Abu Dhabi Commercial Bank PJSC
Q1’20 Earnings Call Transcript

Hosted by Naresh Bilandani, J.P. Morgan
Date: Thursday, 07 May 2020
Conference Time: 16:00 (UTC+04:00)

ADCB Speakers

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Kevin Taylor - Group Treasurer
Monica Malik - Chief Economist
Denise Caouki - Head of Investor Relations
Abu Dhabi Commercial Bank Q1 2020 Results

Thursday, 07 May 2020

Naresh Bilandani: Thank you. Good day everyone, and welcome to this first quarter 2020 results call for Abu Dhabi Commercial Bank, which JP Morgan is very pleased to host. I’m Naresh Bilandani, the Head of MENA, and Equity Research at JP Morgan. We have with us today the senior executive team of ADCB, including the CEO and the CFO, on this call. Please note that this 45-minute call is intended for sellside analysts and investors only. Media personnel should disconnect. I will pass on to Denise now, for management introductions and for the commencement of the call. Denise, all yours.

Denise Caouki: Thank you, Naresh. Ladies and gentlemen, thank you for joining us. We announce our quarter one 20 financial results today. On this call, we’ll be giving an overview of the bank’s response to Covid-19, our financial results, and the successful completion of integration. Finally, we will finish by taking any questions. We provide a detailed presentation which has been shared with you already. I’d like to introduce the host of the call now.

I’m joined by Ala’a Eraiqat, the Group CEO, Deepak Khullar, Group CFO, Kevin Taylor, Group Treasurer, and Monica Malik, our Chief Economist. I will now hand over to Ala’a to begin the presentation.

Ala’a Eraiqat: Thank you Denise and thank you everyone for joining us today. I sincerely hope you are all keeping safe and well. Please turn to slide five for an overview of what we will discuss today. The Covid-19 emergency has presented challenges for governments, communities, and companies across the world. In response, ADCB have acted quickly to roll out a comprehensive package of measures to support our customers, employees, partners, and the community, while ensuring continuity of services.

Despite a very difficult operating environment, ADCB has made good operational progress in the first quarter. We are pleased and proud to announce the integration was completed significantly ahead of schedule to create a stronger and a more resilient bank. Systems integration and the migration of UNB customers was completed seamlessly on April 2nd, just 11 months after the legal merger. As a result of this successful process we have increased our synergy targets further, to one billion Dirhams.

ADCB continued to deliver a very positive operating performance, demonstrating that our underlying business remains robust. Despite Covid-19, low oil prices, and the low interest rate environment, the bank has focused on managing our cost base and realising merger synergies and we will continue to pursue this strategy. When the issues related to NMC and Finablr emerged, we took decisive action to protect the interests of the bank and its stakeholders. We are pursuing all means to resolve the issue and will provide more details later in this call. In these challenging times ADCB is focusing its full power and capabilities to preserve and build long-term sustainable value.

Let me go into more details on our response to Covid-19, on slide six. The reaction to challenges such as this reflect the organisation’s true culture and character. The bank is leveraging its financial strength and expertise to play a full role in supporting the community in line with the policies and initiatives of the government and the UAE Central Bank. In March, the UAE Central Bank launched its targeted economic support scheme, or TESS, to promote economic resilience. ADCB was the first bank in the UAE to launch a comprehensive package to provide relief for
customers.

These initiatives included the deferment of loan instalments, fee reductions and fee waivers, and temporary interest rate reductions. As of today, ADCB has drawn down on 8.3 billion Dirhams under the TESS scheme from the Central Bank very close to our full entitlement and this has provided support to over 32,000 customers so far. We have taken measures to ensure the safety and financial security of our employees, pledging no Covid-related redundancies in 2020.

And the bank has also invested nine million Dirhams to support distance learning for students and to express gratitude to the front-line healthcare professionals. Please turn to slide number ten for information on the successful completion of the integration. We have run a highly effective integration process based on a robust governance framework, with rigorous planning, testing, and execution. The fast track process was completed only within 11 months of the legal merger, or legal day one. And the integration programme was formally closed down on April 15th of this year.

This timeframe was less than half the original target and comfortably beat regional benchmarks. The successful integration is resulting in significant efficiencies. We have therefore upgraded our run rate synergy target to 1 billion Dirhams from the previous target of 840 million Dirhams.

On slides 11 and 12 you will see how the complex integration process was carried out in a methodical, phased approach over the last year. I would like to turn to slide 13 where you will see details of the final milestone system integration, which was completed on the second of April. This involved the unification of IT systems and the migration of former UNB accounts to the ADCB platform in the short, 38-hour, window over a weekend only.

The process was completed seamlessly, with timely communications to all stakeholders. And while 90 per cent of the staff and the teams involved have actually worked remotely, due to the Covid situation. And now I would like to hand over to Deepak Khullar, our Group CFO.

Deepak Khullar: Thank you, Ala’a. And welcome, everybody, to the call, Moving on to slide 14, this provides more detail on the financial benefits of the merger. As Ala’a mentioned, we have increased our run rate synergy target to one billion Dirhams. This is a significant upgrade from the previous target of 840 million Dirhams, and the initial target of 615 million Dirhams when we announced the transaction.

