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# EDITED TRANSCRIPT

BKIA.MC - Q4 2019 Bankia SA Earnings Call

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## PRESENTATION

**Iñigo Velázquez** - *Bankia, S.A. - Head of IR & Rating*

[Interpreted] Good morning. Good morning to everyone. Welcome to our presentation for 4Q 2019. As always, we'll have our CEO, José Sevilla, explaining the highlights of quarter, and then Leopoldo Alvear will get into detail with our results.

Now (sic) [Then] we'll have a Q&A session. And we'll give the floor to the analysts interested in asking questions. So without further ado, I'll give the floor to Pepe.

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much, Iñigo. Good morning. Let's start with our presentation. As always, there's going to be an introduction, and then Leo will get into detail and will explain what happened in the last quarter.

Let's summarize what's happened for us in this 2019 year. We have good overview here in this page. Our year goals were focused on continuing with our goals set in our strategic plan; fostering commercial activity after 2018 with the integration of BMN; achieving cost synergies that we had set for ourselves when we integrated BMN; the increase of quality of assets, the accelerated reduction of NPAs; and as you can see here, to continue to generate capital organically throughout the year. In these 4 aspects, we're happy with what we have achieved.

Regarding commercial activity, this slide -- well, we show it every quarter, the performance of customer satisfaction. To your left, you can see internal service. We performed every year. This perceived quality of customers was deteriorated slightly in 2018 as a result of the integration process, while it had been recovered to levels before the integration, and in the second year half has increased again. To your right, where you're familiar with this graph, too, it shows commercial intensity performed by an external consulting company. As you can see, in 2019, we've increased again these results, and we are ranking first in terms of commercial activity.

More customer quality and more customers. It was another one of our goals and our plan, to increase our customer base. And as you can see at the bottom, to your left, increasing customers with direct income deposits. We've -- sorry, payrolls. We've increased that number this past year. And also digitalization indicators in our customers. Another goal we set for ourselves, the number of digital customers this past year has increased 13 basis points. We've reached 53.3%. The goal in our plan was 75% next year, and we're going to be close. But we think we're going to be close at 75%.

Also, digital sales, you can see the development. We've increased 15% -- 20 percentage point to -- the past 2 years. We've beaten the goal we set for ourselves in the strategic plan, a percentage of digital sales over 35%.

Let's speak about the digital work. Here, we have the assessment of our digital channels, the app, the online world for retail customers and for companies, for business. Surveys performed amongst our customers. We can see how the quality perception in our channels has increased. And in the bottom part of the slide, you see external sources. And there, you can see how, based on Aqmetrix, which is an external provider for rating digital channels of financial institutions, we ranked second in all the graphs. Here, I have to say that peer 1, 2 and 3 are not always the same one. They change from one table to another.

We have online channels. We feel comfortable with them. We're happy with them. And they fare nicely with any of our competitors in each of the alternatives. Throughout the year, we have improved, as you can see on the slide, regarding the launching of new products and services, Bankia Gestión Experta online; this specialized channel for assets employed; digital mortgage, Hipoteca ON; and also the real estate valuation tools.

And one of the successes of 2019 is in this slide. We've grown in mutual funds, and it's been -- our growth has been different compared to our customers -- to our competitors. We've been leaders. We've received 22% of the total new production in the sector. And to your right, you see an increase of almost 17% of the balances of our mutual funds. In this sense, you can see the market share for mutual funds in Spain. It has increased from 6.55% to 7.05%. And we're close to the goal we set for ourselves 2 years ago, which was growing 82 basis points in our market share. It is 7.20 -- and the first semester of this year will be close to 7.2% market share.

Very good year in terms of cards invoicing and insurance invoicing, and together with mutual funds, with the 3 elements that we call added value, products that we had to foster. Cards turnover has increased almost 15% this year, over almost 13% last year. Cards turnover market share, there's an increase of 4 -- 0.4 basis points. And also the cards stock, this makes us closer to the goal we set for ourselves in the plan.

Insurance premiums. In 2018, we had quite a flat year regarding the increase of insurance turnover in Bankia. This was highly linked to integration of networks, but we've had a strong growth this year, over 26% in insurance premiums, and we are increasing our market share. We think that for 2020, these 3 lines of work, mutual funds, credit cards and insurance, are going to have a strong growth, fostered by the new commercial positioning of the bank.

Let's move on to credit. Here to your left, you see the performance of credit stock for the year. After many years, we've had a first year in which credit has grown as a whole. Little growth but it's still growing. The last part of the year, there was a lower increase, a bigger fall of real estate stock as a result of the new piece of legislation that was passed related to these, which has affected the turnover.

Here, you can see the portfolio. It has been an increase of EUR 3 million together with consumer finance. They've reduced the fall of the mortgage stock here. You have the combination, the credit stock mix and how 2019 compares to what we had set for ourselves in the strategic plan as the diversification goal of our portfolio for 2020. So I think that we will be in line with the date we mentioned for the end of 2020.

Let's move on to consumer credit. We've increased our balances, slightly below the goals we set for ourselves in the strategic plan, but still we're increasing our market share. As you can see at the bottom, 5.58% at the end of last year. The goal we had in our plan was reaching 6.6%. Still, it's going to be complicated, maybe in a more dynamic environment, but we think that 2020 is going to be a year in which consumer lending is going to grow over double digit.

