NLB Group Third Quarter 2022 Financial Results Conference Call

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***Conductors*:**

Mr. Blaž Brodnjak, CEO;

Mr. Andreas Burkhardt, CRO;

Mr. Archibald Kremser, CFO

Conference Call Conducted by Chorus Call Hellas

CHORUS CALL HELLAS

PROVIDER OF TELECONFERENCING SERVICES

TEL: +30 210 94 27 300

FAX: + 30 210 94 27 330

Web: www.choruscall.com

OPERATOR: Ladies and gentlemen, thank you for standing by. I am Gelly, your Chorus Call operator. Welcome, and thank you for joining the NLB Group conference call and live webcast, to present and discuss the Third Quarter 2022 Financial Results.

At this time, I would like to turn the conference over to Mr. Blaž Brodnjak, CEO, Mr. Andreas Burkhardt, CRO, and Mr. Archibald Kremser, CFO. Mr. Brodnjak, you may now proceed.

BRODNJAK B: Thank you very much. Warm welcome, everyone. Allow me to first draw your attention to the standard disclaimer, which is the normal use for these occasions.

And I'm really feeling very proud today in front of you, given the fact that we are looking back to very likely one of the best quarters in the history of this banking group, in practically all dimensions. Of course, given the uncertainties and turmoil happening around us, this has not yet been actually translated into our daily business, to the extent that it would be visible in Q3.

So, in practically all dimensions, as mentioned, we have had a very solid progress, be it in terms of retail lending, corporate lending, still very strong fee generation in year-on-year comparisons especially, and still high discipline at cost management. So, this overall adds to the really very solid output. The total result stayed high, in almost €78 million for the three quarters. And on the other hand, obviously very solid quarterly performance, if you compare quarter on quarter as well.

We, at the same time, feel confident enough that we have already in the meantime suggested to the General Assembly to pay the residual part of the dividend that was promised for this year. So, in December, we hope that of course the shareholders will support this payout, and it would be enacted in December still.

And by that, providing very strong dividends yield within this year, and simply continuing on the path of delivering shareholder value, in both dividend payouts and capital gain from, of course, our operations. It has not yet translated fully in the valuation of the share, but we believe that we are on a good way and path actually to, sooner or later, also see this value we create in the share valuation.

We have been reinforcing our business also in certain new pillars of revenue streams. I would specifically focus here on leasing. We are very happy about the progress of our leasing operation in Slovenia, in the last year and a half. And in the meantime, I'm also happy that we have come thus far to actually get the approvals to initiate significant leasing business in Serbia.

And we have established in the meantime also the subsidiary in Macedonia, North Macedonia, by which we are actually exporting this revenue stream also to other core markets of our business group. And by that, adding really earning capacity on the one side, but really having additional focus in terms of supporting our corporate, and above all, of course also retail clients.

The economic slowdown that has been signaled, a recession, a recession forecasted, has so far not found its way into our business operations. So, we've seen further improvement, actually, of the asset quality, further reduction of the NPLs on the one side, very successful collections still.

This has led to the negative cost of risk for the three quarters, on the one side. On the other side, clearly the forecasts for the region, for our core region, for the upcoming period, are actually not signaling the downturn in the sense of negative growth. So, we still see prospects for positive growth, which is in the 10%-plus inflationary environment.

In nominal terms, very solid growth. And by that, of course, we still count on our further incremental addon to the earning capacity. We of course also have been benefiting from, finally, normalization of the interest environment. People call it hikes. We call it normalization after seven years of the historical experiment with negative rates.

So, of course, these are normal times now gradually for the banks, and with our plain, vanilla, retail-focused business model, of course we are benefiting from these developments, being a very solid retail deposit franchise, fully self-funded and self-sufficient.

And in this respect, of course now finally we are crystalizing the value of our business model, which is really easy to understand, predictable, solid, robust, and pretty stable in such an environment, even of course when the turmoil and uncertainties are higher.

Our region is less marked by a dependency on natural gas. Slovenia a bit more, but we have very robust sovereign support. So, the Republic of Slovenia is able to still incrementally significantly support the economy, on the one side clearly through the European Commission’s wide instrumentarium, the toolbox that has been of course now put in place in terms of regulating the pricing of energy.

On the other side, still in case of eventual industry shutdowns, lockdowns, the Republic of Slovenia has had sufficient capacity to assist in corona-like regimes, more or less, the Slovenia corporates. So, subsidizing a need or a short working time, or people put at waiting-for-work status and so on.

So far, it has not been needed. At the current prices of electricity, obviously Slovenian industry has still been benefitting from the nearshoring and insourcing back to Central Europe. So, very robust output. We are looking at very likely a record year for profits of our corporates in Slovenia.

But of course, there have been signals of reducing order books coming from the Central European industrial basin, yet we don't see this as a critical signal at this point of time, yet. So, it looks like we are in a good shape in terms of energy supply and current pricing. It should be actually well absorbed.

Also, in terms of currency regimes and currency actually rates, we don't see yet, or at this point of time, significant risks coming from this, and Archibald and Andreas will elaborate further on.

There have been, clearly, inflationary pressures. There has been a tension when it comes to cost. Yet, through high discipline and focus, we have been able to contain that. We are amidst, obviously, of completion of the restructuring of Komercijalna Banka, and today it's NLB Komercijalna Banka in Serbia.

Of course, after the successful merger, there are still details of delivering the efficiencies, and this of course still engages us, and of course also is consuming some cost, which was envisaged and planned for.