We are on track to capture 75 per cent of the revised synergy target this year and to reach the full target in 2021, as planned. In the first quarter, 185 million Dirhams of synergies were realised and the main drivers of this have been cost efficiency gains from manpower and branch optimisation, productivity enhancements, and economies of scale. We’ve also tightly managed our one-off integration costs, completing integration significantly under our target 980 million Dirhams.

Kevin will now discuss developments in the operating environment. Over to you, Kevin.
Kevin Taylor: Thanks Deepak. Slides 16 to 18 shows key economic indicators and activities. We are forecasting that the impact of the Covid-19 pandemic and lower oil production will lead to a four per cent contraction in real GDP in 2020. The impact on consumer sentiment and our customers’ businesses is likely to continue for an extended period. We do, however, expect a recovery in 2021, with GDP growth forecast to be 2.1 per cent.

The logistics, retail, and food and beverage sectors have been particularly affected by social distancing and stay at home measures. Meanwhile, global travel restrictions have impacted aviation, tourism, and hospitality sectors with a sharp reduction in the number of visitors to the UAE in the first quarter. Sales and rental prices of real estate in Abu Dhabi and Dubai have contracted this year as supply in housing continues to outstrip demand.

On slide 19, a decline in ADCB credit card and debit card spend illustrates how the challenging operating environment has impacted consumption patterns. Card spends began to decline in January 2020, with the trend accelerating in February and March. This drop came as measures were rolled out to shut entertainment, hospitality, and food and beverage outlets.

On slide 20, you will see that on a year on year basis, credit and deposits grew at a similar pace in Q1 20. However, on a quarterly basis, we see flat credit growth and a slight contraction in deposits. Yet banking sector liquidity remains comfortable on an historic basis. GRE, credit and deposit growths, saw strong monthly growth in March, potentially reflecting the impact of Covid-19. During the quarter there was a sharp drop in UAE and US interest rates as the US Federal Reserve took monetary action to cushion the economy from the impact of Covid-19.

After rising in March, EIBOR moderated in April and early May, pointing to an easing in liquidity conditions. I’ll now pass back to Deepak.

Deepak Khullar: Thank you Kevin. Please turn to slide 23, and a summary of our financial performance in the first quarter. Our quarter one results demonstrate that ADCB’s fundamentals remain strong and our businesses are resilient despite a tough operating environment. We reported an increase in operating profit, underpinned by a lower cost of funds and merger synergies which resulted in a sustainable improvement in our cost to income ratio.

We continue to benefit from a robust liquidity and capital position, in full compliance with regulatory requirements. Net profit was impacted by impairment charges which were dominated by NMC, Finablr, and associated companies. For more detail on our income statement, please turn to slide 24. Net interest in Islamic financing income increased by six per cent year on year, to 2.8 billion Dirhams, driven by a steady loan book and a lower cost of funds.

This was achieved against a challenging backdrop of Covid-19, low interest rates, and low oil prices. Non-interest income was 687 million Dirhams, up 18 per cent sequentially, and 11 per cent lower year on year on account of reduced net fees and commission income, as well as lower trading income. The most notable achievement has been the effective management of costs. Operating expenses decreased seven per cent year on year when one-off
integration costs were excluded.

Operating profit increased three per cent year on year, to 2.2 billion Dirhams, and was up eight per cent, excluding integration costs. Net profit, which was 209 million Dirhams, was impacted by the higher impairment charges, with 1.1 billion Dirhams of charges relating to NMC, Finablr, and associated companies. I will now hand over to Ala’a, who will update you on the NMC issue on slide 25. Over to you, Ala’a.

Ala’a Eraiqat: Thank you, Deepak. The significant problems at NMC and Finablr emerged during the first quarter. ADCB responded rapidly, with very decisive actions to resolve this serious issue. We’ve put robust governance and rigorous risk management framework at the heart of ADCB’s strategy, operations, and culture. Therefore, we will do everything in our power to protect the interests of the bank and its stakeholders. Firstly, it is worth noting that NMC has clearly misled over 80 financial institutions, investors, rating agencies, and the London Stock Exchange, and their own auditors.

The company revealed suspected fraud and over $4 billion US of hidden debt. ADCB disclosed to the market in early April that we have approximately $1.2 billion of exposure to the companies of NMC, Finablr, and their related companies. And this is the total credit extended by the three banks before the merger. We took rapid action to protect our interests and safeguard the operations of the healthcare group. This involved successfully applying for administration for NMC, and initiating criminal proceedings against key individuals.

We are now working closely with our regulators, other creditors, and administrators, to recover missing funds. The impairment charge of 1.1 billion Dirhams that we booked in the first quarter complies with international accounting standards and is based on our current information. We do not regard this as a write-off, and our intention is to pursue all means to achieve positive financial resolution at the end of it.

The bank is also taking various additional cost and efficiency measures to partially offset these provisions. I will now hand back to Deepak to continue discussing our financial performance.

