Illimity Bank

"Illimity Business Plan Update and SPAXS 2018 Results"

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OPERATOR: Good morning. This is the Chorus Call conference operator. Welcome and thank you for joining the Illimity Business Plan Update and SPAXS 2018 Results Conference Call. As a reminder, all participants are in listen-only mode. After the presentation, there will be an opportunity to ask questions. Should anyone need assistance during the conference call, they may signal an operator by pressing "*" and "0" on their telephone.

At this time, I would like to turn the conference over to Mr. Corrado Passera, CEO of Illimity. Please go ahead, sir.

CORRADO PASSERA: Thank you. I am Corrado Passera; I am the CEO of Illimity. Thank you very much for being with us today. Thank you in particular to our shareholders, the SPAXS shareholders who had been very supportive in this startup phase that yesterday we completed.

Yesterday SPAXS merged into Banca Interprovinciale, was listed on the main Italian Stock Exchange, MTA and became Illimity Bank. From today on, only Illimity Bank is our name. Illimity is the first Italian new paradigm bank that is something more than a challenger bank as we will try to elaborate during the presentation.

Last July, we presented our Business Plan targets, our deadlines, we respected all of them. We completed all of them, and all the assumptions of our Business Plan proved correct. Today, we are fully operational and we are here to confirm our targets and our investment case. The 4 main messages I will elaborate on and that's Page #3, are the following. We now have a very strong management team on board, the bank is already up and running, as planned the fully digital infrastructure of our bank will be available by the end of the second quarter 2019, and our investment case is fully confirmed.

Page #4, only 12 months ago Illimity was just an idea, today it's an operational…it's a fully operational bank and were listed on the MTA. The main steps of our startup phase were the beginning of February last year when we completed the fund raising of €600 million, and then we acquired the Bank, Banca Interprovinciale. We went through the authorization process and we got this approval of our shareholders for the business combination in August. End of September, we could close the acquisition of Banca Interprovinciale and we could start our operations. That means that we are really a real thing since last October, just a few months in which we started our hiring and we launched our operation. Yesterday March the 5th 2019, SPAXS and BIP and Banca Interprovinciale merged and we were listed on the MTA.

Page 5, first message. Strong management team. Any company is successful or not successful thanks to the quality of its management team. The partners of this project are the 7 people, say 7 plus 1, because Internal Audit is not exactly part of the management team, because he reports to the Board, but the 7 people who run this bank, this new startup are the ones on Page 5. You will hear from them all we are doing, we have done we have in mind.

It’s a very simple organizational structure. Simplicity is one of the key feature of Illimity. We have 3 division, the NPL division on the right, bottom of the page, the SME division, the Direct Bank and Digital Operation division. We have 3 main strong function…headquarter functions, the Chief Risk Officer, the CFO who is also in charge of the Central Functions, and the…Isabella in charge of the Communication activities. Each of them, the 3 division plus the CFO will deliver with me the presentation.

What is really important is that we don't have completed only the first line of management, but also the second line, Page 6. We have a complete OR chart in each of the 5 functions of the bank. We have people coming from 10 different industries, that's a very important point, creativity, and the capability to develop new ideas come from the combination of people with different skills, with different experiences, with different attitudes. And we have been successful in attracting people from many different situations in less than 4 months. Thanks to them, all of them, we are now fully operational.

Page 7, what we mean by fully operational. We already have 200 people, we call them…we call ourselves illimeters, on board, and the strategic activities have already becoming...creating, beginning creating results. We have more than €400 million of business assets on our accounts, very soon they will become €550 million because we have a number of deals that are being negotiated and probably and hopefully will be completed in the next few days.

In this figure, we don't include some other activities we have in Banca Interprovinciale that we don't consider strategic in the long term. It's about €150 million that are still on our accounts, are giving yields, but are not in the focus of our strategic activities. SME division, Enrico will explain what we have done, and what we are about to do. Andrea will talk about the NPL division shortly.

So we are not fully…we are not only fully operational on our activities, but Page 8, we are on track in the building of the fully digital bank that we have in mind. By the end of the second quarter of this year, everything will be fully digital. As you see on Page 4, the new core banking systems are being developed and we will migrate from the old system to the new ones during the second quarter. We have already included in our IT systems two lines of IT applications the NPL one and digital invoice lending one, through the integration of a fintech or a very successful fintech Credimi. And we are about to integrate also European deposit platform that Carlo will describe much better during the presentation. So also in terms of building the new bank fully digital, we are well on track.

Now, a few words on our investment case. What I would like to tell you very briefly is that we have embed in our investment case all the changes that have happened in the last few months since we presented our Business Plan and after embedding all the new challenges, both from a market and from regulatory point of view, we can confirm all our targets in terms of growth, in terms of profitability, in terms of risk profile, in terms of alignment of interest and in terms of strategy. The combination of all these confirmations make in our opinion the execution risk of our Plan relatively low.

Page 10, very briefly because my partners will go more in detail. All our markets are proving larger than we expected. SME Lending, Corporate NPL, Direct Banking Services are showing a dynamic that is more favorable than what we expected. That situation allows us to be even more selective in cherry picking only the deals that are interesting for us. Second point, Francesco will develop it, but I want to just mention it. We decided to downsize in a major way the risk embedded in the government bond portfolio we received through Banca Interprovinciale the cost of this downsizing totally been expensed in 2018 accounts and that is done.

Another point that Francesco will describe more in depth are the two main regulatory changes that have been introduced in the last few months. The first regards the higher risk weighting for unsecured NPEs from 100% to 150% and in our accounts obviously, we have embedded the 150%. In terms of prudential backstops have been introduced a number of new criteria and also in this…as far as this is concerned this criteria are fully embedded in our accounts. So the point is all the bad news are already embedded in the plan.

Our targets, Page 11; our targets are the targets we presented to the market last July. We expect to be a bank with something in the round of €4 billion worth of assets by 2020 and something between 600…€6.5 billion and €7 billion in 2023.