And in 2020, we have started our activity in a joint venture we have created together with Crédit Agricole to in -- to finance consumer lending at the point of sale.

Regarding companies, the -- you can see the increase here. It's been more than 9%. We're growing at more the average rate we set for ourselves in the strategic plan, which was up to 7.9%. And to the bottom, we see regarding market share, we're finishing the year at 7.75%. So we are over our goal we set for ourselves for 2020.

We have to remember that here, we had several lines of work in order to step up or want to foster an increase in market share. The end of the bands we had in order to develop certain businesses at the end of the strategic plan; also promoting developers within this lines of work. And in general terms, the commercial dynamics we have maintained throughout the year.

Regarding mortgages. As you can see, new lending, new mortgages, we've had a similar invoicing compared to the previous year. This is in line with the sector -- with November data. We see that this sector represents same figures regarding mortgages in 2019. And here, I've said before, with an impact from the new mortgage law, at some point, it has slowed down the signing of transactions in the second half of the year. And here, it's complicated to assess to what extent that could be a lower credit demand regarding mortgages.

To your right, you can see the basic indicators, which are very similar. We invoice almost 1/3 of mortgages to new customers, owners, near 1/2 of them, fixed-rate mortgages, and LTV is conservative, 64%. And regarding finance, since [2019], all of this is under sustainable financing.

To your left, you have some important milestones that have taken place last year regarding the commitment of the bank with sustainability and climate change. And our commercial offering, since -- before this summer, we launched -- we created a business unit focused in sustainable financing. We're adapting our credit policies and granting policies to the environment of sustainability that we want to foster.

Regarding the second point, cost synergies, I'm not going to explain this because I think you're familiar with this. Operating expenses, they have fallen 2.5% throughout the year. We will get into detail later on. This means that cost synergies compared to the natural evolution of expenses is EUR 220 million cost synergies, which means more than 50% of the old cost base of BMN.

Asset quality. Here, you see the performance throughout the year. The NPAs, nonperforming assets, that's a figure that's repeated several times, which is EUR 8.4 billion. We've reduced to half the balance of nonperforming assets. So from EUR 16.8 billion to EUR 8.4 billion, the reduction of total NPAs. You have to remember the new strategic plan we had set for ourselves, a reduction goal of EUR 8.9 billion. And we're there. We've barely covered 94% of our goal. This means that we've made an effort. We've increased the reduction of NPAs. In the last quarter of the year, if you remember, the goal was about EUR 1 billion over the years. So the last semester entailed EUR 600 million of NPAs, and we've reduced more than EUR 6 million these NPAs. So this has had an impact, as Leo will explain later on.

But we thought it was a good idea to take advantage of this at reducing NPAs in 2019, although this entails some additional costs in our annual accounts. The gross NPA ratio is 6.4%, close to 6% that we had set for ourselves 2 years ago for 2020 in the strategic plan. And the net NPA ratio is at 3.3%, again, close to our goal of 3%.

So the P&L. I would like to say -- I would like to highlight the closing of core result. You have to remember that in the beginning of the year, the growth was 5%, which our goal -- which meant that our goal in terms of core was EUR 1.3 billion. In the last meetings, we said that we were going to be a bit before -- between EUR 15 million below this goal of EUR 1.3 billion. The final closure was EUR 1.287 billion. As you can see, the net interest income equals the full -- the increase of fees and commissions. And the big part of the improvement of the core result this year is focused on lower operating expenses.

On the other hand, the performance of our profit, profit before taxes, it had this improvement in the core result of EUR 47 million. And the net trading income falls from a high figure in 2018 and the increase of provisions, the lower part of P&L. Later on, we will get into detail. This is what caused this fall of 17.5% of profit before taxes, which leads us to a net result of 500 -- 400 -- EUR 541 million.

We've increased 63 basis points of CET1 of -- capital. CET1 fully loaded closes at 13.02%, which means an increase over that minimum we have set for ourselves of 12%. And as you can see, that's quite to your right, our goal is distributing the excess capital over 12% of CET1.

In order to finish this part, the dividend. The decision taken by the Board is to maintain the dividend per share, approximately EUR 1 million -- about EUR 355 million. Therefore, between 2018 and 2019, we'll be distributing EUR 709 million in dividends, which entails a payout of 75% for this year, compatible with the increase of the capital base -- or capital ratio, 73 (sic) [63] basis points as I've mentioned before.

And I'll give the floor to Leo so that he comment on the second part.

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] Thank you, Pepe. Good morning to all of you. Let's start by going over our P&L. You have the comparison between 2018 and 2019. As you can see, as Pepe said, the net interest income has been reduced 0.7%, balanced by the increase of fee and commission in the same amount. We have lower net trading income as a consequence of the fact that in 2018, we had an important turnover of the same, and this leads us to a gross income that is good, and ROF would be flat as we'll see later on.

Operating expenses, they behaved better than expected as a consequence of the increase of synergies, up to EUR 220 million versus EUR 190 million that we expected initially. This entails a reduction of 2.3% in OpEx and expenses plus net interest income and fee and commission as -- to the core result of EUR 47 million.

