Addiko Bank

Addiko Group 3Q19 Results: Webcast Transcription

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Speakers:
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Operator	Dear ladies and gentlemen, welcome to the conference call of the management of Addiko Bank AG. 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 difficulties during the conference, please press * followed by 0 on your telephone for operator assistance. May I now hand you over to the Addiko team, who will lead you through this conference? Please go ahead.
Razvan Munteanu	Good afternoon and welcome! Thank you for joining our Q3 Earnings Call. I am Razvan Munteanu, CEO, and I am joined today by Johannes Proksch, CFO, and Edgar Flaggl, Head of Investor Relations. We will share with you the latest developments. I will comment specifically on the progress of our strategic transformation, Johannes will provide an insight on the financial results to the end of September 2019. As usual, we will answer questions from the audience at the end of this presentation. Please turn to page 4. In the first box, our result after tax for the first nine months of 2019 stands at EUR 39.6 million on an adjusted basis. This represents approximately 44% improvement compared to the adjusted result for the same period last year. Later in this call, Johannes will refer to the specific one-off adjustments, they essentially relate to the effect of the old Swiss franc portfolios in Serbia in Croatia, IPO-related costs, and deferred tax ramp-up. The reported result of EUR 23.4 million includes EUR 8.7 million provisions for the CHF currency clauses in the old Croatian Swiss franc portfolio, as well as an EUR 8.1 million impact from the CHF conversion law enacted in Serbia during the second quarter of this year. Keep in mind that the reported Q3 2018 results was predominantly influenced by a fair-value recognition of the Tier 2 conversion of EUR 61 million. Therefore, a direct comparison of the year-over-year development on a reported basis is not indicative of actual progress in operational performance. Our financial foundations – liquidity, risk metrics, capital base – remain very strong, with a transitional CET1 ratio of 17.4%. On an adjusted basis, the return on tangible equity improved to 7.1% from 4.2% at the end of 2018. A few considerations about the risk profile in the second box. Our strategy to focus on consumer unsecured lending and SME lending, while maintaining a prudent risk approach, is reflected in the continued reduction of the NPE ratio to 4.4%. We have a healthy coverage of over 75%. The largest NPE exposure now stands at EUR 11.2 million, with the tenth largest at EUR 1.8 million. This illustrates the reduced concentration of our NPE stock. The effect of the Swiss franc conversion law enacted in Serbia in Q2 is fully reflected in the half-year financials and is fully digested. In Q3, an additional provision of EUR 8.7 million has been booked, to reflect the potential impact of the Croatian Supreme Court ruling from September, on the Swiss franc contracts with regards to the foreign-currency clauses.

On the third box, the cornerstone of our strategy is a pragmatic digital approach. This is designed to allow our growth in the focus area, while gradually reducing costly physical distribution. Our number of e-banking and m-banking users increased to 199 thousand, with loans originated through digital channels now at 9.1% in the first nine months of 2019. This represents a material increase from the 3.8% we had for the full year 2018. The automated lending tool for SMEs was fully rolled out in Croatia, in addition to Serbia and Slovenia. Around 17% of SME loans have been originated through the automated tool in the first nine months of 2019 in Serbia and in Slovenia. We also have a promising start in Croatia, where we completed the full roll-out recently. This encouraging increase in volumes, from 9% in the first half to above 17% at the end of September 2019, sets the basis for us to improve the defense of margins in this segment.

Let me say a few words about the business climate in our fourth box. Defending the lending margin is one of the priorities we focus on in the context of a business climate which has not been very favorable over the last few months. With an overall consumer lending market growth of 7.2% since the end of 2018, regulators in the region decided to implement administrative measures and recommendations applicable to all banks, with the purpose to limit the growth of the consumer lending market. Such measures are already in place in Serbia and Slovenia, while in Croatia and Montenegro they come into force in January. While we have the capability to adapt and continue the execution of our strategy in this changing environment, on a quarterly basis there will be effects from the new regulations. We already initiated counter-measures – specifically, more automated and small ticket loans origination, accelerated focus on account packages for further loan cross-sell, focus on revolving lines, and more digital origination. Under the same heading of the business climate, the Supreme Court ruling in Croatia was notified to investors through an ad hoc. It will take several years to materialize, during which the bank will take all steps to protect its legal position, at the same time, having prudently provisioned for the full potential impact over the next years. The draft joint decision of regulators concerning the Pillar 2 requirement, and the Pillar 2 guidance was also notified specifically to investors. We filed our right to be heard, to answer to the regulators. Based on the response, we will continue our actions to demonstrate that the capital level currently held by the bank is already in excess of what the set strategy and demonstrated execution so far would justify. Given the importance to clarify the effects of our different views in terms of capital requirements, we did not pursue the Tier 2 transaction yet, particularly as after sounding the market, the price range was rather wide, and also uneconomic in the context of uncertain capability to distribute immediately the excess capital. Please turn to page 5.