Net profit is going to be a little bit higher than what we expected in July in 2020, and will be in the round of €280 million by 2023. It's a little bit less than the €300 million you might remember in our Business Plan page in July, but it's only because we had a 6% withdrawals after the business combination, and this is exactly the effect.

In terms of ROE, in fact, we confirm the 25% target we had in mind. We could confirm all our targets because we had a number…we had and as we said, a number of buffers, a number of reserves, as I said in July in our initial Business Plan, because our accounts are quite flexible and we can especially in terms of cost, we can manage them according to what happens and sometimes things cannot be forecasted. And the entrepreneurial approach we want to apply to the management of our bank allowed us to adapt to the new rules and to the new situation in such a way that targets are confirmed. Good profitability would not be enough if not matched and if not together with a very solid risk profile.

Page 12 is another confirmation; we take a number of commitments in terms of Core Tier 1 that will have to remain above 15%. In terms of liquidity that will have to remain quite strong throughout the whole period of the Business Plan and in terms of matching of duration. We don't want to play the game of risks between asset durations and liability durations.

We have been able also to confirm the full alignment of interest embedded in the plan Page 13, and the main reason why we can say that is that sponsors and top management special shares, my shares and the shares of the top management will be converted into ordinary shares only when ordinary shares price will exceed €14 that means a returning around of 60%.

All the managers stock option plans are tied to the 2023 targets, all the employees are shareholders that's very important it's a probably a unique situation in the industry and that is something we want to maintain also in the future. And on…in excess of these very pragmatic kind of situations we have a very strong Board of Directors, made of people with the right level of independence, of competence, of experience and diversity to make the whole process going in the right direction.

Only two more words about our strategy because that will introduce the presentations of my partners. Page 14, the view…our view of the industry. The industry is getting totally reshaped by four very strong forces, new digital technologies, new entrants, new regulations, monetary policies, all of them are changing completely and deeply the economics and the features of our industry. We will have new losers and in our opinion all the small and mid-sized traditional banks can be considered them if they don't change dramatically or if they don't consolidate.

We will certainly have a number of possible winners amongst the large banking groups because their…because of their economies of scale certainly big tax will occupy a quite…a market share in a number of simple but large niches. For sure, we will have a number of new winners like Illimity. What do I mean by new paradigm banks that will be winners?

Page 15, it's a summary of what we mean by new paradigm bank. New paradigm banks are more than challenger banks, as I said before are specialized banks and we decided to specialize into…in three and only three very interesting segments of the market. We want to be the partner #1 of Italian SMEs. We want to be #1 corporate NPL…the corporate…the Italian NPL specialists. And we want to have a state-of-the-art direct bank, three areas that my partners will describe that are interesting, that are developing with very interesting dynamics and relatively low level of competition.

The second sine qua non in order to be a successful new paradigm bank are the competitive advantages you must have, and we will have a number of them on the left hand side of the page. Zero legacy is something that nobody else can enjoy the level we can enjoy being with a bank without legacies today and also in the future is quite a competitive advantage.

Being fully digital is an advantage, but it's even more a competitive advantage if you and if we combine a fully digital approach with a human touch, that means that our customers will enjoy the best of the digital services and the best of the human relationship. We will have clear, very strong competitive cost advantages. We will be much more efficient in terms of cost versus the incumbents, traditional banks. And we will have quite a strong cost of capital advantage versus the new players all the different funds that operate in our segments.

The last that is probably the first in terms of importance is the amount of skills and the expertise also through tutors and Enrico will elaborate on it that we have been able to group together in Illimity.

Now, I will leave the floor to Francesco. Francesco Mele, who is the CFO and will go much more in detail on some very relevant issues of our plan in general, then we will move to the different and each of the different divisions.

FRANCESCO MELE: Thank you, Corrado. Before providing a strategic update for each business division, I will summarize in the following few slides key highlights of 2018 SPAXS consolidated result this reflects a combination between SPAXS and Banca Interprovinciale occur in September last year. As well as giving you a progress update of our Business Plan which was first presented in July 2018.

Let's move to Slide 17. Here we have summarized the new challenges that the change of scenario address to us and all these new challenges have been let me say clearly fully embedded in our Business Plan. Now, a few things happened since we presented the Business Plan in July. Certain events were just part of the business combination process. I'm referring in particular to the exercise of the withdrawal rights, which is customary for any SPAXS, approval process. This was completed in November last year for around €38 million or 6% of our share capital and clearly represented the euro for euro reduction in own-funds, but we believe manageable in the overall context.

The other key factor relevant for our business story and investment case were regulatory changes affected the NPE universe, namely the unsecured NPE risk-weighting and the prudential backstop and the deterioration on the other side and volatility in the Italian sovereign credit risk. As I said, we have fully reflected all these challenges in with a strategic and proactive approach in the Business Plan and we used the buffer we had in our Business Plan together with an entrepreneurial approach and also some evidence that are built in the pipeline we've been creating in the last few months.

Starting from the Italian sovereign risk, this was addressed even before former completion of the business combination and relevant cost were fully charged to 2018 results. On the other side, in relation to regulatory changes, I'm going to provide the assessment that we performed on the affected [ph] impact. And also, over the course of the last few months, we benefited also from our business mix being more geared to secure the NPE, which is the evidence resulting from the current pipeline. We also took the advantage of optimizing our funding strategy.

Let's move to Slide 18. Here, we are presenting the clarification produced by the European banking authority in September in response to a specific question on the risk-weighting for unsecured NPE purchased by banks under the standardized approach. Essentially EBA confirm that the difference between gross book value and net book value or purchase price cannot be treated as specific credit risk adjustment by the acquiring bank and as a result of this, a 150% risk-weighting must be applied to acquire unsecured NPEs. We've been able to fully reflect such clarification in our Business Plan, which means that all our unsecured NPEs are risk-weighted at 150% because we had excess capital in our Business Plan. It is important to say also that the current business mix is more geared to secured NPE, which is clearly more beneficial in terms of overall capital absorption.

