# NLB GROUP First Half 2022 Financial Results Conference Call

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***Conductors*:**

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Conference Call Conducted by Chorus Call Hellas


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OPERATOR: Ladies and Gentlemen, thank you for standing by. I am Popi, your Chorus Call operator.

Welcome and thank you for joining the NLB Group conference call and Live Webcast to present and discuss the First Half 2022 Financial and Operational Results.

All participants will be in a listen only mode and the conference is being recorded. The presentation will be followed by a question and answer session. Should anyone need assistance during the conference call you may signal an operator by pressing star and zero on your telephone. At this time, I would like to turn the conference over to Mr.Blaž Brodnjak, CEO and Mr.Andreas Burkhardt, CRO

Mr. Brodnjak, you may now proceed.

BRODNJAK B.: Thank you very much, warm welcome, everyone. Good afternoon. Let me first draw our attention to the standard disclaimer, and then continue with what we believe has been a very strong first-half of this year. Couple of very important milestones achieved again. One has been really stabilization of the Slovenian banking system via acquisition of Sberbank subsidiary, today it is N Banka, which we have, I believe performed in a very responsible and decisive way.

The other, very important one has been really successful completion of integration by which it is really fully completed of Komercijalna Banka and NLB Banka, Belgrade into today's NLB Komercijalna Banka with already very,

very solid performance in line with expectations and even north of it, for the so far stage**.**

Amidst of this process practically we have been also awarded by a rating upgrade, which is…which is a solid confirmation for shape of the bank on one side, and solid performance on the other, and on top of that obviously we have committed within this period to even more ambitious ESG convergence towards Net Zero Emission targets agenda of NLB Group by signing Net Zero Banking Alliance commitment and initiatives.

So by that of course, given the current uncertain and in turmoiled circumstances, we remain fully committed and we remain not only fully committed but really ambitiously moving towards the Net Zero targets.

On the other hand, when it comes to real performance, this has been a very, very solid half of the year, both in terms of growth of volumes, so we are really happy that we have been growing the business in fact in all segments and geographies, so specifically strong trends in retail, housing production which is for us very important anchor product obviously and pickup in corporate demand especially so also in the second quarter which is of course, despite the current…the conflict situation for this part of the world, very meaningful. So, the near…the insourcing, near shoring effects still happening, order books still pretty robust, dependence on Russian gas. Andreas will be talking about this later on in the subsidiary countries a bit less pronounced than in the developed Europe whereby in Slovenia since manageable, and above all we have had continuously for this period also very, very solid performance of our quality in terms of, you know, asset structure and performance of these assets.

So we have seen further decrease of NPLs. We have seen very solid output in terms of negative cost of risk still in the first half of the year and on the other hand, really we have seen also further strengthening of capital, so this acquisition of course, N Banka has been positively recognized and acknowledged already, through the negative goodwill recognition on one side, on the other side clearly, we have also strengthened our foundations in terms of the MREL requirements and funding, so besides of course booking already and acknowledging fully the negative goodwill, we have immediately after the first half also successfully issued the MREL instrument senior preferred bonds,€300 million in size by which we have fully secured of course MREL requirements for this year as well.

And we have been in pretty advanced debate with supranational on AT1 issuance which further beef up capital. We believe of course that in these times it is important to you know further work on the solid capital base to on one side, of course provide for a very, very significant and swift organic growth which we like the most, because this is obviously within the defined risk appetite and underwriting criteria perimetry so this is growth we really fully control, very sound growth, strong housing especially loan production with historically proven very low delinquencies, and by that, of course also very, very solid cross-sell capacity attached to it.

So, we have of course been closely monitoring the exposure towards Russia-Ukraine and adjacent countries of the bank itself, the Group itself, and above all our clients, and we believe this is absolutely within the manageable territory and framework. On the other hand, clearly as I mentioned before, our region is still foreseen to be growing in the upcoming period, significantly growing on one side, and secondly showing also a bit less dependency or significantly less dependency, depending on the country you look at on natural gas as one of the main energy sources.

So, key developments in terms of numbers. I was mentioning gross loans growth, and that's really something that is extremely encouraging. We are talking about the especially strong robust growth in housing loans and now in last period also corporates and this is true for Slovenia especially, which is especially…which is encouraging even more, year-on-year growth in housing loans was even above 20%, so if you look at year-to-date numbers excluding N Banka's acquisition, obviously this is, you know, in half-year year-to-date practically almost double-digit growth. Of course, that's very significant.