The key driver of our strategy is a transformation of our book from non-focus to focus, and this way releasing the funding, capital and generating the earnings to grow in the focus area. The transformation of the book continues, reaching 61% of the book in the focus area, up from 56% at the end of 2018. The adjusted net interest margin progressed to 3%, up from 2.8% for 2018. It remains stable to the first half of 2019, even in the context of a still long period of low negative interest rates. We remain committed to our mid-term target of roughly 4%. Continued deposit repricing, and liquidity optimization contributed to defending the NIM, along with a shift from the loan book from non-focus to focus. The net commission income grew close to 8% compared to the same period last year. This is below our target, mostly driven by lower net commission income from our card activities. This was partly compensated by net commission income acceleration in SME, and a strong FX and dynamic currency conversion performance in the third quarter. We also raised the priority for the modernizing of our card platform, with various roll-outs planned for 2020. The adjusted cost income ratio improved to 75.2%, from 78.1% in 2018, with further cost optimization measures on track, as announced in our previous call. Given the business climate I described earlier, we will accelerate cost measures in 2020. As a consequence of improving all the operational parameters, the return on tangible equity also improved to 7.1%, up from 2018's 4.2% on an adjusted basis.
An important element of guidance is the dividend payout. We remain committed to the out-of-profit payout. The timeline of distribution of excess capital is under review in the context of the Pillar 2 requirement and Pillar 2 guidance clarification. We maintain the view that the bank is well capitalized and carries capital in excess to what our business model and strategy reasonably require. Depending on said clarifications, we will define our action plan to deliver our promises. Growth in our focus area and distribution of excess capital generated. Please go to page 7.

The business model we implement revolves around transforming the part of our book related to the non-focus areas – mortgage, large corps, and public sector – into focus areas of unsecured consumer lending and SME lending. Since 2016, when the share of focus business in our book was 40%, we transformed along the lines of our strategy, reaching now 61% in the focus area. We are constant in the ability to defend the yields of our focus areas, they are illustrated on the right side of the page, particularly promoting convenience and speed and without compromising the prudent risk approach of our business. Look at the risk adjusted yields. In a demanding business environment, we are at 6% in consumer. Gross yields dropped marginally, mostly as a consequence of conversions of longer tenor loans in Serbia, to meet regulatory requirements set for the end of the year. After an initial drop, the yield of the new business in consumer increased by 30 basis points since the beginning of the year. So today, they are back to or above the level of the consumer-backed portfolio. The SME gross yields on new volumes remained relatively flat. Please turn to page 8.

The particular and unique aspect of our approach is that we combine growth while preserving capital and ensuring, this way, a sustainable dividend capability. I remind again our view is that we are well capitalized, and we work to align this view with the regulators. Our growth comes from the focus areas of consumer unsecured lending and SME lending. Our value proposition is very clear: convenience and speed. This allows us to defend margins, while maintaining a prudent risk approach. To achieve this, we deliver our value proposition by strict collaboration between risk and business, and standardizing our products, standardizing our risk policy, standardizing and automating the underwriting processes. This allows us to defend our position in the context of the new consumer regulations. We continue this process in both consumer and SME. In consumer, we continue to expand the automated lending approach, using standardized application processing systems and credit decision engines. This allows us to increase the gross yields for the new consumer volumes by 30 basis points, while maintaining a healthy growth of 21% CAGR between 2016 and Q3 2019. You see this on the left side of the page. The net commission income performance in the segment is predominantly supported by bancassurance, foreign exchange and dynamic currency conversion services so far. Cards' transformation is, therefore, a priority project this year and in 2020, to provide us with the basis for continuous growth in net commission income. In the SME segment – you see this on the right side of the page – growth remains healthy as well, with 20% CAGR between 2016 and Q3 2019. The pressure on gross yields in SME is counter-acted by a shift to better ratings, shorter maturities, and an accelerated net commission income in the segment. You see here the 21% increase of NCI to the same period of last year. As I will mention in the detailed segment, the rollout of the automated loan approval for SMEs, now accounting for 17% of new volumes, gives us the basis to execute the segment strategy and enter higher-yield SME lending segments. A few facts about the consumer lending market in our region on page 9.