It is worth also noting that subsequent changing in the regulatory framework explicitly recognize the difference between net book value and gross book value for portfolio acquired by banks, which is this, the prudential backstop and so the position, which I think is very conservative might be reopened in coming months.

If we move to prudential backstop on Slide 19. In the last part of last year, European institution worked around the planned amendment of the capital requirement regulation. The most relevant change introduced is the prudential backstop, which consist as you know in a minimum progressive coverage on NPE over time for prudential purposes. The prudential backstop is applicable to all banks including specialized banks like Illimity and it is applicable to loans originated following the formal implementation of the amendment, which is expected during the spring.

An important point recognized in the amendment is a discount to GBV for purchased NPE explicitly qualifying as coverage, which is very important for our Business Plan. Our assessment, as you can see on the right hand side is that the impact we believe is very limited within the Business Plan time horizon and is manageable in the long run, also in light of its gradual impact.

The resulting Common Equity Tier-1 volatility is also minimized by actual collection in excess of the applied coverage according to the backstop calendar. As you can see…as you can imagine, solid capitalization is therefore going to be more than ever a key competitive advantage.

On Slide 20, here you can see how prudential backstop works, on the left-hand side, different calendar depending on the NPE category, 3 years full coverage for unsecured exposure, 9 year for NPE secured by real-estate and after 7 year for the other secured NPE. The final backstop calendar is smoother than the Pillar 2 ECB addendum criteria as well as the original proposed amendment.

In light of our portfolio feature in terms of vintage, in terms of high vintage for the NPL and also for the UTP, we expect no impact on the

NPL during the Business Plan time horizon and a marginal impact on the UTP. For the new finance business, we foresee no impact in light of its shorter credit cycle.

On Slide 21, we have summarized the expected impact on our NPL investment portfolio. Based on the assumption consistent with purchased portfolio actual data, the backstop will start affecting our Common Equity Tier-1 after 2023. By 2024, 12% of total purchased NPL are expected to be affected by the backstop. This is going to grow to 62% by 2030, to 81% by 2036 and only after 2042, the entire NPL portfolio is expected to be affected by the backstop. At that time, clearly the volatility in terms of capitalization will become pretty manageable.

On the left-hand side, you see the assumption we are using for this analysis, 4 years from origination to NPL, 2 years from performing to non-performing, and another 2 years from a non-performing UTP to bad loans…or NPL.

Let me now move on Slide 22 to the Italian sovereign debt risk. Clearly, since SPAXS signed the agreement in April to buy Banca Interprovinciale, the credit profile of Italian sovereign debt started to deteriorate materially. You probably remember that in our July 2018 Plan, we disclose a run rate of 10% target over total assets for our financial portfolio with no county representing more than 3%.

In light of the different macro scenario we faced and we are still facing, we promptly reacted accelerating the original planned de-risking strategy. We started executing such strategy after the shareholders meeting, which approved the business combination last August, but even before the formal completion, which occurred only in September.

As part of the de-risking strategy, we disposed €430 million of Italian govies before year-end with an after-tax cost of €10 million. At the beginning of 2019, we sold an additional €65 million of govies for a marginal cost. Our financial portfolio currently includes €139 million of Italian govies of which €124 classified as amortized cost, as held to collect. This compared to €565 million of Italian govies at the beginning of the year, but more importantly the credit risk of the held to collect & sell Italian govies have been reduced to negligible value, which means that for 1 basis point of deterioration in the credit spread, the deterioration in the value of the portfolio is equal to €6,000.

Let me now move to 2018 accounts. This is the best, we are showing on this page SPAXS consolidated account which is the best proxy for Illimity, for the bank resulting from the merger and the starting point for 2019. Also the business combination was completed only at the end of September. 2018 is an important year as we laid foundation for our Business Plan. I want to underline the following 4 points. We are enjoying a strong liquidity and capital position with €440 million of cash and €126 million of unencumbered high-quality liquid assets and a Common Equity Tier 1 ratio in excess of 90%.

Despite it was a very busy end of the year in order to put together old organization, the system, the activities, we also started a stronger commercial performance originating new business for €170 million of net asset. This number has now grown to €250 million and including the component of Banca Interprovinciale SME book, we have now net asset of €450 million which is going to grow to in excess of €0.5 billion in light of pending transaction.

Third, our organization is growing through the addition of qualified [indiscernible] illimiters and we have now reached around 200 people.

Last, the €23 million of negative result which is in line with the Business Plan include not only the cost of the accelerated de-risking strategy which in the consolidated account is only €2 million versus a €50 million pretax for the entire 2018, but also around €40 million of one-off startup cost.

Moving to the 2018 consolidated profit and loss, it is worth highlighting that the €172 million of new business only marginally contributed to revenues due to the onboarding, timing and so the fact that they were booked toward the end of the year. Of course, the contribution will materialize fully in the course of 2019. One-off cost include around €10 million of charges related to the business combination and €2 million for the termination of the current IT outsourcing concept in order to migrate to the target IT platform.

Slide 25 on our balance sheet which can be summarized as follows, €440 million of cash and €126 million of unencumbered high-quality liquid assets, €484 million of customer loans of which €172 million from new business generated in the last quarter, €22 million of goodwill mostly due to the impact of the de-risking strategy, €557 million of shareholders equity. Last but not least, as you can see the Business Plan target on Slide 26 disclosed in our July 2018 presentation are substantially confirmed by the current target.

We show guidance with a narrow range for 2020 and for 2023 consistently with the July 2018 presentation. Total assets are expected to grow from around €4 billion to €6.6 billion. You can see equity is expected to double from 0.6 to 0.7, in excess of €1 million by 2023. Risk-weighted assets are very similar to total assets, representing a significant risk-weighted asset density in light of nature of our business.

