valiant

Half-year results conference call

8 August 2019

10 a.m. to 11 a.m.

Presentations by

Ewald Burgener, CEO of Valiant

and

Serge Laville, acting CFO of Valiant

Introduction

Ladies and gentlemen, analysts and media representatives,

I would like to welcome you all to this presentation of Valiant’s 2019 half-year results. Thank you for taking part in this conference call. We are joined today by our acting CFO Serge Laville, Head of Investor Relations Joachim Matha and Head of Media Relations Marc Andrey.

Following the success of the media and analysts conference call and the positive feedback we got from participants on the 2018 full-year results, we have decided to hold another joint conference for media representatives and analysts on our 2019 half-year results.

I am delighted to report that Valiant is well on track, and specifically that
- Group profit rose year on year in the first six months of 2019;
- we were able to keep the net interest margin steady in a persistently challenging market environment marked by falling interest rates;
- and we are rigorously implementing our current strategy and working intensively on the strategy update for the period up to 2024.

I will start by telling you about our business performance in the first half of 2019. Next, Serge Laville will take you through the financial results in detail. Serge Laville is standing in for the newly elected CFO Hanspeter Kaspar, who will join Valiant on 1 October 2019. Finally, I will look ahead to the second half of our financial year. We will be happy to take your questions at the end.

As on previous occasions, we are holding this conference call in German. You are welcome to put your questions to us in English, German or French as you prefer – and we will respond in the same language.

H1 2019 highlights

Let's start with the most important figure: we further improved our Group profit year on year in the first six months of 2019: it rose by 2.9% to CHF 61.5 million. Our interest business once again proved to be a pillar of strength. We are proud that we were again able to maintain the net interest margin at 1.11% despite record-low interest rates. This stability in our interest business has long been one of our major strengths. And we will continue to fight for every basis point. We also recorded another strong increase in net interest income before value adjustments, which rose by 2.9% to CHF 155.2 million.

Loans increased by CHF 422.3 million overall to CHF 24.4 billion, a rise of 1.8%.

We can therefore confirm that we are well on track. We have stayed on course and are rigorously implementing our strategy, which helped us to achieve a successful six months.

H1 2019 review

Tenacity and consistency are the characteristics that have defined us for many years. As CEO, I am continuing along the path successfully paved by my predecessor Markus Gygax. As you know, he was elected to the Board of Directors at the Annual General Meeting in May. Tenacity and consistency are also the key pillars of our strategy, driving us forward with strength and zeal but at the same time ensuring a risk-conscious approach to decision-making. We have proved that we are following a clear plan but are also flexible when it comes to leveraging opportunities.

We have continued to convert the front-office areas in our branches over the last few months. These spaces are geared towards the future and enable us to combine personal advice with digital services. We have already modernised 27 existing branches and more will follow over the coming months and years.

As well as converting existing branches, we are also expanding our market presence by adding new locations. Most recently we have done this in French-speaking Switzerland, where we opened our newest branch, in Nyon, in February. At the same time, we moved into new premises in Winterthur, where we will service medium-sized companies, and we expanded our Langenthal site. These developments have enabled us to strengthen our Corporate Clients segment, which is of huge strategic importance for Valiant.

In line with our "simply a bank" claim, we have continued to press ahead with digitalisation. For us, digitalisation and simplifying services for our clients means first and foremost increasing efficiency. In March for example we rolled out online appointment scheduling so that our clients can more easily make an appointment with a client advisor. We were also able to significantly reduce the lead times for lending processes. We now have what we call a "credit motorway", as our client advisors are able to carry out the administrative tasks and credit checks much more quickly. This gives them more time to actually talk to our clients, who also benefit from much faster processing of their request.

It is streamlining like this that enables us to establish Valiant as a digital pioneer in the banking sector and to follow through on our promise to make our clients' financial lives easier.

We are of course pleased that our efforts have been recognised. In the annual private banking ranking compiled by business magazine BILANZ, we once again impressed the jury with our high level of investment expertise. We were one of only two banks to be rated "excellent" and to earn the title of "longstanding quality leader". This reflects our consistency and endurance, but also our top-notch service quality. This is the seventh year in a row that we have been recognised in the BILANZ ranking.

Another milestone I would like to mention is that at the beginning of July we successfully placed a mortgage covered bond on the capital market for the second time this year and the fourth time in total. Valiant's covered bonds are an attractive alternative for institutional investors in the highly concentrated AAA segment of the Swiss Bond Index. We have issued a total of CHF 1.45 billion in covered bonds to date, and further regular placements are planned. Covered bonds are the third pillar of our funding strategy, alongside client deposits and central mortgage institution loans ("Pfandbriefe"), and allow us to further reduce our funding costs. This, in turn, helps us to protect our net interest margin as much as possible.

Now we come to the financial results. Our solid operating performance in the first half of the year is also reflected in our solid financial indicators. I will now hand you over to our acting CFO Serge Laville for the details behind the numbers.