We've seen a very, very solid result in terms of net fees and commissions. If you look at net non-interest income evolution of course we had some one offs from last year, if you look at the recurring fee and commission income trend, it is absolutely, I would say, I would call it stellar, because you know we are looking at practically 14% net of N Banka growth you know coming from plain vanilla really banking business and asset management business, and you know, this is obviously a kind of result of last year's developments by introducing the high balances on one side but we have an inflation making people to rethink where to invest money holding in bank accounts of course in that to the asset management products.

Despite uncertainty, we still have very strong production of investment funds and unit-linked insurance products and of course we…once we sell the housing loan, the average cross-sell you know ratio is above 5, since means we sell 5 other products as well, so this is very robust result of actual commercial activity. The bank has been gaining market shares in retail and corporate in Slovenia and of course also in other key markets we have had new business production ahead of market average and by that also gaining market shares. We are especially pleased about these trends in Serbia as of course main focus point after the successful first acquisition and now completion of integration.

Now, for recurring results before impairments and provisions is very strong, 25% uptick before N Banka and you know a bit more with N Banka, which shows that the recurring substance of this business is very sound, and not only very sound, it has a very solid trend, you know, and pace.

Net interest income is moving up, so net of N Banka, 9% increase, of course not following fully the volumes, but if you look at, you know, nevertheless the numbers, they are very solid, not yet actually reflecting the hike on the revenue side, because this is first half of the year, where EURIBOR's are not yet solidly positive, now we are looking already at solidly positive EURIBOR's on one side, on the other side clearly because we have kept some TLTRO positions still that expired more or less around the first half of the year, so there is some volatility in the balance sheet, we have reduced by €750 million by repaying TLTRO so you will not see these effects in the second half of the year, but nevertheless, Andreas will show you the NII sensitivity for eventual hikes, and you know definitely this banking Group is almost €6 billion long EURIBOR position would be benefiting for you know moderate increases of EURIBOR obviously, so of course we don't count an increase is really introducing a significant credit risk to our client base. You see this already in net interest margin evolution and operational business margin evolution. So we are seeing the turn, we're seeing the rebound. And the more it is even expected to be seen then in the second half of the year, once, of course, the hikes are kicking in fully.

High balance fees have been abolished, of course, immediately as ECB has moved out of the negative territory, but negative implication of this is slightly positive, right? So we will not be charging for high balances, but of course, we will not be charged from the ECB. So in this respect, this is not being painful for the banking group, further more with the hikes we are benefiting.

I was mentioning net noninterest income, when it comes to, of course, one-off effects. One needs to understand that last year, there were really some collections happening, some settlements happening that have brought one-off positive effects, especially in Q2. So there is a bit of, of course, Q2-to-Q2 significant difference. But if you look at the annualized level, we are really looking at a very robust

14% and together with N Banka, 17% growth of fees and commissions, which is the gist of our business, right? And we are really happy about this so far.

Costs have become, of course, the tension point. On one side, inflation is, of course, introducing significant wage inflation expectations. On the other hand, of course, supplies, be it the energy, be it anything else, security services, physical security and so on with the wage of minimum…regulated minimum wages in Slovenia and, of course, also some other countries there have been significant growth of wage expectations.

Clearly, if the inflation rates are between 8% to 15%, you cannot expect that you know, the wages will be on hold. So part of the increase of costs is coming from the, of course, increased wages on the other hand, from G&A, from the general administration and costs.

However, of course, we have been working significantly on further improvement of efficiencies of our processes. We have been working obviously on the branch layout. We have been now already accelerating certain initiatives within the integration with Sberbank, towards N Banka towards the end of the year. And of course, we have been significantly working on the further headcount reductions.

If you look at the numbers here in the slide, you would see that number of employees has been decreasing steadily. Here, it's a one-off, of course, uptick because of acquisition of N Banka with originally 350 people, but currently, we are already at 209 more from the beginning of the year. So this is continuing and will continue as we have been explaining throughout the coming months and years. And by that, of course, significantly offsetting the pressure, especially on the employee costs and infrastructure costs.