And of course, we are amidst the integration in Slovenia with mBanka, and Archibald will give you the details, where of course we will still have throughout 2023 certain impacts, and we will be talking about this around the outlook. So, if I wrap it up, we have been working also on further strengthening the capital base.

We have successfully issued the AT1 Note at €82 million worth, which is of course a significant boost to our capital, and proof that we are able to issue capital instruments. We have been exercising ongoing efforts to beef up the capital with additional Tier Two and, of course, fulfilling the EMEA requirements to senior preferred bonds.

And these efforts will continue, sticking to our Midterm Funding Plan. And by that, simply being in a position to solidly accompany our corporate and retail clients in the upcoming period, and still have certain reasonable, eventual, or inorganic growth capacity.

But at this point of time, we have not been engaging in any such projects. By that, I would pass the word to Archibald, to guide you through the financial part, and then Andreas will talk about the asset quality, and Archibald around mBanka's integration, and myself then completing with the outlook. Thank you, Archie.

KREMSER A: Thanks, Blaž. I'll start with a quick reminder of where we are in terms of macro. I'm obviously not going to run through all the numbers, but we found it useful to remind you of anchors of reference.

Blaž mentioned the most important messages, which is, we still look at the growth environment in our region, actually still exceeding Eurozone averages. So, these are still growing economies. No surprise here. No change.

Of course, the pace has lowered, our expectations have lowered for next year, but even that might improve once the bad news flow recedes, which eventually will happen.

Inflation is, of course, also high in our region, and to some extent it bites a bit more, because we are in lower-income territories and food inflation is high. So, we are watching very carefully how this might affect, at some point, specifically consumer lending. Andreas will talk about that. Also, at this point, there are no indications of any such things happening.

Our fiscal positions are still solid, as you see, and actually consolidating post-COVID. And moreover, we still are in territories where we see relatively high unemployment rates, which these days is to some extent good news, because inflationary pressures on labor in particular will be muted.

Also, in Slovenia the situation is different. We practically see here full employment and, for sure, some pressure on labor costs can be expected specifically here.
I think it's very important to remind us that also the currencies in countries we operate in are solid, of course helped by responsible central bank actions.

In the various markets, as you see here, rates are rising, specifically Serbia of course is worth mentioning. And so, overall, this region is still relatively low-leveraged, so that also makes us a bit sleep better, should things or circumstances worsen. And again, just to remind us that also we are in very unusual times, we believe this region is relatively well positioned for those times.

Also, in regards of energy mix and energy dependencies, what used to be weakness, a relatively high dependence on fossil, of course these days helps mitigate the effects on the gas and wholesale electricity markets. So, in that sense also here our region is relatively robust.

We have, of course, supported here and there on an as-needed basis, where we have been called to support, be it Serbia, be it Slovenia. And we have the balance sheet and strength to do that, but so far this has been limited, and for us, frankly also been an opportunity.

In terms of financial situation as such, this was, as Blaž said, a very robust quarter. You see €90 million pre-provision, and negative cost of risk, so it doesn't get much better. Very robust revenue drivers, not just rates. Actually, still our revenue expansion is driven by volume growth more than rates.

Also, of course, as you know, the rate movements in the last quarter have been very material. Euribor was up by in the range of 150 bips and more. So, this of course doesn't yet show through, and indicates to you that there is still more to come.

In terms of revenue upside, we've always talked about our long-Euribor position. Now it's, of course, showing through. So, all indicators heavily in green. Cost still very much in check, really a highlight these days.

But of course, I have to mention that, and you'll see it in the outlook, times are getting tough in terms of maintaining costs stable. We have labor cost inflation here and there. We have energy re-pricings, of course. We are working on measures to mitigate that, but for the time being, there will be cost pressures going forward.

On the other side, we have still substantial revenue improvement potentials, even on the back of the current balance sheet position, without still yet any new business, which of course comes in at visibly higher rates already. Interest income, as you see, very visible NIM expansion in the last quarter, on the back of, as I said, still deposits downpricings, especially in our subsidiary markets.

Volume growth across all regions, not yet really showing the effects of Euribor, and so it indicates that there is still quite some potential in NIM. A good guess for next year is, we might be in excess of 2.5% or in the range of 2.5%.

And of course, what we watch, the operational business margin, as you see, showing similar trends. Also, there is a bit of an offset from NIM revenue and fee revenue, as of course the high balance fees have been abolished and are gone for good.

That also shows in non-interest income also, even without mBanka, a very healthy trend. This is a combination of very robust performance across a range of products. In Slovenia, very solid sales of ancillary products, continuing in Serbia. We, of course, have been repricing, and so you see really robust numbers.

On costs, I mentioned our Q3, more or less benign. And I think it’s worthwhile looking at our discipline in executing on integration projects, especially in Serbia, upcoming now in Slovenia. You see quite visible reductions in staff and branch headcounts, branch counts.

And of course, this is still a work in progress. So, to some extent, we will mitigate some of the cost pressures with, of course, remaining and become more efficient on what we call the physical footprint.

Loan dynamics, I mentioned very robust growth, and of course we are having more intense debates here and there on loan and risk appetite. But so far, there is no deterioration really visible, neither in fundamentals, as I said, on macro, nor in corporate or household balance sheet. So, we feel very comfortable with feeding and accommodating for that growth and demand. And so, our capital remains to be very robust. You see us, we have stocked up on AT1. That is still to be shown.

And of course, we are still very much interested to top up on Tier Two. We've been very vocal about that. Markets, so far, have been more or less shut in this extreme volatility. Now we see signs of that to come back to more normal circumstances, also of course on elevated or higher cost levels.