Deepak Khullar: Thank you, Ala’a. Let me continue with the key balance sheet highlights on slide 26. Our asset base displayed resilience, with total assets at 412 billion Dirhams as of 31st March 2020. Net loans were on par with the previous quarter, in line with the UAE bank in sector average for the first quarter of this year. Meanwhile, customer deposits increased slightly, to 263 billion Dirhams, outpacing an industrial average contraction of one per cent year to date.

Total shareholder equity stood at 48.5 billion Dirhams at the end of March, 13 per cent lower than the previous quarter. This was mainly due to the 2.6 billion Dirhams dividend pay-out and the decrease of four billion Dirhams in the fair value of investments through other comprehensive income. The mark to market adjustment was due to an increase in market volatility in quarter one 2020.

For more detail on our balance sheet metrics, please turn to slide 28. Post-merger, our exposure is well balanced across economic sectors and between wholesale and consumer banking. As a UAE-centric bank, 94 per cent of our
loans are in the country. Our deposit breakdown can be found on slide 29. A key focus for the bank has been to increase our CASA deposits, which has contributed to a lower cost of funds.

CASA deposits increased six per cent quarter on quarter, to 108 billion Dirhams, and comprise now 41 per cent of total customer deposits, compared to 39 per cent at the end of 2019. This was achieved despite the declining interest rate environment and a highly competitive landscape and is a reflection of the confidence that customers continue to place in ADCB. Meanwhile, the bank continued its strategy of exiting expensive time deposits, which declined three per cent from year-end, to 155 billion Dirhams. I will now hand over to Kevin to discuss our liability mix further. Over to you, Kevin.

Kevin Taylor: Thanks, Deepak. Turning to slide 30, you can see the high degree of diversification in our liability base, with customer deposits accounting for 72 per cent of total liabilities. We have also maintained a healthy wholesale funding mix, which totalled 58 billion Dirham at the end of the quarter. We continue to be a net lender in the inter-bank market, to the tune of 13 billion Dirhams. And our liquidity position remains robust, with the liquidity coverage ratio standing at 115.1 per cent at quarter-end, and our loans to deposit ratio at 93.8 per cent.

Turning to slide 32, as Deepak mentioned, capital decreased due to dividend pay-out and the adjustment in the fair value of investments. Our capital adequacy ratio decreased to 14.13 per cent at the end of the quarter. Meanwhile, CET1 ratio stood at 10.82 per cent. I’ll now pass back to Deepak to talk to the slides on asset quality.

Deepak Khullar: Thank you, Kevin. We reported total impairment allowances of 1.9 billion Dirhams in the first quarter, with NMC, Finablr, and associated companies accounting for approximately 1.1 billion of the total. As a result, the cost of risk has increased to 2.34 per cent in quarter one, from 0.98 per cent in the fourth quarter of 2019. Excluding NMC and Finablr, the cost of risk would be 1.1 per cent.

On slide 34, you can see that the NPL ratio was 4.65 per cent as of 31st March 2020, up from 3.16 per cent at the end of 2019. Including POCI, or purchased or originated credit impaired assets, the NPL ratio was 6.09 per cent. Our coverage ratio stood at 108.8 per cent at the end of quarter one. POCI assets totalled 3.85 billion Dirhams, up from 3.17 billion at the end of 2019. I would like to remind you that these assets were transferred to ADCB in our merger with UNB and Al-Hilal Bank at a fair value that accounted for the expected credit losses.

The purchase price allocation exercise was completed in the first quarter, as planned. I would like to provide a little more detail on our income statement on slide 36. The cost of funds in quarter one stood at 1.98 per cent, an improvement of 63 basis points year on year, due to CASA growth and lower benchmark rates. Meanwhile, net interest margin improved by 44 basis points year on year, to 3.18 per cent in quarter one 20.

Sequentially, net interest margin improved by 44 basis points, and net interest income increased by three per cent. The improvement in net interest margin was due to various contributory factors, such as the reduction in cost of funds by 22 basis points over quarter four 19, while yield on assets remained largely static due to one-offs such as fair value adjustments and interest releases. On the next slide you will see details of non-interest income. Net fee and
commission income decreased 17 per cent year on year, to AED 431 million. Card related income declined due to a one-off gain in quarter one 19, and loan processing fees decreased due to lower volumes.

Trading income decreased due to reduced gains from foreign exchange and securities trading. I would now like to turn to an analysis of our operating expenses, on slide 38. One of the major achievements of the last year was the effective management of our cost base and realisation of merger synergies. We have ensured that our one-off integration costs come in far below budget.

Synergies and other cost management measures have ensured that general administrative costs were four per cent lower in quarter one than a year earlier, and staff costs were 13 per cent lower. As a result, the Group’s cost to income ratio, excluding one-off integration related costs, improved by 327 basis points year on year, to 34 per cent. We believe there is room for further improvement as the bank continues to focus on effectively managing costs.

Please turn to slide 39. In summary, ADCB successfully completed the final milestone of the integration process in the first quarter of 2020, ahead of schedule and below budget. This was, as you would know, earlier planned for quarter two 2020 and we managed to bring it forward by a full 90 days, to do it as at the end of March.