The beauty of the business model is that there is plenty of opportunity to grow, even with a conservative market share assumption. The unsecured consumer loan market grew by 7.2% during the first nine months of 2019. The market is growing significantly, showing that there is demand for what we focus on. The business climate is testing on the consumer lending side, as I mentioned earlier. We nevertheless see healthy growth in the mid-term, therefore we remain focused and adopt counter-measures to continue our market share growth. We increase the automation to accelerate access to smaller tickets; we focus on account packages, which give us the basis to cross-sell new loans; we focus on revolving lines; we accelerate digital origination. Referring to the market share, we have grown – as indicated on the right-side of the page – in all markets except Montenegro, where we are already above the 8%-10% target market share in consumer lending. As mentioned, we see the region remaining an attractive area to focus on consumer lending. Four facts about this: 1) 8%-10% is a target, in line with our growth through transformation and competent risk; 2) we can increase the weighted 5.2% market share across countries, giving us ample space to continue our strategy; 3) we target growth primarily in our larger markets, as it already works in the smaller ones; 4) digital will help us further, as it will reduce the dependency between our footprint and growth targets. A few facts about our progress on digital, which is so critical, on page 10.

Please allow me to repeat our digital mantra in the group: We have a very pragmatic approach to digital. We take proven solutions from more developed markets and roll them out to our customers. This way, we achieve three benefits. We deliver convenience and speed, in line with increasing customer preference for digital services. We keep the cost of innovation down adopting solutions proven in more advanced markets. We enable our growth without adding new branches – actually, reducing the number of branches as digital preference materializes. Of the most important KPI we monitor on the digital front, and illustrated on the right top of this page, I highlight the volume of unsecured loans originated digitally. It currently stands at 9.1%, up from 3.8% for the full year 2018, and up from 8.2% in the first half of the year 2019. Our total number of digital users, on the left side of the page, also increased to just under 200 thousand. As mentioned earlier, the automated lending tool for SMEs is now responsible for 17% of new volumes, compared to 9% at half-year 2019. This illustrates both the progress we achieved, as well as the further opportunity we have to extract from the digital channels. Before handing over to Johannes for further details on our financial metrics, a few words on our progress in establishing leadership in digital lending for SMEs. Please turn to page 11.

The automated lending tool for SMEs is now fully rolled out to Croatia, our largest market. In Serbia, Slovenia, and Croatia, we cover a broad range of products to existing and new customers, including simple term loans and trade finance instruments. Croatia is the third market - the third country - we onboarded to the Group-wide SME business process platform, with a clear road map defined for Bosnia & Herzegovina and Montenegro to be included in the first half of 2020. The automated tool delivers exactly our value proposition, reducing the time-to-decision, number of touch points, and increasing customer convenience. The efficiency of the platform allows us to enter the segment of lower turnover customers, with smaller loans supporting the defense of our gross and risk-adjusted yields in a continuous low-interest-rate environment. Please allow me now to hand over to Johannes, to cover our financial metrics in more detail. Please, Johannes.

Johannes Proksch

Thank you, Razvan. Before I come to dive into the financials, let me highlight that we adjust our numbers in order to provide you with a clear view of the underlying historic development. This will become less important as you become more familiar with our figures, and as the major transformational steps are behind us. We have therefore provided you with an extra two pages in the Appendix, and I will highlight on the relevant pages the main adjustments. Here in brief, a significant impact in 2018 was the Tier 2 waiver in the first quarter by our – at that time – sole shareholder. We adjusted our 2018 figures accordingly. More importantly, the major one-offs in the nine months of 2019 were, in “Other result,” a EUR 2.3 million restructuring cost for the announced cost optimization program, which was built in the second quarter, and so far we used from that amount EUR 1.2 million; the IPO-related cost – or, as we call them “Capital Market readiness cost” – was ultimately EUR 2 million; and the costs related to the Swiss franc conversion law in Serbia, of EUR 8.1 million. Now, the new one in the third quarter was the provision in relation to the Croatian Supreme Court ruling regarding Swiss franc loans of EUR 8.7 million, and it is now also reflected in the Q3 results.