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H1 2019 financial results

Thank you, Ewald Burgener. I too would like to welcome you to this presentation. I am delighted to take you through our half-year results.

In summary, Valiant turned in a solid performance in the first half of the year. In addition to the rise in Group profit, adjusted operating profit improved by 1.9%. Reported operating profit fell because of a one-off dividend payment in the previous year. I will come back to that later. Our strong results were mainly attributable to solid net interest income, which rose by 2.9% after value adjustments. At the same time, operating expenses increased by a moderate 2.3%.

The solid rise in lending also led to an increase in risk-weighted assets. As a result, the capital ratio fell slightly to 16.2%, compared with 16.5% at the end of 2018. The reported total capital ratio does not include the intra-year profit contribution generated during the first half of 2019.

Net interest margin steady at 111 basis points

I will start by talking about how our margins and interest rate risks have fared.

The negative interest rate situation intensified in the period under review. For the first time, yields on Swiss government bonds with maturities of well over ten years fell below zero. This reaffirmed our assessment that banks will be dealing with negative interest rates for the foreseeable future. We adapted our business model to this situation a long time ago. Although negative interest rates are certainly not beneficial for the net interest margin, the Swiss National Bank's exemption threshold does give banks a certain amount of room for manoeuvre.

We continue to fight for every basis point of our net interest margin. The average interest rate on assets fell by 5 basis points compared with 2018, to 132 basis points. The average interest rate on liabilities fell by 4 basis points year on year to around 21 basis points at end June. This was partly attributable to the repayment of the Tier 2 bond in April 2018, which meant that the annual payment of around CHF 6 million was no longer due in 2019.

Our funding and treasury management activities continue to be extremely successful. For example, we have so far been able to largely offset the ongoing pressure on the net interest margin by issuing covered bonds. Client deposits, which remain our most important source of funding, increased by 0.7% in the first half of the year. Over 75% of our loans are still funded by client deposits.

Our covered bonds are another key source of funding. We issued a total of CHF 1.05 billion in covered bonds between autumn 2017 and the end of June 2019. In July 2019 we issued another covered bond with a term of ten years and a coupon of 0%. This takes the total amount of all our covered bonds placed to date to CHF 1.45 billion. The total funding ratio, which incorporates all forms of funding, was 101.4% at the end of June.

Interest rate risks remain low: Valiant is well positioned

Interest rate risks remained low and we are confident that we are ideally placed to deliver further earnings growth in the current interest rate environment.

The top chart shows the duration for assets, which remains stable at 3.2 years.
At 2.93 years, the duration of liabilities changed only marginally.

The middle chart shows present value sensitivity, which Valiant has been able to reduce significantly over the years, with a rising or largely stable net interest margin. Present value sensitivity given a parallel interest rate increase of 150 basis points fell from -5.97% to -4.27% in the period under review. This was because we entered into payer swaps, which eased the pressure on sensitivity.

The swap volumes in the bottom chart increased relative to total assets. We booked CHF 3.34 billion in swaps at the end of the second quarter. The additional swaps in the second quarter were primarily to hedge against yield curve flattening.

Operating income stable

We now come to our income figures. I will start with net interest income. Net interest income before value adjustments further improved on its already very good performance in the year-earlier period, rising by 2.9% to CHF 155.2 million.

Value adjustments for credit risk totalling CHF 3.3 million net were recognised in the income statement in the first half of the year, of which CHF 1.3 million in the first quarter. Our need for value adjustments therefore remained low, underscoring the high quality of our loan portfolio.

Fee and commission income fell by 1.6% year on year to CHF 29.8 million. Net trading income was essentially unchanged year on year, falling by 1%.

Other operating income was down 25.4% to CHF 14.7 million. This reduction was chiefly attributable to the sale of Aduno's acquiring and terminal business in the first half of 2018, which generated additional one-off income of CHF 9 million last year.

Excluding value adjustments for credit risk and losses in the interest business and the Aduno special dividend, operating income increased by 3.9%. Unadjusted operating income fell by 0.6%.

Operating expenses

Operating expenses rose by 2.3% or CHF 2.6 million to CHF 116.5 million in the first half of the year. Costs are thus rising in a controlled manner and at a slower pace than adjusted income. The main reason for the increase in costs in H1 2019 was higher personnel expenses associated primarily with our expansion strategy. We created nine new full-time equivalents. Other operating expenses were slightly lower, however, falling by 0.2%. This confirms that we have a firm grip on costs.

The cost/income ratio before depreciation increased from 55.1% to 56.7%. After depreciation, it rose from 60.5% to 62.2%. Adjusted for the one-off income from Aduno in the previous year, the cost/income ratio improved by around 1 percentage point.

Adjusted operating profit

Let’s move on to operating profit. Adjusted operating profit was up 1.9%, reflecting the improvement in our operating performance. The special dividend from Aduno recorded in the first half of 2018 resulted in a 9.3% year on year reduction in reported operating profit in the period under review.