So, in this sense, our SREP, to be published soon, is not going to show much of a change. A little bit of easing, as anticipated. I talked about the wholesale funding. Of course, all eyes on MREL across the industry, no different from us. Here you see, I think, a very clear status quo.

We have been issuing successful last year, also not just Tier One, but also senior preferred. Of course, the price levels we don't like to see, but to some extent we have to acknowledge market circumstances.

You see here how the mechanics work, and of course there's a step-up logic, until our targets become final in beginning of 24. And so, we of course are continuing to run our Funding Plan, which still envisages some €600 million in the course of this and next year, as a combination of Tier Two and seniors. And by that, I pass on to Andreas, on asset quality.

BURKHARDT A: Yes, Archibald. Thank you very much. Actually, the colleagues have now mentioned already quite a bit. First of all, we are continuing to solidly grow, and solidly growing means also very well diversified.

Secondly, the first three quarters on cost of risk were, again, very good. Actually, negative cost of risk, and we are further decreasing NPLs.

And thirdly, of course in this situation, very turbulent times. We are very careful. We're doing stress testing. We're becoming more selective. We are adjusting parameters where needed, so, very prudently, of course, in this situation going forward.

If you look at the growth in the different segments, so both corporate and retail corporate, bigger corporates and SMEs, and also retail, consumer, and mortgages, growth everywhere very well dispersed through these categories.

And of course, what you can see, also that we continue to have this geographical dispersion which you're used to from us. So, Serbia obviously here got considerably bigger with the acquisition of Komercijalna Banka, but otherwise very stable, simply because we are solidly growing more or less everywhere, with a similar speed.

On NPL ratios, as I said, again improving in this year, again reducing also in net terms, even after the acquisition of mBanka. So, €352 million at end of September, of which €160 million actually have zero delays. These are mostly restructured clients, which are not yet healed. So, in net terms, if you also deduct that, we come to I would say really very small numbers.

Coverage, you're used to that, that's very solid. So, cash coverage plus collateral in the 150% range, that's, for sure, very solid.
And what you see in the dispersion of the NPLs is that also this has normalized. This is normal debt in Slovenia, which is still the biggest bank in the system.

Obviously, we are underrepresented at the European Union, and of course in the other countries a little bit more rich, but that's also what is expected. So, in that sense, normal. If you would have seen that a few years in the past, then Slovenia would be much stronger represented. Especially the bank ten, 12 years ago did cross-border, which was not healthy. This is what you still saw. This is now gone to the biggest extent, so here also a normal picture.

If you see a little bit more detail the cost of risk, that's minus 13 bips. Obviously, not so negative than it was in the same period last year, but still negative. This picture's a little bit complicated, so don't get confused.

We have an €8.9 million one-time effect from the acquisition of mBanka, but in the cost of risk you annualize that. So, in nine months, obviously you take three quarters out of that. That's why the calculation of these figures, to come together, is not that easy.

And what you see if you go a little bit more in detail, and if you don't see it on this slide, is on the retail side we have actually provisioning increase. That's coming, on the one side, simply from volume effects. So, we are increasing our volumes. That's why pull provision is going up.

On the other side, we have of course deteriorating macros. This you see in the pull provisioning logic. And then, on the other side, we also have sharpened our early warning logic, so you have here now more parameters which indicate an early warning.

All of that led to some inflow in retail. Nothing dramatic, but visible. And on the other side, on corporate we had a couple of very successful resolutions, also of already written-off items. So, this is actually, so far, overcompensating the retail impact of these nine months. You see a €7.5 million release.

What needs to be mentioned on interest rate sensitivity, that's of course at the moment also an interesting one. 100 bips change in interest rate brings us approximately €61 million, so obviously we are profiting from this situation.

Of course, in the current situation, many things come together. If you see more sharp rises in interest rates, that's obviously multiplying that figure. On the other side, it's supposed to increase cost of risk, of course for a fraction of that, but nevertheless. But honestly speaking, in the current situation, the little bit unusual situation is that the much bigger discussion is obviously the inflation, and the interest rate increase in that sense is not really the key topic.

And as soon as salaries have followed the inflation, of course to a certain extent you could even see a decrease of cost of risk, because a loan obviously is devaluating compared to the income. So, there are a lot of ups and downs.

You see here the pure NEV calculation, but if you want to understand of course our balance sheet and the development in risk, there are multiple factors coming in. With this, I'm handing back over actually to Archibald. Thank you.

KREMSER A: Thanks. Now a few words about the mBanka integration. So, that's now a quite tedious technical process that is playing out. The bank itself runs very stable. We're happy with a pretty solid financial performance.

Client numbers have stabilized. We've seen a bit of outflow early, but this has now stabilized. The business is well integrated in the group. We have physically embedded the retail branches in our network. Of course, they still operate as independent branches.
And governance, of course, in control. Our colleagues are sitting in the board.

So, we are very happy with, let's say, the business as usual in mBanka. Sorry. And here, in regards of the integration as such, of course there're the positives and negatives. There is a cost to that. This cost is well planned, established. There is no magic to it. I think it's a healthy proportion to the run rate cost of the entity.

And of course, once we're done with the integration, there is also quite some, let's say, financial upside from synergies. At the moment, to be honest, we're much more interested and focused on the first part. Stabilize the operations, stabilize HR.

We want colleagues in mBanka to remain focused on their jobs, and for many of them, we'll have very good opportunities in both front, mid, back office, and IT. So, really the focus is on getting this integration done smoothly, and of course there're plenty of conversations happening also with the regulators.

