



ALIOR BANK S.A.

ALIOR BANK Q2 2016 RESULTS ANNOUNCEMENT

Conference call held on 11 August 2016, 08:30 GMT

Edited transcript

Speakers:

- Wojciech Sobieraj, CEO
- Witold Skrok, CFO

Participants:

- Dariusz Górski, BZ WBK
- Kamil Stolarski, Haitong Bank
- Alan Webborn, Societe Generale

Host: Good morning, everyone. Thank you very much for participating in Alior Bank's results conference call. I will leave the floor to today's speakers who are Wojciech Sobieraj, CEO, and Witold Skrok, CFO.

Wojciech Sobieraj: Good morning and welcome to our quarterly presentation. I will go through the first two pages of the results and then pass over to Witold for the details.

In a nutshell, on the one hand – on the operational side – it was a very boring quarter: all our business lines performed in line with our expectations, there were no surprises in corporate or retail lending, we grew according to the plan exceeding PLN 1 bn net growth, cost of risk is under control and much below the level that we envisaged for the full year, so it was business as usual. On the other hand, it was one of the most exciting quarters in the history of Alior, because we finalised the transaction with BPH, we concluded the rights issue and, at the same time, we have proven that we are not stopping on innovations and new product development. If you go to our pages and then we will go into details later, we completely changed our offer for small business clients using internet banking and now have a new advisory portal for them. At the same time, we are working on our main project (after the merger) for this year, which is a new mobile and internet banking platform, which will be introduced by the end of the year. As for the other topic, the transaction with BPH, I think it all goes according to the plan, all approvals were obtained by us, GE and BPH in due time, all preparatory work on the demerger of BPH goes as it was planned, and the remedy programme for BPH and the results of this remedy programme are also in line with the expectations and forecast from the beginning of the year. I think in the next few months we will see the demerger process and legal merger between Alior and the organised part of BPH, and we are confirming that we would like to conclude the operational merger of both banks by the end of March 2017. Let us continue to the next pages for operational performance.

Witold Skrok: As Wojciech mentioned, there was a very solid growth of operating income, up 13% in 1H this year vs 1H of the previous year; cost is under control excluding the first bookings related to BPH integration, because as you remember, we concluded the legal part of the work at the beginning of Q2, this is why we had to book the first invoices we received. The net profit, even if you adjust it – in Q1, we paid the banking tax only for the two months, and in Q2, it was the full quarter we paid the tax – with this adjustment, the results are very impressive. As Wojciech mentioned our loan growth, we are very satisfied with the Q2 performance, which means that we are on track with our annual target, which we announced at the beginning of this year (PLN 5 bn). What is important, the growth is driven in all business segments, so we are growing and staying on two legs: corporate and retail. As to the deposit base, as you remember, in Q1 we collected a lot of deposits just to have an investment buffer for the tender offer, which we announced in July. Since the capital increase has been registered by the court – it happened in late June – we started to slow down and reduced the level of deposits to adjust to the expected L/D ratio at the level of 95%. If you look at the credit risk overview, Wojciech mentioned that we experienced the improvement of the cost of risk, so it also gives us an opportunity to improve the NPL ratio due to the growth of our portfolio: we have a slightly higher NPL ratio vs the previous quarter, but the coverage ratio is almost at the same level, which we observed in the previous quarter, and below the market average.

Wojciech Sobieraj: Also with the NPLs, we have not sold anything from our portfolio. We believe that last year we had this successful transaction, the first ever sale of NPLs from Alior at PLN 645 m and we believe we will grow the portfolio to this amount not selling the chunks, because then the price is not as attractive. It is unlikely that we will sell off any NPL in Q3 this year, and it is not likely even in Q4 2016. We will wait until at least PLN 0.5 bn of the portfolio is ready for one chunk sale.

