Addiko Bank

Addiko Group 1Q22 Results: Webcast Transcription

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Addiko Bank

Operator	Ladies and gentlemen, welcome to the conference call of Addiko Bank. At our customer's request, this conference will be recorded. As a reminder, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. If any conference call participant has difficulty seeing the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over to Addiko's management team, who will lead you through this conference? Please go ahead.
Herbert Juranek	Good afternoon, ladies and gentlemen. I would like to welcome you to the presentation of the results of the first quarter of Addiko Bank. We have prepared the following agenda for you. In the beginning, Ganesh and I would like to give you the key highlights of our first quarter results, the positive developments of our business initiatives, and the insights into our new marketing approach. In the second chapter, Edgar will provide you more details on the financial performance and Tadej will inform you about the risk perspective. After that, I will do a quick wrap-up before we go into Q&A. Well, compared with the first quarter last year, our net profit of the first quarter 2022 improved by 30% to €6.5 million. This means €0.33 earnings per share. The return on tangible equity increased significantly, from 2.5% at year-end to 4.5%. The operating result went up by 26% to €14.3 million. This number is driven by positive operating performance and the reduction in operating expenses as a consequence of our transformation program. The NPE ratio was further reduced from 2.9% at the end of 2021 to 2.8% at the end of the first quarter. The NPE ratio of on-balance loans improved to 3.9%. This development was driven by continued NPE volume reduction to €187 million. Furthermore, our NPE coverage ratio improved from 71.9% to 72.2%. The quarterly cost of risk decreased YOY from €4.1 million to €1.2 million. This means in basis points from -12 to -4 basis points. Finally, our funding situation remains quite solid, at €4.68 billion customer deposits and the liquidity coverage ratio at 259%. Our capital ratio was influenced by external factors, namely the current market development in bond prices and higher risk-weighted assets due to the structural FX guidelines. The transitional CET1 ratio stood at the end of the first quarter at 20.4%, and IFRS 9 fully loaded at 19.7%. Just to reiterate briefly some important topics already given at the AGM. Our exposure to Russia and Ukraine is limited to only indirect exposure. The Swiss franc law in Slovenia is temporarily suspended by the Constitutional Court. We keep the outlook 2022 unchanged, despite elevated inflation pressure. The inaugural share buyback was completed in April 2022, and we have two new supervisory board members, Sava Dalbokov and Johannes Proksch. Now, let's have a look at the business development in the first quarter. To start with the important: we are happy about the results because it shows that in addition to the effective cost

management, our Transformation Program is also gaining traction on the business side. The overall growth on the focus book is already up 8% YoY. It could have been more, but we intentionally further reduced low yielding tickets in the medium SME area. So, if you look into the details, you see that we managed to grow our focus book, excluding the medium SME loan book, by 15% YoY. Micro and small were even up 26% YoY, and new business in the focus book was actually up 42% YoY. At the same time, we achieved to improve the yield in focus business slightly to 5.4%, despite pricing pressure in the market. Consequently, the focus book stood at the end of the first quarter at 76% of gross performing loans. All of that was achieved on the back of keeping our prudent risk approach.

Ganesh will give you more insights of our progress with our business initiatives in a minute. Before he will do that, let me show you how we want to continue to keep our momentum without leaving our prudent risk path. We, the management, are convinced that in order to achieve sustainable success, we do not only need to further improve and innovate our products and services, but also to make our potential customers aware about it.

In addition, our judgment as a team was that our current marketing approach is a bit outdated and ineffective. But before jumping immediately into a new advertising campaign, we wanted to think broader, get the big picture, and redefine what Addiko stands for. At the end, the challenge was to put everything into one sentence without overloading it. So, the newly defined purpose of Addiko is: "To make customers' life easier, to help them in unpredictable situations, and to help them get things they want". This simple sentence will give us guidance, especially in our transformation efforts, being a former universal bank.

Based on that, our new brand promise shall be: "As experts in consumer and SME lending, we stand for speed and flexibility, and we promise to be there for you in all situations where you need that extra boost." Translated to every days life, this means we want to be close to our customers and support them when they need a loan for a new dishwasher, or a bike for their kids.

But how to deliver our message to our customers? We did a lot of research and realized that a brand character is a very effective method for driving long-term market share and building brand equity. Consequently, in order to support us in our efforts, we hired a new brand ambassador called Oskar. Oskar is a hamster who left his wheel to make lending easier and more convenient for our customer. He will promote that we are your best choice for fast loans. By doing that, he will become the boss and be part of our team. This means he will take place in our boardroom to represent our clients. The management team of Addiko is very confident that the recruitment of Oskar and our new marketing approach will create positive awareness in the market, strengthen our brand value, and most importantly, support our growth ambitions in our focus business.

