Update conference call concerning the containment measures and management of the epidemiological emergency by COVID-19

on

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Massimiliano Belingheri: Thank you, everybody, for joining us today, given the news coming out of Italy and Lombardy and Milan in particular. We wanted to give you an update on what are the measures that we have taken to ensure business continuity for our business and importantly, what can be the impact of this coronavirus on our business.

I think it's important that we go back to our business model, which has a relatively low level of interaction, physical interaction, with our customers and our debtors both on the factoring side in terms of customers, but also on the retail side, since we operate with an online only distribution model. That's actually a strong point of strength at the moment, because clearly we can operate our business remotely without having any major impact on the interaction with the various parties.

And so, if we look at what we have done, we had a clear plan for events of this type. We have the full infrastructure of the bank, and the key processes that are able to be operated remotely. As of today, we have moved all our staff in Milan in smart working, while we've kept the physical presence active in Rome and with some people in Milan as well, for some critical function. So, in a sense, we have the business operating normally, although clearly people are not traveling to work anymore. In Milan, the international business, which you always remember is 40% of our activities remains entirely unaffected at this point in time, although we have prepared also our subsidiaries for a potential spread of coronavirus.

So that is if you want on the business side and on our infrastructure, if we look at the market and our ability to operate, the impact again we think is going to be fairly mild. The only measure that seems to have the potential impact on the business is some delays in the legal processes, but that should take only lengthening a few months, and as you know, the legal process are helpful for us in terms of negotiating the debt or the collection, but that's not necessarily needed in order to collect the money from the debtors.

What we are likely to see in an environment where the public administration has been asked as much as possible to operate in smart working, as well it is potentially a lowering, sorry, lengthening of the payment time of the public sector which as you know, is potentially beneficial for our business both in terms of demand and overall returns for our assets, so that could be potentially positive. More importantly, clearly there is more demand for our services from customers, we expect an increase in healthcare expenditure and in particular pockets where customers need to set up CAPEX to actually service the public sector, we should expect more demand for our factoring product.

As you know, we've always run our balance sheet and our business in order to cope with potential shocks either on customer demand or on payment time of the public administration. And as of today, our available undrawn funding lines, unpledged government bonds and cash deposited in other banks reaches an amount of €935 million. To give you an idea, at the end of the year that same amount was only €600 million, so we have actually significant excess funding in order to cope to any peak of demand ahead of important month for us as they are March or the second quarter.

In general, the... if you look at our credit risk, which is again a concern on lenders, in case a recession were to hit, we should remind ourselves that our exposure is largely to the public sector.

Our private sector exposures are mostly concentrated in hospitals in Italy and in Poland. Poland is not yet affected by the coronavirus and remember that the dilution risk again is kept in check by having exposure in terms of customer, mostly through large suppliers of the public administration.

Again, in terms of operational impact, roughly 30% of our business is written with customers in Italy, that operates in the so called orange area, i.e. Lombardy and the provinces, where the government measures have been introduced, that’s roughly 15% of the total of the volumes of the Group. That's because actually large concentration of our customers in Italy is around Rome, where most of the International pharma companies are based and so, even in that respect, we should be impacted only marginally if at all.

So, the message we want to give to the market is I would say threefold. First of all, operationally, we continue to operate normally, as if the virus had not struck and those measures have not been implemented, clearly with a different way of operating for our employees, but with the ability to service our customers and collect from our debtors. Secondly, we are prepared in case there is more demand for our services from customers, or there is more demand for funding in case government payment time lengthens. And that's something we've always been focused on with, as you may remember, a very conservative asset liability management structure with ample liquidity, and a strong balance sheet. And third we keep monitoring the credit risk in our portfolio. But, in general, given the nature of our customers, we feel pretty positive about where we are today.

That's what we want to communicate today, but it was important to interact with you guys and I leave the floor open to any questions you might have.

Q&A Session

Operator: We will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question please press "*" then "2." The first question is from Antonio Reale with Morgan Stanley. Please go ahead.