And now, on page 13, let me explain how the strategy is reflected in our numbers, by highlighting the progress we made in the nine months, or third quarter 2019, compared to the previous year’s period. Like in the past year, in the nine months of 2019, compared to previous year, the higher rates on the focus business translated into a further increase of our interest income from this portfolio. And, as a consequence of further reduced deposit yields, we increased our net interest margin by 21 basis points, to 2.96% or roughly 3%. Our net commission income, of which 90% are related to our focus business, further increased by 7.8%, predominantly driven in the consumer area by payments, meaning account packages, as well as bancassurance, and with accelerated contribution from SME-related products, as mentioned by Razvan earlier, with a card income that was lower than expected. This positive development in net interest income and net commission income is also visible in the quarter comparison. Operating expenses have remained flat. Our announced cost optimization, the reduction of the FTE number by 180 and 8 branches in the second half, will keep OPEX in line with 2018 and will result in a cost decrease in 2020. The optimization program is on track and intended to reach higher targets. All this has helped us to reach, as mentioned this morning in our press release, an adjusted post-tax profit of EUR 39.6 million, or reported EUR 23.4 million, the main difference being the CHF conversion law reflected in risk provisions of EUR 8.1 million in Serbia and a Supreme Court ruling on CHF clauses in Croatia, with a further provisioning of EUR 8.7 million being the main differentiator. All of the above led us to an adjusted return on tangible equity at 14.1% CET1 of 7.1%.

The pages 14–15 provide our usual breakdown, to show a granular picture on the development of our interest income and expenses composition, and respective yield-related developments. On interest income – and now I am on page 14 – I would like to highlight the continuous increase in the part related to our focus business, reflecting now 72% of the total market-related interest income, and clearly overcompensating the gradual decrease in the non-focus area; and the relatively stable development of our yields, on the right-hand side, despite a negative market interest environment, proving again that we were able to defend our margins in a challenging environment via our proposition of convenience and speed. As mentioned by Razvan earlier, new business yields in consumer have actually increased by 30 basis points year-to-date, which is a promising sign that we will achieve stabilization of the overall consumer book yield. SME remains relatively flat. For the ones of you interested in the development of our Other Interest Income, we have a page in our Appendix highlighting the continuous decrease in our revenues from our bond portfolio of roughly EUR 1.2 billion, the decrease in unwinding income, as we continue to resolve successfully our non-performing exposures, and the interest-like income of EUR 3 million in the third quarter related to fees accrued over the lifetime of the loan. This was positively influenced in the second and third quarter by the Swiss franc mortgage conversion in Serbia.

And on page 15 we illustrated our disciplined repricing of deposits over the last years, which is also in 2019 contributing to decreased interest expenses on the back of reduced funding yields by roughly 14 basis points year-over-year, meaning we pay today on average 52 basis points on our funding.

Now, net commission income on page 16. As highlighted earlier, the first nine months of 2019 compared to the previous year's period showed an increase of close to 8%, of which 90% are related to our focus business. An increasing share of SME-related net commission income, as our clients have increasingly used us for transactions and digitally sold guarantees, trade finance business, while the consumer area had a strong third quarter, predominantly driven – as mentioned earlier – by foreign exchange and DCC.

Let's move now to operating expenses on page 17. As mentioned earlier, 2019 has shown so far a continuation of operating expenses from 2018, of roughly EUR 47–48 million per quarter, or just below EUR 190 million for the full year 2018, while shifts in 2019 are reflected in the various cost categories. Apart of the neutral shift between depreciation and admin expenses, related to the adoption of IFRS16, of approximately EUR 5.3 million into depreciation, higher depreciation and IT are increasingly compensated by other cost items, such as premises expenses and intellectual expenses, except marketing, which we keep relatively flat over time. The announced cost optimization initiative, with reduction of 180 FTEs and 8 branches, is ongoing and well on track, and we are in the process of increasing our initial target as our digital distribution capabilities increase. In addition of that, we are assessing to reduce IT costs related to legacy systems, and at the possibility of transforming subsidiaries to branches, following our strategy to become a single bank as close as regulatory possible.