Loan dynamics, I mentioned, very encouraging. So in all the segments and geographies, we have very solid growth. Here you see total margins. This is not necessarily net interest margins, right, I mentioned that they are already rebounding. And of course, there was still some lag in subsidiary landscape, when it comes to the deposit pricing. But generally, we are really happy about the developments in practically, as I said, all segments and geographies, growing business significantly and gaining market share. So we are growing relatively quicker than the competition.

And we firmly believe that you know, since majority of retail production is within the housing loan origination perimeter. And this is happening in Slovenia, for example, at the average loan-to-value of 62%, you know, and significant cross-sell ratios that this is really a very sound business, and we really count on this to be only sustainable. We have, in the meantime, significantly increased fixed rates. So the new production is happening at higher rates. It's not yet seen in stock of the entire portfolio, but it is absolutely happening as we speak and will be kicking in into the revenue side. And of course, with the hike of EURIBORs, we believe, of course, also the floating production will be, of course, improving total economics of the business.

Capital structure has been very solid. So beyond the N Banka's acknowledgment of negative goodwill, I mentioned we have had a very strong running result. So part of it was already acknowledged within the Q1 result. But on the other hand, we have a very solid running result. And of course, as I said, we are working on further AT1 issuance before the end of the year in the amount of around €80 million.

And of course, we are still working on the Tier 2 issuance, so this is still something which we are basically trigger-ready at. So as soon as markets become susceptive for issuances of our quality, we would definitely pursue this opportunity as well, and by that really we provide a capital base for eventual further growth. So for organic growth, we are well equipped with capital for organic growth and announced dividend payouts, but for eventual M&A, obviously, we need a beef-up. We are really happy about you know, such strong organic growth.

This is, of course, creating risk-weighted assets. This is, of course, consuming capital. But as said, this is within the perimeter we absolutely manage, because this is clearly within our risk appetite and underwriting criteria. So that's really something we actually, at this point of time, pretty much appreciate.

By that, I would pass the word to Andreas for the asset quality piece and then come back for the outlook.

BURKHARDT A.: Yes, Blaž, thank you very much. From this section, I would like to take you away 3 main messages: First, Blaž mentioned it already, very solid loan growth in all customer segments; secondly, a very sustainable growth, so asset quality remains very high, and NPLs remain low; and thirdly, given circumstances, of course, there are also some sensitivities.  So towards the end of my part, we will talk about 2 of them.

Yes, SME, corporate, on the one side and retail business on the other side, we are growing in all segments.  Obviously, on top of that is also added the stock of N Banka now.  But without that, we are growing solidly.  As you can see here, we have…and that was, I think, briefly mentioned already before from Blaž, one special effect if you look on state, state exposures, including also placements with Central Banks.  And as Blaž mentioned, we have been repaying €750 million TLTRO.  So that's, of course, reducing that position.

On geographical distribution, not very surprisingly, you can see a little bit more than half of Slovenia.  Focus, of course, on Serbia.  Here, we were buying Komercijalna Banka and then the rest distributed throughout our other geographies and a little bit cross-border, which you see here mostly under others.

Asset quality, as I mentioned, remains very high, so more than 94% Stage 1, 3.4% Stage 2 and Stage 3 was only 2.2%, maybe two details about Stage 2.  So first of all, you see no changes in Stage 2 with the acquisition of N Banka.  That's actually not surprising, same then for Komercijalna Banka.  Initial recognition is at fair value.  This means you have either Stage 1 or Stage 3.  That's why this position here is not changing.  And then you see in Q2, that's the other detail in retail in a little jump. Actually, if you see it in absolute numbers, it's not that big, it's €23 million. This has 2 effects, there's a model adjustment, that's one part. And on the other side, macro assumptions apparently have been changing and that is, first of all, affecting here retail.

NPL, you see, of course, also in absolute numbers, still slowly decreasing. Of course, on the other side the €20 million coming in end of March from N Banka. That's also a very moderate number overall, we stay with 2.2%. And actually half…well not half, let's say 40% of that doesn't have any delays. So these are primarily clients which are or were in restructuring, and are not yet cured. On top of that, we have a very solid coverage ratio and this obviously compared to last December stayed more or less unchanged.

As Blaž also mentioned already, we still stay slightly negative this cost of risk…very low cost of risk. As I explained already last time, a little bit counter intuitively we are building €3.3 million, and we are talking negative cost of risk. This is the special effect from N Banka because €8.9 million were built initially. And that's of course annualized, so if you deduct half of that, then you can expect to this minus 6 bps cost of risk.