Due to the efficient process, we have revised our synergy run rate target to one billion Dirhams and have reduced our cost to income ratio significantly. The bank delivered a robust pre-provisioning operating performance, while net profit was impacted by impairment allowances related to NMC and Finablr. The bank will pursue all possible avenues and legal routes to recover funds from these companies.

Due to the current uncertainty regarding the duration and the severity of the Covid-19 pandemic, we cannot predict at this stage the financial impact for the rest of the year. We will focus on further managing our cost base and will continue to take a prudent approach to provisioning. The resilience of the ADCB franchise is reflected in the fact that CASA deposits continue to rise in the first quarter, even in a difficult operating environment.

The bank continues to play a full role in supporting the community to alleviate the economic impact of Covid-19. I would now like to open the floor to questions.

Operator: Thank you, Deepak. As a reminder, everyone, that is star followed by one to ask a question today. If you do change your mind and wish to withdraw your question, please press star followed by two. And please ensure that your line is unmuted locally. Our first question today comes from Hootan Yazhari of Bank of America. Hootan, your line is open.

Hootan Yazhari: Hi there, everyone. Thank you for the call. Just in understanding your provisioning for this quarter, you’ve indicated a four per cent decline in GDP. Is that the number that you are currently running through your ECL models? Or were your ECL models stressed before you came up with that forecast? And presumably if the economy weakens further, there is more stress to come there? Some clarity on those points would be appreciated.
Second question I have is regarding liquidity. You saw roughly your LCR dropping from 130 to 115 per cent, can you give some clarity as to what were the driving factors behind that? And where you expect those trends to go, indeed what sorts of steps you’re taking in order to shore up liquidity given the storm that’s ahead. Thank you.

Deepak Khullar: Thank you, Hootan. I’ll let Kevin take the question on liquidity, but let me address your first question on provisioning for this quarter. So the bank has run several macroeconomic variable scenarios by incorporating changes to weights of various scenarios, reduction in oil prices, drop in real estate prices, negative GDP growth. And the results of these scenarios vary widely, depending on the severity of the downturn. And, as such, we have incorporated an overlay, which is included in net impairment charges of 1.8 billion Dirhams that we’ve taken.

So, yes, at the start of the year, obviously we had a very different scenario in terms of growth in the economy, roughly about one, 1.7 per cent. That has obviously now changed and we’re building that. So as we progress during the course of the year, we will obviously be taking a look at these models and if there are any adjustments required, obviously we will adjust those accordingly. I’ll let Kevin take the question on liquidity. Kevin.

Kevin Taylor: Thanks, Deepak, and thanks for the question. Just to highlight the fact that the Central Bank has reduced its requirement for LCR to 70, so against that benchmark, obviously we’re quite substantially over the requirement. We did lower the LCR, or some components of our liquidity and, frankly, that was by planning. As Deepak said, we have continued to run off our short-term or expensive liabilities through the period. We were very happy to acknowledge the fact that we’ve improved our CASA ratio as we now look at the sticky deposits we have on operational balances at the same time.

And we also, in the first quarter, raised above planned wholesale funding as well. So, right now, as we look at our liquidity, we feel pretty comfortable with that. As Ala’a has said also, we’ve drawn against the TESS scheme as well, against all our contingency and stress tests. We think that we’ve got quite adequate liquidity and happy at these levels.

Hootan Yazhari: Understood. But presumably if you wanted to increase your LCR ratio through the balance of the year, that wouldn’t be difficult for you?

Kevin Taylor: No. What’s interesting about the banking system right now is that the system in liquidity actually remains quite comfortable. I think you’ve seen some in the last couple of weeks also declines in EIBOR. I think that’s also supporting the fact that the system liquidity is quite reasonable at this stage. And I think also ADCB, historically, has also benefited from a flight to quality.

And that’s the point that Deepak made, where people recognise the strength of the balance sheet, the ownership, and so on. So that’s always been a plus for us. And the fact that our CASA accounts are increasing at this time underpins that assumption as well.

Hootan Yazhari: Thank you.
Our next question today comes from Alok Nawani of Ghobash Trading and Investment. Alok, your line is open.

Alok Nawani: Good afternoon, gents, and thanks very much for the call. Two questions from my side. The first relates to your integration expenses, on slide 14. So far, between 2018 and the first quarter of 20, you’ve incurred about 535 million in integration costs and that’s 445 million lower than your target of 980. Are we to understand that you will no longer have to spend the balance? And, if so, if you can shed some light on how this was made possible. That’s one.

The second is on NMC and Finablr. We were just wondering if you’ve received any guidance from Central Bank on how to approach provisioning for this case. Thank you.

Deepak Khullar: Thank you, Alok. Let me take the question on integration expenses. So, yes, we are today at 535 million and this is OPEX integration expenses. We also have CAPEX expenditure, which is not yet capitalised but will be capitalised during the course of the year. Which will be roughly in the range of 175 to 200 million, thereabouts. So, in total, you’re looking at about 700 million of total integration spend.

