Interim Report 2018

January to June

PostFinance

Surpassing support

PostFinance is one of Switzerland's leading retail financial institutions. With simple, straightforward services, we are the ideal partner for anyone who manages their own finances, anytime and anywhere.

There was a huge fall in net interest income due to persistently low interest rates and expiring old capital market instruments. This development will continue in the second half of the year.

125 million

francs in **earnings before tax (EBT)** as at 30 June 2018.

122 billion

francs represents the level of **average monthly customer assets** as at June 2018.

2.9 million

customers place their trust in PostFinance to meet their daily financial needs.

1.8 million

users manage their money with **e-finance**.

3,377

full-time equivalents or around 3,800 employees work daily to serve our customers.

Interim Report January to June 2018

Foreword

Rolf Watter
Chairman of the Board of Directors

Hansruedi Köng
Chief Executive Officer

We successfully introduced our new banking software in the first half of 2018.

Dear Reader

PostFinance generated earnings before tax (EBT) as per Group IFRS guidelines of 125 million francs in the first half of 2018. The fall of 247 million francs year-on-year was principally due to the 102 million franc decline in the result from the interest differential business. In addition, a one-off gain from the sale of two equity portfolios amounting to 109 million francs had a positive effect in the prior-year period. The decline in the result is in line with our expectations due to the persistently low interest rates on the money and financial markets. This negative trend looks set to continue in the coming years as current high interest-bearing bonds from earlier investments reach maturity, but can only be reinvested for very low returns. This makes it all the more important for politicians to rapidly reveal which competitive opportunities they want to grant PostFinance in the future. If the lending prohibition is maintained, the owner will have to accept that we will be unable to distribute any more dividends for several years.

New banking software

We updated our banking software over the Easter weekend. We prepared meticulously for the biggest and most important project in the history of PostFinance by simulating the "go-live" four times with real data and in real time frames. Thousands of PostFinance employees tested the functional and performance capacity of the systems during several trial days in order to be ready for the launch. The tremendous preparation work was worthwhile. Even in the initial operating phase, the new platform proved to be particularly stable and efficient. We aim to be Switzerland's leading digital bank and one of the top 10 digital banks in Europe by the end of 2020. Thanks to the new banking software, we have laid the foundations to enable our customers to benefit from modern digital products and services more rapidly in future.

Reduction of up to 500 positions

Society – and with it, banking – is becoming increasingly digital, bringing about fundamental changes in customers' needs and behaviour. At the same time, we are suffering badly from the current negative interest rate environment due to the ban on issuing our own loans and mortgages. In order to counter margin erosion and the associated decline in revenue, we are planning measures in various business units to increase efficiency and reduce costs. By the end of 2020, we will be able to manage with fewer employees than today due to the automation and digitization of processes, the realignment of private and business customer advisory services, and the outsourcing of business activities. This means that in the next two and a half years a total of 500 full-time positions will be cut. Most of these should be absorbed by natural staff turnover, the expiry of temporary employment contracts and (early) retirement. We will not be able to avoid redundancies as well. This is a painful decision, but it is unavoidable if we are to ensure the long-term competitiveness and successful continuity of PostFinance.

Changes in the Board of Directors

Susanne Ruoff announced her resignation as Swiss Post CEO on 10 June. She stood down from the Board of Directors of PostFinance Ltd on the same date. Adriano P. Vassalli announced his resignation from the Board of Directors of PostFinance Ltd on 16 June. These resignations have no influence on the strategic and operational management of PostFinance Ltd. All projects and decisions will be implemented as planned. Two new members of the Board of Directors are being recruited in close consultation with Swiss Post. The Board of Directors and Executive Board wish to thank Susanne Ruoff and Adriano P. Vassalli for their hard work.

Thank you

We would like to thank our employees for their great commitment in the past few months. The introduction of the new banking software was a major challenge for us all. What is more, the planned reduction in staff numbers could cause fears and uncertainty. It is important to us, especially in such difficult times, to be an employer that assumes its social responsibility towards its employees. We do this by supporting them closely in order to pinpoint prospects and find socially acceptable solutions.