Witold Skrok: Plus, in Q2, we recalibrated our PD model, and what we observed was PD improvements on the ex-Meritum portfolio, so this is a good sign of where the cost of risk should go in the coming quarters. Next, slide 10, net interest margin development. As you remember, last quarter we had a discussion about the NIM drop in Q1 vs Q2. Our answer to that was: mainly by the development of our AFS portfolio, and on this slide we made an illustrative comparison of what margin we should expect in Q1 and Q2 this year if we apply the same amount to the AFS portfolio. It means that the margin was stable at 4.4. Please bear in mind that this AFS portfolio is related to the merger, so when equity is reduced –and Wojciech just mentioned the integration with BPH – this portfolio will be replaced by interest-bearing assets, which we expect to have from BPH.

On the next slide, slide 11, you can see our profitability, which is sustained in this quarter vs the previous one. The risk-adjusted net interest margin was flat in the last three quarters, so it is stable, and it is a core element of our future net interest income.

On slide 12, we present the fees and commission income. We are satisfied with the level of revenues, however, if you look at the F&C expenses, there is an increase q-o-q. This growth is explained by a higher cost of card processing. We have an agreement with FDP that with a lump sum we exceeded the certain threshold and we started to pay more as our customers use their cards more actively than in the previous quarters so this is a business-driven growth of costs. The second element is higher provisions, which we paid to our agents. They sell more cash loans and other products, so we paid more to them in salaries. There is also higher cashback for T-Mobile customers, plus the development of the volume growth q-o-q.

Next slide, capital position. This is obvious that after a very exciting quarter, we concluded a capital increase, it was done a few days before Brexit. Now, we experience a very safe position, but, of course, this is for the transaction purposes.

On the next slide, you can see that despite the one-off and integration costs, our C/I ratio is at a very good, low level, we are practically No. 3. Please bear in mind that the cost related to the equity relief guarantees is not a recurring cost, it will not be shown in the next quarter, as we terminated this guarantee at the end of July.

If you look at the number of customers (slide 15), we experienced a solid growth, and the number of customers in the next quarter will drive volumes, which we expected to grow, as I mentioned in the beginning.

Sales network: we are in the process of optimising the sales network, but more details will be provided by Wojciech. Thank you.

Wojciech Sobieraj: On slide 16, this is our current distribution network. I think it is large – it is 300 branches of our own, over 500 agencies, and adding the exclusive relationship that we have with Tesco and T-Mobile stores, we are really in top 3 distribution networks in Poland before the merger with BPH. I believe that it is fair to say that 800 – bearing in mind the decline in branch-based transactions, the trend that continues y-o-y – it is enough to have 800–1,000 points to be in top 3 for a retail bank. I think we are No. 9, so there are plenty opportunities for us to fill the branches with more clients. At the same time, on this page 16, we have not mentioned that in the meantime, we became a strong No. 2 player in the Polish consumer finance after Santander based on the volumes. Our position is strengthening through our stores, retailer and partner networks, not only in the e-commerce space, when we started with Allegro years ago, but now also with the traditional retailers.

On page 17, this is what we have done in Q2 to upgrade our offer for small businesses. We launched Zafirmowani.pl, a new portal for companies, and this is something unique, I would say, on the Polish market, because we are offering not only the advice and community type of networking for companies, but also with our partners we are offering them fully automated, all-electronic processes not only in banking, but also in taxation, advisory, book-keeping, telecom, insurance areas by Link 4, T-Mobile, EY, and a number of other reputable companies. We have opened I-konto Biznes, a fully automated account opening process; the mobile banking has been refreshed, and we are proud to announce that we are now ready to make a credit decision for the small companies in 30 minutes, and the time to cash is less than 20–24 hours – this becomes standard in all our branches and agencies.

T-Mobile. On 18 July, we reported to the National Bank of Romania that we are ready to start our operations there. Now, it is summer, so we are in the process of testing the reporting and doing the transactions without marketing campaigns yet, but the Romanian operations are ready. As far as the Polish cooperation with T-Mobile [is concerned], it works well: according to our plan, we are working on a new Internet and mobile platform for these clients, in the same context as the mobile Internet platform for entire Alior, a big bank. 90% of the new financing is now for the clients new to the Bank, so it is a good channel to get into new relationships. What I can say – most of the equipment that is currently sold by T-Mobile is financed by Alior, so this vendor financing is being replaced by Alior financing if you are buying a tablet, smartphone or any other form of device from T-Mobile. Sales volumes are growing y-o-y at high speed of 50–100%.