What’s hitting the P&L directly is 535, which is OPEX. And then the 200-odd that we have in CAPEX, that will show through the depreciation line over the next two to three years as we depreciate those assets. But, yes, you are absolutely right, we’re still likely to come well within the budget we have put ourselves of 980 million. And there are a number of things that we did to make this happen, it hasn’t happened out of accident but by planning.

A, we brought the integration forwards significantly. If you remember, when we announced the transaction we said that we would complete this integration in 2021. We have brought that forward to just about 11 months from the announcement date. So making it happen quicker, even on the IT side, there have been a number of different methodologies we’ve adopted to bring the costs down. And it’s just a larger focus on how we do it and how quickly we do it. So I think it’s a good outcome for us that synergies have gone up from 640 million to one billion, from initial to now.

And costs have come down now, from 980 to roughly around the 750-odd mark, or the 800 mark. So there will be some integration-related expenses coming through in quarters two, three, and four, but not to the same level as you’ve seen in the last previous two or three quarters.

On your second question, on NMC, Finablr, whether UAE Central Bank has given any guidance on provisioning, the answer is no. There hasn’t been any specific guidance from the UAE Central Bank. Obviously, they have enquired about how we are staging the account and what provisioning we’re taking. And what we have now taken has already been communicated to the UAE Central Bank. So they are aware of our position on this.

Alok Nawani: That’s great. And just to follow up on that in that case, how are you thinking about further provisions on this account going forward?
Deepak Khullar: I’ll hand over to Ala’a to take that.

Ala’a Eraiqat: As you can imagine, this is a very fluid situation. This current provisioning, we intend to make it significant as the first quarter, or the first financial period that we reflect the provisioning. So we went for a full 25 per cent across both companies and their related outstanding. This is, we feel, sufficient for today, given all the information we have. Our discussions with the administrators, with the lawyers, with the current management, with the banking community, means there has been a lot of input into this and we feel this is sufficient for now.

These inputs could change, could worsen, could improve. I hope it will improve and then we will definitely do the same thing at every quarter and assess then. But, for now, this is fine, adequate.

Alok Nawani: Great. Thank you very much.

Operator: Our next question today comes from Shabbir Malik of EFG Hermes. Shabbir, your line is open.

Shabbir Malik: Thank you very much. My first question is regarding this administration, just a fundamental question. What are the merits of putting NMC under administration for the bank? My second question is that there were certain one-offs which helped your asset yield, I was wondering if you can shed some light on that so that we can understand what the drivers of those one-offs. And I think one of the notes in the financial statement suggests that after completing your PPA exercise you’ve recognised additional goodwill of, I think, about around two billion Dirhams. I was wondering if this has been already reflected in your capital adequacy ratios. Thank you.

Deepak Khullar: Thank you, Shabbir. Let me take your last question first, on the PPA exercise. Yes, as we’ve informed the market, we were doing the PPA exercise based on portfolios and we had a portfolio on the retail book that we were yet to complete the exercise on. Which we’ve completed this quarter, as planned, as we mentioned to the market, and we’ve taken a fair value adjustment of 2.1 billion Dirhams. And that kind of caps the overall fair value exercise and the goodwill exercise. There is nothing more to come. That closes that chapter.

In response to your specific question, whether it was considered in our capital ratios, the answer is yes. Because goodwill is deducted from your overall capital base and CET1, so this has had an impact of roughly 59 basis points on our CAR ratio, which is already in the quarter one CAR ratio. In terms of the one-offs on asset yields, we’ve had some write-backs or interest unwind on some of the fair value on assets we have taken as these assets perform and continue to perform. So we’ve got some of that coming through.

And to your first question, on administration and the benefits of that, I’ll hand over to Ala’a to explain a little bit more in detail on that. Ala’a, over to you.

Ala’a Eraiqat: Thank you. Putting the company in administration was really required. First of all, imagine this, the management of the company disclosed $4 billion of loans that are not on the balance sheet. You can’t put any word to describe this, but you cannot have the same people who caused this significant difference in
balance sheet, or variance, to continue to run it.

Number two, we couldn’t go to liquidation immediately because we believe there is value in the company and its related companies, and we need to preserve that in order for it to be able to pay its debts in a timely manner. Third, also we needed to protect the hospitals. We also, even though we take our loans back, but we have a pandemic like we haven’t seen in our lifetimes and we could not be the bank that goes and closes these hospitals just to get paid.

So we needed the hospitals to continue to be operational and to do what they need to do as healthcare providers. And we needed this also to provide the right cover to conduct thorough, proper, forensic, investigation and also involve the authorities, because whoever did this act needs to be brought to justice. So we needed to protect our interests, protect the operations of the hospitals, at least the key operations. We needed to complete the investigation, coordinate with the judicial and justice all over the world and bring those criminals to justice.

I hope that answers your question.

Deepak Khullar: If I may just add to Ala’a’s comments, I think one key distinction that people have to realise is the appointment of an administrator is to run the company on a going concern basis and to keep its operations running, as Ala’a explained. And it’s very distinct from putting a company in liquidation or in winding down, which is not what we intend to do, or what we are intending to do. We want the business to run.