You also see that we have almost €20 million in half a year repayments from written-off receivables. So, our workout is still doing a very, very good job. And this tells you that, of course, our overall cost of risk situation is solid…very solid actually without that, but of course, it's still helped a little bit like in the last 2-3 years already by this excellent result also from the workout team.

Yes, then coming to the two sensitivities. One, there obviously now is energy sensitivity, so gas usage, mostly Blaž mentioned already. I mean, the dependency here in the region is smaller than on average in Europe. A little bit more, but clearly under Europe, average still in Slovenia, and then in our other countries even much less.

We were doing some stress testing, on the one side coming from stress scenarios, which actually we had developed already before. And this gives us a certain output and then we were, let's say, validating…double checking this on the other side with the mostly affected industries, which result we would see. They are not very surprisingly…these 2 things are coming closely together.

One key message here is that we are below €500 million with the total exposure towards these industries. And the second key message is that even in a…well, quite sharp stress, we stay within our maximum cost of risk, which we ever want to see, that's 90 bps. So, we stay below that. And on the other side NPL by EBA definition, we would say below 4% NPL. Currently, we are at 2.9%, so just if you have a comparison on the impact here.

So of course, that's the current situation, in that respect it’s not fun, but also here our portfolio is very robust and actually not too big extent connected to these troubles which if you ask me is also a good message.

And on the other side, and as Blaž mentioned already, we are considerably long with our EURIBOR position. That means when we are talking about net interest income sensitivity, increase in EURIBOR, of course, helps us…supports us. So, a 100 bps change is here €65 million P&L impact, of course, on an annual basis. And what I have to say, of course, as a CRO this is assuming that these shifts don't happen too radically and too fast, because on the other side, we of course will then see impact on our NPLs. I have to say what is currently predicted and currently foreseen, I'm not expecting any impact on NPLs. So, the increases here are much too moderate. And that means that we would really see this positive impact from such a rise.

With this, I'm handing actually back over to Blaž. Thank you.

BRODNJAK B.: Thank you, Andreas. Of course, everyone is interested, how we are progressing with the integration efforts of N Banka. So, firstly, I would like to highlight that, of course, we have pretty fresh experience with integrations in couple of markets. So, this is not coming something as you know, we would not be able to manage. We have been pretty advanced in understanding the whole process and project. We have on-boarding, of course, also external support. Our teams are fully working on this as a top priority.

We aim to legally and operationally integrate both banks in Q2 next year, which is pretty soon obviously. We are already almost in the fourth quarter of this year. So, we are fully confident we will be able to pull it off within the reasonable time, and of course, also envisaged material consequences. So, we have been working obviously on really detailed understanding of first the integration costs. That might be in the ballpark of let's say €15million to €16 million, and on the other hand on the synergies fully annualized, let's say in the ballpark of around €12 million.

So, this is something that we are now profiling detailed view, but pretty confident so far already. So, as said, that's top priority, we've known how to do it. We have the toolbox. We have the teams. We have the attitude to successfully pull it off within the envisaged upcoming timeframe and within the money that was foreseen. So, in this respect, we are very positive about this.

And on the other hand, clearly then coming back to the outlook and wrapping up the intro parts, leaving room for questions. Very robust first half. Very happy about it. Clearly tension on cost side, we are, of course, addressing this on one side with further optimization measures right sizing of course, the talent pool on one side, the physical footprint on the other side, digitization efforts, but at the same time we expect this to be paralleled finally with certain hikes in interest environment.

So, you know, it is not about ECB's moves only, effective EURIBOR’s 6 months and 3 months, EURIBOR’s are obviously sound and positive which means that at roll-overs of our books and this is… practically close to €6 billion as I mentioned. The repricing is happening, right? So, in the second half we will have gradual pickup of revenues and you saw the sensitivities.

So you know, this would have to we expect more than offset…significantly more than offset the pressure on costs. And we are guiding here in terms of cost of risks to still staying below 30 basis points this year. So, even in case of eventual full gas embargo, the gas terminals the gas terminals are full to the extent, of course, this year, we would not expect shortages of gas supply, so the gas will be coming. We have been assured of that obviously from Slovenian providers, and of course also wholesalers that the gas for sure at least until the end of the year should not be an issue.

