to dissolve the provisions for the sector. Good thing is a stable FX. That's why it supports very much the exporters. As you know they are overrepresented in our 108 000 strong corporate base. Carlo Tassara – the story continues. 2011 we were looking for the investors, 2012 dual process, 2013 – well, nothing new. Whatever is written in our prospectus, it still holds. The 34% we need to find by the end of this year. The process is ongoing and UBS is in charge working with Carlo Tassara the owner and seller of the 34%. We support them in this process as much as we can. Regulatory issues I think insurance periodization issue has been resolved. We are compliant with MSR 18. Regulation T:Well, some of you had expected that much bigger, much change coming from the relaxation of recommendation T. I was always much more positive on operational issue, that this change of the "zaświadczenie" into "oświadczenie" which means that the client doesn't need to carry the slip, the payroll slip from workplace it helps in operations, it helps us in consumer finance world because the IT hookup is much easier with the stores. However the method that the banks are looking in their internal scoring systems, I think these methods were not changed much by recommendation T. We see that through our acceptance ratio, which basically the loan applications to loan granted hasn't changed much. Organic growth: I think still I believe it's gonna be very boring conference this time because we have nothing to say in terms of a new major acquisitions, new major merger, the bond program that we announced and we got approval from our supervisor board – it's still on hold waiting for better opportunities. These opportunities haven't materialized yet. We are doing our job. And I think we feel very much confident, that we are doing the right thing in our daily work without exploring basically our advantages. IT and the operations are better than the competition, so it's a time to fill our distribution, our branches with more clients. The rest I think is a backup so maybe…

[lady's voice] We have already a question from one of the conference call attendees…

I've seen that so maybe I can handle this?

Maybe I will read it first, OK?

Yeah.

"OPEX growth dropped to just 11% year over year in first quarter 2013 compared with the 17% in fourth quarter 2012. What was behind the declaration and should we expect this level of growth for the full year?"

So I can answer that. I do not see the 17 somewhere, I have number from fourth quarter till fourth quarter – it's plus 16 million and first quarter last year till first quarter this year is plus 20 million and this growth of constantly increasing total general administrative expenses will continue because we do have more of the Alior Express branches, we do expand into consumer finance – in total we'll hire 1000 people this year, but as Wojciech mentioned earlier more than 90% of our new hiring is client facing. So it's all based on creating more business and not for managing elements of operations or controls with a higher proportion of cost.

And, I think, I can comment. You should get… If you call it deceleration — I think you should get used to it — because last year I was trying to draw your attention to the fact that we're heavily investing in Sync, in Alior Expresses, in the branches. And that our results could be much better without these investments. Nowadays, this year, we have… In our expansion platform, we have still these 100 low-cost branches to be built. This is one reason for the decline (17 to 11 percent). There are some aspects that are very much positive, that are related with the slow-down on real estate market, namely, the rents are going down. We are re-negotiating all the rents. Bear in mind that some of our branches are going through already ending the 5-year period. We re-negotiating them. You are probably now in the lousiest headquarters of Polish banks in Warsaw. I think the next conference will be even in a cheaper location. So, this is another way to save money. I think, as long as we are in charge, we have nothing against this. And we will continue this move. So , 17 percent quarterly growth, without extraordinary things, without a new project, without new mergers, without new opportunities, new projects in expansion, that we would definitely tell you about, will not be repeated.

The next questions are from David Nangle. It has four questions. One is – can we tell something about NIM guidance for 2013? The guidance we can give is that the 4.1 is after suffering from a number of… one off elements and rate cuts and deposit campaign last year, so we do expect on the same structure book, an increase. And we do expect a change in structure with more of the cash loans, but if this is not materializing, because we have some very large corporates we will not be sorry for that. We're not out focusing only on the NIM, that we are clear with that. Second: can we give a guidance for profit for the end of the year? Earlier we said the consensus 414 which was out there – can we – he's writing – can we meet or beat the consensus? We are still claiming that the 414 is absolutely realistically achievable. Third question is asset quality – can we give more colour on Polbita? Polbita is performing very well and it is back to normal loans and we have a process going on where we are making sure that the results of Polbita is performing even better and we do expect to have a sale before year end. And the last question he has is deposit campaign we see a growth in March again and have we got a new campaign? No, we do not have a new campaign on pricing as Michał Hucał mentioned earlier and we have started out with some other elements of campaign where it's not the NIM, which is the suffering element and we do have a very large growth in number of customers as well and we have a very strong CRM helping us to get to more of what you call first choice being Alior.