In the lower part of the P&L, we have the performance provisions. And as Pepe has explained before, as we'll see later on, we've had a great [inflows] in the reduction of NPAs over the fourth quarter, which means provisions that we expect have been an effort this year that will not repeat in 2020.

And with all this, we have this result of EUR 541 million. The difference with 2018 is based on the reduction of ROF of -- sorry, in trading income and extraordinary provisions in order to reduce the NPAs in Q4.

Let's go over the performance of net interest income. To your left, you see Euribor performance in gray. You have Euribor according to forward curve of November 2018. Based on that, we planned the budget for 2019. And at the bottom, the green curve, you see the performance of the real one and the forward one the curve has now for the rest of 2020. The first part of 2019, Euribor was around minus 12, 13 basis points. It was reasonably similar to what curve -- forward curve was telling us. But the second part of the year, the average was around 21 negative basis points, and we saw a difference compared to what we expected. The average in 2019 was around 21 basis points. And the average we have for 2020, according to the current curve is around minus 25 basis points.

Even though the Euribor has had a rough performance, we've managed to balance -- partially balance this performance with good commercial dynamics, maintaining -- performing credit as stable, even positive. And the mix of our production, we're focusing in consumer finance and companies with a high-yield and, therefore, improve the total mix of our back book. However, we had a negative impact as a consequence of the lower contribution of our portfolios because we ended 2019 with EUR 2.4 billion in portfolio compared -- less compared to 2018 and we had a more -- higher excessive liquidity, and because we have to assume for the same. The cost of customers is stable, around 1 -- the gross customer margin is around 1.64%, stable.

For 2020, we expect a fall in net interest income as a consequence of the performance that we have mentioned before, that will be higher in the first part of the year, which -- because we are repricing against mortgages at 0.12 compared to 0.25 of -- negative Euribor, and we have EUR 2.5 billion in portfolios that -- this year. We need to see whether we have an asset where we can reinvest under our philosophy and not investing in assets with high risk. We'll continue to take a look at sovereigns and, more particularly, the Spanish one.

Let's move on to fees and commissions. They increased 1.2% over the year. But as we've said, in 2019, some of the fees and commissions are not comparable between 2018 and 2019 when we take out this fees and commissions from 2018 that came from management fees and commissions from BMN customers before applying the commercial position in Bankia, amount of provisions that we charge for selling write-offs of BMN that aren't fit anymore, we see that comparable commissions -- fees and commissions have increased 5.6%. And as you can see to your right, this increase in the fees and commissions has been higher in the second part of the year. And second semester, fees and commissions have increased 6.7%. This increase is the result of the good commercial positioning that Pepe has explained, the increases we've had in performing credit and all the increases we've had in assets outside balance, mutual funds, pension plans and insurances that have increased almost 5%.

Additionally, we expect in 2020, as a consequence of the new commercial positioning we'll be implementing, that will be up and running, at the end of February, we'll have an additional increase of provisions. So for 2020, we think that we should have provisions throughout the 12 months will increase double-digit compared to 2018. However, it will be after Q3 -- sorry, Q2 when we start to see this increase of fees and commissions as a result of this new positioning because this has been applied. This is going to be applied since the end of February.

As you can see, the gross -- recurring gross margin, as I've mentioned before, is stable. The reduction of the net interest income is set up with the increase in fees and balance -- commissions. In OpEx, we've reduced them. Because of the synergies that Pepe has mentioned before, we've ended up having those synergies in 2019. When we compare Q4 against the same period in the previous year, the reduction of expenses is 4.3%. How we maintain our competitive advantage regarding our -- compared to our peers, because our APR expenses are less than our peers through September. We expect a reduction of expenses because we've finished extracting all the synergies from our transaction with BMN.

Let's go through our core results. And as we've seen in other quarters, it continues quarter-after-quarter, EUR 2.8 billion (sic) [EUR 1.28 billion], 3.8% of increase compared to 2018. As you can see, Q4 in 2019, we've had a positive result because of the synergies from BMN. The guidance we have for 2020 is maintaining stable core result. We'll see a decrease of the net interest income and increase in fees and commissions of around double-digit and a reduction in expenses around 2%.

Let's take a look at the lower part of the P&L. We wanted to differentiate it between the organic part, the performance of -- the quality of our assets and the part which is a consequence of the acceleration in the reduction of NPAs.

Let's take a look at the organic part, the risk cost. The cost of risk has been 26 basis points. If we add 2018 and 2019, we are in line with the 24 basis points we set for ourselves for the strategic plan period. And you see that the gross NPL entries and the net NPL entries, gross, less recoveries and foreclosed assets, among other things, are reasonably in line. Throughout the quarters, we're not seeing a change in cycle. We are not seeing a reduction in the quality of assets.

And as you can see on the slide, we expect that for 2020, we maintain this cost -- organic cost of risk around 20 and 25 basis points. And the deviation or the variation between having -- being in the lower part of the rank will come from the recoveries level we have, particularly, in lending to companies. But as I've mentioned before, what we are seeing regarding cost of risk -- organic cost of risk is not different from what we've seen in previous quarters.