Let's now move to risk on page 18. We have already presented a significant progress previously, and we now further reduced our NPEs to currently 4.4%, while increasing coverage ratios. Here, you can see the continuation for the third quarter 2019. During the first nine months, we have been particularly successful in restructuring our largest non-performing exposures by far, a large Croatian retailer, and selling the resulting equity piece in the market at a gain. This exposure is now down to EUR 11.2 million, with a very high coverage. Among the top ten largest corporate non-performing exposures, we were able to resolve two during the third quarter: the second largest non-performing exposure in corporate is therefore now EUR 6 million in size, and the tenth close to just below EUR 2 million.

Broken down by segments on page 19, you see that we were to keep non-performing exposures in the focus areas in control while growing the portfolio, with increased coverage ratios. And in the non-focus areas, we were able to release provisions related particularly to mortgages and large corporates, which helped us to overcompensate the impact related to the Serbian CHF conversion law on mortgages of EUR 8.1 million in the second quarter of 2019, which was reflected in credit loss expenses. The consumer-related risk provisions of EUR 17.1 million for the first nine months of 2019 are better than expected, reflecting the portfolio ramp-up which is based on our prudent underwriting and portfolio quality assessment process. The comparison to the full-year 2018 provisions in consumer is limited, given that they were positively influenced by releases, as a consequence of the sale of legacy portfolios.

And now a brief update on our capital position on page 20. Not much has changed within the nine months of 2019 with regards to our regulatory capital ratios, and we continue to have a very healthy total capital ratio and a CET1 ratio of 17.4% on a transitional basis, or 16.8% IFRS 9 Fully-Loaded. We remain focused on capital optimization, including the issuance of the proposed Tier 2 transaction, following clarity on the SREP 2020 and excess capital distribution. In the context of the draft SREP decision 2020, we updated you on our discussions with the regulator during our investor call on the 10th of October and have since sent our objections to safeguard our right to be heard on 25th of October. And now back to Razvan.

Razvan Munteanu

To conclude, on page 21, we execute our specialist strategy. The book transformation is fundamental to our delivery of both growth and distribution targets. We are addressing the market environment challenges, and as a focused player, we see ourselves as better placed to implement effective countermeasures responding to the current climate. We absorbed the one-off impacts from the old Swiss franc portfolios in Serbia and Croatia. Given the clarification required with regards to the excess capital and timing

	of a possible extraordinary distribution, we decided not to rush the Tier 2 issuance at a price we anticipate to decrease once such clarity is achieved. We therefore continue counter-measures, we accelerate cost optimization measures, including a potential EU branch structure. Most important, we remain committed to our approach: growth in focus segments, distribution of dividends out of profit, and distribution of excess capital once available. With this, I would like to thank you for listening to our presentation and open the floor to questions. Please, Operator.
Operator	Ladies and gentlemen, we will now begin our Q&A session. If you have a question for our speakers, please dial 01 on your telephone keypad now to enter the queue. 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 cancel your question. If you are using speaker equipment today, please lift the handset before making your 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 now or enter your question in the webcast. We have received the first question via the telephone. It is from Jovan Sikimic, from Raiffeisen. Your line is now open, Sir. Please go ahead.
Jovan Sikimic	Hello. Good afternoon, gentlemen. Thanks for the call. I have a couple of questions. I know that it's a tough topic, but with the FMA, if you can update us on what the time plan is, if it's possible to make any kind of forward-looking statements on that. Because dividend proposal if, then should come, I hope, April-May and maybe you can give us an update on whether you expect to settle these capital requirement discussions with the FMA.
Johannes Proksch	We basically already gave indications on our time expectation during our call on the 10th of October. Basically, as I mentioned before, we submitted our objections to the draft SREP decision on October 25th. We normally would expect a final SREP decision towards the end of the year, maybe even in the second quarter. Last year it was particularly late, we received the final SREP in June. We understood this was exceptional, also other banks received it very late. And that would basically be most probably the first point when we see more clarity. Obviously, the next one will be when they start the assessment for the next SREP, which basically happens during the summer months. This is the indication we can give you at the moment.