Antonio Reale: Hi, thank you for the presentation, very useful. I've got a couple of questions, please on your business. First of all, maybe just the opportunity to give us an update on your sensitivity to an interest rate cut, if you could just give us sort of your latest? And then from what I understand, just a clarification, obviously from everything that is happening, public finances in Italy will remain under stress. And I wonder what this does to your DSOs, do you have any sensitivities that could provide sort of… as a bit of colour in terms of your DSOs going forward and the implications this has on your net interest income?
And lastly, I…it's likely the point on sort of the underlying cost of risk given your business model. However, I wonder in the framework as part of the expected loss framework, IFRS9, are there any sort of changes that we should keep in mind looking at sort of GDP estimates going forward? Thank you.

Massimiliano Belingheri: Let me start from the last one. I mean under IFRS9, we shouldn't be impacted remember most of our exposure vis-à-vis the public sector. So, we don't have a direct link with the level of economic activity in the country. So, in our model, it's a very marginal component. So, we shouldn't see any impact in the…if you want in the generic provision has been taken under IFRS9.

On the interest rate cut sensitivity, if you remember, we have liabilities that are in terms of duration to a large extent longer than the duration of our assets. A large portion is on fixed rate. So, we will not have a significant impact in reduction on interest rate immediately on our liabilities, because only the…on the wholesale funding side gets re-priced quickly through the [re-burn] base rate. What is unclear to us is actually what will happen to the credit market, because we think actually given the nervousness or the potential nervousness around the payment time of the public administration gives now the opportunity to price better for the incremental volumes we have. But in terms of interest rate sensitivity, because our liability tends to have a longer duration of our assets, we tend to catch up over time around that. But most of them are as I said fixed rate.

In terms of the DSOs, look, we don't have…since yet, to be honest, any impact on the payment time, but the measures are very recent, the one that have been implemented vis-à-vis the public administration. The sensitivity to our book, if you take the detail it is roughly 60% of our book and the DSOs around 150 days, clearly 30 days lengthening means a 20% increase in our balance sheet on Italy, which in turn is 60% of the group. So, a 12% increase. Clearly, that's an increase which will tend to translate almost immediately net interest income and, because the cost base is fixed, that should have a positive impact to the bottom line, that's in rough terms what should happen.

Antonio Reale: Thank you.

Operator: The next question is from Simonetta Chiriotti with Mediobanca. Please go ahead.

Simonetta Chiriotti: Yes. Good afternoon. My question in regards the collection rate. Don't you think that with the Italian public finance under pressure going forward, the collection also… your collection rate could be a bit under pressure? And the second question is, yes, on some data that you gave before. In terms of volume in the red zone, in the orange zone, I didn't catch the number, if you could kindly repeat this data? Thank you.

Massimiliano Belingheri: Yes. So of the Italian volumes, 30%, 3 0, comes from customers, who are headquartered in the orange zone, 70% 7 0 from customers who are located outside, that's for the Italian volumes, which clearly are a fraction of the volumes of the group, so roughly only 15%, 1 5, of our group volumes come from the orange regions, so this one.

On the collection rate. Look, I think the collection rate is always…the collection time, if…the collection rate is always 100%, the collection time it is always a function of 2 things that is the funding and the efficiency of the public administration. I don't think necessarily there's going to be a constrained in the ability of the government to fund itself. The incremental cost of the resources available is a few billion euros. Clearly, there will be an effect on tax receipts, which should widen the deficit, but the initial estimates are not really massive. So, in that respect, we don't expect a massive gap. I think what might have more of an impact, which is a second effect is on the efficiency of the public administration, i.e., if I start to have a lot of civil servants not showing up at work or having to work in smart working, this might slow down the payment, the payment performance of the various public administration. What we have been doing actually already, since a few weeks, is to price a potential delay, and we will continue to do that. And again, remember if in case we didn't price correctly, and there is a shift, yes, we have some dilution on our returns, but it is pretty marginal, because most of…a large part of our returns comes from the late payment interest which actually gets increased by the delay.

Simonetta Chiriotti: Well, you don't see the…even in the following months, I mean, not now, but going forward, you don't see the necessity to settle with the public administration at a lower amount…at a lower level of LPI's for the current situation?