	Now Ganesh will give you more background on our business development in the first quarter and our new marketing repositioning program.
Ganesh Krishnamoorthi	Many thanks, Herbert. Good afternoon, everyone. As Herbert mentioned, our Transformation Program has produced strong results in quarter one. On Page 6, I would like to highlight some growth initiatives in our key focus areas, followed by Q1 growth results. Please let me start with the four key revenue growth levers in consumer. Our first lever is growing net disbursements. I'm glad to inform you, our several growth initiatives, together with strong marketing, sales productivity and digital performance have resulted in 40% YoY growth in our gross disbursements. The second lever is about growing our active customer base. In Q1 initiatives like PSD2 income verification, which replaced our traditional salary verification method, instant payments, increased digital marketing approach, and launching fast cash loans with lower ticket size, lower tenor loans differentiated us from the competition and are driving higher than 150% growth in new customer acquisition over quarter one last year. We will continue to work on our goals to make paperless and fast lending experience, to make our customers' life easier. The third revenue lever is about driving higher margins and fees. Our net commission income grew 18% YoY and was mainly driven by 37% higher sales in cards, account packages, and lending, and complemented by a high penetration of bancassurance and recent economic revival in tourism. We will continue creating value for customers by providing financing whenever and wherever at their convenience and test it with a higher interest rate to compensate inflation. Moving on to the SME front, our better lending services to underserved micro-SMEs through our digital platform are seeing good results, with 85% YoY growth in gross disbursements. We are working on further automating an end-to-end digital lending platform for micro and small SMEs and enhancing it with functionalities like loan prolongations, which will provide a faster service to the client, giving us the opportunity with higher pricing and fees. We have also reached a new milestone: that 63% of our lending business is being done in our digital platform. We believe there is a good scalable market opportunity to drive profitable organic growth in this focus area for the future. Moving to the third focus area: our expansion plans. Our expansion plans are based on our solid plug-and-play embedded financing platform, which enables our partners like car dealers, electronics sellers, small merchants, big retail merchants, to provide financing at their point of sale to their customers. Last but not least, we continue to improve our operational efficiency through process simplifications, branch reductions, and digital automations.

Moving on to Page 7. Here I would like to highlight that we are on a good path to deliver our vision as the best specialist bank in the region, and that Addiko's ecosystem is the key to achieve our specialist status. Please refer to the right side of the slide. Our desired state of the future is to provide a solid plug-and-play financing platform, which enables our partners, in a modern digital marketplace, to provide financing to consumer and small businesses at every touchpoint, thereby creating a new ecosystem making financing accessible and providing that extra boost whenever and wherever they need financing. This year is a steppingstone on the path to enable this Addiko ecosystem, as we are developing in four essential areas.

Number one, as Herbert mentioned, we have already launched the repositioning campaign with the brand character to amplify our marketing and PR communication. Number two, we are launching the Buy-Now-Pay-Later service in key markets with a FinTech partner this month. Number three, we will enhance our platform with a best-in-class card offering. Number four, we are enrolling new partners in each of our markets, having our focus on the lifestyle areas, with the highest importance for our target customers.

On page 8, Herbert talked about the alignment we made between the specialist bank strategy, Addiko's purpose, and the Addiko brand promise. Let me provide you with further details how and where this marketing change is visible to customers. Addiko's brand repositioning has been introduced last week in all six markets this month, through an omni-channel marketing campaign. The new brand character, Oskar, replaces the previous triangle symbol, and he will from now on, be the message carrier for Addiko, both outside to potential and existing customers, as well as internal to all our employees to reinforce customer centric focus. The brand character Oskar has a voice in every market in the local language. And is visible starting last week across all media channels like TV ads, outdoor billboards, social media, digital advertising and mobile. We have an intensive TV campaign throughout May, which will be continuing in June and July, particularly when it comes to digital advertising. Oskar's message addresses our existing customers speaking about how Addiko promises to deliver cash fast and uncomplicated whenever and wherever they need an extra boost, and will act as a customer representative champion, as Herbert mentioned. For new and potential customers, Oskar is inviting them to try Addiko and he's communicating that we are here to serve young employees, pensioners, starting entrepreneurs, and digital-savvy people.