Here you see the various streams as they play out. Again, all a well-established playbook in the group. In the meantime, I have to really thank all the colleagues that run these efforts across the various streams. As I said, it's a lot of tedious hard work.

So, at this point, really thanks to colleagues in mBanka and NLB, to helping us get this done stable and predictably, without any disruption. That's the main ambition. We have actually shifted a bit the merger timing, from April to September, to give more time for a more, what we call, sustainable integration process.

We by that avoid investment into our mainframe environment, and can focus on the future core system. So, we have allowed for that flexibility in order to reap that benefit, and I think there is a very good case for doing that, because that gives us a good pilot, in reality, for our core banking consolidation that we anyway have to run in Slovenia.

Remember, we have two core systems, one for retail, one for corporate, so the mBanka clients will now be mostly ending up already on the new target system, which is the one for corporate.

It's a system called Temenos. And by that we think we have also a little bit accelerated our IT agenda. That's in regards to timing. So, as I said, so far it works well, but of course there's still lots of ground to cover, and the next months will be, let's say, full of work, and I hope not too many surprises.

BRODNJAK B: Thank you. I mentioned at the beginning already, we have been really now focusing on enhancing and boosting the leasing business, the upcoming important revenue stream.

And I already mentioned that NLB Slovenia, NLB Lease and Go in Slovenia, as we call our subsidiary, has been fully operational, has been introducing novelties in terms of end-to-end digital solutions to our clients and distributors and so on. So, this is something that we are really now heavily investing in, in terms of time and attention.

And on the other hand, clearly, we have, as said, already more or less been ready to launch operations in North Macedonia and Serbia. So, the three most meaningful markets would by then be covered, and of course we will be then analyzing further opportunities in other markets.

So, this has been clearly a 100% sponsored business by the parent bank and sister institutes, then, in the subsidiaries. And in this respect, we believe we can really leverage on the channels we've got, on the information capital we've got, established relationships that we've got at the bank.

And by that, really use lease capacity as more or less, as we call it, a product factory, providing really applicable solutions to our clients, and especially addressing then the contemporary mobility paradigm which has been in front of us. It's something that's coming pretty quickly.

In this respect, clearly our ambition is to actually exceed €1 billion of assets via organic push, clearly, to the revenue stream, whereby we will not shy away from eventually analyzing and exploring also some M&A opportunities that might come our way in the upcoming years.

But clearly also organically, there is a very strong revolution and evolution path in front of us, designed, defined, and there is full commitment of our teams to deliver on that. And by that, of course, meaningfully add to the revenue capacity and, of course, we believe also the earning power in terms of the bottom line.

Outlook. We have modified a bit the outlook, so we are actually now talking about a higher level of revenue. For the next upcoming year, also this year, especially 23, there is a revenue hike coming from the interest rate normalization on one side, but really solid performance in terms of volume growth in retail and corporate.

I'm specifically happy that Slovenia has finally rebounded really as a strong, robust economy from the European monetary zone, partly because of before-mentioned nearshoring and insourcing back to Central Europe, partly because of the robustness of the Slovenian economy as such, being one of the most diversified industrial economies in Europe.

So, this is something that of course, on the one side, is carrying certain risks, given the electricity and gas supply and pricing. But on the other hand, of course we are really close to Vienna, close to Munich, Milan, Switzerland, this really powerful industrial basin of Central Europe, where we can be really, as a Tier One supplier, benefiting from this.

And the automotive industry in Slovenia is talking about €3.5 billion revenue in the upcoming couple of years and so on, so this is really a significant boost.
As you know, Slovenia is exporting €40 billion, which is 80% of Slovenian GDP practically, and we are really counting on that to continue. Other countries are, especially if you look at Bosnia and Herzegovina, exporting electricity, corporates in Bosnia paying actually €50 for electricity, the same for households is true.

So, the situation is really a mixed bag, but this region has been more or less in a pretty unstable environment for decades. And also, inflation as perceived by people in this region is maybe a less evil phenomenon, as perceived maybe from someone from Western Europe that was used to 40 years of stability.

But this region is more or less used to instability and imperfections, and of course there is always value in imperfection for someone that is a specialist and understands that well. And this is what we believe we are, really a specialist that can understand risks and can address these risks properly in the sense of managing them. Not avoiding them, but managing them reasonably.

So, we are signaling more revenue. We are, as Archibald also said before, seeing of course tensions in terms of cost pressures. There has been a 10%-plus inflation. This is driving, of course, our wage expectations up.

This is indirectly or directly, given the regulatory and legal increases of salaries, of minimum wages. For example, such as in Slovenia and so on, is actually introducing immediate supply-side re-pricings.

And of course, we have to simply balance this with focus on processes, with focus on efficiencies, with focus on energy consumption, with focus on really project portfolio prioritization. And that's why we see, we would say, still a really moderate mid-single digit percentage growth in costs, which is of course more than offset by the significant growth of revenue.

On the other hand, we see we still have a solid output in terms of the ROE, so real shareholder value creation. We were talking about around 12% so far. Now we're talking about exceeding 12% ROE.

And of course, we plan to continue with very solid dividend payout. We were talking about €500 million cumulatively until the end of 2025, including the 22 payment, which is a very solid dividend payout.

And we believe that this business is actually on a good trajectory to become even more propulsive, and in this region especially positioning itself as not only the systemic company, but responsible and very successful systemic company.

Archibald was talking about us supporting stabilization of the energy pillars in the region. This means that we provided practically 35% of funding, and we were the ones leading the syndicates arranging these facilities.