In terms of P&L, we expect to generate revenues between €250 million to €310 million in 2020 growing to €675 million by 2023. Loan loss provision has been set conservatively between €50 million and €63 million which represent as you can see on the right hand side a cost of risk around 200 basis points in 2020. Clearly, this is also in light of the start-up nature of our loan book and are expected to grow to €95 million by 2023 which represent a cost of risk of 170 basis points.

Net profits, €55 million to €70 million in 2020 in light of a slightly different business mix of the SME division growing to €280 million in 2023. Also the main KPIs are confirmed. Cost to income of around 50% in 2020 and below 30% by 2023. ROE high single digit by 2020, 25% in 2023. Gross organic NPE ratio which exclude only the UTP loan deteriorating into NPL, as part of the turnaround business, between 5% and 7%. We start from around 7% for Banca Interprovinciale at the end of 2018, expected to remain flat at 7%.

Common Equity Tier 1 always in excess of 15%. We expect to start paying dividend in 2022 and we expect to have a payout ratio of 25% or €70 million of dividend in 2023. Let me now handover to….no sorry…liquidity, very important point.

In terms of liquidity, you can see that we have a very diversified and balanced funding mix. We will start very soon with our European deposit platform for which are expecting authorization, but out Illimity retail platform, which is in blue that you can see on this chart, is expected to grow and scale consistently with the development of our own digital platform.

By 2020, it is expected to be the largest retail component representing 19% while the European deposit platform is going to represent 10%, corporate deposits 12%. The wholesale component is still very important in 2020, overall, 39% with ECB at 11% and 28% other institutional counterparty. We expect to start institutional product investor also in due course, but it's a marginal component in our plan of 4%, in 2020, equity 16%. 2023 retail deposits are expected to grow to 29%, also the European deposit platform is expected to grow at 19%, corporate which is mostly sight is expected to remain around stable [indiscernible] 14%.

The wholesale component will be significantly reduced and the ECB component essentially due to the invoice lending securitization process and the possibility to use this paper as a digital paper [ph] for funding purposes is expected to be the largest component of the wholesale. In terms of asset and liability management, we confirm a very disciplined approach, essentially we have a very similar duration between asset and liabilities and we can leverage on stable funding which is going to represent more than 80% of our funding base.

Let me now handover to Enrico which is going to summarize key development effort of the SME division.

ENRICO FAGIOLI: Okay. So we stay on Page 29. Our goal is to be a specialist lender to Italian SMEs and we have an innovative approach and we are focused. Our approach is based on 2 main factors, Tutors and technology. Tutors are those professional with an industrial background, they have a strong financial knowhow. They provide support to the division with their understanding our planned business. It is important to say that the no relevant deal has being executed up to now or will be executed in the future without the presence of a Tutor. And regarding technology, we want to use it in order to achieve a sound credit assessment of clients and investments, so our division will use the most advanced technologies and Big Data and Artificial Intelligence.

Then, we are focused…and we are focused on three main area of business, turnaround, meaning that we purchased UTP loans often granting new finance together with the buying of the new loans and providing refinancing opportunities. We are focused on cross-over acquisition finance. So our lending targets are those company that have sub-optimal financial structure, but good industrial fundamentals and that need financial resources in order to support internal or external growth. Factoring and it is an invoice lending or factoring offered through a digital platform and it is a full range of products focused especially on those companies operating in the industrial district need…in need of streamlining the supply chain.

Page 30, we are very proud to say that we are now in a situation to have a complete organizational structure. So we are fully operational and we have to say that, we have built-up a strong team, highly experienced and a very composite mix of back grounds. People coming from advisory, banking, businesses and as Corrado said before, this is one of our strength together with the present of tutor, up to now we have the first eight tutors working with us and they cover relevant sectors like food and beverage, energy, construction and so on.

We are up and running and we have since the business combination we have analyzed 97 potential turnaround and cross-over opportunities for…was about €1 billion and out of this 97, 37 has been declined and 51 are currently under evaluation, 5 have been already executed and 4 of them are already approved and they are to be executed in the next two to three weeks.

In the turnaround business, we have already invested €75 million these are three deals encompassing diversified situation and financing structure from the initial phase of the industrial restructuring to the final steps back to the performing status through the refinancing of a position now almost normalized. We have also executed our first acquisition finance, I want to stress that our acquisition finance specialists are onboard by a bit more than 1 month and also the first cross-over deal. Those transactions together with the former Banco Interprovinciale, SME lending book brought to a total of €176 million of loans to SME customer and they will become 206, if we consider the other four deals we have already approved and to be executed shortly.

With regards to factoring, the partnering [ph] with Credimi is fully operational. The business is up and running ahead of our plan, which initially envisage the launch of our business in 2019. In a couple of months, so January and February we have granted around €30 million of factoring commitment what we call plafond and we have started also the development of our own proprietary IT platform for factoring which we expect to implement during 2019.

The main target of our division, so I was saying, there is a huge market, plenty of opportunities to pick the deals that are most consistent with our strategy and also there is some characteristic and the three have assisted to. Our pipeline it is a little bit more of a secured…formed by a secured possible deal than we had expected. And so, given this...this situation, and given also the situation of the market we have taken the opportunity to review our perspective business mix towards the higher security component.

We have also made a fine tuning of our projection in the turnaround business introducing a new kind of transaction in our business plan model, which is refinancing. This is actually the...it entice the purchase of an UTP loan that is near the end of its restructuring phase, and this financing instrument has attractive margin with less risk and we see many opportunities like that in the market. Is that example of this type of transaction are two deals that we have executed and announced in November, one is named Clapper [ph] and the other one is name Itas [ph].

All in all, we confirm our Business Plan target in terms of profitability and growth. Going to the...from 2020 to 2023 our key driver of profitability improvement will be either the progressive build-up or the…the operating scale, and also the turnaround profitability profile which includes earn-out and payment in kind structure which materialize at the end of the restructuring phase. At the time, when our exposure reclassified to a performing status, at that moment when this will happen our loans will be at least partially reimbursed or refinance with the participation of other lender.