Let's take a look at the P&L, the bottom part, the provisions of the year, more particularly in Q4. There's been an important acceleration in the reduction of NPAs. In Q3, we presented the results, and we said that we wanted to reduce NPAs around EUR 500 million or EUR 600 million. The reality is that we have reduced EUR 1.25 billion this quarter. It was EUR 1.4 billion up to September, and we've added more in the Q4 as a result of the sales of NPAs portfolio that are -- had -- EUR 819 million in the quarter.

Additionally, as we've said in our breakfast with analysts in the middle of December, there's been an impact of revaluations, which has been extraordinary in our opinion. And therefore, we think that since we've reached a net NPA ratio, which is what we see, the percentage of NPAs that is not covered with provision of 3.3% when our goal was reaching 3% at the end of 2020, we don't think that we are going to have portfolio sales in 2020 since the organic recovery should take us through that 3% we have as a goal.

In other words, we consider we have EUR 150 million in the lower part of the P&L that shouldn't be recurring. That was extraordinary result of the acceleration in the reduction of NPAs, of this reevaluation, that shouldn't take place again. And therefore, we shouldn't have them in 2020.

Let's take a look at the asset quality. I'll go very quickly because I've already mentioned it. We have seen a reduction of EUR 2.5 billion NPAs, 23%. So this is over what we had set for us as a goal at the beginning of the year. And there is reduction of the NPA ratio, 1.8 percentage points, 6.4% in gross terms. The goal in the strategic plan was 6% at the end of 2020. Reduction in the net NPA ratio to 3.3%. As I've said before, the goal is 3%, and we maintain or increase the NPA coverage around 49%, as you can see to your left.

Regarding NPL, there is a reduction every year. The NPL ratio is 5.0% and the NPL coverage ratio is around 54%. And regarding foreclosed assets, there is a reduction of EUR 1.9 billion. There's been an increase in the coverage ratio of -- from 26% to 31%. And the mix of reduction if -- the portfolio sales that we had over Q4 and retail sales that we have for the exercise, at EUR 363 million.

Let's move on to liquidity and solvency. Our ratios are very solid in terms of liquidity, loan-to-depo ratio is 92%. The regulatory ratios, LCR, over 200%, and NSFR, over 124%. Our liquid assets are more than EUR 3.5 billion. Disintermediation ratio has increased significantly in the exercise. It's now at 13.3% as a result of the good performance of the mutual funds that Pepe has explained.

And last but not least, we've also increased significantly our MREL ratio. We've increased this in 3.6 percentage points and to 21.9% as a result of the EUR 3.5 billion issuance of senior loan preferred and senior debt that happened during the exercise. The ratio we -- the MREL ratio we have is 23.66% on the 1st of July 2021, so we're quite close. I estimate that with EUR 2 billion, EUR 3 billion efficiencies, we would reach this ratio.

Regarding solvency. Another good year in terms of capital generation. We've generated 63 basis points this year. Our solvency ratio is 13.02%; CET1 fully loaded, 12.85% in terms of management. Total solvency is 16.79%. We have big buffers. Our ratios compared to regulatory ratio are more than 500 basis points. And the leveraging -- leverage ratio is 5.3% -- 5.4%. Although there's been a cash payout in this exercise, we've increased our capital ratio more than 60 basis points.

Pepe, you have the floor for the closing remarks.

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] So we're beyond the 30 minutes we had set for ourselves. I'll go very quickly. For my closing remarks, I go back to the beginning. For us, it's been a year with an important commercial dynamism. We've consolidated the efficiency improvement, we've accelerated the asset quality, and we've generated capital again over 13% with an increase of 63 basis points this year.

And without further ado, let's move on to the Q&A.

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## QUESTIONS AND ANSWERS

**Iñigo Velázquez** - *Bankia, S.A. - Head of IR & Rating*

[Interpreted] Thank you very much. Now we would like to have as much analysts as possible, so a maximum of 1 or 2 questions per person. Without further ado, operator, the first question in the Spanish line.

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**Operator**

[Interpreted] (Operator Instructions) And first question from Javier Echanove, Banco Santander.

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**Javier Francisco Echanove** - *Grupo Santander, Research Division - Equity Analyst*

[Interpreted] I wanted to ask 2 questions. The first one, I would like to know how you're doing with the current NPAs coverage. And the 30% of coverage in the foreclosed assets that regard -- considering the coverages you needed in order to carry out portfolio sales. And the second is you've mentioned something related to guidance for cost for 2020, but I didn't understand it. Do you see any possibility to have additional exercises of cost reductions based on the pressures you may have on revenues and the capital excess you have.

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Regarding NPA coverage, we feel comfortable with 48%, around 49%. And with that coverage ratio, I think we compare okay with the sector, and we feel reasonably comfortable. Regarding sales carried out over the past quarter, they are due to foreclosed assets but also NPL portfolio sales. So there's not like a coverage of one element against the other. There's not an unbalance.

What happens when we sell is that we assume the best margin that is captured, that the buyer is taking. And that part of that margin, which is addition to the ones we have in our retail sales, creates this deviation, of this higher cost of risk in our P&L.

Regarding guidance for 2020, and please correct me, Leo, if you want. For 2020, as we've said before, we're not expecting a reduction of costs. We are working with the guidance of core result that will be equal to [EUR 0.280 billion], with a reduction of -- with the growth of cost of 2%, we think this is going to be the speed of the increase in 2020, with 2 years of cost reduction, would go back to natural growth. This year, our forecast is around 22%.