Jovan Sikimic	Okay. So, regarding SREP 2020 but, as you earlier said, you expect that this SREP 2020 will be more or less the final one, right?
Johannes Proksch	There are little precedents for this one, but for the moment, we use all the possibilities which we have, which was basically the submission of the objection to uphold our right to be heard. And then let's see if this is taken up. And, if not, we will ultimately have clarity on that one once we get the final SREP letter.
Razvan Munteanu	Maybe I would add, there is no precedent, but also nothing so far in our discussions with the regulators that could change our view that the bank currently carries capital in excess to what our business model reasonably requires.
Jovan Sikimic	Okay. And I would have another. You mentioned that growing yields in consumer loans, particularly for the front book – in which countries is this the case? If you can make a short statement on that, would be great.
Razvan Munteanu	We see a growth in the new book consumer yields in all markets. So, in all markets there is a growth in the yield, with the exception of Serbia, where we have a technical decrease, I would say. As you are probably familiar with the regulatory requirements there for the end of the year. We have to shorten our tenors, and in the first part of the year, we rebooked a number of loans from the past into shorter-term loans. But we see now growth in Serbia as well of our new book yields. So, we see a growth in basis points, as I indicated, 30 bps across the board, in all our markets. And this is by focusing on smaller, shorter-term loans, where the automated lending approval and APS and decision engine-based tools allow us to move away from the price discussions.
Jovan Sikimic	Okay. And you mentioned also restrictive measures around in the region, do you expect further that maybe you can compensate I don't know some pressure on growth via pricing? Or, what's your view on how those measures can impact the business?
Razvan Munteanu	That is correct. We see the regulation typically pushing the average ticket size and duration of loans down, and, typically, this is the area where the yields are better. And, if you look at the specific impact of the regulations, they are not pressing it extremely much down – so, we are still staying in the range of four to five thousand EUR average loans.

Jovan Sikimic	Okay. Thank you for this. And a question on consumer loans, on the cost of risk in consumer and SMEs and in the key areas. I calculated that, in consumer, you had in this quarter almost EUR 8 million, and in SMEs around EUR 5 million. So, is it the new 'normalized' provisioning level in each quarter that we can expect?
Razvan Munteanu	Let me hand this over to Markus, our CRO, who is here with us on the call.
Markus Krause	What we have reported here, as year-to-date numbers, is fully in line with our expectations and as Johannes mentioned before even better than the plan. So, this is caused by ramping up the portfolio where gradually the risk kicks in, while we were even as said assuming more conservative numbers for both segments – SME as well as consumer.
Razvan Munteanu	So, we performed better than anticipated.
Jovan Sikimic	Okay. And this was one I think one-off release in corporate center, what, if you could explain, what was this exactly. It was the EUR 5 million, right?
Markus Krause	Yes. It was technical items related to IFRS 9. When we introduced, we had some model risk charges in the IFRS 9, requested also by auditors these days, and now after having more time series, more data available we could release some portion of it.
Jovan Sikimic	Okay. And my last question, if I may. There were no tax payments this quarter, any particular reason?
Johannes Proksch	If you look at our earnings release, which was also published this morning, you can see that there are taxes paid of EUR 5.8 million in the three quarters of 2019, I think in the third quarter specifically you're right, you're right. I need to come back on this one. I cannot give you an answer straight away. I need to come back on this one.
Jovan Sikimic	Okay, okay. Thank you. Thank you very much. Thank you, guys.
Operator	And the next question received via the phone is from Simon Nellis, from Citibank. Your line is now open sir. Please go ahead.

Simon Nellis	Hi. Thanks very much for the call. I guess my first question would again be on capital. What's the plan if the 4% P2G challenge doesn't work, and if they reiterate that 4%? What would you do then? That would be my first question. And then maybe we can take them one at a time; I can ask my next questions after.
Johannes Proksch	I can only say that our business does not require this capital ratio. So, I understand the question, but the profitability of our business, related to these kinds of capital requirements is - then their requirements are excessive. So, we continue to work with the regulator towards this transparency, and we don't want to update or amend our view on this one. That's basically our position.
Simon Nellis	Can I just get a clarification on the P2G of 4%? So, that has to be met with CET1 capital, correct?
Johannes Proksch	Yes, correct.
Simon Nellis	And then, whatever CET1 capital is used to fill the P2G, that can't be used a second time to fill the AT1 and Tier 2 buckets, right?
Johannes Proksch	I'm not sure I understand. I mean, this is quite normal. The Pillar 2 Guidance is required to be filled up, it's basically for the stress reserve with CET1. And the 1.5%, so Tier 2 and the majority of AT1 can be used for the Pillar 1. So, basically, we are moving the 8% to 4.5% - but that's relevant for every bank and this is not an exception in our case.
Simon Nellis	I guess the question is: if that 4% P2G stands, I guess you would still have to issue Tier 2 to meet the additional AT1 and Tier 2 buckets? Or would you try to fill that using retained earnings?
Johannes Proksch	So, we would need to fill it up. The question is, what we so far have not received from the regulator is the time to ramp up, and the measures which they would put in place if we don't do that. But that is a subsequent question to the one "is the 4% the right number?"
Simon Nellis	Right. Okay. And then, just on the tax issue again, I think your tax rate was 17% on an adjusted basis, so what is your expectation for the tax rate this year and going forward? Will the guidance still stay the same? That is my second question.
Johannes Proksch	We use 21% as a tax rate for all our calculations going forward.