The same is more or less true actually also for Q1 of next year. So, as long as the gas terminal capacities are being filled up to 80%, as long as there is solidarity with the European Union, which is something that Slovenia definitely counts on as the country without own gas terminals, we should not be seeing any, you know, issues within the production capacity of Slovenian businesses. But even if so…Andreas was talking about 90 bps as really, you know, worst case stress scenario, we believe, of course, Slovenian corporates are in a very strong shape.

We have had the record level of employed people, so active population is at the historical height, and of course the unemployment is at the historical low, which means that, of course, even in very certain recession scenario, this will be more than manageable not introducing excessive cost of risk. This is our firm belief as of today. Clearly, you can have your own assumptions, but this is how we see the situation. We also believe that Slovenia being from the countries of the most…from the regional countries, obviously, the most exposed, of course, to the natural gas consumption is robust as a sovereign as well to the extent that there would be, you know, support schemes available.

So, the household pressures have already been managed by the government of Republic of Slovenia to regulation of oil prices, regulation of other energy sources, pricings for the households. So, in case of really significant turmoil, we believe there is still some room for the Republic of Slovenia to intervene when it comes to the economy…so, you know, the production sector. And in this respect, we believe that Slovenia will and shall overcome this unpleasant situation in still very robust way.

So, if you look at the total indebtedness of Slovenian Corporates and households and you compare this to, you know, other countries in European Monetary Union, you would see that they are very lowly indebted still and that the banking sector has been strongly capitalized and I mentioned we are still further working on further beef up of equity obviously, capital and extreme liquidity. So, you know, we will be providing and extending funding, working capital lines and by that relieve the pressure to Slovenian corporates if needed. Households will historically proven, you know, manage this pretty well.

So, coming then to the next year, of course, no one has a crystal ball. We have been for years now guiding to normalization of cost of risk to this territory of 30-50 basis points. So, extreme adverse scenarios would be above that, but as said we don't expect in any reasonable scenario going above 90 bps. We have planned to still continue growing the business significantly and assuming we can of course issue the Tier 2, we would by that open up room for eventual for the M&A growth.

So, organic growth is very strong. We are very happy about it and we aim to continue and still have the potential to continue. For that, we are well equipped with capital, but of course given the so strong organic growth, the previously announced M&A potential has been slightly impaired. And of course, for a more meaningful M&A, we need more capital. And you know that’s why it is not very likely that we would engage in any M&A process in the upcoming couple of months until we are able to then of course meaningfully issue Tier 2 instruments.

The goal is there. We are working on it. We are able to do it. We believe we are worth the risk, worthwhile the investment. But of course, the markets need to become susceptive for the issuers like us. So, all over, the dividend is…the dividend promises remains very solid. We see that the residual €50 million to be paid out this year is by no means in danger. So, we actually stick firmly behind this one, and we aim to call the Extraordinary General Assembly still before the yearend to be paying out €50 million still within this year.

By that I would wrap up by claiming we feel strong, we feel confident and we are gaining market shares in our business, in segments and geographies, and we believe we will overcome these uncertainties, you know, among the best actually in this part of the world. And by that, I would thank you very much for the attention. You know, our team, they are available for any questions we might not be able to respond immediately today but of course now we remain open for any of your questions.  Thank you very much.

**Q&A**

OPERATOR: The first question comes from the line of Nellis Simon with Citi.  Please go ahead.

NELLIS S: Hi, thanks for the opportunity.  I have a few questions.  I guess firstly, thanks for providing the targeted synergies for the integration.  Can you give us maybe a little bit more in terms of timing and how long it would take to incur those restructuring charges and when you would expect the annual synergies to be in place fully?

And then just on NII sensitivity provided on Page 28, just to confirm that positive 50…that means  a  50 basis point increase from your current zero level, right?  Just want to make sure that that's the case.  And I just wanted to also ask if, I think previously from negative 50 to 0, you suggested there will be like a €26 million positive impact. How much of that positive impact has been felt, if any, in the second quarter and when would you expect that to come through to earnings?  I will leave it there for now.  I have a few others but, you know…

BRODNJAK B.: Thank you, Simon.  So, the colleagues will come back to you on the details on,you know,  but mainly, you know, this was happening towards the end of June when it comes to the real, you know, changes in first half. So, first half was not that heavily impacted yet by the interest change.