We would like to thank you, our customers, for your loyalty. We will not be able to avoid introducing further fee increases in the coming months. Such measures are unpopular, but are unfortunately inevitable in the current market environment. Nevertheless, PostFinance will remain committed to ensuring a transparent, usage-based and comprehensible fee policy as well as good value for money.

Rolf Watter
Chairman of the Board
of Directors

Hansruedi Köng
Chief
Executive Officer

Presentation of figures

The amounts shown in the report are rounded. 0 is a rounded amount, indicating that the original figure was less than half of the unit used.
A dash (–) in place of a figure indicates that the value is zero.

Key for charts and tables

Current year
Previous year

Languages

The report is available in English, German, French and Italian.
The German version is authoritative.

Management report

With 2.9 million customers and total assets of 126 billion francs, PostFinance is one of Switzerland's leading financial institutions. In its role as market leader and with more than a billion payment transactions a year, it ensures a seamless flow of liquidity on a daily basis.

Around 1.8 million customers handle all their finances online.

Key figures

In the first half of 2018 PostFinance recorded earnings before tax (EBT) of 125 million francs, down 247 million francs year-on-year. The interest differential business is the most important source of revenue for PostFinance. There was a huge fall in net interest income due to persistently low interest rates and expiring old capital market instruments. This development will continue in the second half of the year. In addition, a one-off gain from the sale of two equity portfolios amounting to 109 million francs had a positive effect in the prior-year period.

Further growth was recorded in sight deposits of business customers despite the fact that customer asset fees on credit balances over a certain exemption limit had to be maintained for selected individual customers due to the negative interest rates on sight deposit balances at the SNB. The customer asset fee charged to private customers with a credit balance of over one million francs concerns only a very small number of customers, and had only a marginal impact on the development of customer deposits. A trend was observed towards transferring assets from savings accounts to investment products such as funds and shares. The sales figures confirm the emphasis placed on customers who manage their own finances and use our simple, attractive products.

PostFinance Ltd | Key figures

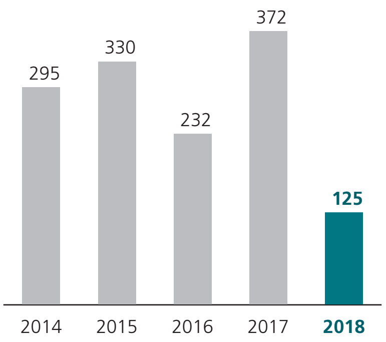
as of 30.06.2018 with previous year for comparison

Balance sheet		31.12.2017	30.06.2018
Total assets as per IFRS	CHF million	120,848	125,884
Capital ratio as per guidelines for systemically important banks	%	17.1	16.82
ARB leverage ratio	%	4.67	4.55
Income statement (as per Group IFRS guidelines)		30.06.2017	30.06.2018
Operating income	CHF million	913	683
Operating profit (EBIT)	CHF million	387	146
Earnings before tax (EBT)	CHF million	372	125
Return on equity [1]	%	13.4	4.4
Cost-income ratio	%	57.6	78.6
Customer assets and loans		31.12.2017	30.06.2018
Customer assets	CHF million monthly average	119,797	122,430
Funds, securities and life insurance	CHF million monthly average	9,968	10,167
Customer deposits	CHF million monthly average	109,829	112,263
Development of customer deposits	CHF million	−611	2,476
Managed assets as per provisions of Circ. 2015/1 [3]	CHF million	46,305	45,871
Inflow of new money as managed assets	CHF million	−714	−379
Mortgages [2]	CHF million	5,650	5,750
Market and employee key figures		30.06.2017	30.06.2018
Customers	In thousands	2,934	2,876
Private customers	In thousands	2,634	2,582
Business customers (incl. banks and agencies)	In thousands	300	294
Accounts – private customers	In thousands	4,421	4,410
Accounts – business customers	In thousands	393	387
Average headcount	Full-time equivalents	3,508	3,377

1 Return on equity = earnings before tax (EBT) as per Group IFRS guidelines / average eligible equity capital as per ARB.
2 Commission income in cooperation with financial partners.
3 PostFinance reports customer assets and managed assets. “Customer assets” includes all assets held by customers based on average monthly assets. “Managed assets” encompasses only values deposited for investment purposes on the reference date.