Simon Nellis	That would be for all years, right? For 2019 and onward.
Johannes Proksch	Yes. Yes.
Simon Nellis	And then just on fee growth. It seems to be growing, I mean its growing which is nice, but it is growing at a slower pace than I think your mid-term guidance. Is that expected to change? Are there initiatives to increase that? Or what is happening there?
Razvan Munteanu	Hi Simon, it's Razvan. So, we are seeing a slower growth than anticipated in fee income, mostly accountable to the card-related fees. We have considerable plans to ramp up primarily the card platform, with various roll-outs in 2020. And this would give us a substance for continued growth. We also made a number of adjustments, given the overall challenges on the interest rate environment, changes in pricing, and we see continued growth from current account packages both in SME and consumer. So, we have a variety of actions to accelerate the fee income growth.
Simon Nellis	Okay. And then just maybe two other questions. I was wondering if you charge any upfront fees when you issue consumer loans, and if they are material. That would be my first question.
Razvan Munteanu	We do charge fees for consumer loans, but they are accounted for as interest-like income. So, you see them in our interest income results, not in the fee results. We call them fees, but they are treated as interest-like income.
Simon Nellis	And are those fees returned in part to clients if they repay early?
Razvan Munteanu	No. They are brought forward. They are recognized earlier, so they are recognized at full repayment, in case the customer repays early.
Simon Nellis	So, they get back pro-rata part of that fee.
Razvan Munteanu	No. The customer does not get it back, but they are recognized with us as full income earlier, if the customer repays earlier.
Simon Nellis	Right. Okay. And then in Slovenia, I think they have put some restrictions in place related to the maturity of consumer loans and PTI restrictions. Do you see any material impact from those?

Razvan Munteanu	As I was indicating, on a short-term basis we do see impacts coming from these regulations, and we had the experience last year in Serbia, Croatia, or so in Bosnia three years ago. So, there is a temporary impact. In essence it is a time for us to implement counter-measures, understand the response of competitors and the consumers - but in essence, the market in one or two quarters returns to former growth. Unsecured lending remains a key driver of economic growth in these markets, and this is why we were mentioning that the market growth was healthy, and we see it continuing in a healthy manner going forward. We are adjusting already. We are preparing for more granular loans, as I was indicating. So, we will focus on smaller loans, where our ability to automate and use application processing systems and decision engines, gives us a unique cost base, allowing us to go to more granular loans. And also, we do more digital distribution, to tap into a broader customer base. So, all these are counter-measures that we are gradually rolling out to address these types of regulations.
Simon Nellis	Okay. Thanks very much.
Edgar Flaggl	Alright. Operator, we have a few questions on the webcast.
Operator	Yes. There are no further questions via the phone.
Edgar Flaggl	Okay. We have a few questions over the webcast. I will start with one from Interkapital, from Ivan Dražetić: "What is the ratio of local currency loans in overall loan portfolio in Croatia/Serbia?"
Razvan Munteanu	We only originate new loans in local currency, in essence. And the only foreign currency loans are the ones from our various legacy portfolios. Now, I do not have at hand the exact figures of the portfolio.
Johannes Proksch	On page 33 of the presentation you can basically see what we still have from the mortgage portfolio, and this is EUR 142 million overall exposure in Swiss francs. That's on page 33, you see the composition also by countries.
Edgar Flaggl	We have a few other questions from Erste Bank, who seem to have some issues dialing in. I will start with a question from Mladen Dodig: "Could you be so kind to elaborate on guided dividends - what is most probable scenario for payout of the 2019 dividend in the year 2020 and what it will depend on? Also, if you can say us more on Tier 2 market expectations?"