Depreciation and amortisation were steady year-on-year at CHF 11.2 million. Other provisions and losses remained very low at CHF 0.6 million.

Group profit

Valiant increased its Group profit by 2.9% overall to CHF 61.5 million in the first half of the year. Extraordinary income related to property sales.

Cautious lending growth

The Swiss real estate market is currently growing at around 2-3%. With regard to investment properties, we continue to deliberately avoid certain transactions due to our cautious capitalisation rates. Thanks to our growth strategy and despite our still prudent lending policy, we expect lending to increase by 3% this year. Our growth strategy is working.

While loans due from customers fell by 1.6% in the first half of the year, mortgages grew to CHF 22.9 billion, representing a solid increase of 2.0%. Growth in new market areas as a result of our expansion is proceeding according to plan. Overall, Valiant recorded lending growth of around 1.8%. We are on track to achieve our growth target of 3%.

Up to the end of June, total lending increased by 1.8% to CHF 24.4 billion. The coverage ratio for client deposits and the overall financing rate were 75.4% and 101.4% respectively. We are also well placed in terms of liquidity, with a liquidity coverage ratio of 115% at the end of the second quarter. You will find these and other key asset & liability management indicators in the notes.

Loan quality is very high

The quality of our loans remains very high, with 97% of all loans still backed by collateral. The proportion of first mortgages is a stable 94%. The average residual maturity of fixed-rate mortgages is 3.9 years. The net loan-to-value ratio is 63.4%.

Further information on value adjustments and provisions for credit risk, which remained very low at 0.2% of loans, can be found in the notes. Non-performing loans decreased compared with the end of 2018 and currently account for just 0.12% of total loans.

Total capital ratio

Our capital base remains very solid. Eligible capital stood at CHF 2.176 billion at the end of June and comprised solely CET1 capital. The total capital ratio of 16.2% is at the upper end of our target range of 15-17%, even without including the profit generated during the year.

And there you have it, our results for the first half of 2019. Many thanks.

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Outlook for the second half of 2019

Thank you Serge Laville for your presentation. Let's now move on to the outlook for the second half of 2019. We have quite a few things planned for the rest of the year.

We will continue to rigorously implement our current strategy, which focuses on profitable growth, expansion and digitalisation. The conversion of our front office areas will also continue apace: by the end of the year we expect to have modernised 39 of our current branches. In this way, we are optimising our existing branch network.

At the same time, we will be further expanding our presence from Lake Geneva to Lake Constance. In addition to the new branches in Rheinfelden, Wil, St. Gallen and Frauenfeld, which have already been announced, we have now earmarked Rapperswil in the canton of St. Gallen as a further location for expansion. How soon we can open the branch will depend on how quickly suitable premises can be found and made ready for us to move into. The process of evaluating suitable premises and recruiting new staff has already begun. Five new client advisors are to be appointed for the branch on Upper Lake Zurich.

In the autumn we will expand our offering by opening up our mortgage business to third parties, initially in eastern Switzerland. This mortgage comparison service will enable us to offer a broader range of products to our price-sensitive clients. We will also be able to continue supporting them with a comprehensive offering even if they opt for a mortgage from another provider.

We are also aiming to launch our new multi-banking service, a key project for small and medium-sized businesses, in the autumn. Business owners will in future be able to use Valiant's e-banking application not only to manage their Valiant accounts but also to obtain an overview of all their banking relationships. We are currently conducting exhaustive testing of the multi-banking service with a small number of clients.

And we are already working on our strategy update for the period up to 2024. In addition to the Board of Directors and Executive Board, we are actively involving our employees in the process. That way, we can ensure that our approach to the challenges of the future is set from within and enjoys broad support. We will present the updated strategy on 10 September 2019.

Our extremely solid half-year results reaffirm our expectations of a slight year-on-year improvement in Group profit for full-year 2019. We are aiming for lending growth of around 3%. We will also do everything we can to boost fee and commission income.

Summary and conclusions

Dear analysts and media representatives, to sum up:

- Valiant is successful. Growth and interest business were healthy in the first half of 2019 – as shown in particular by our stable net interest margin of 1.11%.
- We were able to accelerate growth year on year without changing our risk policy.
- We are modernising our branch network and opening branches in new market areas. The aim is to establish an end-to-end physical presence from Lake Geneva to Lake Constance.
- The forthcoming new branches in Rheinfelden, Wil, St. Gallen, Frauenfeld and Rapperswil represent further milestones along this path.

- We are working intensively on updating our strategy for the period up to 2024 and involving our employees in the process.
- Our operating performance was solid, and the numbers are strong. We are expecting a slight year-on-year increase in Group profit for the year as a whole.

For many years now, Valiant has taken an implementation-driven and dynamic approach. This has been – and still is – the basis for our company's strong performance. We are on the right path and will continue to forge ahead in the future.

Thank you for your attention. Serge Laville and I are now happy to take your questions.

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