We started this year with 27% of our clients transferring their salaries to our bank. The best Polish banks PKO… the best – the banks with the highest proportion of customers bring the salaries to their account is PKO SA and PKO BP. They are at roughly 42-43%. We, our goal is to increase our ratio from 27 to… by 10 percentage point over some period of time. The process is going quite well. So we are moving now very strongly from the contender into the first choice league of banks and I think 27 by the way is nothing to be ashamed of, it's the result on average in line with the Polish banks, but I think we could do much better than that and the campaigns and products that Michał described are the weapons to get more of the client world.

So far there are no further questions from the remote audience.

OK. Sorry for asking…

So we will have to use a microphone to make sure that the callers can hear you.

Sorry for asking a very detailed question but it may have to do with Polbita, but I noticed that in your year-end statement or balance sheet the NPLs for the corporate segment numbered 562, whereas now they are 450, so there's 110 million difference – was there a reclassification of a large exposure from NPLs to non NPLs and if you could…

Polbita is out and we have another non single, it's a large number of smaller cases coming in after having analyzed annual financial statements where we have decided to classify as NPL.

But Polbita is out?

Polbita is out.

So you restated your year-end, OK.

No, it's not restated. No, no. Polbita is in at the end.

OK. And I know we touched upon a subject but the pace of reprising of deposits and loans, because it's clearly your loans have reprised very quickly and deposits have not so… and there are further rate cuts coming, so I understand your comment on the mix change and so on, but… and also I noticed that your deposit mix has changed – has more savings account and so on and some deposit but now the rest will be impacted, there's no way.

That's right. Any comment on those two speeds?

So we have… in Autumn last year we had this deposit campaign where we had 100 days deposit so called and we made most of them just before the rate cut, so we were unlucky with that and that meant we were suffering both January and most of February with a double dip both because we had a price promotion on the campaign and we suddenly had another funding basis of replacement of this money. The other element of NIM impact is coming from the various other campaigns we have run in the past, and also on Sync we have had some price promotion campaigns where we're seeing less of that. But else we are down at reprising time equivalent for turn deposits of roughly one and a half months. So the latest rate cuts, yes, we will also have here a time period which will have to stand before we can reprise but we have the same on the lending side, where most of the loans are one and a half months.

Speak of deposition acquisition loss was based on our decision, it wasn't that we are not so efficient in acquiring, but we do not want to acquire term deposit in the huge scale that won't be appropriate for our cash loan or other credit product development.

Also to answer this… the part of the question – it's not linked with the deposit but with the loans. I think the only weapon for the banks to fight for net interest margin on the lending side is rather change of the composition of the loan book than the fight for better pricing within the particular segment. The demand for good quality corporate customers is so low that I would… and it's not rump up yet that I think the expecting that the banks would be able to recover part of the margins to better pricing for corporate segment, I think it's not here to be materialized. That's why most of our competitors announced that they will be now moving on consumer lending side as in our strategies for 2013. The only difference between them and us is that we spent the entire 2012 on building collection, consumer finance network, Alior Express branches and we are ready to move and to change this shift to the consumer lending. And I think this rather changing of the composition within our loan book is the weapon to maintain the net interest margin on the level. Reprising for corporates in 2013 not in this environment. I don't expect that any good quality company is ready to pay more because the banks need to recover net interest margin.

Any comments on the interchange, fee, cuts and impact on the results on the quantification – was it a few million item – smaller, larger?

We only as you know on issuing side and I think here the impact is… will not be even noticeable in our statements. The income from the interchange is I would say not significant part of our revenue. However it always must be however – I think if… in our presentation there was not a mention on two things. One is big data, because we were stupid enough to talk about big data earlier, we said we are not talking about the big data at all. Second is that we are not talking about the mobile payments. We are deliberately not using these two things. Big data has nothing to do with interchanges. I can confirm that Alior is involved in practically – not all – most of the mobile payment projects that are going on currently in Poland and the drop of interchange might be recovered by again change of the composition. Because it's gonna be a new change in Poland from payments that a based purely on cards to payments that are based on cards and phones. I hope only Alior is relatively small yet innovative player in this field that we will be part of the winning projects.

SMS question.

Yes, we have one SMS question.

[laughter]

I'm coming for dinner home.

[laughter]

OK, so it's question from Barclays. Also just quickly to reiterate my online questions. Fee growth of 1,5% quarter over quarter is much below loan growth now. Used to be volume driven. Has there been reprising especially on bank assurance? So this is the first question.