Next comes page 21, the 2016 outlook. When you look at the numbers from the beginning of the year – PLN 322 m, NIM, C/I, cost of risk, loan growth of PLN 5 bn – I think we confirm all these numbers. There might be a different balance between the net interest margin of 4.6% and the cost of risk of 2.3%, but the difference between the two will be at the level of 2.2–2.3% rather than 2.3%– 2.2%. C/I will definitely be below 48%. We expect some improvement of the overall net income level, for instance, this PLN 11 m that we paid for the capital relief guarantee will not come back. On the other hand, from Q3 onwards, we will be reporting the costs of the merger separately; in Q2, it was only PLN 11 m linked with the transaction itself. I think the cost of the merger will depend on when we start the legal merger – is it 1 December or 1 November, after the testing that will start in September. We will know at the end of September when the legal merger starts with BPH and after the legal merger, we will try to work over the period of 4–5 months to prepare the operational merger by the end of Q1. In the aspect of these potential merger-related costs, I think regardless of them we would like to make sure that PLN 322 m is achieved and delivered by the end of 2016. I think that is pretty much it. If you have any questions, please feel free.

Host: OK, we are now ready for questions from the audience in the room. Does anybody want to ask a question?

Dariusz Górski: Thank you very much for the presentation. I have a follow-up question on your comment regarding the cost of card settlement. Was this one-off in nature or is this a recurrent level that we should expect in the subsequent quarters? And my second question will be on your volume growth. You have been delivering on your earlier commitment, but nonetheless it seems to have flattened. What do you see in your pipeline – other banks are not very positive – for the rest of the year?

Wojciech Sobieraj: So, with FDP and these card transactions, I think that it is fair to say that we are now looking forward to the merger with BPH, and the number of cards and card transactions will practically double. So, we will go there and we will try to renegotiate the transactions, volumes and per-transaction costs. It is fair to say that, even if we do not negotiate anything better for the merger with BPH, these costs will be there for Alior standalone. I am almost certain that we will be able to negotiate these volume discounts. I cannot assure if it is going to be in Q3 or Q4, but it is the function of two things: (a) whether we maintain the outsourcing model of operations in the card business or whether, after the merger with BPH, we are big enough to do it on our own, and (b) what kind of volume discounts we will achieve from the outsourcers. So, this is on the cards question. Then on the outlook for the loan growth. I think we would like to maintain that we will grow the loan portfolio by PLN 5 bn for the whole year. It is true that the amount of loans and loan applications was not as spectacular as we thought it would be at the beginning of the year. What we see is explained by two phenomena. One is the repayment of loans, especially by large companies. We do not have a lot of large companies in our portfolio, but then they have access to much cheaper forms of financing on European markets, and this is one negative phenomenon. The other one is a slight delay in the EU programmes, so we see a lot of applications for investment loans by the companies that are on hold. I guess in Q3 and Q4 they will be finalised. If we look at our portfolio of loan applications, the situations with mortgages, cash loans, consumer finance, working capital financing for companies are all according to the plan or higher, it is only the net growth of investment loans for companies that is slightly disappointing. But we believe it is a temporary phenomenon, we saw that in 2009 and 2010.

Witold Skrok: Just a remark about the cost of card processing. We should not expect growth, because, according to the contract, we have reached a certain threshold after which we adjust the lump sum, so the growing business will not increase fee expenses in the coming quarters. And, as Wojciech has

mentioned, we have renegotiated the contract that will come into force at the beginning of the next year.

Dariusz Górski: Thank you very much. A follow-up, if I may. There is a bit of a divergent trend between the employment at the branches and the number of branches. Why is that?

Wojciech Sobieraj: I think what is going on with the branches now is the following: if a branch is a smaller one, we call them transaction-related branches. In the long run it becomes less profitable to operate. Then such branches are reduced, shut down or changed into agencies. Bigger branches, or premium branches, as we call them, become advisory centres servicing SME and affluent clients, sometimes with the help of mobile agents, who travel to clients. To cut a long story short, we will have more bigger branches servicing these two client segments and, if the trend in branch-based transactions continues, we will reduce smaller outlets and convert them into agencies.