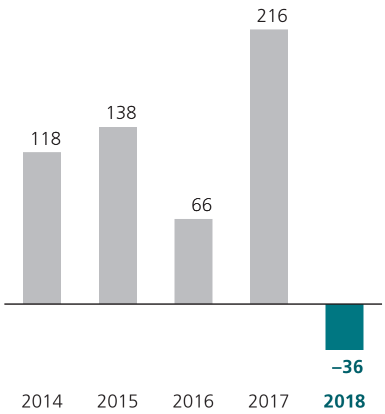
Earnings before tax (EBT)

1.1. to 30.6.2018 with prior-year period
CHF million



Economic value added[1]

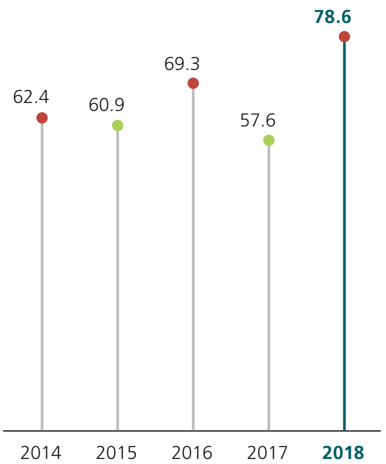
1.1. to 30.6.2018 with prior-year period
CHF million



[1] Economic value added = earnings before tax (EBT) as per Group IFRS guidelines less the cost of equity of the average eligible equity capital as per ARB.

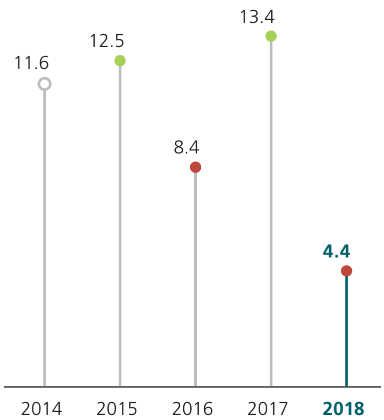
Cost-income ratio

1.1. to 30.6.2018 with prior-year period
Percent



Return on equity[2]

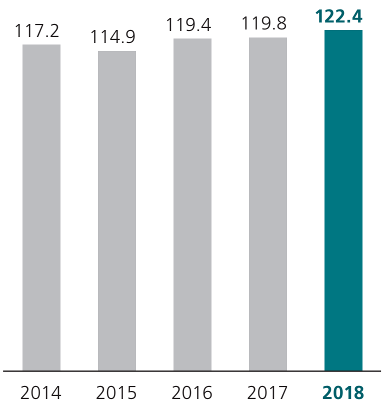
1.1. to 30.6.2018 with prior-year period
Percent



[2] Return on equity = earnings before tax (EBT) as per Group IFRS guidelines / average eligible equity capital as per ARB.

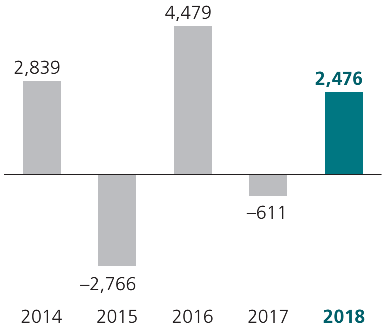
Average customer assets (monthly avg.)

2014 to 2018
CHF billion



Development of customer deposits

2014 to 2018
CHF million



Commentary on business performance

Strategy

PostFinance aims to help its customers manage their money as easily as possible. Its approach is based on an in-depth understanding of what customers need, both now and in the future. Working to achieve this is what drives all employees on. To reach its goal, PostFinance is prepared to take unconventional steps and to keep surprising its customers in a positive way. As a digital innovation leader in the Swiss banking world, PostFinance is taking advantage of its strong starting position and evolving from a traditional financial services provider into a digital powerhouse.

General developments

High pressure on interest margins.