Shabbir Malik: That’s very helpful. If I may ask this one follow up question on that. Do you think there were ever any red flags that could have been missed? Or to put it another way, have you done anything different now to make sure something like this does not happen again?

Ala’a Eraiqat: Thank you for that question. I don’t think there was a learning only for ADCB here, I think there is a learning for every bank in the world. There is a learning for investors. There is a large number of investors in NMC and Finablr and the London Stock Exchange. Honestly, there was no red flag. Just imagine, number one, there is not one exposure, there are two large exposures across three banks. They came in all together.

We have, of course, went and looked back at the relationship. The relationship of NMC with ADCB goes back before the establishment of ADCB. Before ADCB, in 1985, was a merger of three banks. The account of NMC was with ADCB before 85. Number one. Number two, it is an operation that we see here. It’s not a fly by night operation. Every resident in the UAE must have at one time, at least once, have encountered NMC, walked into NMC, or had something or somebody to do with NMC.

They serviced over nine million people in 2019. They have 200 hospitals and clinics and so on. So every due diligence was done. Add to that all the comfort you would get from a publicly listed company and listed where? London Stock Exchange, FTSE 100, elite. They were the darling of investors. So even if there was a minor question there of analysts but they have always been smooth with the fact they are listed and audited, big four, all of that.

Does this mean we have changed the way we do business? Yes. To be honest, our alerts, our flags, our fraud alerts,
and everything now is in a different world than it was before. And I don’t think this is only or ADCB, I think the whole banking and investment community are learning from this, and there are more to come. Hope that answers your question.

Operator: Our next question today comes from Mohammed Almussa of Hasana Investments. Mohammed, your line is open.

Mohammed Almussa: Hi gentlemen. I had a few questions, the first of them would be as we continue to monitor all the banks, including ADCB, how should we think about the difference between the pre-prudential filter CET1 and the reported one? For ADCB it’s about 20 basis points. Assuming that is deemed a bad loan post-Covid, is that going to be recycled into the P&L?

Deepak Khullar: Sorry, Mohammed, I did not quite understand your question. If you don’t mind either amplifying it or repeating it, please.

Mohammed Almussa: Yes. So you’ve reported a prudential filter CET1 which includes the prudential filter, hence the not adjusted for the TESS programme and the Central Bank’s relief programme which is 20 basis points below the CET1 that is reported.

Deepak Khullar: Okay, let me put it this way, our CET1 reported is 10.82 per cent. The minimum required by the UAE Central Bank for the next 12 months is eight per cent. So we are well above that percentage. The impact that we have seen to our CET1, which was over 13 per cent as at 31st December, was on account of two or three elements which we have explained in our investor presentation. The first one was the four billion mark to market that we’ve taken on the investment portfolio. We’ve already seen a lot of pull-back on that as of now, to date. But that was 130 basis points. We’ve seen a 59-basis points impact on account of the fair value we took on the retail book, and then there was an 80-basis points impact on account of the dividend pay-out. So these are the three key elements that have impacted. And obviously the impairments that we’ve taken overall as well, which is reflected in a lower quarter one net profit that’s already been built into the CET1.

Mohammed Almussa: That’s quite clear. What I’m referring to is a note on page 47 of the financials, which is the CET1 that is adjusted for the prudential filter, which is 10.6.

Deepak Khullar: Sorry, I’ll have to just take a look at that and come back to you.

Mohammed Almussa: Okay. My other questions would be related to the balance sheet growth. Do you expect that to follow a similar trend to 2019? And the second question is the size of the unwinds in the first quarter.

Deepak Khullar: In terms of balance sheet growth, we don’t see significant balance sheet growth coming through in this year. GDP is declining by 4 per cent, roughly, for the balance of the year. Obviously, we don’t
think we will see significant growth, or it will probably be flattish. We will also probably see very little attrition in terms of loans going forward, both on the consumer and wholesale side.

So I would think it will be a pretty flattish balance sheet for the next three quarters. In terms of the unwinds, yes, we will see unwinds coming through as clients perform. So as they perform, and if you remember way back when we took the accounting impairment for Dubai World, which was roughly 1.1 billion Dirham, as the loan came closer to maturity that was written back to the income statement on a quarterly basis.

So we will see unwinds coming through in the income statement but that will depend, again, on the performance of the loans on which we’ve taken fair value.

Operator: Our next question today comes from Aybek Islamov of HSBC. Aybek, your line is open.

Aybek Islamov: Thank you. I just have one question. Can you elaborate on this four and a half billion Dirham loss on securities to fair value? Are they comprehensive income which affected your quarter one? Where is it coming from? What types of securities, geography? And what do you see on your position on that securities position in April, after you reported your Q1 results? Thank you.

Deepak Khullar: Thank you, Aybek. I’ll pass over to Kevin to take that question. Kevin.

Kevin Taylor: Thank you for the question. Most of the number you’re referring to came from GCC-related securities. GCC was particularly impacted, one, because of Covid and, two, because of the volatility that we’ve seen in the oil price more recently. So it’s not a shock, and I know that other banks have seen similar outcomes on their portfolios.