So, NLB is again back in the seat of the responsible, strategically important systemic financial institution, in the whole region. By that, I would wrap up the presentation part, and I would invite for any questions or dilemmas you might have. Thank you very much.

Q&A

OPERATOR: The first question is from the line of Ronak with EFG Hermes. Please go ahead.

GADAHIA R: Thank you. Thanks for the presentation, and congratulations on the numbers. Just a quick maybe clarification from Archibald.

He mentioned that the bank is in the process of raising up to €600 million of longer-term funding this year and next, with regards to the MREL requirements. Is that in addition to what the bank has raised already, or that figure of €600 million includes what you've already raised in 2Q and 3Q? Thank you.

KREMSER A: That's incremental. That's incremental, is the short answer. And it's going to be a mix of seniors and Tier Twos. We'll be looking at those routes because there is value in Tier Two.

Blaž mentioned some possible M&A options, specifically leasing is on our radar, but also other tactical opportunities. We would like to be prefunded, because that simply puts you on a much better footing for M&A.

So, we will of course be paying more than we would want to in the market circumstances that we are confronted with, but first of all, MREL is a regulation, so there is no way around it. And second, it'll be more than offset from the earnings opportunities we see ahead of us.

BRODNJAK B: And it will further strengthen the capital base for dividend payouts, so this is something that we believe is accretive, too, for shareholders.

GADAHIA R: Okay. Just as a follow up, could you maybe just tell us what's the indicative rates you're seeing right now when you speak to your bankers?

KREMSER A: The seniors are in the sevenish territory these days, but that's subject to supply and demand, and Tier Twos are a little bit higher. Too early to tell, because the situation changes. Very volatile.

Rates have gone up substantially, swaps have stabilized, and we see a lot of transactions coming to the market at quite reasonable rates. And you've seen us raise AT1s at I think a very reasonable rate, given the circumstances, so we'll see how it goes, but we're quite confident.

GADAHIA R: Okay. Isn't there a small risk here, that the longer you wait, maybe if inflation continues to surprise and if the ECB is forced into raising much more aggressively than the market is currently expanding, that it just becomes more and more expensive?

KREMSER A: I wouldn't disagree necessarily, so that's why we're pretty much on the matter as we speak.

GADAHIA R: Okay, understood.

OPERATOR: The next question is from the line of Simon with Citibank. Please go ahead.

NELLIS S: Hi. Thanks for the opportunity. Yes, I guess a quick question would be just on the long-term dividend guidance. I think you're still saying you're going to pay out the €500 million, I guess, from out of the 2021 to 2024 earnings.

But if you have higher capital because of the AT1 issuance's better results, and if you can't find acquisition opportunities, would you revert to the 70% payout that you had been guiding during your IPO? Can you just walk through your thinking there?

BRODNJAK B: This is a very specific period of time, and the opportunities might come your way overnight practically, and in such situations, you want to be ready. So, it's actually a mix of aspects to apply.

On one side, regulators potentially signal certain increases or buffers of this or another nature, signaling a recession and so on, which is always good to be then actually in capital rather than chasing capital.

On the other hand, having a really stable €500 million payout secured is also of value, but we believe there would be and might be opportunities coming our way soon. So, talking about then suggesting a higher dividend next June, and then in July getting an opportunity, is not necessarily the most productive way of thinking.

So, we believe paying out €110 million next year, given today's price, is a very solid dividend payout. Very solid. And at the same time, then having the capacity to grow while we are able to grow at a significant pace, in a sense still keeping certain incremental… Not high.

We are not talking about billions. We're talking about a couple of hundred million or less than €1 billion actually incremental M&A potential, is I don't think a luxury.

It's actually a good position to be in, frankly. At the end of the day, it's the shareholders' call. They can always suggest something else.

But we believe that we are running this business in a balanced way, securing solid dividend payouts, securing accretion of value through the organic evolution, but keeping some moderate cushion actually for eventual M&A.

This is not really being in a luxurious position. This is really, I believe and we believe, being in a balanced position to address the opportunities and threats and risks properly.

NELLIS S: Okay, that's pretty clear. Actually, I would have a question on the capital walk. So, come the fourth quarter, the dividend that you're paying out, the €50 million, that's already excluded from the capital base, the regulatory capital base, the CET1, today. Correct?

KREMSER A: Correct.

NELLIS S: And then I guess you'd add in the retained earnings that you haven't recognized yet, but then you'd deduct the full €110 million that you're planning to pay next year from the regulatory capital? Is that right?

KREMSER A: Yes. So, that happens usually at yearend, yes.

NELLIS S: Yes, and then just one last one. If you can give an update on the Swiss franc mortgage law, the Supreme Court case. Are there any new developments there that you can update us on?

BRODNJAK B: No, there are no new developments to report.

NELLIS S: Okay, that's all from me. Thank you.

BRODNJAK B: Thank you, Simon.

OPERATOR: There are no audio questions at this time. We will now proceed with any written questions from our webcast participants.

And the first question is from Jovan with RBI. And I quote, do you expect a hike in capital requirements as some of your peers reckon with circa a hundred basis points uptick till the start of 2024?

If yes, how does this affect your dividend plans, and what would be the level of CET1 you may feel comfortable with? Thank you.

BRODNJAK B: That’s a speculation. We don’t expect it, but there have been rumors that there might be some systemic buffers introduced. We’ve heard these rumors in Slovenia, but this is a common public secret, so there is nothing concrete on the table. On the other hand, exactly what Simon asked before.

That’s why we are also beefing up capital, in order to secure the dividends, even in case obviously of eventual hikes in regulatory requirements, which might impair a bit of course then M&A potential, but not necessarily impair our organic evolution, while still securing the solid dividend payout.