The Swiss economy is currently experiencing a broad-based upswing. Industrial companies are anticipating robust growth in international business. With value added growing considerably in the service sectors and the labour market continuing on the road to recovery, the mood is very good overall. A SECO Expert Group expects the upswing to continue at a similarly rapid rate. It predicts robust GDP growth of 2.4 percent in 2018. The export sector will remain a key pillar of growth. The outlook for the US is a little more positive, while the remaining key economic areas are also looking in very good shape. This has pushed up international demand for Swiss products, with a weaker exchange rate for the Swiss franc compared with the past two years also driving growth in exports. Domestic economic forces will also underpin growth. Production capacity utilization is looking high, order books are well filled and financing conditions are favourable. The SECO expects employment to grow appreciably once again in the coming quarters. The upturn in the labour market will also bolster private consumption. Global economic risks have increased, however. The trade dispute between the US and key trade partners has escalated to new heights after the implementation of US tariffs on steel and aluminium imports. If the situation were to deteriorate further between the major economic areas, this would significantly curb global trade, Swiss exports and, ultimately, economic growth. Political uncertainty in Italy has also deepened. While the newly elected government recently reaffirmed that it does not intend to leave the monetary union, its programme, which proposes expansionary fiscal policy measures, is creating major uncertainty.

The Swiss National Bank (SNB) is maintaining its expansionary monetary policy, with the aim of stabilizing price developments and supporting economic activity. Interest on sight deposits at the SNB remains at –0.75 percent, and the target range for the three-month Libor is unchanged at between –1.25 and –0.25 percent. Negative interest rates and the willingness of the National Bank to intervene in the currency market make investments in Swiss francs less attractive, thereby reducing pressure on the franc. For 2018, the SNB has predicted inflation of 0.9 percent. In the US, inflation has almost reached the target level set by the Federal Reserve. The Fed therefore plans to continue its normalization of monetary policy. In the euro area, by contrast, core inflation has continued to move sideways in recent months. The ECB intends to pursue its asset purchases over the next few months, and to leave its key rates unchanged. Japan is also likely to maintain its highly expansionary monetary policy as inflation remains modest.

Assets and financial situation

Customer deposits increased by 2.5 billion francs in the first half of 2018. Further growth was recorded in sight deposits of business customers despite the fact that customer asset fees over a certain exemption limit had to be maintained for selected individual customers due to the negative interest rates on sight deposit balances at the SNB. The customer asset fee charged to private customers with a credit balance of over one million francs concerns only a very small number of customers, and had only a marginal impact on the development of customer deposits. PostFinance continues to invest a large proportion of its assets in long-term fixed-interest financial investments in Switzerland and abroad. A very large amount of liquidity was still held at the SNB as at 30 June 2018.

A trend was observed towards transferring assets from savings accounts to investment products such as funds and shares. PostFinance provides services in the commission business such as funds, e-trading, life insurance and credit cards in cooperation with partners. For the first time, average customer assets in investment products stand at over 10 billion francs.

Profit situation

PostFinance generated earnings before tax (EBT) of 125 million francs in the first half of 2018, which represents a decrease of 247 million francs year-on-year.

The interest differential business is the most important source of revenue for PostFinance. The ongoing low interest situation is increasingly weighing on interest margins. Interest income decreased by 102 million francs in comparison with the first half of 2017. This situation will remain a challenge for PostFinance over the next few years.

In addition, operating income in the comparison period benefited from one-off capital gains of 109 million francs from the sale of two equity portfolios in January 2017 as part of the revision of the investment strategy.

In comparison with the first half of 2017, headcount decreased by 131 full-time equivalents to an average of 3,377 full-time equivalents. As part of its new strategic focus, PostFinance is placing an emphasis on the simplification and digitization of its services and processes. Vacant positions were therefore only partly filled in the first half of the year. PostFinance outsourced paper-based payment transactions to Swiss Post Solutions on 1 June 2018. Around 80 full-time positions were transferred as a result. Personnel expenses fell by 6 million francs.

Investments were required in strategic projects to modernize the core banking systems, which were successfully introduced over the Easter weekend of 2018, leading to additional depreciation and amortization. General and administrative expenses were up year-on-year as a result of these projects.

Despite a consistent focus on costs, the cost-income ratio rose to 79 percent due to the lower operating income year-on-year. At 4.4 percent, return on equity was in line with our expectations due to the decline in operating income caused by market interest rates, combined with the slight rise in expenses for the modernization of our core banking systems.