To answer the second part of your question, we have seen some of this bounce back subsequently and if the market continues to recover then we would expect to see more of this bounce back. And obviously it’s a function of time as well, as bonds get closer to maturity and so on. But the second part is yes, we have seen some recovery in that number.

Aybek Islamov: Thank you.

Operator: Our next question today comes from Rahul Bajaj of Citi. Rahul, your line is open.

Rahul Bajaj: Hi, thank you, gentlemen. Just two quick questions from me, again on NMC. Firstly, I just want to confirm, are you able to disclose is NMC in stage two or stage three of your IFRS9 stages? And, secondly, just trying to understand how long such administration exercise takes, trying to understand how long we should be preparing to see provisions coming in or going out related to NMC. Is a year enough to ballpark scope the size of this provision? Thank you..

Deepak Khullar: Ala’a, would you wish to take that?
Ala’a Eraiqat: Yes. It is stage three, so our numbers include NMC as stage three, if that answers your first question. The administration usually is for a 12-month period, of course this is not your usual situation, but this is not open-ended, and I don’t think we will wait for the full 12 months to assess the provisions. As I said, the provisions have been assessed now, as what we know now. Yes, now we are in a period we are still uncovering information and forensics and all of that. But I don’t think we will need the full year to fully understand how much provisions need, what is the value of the company, all the related companies, and so on. That, we should get much sooner than that.

Rahul Bajaj: Thank you.

Ala’a Eraiqat: That answers your question?

Deepak Khullar: If I may just come back to the question that Mohammed Almussa asked, from Hasana Investments, on the prudential filter. This is primarily what the UAE Central Bank has come out to say that any further provisions that you take from 31st December 2019 can be apportioned over a period of five years for the purposes of capital calculations. So on the income statement, you’ll have to take a direct hit, but for capital adequacy purposes, you need to apportion that over five years, or you can apportion that. So that is the major difference, and that happens only in stage one and stage two accounts, not on stage three. I hope that answers the question.

Operator: Our next question today comes from Jag Pasunoori of Franklin Templeton. Jag, your line is open.

Jag Pasunoori: Thanks a lot for taking my questions. One more question on NMC, do you think credit bureau for corporate loans in the UAE would have subsided or prevented this NMC exposure? That’s one question, and then the second one, what is the percentage of loans under principal lending [unclear] moratorium by the end of the first quarter? And have you seen any huge jump in these requests for principal and interest moratoria so far? Thanks.

Deepak Khullar: Thank you, Jag. Probably, Ala’a, do you want to take the first one, on the credit bureau?

Ala’a Eraiqat: There is a risk bureau within the Central Bank that corporate exposures get reported to it. But remember here, they didn’t only borrow from UAE-based banks. They borrowed from 80 plus banks all over the world. So some of the UAE banks have reported their exposure and that somehow corresponded to the numbers in their balance sheet. Remember, this is a fraud, so when you do a fraud you cover all the bases and they would have covered this.

So whether there is a completely separate credit bureau for corporate, or what is there today in the Central Bank, I think a fraudster would have doctored the numbers to make them tally, the same way it tallied here. And they’ve gone all over the world. There are huge numbers of loans that have been taken from the small chunks of amounts
from a number of banks all over. So I don’t think it would have made that big of a difference.

**Jag Pasunoori:** Agreed, I understand what you are trying to say, but the reported balance sheet debt was 2.1 billion, as you are saying as well, but the UAE banks’ exposure was close to three billion. At least this part would have been uncovered, right? That was my question.

**Ala’a Eraiqat:** No.

**Jag Pasunoori:** [Overtalking] someone might [unclear].

**Ala’a Eraiqat:** No. Still not so sure, because there are some loans that are guaranteed by the company to certain individuals. Some, there is a gap between the time you report, and you don’t. So, as I said, there will always be these gaps and they could always cover it and explain it. That’s what I’m saying, the gaps will always be explainable, and they will have the documents to support it, whether it’s a gap of reporting or it is guaranteed.

Because you don’t report the guaranteed portions, you report it as per the borrowing. So, yes, maybe the whole system could benefit from a revamp and improvement, yes. But on such high level, well-articulated fraud, they would have covered it also. They would cover the gap. They won’t let a technicality like this make them get caught.

**Operator:** Our next question today comes from Vikram Vis of NBK Capital. Vikram, your line is open.

**Vikram Vis:** Thank you for the call. I have two questions. My first question is on the capital adequacy calculations. The Central Bank has obviously produced a minimum CET1 ratio, my question is would the CET1 ratio reset back to earlier levels on 1st January 2021? That’s my first question. My second question is I just want to understand the integration expenses a bit better. So the total integration expenses for this year will be 700 million Dirhams, right, including the disposition part of it? Thank you.

**Deepak Khullar:** Thank you, Vikram. Let me take the integration expenses. So the OPEX related integration expenses, which have hit the income statement directly, is about 143 million that has hit the income statement for the first quarter of this year. On an overall basis, since the start of the programme til today, we have hit the income statement with roughly 535 million Dirhams of OPEX expenses. I said in addition to this there are CAPEX expenditures which we will be capitalising.