Talking about cost income they will reach a low level in 2023, if we want to exclude the impact of the turnaround business, the cost income will be in the region of 30% even in 2023. We expect a gross organic NPE ratio to be in the region of 5% to 7% in 2020 and 8% in 2023. I want to point out that the costs of risk estimate are very conservative as you see in the next...in the next Page 33.

This…in this page we are saying what we need to do in order to reach our goal. We need to have accumulated net book value of turnaround loans of about €2.8 billion, se we mean to execute 2.8 NBV of a turnaround transaction that based on the average discount to GBV the gross book value that we expect to have in the various transaction is more or less equivalent to a nominal value of €4 billion of purchase restructuring, refinancing UTP loans. Then, you have to add another €900 million of new finance and that make a say origination of around €5 billion in the period going from now to 2023.

Refinancing, as I was saying before is a type of bill where we buy UTP exposure at the end of the industrial restructuring of the borrower. And well, the borrow is presumably going to be allocated in a performing status. This transaction offer in our view…internal return of about 7% to 10% with danger rate which is below that of the restructuring deals estimated in the 10 to 20 range because of the risk profile.

Restructuring is...just to remember what we mean as a restructuring is a financial support to corporate in distress in industrial financial situation, but nonetheless with strong industrial potential. This transaction often involve branding new finance, instrument to allow the industrial turnaround. And these deals generally envisage an investment by us at discount versus the gross book value of the loan and are most of the time combined with earn-out and payment in kind revenue stream, as I was saying before.

Even considering and this is a major point for us, even considering the risk in nature of the turnaround activity. We think that we have assumed a very conservative danger rate because actually we are assuming to have one failed deal every five executed deals. And we consider it a very, very conservative approach.

Talking about cross-over acquisition finance, our target…the target of the generation is a gross amount of €1.6 billion of cross-over and acquisition finance loan across the Business Plan horizon. The market in…for this kind of loan as we have said before is huge and there are several business opportunities in various and diversified area. It is also efficient in terms of…from a funding perspective and also offered benefit from a diversification.

Turn around and cross-over in this segment, risk management and monitoring are keys either in the origination or in the monitor phases. And therefore, we want to perform, and we will perform the monitoring and the analysis with the support of Tutor, as we said and we are also developing tools and method for predictive monitoring of the board based on artificial intelligence and machine learning. And this is the, let's say the credit machine activity…main activity.

Talking about factoring, our third leg, we estimate to reach €1.3 billion of factoring stock outstanding 2023, meaning that we need to have a turnover at that…in that time of about €4 billion, given the fact that we estimate the day sale outstanding, DSO of 100 days. So meaning that, we have a rotation of about 3.5 times, 4 times a year.

Factoring for us, it is a business that we consider low-risk, could be sold also factoring activity to cross-over and turnaround clients. And it is also very efficient from a funding perspective. As a specific securitization vehicle could be set-up and the senior notes could be used for funding. Actually, the same structure could be also partially applied to cross-over lending, but the cross-over lending is more concentrated, like factoring is more granular. So it's, I think is the best instrument to be securitized for funding purposes.

And also we are studying transfer…risk transfer solution that which would reduce the cost of risk and [indiscernible] also the capital absorption, boosting the return on equity. And here again, the risk…cost of risk assumption in our opinion are very conservative because we are estimating a 100 basis points of cost of risk. Even if we are considering Risk Transfer Solution which could reduce the risk exposure to…up to 90%. So insurance in this field can be both covering up to 90% of the exposure.

And in depending on that we have in any case estimated a cost of risk of 100 basis point.

Last point, what we are doing now. So what are our next steps. We have a pipeline of about €680 million and we go back to what we were saying before, we have about the 51 deals ongoing, 16 of them are within the turnaround, let's say, segment and 35 within the cross-over acquisition finance. While regarding invoice lending which is a rolling activity, we have at the moment around €80 million of commitment going forward to be approved.

Our credit machine activity is going on. So it's…we are building database credit scoring and we have undergoing the implementation of tools to support the credit underwriting and monetary. And regarding talents, we are going on with recruiting activity and particularly regarding Tutors, we are having contact with other Tutor in order to reach at least 10-Tutor fully operational by the end of 2019, 8 of them are already operational, so probably this target is a little bit conservative as well.

Thank you. So I hand over now to Andrea for NPL.

ANDREA CLAMER: Thanks, Enrico. Okay. As Page 36…as NPL division, we are becoming a lead player in the corporate NPL market for three businesses, Investment, Senior Financing and Servicing. Specifically, we buy NPL portfolios and single names, secured and unsecured focusing on corporate debtors. We provide also financing solution to other NPL investors and we manage captive and non-captive NPL portfolios and single names through our servicing unit. Across all these 3 areas, the use of Big Data and Analytics tool is giving us a clear competitive advantage.

Slide 37, we will cover the entire NPL value chain, following the transaction on the investment phase to the servicing one. We do carry out due diligence and pricing, but also onboarding, recovery activities. We have already created our servicing unit that will be acquired by Illimity in the second half of 2019. We are also focusing on additional servicing activities for assets disposal useful for leading NPL portfolios. This distinctive business model will allow lower costs, internal growth, faster and higher recovery and will give us a competitive advantage in bidding processes.

Slide 38, the Illimity NPL business line accounts almost 50 professionals, 20 for the investment team, and 25 for the servicing unit, and many others are coming.

Slide 39, what we have done so far? We have acquired portfolios and single names for a net book value of around €100 million. And today, we close…choose small additional deals for €50 million. Moreover duly the next days, we will acquire another portfolio for other €26 million of net book value. Very important IRR and the cash-on-cash multiples are higher than the Business Plan assumptions and actual collections are above pricing expectations. The ERC is equal to €170 million that corresponds to a cash-on-cash of €1.75 million.