Outlook

The ongoing uncertain situation on the domestic and international financial and capital markets with negative interest rates in some cases increasingly presents PostFinance with significant challenges. Due to the current investment climate, the high level of liquid assets cannot be profitably invested in the capital market. The negative interest on sight deposit balances charged by the SNB is partly being passed on to major customers and wealthy private customers. Upward pressure on the Swiss franc is expected to persist, despite the intervention by the SNB. An increase in the key rates in Swiss francs in the course of the year can therefore be ruled out.

The competitive disadvantage that we face in not being able to issue our own loans and mortgages is becoming increasingly pronounced. For this reason, and to guarantee PostFinance’s long-term profitability in the current market environment, it is therefore essential to diversify the income structure and to tap into new sources of revenue in which non-interest income can be generated.

Added to this are changing customer requirements: our society, and with it the banking world, is rapidly becoming more and more digital. We will therefore pursue several strategic thrusts as we pave the way to becoming a “digital powerhouse”.

PostFinance interim financial statements

PostFinance Ltd issues financial statements in accordance with Group IFRS (International Financial Reporting Standards) guidelines and the Accounting rules for banks (ARB).

Balance sheet

PostFinance Ltd | Balance sheet as per Group IFRS guidelines

CHF million	31.12.2017	30.06.2018
Assets		
Cash and cash equivalents	2,113	1,533
Amounts due from banks	37,105	41,525
Interest-bearing amounts due from customers [1]	360	412
Trade accounts receivable	23	6
Other receivables [1]	704	612
Inventories	4	4
Financial investments	79,309	80,593
Participations	19	26
Tangible fixed assets	420	410
Investment property	261	265
Intangible assets	181	179
Deferred tax assets	349	319
Total assets	**120,848**	**125,884**
Liabilities		
Customer deposits [1]	113,720	115,313
Other financial liabilities	843	4,438
Trade accounts payable	106	72
Other liabilities	101	129
Income tax liabilities	11	0
Provisions	263	246
Deferred tax liabilities	82	36
Equity	5,343	5,549
Profit	379	101
Total liabilities	**120,848**	**125,884**

1 Change in recognition method for the credit card business (restatement 2017).

Income statement

PostFinance Ltd | Income statement as per Group IFRS guidelines

CHF million	2017 01.01.-30.06.	2018 01.01.-30.06.
Net interest income, net of impairment	476	374
Net income from services	83	86
Net commission income	43	55
Net trading income	121	95
Net income from financial assets	94	–7
Other net income	96	80
Operating income	**913**	**683**
Personnel expenses	–252	–246
General and administrative expenses	–247	–259
Operating expenses	**–499**	**–505**
Gross profit (EBDIT)	**414**	**178**
Depreciation of fixed assets	–27	–32
Operating profit (EBIT)	**387**	**146**
Net financial income	–15	–21
Earnings before tax (EBT)	**372**	**125**
Expenses for current taxes	–33	–4
Expenses for deferred taxes	–27	–20
Expenses for non-reclaimable withholding tax	0	0
Income taxes	**–60**	**–24**
Profit	**312**	**101**

Reconciliation of IFRS income statement with ARB

PostFinance issues financial statements in accordance with Group IFRS (International Financial Reporting Standards) guidelines and the Accounting rules for banks (ARB) set out in article 6 ff. of the Banking Act and article 25 ff. of the Banking Ordinance (FINMA Circular 2015/1 "Accounting – Banks"). The following table shows the differences between the two accounting standards in the income statement. It reconciles the interim results in accordance with Group IFRS guidelines with the ARB financial statements.

PostFinance Ltd | Reconciliation of income statement as per Group IFRS guidelines with ARB

CHF million		2017 01.01.-30.06.	2018 01.01.-30.06.
Profit as per Group IFRS guidelines		**312**	**101**
Interest and dividend income from financial investments	Amortization of revalued held-to-maturity financial investments	–14	–3
Various income statement items	Valuation differences for financial investments as per ARB	–23	3
Changes in value adjustments for default risks and losses from interest operations	Reversal of impairment/impairment on loans incl. taxes	–	73
Result from the disposal of financial investments	Realized gains from (earlier than scheduled) sales	–33	0
Personnel expenses	Valuation differences between IAS 19 and Swiss GAAP ARR 16	–7	5
Value adjustments on participations and depreciation and amortization of tangible fixed assets and intangible assets	Revalued real estate	–2	–2
	Goodwill	–100	–100
Various income statement items	Valuation differences for participations as per ARB	–33	–3
Extraordinary income/extraordinary expenses	Realized gains from participations	2	0
Taxes	Deferred tax income as per Group IFRS guidelines	27	20
Interim profit as per ARB		**129**	**94**

Statutory interim financial statements

PostFinance issues interim financial statements in accordance with the Accounting rules for banks (articles 25-28 of the Banking Ordinance, FINMA Circular 2015/1 "Accounting – banks" ARB).