Kamil Stolarski: Could you please give us an outlook on your expectations as regards bancassurance and brokerage? They tend to be quite volatile.

Witold Skrok: This occurs when we reduce the number of insurance-related products in our overall sales. This is point one: we should not expect increasing numbers for this line. The brokerage fee is related to the performance of our stock exchange and the products we sell there. Due to the credit risk, we are very selective in terms of the investment products we offer to our [credit], but I think that this line should grow slightly in the course of this year.

Wojciech Sobieraj: This was the worst quarter for the brokerage house since the beginning of Alior. There is nothing wrong with our fundamentals. Someone offered better pricing and so on, and our brokerage is still viewed, on the retail side, as one of the best on the market. Yet, the number of transactions, and volumes, and [orders on] the stock exchange – and hence the income – lowers. We will be reopening... I forgot to mention that there will be a new brokerage mobile-based application available in Q3 or Q4 this year. It is in the last weeks of testing. And then it will help us build the volumes again, maybe, if the market also goes up.

Kamil Stolarski: Ok, thank you for that. The next question is on the quality of the loan book. I think that NPLs increased in the corporate segment by more than PLN 200 m. [...] It also seems that you did a minor reversal of [NPLs] in the retail segment. What was that for?

Witold Skrok: This was due to the tax reasons. We shifted part of the NPL portfolio to the subsidiaries and recognised the losses. But the amount is insignificant. As the corporate segment is concerned, there is nothing unusual. Some of the portfolio which we mark as NPLs have to stay for one year to get a relief, and this is why they are still in the process of getting to be reclassified into the normal portfolio.

Wojciech Sobieraj: So, nothing changed in our biggest exposures from commercial lending. We did not experience any problems with any of our clients in the reporting quarter.

Kamil Stolarski: Clear. The last question is on your liquidity position. It seems that today you have twice as many bonds as you had a year ago. What do you plan to do with that?

Witold Skrok: I will explain this. First, when we signed the SPA with GE, we built up the portfolio with which we expected to secure the tender offer. We wanted to protect the price of BPH, and the reason to have this buffer was to be ready to announce the tender offer at any time. Second, when we increased our equity, we reinvested this equity in the AFS portfolio, including bonds and National Bank of Poland

papers, and this portfolio will be converted into cash when we acquire the shares from GE and minority shareholders.

Kamil Stolarski: Thank you.

Host: Any other questions from the audience in the room? Operator, I kindly ask you to open the lines for questions from the remote audience.

Operator: Thank you. As a reminder, if you would like to ask a question, please press “*1” on your telephone keypad. If you would like to cancel your request, please press the “#” key. Your first question comes from the line of Alan Webborn. Please, ask your question.

Alan Webborn: Hi, it is Alan Webborn from Societe Generale. Thank you for the call. In terms of your NIM, I mean you have shown that the number is flat on the LFL AFS portfolio from Q1 to Q2. Do you think that is going to stay the same as you go through the rest of the year, just for understanding what the make-up of your full-year NIM forecast is? Is the weight of the AFS portfolio going to get bigger? Do you think that the core NIM could improve, just to give us an idea on the dynamics of that? Because presumably the money goes across, at what point, at the end of the year or at the beginning of the next year? Just to understand the dynamics of that would be helpful. Secondly, on your fee income. Could you perhaps tell us if there is a seasonality in the fees related to current account loans and transfers? It is clear it was a bit lower in Q2 even though you had continued strong loan growth in Q2. Could you help me understand what is going on there because I thought that could have been growing a little bit more given what had been going on in terms of volumes. And, I suppose, the last question. You have said there will be no new issues in terms of corporate NPLs. Nevertheless, the NPLs total has gone up by 1 pp. from Q1 to Q2. Could you just talk us through the reasons for that? That would be helpful, too. Thank you.