In relation to senior financing, we have already closed one transaction for our financing amount of €51 million and an additional deal will be closed shortly for a total financing amount of €82 million. So as already Corrado said in these few months, we have deployed €163 million and other €110 million are being closed for a total deployment of more than €270 million. Last but not least, our servicing unit has obtained the License 115 and already has almost €600 million of assets under management.

Slide 40, our total portfolio so far has a gross book value of €1.2 billion, and has a composition in line with our Business Plan assumptions. 80% refers to unsecured loans even if in terms of net book value almost 70% refers to the secured part. In terms of Vintage, the 74% as a default year after 2010, in terms of borrower type, 75% refers to corporate debtors.

Slide 41, for the next 3 years, we have ambitious targets with expected total revenues of €245 million, in year 2023 and a net profit of €115 million. In 2023, the division ROE will be 23% while the cost income will be 30%. And the servicing units stand-alone revenues will be €65 million in 2023.

Slide 42, during the next 3 years, we will buy NPLs for a total net book value of €3 billion. During the next days we will also finalize senior financial transaction for a total amount of €82 million. Other 4 financing deals are under evaluation for a total amount of €125 million. Finally, our servicing unit will manage by the first half of the year,€1 billion of gross book value and by the second half, it would be operational also for servicing non-captive portfolios.

Thanks for the attention. I will leave the floor to Carlo Panella.

CARLO PANELLA: Thanks, Andrea for the introduction and good morning, everybody. I will drive you first through the Direct Bank and then across IT Digital platform. Going to Slide 45, I want to tell you that we are developing a new funding bank and it will be operational by the end of the second quarter of this year. It will serve both consumer and SME target and it will be a partner for all the business divisions and it will provide best-in-class digital channels for everybody, attract a stable deposit from retail and SMEs, and support Illimity brand value through investments in marketing and communication. It has been designed around 2 axis, simplicity plus completeness, and technology plus human touch to be a better breed digital bank.

In Slide 46, we have designed the Digital Bank where the key application is innovation and customer experience more than in products. On one side, to design something new, we have been looking at non-banking sector success stories for user experience. On the operating side, we have merged a full set of products with convenient pricing. So Illimity will be a unique player in the Italian market, the completeness of the product range will be made easy by non-banking user experience and this will be enforced by convenient pricing and as an account aggregator, in this way Illimity will position in an underserved area of the competitive landscape. And this will be the key for success to create the first new paradigm bank for retail in Italy.

Going to Slide 47, to achieve the result of course it is important, but it's mainly a key enabler. So the open architecture needs to integrate with the external environment and with customers. Digital means to be fast and to have lean processes, so for instance, on boarding for a new account will take less than 10 minutes. This agreement to understand behaviour and anticipate customer expectations and experience coming from passion [ph] for details and other over the top online players practices. But tech and design themselves are not enough. We will assist customers with a powerful customer center that will give support both for operations and savings.

Slide 47 which is the results technology is providing of course the important thing, but community is the key. So customers are at the center of the bank strategy and we are engaging people to work with us to design service by creating prototypes. We are testing all features, pricing experience with over 20,000 people that joined the community…sorry Slide 48.

These people were engaged online and they represent an extensive focus group we interview constantly to drive decisions. Based on that, they needed [indiscernible] mobile only bank and that's what we are developing. After the creation phase, this audience will become Illiminitis ambassadors and will support the launch of the retail bank.

Slide 49, the organization of Direct Bank is fully operational. We hired resources from different industries to bring innovation and a new approach to user experience, marketing and sales. They are coming from mobile communication, consumer high tech goods, and foreign banks. This line of competencies will drive the design of Illimity Direct Bank from a different perspective. In terms of main achievements, we are on track with the plan presented in July for products and CRM issues advanced [ph] setup and the IT platform is in test phase. We already started working on the launch campaign.

Slide 50, in 2023, we expect to have €3.1 billion of deposits both from Italian and European markets through Illimity retail products. And we planned our bank to reach breakeven in year 2022. The major part of revenues will come from deposits and €15 million will come from o/w [ph] fees and third party products commissions, loans, mortgages and insurances.

And another important KPIs are customers, 200,000 customers is not the target, but it's a baseline to have a Direct Bank with positive results. So we aim more than this. And the total investment in marketing and communication for the Business Plan period is €50 million mainly dedicated to direct acquisition and brand development.

Next steps for Direct Banks are the launch by the end of the second quarter of 2019, and then start the acquisition campaign by the third quarter of 2019 and complete in the same quarter the product offering by third-party products.

Turning to digital operation IT platform…going to Slide 53. We can say that the IT platform has been designed starting from the concept presented in July and the system has been designed around data and API and its cloud ready using state-of-the-art technology. Cyber security is also a key point that we are addressing with the newest technologies including artificial intelligence tools, and the openness will be the enabler for future enhancements.

In this slide you can see the high level design of the whole architecture which implementation is underway. I want to give you just a few details on two main components, Open Banking Layer that is already running as well as Data Lake that is running and the Big Data are already stored in it. So this is the base for machine learning and artificial intelligence mentioned by my colleagues used by business divisions.

Going to organization in Slide 54, also in Digital Operations is fully onboard. IT department is already operational in all areas and is made of security experts, data scientists and engineers and architects and it is an IT design to manage an Open Banking model and digital platform. The centralized structure of customer center and back office has been defined, people are engaged and they are starting using new processes.

Going back to the slide presented by Corrado at the beginning, we confirm that in Slide 55 that the full digital platform will be up and running by third quarter 2019. The migrations of core banking is on the way and will be completed by May. NPL platform has been released the first version and the evolution is already on the way factoring has been released with [indiscernible] but we are developing our own platform, and it will be ready by this summer. And the European deposit will be released in these days. We are also implementing a leasing platform to manage [technical difficulty] everything is on track.

Now, I hand over to Corrado.