To summarize my growth section, we pursue a process driven transformation with a clear vision to grow and extend the platform into a bigger ecosystem, where customers find simple and fast lending solutions to whatever lifestyle needs they have. We believe this is the key to continue providing strong differentiation to other players that are active in our region. Please let me hand over to Edgar.

Edgar Flaggl

Thanks a lot, Ganesh. And hi, everybody. Now on page 10 to our financial performance in the first quarter this year. Starting on the left side of the page, with the composition of the P&L.

Our unaudited net profit amounted to €6.5 million compared to €5 million last year, as Herbert pointed out already. At operating result level the YoY increase was 26%. This is a quite good result, considering that the first quarter this year includes one-offs such as defense costs against the onerous Swiss franc law in Slovenia, reserves for floor clauses in Slovenia, and lower gains from financial bonds following our strategy shift to hold to collect. Net banking income continued on a good trajectory, with NII flat in the bridge year 2022, driven by the accelerated rundown in non-focus and medium SME loans. This also explains the reduction in the average loan book of close to €280 million YoY. In that sense, the currently flat NII is proof that our strategy to reallocate capital to the focus areas is working, while strong NCI allowed us to compensate this accelerated reduction in non-focus, as well as low-yielding and higher-ticket medium SMEs.

Our gross performing loan book started to grow again, with an increase of just shy of €60 million, and that thanks to strong new business in our high-yielding focus areas, illustrating that we are on track in the transformation of the bank.

The other income, comprising the net result of financial instruments and the other operating result, is down versus last year, mainly driven by lower gains from the sale of our financial assets that are part of the liquidity portfolio, and that is in line with the new investment strategy to keep positions until maturity to collect interest income.

Now down to operating expenses, which have been one of the key priorities of our Transformation Program. Our operating costs are down 7.5% YoY, and 5.8% versus the fourth quarter last year. Excluding OPEX, that is related to the Swiss franc law topic in Slovenia, and to the Euro implementation project in Croatia, totalling roughly €0.2 million, our pure operational OPEX run-rate for the first quarter this year was at roughly €41 million, beating our guidance of €41.5 million on our last call. I will come back to OPEX in a moment. The Other result remains influenced by charges related to active and passive legal claims, including our initial costs for our BIT claim against Slovenia. In addition, we built a reserve of €1.8 million for a potential mass claim regarding EURIBOR floor clauses in Slovenia. Together with our quarterly review of legal provisions, also related to Croatia, this reflects the continued prudent approach of the team on legal risks.

Now the credit loss expenses, which once again remains benign, due to the stable portfolio quality. Tadej will share the usual update on the highlights in a few minutes. Briefly over to the right-hand side of the page with our key operational P&L drivers and their development over the last five quarters.

As Herbert and Ganesh pointed out earlier, we have visible results from the Transformation Program on the business. This is reflected in a good development on both NII, and specifically NCI, during the first quarter, which usually is the weakest quarter in any given year. Just to keep in mind, given the accelerated reduction of non-focus during the second half of last year, the starting point in terms of interest-bearing loan book for the first quarter 2022 was the lowest in any of the five quarters shown on the page.

On OPEX, as mentioned, we are happy with the development in the first quarter, which brought our cost income ratio down to just below 71%. However, we also remain cautious of the dynamics for the rest of the year. The spending on the Euro implementation project in Croatia will inevitably ramp up and we still expect mid-single-digit one-off costs for this. We also see significantly elevated inflation pressure across all our markets, which specifically puts additional burden on supply, services, and energy costs, but increasingly also on wages. We do see several large banks in our region adjusting wages significantly. And since we cannot fully avoid this, we are working on finding mitigation measures to minimize this impact.

Now to page 11, which illustrates our capital position. During the first quarter, the overall development in terms of capital is mainly related to two topics, as Herbert pointed out already. First, the changes in OCI, driven by the current market volatility in sovereign bonds in general and specifically in the CSEE region. And second, changes in RWAs from the guideline on structural FX, which you see across the banking sector. Some flavor on the OCI development: roughly 60% of the current dip in OCI stems from plain vanilla Croatian and Serbian government bonds. So, right within our region. From a credit perspective, we do have a very stable bond portfolio, predominantly issued by governments of the region. So that all adds to a fully loaded CET1 ratio of 19.7% while the transitional CET1 ratio stood at 20.4%. These ratios do not include interim profit or accrued dividends.

Now shortly on SREP: no changes to our previous disclosure. We still remain cautious on future P2G, since among the whole environment, the Comprehensive Assessment stress test is based on the Covid year 2020, which results in a higher capital depletion, and could therefore lead to higher P2G again in the next cycle. And now over to Tadej for an update on our risk metrics for the first quarter this year.