Massimiliano Belingheri: No, absolutely not, and the point why I made the point around availability of funding, and why we setup multiple funding sources, through the deposit markets for the institutional bond markets through our relationship with the banks is never to be put in the same situation that we felt we had in 2011 and '12 of payment time length, but we didn't have access to factoring. That's basically what we've always been prepared for. And the bank is fully prepared for it. We know that in case payment time lengthen the effect one... clearly, we generate much more capital, because asset sits on our balance sheet for longer, our costs are fixed and therefore it flows through the P&L.

Secondly, there is more demand from our customers at better prices to be honest, and therefore again it's positive for us. So, with all of this we can actually be the marginal taker of deposits. And we've seen in the past that the increased price on the asset side is not…is much higher than increasing spread on the liability side. And so we can play that, that opportunity in case it happens. But importantly, in order to assure continuity of our business, we've always kept, as I just said, plenty of available funding and liquidity in our balance sheet. If you look at the number

I gave, €935 million as of today, that's clearly a significant amount if you consider that our balance sheet as of December in terms of customer loans was only €4.1 billion, so we have almost 20% of our incremental potential on our balance sheet. As of today, we are doing anything without launching a campaign for deposits without launching a bond or raising other money in the wholesale market.

Simonetta Chiriotti: Thank you.

Operator: The next question is from Filippo Prini with Kepler. Please go ahead.

Filippo Prini: Yes, sir. Good afternoon. A very brief question, I would like to ask how flexible is your structure to deal with these possible higher volumes to work on. I mean, should we expect that the additional volume that we may capture in next month will go down to the bottom line or maybe you should increase your cost in terms of process, in terms of number of workers to deal with this potential peak? Thank you.

Massimiliano Belingheri: Yes. I would answer the two different increasing volumes you need to consider. The first one is, I am buying the same amount receivables, the receivables sits on my balance sheet for longer. Therefore, my interest income in absolute terms is higher. The fixed costs are exactly the same. If an invoice sits on my balance sheet for 6 months or 9 months, still sits on my balance sheet and the amount of effort operation you need to do is exactly the same. So that actually flows through directly for the bottom line.

Now, on the incremental volumes, there are 2 things to consider. The first one is we have about €3 billion of volumes which are managed only, they are not sold. If those shifts from managed one to sold, again, we have zero marginal cost, because simply we are managing those volumes anyway. In case there are incremental volumes, even there frankly, we are talking about marginal impact and, to be honest, because last year the Italian business did not perform as we expected, the extra capacity that we had built, should be able to cope with that extra demand.

And in Italy we have roughly 200 customers and we have 9 salespeople. So, we are not talking about massive numbers to generate incremental volumes.

Filippo Prini: Okay. Thanks a lot.

Operator: As a reminder, if you have a question, please press "*" then "1." There is no question at the moment. The next question is a follow-up from Simonetta Chiriotti with Mediobanca. Please go ahead.

Simonetta Chiriotti: Yes, it is because of the specific subject of today's call, but maybe, it's related, I don't know, just to have from you an idea of what is happening on the split payment. I don't know if the current situation makes any difference in terms of renewal or not renewal of this measure. Thank you.

Massimiliano Belingheri: Yes. We are trying to understand again in a situation where companies are going to be more stressed for cash. I think probably confirming sooner rather than later, then the split payment is not going to be extended, it's going to be a positive. So, we are trying to understand if and when the government will make that official. So we don't have any news, but this is clearly an area where we think it should actually be a positive for the economy in case there will be a reintroduction of the split payment…reintroduction of the normal VAT, the abolishment of the split.

Simonetta Chiriotti: Sure.

Operator: Again, if you have a question, pleases press "*" then "1." There is no question at the moment. This concludes our question and answer session. I would like to turn the conference back over to Massimiliano Belingheri, for any closing remarks.

Massimiliano Belingheri: I would like to thank you for joining us today and it's a busy time in the market and it is tense moment in many respects in our lives. So, we wanted to convey the message that the business has been prepared for what is happening and we are there for our customers to be able to deliver to them the service they need in this moment. Clearly, it's probably something which we will continue in terms of effect and we are monitoring, we are monitoring the impact on our business, but we are quite confident that we shouldn't have any major negative impact on our business going forward. Thank you very much for everybody for attending today. Thank you.