And then remind me the second question was on integration. Yes, the synergies will…I mean we would try to frontload as much as possible restructuring charges this year, but of course, we have to follow the meaningful…the actual flow. So, you would see them this year and let's say within first half of next year and full synergies will kick in, with 24.

NELLIS S: Okay, and just to confirm, the numbers were €15 to €16 million of integration cost and €12 million of potential synergies.

BRODNJAK B.: From today's point of view, an assessment. This is not yet final numbers but this is pretty good assessment. And then remind me on the first one please.

NELLIS S: Actually, that is all my question. Actually, I just had a follow up which would be…you outlined this negative 90 basis points impact from kind of a harsh gas scenario. Would you have to cut the dividend you think under that harsh scenario or is that…you haven't really observed that.

BRODNJAK B.: Firstly, we don't believe in this one. And secondly, we will beefing up the capital further. So, we will be definitely working on Tier 2, right? So, we hope that at least if not this year, at least in the beginning of next year, we will be able to pull it off and of course by that we will definitely lock in and secure the dividend for the next year as well. This year's dividend is by no means in jeopardy. And as we don't envisage as of today the real stress to crystallize, we don't see now as from today's perspective, not being able to pay out dividend, but you know, if the world collapses, that's a different story, but no one has a crystal ball.

NELLIS S: And then just last on capital. I see that there is still significant fair value hedged through actually both on equity and capital. Do you expect that the worst is done? And I see you're also accruing some of the earnings now…the first quarter earnings into the capital base. Are you going to continue doing that in the future?

BRODNJAK B.: Yes, I mean, if you follow the spreads in last weeks weeks this has been slightly reversed already So, pressure seems to be released a bit. It's actually helping back the capital, right? And you know, of course, I mentioned specifically in the presentation before we have a very strong running results, right, and significant parts of this running result will of course end up in capital at the end of the year, right, or the beginning of next year. So, we are beefing up capital also with the…with the great result.

NELLIS S: Got it. Okay. But..the plans are continuing to accrue a portion of quarterly earnings into the capital ratio?

BRODNJAK B: Well, we, of course, have signaled what will be the dividend payout next year and within this frame, right, we will be of course managing our capital. So, we will not try to jeopardize €110 million dividend but, you know, of course, we have significant substance in form of the running results.

NELLIS S: Yeah, thank you very much, thanks

BRODNJAK B: Thank you, Simon.

OPERATOR: At this time. We do not have any further audio questions. So, we will proceed with the written questions from the live webcast. The first question comes from Jovan with RBI. And I quote, please explain in more details, the 90 bps risk cost guidance from the gas supply model assumptions. Is it the worst-case scenario, any government subsidies included?

BRODNJAK B: I think we have discussed this on a couple of occasions, right, within the presentation. So, this is really adverse scenario. And this is not including any of course, government assistance. So, whereby I mentioned that the government of Slovenia at least and I believe Serbia as well, is in a position to provide support, right? So, this is really worst case. Andreas, would you add anything?

BURKHARDT A: Yes, so I mean, look, worst case is moon is falling on the earth. But on the…what we can currently see, I think that's really the worst, which we would assume that could happen. So, I would not see a scenario, which would be more severe than that. I mean, you just have to look out now on the other side of the planet, if China would invade next month Taiwan, then maybe things look again different, right? So, the current stress assumptions of course, assuming the sensitivities which we have on the table, and that's already a pretty harsh stress. So, in that sense, I can answer the question is yes. That's the worst case of what we assume. And this is also true as Blaž already mentioned, that is not yet including any government support. So, obviously with pain levels increasing, especially here in Slovenia, which is, compared to our other markets, more depending on gas. We would, of course, also expect such effects to kick-in at a certain point of time and this is not included here.

OPERATOR: We have another question from Jovan with RBI. And I quote, which amount of risk costs have you frontloaded in the Q2 for the upcoming energy crisis and higher inflation?

BURKHARDT A: Well, net, zero, I have to say. So, the new macro assumptions, I mean, sometimes you're already forgetting how fast the world is moving. I mean, the last update is from June last year, so we hit…now a regular update is June this year. And honestly speaking, the situation for corporates rather led us to a small release, whereas the assumptions for private individuals, especially because of inflation, led us to an increase, but net of that it's basically zero, so in that sense, no frontloading, if you want. That's a different situation than in 2020. Here we were really expecting actually a little bit more than what can really happened. We really…were really expecting more sharp impacts. And that's why you saw first in 2020, quite some build up and then subsequently because the world was not that dramatic release. So far, that's not the situation which we see right now.