Tadej Krašovec	Thank you, Edgar. And let's go to the slide 12. I can conclude that the credit risk situation was quite uneventful in the first quarter of '22. On the left side, we see that we have continued with an NPE decrease and slightly decreased also NPE ratio to 2.8%. That is net decrease of €7 million in nominal amounts. NPE formation in the same period was below expectations, and NPE decrease remains our focus further on through the year as part of our Transformation Program. So, no material changes in that respect in the first quarter. On the next slide, if you can go to the Slide 13. Overall, I can say that our portfolio remains strong and even better than expected. However, we have to recognize that several topics – war, inflation, and supply chain disruptions, some of those Edgar mentioned before – increase market volatility and can potentially affect credit risk going forward. At the same time, we are well positioned to manage such situation. Quality of the portfolio was reflected also in the cost of risk. Allocation in the first quarter was lower than we expected and amounted to €1.2 million. That is cost of risk of only 0.04%, which is – for comparison – three times lower than in the same period last year. That mainly means we had some one-time positive cases in the first quarter, and it doesn't predict that the rest of the year will automatically follow this trend. While the consumer business or consumer portfolio behaved very close to our plans, allocation of provisions was in the amount of €4.3 million, SME and the non-focus portfolio performed better and were the source of provision releases in amount of €3.2 million in the first quarter. Again, let me conclude that we have achieved planned or even better-than-planned risk results, depending on the customer segment we're looking at. At the same time, I have to recognize that the volatile market conditions could potentially have an impact on the credit risk. This is why we are keeping a close eye on the situation and are introducing some mitigation measures already now. With that, I hand over to Herbert for the outlook and wrap up.
Herbert Juranek	Thank you, Tadej. As mentioned, our Transformation Program is well on its way. In 2022, the emphasis is shifting from restructuring and cost measures more towards growth initiatives to kickstart our business. In that context, we consider our brand repositioning as quite important, and we will concentrate our activities to further improve our digital capabilities and to extract value out of the partnerships which we have built in the recent months. We will

	continue working on our strategy to deliver our goal to become the best specialist bank for consumers and SMEs in Southeast Europe. This also includes our goal to further improve our risk management systems, to ensure a prudent risk approach, but also to support our growth path in an efficient way. At the same time, we will continue our constructive cooperation with the regulator and our efforts to manage our NPEs effectively. As said in the beginning, we keep our outlook for 2022 unchanged, despite inflation pressure and despite all macro-economic influences. Nevertheless, I want to mention. This outlook does not include any potential impacts from the Slovenian Swiss franc law or potential knock-on effects from the war in the Ukraine. Based on the current view, we do not expect negative influences from Covid-19 anymore going forward, but we expect market volatility and inflation to remain on an elevated level in 2022. As mentioned by our CFO Edgar, we will be confronted by consequential cost updrifts, which we need to counterbalance with other measures. However, we as the management team of Addiko are positive on our business model and on the opportunities our market has to offer to us. We continue to work with full ambition to improve the bank in the interest of our customers and of our shareholders, to create value for both of them. With that, I would like to conclude the presentation. The finalization of the AQR is expected until the end of the second quarter, and our presentation of the half year results is scheduled for the 17th of August. I would like to thank you for your attention. And we are now ready for questions. Operator, back to you.
Operator (Q&A)	Thank you very much. Ladies and gentlemen, if you have a question for speakers, please dial 01 on your telephone keypad. Once your name has been announced, you can ask a question. If you find your question is answered before it is your turn to speak, you can dial 02 to come to your question. If you are using speaker equipment today, please lift the handset before making a selection. If you participate via the audio webcast, you can write questions via the Q&A function of the webcast by pressing the question mark button. One moment, please, for the first question. As a reminder, if you would like to ask a question, please press 01 on your telephone keypad. And we have a first question. It is from Mladen Dodig, Erste Group. Your line is now open.
Mladen Dodig	Good afternoon, gentlemen. Thank you for the call, for the event, and congratulations on the results. I think the chart on Slide 10, top right corner, says it all. My questions are first regarding Slovenia. So we have heard on the market some speculation on when the Constitutional Court in Slovenia might decide in respect to the recent political changes, etc. etc. Do you have any insights, updates on this issue?

