Garanti BBVA's 2023 Earnings and 2024 OP Guidance Webcast Transcript

This past year, characterized by extraordinary challenges, has truly tested our strength and resilience. Yet, our solidarity and unwavered commitment to excellence lead us to achieve, once again, outstanding results.

Before delving into the specifics of our performance, I will begin, as usual, with a brief overview of the broader macroeconomic environment.

As a recap, monetary tightening continues in order to rebalance the economy. Given the gradual steps so far, domestic demand is slowly cooling down. In the very short term, fiscal policy will be key to determine the pace of adjustment.

We have also started to see the positive signs on foreign capital inflow, which will contribute positively to the growth outlook.

We expect 2024 GDP growth to be 3.5% with domestic demand decelerating further and net exports contributing much higher.

We forecast consumer inflation to slow down to 40-45% range by end 2024, given the recent improvement in inflation trend and enhanced likelihood of keeping a stable currency.

In 2023, excluding earthquake spending, budget deficit was 1.7% of GDP, far below the Maastricht criteria of 3%. We expect fiscal prudence to continue to help the targeted disinflation path.

We also foresee the current account deficit shrinking down to $30-35 billion for year 2024, expecting ongoing favorable conditions for its financing.

Before getting in the numbers, the summary is basically our core banking revenue driven net income generation capability.

Our distinction: contrary to what market expected, as GarantiBBVA, we could sustain the quarterly growth in earnings also in the 4th quarter.

With a 23% quarterly earnings growth, 4th Qtr earnings reached a new record level, 29.3bn TL. With this, our 2023 earnings totaled 86.9bn TL suggesting a 49% EPS growth for year 2023.

These figures include the free provision reversals we have done through out the year, however even when adjusted, it does not distort the main story of consistent growth in quarterly earnings.

ROAE for the year ended to be 45% vs our OP expectation of above 28%. Thankfully, We could outperform our budget in a significant way.

Even if we had not reversed our free provisions in the year, our ROAE would have been a still significant 41%

More importantly, the bulk of the earnings is what we call are of ‘high quality’.

High quality revenue generation capability - meaning core banking revenue generation remains to be our inherent strength.

Even in a year of rising interest rates and heavy regulations that lead to significant increase in funding costs, we could offset such a downside with higher growth in pure trading and net fees & commissions. Our Core banking revenues, even in the year of shrinking Core NII, could surge by 47% yoy.

Trading income boost was driven largely by the high FX buy and sell activity, especially in the first half of the year.

While the net fees and commissions boost was from the extraordinarily high rise of the payment systems business as well as the high banking transaction activity in the year.

High quality earnings is the natural outcome of our strategy of growing assets via customers

Performing loans’ share in assets make up the majority, 54%, whereas securities share – including some limited regulatory driven fixed rate security additions and CPI linker accruals - remain at 15%.

Tightening measures of the new economic administration hit the 2nd half of the year with a pace cut in TL loan growth. In the 4th quarter, given higher interest rates, quarterly TL loan growth was a limited 11% bringing the YTD growth to 59% - a level slightly above the average inflation guided. With this, we likely sustained our #1 position in TL lending.

In 2023, contrary to the sector trend, we took the opportunity to grow our FC loans and met the growing demand in this stabilized currency environment.

On next page you can see the lower growth pace in TL loans, especially in business and credit cards… whereas relatively higher growth was booked in consumer lending, namely lucrative GPLs.

Our TL performing loans reached 751billion TL as of the yearend.

During the year, we could further strengthen our leadership in TL loans, particularly with market share gains in SME and commercial lending. On the consumer side as we insisted on reasonable pricing, we had at times intentional market share loss to defend margins.

Similarly in credit card business, even though the yoy growth seems is an astonishing 117%, the cc business growth in the sector was even an higher 136%

Ours was a natural demand driven growth given our leadership in cc. Yet, we were not too concerned with our market share loss in the year from the comparatively lowest yielding business. You may recall that the credit card rates were exceptionally low for most of the year and only in the last quarter it got to a reasonable level.

Moving on to the quality of the total loan book of 1.3trillion liras: 88% is stage 1.

130 bn liras or 10.3% is stage 2. The noticeable drop in stage 2 even in a currency adjusted manner, relates to one big file that used to be in prudence under stg 2 justifying its upgrade in staging.

Yet, the coverage for stage 2 has been further solidified at above 21% levels.

As for the NPLs, They make up 2% of the total

That the Net NPL inflow in the quarter suggested some normalizing trend. More than half of the new NPLs in the last quarter relates to retail and credit cards portfolio – as expected, upon the end of the cheap funding period. The rest related to the wholesale portfolio with one big file in construction sector. Thankfully, this file at Garanti needed only minor provisioning as it was already highly covered while in stage2.

Our total provisions on balance sheet, including the written down portion, is 69 billion liras or 68.8 billion to be exact – this is the highest provision level in the sector and represents a total cash coverage of 5.4%.

On the next slide, we can see how this translates into cost of risk

Net COR as of the year end ended to be exceptionally low. It's been far better than our OP expectation of around 100bps, with only 61bps. And this figure is even after including the provisions relating to the earthquake. This far better net CoR is not only due to the low NPL inflows during the year, but also is owed to the exceptionally strong collections performance in the year given the highly liquid - low interest rate environment of the 1st half.