CORRADO PASSERA: Just a final word on the execution risk. We are obviously talking about quite ambitious kind of targets, but our assessment of the execution risk embedded in our plan is…if I can use the word quite low. Why would we consider the execution risk relatively low? First of all, we said market dynamics are more favorable than expected, a number of our business lines can be considered counter cyclical and we are building a number of very concrete competitive advantages. Skills first, both in terms of banking skills and industrial experiences. Enrico mentioned and developed the concept of tutors is a key factor for success to be able to look at the different industries from inside not only from the banking point of view.

In terms of technology, we have a commitment with you to be state-of-the-art and to remain state-of-the-art. And when we say technology, we don't only mean Direct Banking mechanism and technologies, we mean applying deep data skills to all our activities to our decision-making. The credit factory concept has to do with that. We have invested and we are investing in top computer science kind of skills in order to build a distinctive competence in how to apply these technologies to credit scoring, credit evaluation, credit monitoring.

Our costs are low and are very flexible. That's another competitive advantages, vintage versus practically all traditional players and our cost of capital just because we are a bank and we decided to be a bank mainly because of this competitive advantage is very low and will remain very low if compared with any other players known…with a known banking status. We are talking about several percentage point of advantage versus most non-bank players.

The plan embeds a number of conservative assumptions. We have been a very conservative and very prudent in estimating our cost of risk. And I can tell you that we count on the fact that we will not reach those levels. A number of new opportunities have not been embedded yet. We call them boosters is a way to make our capability and our size even higher without going beyond our equity limit are not yet part of the plan. And thanks to all of these, we are very selective with this we can afford to be very selective in closing our deals.

In terms of implementation and it is an important point, because when you want to buy…when you want to build the first fully digital bank implementation is a key capability. We are so far on track and we as Carlo was saying, we are quite confident that we will respect all the deadlines and we will be a fully digital bank by the end of the second quarter. And the bad news that came out during 2018 are in 2018 figures and all those challenges both from a market and regulatory point of view are totally already embedded in our Business Plan. That's our estimate of our execution risk.

Last page is only to say that…Page 58. We will report every quarter in terms of results…in terms of our results, our KPIs, our strategic progress, because we will…we want to have a very open and transparent relationship with analyst and investors. We decided to be a bank, we decided to be a listed bank and we are proud of both these decisions.

Let me now open the Q&A session. I think that someone will take care of it.

Q&A

OPERATOR: Thank you. This is the Chorus Call conference operator. We will now begin the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone, to remove yourself from the question queue, please press "*" and "2." Please pick-up the receiver when asking questions. Anyone who has a question may press "*" and "1" at this time.

The first question is from Giovanni Razzoli with Equita SIM. Please go ahead, sir.

GIOVANNI RAZZOLI: Good morning to everybody and thank you for the presentations. I have 2 questions; the first one is on the turnaround divisions, is Slide #31. I've seen you have already closed trading. I was wondering whether you can share with us some more details about them, or one of them if possible, so that we have a more down to ground flavor of what you are doing. And if you can salso elaborate on the you know, accounting treatment of this very briefly, so that we have an idea of how you know, the value generation out of these activity works? And the second question relate to the digital bank, we've seen some number of your competitors growing very rapidly the customer base over the last few months, I'm referring to the numbers of…26. I was wondering whether you can share with us, what's your feeling about the competitive landscape of the digital industry…of the retail digital banking industry in Italy so whether do you see increasing the challenging environment or whether you do see lot of room to exceed also your Business Plan targets that vis-à-vis is what we have seen far since quite prudent. Thank you.

CORRADO PASSERA: Okay. The first question will be answered and addressed by Enrico, and then I…myself and together with Carlo will answer to the second one.

ENRICO FAGIOLI: Okay just today, I have been told that has been issued a press release regarding one of these transactions which name is Calvi Group. This is a relevant transaction for us. We have invested around €40 million. Calvi is an international manufacturer of steel profiles. They have undergone two restructuring plan, one in 2011 and another one in 2015, and their operational results have increased and they have now a situation in terms of growth of revenue and EBITDA which have showed to the market the possibility for them to execute effectively turnaround.

Now we have both and also we have extended a new finance to them. We have done this transaction together with a fund which is IDeA and we have divided with them either the acquisition of the existing debt or the extension of new finance. New finance is in the range of…in total is €30 million our share which is 44% is roughly €6 million and then we have bought all the other kind of tranches of debt outstanding.

The price that we have paid is in the range, I cannot be very precise about that but it is in the range from 60% to 70%. And so, we have a discount of about 30% on the nominal value of the debt that we have both. So this is what we call refinancing situation because we expect to be able to refinance the Calvi in the next, let's say, 18 months to 24 months after the completion of their turnaround…industrial turnaround which has already started as I told you before. When this refinance will be…when this restructuring will be actually closed and we will succeed in refinancing this position or having it reimbursed.

We will have let's say a capital gain of the difference between the prices we have paid for the existing debt which is 70 as I was saying before, and 100 which is the nominal value of the debt. And while the new finance it is extended at par naturally at 100%. So the return on this…in this kind of deal which is more or less the return in which is in line with our Business Plan is coming either from the interest margin that we get in this, let's say, period on the nominal value and also of the…out of the capital gain that we will have when our [indiscernible] both discount will be reimbursed or refinanced or the reposition as a performing…in a performing state at the same nominal…at the nominal value.

GIOVANNI RAZZOLI: So sorry…if I may…you are basically…your assumptions are purely based on cash so it is cash you are…

ENRICO FAGIOLI: Absolutely on cash, because we have both the discount and then when we will…when the restructuring will be hopefully closed we will be able to having…we will have a reimbursement…partial reimbursement. We will have refinance and so we will have a cash effect which produce the capital gain on the specific position.

GIOVANNI RAZZOLI: Okay. Thank you.

CORRADO PASSERA: As far as the second question, I must say that the figures coming from competitors about new accounts, number of payments are the evidence of a market that is really exploding. So this is really good news for us.