Regarding the foreclosed coverage, this 31%, the one we show is covered since they become foreclosed assets. If we speak about the coverage from the beginning, this coverage is different. We don't have a floor as you know, and we think that these assets when you compare with all the peers, these compared quite positively.

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**Operator**

[Interpreted] The next question comes from Jose Abad, Goldman Sachs.

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**José Maria Abad Hernandez** - *Goldman Sachs Group Inc., Research Division - Executive Director*

[Interpreted] I think that the guidance, cost of risk, you're forecasting a decrease of cost of risk from 26 to 20, 25 basis points. Could you please elaborate? Because in a context such as the current one, what we clearly see is a slowdown. Your own research team has a forecast of 1.5% of growth this year compared to 2% last year. What we would expect is that provisions would increase almost automatically? Because of an increase of expected loss, we wouldn't expect them to fall. And the second question related to this in consumer finance, could you please tell us what's the cost of risk of retail customers in your portfolio? If you don't have that figure, at least, the proportion of cost of credit coming from retail customers.

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Okay. I'll explain something and you want -- you can add. If we speak about full, it means total sales. For 2020, there will be a lower need, also because our approach is a reduction of NPAs but more based on our organic performance and not portfolio of sales, which was the effect that you've seen in 2019. I don't know if you wanted to elaborate a bit more regarding the cost of risk. It is true that from a cyclical point of view, we are seeing a slowdown. But as we've mentioned previously, we think that the relevant part of the cycle regarding provisions for -- in solvencies is the one related to the performance of the labor market, which to think that within that 1.5% you've mentioned of economic growth, employment as people registered with the social security can grow between 250,000, 300,000 in a year. We wouldn't be around the 500,000 that we've seen over the past years, where employment is still going to be created. I think we -- we think this is positive in order not to change our estimations for the cost of risk or where this 25 basis points we've included in our presentation.

And then cost of consumer finance, do you have the figure?

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] Yes, the cost of risk of consumer finance that we have, the pre-approved, which is 80%, 85% of the production we have is around 2%, and it's been like this since we started. Do you have this type of product? Like 4, 5 years ago, so it's quite stable. Then if you include drafts and cards, the total cost is around 3%. But the consumption -- the consumer finance we have, which is around 85%, is around 2% and very stable.

**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Just a comment, in the Excel file we've included data from segments where you can find these figures.

**Operator**

[Interpreted] Next question comes from Francisco Riquel from Alantra Equities.

**Francisco Riquel** - *Alantra Equities Sociedad de Valores, S.A., Research Division - Head of Research*

[Interpreted] Two questions. Could you please elaborate on net interest income for 2020? More particularly, the headwind you expect from the contribution of the bond portfolio, taking into account the sales in 2019 and whether you expect more in 2020. And if you think that this could be balanced with the creation of business that was weak in Q4. So could you please elaborate how do you see credit lending for 2020? And second question is, could you please give us updated information regarding the capital return goals you need in order to achieve your goals and what schedule we could expect?

**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] Thank you, Paco. Sorry, we're taking notes. Well, the contribution of bond in 2020, so I was trying to explain in the presentation, is going to be lower compared to 2019 as a consequence of the fact that, first, we have less bonds that we used to have at the beginning of last year. We have EUR 2.5 billion of amortizations this year. And we have to see if we're able to find assets in which we can reinvest, an asset without risk, sovereign debt. We're not going to work with higher-risk assets. And basically, we're speaking about Spanish sovereign data.

I guess, there will be a bit of reinvestment, but the yields at which we have this reinvestment will be a bit lower -- or lower compared to our back book because we're not going to have extraordinary terms. So the contribution of our bond portfolio will be lower compared to 2019. I cannot give you a figure right now because it will depend on the reinvestments we will be able to do. And regarding lending, do you want to explain, Pepe?

**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] This past quarter regarding balance performance was a bit lower compared to the previous quarters. I think there is always some seasonality effect, more particularly in the mortgage portfolio, which was a bit below forecast regarding new mortgages. And for us, this is something we want to relaunch in 2020. We're working in our plans regarding the performance of the mortgage portfolio this year. And some write-offs that were not expected in business lending, the corporate banking part that have reduced our lending balance at the end of the year compared to September.

Having said that, for next year, we see an evolution of the corporate and retail portfolio compared to what we've seen before, around EUR 3 billion in corporate and around EUR 500 million, EUR 600 million in retail. And we think that the negative contribution of the mortgage portfolio, EUR 3.3 billion this year, should be lower, around EUR 2 billion, and the net of all this should give us a margin to increase our credit back book, around EUR 1.5 billion. That would be our goal for this year.

And this is what we have in terms of credit increase.

You've also mentioned the capital schedule or the performance we would need and understand in order to reach EUR 2.5 billion of capital excess. Well, the numbers are quite simple here. Assuming the maintenance of the third dividend as the one paid out in 2018, 2019 and considering that today, with 13.0%, we have an excess of EUR 800 million, we would need to generate 100 basis points of capital. More or less, the ratio around 14% net of dividend payout at the end of this year.