Herbert Juranek	Thank you for that question. As you know, the injunction was approved by the Constitutional Court. According to what we hear, the feedback we got is that the Constitutional Court wants to take a decision fast. Fast means, from our perspective, within the next three to nine months. So, overall, we expect most probably that the decision will happen this year. According to the feedback of all our lawyers, internal and external lawyers, international and local lawyers, the common opinion is everything will be decided, according to the books and to the laws. The law should be turned down completely. That's our expectation. But of course, we don't know. We need to wait for the ruling.
Mladen Dodig	I asked the question because the last word I have heard is everything between six months and two years, but two years really looks too long, especially since you have recommendation from the regulator not to consider dividends until it is fully clarified. But this three to nine months does sound reasonable. Second question is regarding the rate hikes in the region. Can you provide us with information how much of your portfolios are exposed to the variable rates?
Edgar Flaggl	Sure. Hi, Mladen. Thanks for the question. This is Edgar speaking. So we did not include in the first quarter deck an updated version of the interest rate sensitivity. But if you look back just a couple of weeks ago, based on the full year '21 financials, in our deck we had page 40 which shows that the overall book is roughly 40% variable. That, of course, differs among different business segments. So, on the consumer side it's, you know, roughly 90% plus fixed, while if you go to the non-consumer, it's more on the variable side.
Mladen Dodig	Okay, okay. That's all for now. Thank you. Thank you once again, and maybe if I come up later with some other questions, I will log in.
Operator	At the moment, we have no further questions via the telephone lines.
Herbert Juranek	We have one question here from Wolfgang Matejka. I read the question, and then we will go to the answer. "Could you please repeat the marketing costs related with Oskar?" Who takes that, Edgar or Ganesh? Ganesh.
Ganesh Krishnamoorthi	So the Oskar production costs are 150k, which includes like the ad production for TV and also billboards, you know all the materials, brochures, etc.
Edgar Flaggl	But then we have another question from Wolfgang. Is your risk control system different to your competitors? And how do you handle possible changes in the ability of your clients to repay their loans?

Tadej	I take that. It is hard to judge and compare the risk control systems between the banks on the market. But I can say, for us, that we have several layers of different risk controls implemented, from the high portfolio level down to the sub-segments of different consumer and corporate segments. On top of that, our process of early collection, or early warning system even, I think is one of the best on the market and actually catches clients already very early in the potentially problematic phase. Regarding how we tackle increased monthly living costs of the clients. So first, for the new business, we have already introduced in almost all countries increased monthly living costs that go into the calculation of the free monthly salary of the client that can be used for the loan repayment. In that way, we are trying to incorporate already this part of inflation. For the clients that are already in our portfolio from the past, we have actually proactive approach and early warning system that allows us to identify, let's say, problems early and offer clients reasonable restructuring, if that is needed. So far, up to now we didn't see material changes in the performance of our consumer portfolio, even though that we see high inflation in practically all of the countries where we are present. Hope that answers the question.
Constantin Gussich	I have one more question from Wolfgang here. As mentioned by you that you want to keep the bonds in your portfolio until redemption, isn't there the option for you to value them at 100% open to you.
Edgar Flaggl	Thanks a lot, Wolfgang. This is Edgar speaking. Very good question. I start a bit broader on this topic. So, first of all, when the new management defined the enhanced strategy and on the basis of the strategy the new plan - which was approved last year also, and up to the supervisory board. This plan already reflects a lack of gains compared to the amounts we had in the past in this bank from recycling – as they say in accounting – of bonds in that sense. Why? Because the focus was clearly to focus on consumer and SME, point one. Point two, with the accelerated reduction of non-focus, there was even more liquidity available. So, liquidity and capital freed up. In that sense, we have clearly shifted the strategy towards keeping especially the bonds with a juicy coupon until maturity, to collect interest income because that's the main source of our revenue still. So, in that sense, there is very good arguments on that, but the topic is much broader because when IFRS 9 was implemented – so, decided in 2017, implemented from the 1st of January 2018. Back then, on the old strategy, under the old management, it was decided to keep the bonds on the fair value through OCI. But that was based on a totally different business model as we have it here now, what we run as a new team going forward. So, we are in the progress of assessing this, is the short answer.
Constantin Gussich	Good, thank you. Operator, I do not have any more questions on the webcast. Do you have any questions on the telephone line?

Operator	No, there are no further questions via the telephone line.
Herbert Juranek	Okay, thank you. Okay, if there are no further questions, we thank you for your participation and your attention. And we, as management team, we go back to work in order to further improve the bank. Thanks a lot and have a good afternoon. Thank you. Bye-bye.
Operator	Ladies and gentlemen, thank you for your attendance. This conference has been concluded. You may disconnect.