Our assumption is that only payments kind of intakes will have a lot of trouble in making real money and what we have in mind is to provide to our customers, everything that has already been provided by the players today present on the market, but we have in mind something more and probably also a better way to do it. I will not elaborate on it, because we will disclose our strategy only at the end of the second quarter probably in June and I want to leave some surprise for that day.

Carlo, want to add something.

CARLO PANELLA: No, I think that you completed the answer.

CORRADO PASSERA: Okay. Thank you.

GIOVANNI RAZZOLI: Thank you.

OPERATOR: The next question is from Manuela Meroni with Banca IMI. Please go ahead.

MANUELA MERONI: Hi, good afternoon and thank you for the presentation. I have three questions, the first one is on non-performing loans in 2018, you bought approximately 20% of secured non-performing loans and 80% unsecured. I am wondering if you expect to keep the same portion also in the course of the Business Plan. And again on non-performing loans if you can share with us some indication about the competitive scenario, what you are seeing in terms of available deals and in terms of pricing if there is any pricing pressure on the non-performing loans right now? The second question is on the cost of risks, in your Business Plan you assume a cost risks lower compared what you...you told us in July. So I am wondering what are the differences behind that is, is lower costs of risk and you are also assuming a reduction in the cost of risks between 2020 and 2023. So any indication about this trend would be helpful for us? And third question is on the cost of funding, if I am not wrong in July you mentioned you expected about 2% cost of funding cross the plan. So I am wondering if you can confirm this level.

CORRADO PASSERA: Okay. Andrea Clamer, will give an answer to the first two areas of questions, while Francesco Mele will address the last two points.

ANDREA CLAMER: Okay, you know, in relation to what we acquired in 2018, you are correct, we bought mainly in terms of gross book value unsecured, but as you can see we paid mostly the secured part. Then, in terms of capital deployed, we paid more of this second part. In addition to what we expect in terms of composition for the next years definitely we will buy more secured than unsecured also, due to the change in terms of regulation.

Moving to your second question and then to the competitive scenario, we saw the 2018 as an incredible year in terms of disposal we reached the peak in terms of amount effectively disposed. And the first evidence of the 2019 are in line with what we saw in the past years. Definitely they are more focused buyer, there are new potential trends of acquisition like leasing NPL that could be interesting for us.

CORRADO PASSERA: Okay, Francesco about cost of risk and cost of funding.

FRANCESCO MELE: Okay. In terms of cost of risk, the main difference between the July forecast and what we have now in the plan, derive from the slightly different mix for the turnaround business the secured component is slightly higher than what we had in the July 2018 Business Plan, and secondly also there is the…in the more [technical difficulty] and also there is more relevant component of the refinancing business which was not included when we originally presented the plan for which the danger rate is around 10% compared to the restructuring and new finance business where the danger rate is higher. So this is the reason for the slightly lower cost of risk, which we believe in any event is very conservative. We have not included the initiative on the invoice lending business for which we have maintained a very conservative level of cost of risk.

The declining cost of risk over time is just a mechanical application of building a loan book over time where you have the generic provision in the beginning and then when the book, the becomes stable the contribution of this component become less relevant.

In terms of cost of funding, we confirm the cost of funding that was included in the Plan, around 200-basis point. Clearly, we have reflected the deterioration in the market, at the same time, in the mix we have included the use of invoice lending paper for refinancing with the ECB, which was not factored during the July 2018 Plan, which reduce on the other side the cost of funding. We see the market still very favorable. We are testing also the European deposit platform. And the feedback we are receiving in terms of pricing is consistent with the number we have been providing.

MANUELA MERONI: Okay.

OPERATOR: The next question is from Gianluca Pediconi with Momentum. Please go ahead.

GIANLUCA PEDICONI: Good morning, ladies and gentlemen. A few questions, the first one on 2019. How much cash should we expect to burn and when do you expect to breakeven?

The second question is let's say, more tactical, you deem that your targets are ambitious, but with a low execution risk. But at the same time, you are raising 2020 targets. By definition, you are also increasing the execution risk; wouldn't it be wiser just to stick to the original plan and maybe later on raising the targets?

And then the very last question is on the stock option plan, if we may have some more color? Thanks very much.

CORRADO PASSERA Okay. I will start and then Francesco will probably elaborate on some of the points, I will make. As far as 2019, as decided since the very beginning, we decided not to give exact guidance of the budget. But I can certainly tell you that we have in mind and we will do our best to reach on a quarterly basis a breakeven in the last quarter of the year. As far as low execution risk, we just listed the good reason for considering the risk quite manageable.

As far as, profit target 2020, I think I agree with you. My partners decided that it was…we had to be transparent, and to add what we expected to have in 2020. I would have left 50 and then make a good surprise. But I mean that we are a democracy [technical difficult] point within the bank. And the majority decided to add '20, 20 more million. In any case, it's not such a bad news really.

Okay. Last point was about stock option and I will leave it to Francesco because…

FRANCESCO MELE: Our Plan is linked to the 2023 result. We have a maximum allocation of 2.6% on a fully diluted basis. So far, we have allocated 1.7% of this number. It is a very…we believe strongly aligned to the performance of the bank, there are let's say PBT [ph] and capitalization and the bank being profitable towards the end of the plan. But the payment and the performance data are pretty, pretty much close to the target of the Business Plan. Just to give a sense ROE, which is going to be the most relevant…the performance again assume that these stock options become vested and so can be exercised only to the extent the ROE is in excess of 20% and become fully vestable [ph] only when exceed 25%. The performance gains [ph] are mostly ROE, cost to income growth, organic NPE ratio, and capitalization where ROE, cost to income, and gross organic NPE ratio that's for us are the most relevant KPI, are the most important one for the execution of a stock option plan.

GIANLUCA PEDICONI: Thank you very much.

OPERATOR: Mr. Passera, there are no more questions registered at this time.

CORRADO PASSERA: Thank you very much and thank you to everybody. We will…with this conference call, we start something that will last for years and that will find ourselves and yourself around the table at the end of every quarter. Thank you very much indeed to everybody.