Johannes Proksch	I will cover this. I mean, we largely elaborated on this one during our call on 10th of October, but we clearly would like to continue to stick to the guidance when we said we aim to pay out of profit the EUR 40 million. I cannot give the precise year-end profit target now, but this is basically what we were guiding everybody towards. Now, obviously, the impact, and we have highlighted this one, the one which was as significant that we could not compensate, was the Swiss franc Supreme Court decision in Croatia of EUR 8.7 million. This has impacted us, and now basically, the topic is "what will be the year-end profit?" I don't want to guide you or provide more details on this. I think you understand where we are. And, obviously, profits, this is the one where we do not see any issues with regard to the new SREP draft decision. What is above profits bears a slight risk that the discussion could come out on that one. I hope you understand that this is the most I can say to this question. Tier 2 timing. We provided you with all the details on why we didn't raise it now. We believe that the second and third quarter will provide more transparency on the draft SREP decision. And we will be ready with the Tier 2 at that moment, to basically then fulfill our initial intention to pay out an exceptional dividend resulting in an excess capital. So, therefore, this is timed with the transparency gathered with the regulator.
Edgar Flaggl	We have one more question from Jiri Feres, from Erste Bank as well: "Can you share the feedback with regards the pricing of the Tier 2?"
Johannes Proksch	Well, we were guiding you and there is also, if you look on our earnings release, we have highlighted this on page 12. It was a wide range, and we were not willing to fill up the full amount at that kind of cost. It would not have been commercial, and that is ultimately why we decided to continue to work on the Tier 2. We are doing this with some anchor investors and investors which were interested at an acceptable price. And we are timing this now, as I said, towards the next year. And that is basically as much as I would like to say on the pricing of the Tier 2.
Edgar Flaggl	The next question on the webcast is from Peter Bielik, EBRD: "Thank you for the presentation. Is the special dividend on the agenda after T2 capital issuance? Can you please give insight on your minimal capital buffer levels going forward?"
Johannes Proksch	On the special dividend, we always said – and this was also part of the call – it's not a question of the if, it's a question of the when. So, we continue to be committed on this one. And we have also, as you have seen in the presentation, not amended our mid-term guidance of 16.1%. Of course, we will have the discussion with the regulators, and we will update in the context of the year-end

	financials, the stress model, the five-years plan, and so on. But, for the moment, we see no reason to deviate from the 16.1%, which includes a 1.5% management buffer.
Edgar Flaggl	The next question on the webcast is from Thibault Nardin at Wellington: "Did you have already your discussions with the SRB, if yes what was their view on your strategy?"
Razvan Munteanu	Markus, you will take that?
Markus Krause	Yes. We had, a few weeks ago, a meeting with the SRB College of Supervisors, where we got the opportunity to present on the separability analysis, which is one of the conditions for the Multiple Point of Entry, with Croatia as the entry point. We have proven in a quite comprehensive documentation that the separability is given from an operational and financial perspective. The documentation has been appreciated very much by the SRB, and they take it into consideration for their further steps.
Edgar Flaggl	We have no more questions on the webcast. Operator.
Operator	We have no one at the phone also, so I hand back to you for the conclusion.
Johannes Proksch	Maybe just one. I would like to answer an earlier question on the taxes. It's related to the Swiss franc provision which we did in the third quarter, and, in connection with this – this is a little bit technical – the ramp-up of deferred tax assets, so the outcome is a 0 in that particular quarter. Just to also reply to that question.
Razvan Munteanu	To conclude, let me remind the key points that we want you to take away. Our core business performance continues in line with our strategy. We address the business climate challenges. As a specialist, we are better placed to implement counter-measures on revenue, on cost, and potentially on setting up an EU branch structure. We maintain the view that the bank carries capital in excess to what our business model reasonably requires and work to align this view with the regulators. Finally, and most important, we remain fully committed to our approach, especially generating growth in the focus area, distribution of dividends out of profit, and distribution of excess capital, once available. With this, I would like to thank you for joining us on this call. Thank you very much.

Operator	Ladies and gentlemen, thank you for your attendance. This call has been concluded. You may disconnect.