Witold Skrok: OK. Let me start with the AFS portfolio. As I have mentioned, it is related to the transaction, and when we increased the equity through the acquisition of BPH, we reinvested this into bonds and the other [assets], which is shown in the AFS portfolio. This is the fact of where we were at the end of June. It is expected that by the end of September we will acquire the shares from GE and minority shareholders, so this portfolio will drop and will be shown in another line of our balance sheet. However, we will not consolidate BPH, so it will not have impact on the P&L at the end of Q3. Depending on the demerger plan that I have already mentioned, here we have two deadlines. The first one is the beginning of November or the beginning of December. Depending on that, when we start to consolidate the core bank, this is the part of BPH which we are about to acquire, it will start to have impact on the P&L, and it will increase our NIM, but it will be first shown in Q4 2016.

That was question number one. The second one, on fee and commission income. You should bear in mind that the growth of the volume, especially of the retail portfolio, has but a minor impact on the fee and commission income as all charges are recognised according to the effective interest rate, and they are shown in the NII margin. Only a minor element is shown in the fee and commission income. And this is why we experience a certain [inaudible] when the volume grew quite rapidly, and the fee stayed stable. And the second element is that I do not see any seasonality between the quarters but a part of that is related to the transactions that the customers made, it will be driven by the behaviour of our customers.

Wojciech Sobieraj: And one more comment to that. Contrary to our competitors, we have not increased the fees for the clients, and the result is visible on page 8. Q-o-q we grew the current accounts of the retail clients by more than PLN 1 bn, and this PLN 1 bn significantly reduces our cost of funding. So at the end of the day we made a decision that it is better to wait with potential changes in fees and commissions charged to the retail clients and get them more into keeping the balances with us. I think it

is not fully visible in our results yet because the LTD ratio is at an unacceptable level of 90%. We do not want this buffer and, as Witold has mentioned, we will go back to 95% after the transaction with BPH is concluded. But this was a deliberate decision by us not to squeeze out the clients with more aggressive pricing on fees.

Alan Webborn: Is it the right interpretation that there was slightly less customer transaction activity in Q2, or is that not correct?

Wojciech Sobieraj: Most of the fees are coming with the monthly charges to the clients, and our fee and commission [income] for retail clients is built in a way that when a client is making transactions with us at an appropriate level, then we are not charging them for their current account. And our competitors have introduced monthly payments while we have not. I think the number of transactions, especially through the electronic banking channels, has actually increased in the bank but you have not seen this in the form of increased amounts from fees and commissions. What happened in reality was more of our clients treating us as the bank of choice, keeping their balances on the current accounts and actually doing these transactions, not to pay their monthly payments associated with current accounts.

Witold Skrok: As Wojciech has just mentioned, we offered the customers to treat us as their bank of choice, when they trust their salaries into our accounts and we do not charge them any fees for running those with us in terms of current accounts and withdrawals of money from ATMs, and we do not charge any fees from the customers. However the way we earn the money is our NII.

Wojciech Sobieraj: However, I think it is fair to say – page 12 – that we are not satisfied with the 76 m level, our ambition is to work on both the revenue and the cost sides of the fees and commissions, and we have a small special project to get this number back to 100 m per quarter. This quarter was not that satisfactory but we know the ways how to activate the clients to get back to 100 m net fee and commission [income] per quarter.

Alan Webborn: Your explanations are very helpful, thank you.

Witold Skrok: And the last one was about NPLs. We should look at the cost of risk and the NPL portfolio, so we are looking at the exposures [inaudible] few corporate customers where we have very strong collaterals. We have reclassified them into “under watch”, and we also treat them and reclassify them into the NPL portfolio but it has no impact on the cost of risk.

Wojciech Sobieraj: I would say it is a reclassification, and, as Witold has mentioned, the financial situation is improving with a number of clients, even dramatically, but according to the regulations we need to wait for one year to reclassify them back to the normal business, and I think that you will see a couple of them coming back in Q3 and Q4 to the normal portfolio.

Excuse me, do we have any more questions from the remote audience?

Operator: Thank you. As a reminder, if you would like to ask a question, please press “*1” on your telephone keypad. If you would like to cancel your request, please press the “#” key.

Wojciech Sobieraj: Ok, it looks like we do not, that concludes our conference. Thank you very much and have a great day. Thank you.

Witold Skrok: Thank you.

Operator: That concludes our conference call for today. Thank you for participating. You may all disconnect.