Is this possible? Well, we think so. As you know, here, there are elements, some of them we can control them. Well, they're not so much. We think that we will have more information over the coming months regarding models, internal capital models, and this is the scenario we have ahead of us.

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**Operator**

[Interpreted] Next question from Fernando Gil from Barclays.

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**Fernando Gil de Santivañes d´Ornellas** - *Barclays Bank PLC, Research Division - Research Analyst*

[Interpreted] Regarding provisions. The extraordinary amount you've broken down for 2019 were EUR 150 million that shouldn't be in 2020. I just wanted to confirm that. And second question regarding mortgages, what's the trend you're seeing in pricing after publishing 1.5%, this yield of the average mortgage portfolio this quarter?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Yes. EUR 150 million is what we estimate that we've had as an extraordinary thing in 2019. Regarding the pricing of the mortgage portfolio, well, there's a difference between the initial price and the average yield of the portfolio, which is -- what is the figure -- the performance is a bit below 1%, but then to -- price is a different thing. The new mortgage portfolio is already average performance, the portfolio stock has -- a situation we have regarding the price of mortgages is what we've seen over the past years. I would say, the competition is high in order to get mortgages in the market and spreads tend to be -- to adjust.

We've seen some of our competitors with movement of prices downwards, then the growth of prices upwards, our mortgage offering has not changed much in terms of price over the past year. This is the price policy we've maintained and it's reasonably constant over the past quarters. I don't expect big changes in initial prices in our mortgage portfolio. And as always, if our competitors do something, well, they reduce slightly prices downwards.

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] I think the changes we can see compared to other quarters in which the front book figure in mortgages was around 1.6% come from the mix of fixed and floating that we've had each quarter. It's true that the fixed mix has been reduced a little bit and the price has reduced a little bit. But there's a not huge change.

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**Operator**

[Interpreted] Next question comes from Carlos Cobo, Societe Generale.

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**Carlos Cobo Catena** - *Societe Generale Cross Asset Research - Equity Analyst*

[Interpreted] A couple of questions. I want to ask you about the speed of entries in NPL. What percentage of the credit book would that be in order to understand the stability you're mentioning in underlying provisions? Because at system level, we've seen that it's been stabilized, even gross entries are increasing. And it could make us think, as José has said, that the cycle could be leading you to bigger provisions. And on the other hand, regarding expenses, it seems a bit high, the growth in expenses, considering the pressures in the P&L. And I would like to understand if that growth comes from inflation in salaries of whether these are projects that we're going to start to launch now?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much. I'll start with the second question regarding the expenses, and then you can answer the first one. This increase of 2% in expenses, well, not many new things. We are in an environment in which, basically, we're impacted by the increase of wages. They're established in collective bargaining agreement that affect the industry as a whole. And the salary inflations, if you consider the bargaining, the wage increase and additional increase due to other factors related to the increase of salaries, around 2.5% -- between 2.25%, 2.5% of an increase of salaries. And this goal we have, this initial scenario we have, the growth of 2% in expenses, is due to the growth of salaries.

I usually say in private that our -- we have monetary policy that was -- to increase inflation goal in Europe to 2%. And I think that, at least in Spain, in general terms, banks have an increase of expenses around 2% or over 2%. That would be the inflation goal of the ECB. And we have that part -- the negative part due to the increase of expenses and the negative part of negative interest rates that are there that have come to stay for a while. Therefore, the answer is yes, the salary bargaining, which is established in the agreements.

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] And regarding gross entries. As we said in our presentation, on Page 28, gross entries are reasonably stable, it's around EUR 400 million per quarter, which is, if I'm not mistaken, 0.3% of the credit book. This -- gross entries in 2018 were higher, around EUR 500 million, but we were recovering more although the difference was not that big net increase. But 60% approximately of our book are mortgages. And most of them are very old mortgages. Mortgages that date back from 2007, '08, '09 to mortgages that have survived this crisis, the 7 years of crisis, we rate them AAA if they've survived the crisis. It's very complicated that they will become NPL. So the stability we're seeing in gross entries is quite clear. Right now, we're around EUR 400 million per quarter.

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**Operator**

[Interpreted] Next question by Marta Sánchez, BoA.

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**Marta Sánchez Romero** - *BofA Merrill Lynch, Research Division - Director and Analyst*

[Interpreted] First question, regarding fees and commissions. The guidance you've mentioned, you expect double-digit growth in 2020 compared to 2019. What are the main drivers, particularly how -- you explained the good performance we had in funds compared to the industry. You've grown faster. What's the extent do you offer from Bankia to BMN? Do you think you can grow in net inflows at the same rate next year? And second question is regarding NPAs. I think you've said that you don't expect to have institutional sales. What's the net reduction goal for NPAs in 2020 and net reduction of foreclosed assets? It makes sense perhaps to use the excess capital you have in order to clean the NPAs faster.

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much, Marta. Regarding mutual funds and fees and commissions, they're partially related. And I think the good performance we've had in investment funds in 2019 is due to commercial discipline, to commercial strategy, and that's why we're happy because we think that our network is highly focused on our customers, in our business. It's true that as you know, our percentage of mutual funds in our bank is still a bit below our competitors. We're coming from behind in Bankia's network. We've grown a lot. And in the old network of BMN, the penetration of the mutual funds was very low. And we're particularly happy about the fact that in BMN network, we have managed to go very quickly in the distribution of mutual funds with our customers.