4th quarter though, started giving signals of normalization esp. in the absence of such high collections performance.

On the Funding side, as it has been our historic legacy, we actively manage our funding structure to deliver superior margins. Deposits alone, fund 3 quarters of the assets, and 40% of this, is demand.

Despite the high interest rates, the high weight of demand deposits remains to be the key financial differentiation in terms of margin outperformance.

Borrowing's share in funding assets, on the other hand, stands at a low 6.5% - Total external debt is now $4.1bn – and you can see the breakdown of our foreign debt in the pie chart on the right hand side -- securitisations make up nearly half and 21% of the external debt is in the form of syndications.

100% of the new issuances since 2021 has been ESG linked. And now ESG linked funding makes up 28% of total wholesale funding

Of the total FC debt of $4.1bn, $ 1.4 bn is due within a year. Against that we had a FC quick liquidity buffer of $6.3bn as of the year end.

In line with the regulations, liraization efforts continued throughout the year.

There was 17% growth in TL time deposits, bringing the year on year growth to 134%. In this period, FC deposits' shrinkage at Garanti though was a limited 4%.

Regarding demand deposits, Garanti continues to lead in customer demand deposits' share in total with 41%vs. the average of private peers of 38%. This presents comparatively high funding advantage and manifests itself in our superior margin performance.

The rising interest rates, and added regulations took funding costs to even an higher level, while loan yields – even though they were at relatively more sensible levels, were heavily regulated. This caused further pressure on spreads and of course on margins. Accordingly, the core margin adjusted with the FC protected deposit scheme's additional remuneration was down by 94bps in the quarter and by 334 bps on a cumulative basis yoy

CPI impact on margin was positive in the last quarter, as we did the adjustment for the actual CPI reading that came in 62%. This meant significant adjustment vs. the 48% cumulative CPI estimate that we had used in the prior valuations.

Moving on to the performance in net fees & commissions,

We could grow our NF&C by 37% in the quarter and 140% year on year.

Payment systems business contributed the highest to this well above the projections performance with a growth that was almost twice the pace of the other fee businesses. This exceptional performance in payment systems is owed to the rising interest rates and also was a natural outcome of our number 1 rank in both issuing and acquiring volumes as well as us serving the highest number of credit card customers.

Other contributors to this robust fee performance are definitely; the strength in relationship banking and digital empowerment contributing to not only to grow our active customer base, but also penetrate further the existing customers.

Our mobile active customers are now near 15 million and Digital sales in total reached 90%

Our leadership in TL cash and noncash loans, manifested itself with 83% increase in lending related fees. Brokerage and AM fee growth was also an amazing 113%. Owing to customers, using us as their main bank, our Money transfer fee growth was also well above expectations, at 98%.

Our well diversified fee businesses signal the sustainability of Garanti's superior fee generation capability

As for the operating expenses performance, on slide 16

Quarterly opex growth was 21% and annual growth was at 103% - suggesting that we ended the year in line with our guidance even with the impact of the earthquake and currency. 3% of this annual growth was due to the earthquake related donations and 11% related to the currency, without impact to the bottomline – as the FX portion of opex gets fully hedged. Thus the adjusted figure is actually 89%, suggesting our cost concious and real outperformance in cost management.

Looking at our 'best in class efficiency ratios';

Cost income was 35%, fees coverage of opex was 78%, opex in avg assets was 3.2%

As per Capital,

It remained strong as net income compensated for the negative impacts of FX and market risks. Without the BRSA's forbearance, our consolidated CAR was 16.5% and CET1 was 14.5%

The FC sensitivity on our CAR is that for every 10% depreciation, it is 37bps negative.

In summary, Wrapping up the year, we were able to outperform our 2023 guidance by delivering an ROAE of 45% vs. our above 28% operating plan expectation. The significant pressure on margins due to increase in funding costs and heavy regulations was more than offset with exceptionally low net CoR, superb performance in fees, and trading income support.

We are thrilled to see the reflection of this outperformance on our share price performance which increased by 33% in USD terms, outperforming the banking index by a significant 21%.. With that, we finished the year as the most valuable bank in Turkey.

These outperformances are very meaningfull for us especially in the year marking the 100th anniversary of our Republic.

We are more motivated than ever to continue creating value for all our stakeholders.

For year 2024, we expect a TL lending growth around CPI which suggests a slight slowdown compared to 2023 parallel to the ongoing monetary tightening and expected economic slowdown.

More colour around growth expectations is that we expect a pick-up in pace in the second half. And project the growth to be a balanced one across business and retail within the framework of regulation.

We project a low single digit growth in FC loans this year as we expect demand to pick up.

On the cost of risk side, as I have mentioned we had an exceptionally low cost of risk year behind and 4th quarter 2023 inflows suggested some normalizing trends. Accordingly, we expect a normalizing net CoR at around 125bps by 2024 end.

On the margin side, we will aim to manage the total margin flat yoy. There will most likely be a decrease in CPI contribution given the lower CPI expectation for the year. We project the Core margin side though to largely compensate for this drop.

On the fee and opex growth, our guidance is that the growth in both of these items would be above CPI due to the roll over affects for opex and normalizing fee growth.

These all should suggest an ROAE for the year that is in the mid 30s.

Please keep in mind that these expectations are built on the assumption that the current regulations will remain intact and no new regulations will be introduced. Any change in these may lead to an either an upside or a downside on the guidance.