So loan has grown 9% and fee has grown 1,5% - that's the question. I'm not aware of any significant element. I can dig further down to see what is the drive of that but I'm not aware of any reprising on this insurance distribution.

I can confirm that the other way around – there was absolutely no reprising on insurance. I think that insurance although it draws a lot of attention it's only part of our fees and commission income and I think there was nothing particular happening this year. Part of the fees and commission are linked with the lending products, part of them are independent because for instance the FX component comes there. I think making the equation mark between the growth of the loan book and the fees and commission I think it's overstatement. I can reassure that here we had nothing like a strategic reprising on our fees and commission.

OK, so the second question…

But if we look at the loan growth total 9%, part of that is corporate and other part is retail, so I think we should look for the answer there in terms of looking of what is the fee income growth specifically from insurance also.

Can I read the second question? NPLs appear to have been restated for 2012. I understand why that's on corporate but what was the adjustment on retail?

NPL definition is now alligned with what KNF is using and there has been a wish to have more comparable NPLs between the banks and the NPL reinstatement here for private individual has meant that we are now showing a growth in NPL for private individuals where under the old model it would have been a slight reduction. So we have more of the private individuals non mortgage and with a small provisioning based on collective models.

Can I read? OK, so one more question. Does the NIM guidance include further rate cuts?

The NIM guidance does include the rate cut we saw yesterday and the further expected 25 base point.

OK, one last question. Why are IBNR reserves being dissolved in the current macro rising risk cost on consumer loans? What is the updated provision in guidance?

Because IBNR for private individual is a function of the quality of our collection efforts in the past and we are constantly reviewing the quality of these collections and we see an improvement going forward and that's the reason why the IBNR for the first quarter there's a slight dissolvement of 2.5 million zloty.

OK, any questions from the audience?

We have one question.

I have two questions. One is on Polbita. I think you've mentioned that Polbita was classified as NPL at the end of the year, but you are showing ten biggest lenders and I assume that Polbita was one of the top ten and at the end of the year all of those ten were classified as normal in your statement. So am I missing something in… this is note 14.

It is not between the top ten.

Polbita looking at the whole size – this is definitely not in top ten.

OK.

Because the… we are together in Polbita… the total size of the loan to Polbita couldn't be within the top ten range. But I think that Polbita on the exposure of Alior to Polbita is definitely not in top ten of our credit exposure.

Tenth biggest credit exposure was at the end of the year was 56 million. It's page 31.

I will analyze that and come back…

Ten largest credit…

… a statement out in the…

Maybe, well, the question about it is because you expect to sell it, right?

Yes.

And after the sale you still retain some exposure I would presume?

Depends on who is buying it.

But you don't expect to be a problem?

No.

OK.

Not at all.

And the second question I would have is around bank assurance. I think you've made a comment that you comply with IAS 18. The other banks we talk to they say that the KNF is pressuring to actually accrue and even the banks prudently try to accrue as much as possible over time versus the cash approach. You have different approach. KNF also stated in the letter that they would like to have banks – you know – having the same approach. Do you see this as a problem going forward?

We do not see it as a problem going forward. The regulator would like to ensure that the income in whole financial sector is periodized better, so that the insurance companies when they are periodizing the cost over the life time of the insurance in some banks doing the distribution is booking the element of the distribution fee up-front. The challenge here is that we are in one sector in their opinion. If it would be independent distributors of this they would book it up-front as well, so that the whole society would still have this challenge. So there is given out accounting regulation – in this case international accounting standard number 18, which is prescribing how to do it. We have very advanced model for this purpose and it has been reviewed in the past and has been found good. So that there's constant dialogue if they would like to see more. We are part of that dialogue. But we are fully complying with international accounting standard 18. We cannot be pushed based on accounting standards.

Do you have any questions?

I think that coming back on Polbita issues – I think that we will answer this question directly, because it seems to me that this company on position number six might be at the end of this year… because there are two parts of Polbita, one is working capital financing for the stocks and one is the loan for the company. So I think let me review this and answer your questions. I think the only part of this loaning might be booked here as Witek is mentioning.

We are still waiting for additional questions.

But to clarify the issue as of today Polbita is performing, we intend to sell it and we… it's not in the NPL at the end of the first quarter this year. For sure.

I guess we have no additional questions. One last chance. OK. Thank you very much then for attending the results conference. I would like at the end to apologize for some temporary technical difficulties we had and I know that some of the attendees couldn't hear us for some short time, but this will be to be checked on the website. Thank you very much.

Thank you.