For 2020, we still see this good performance because what we're doing here is moving our commercial positioning with our customers in order to increase cross-selling. Many of these customers, they have direct income deposits. And basically, through our program called POR SER TÚ, fees and commission exception program, we're fostering new mutual funds. So it is going to fare well in 2020. We're going to foster the use of credit cards and, of course, the purchase of insurance products. That's why we think these 3 lines are going to grow well.

And the performance of fees and commission is going to be positive. Before we said that in recurrent terms, our cruise speed is around 6%. And we think that this change price policy for 2020 should allow us to take an additional lead and position ourselves over the 2% increase in fees and commission, 2% growth.

We think that next year, we should be able to reduce around EUR 5 million in our NPAs' number and -- organically in a normal way. And with -- the ratios would be around 6% gross and 2% net of provisions. And that's the scenario, the initial scenario we have. So far, we're not considering any other issue. And as always, throughout the year, we think that there's something that could make us go faster. If those have an impact on P&L, we could consider it.

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**Operator**

[Interpreted] Next question from Alvaro Serrano, Morgan Stanley.

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**Alvaro Serrano Saenz de Tejada** - *Morgan Stanley, Research Division - Lead Analyst*

[Interpreted] About fees and commissions and then capital distributions. About fees and commissions, you insist on the fact that this policy on fees and commissions had improved your Net Promoter Score. This was an important part of your commercial policy. Could you please explain that price policy? How did it change? Are you charging for maintaining the accounts? If it's a percentage of our deposit, could you please explain this change in the price policy and why you are more or less comfortable with the fact that there won't be collateral effects in terms of position? And why do you trust that this is going to be feasible?

And second question, could you please share with us your last ideas -- your latest ideas on distribution of capital? You've said in the past that you're waiting for the approval of the model. Is there any update? Timings maybe? Why is that necessary to wait for the model if you're already at 13% and PL is quite controlled? And if then no problems in the outlook, please remind me what -- why you are waiting for the model and not distributing the capital?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much, Alvaro. I'll explain the part related to fees and commissions. So you can elaborate on capital. You were saying -- well, I -- if our price policy can have an impact on perception or collateral effects, I would go back in the response regarding environment in which our competitors are hardening their price policy in terms of fees and commissions. And therefore, this is the environment we have in this sector. We want to have the better offer without fees and commissions for our customers, our loyal customers. And we're still very simple. We want them to have their direct income deposits with us. We've added some additional requirements, like continuous use of credit card or having mutual funds over a certain amount of money or insurance, home or life insurance, over a certain amount of money. It's or, or, or.

Therefore, we're changing some of the requirements in this sense. And we think that for many of our customers, it's going to be easy to be in this new environment of no fees and commissions and, therefore, our offering will still compare well with our peers because they're all hardening the conditions. And sometimes it's -- the consumers are confused. And not just that, this will allow us to improve -- to grow our revenues and fees and commissions next year. We are optimistic that this change in policy will achieve these 2 things. And regarding capital?

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] Regarding capital, nothing has changed since we talked before Christmas with you, the analysts or in a roadshow Q3 last year. Our commitment to distribute capital is something we maintain. We want to be clear on how we're going to finish in capital ratios, we and the regulator there to material -- and certainly, first of the IRPH resolution. We have to see what happens. It should be reasonably soon. So nothing has changed since we talked in December. We're waiting for the resolution.

And second, the approval of the models. This is a milestone that we think it's material. It should take place in the first part of this year. So there have been no changes compared to what we talked. The field work has finished and we are waiting to receive, first of all, the draft report and then the final report. That -- as I was saying, we expect to receive over the next -- over the coming months. Once we have closed these issues -- you know that this year, we have stress test. We don't think there will be a problem there. And then we'll have a clear picture of the capital situation of the group. And therefore, we will be able to carry out or not the regulation policy.

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**Iñigo Velázquez** - *Bankia, S.A. - Head of IR & Rating*

[Interpreted] Next question. Just one question so that we can have more analysts.

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**Operator**

[Interpreted] The next question comes from Daragh Quinn from KBW.

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**Daragh Joseph Quinn** - *Keefe, Bruyette & Woods Limited, Research Division - Analyst*

[Interpreted] I had a question regarding digital sales that you've mentioned, they have increased to 35%. Could you please give an idea of the percentage and economic value of these sales? And the midterm, I imagine that you expect that percentage to increase. What are the implications for the distribution and for the necessary investment in order to become a more digital platform?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much, Daragh. In million euro economic value, I don't have the figures with me, but we can provide them to you through Investor Relations team. I think that the bottom line of your question is that digitalization is moving forward. This is a clear reality. And, of course, in the mid and long term, this makes us think that the need of the -- or how we will depend on our branch channel will be lower. Bankia in 2012 had 3,000 branches, BMN had 700 franchises, so 3,700. And now we're around 2,000. So the branch channel is going to be less necessary. And we always see this as an opportunity, it should help us to reduce costs and to provide a better quality of service to our customer. Our customers want to have a remote relationship, a digital relationship with Bankia, and I think this is a positive side of it. And in the mid and long term, it will help us to reduce our cost to be more cost-efficient with our new digital customers.