So, we are observing and, of course, adjusting as per the requirements.

So far, Archibald was mentioning actually the SREP, which is actually going positively our way. But then, of course the Bank of Slovenia might be looking at some local macro-potential, whatever, measures. They have continuously, in the last years, traditionally had a totally different view on the environment of the banks, so this we cannot influence.

There has been no dialogue with them based on the arguments, so this is something that we simply don’t have any obvious insight in.

We are working on fundamentally strengthening the capital base, both from earnings and from the capital markets, and we will simply continue this way, in a more or less balanced structure and a balanced approach.

OPERATOR: Thank you. We have actually four more questions from Mr. Jovan, from RBI. I will read each one. What is behind the increase in average cost of funding in Q3? Do you experience increases in deposit costs? And if yes, in which markets?

KREMSER A: It's not really deposit-driven. Also, we have here and there smaller tactical adjustments, but it's the wholesale funding, of course, kicking in. So, we have 300 million seniors issued. They start to show. And otherwise, we still sit on a very large site deposit base, which of course these days comes in very handy.

BRODNJAK B: Yes, now our robust retail deposit franchise really shows its value. So, we have the LTD of 56% groupwide, and it's in Slovenia and Serbia even more favorable, in the two most material markets, and we are simply benefiting from it. So, the real hike is coming from the MREL funding, from the core business. We are not forced to reprice the deposit base.

KREMSER A: And that's given a bit of a handle on what we expect NIM to land on, given all the ups and downs, so there's still room for upside, in our view, and the 2.5% seems pretty well in reach for next year.

OPERATOR: Thank you. Mr. Jovan also asks, how do you explain the upgrades of regular income for 2023, and at the same time lowering the loan growth guidance to mid, from high-single digit, and keeping the NII sensitivity unchanged?

Has your CAGR rate outlook for Euro area changed over the last quarter? If yes, what would be the sensitivity from sharper rate hikes of 200 basis points?

KREMSER A: Our outlook is based on basically 2% Euribor, so now you can speculate if it's going to be higher or lower.

We've published the sensitivity of that decision, and I think the best handle I can give is to reiterate that because we also have the funding kicking in with incremental costs, so I think the 2.5% overall NIM is our best guidance we can provide, and that factors in a Euribor of some 2%.

OPERATOR: Thank you. The next question is, do you have a kind of sensitivity of risk costs in case of weaker-than-expected GDP in the region, especially in Serbia and Slovenia? Thank you.

BURKHARDT A: Yes, sure. So, we're doing regular stress testing, but of course now in these times, even more intensively.

And the most severe scenario which we're assuming, is going considerably below the current GDP growth assumptions for next year, so in negative territory, especially in Slovenia and Serbia.

And in this case, which we see really as relatively extreme and conservative, we would stay within our maximum cost of risk, which we want to be through the cycle in any case in. As you know, that's 90 bips cost of risk, so we would stay within that.

In reality, we're expecting much lower figures. You saw it before in the 2023 Guideline, we're currently assuming 30 to 50 bips cost of risk.

That's, of course, an uptick compared to this year, and I think that that's also fair to assume.

But yes, of course we stress beyond that, and the situation is very manageable from these stress test results, and as I said, would stay within our maximum cap we're always talking about for such situations.

OPERATOR: Thank you. And we will finish up with Mr. Jovan's last questions with RBI. High-risk cost release in Montenegro. Any special large case?

BURKHARDT A: Yes.

BRODNJAK B: And this is as specific as we can get.

BURKHARDT A: So, yes, a large case and two, three midsized cases. Yes, these were a few special effects which were accumulating in Q3.

On the other side, Montenegro is one of the countries where our sharpening of the early warning system in retail has triggered a little bit of increase in cost of risk, so that's already planned. But yes, the regular development is very solid. Nothing special in this. The main difference is coming from these releases, yes, exactly.

OPERATOR: Thank you. We will now move on to Mr. Tomaž's, from Slovenia, question. Could you please be so kind and provide some additional info in regards to quick fix of fair value through other comprehensive income revaluation in the amount of €60 million? Have you reclassified govies, recognized under fair value OCI, to amortized cost recognition?

KREMSER A: This is a regulatory quick fix, so there is no reclassification underpinning this concept. That's an ECB scheme that was put in place actually for COVID, and it still is valid, so we opted in for no particular reason, other than of course taking the obvious benefit.

OPERATOR: Thank you. Next question, Anton from Allianz. And I quote, could you quantify the expected contribution from the leasing business in 2022 and 2023?

BRODNJAK B: We cannot be more specific than what we said. So, we account on, in the midterm, €1 billion of assets and significant contribution in terms of also bottom line. And of course, if you look at the end-to-end look-through, of course this would be a meaningful addition to the group's results. And I cannot be more specific at this point.

OPERATOR: Thank you. The next question is from Đivo, from InterCapital. What was the reasoning behind issuing your latest bond? Did you need the additional Tier One now, especially at a rate of almost 10%?

BRODNJAK B: No, it is as mentioned before. It is one of the possible measures to beef up capital, and of course we want to do it in a meaningful and balanced way.

So, of course we want to be solidly above hurdle rates, when it comes to Tier One capital and of course total capital. That is securing normal evolution of the business in a balanced way, while, of course, providing stable dividend payout flow and organic and inorganic opportunities to grow the business. So, there is no other reason than that.
We were not in distress. We simply believe it is of value and is benefiting key stakeholders of this banking group if we did this work on beefing up capital. And of course, I'm happy that we have access to capital markets, and of course we can do it in a balanced way.