The statutory interim financial statements as at 30 June 2018 indicate earnings after tax of 94 million francs.

Balance sheet

PostFinance Ltd | Balance sheet as per ARB

CHF million	31.12.2017	30.06.2018
Assets		
Liquid assets	38,476	42,254
Amounts due from banks	4,823	4,842
Amounts due from securities financing transactions	24	105
Amounts due from customers	12,173	12,316
Mortgage loans	0	0
Trading portfolio assets	–	–
Positive replacement values of derivative financial instruments	43	53
Other financial instruments at fair value	–	–
Financial investments	62,819	64,146
Accrued income and prepaid expenses	556	541
Participations	122	127
Tangible fixed assets	1,223	1,212
Intangible assets	1,000	900
Other assets	374	274
Total assets	**121,633**	**126,770**
Total subordinated claims	13	4
of which subject to mandatory conversion and/or debt waiver	–	–
Liabilities		
Amounts due to banks	543	597
Liabilities from securities financing transactions	–	3,450
Amounts due in respect of customer deposits	113,292	114,999
Trading portfolio liabilities	–	–
Negative replacement values of derivative financial instruments	728	690
Liabilities from other financial instruments at fair value	–	–
Cash bonds	93	86
Bond issues and central mortgage institution loans	–	–
Accrued expenses and deferred income	108	126
Other liabilities	6	3
Provisions	45	43
Reserves for general banking risks	–	–
Bank’s capital	2,000	2,000
Statutory capital reserve	4,682	4,682
of which tax-exempt capital contribution reserve	4,682	4,682
Statutory retained earnings reserve	–	–
Voluntary retained earnings reserves	–	–
Profit carried forward	–	–
Profit	136	94
Total liabilities	**121,633**	**126,770**
Total subordinated liabilities	–	–
of which subject to mandatory conversion and/or debt waiver	–	–

Off-balance sheet

PostFinance Ltd | Off-balance-sheet transactions

CHF million	31.12.2017	30.06.2018
Off-balance-sheet transactions		
Contingent liabilities	33	85
Irrevocable commitments	722	717
Obligations to pay up shares and make further contributions	–	–
Credit commitments	–	–

Income statement

PostFinance Ltd | Income statement as per ARB

CHF million	2017 01.01.-30.06.	2018 01.01.-30.06.
Interest and discount income	89	71
Interest and dividend income from trading portfolios	–	–
Interest and dividend income from financial investments	356	301
Interest expense	3	2
Gross result from interest operations	**448**	**374**
Changes in value adjustments for default risks and losses from interest operations	14	85
Net result from interest operations	**462**	**459**
Commission income from securities trading and investment activities	22	30
Commission income from lending activities	9	10
Commission income from other services	311	304
Commission expense	–219	–206
Result from commission business and services	**123**	**138**
Result from trading activities and the fair value option	**105**	**111**
Result from the disposal of financial investments	67	0
Income from participations	2	6
Result from real estate	43	34
Other ordinary income	50	43
Other ordinary expenses	–8	–12
Other result from ordinary activities	**154**	**71**
Operating income	**844**	**779**
Personnel expenses	–260	–241
General and administrative expenses	–257	–274
Operating expenses	**–517**	**–515**
Value adjustments on participations and depreciation and amortisation of tangible fixed assets and intangible assets	–160	–140
Changes to provisions and other value adjustments, and losses	–5	–4
Operating result	**162**	**120**
Extraordinary income	3	0
Extraordinary expenses	–	–
Changes in reserves for general banking risks	–	–
Taxes	–36	–26
Six-month profit	**129**	**94**

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