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**Operator**

[Interpreted] Next question, from Ignacio Ulargui from Exane BNP Paribas.

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**Ignacio Ulargui** - *Exane BNP Paribas, Research Division - Analyst*

[Interpreted] Question related to your strategy that you announced last quarter in order to charge to big deposits and financial institutions. There's a guidance about EUR 3 billion deposits a quarter. Could you please update the customers related to this strategy and the impact in 2020?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much, Ignacio. The relation, that was what you said? Anyway, that -- as we've mentioned, fees and commissions for, I think that regarding collect -- charges from deposit to certain customers were -- in the sector -- the entities, there may be nuances but over a certain size. We're all trying to pass on the negative costs. We have a fund to our customers, and this has been accepted quite naturally. I think that as time goes by, this becomes a common practice in the sector. I think that this is being accepted in a natural way. Maybe in the short term, we'll see and we'll pay attention to it, some sort of transfer between credit and deposits by companies, companies that may be -- had an excess of cash and also credit debt positions. They were doing some netting between debt positions that could have an impact in the short term to credit balances. But in general lines, we think everything is very normal.

Regarding the impact in the P&L next year, do we have any figure, Leo?

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] No. It's a mix. It's a mixture. The exit of deposits entails lower liquidity and lower liquidity costs, which you know how much it is, 0.50. And if companies decide to stay, part of them will have charge in net income -- interest income and many of them will come through the line of fees and commissions. It's going to be a mixture. We have some scenarios, but they depend on the flow movements, as Pepe has explained.

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**Iñigo Velázquez** - *Bankia, S.A. - Head of IR & Rating*

[Interpreted] So let's move on to the English line.

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**Operator**

[Interpreted] Next question from the English line, Britta Schmidt from Autonomous.

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**Britta Schmidt** - *Autonomous Research LLP - Non-Designated Member*

One clarification and one question, please. On the fee growth guidance, double-digit fee growth. Can I just confirm that you were guiding to underlying fee growth being 6% and the top-up coming from pricing policies? And then I would like to get your view on [CO5] as to whether you think that there's something that could be interesting for Bankia? And maybe you can comment a little bit on your issuance plans for 2020?

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] Yes, Britta, the fees, what we say basically is that in 2018 -- sorry, 2019, there was an increase of fees and commissions once we remove extraordinary things of 2018 around 18%. And the guide, the double-digit we've given you, we think that we should be able to build it up because of the evolution of our fees in 2019 and assets under management and churns and performing credit as a consequence of our commercial policy. That will make us reach this double-digit we've mentioned.

Regarding capital impact as a consequence of new regulations, we don't think that we're going to have an impact, a significant impact over the next years. Nothing in exercise -- in year 2020, nothing negative. As you know, the new impact will start in 2021, 2022 if Basel III is applied. And as we explained in our breakfast, we're not expecting an impact, at least negative impact.

With the implementation of [CO2 [and [CO5], we think that the net should be positive for us. And in Basel IV, the great -- the biggest uncertainty that we can have is due to operational risk because if we have an impact in -- due to credit risk, it will be positive. And we have to add the 104 base -- the possibility of building part to our pillar through more issuances of Tier 2, and -- which we could -- leads to have a release of 90 basis points in CET1. So therefore, over the next 2 to 3 years, we're not expecting any significant impact, at least not negative.

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**Operator**

[Interpreted] Last question comes from Sofie Peterzens from JPMorgan.

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**Sofie Caroline Elisabet Peterzens** - *JP Morgan Chase & Co, Research Division - Analyst*

Here is Sofie from JPMorgan. I was wondering if you could just comment on kind of your view on M&A, how you think about it, how you think about M&A versus distributing excess capital to the shareholders? And then just also a quick follow-up on IRPH, you mentioned that there will be something soon. Do you have any date or any additional details that you could share on the IRPH issue?

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**José Sevilla Álvarez** - *Bankia, S.A. - CEO & Executive Director*

[Interpreted] Thank you very much. Regarding M&A and the excess capital, I would say -- well, we mentioned it when we launched our strategic plan, for us, the goal over these 3 years was not continuing carving out more transactions, such as the one we had with BMN. We wanted to use the excess capital generated in order to give it back to the shareholders. And we still think the same thing. And in the sense, we're not considering anything. We're not analyzing anything or considering any transaction. There was something else, right?

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**Leopoldo Alvear Trenor** - *Bankia, S.A. - Deputy General Director of Financial Management*

[Interpreted] IRPH. We didn't have any new thing. As you know, after the hearing in September with the General Counsel, we are waiting for the final judgment to be issued. 3 months have gone by since the hearing took place. We don't have inside information, but we expect that over the next months, this ruling will be issued.

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**Iñigo Velázquez** - *Bankia, S.A. - Head of IR & Rating*

[Interpreted] Thank you very much for your interest. I really like to apologize to the analysts that couldn't ask their questions. We have a busy agenda today in our IR team. We are at your disposal in order to provide you with the answers to your questions. We'll have a follow-up with the rest. Thank you very much. The presentation of results for the first quarter will happen -- will take place in April.

Thank you very much.

[Portions of this transcript that are marked Interpreted were spoken by an interpreter present on the live call.]

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