So, of course if you're growing in Tier Two territory, you do of course also what is possible to do within Tier One capital territory. We all know that we are limited when it comes to actual ordinary issuances of capital, given the ownership structure.

So, the Republic of Slovenia is invested by 25% in one share, and any of course regular recapitalizations would require the participation of the Republic of Slovenia. And of course, we don't want to call for the capital from the Republic of Slovenia at this point, so we of course use other instruments within the capital toolbox that are available.

Because NLB has, of course, had a pretty conservative capital structure, and we have not used otherwise totally regular and standardly-used instruments.

We are basically stocking up a normal toolbox of capital, of capitalization if you want, and we are still halfway there. So, we have still more room to do the AT1s, we have still more room to do the Tier Twos, and we are simple following the balanced agenda. Nothing else.

KREMSER A: And to be fair, the 10% is well below the cost of equity, so this is still positive leverage for shareholder equity, and that is clearly creating value for shareholders. A Tier One bond is a near-equity instrument. Just to remind everybody, this is not a regular bond, this is a near-equity instrument.

BRODNJAK B: Absolutely.

OPERATOR: Thank you. The next question is a follow-up question from Anton, from Allianz. What are your NPL ratio expectations for Q4?

BURKHARDT A: Look, we expect to have at the end of the year slightly positive cost of risk. As you see in our guidance, we in any case want to stay below 30 bips, and that tells you that of course the NPL ratio will stay at a very similar level.

If the 30 bips would materialize, and I'm optimistic that we will stay clearly below, that might of course mean that we might go a few million up in NPLs, but this still remains to be seen.

Obviously, the situation at the moment is very volatile. But for sure, we will not see any dramas or serious upticks, and we will for sure stay within the guidance, probably very solidly.

OPERATOR: Thank you. The next question is from Vladan with IPOPEMA. From which categories do you see higher cost pressure in fourth quarter 2022? Thank you.

BRODNJAK B: It's coming from the usual Q4, more or less, hikes, which is partly specific rewards, partly of course you end up and activate certain projects and so on. So, there is nothing really peculiar or specific for this year.

There might be some still provisioning, of course, related to restructuring, when it comes to of course severance and such structures for both banks still, but nothing that would be out of what we have been communicating so far, more or less. Archie, would you add to that?

KREMSER A: No, the usual seasonality, because frankly some energy hikes have come back a bit. And other than that, it's Q4 is traditionally a bit cost-heavy, so if you look at our previous Q4 balance, it shouldn't be too different.

OPERATOR: Thank you. The next question is from James, from Raffles. With large exposure to Serbia now, what is your take on the Kosovo situation, which appears to be heating up?

BRODNJAK B: It depends on how you look at heating up, right? It has been heating up for 20 years, or 30 years, even. So, we count on, of course, at the end of the day, smartness and wisdom of leaders of the region, that of course this would not end up in a bigger conflict.

We believe that there is significant value, and finally at least we perceive certain messages and signals from the European Commission, that there might be, nevertheless, an acceleration of the accession process of the Western Balkans towards the European Union.

And that's the name of the game. So, as soon as there is real perspective offered, and of course in turn something is delivered by the leaders of the region, I believe that this situation will stabilize entirely.

But it is, of course, on both ends. It's not just looking at Serbia, it's also looking at Brussels. Western Balkans needs authentic perspective and, finally, also acting upon by the European Commission. We are, of course, big promoters and advocates of accession of the entire Western Balkans into the European Union, as soon as possible.

OPERATOR: Thank you. The next question is from Mladen with Erste Bank. Please go ahead.

DODIG M: Yes. Hello, gentlemen. Thank you for the call. Thank you for the opportunity. And once again, congratulations on the great quarter and great nine months.

Just one question regarding the macro-outlook for the region.

We have seen recently that the supranationals and institutions active in the region are significantly cutting down on the 2023 growth and reiterating uncertainties. Maybe if you can just give your view.

You already talked about it, but maybe just in the light of those revisions, which are quite substantial, for example, from the IMF on Serbia in particular. How do you see development of, for example, pull provisions and the risk on the whole? Thank you.

BRODNJAK B: Andreas, do you want to do the risk parameter? Maybe I'll start with the growth. But if you look at the growth indications, we are not looking at forecasts that are showing real decline.

Even in case of a 0.5% growth indication, this is in nominal terms very high growth still, so the nominal output is still very high.

It is neutralized by high inflation, but it is still positive evolution in terms of value, so in this respect we also see significant potential for further still healthy growth.

If we look at the housing loan production in the last couple of years, two thirds of apartments were bought by cash, and what NLB financed, so this one third that was covered by bank lending, was within the LTVs, on average, of 62%. This is very solid production, very healthy production.

And also, when it comes to consumer lending, all of this is based on cash flow principles, so as long as the unemployment is still stable. And in Slovenia, Archibald was mentioning full employment. The businesses are still seeking for people.
Industrial outlets and facilities, factories might of course have electricity prices exceeding €300, be forced to shut down, but they would be subsidized through the governmental support, especially in Slovenia, and we believe Serbia still has capacity.

Other markets are much less dependent on gas, on the one side, but on the other hand, are used to improvise a bit more, even. So, this is something that we believe is still containable.

Andreas was mentioning inflation, but please note there are two sides of this sword.

On the one side, inflation of course also devalues the real value of debt. In a growing-inflation environment the debt also is somewhat devalued, so it has both ends.