BRODNJAK B: I mean, we need to remember the times before COVID, right where ECB was crying for 2% growth. I mean, we still see forecasts of 3%, 4% growth for the region, which is 3 years ago we would say, "Are we overheating," right? So, in this environment with the 2 plus percent growth, you don't expect delinquencies. You will have single issues with production facilities that, you know, might have shortage of gas supply, but I signaled that, for example, Serbia has procured at very good terms gas for 3 years. Slovenia is in principle, you know, according to the people that are running the system, the energy system and the grid, in a pretty good shape as long as there is solidarity in Europe, as I mentioned, right? So, the…as long as the gas terminals are at 80% full, and Slovenia's gapping you know through the pipeline from Austria, the allocations, we should be in safe hands until April next year for sure. So, you know, in a growth environment you don't expect fall-outs.

OPERATOR: Another question from Jovan with RBI. Why release of risk cost at the level of N Banka?

BURKHARDT A: So, I hope I understood the question correctly. So, we release of risk cost in NBanka. So, that…that's very simple. I mean, in the second quarter, they simply had some unexpected good resolutions of cases and that simply released cost of risk. So, I think the initial setup where we built extraordinary €8.9 million was very rational and logical, but we then saw, actually in the second quarter, some more positive developments and repayments actually and that's where the releases are coming from.

OPERATOR: A final question from Jovan with RBI. The raised regular income guidance from 690 mn to 730 mn, which effect from N Banka is included here?

BRODNJAK B: Well, that's more or less, your running revenue rate of N Banka, and this is in the ballpark of which is public. So, you can see what is N Banka's annual revenue share, and then you can, of course, make your math. On the other hand, clearly, we have envisaged pretty moderate hikes still, and so let's see where it ends up. So, we are pretty confident that these revenue rates are, you know, on a reasonably guiding and guiding the N Banka's allocation portion is just more or less within their pro rata share of revenue, not more.

OPERATOR: The next question comes from the line of Antun from Allianz. Congrats, on great results again. Could you please provide an outlook regarding the employee costs and the number of employees for the rest of the 2022? Do you expect any additional salary increase in Q3 or Q4?

BRODNJAK B: Well, I mentioned the continuous tension, right? So, there has been of course, pressures in this direction, that's why we have been on a cautious side, and we have, you know, guided now for the…up to, below €460 million which is of course in the region and covering what they expect going further, you know, further increases of employee cost on one side and further pressures from the vendor landscape. And we believe we should be, you know, within these margins. We don't plan more.

And then for the next year, we plan to keep on the same…keep this on the same level, which was…which seems ambitious but, you know, should be actually coming from further decrease of talent pool and adjustment of the physical footprint. And of course, digitization and further improvement of prospects, by that cost reduction. So, this is direct response.

I mentioned within the presentation that we have, of course bought the bank with 350 employees, but the actual increase until end of H1 was 209. So, net 150 was already reduced. And we also publicly mentioned that, you know, we aim to end up 2023 with 2,200 maybe even a bit less people in Serbia which was down from 3,300 at the beginning of '21. So, this continues. So, we are half way through, and half way done and we are continuing with this. And, of course, we are also continuing Slovenia. So, we will be offsetting then further wage inflation pressures by adjusting of course the talent pool.

OPERATOR: We have a follow-up question from Simon with Citi. Please go ahead.

SIMON: Hello, thank you. Yes, just on the new cost guidance. So, I just wanted to check that that includes the expected restructuring charges from N Banka.

BRODNJAK B: Yes, Simon.

NELLIS S: It does. Okay, cool. Thank you.

BRODNJAK B: Thank you.

OPERATOR: The next question comes from Rollo from Schroders, and I quote: "Guidance for 2023 cost is for similar amount to 2022. Where there not some one-offs in 2022 and opportunities for saving into 2023 from N Banka to potentially bring costs lower or is inflation proving to be higher than expected hence costs likely will be flat?"

BRODNJAK B: Look, we are currently looking at 8% to 15% inflation environment in the…in our part of the world, right? So, it is not fully realistic to expect, you know, you can offset more than this…such high inflation, you know, even if you are highly rational in cost management. So, if you are able to keep it flat, we believe this is pretty good achievement in such a high inflation environment. And, of course, will be a result of very diligent and decisive adjustment, as I mentioned, of the talent pool and physical footprint.