The depreciation on that will flow through the income statement over the next three to four years. So it won’t be 200 million hitting the income statement this year, but only probably a quarter of that hitting this year in terms of depreciation and the balance going over the next three years, depending on the useful life of those assets whether it’s four or five years.

And in terms of the capital adequacy question, yes, we are at 10.82. If you just add back the mark to market on the investments, which is 130 basis points, that takes you straightaway to 12.12 per cent if we just pull that back. And
anything above a 12 handle on a CET1, where the UAE Central Bank has a minimum of eight, is a pretty good outcome. We are four per cent above that in any case. So I think we’ll be fine. And depending on the profitability over the next three quarters as well.

Vikram Vis: Yes. That’s clear. My question was now that the Central Bank has reduced the CET1 minimum, I was just trying to estimate when will this go back to the ideal levels? Is this a window of 12 months?

Deepak Khullar: Yes. The window is 12 months.

Vikram Vis: 12 months, okay. And just on the integration costs, the total integration cost for this year is going to be 700 million, or how much is the number? What is the expected number for this year?

Deepak Khullar: No, the cumulative integration expenses, from the beginning of the programme in 2019 till the end of 2020, is going to be about 700 million. This year, we’ve only spent 143, there will be probably another 100 or so. I don’t have that number exactly, but they will be much lower than what we’ve incurred in the previous quarters. So it’s a cumulative of 700, first quarter is 140-odd, probably a little bit flowing in quarters two, three, and four.

Operator: Our next question today comes from Pascal Moura of DPAM. Pascal, your line is open.

Pascal Moura: Hello, thanks for taking my question. A question regarding NMC, clearly had debt in the balance sheet was misleading, do you have a view on the operating margin of the company if they were equally misleading? And do you know if NMC is currently having a positive operating cash flow or if it’s bleeding cash?

Deepak Khullar: Sorry, the question was around the operating income of NMC? If that is correct or not?

Pascal Moura: Yes. Clearly the balance sheet statement was misleading, do you know if the operating margin of the company was equally misleading? That’s one question. And the second question is do you know if currently the company is operating with a positive operating cash flow, or if it’s bleeding cash? I’m just trying to assess the value of the investment for you, or if something positive could come out of it.

Deepak Khullar: I think the administrators got into this role, I think on the seventh of last month. So it’s just been a few weeks that they have been in that role and it’s a bit too early to say what their findings are. We’ll have more details in quarter two, as we come along in the next few weeks, both on the EBITDA margins etc., and any other findings that they have. As of now, we don’t have any further information on that. Unless, Ala’a, if you wish to add anything that you may be aware of?

I think, Megan, we can just have one last question and then we end the call please.

Operator: Okay. No problem at all. Our next question today comes from Chiro Ghosh of SICO.
Chiro, your line is open.

**Chiro Ghosh:** Hi, this is Chiro from SICO Bahrain. I have two very quick questions. The first one is I see the fair value adjustment went up from 3.1 million to 4.5, just want to get a sense of this, what is the [unclear] accounting treatment? I just want to get a sense of what exactly is this. That is my first one. The second one is you wrote in the presentation, also in the press releases, that the yield on the assets was supported with a lot of one-offs, so if you can throw some light, how do you expect the bank needs to go to remain for the rest of the year?

**Ala’a Eraiqat:** I’m back on the call, I just didn’t hear the question. I was disconnected. Deepak.

**Deepak Khullar:** So, Ala’a, the last question that’s come in from Chiro Ghosh is fair value went up from 3.1 to 4.5, we’ve explained that earlier, the fair value additions were on account of the retail book. We took an additional 2.1 billion of fair value adjustments. That completes the purchase price accounting exercise for us. And the yield on assets was impacted largely by the lower cost of funds, both from a cost of funds perspective and also the quantity of deposits that we had. So deposit base also came down significantly compared to quarter one.

We did have, I won’t say a one-off, but it’s the interest unwind as I explained earlier, and that is likely to come through every quarter, not to the same level, but I think margins will be impacted going forwards. And probably, going forward, margins will be around the three per cent mark, or slightly below that.

**Chiro Ghosh:** Just a follow up, so the fair value adjustment would more likely remain at this level, 4.5 billion, right?

**Deepak Khullar:** Yes. Fair value exercise is complete, we are not making any further adjustments to that. Thank you.

**Operator:** We have no further questions on the line so I will hand back for any further remarks.

**Deepak Khullar:** Well, thank you very much.

**Operator:** Thank you, everyone, for joining the call today.

**Naresh Bilandani:** Please reach out to the IR for any further questions. Thank, Ala’a, Deepak, Kevin, and everybody else from ADCB for their time, and thanks to all the participants for dialling in. Thank you.

**Denise Caouki:** Thank you Naresh. Thank you, everyone. And please feel free to get in touch with us if you have any further follow up questions. Thank you.

**Ala’a Eraiqat:** Thanks Naresh, thank you folks.

**Naresh Bilandani:** Thank you, guys.