There is, of course, first introduced pressure, but of course on the other side of the balance sheet of the households, it has also effects. But, Andreas, you might add certain thoughts on that?

BURKHARDT A: Yes, I guess not too much to add on what we have said already previously now, today. Again, we have made stress test scenarios, up to relatively extreme ends. The current assumption of 30 to 50 bips cost of risk for next year is already coming from much more shy views on macro-outlook than we would have a year ago, I guess, expected. So, yes, obviously this is changing.

Even the extreme scenario, as I said already before, it keeps us well within this maximum level of 90 bips. But again, that's also with the changes which we see now every day, nothing which we expect, so we still see this as an extreme scenario.
What is true, and you heard this in different colors today already, but of course at the moment, the unusual thing is that there are many open parameters, of which one is also inflation, of which one is also energy.

If you see expectations, which we saw a few weeks ago, and where we are today, this was reversing a lot.

Now the question is where we will be in four weeks, where we will be in eight weeks, where we will be through the winter. And will we see somewhere shortages? Because that would be the more sensitive item than just the price as such.

So, there are many open parameters. But on the retail side, I think in the current situation I see pressure on the short run.

But again, as Blaž just mentioned before, again also of course on the mid run also some relief, as soon as salaries have caught up with the situation. You have basically a situation where the debt has devalued to a certain extent.

And on corporates, what we simply saw in COVID times, and what also now seems to confirm in these days, is that companies in this region are used to relatively many troubles. They are flexible. They adjust fast.

And honestly speaking, the big clients, of course we are going through one by one really frequently now, and the way how they're reacting on this situation and how they cope with this situation is, almost surprisingly sometimes, positive.

So, here also in some cases, we have very few clients which are directly related with business to Russia or Belorussia or Ukraine, but of course we have a few. But also, here the situation is really very stable, maybe for these clients a little bit counterintuitive, but that's the fact.

So, there are many points about this, I could talk now a long while, but overall, the situation seems very solid and very controllable.

And honestly speaking, for such a situation, also cost of risk for next year, as we see them, pretty moderate. And actually, that's another confirmation that we are rather a little bit conservative bank, and that we have a quite robust portfolio.

Of course, as the CRO, that's always a higher tension point in such a situation, and now after two years of COVID, again, for a different reason. So, I'm watching this very closely, but so far, I have to say, so good.

BRODNJAK B: If you look at this slide now… Sorry, I apologize. If you look at this slide, there is still a lot of room for the conservative structure of household and corporate finance.

DODIG M: No, I agree with you on all points. I just think I noticed in your guidance slide, the 2023 loan growth was slightly tuned down.

With the mid-single digits, it’s still significant growth. I hope I didn’t make a mistake. I thought that was the reason why your reaction maybe to these forecasts for 2023.

BRODNJAK B: No, it is actually based on our expectation, and we have to wait to see whether it would crystalize, that given the rise in rates, housing loan demand will simply reduce.

It is unrealistic to expect that we would see the same housing loan growth as we’ve had year-on-year so far, which was exceeding 20%. And we feel already now in the last month, actually the last weeks, that housing loan demand is simply taming. It is being reduced, regionwide, a bit.
And of course, now is it going to end up in mid-single digit, or is it going to be high-single digit?

No one’s holding a crystal ball, but in a nominally growing world, this is what you want to say.

If you have an inflation rate, on average, in the region of 12%, it is not really realistic to expect that there will be no growth of lending. So, maybe it’s slower than GDP in terms of nominal, but it will still be meaningful growth.

And all this new incrementally-originated growth is happening, of course, at different rates than the stock. And then on top, the stock gets repriced on the long-Euribor position throughout the rollovers.

So, all over, this is all good for the, of course, P&L of the bank. Even if the new production is a bit lower in terms of volume, it is happening at a significantly higher rate than the stock, on average.

And on top, the stock is repricing through the Euribor repricing, so this is of course for the bank profitability a very good trend in any case.

Now, of course, can we have the luxury position of having double-digit growth in a totally uncertain environment, in practically amidst of the Third World War, and incrementally accreting so much value? This might be maybe too optimistic.

So, we want to be conservative while communicating to you, and not overpromising, and rather positively surprising than the other way round.

It's simply, I believe, we have demonstrated so far this is the appropriate way of positioning our business.

It's maybe not beefing up the valuation as we believe would be the deserved one, but it's, we believe, a more prudent and more responsible way of communicating to you.

DODIG M: Thank you very much for your answer. Just one short thing. I think Mr. Kremser mentioned on M&A, you want some more leasing companies? Did I hear that correctly?

BRODNJAK B: There is nothing concrete on the table, but there might be opportunities. And of course, if there were opportunities, we would look at them. And that's all we can say.

DODIG M: Okay, thank you very much. Thank you.

BRODNJAK B: Thank you.

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

BRODNJAK B: Thank you very much. It was a rich debate, so we're happy there is significant interest of analysts, investors, into our business. We feel very confident. Frankly, very confident at this point of time.

We believe that NLB is in the best shape ever. We have demonstrated our responsibility and our strength to cope with existing uncertainty and, on the go, still create significant value to the stakeholders, which are not limited to shareholders.

So, we are of course also a significant pillar of the society in the countries we work in, and we will continue with also the very ambitious ESG Agenda. So, we are now really even more ambitiously looking into energy efficiency projects, into of course new renewable production facilities and projects.

And we'll simply continue on this path of being a pioneer of this movement, at least in our part of the world, and in this respect contribute, of course, to the global benefit and welfare.

On the go, keep monitoring us, keep accompanying us, and keep investing in us. Thank you very much.