So, you know, if on the other hands inflation keeps at this rate, we would expect hikes, you know, and sensitivity was at 100 bps, right? So, as 200 bps, you can calculate what this means on revenue. So, you know, of course the cost is 1 dimension, but there is a revenue dimension. So, if the cost pressure keeps being strong, because of high inflation we would expect the ECB moved nevertheless even more ambitiously, you know, at 200 bps. You know, we are looking at 100 plus million of revenues. So, keeping then cost flat is bringing significant improvement of results.

OPERATOR: The next question is from Alex from Wood and I quote: "Do you assume any rate hike assumptions in the outlook of 2022-'23 besides the percent 50 bps hike?"

BRODNJAK B: Well, we are more or less at this level. So, you know, if this is much more ambitious this should be helping. This is not envisioned.

OPERATOR: The next question comes from Peter from Slovenia. And I quote: "NIMs have finally started to increase. Do you expect such momentum to continue or do you expect growth in NII based on higher rates to moderate?"'

BRODNJAK B: Well, of course this is a function of the ECBs approach. So, if you know, and of course then resulting EURIBORs in the market. Currently if you are looking at 50 to 70 bps EURIBORs depending on 3-6 month's universe, right, this is already significant hike, right? If now ECB moves to September, by you know at least 25 or 50 bps and then if the markets end up at 100 bps, this will of course further help margins. We have been increasing significantly and its public. We can just increase fixed rates, you know, by more than 30-40 basis points in Slovenia alone for their long-term mortgages, right?

So, in this respect, you know, new production is coming in at significantly higher rates, while of course deposits are not re-priced and will not be re-priced for quite some time you know, given our LTDs of, you know, low 60s. So, in this respect, there is a significant room for improvement of the margins and by that as I mentioned before, of course, improving the economics of the business. Hopefully, not been eaten by the cost of risk, but this is a function of the crystal ball debate from before.

OPERATOR: Ladies and gentlemen, there are no further questions at this time. I will now turn the conference over to management for any closing comments. Thank you.

BRODNJAK B: Thank you very much everyone for constructive questions. So, as I mentioned at the end of the presentation, we feel very confident, we feel strong. We believe we have what it takes. We have the tool box and the experience to deal even with the recession scenarios within manageable framework when it comes to the economics of the business. We stick to the promise of paying out residual €50 million. I don't see any grounds not to, this year. So, you know, this is a good news. We are further working on beefing up capital, because this is on one side enabling and further very strong organic growth, which we like very much, because as I said, this is within the risk appetite and underwriting criteria perimeter which we manage, you know, very proactive and actively.

And on the other hand, we will be further trying to improve capital to be able to grow also through the M&A. We don't see any real actionable opportunities at this point of time. We don't plan to engage in the coming months, but we will prepare grounds to be able to be really active in the upcoming years.

Thank you very much again and until further occasion and opportunity, stay healthy and stay, of course, positively tuned.

OPERATOR: We have an audio participant a Mr. Mladen with Erste Bank that would like to ask a question. So, please go ahead.

DODIG ML: Okay, I thought it was over. So sorry I had a problem with the phone. So, this option was working. But just if you want to…,first of all thank you for the opportunities and congratulations on the results and all the developments especially here and Serbia and thank you for adding the Serbian number for this call.

One question regarding the loans with variable rates. I think you mentioned in the first quarter the size. Could you give us an update, what is the current amount of loans with the variable rates?

BRODNJAK B.: It's almost €6 billion. The long position is almost €6 billion on the group level. This is what I can give you. The rest talk to the IR guys. Close to €6 billion. You will see this from the NII sensitivities, right?

DODIG ML: Yes. The €6 billion right? I thought it was that, but miscalculated. And the second thing rather local. So, today central bank in Serbia freezed the…increase…price increases for fees and commissions in the banking sector. Does this affect your plans in anyway regarding the Komercijalna Banka performance or something like that?

BRODNJAK B.: The effect would be single-digit million and by that not material for the group. We don't expect, you know, this to significantly challenge the results.

DODIG ML: Okay. Thank you very much and sorry once again for…

BRODNJAK B.: Okay. Take care everyone.

BURKHARDT A: Thank you.