Abu Dhabi Commercial Bank PJSC Q3/9M 2020 Earnings Call Transcript

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ADCB Speakers
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Hi, good day everyone. It’s Naresh Bilandani from JP Morgan. I welcome you all to the third quarter 2020 results call for Abu Dhabi Commercial Bank. As always, we have the full management team with us today. I will pass you on to Denise who will introduce the management and we can kick start the presentation. Denise, all yours.

Thank you Naresh. Ladies and gentlemen, thank you for joining us today to discuss our third quarter financial results, which were announced today. On this call we will be giving an overview of the Bank’s financial performance, merger related synergies and progress on our digital transformation program. Finally, we will finish by taking any questions.

We will be referring to third quarter earnings presentation, which can be found on our website. I would now like to introduce the host of the call. I am joined by Deepak Khullar, Group CFO, Kevin Taylor, Group Treasurer, and Monica Malik, our Chief Economist. I will now hand over to Deepak to begin the presentation.

Thank you, Denise, and good afternoon everybody and welcome to the call. Thank you to everyone for taking the time to join us. I trust you’re all keeping safe and well and presumably you all have a copy of the third quarter results in front of you, and I just request you to turn to slide five for an overview of what we will discuss today.

I’m pleased to report that ADCB produced a solid set of results with net profit increasing 11% quarter on quarter. One of the highlights was a sequential rise in non-interest income, particularly from loan processing and card related fees.

Operating profit before impairment allowances for the nine-month period was at par over the same period in 2019, which was a positive achievement given the challenging operating environment this year.

We saw further evidence in Q3 that the group’s digital transformation program is delivering strong results, with a sustained increase in the use of digital channels at ADCB and Al Hilal Bank. We have moved decisively to reduce our branch network to premerger levels, reflecting the fundamental shift that we have experienced in customer behaviour and preferences.

Our cost to income ratio is significantly improved, with 335 basis points, year-on-year decline for the nine-month period. We also continue to make strong progress on capturing merger synergies and on implementation of the cost efficiency program, introduced earlier this year.

We saw a sequential rise in gross impairment charges on loans and advances. However, net impairment charges were lower, sequentially, in Q3, on account of recoveries and releases.

The Bank continues to take a prudent approach to provisioning and risk management, in full recognition of the macroeconomic conditions, which have been impacted by the COVID-19 pandemic and lower oil prices. While the macroeconomic situation remains challenging, we are focusing all our efforts on building long term sustainable value.
On slide six, I’ll provide an update on our response to COVID-19. The Bank continues to leverage its financial strength and expertise to support key stakeholders in the community, in line with the measures adopted by the government of the UAE and the Central Bank of the UAE, in response to the COVID-19 emergency.

The UAE Central Bank launched its targeted economic support scheme or TESS, in March of this year to support economic resilience. ADCB stepped up to roll out the country’s first banking relief package for customers, including instalment deferment, fee reductions and waivers, temporary interest rate reduction, and rescheduling of working capital facilities.

To date, we have utilised our full allocation under the TESS - AED 8.9 billion, extending support to over 67,000 customers or just over 6% of our customer base. I will provide further details on the customer deferrals later in the presentation.

Turning to slide seven, you will see the significant progress ADCB has made in digital banking. The Bank has grasped the opportunity to accelerate its digital transformation program with 60 releases of new digital products and services in the first nine months, double the pace of last year. Usage of our digital platforms has increased notably. Registered users on ADCB’s digital platforms have increased by 18% over the last year, to approximately 800,000 customers.

Meanwhile, Al Hilal Bank, which last year launched a new digital led retail strategy, saw digital transactions rise 90%, year-on-year, in quarter three. Digital onboarding has been particularly successful with increasing numbers of new-to-bank customers joining through ADCB’s Hayyak app and Al Hilal Bank’s Ahlan app.

Our Wholesale Banking digital platforms have also continued their positive momentum with ProCash transactions now accounting for 93% of all cash management transactions.

To support the microbusiness and the SME community, which was heavily impacted by COVID-19, we launched ADCB Pace Pay. This platform is the first of its kind in the UAE and allows businesses, microbusinesses in particular, to collect card payments through their mobile phones instead of physical POS machines. The app is already serving 125 businesses, and continues to gain popularity.

On slide eight, you will see more details of the increased penetration of ADCB’s digital services, which has been sustained after the easing of stay at home measures in the UAE.

Growth in mobile banking continues to outpace online banking. Unique mobile bank logins in September were up 22% year-to-date, with mobile fund transfers up 56%.

Please turn to slide nine. As momentum behind digital banking grows, the nature of branch and ATM usage continues to evolve. This year we saw cash and ATM transactions decline sharply during lockdown, and they remain well below pre-COVID levels. The Bank has responded decisively to this fundamental shift in customer preferences, by permanently closing certain branches that were out of service during lockdown.

ADCB now operates 54 branches, which is at par with our premerger network, down from 73 branches in Q2, and a peak of 127 when we combined with UNB and Al Hilal Bank in May 2019. There has been no impact on service levels. In fact, customer interactions were 75% higher in September than they were in January. We have also entered the advanced stages of exiting non-core overseas operations, reinforcing our UAE centric strategy.
I would encourage you to take a look at slides ten and 11, where you will find details of digital adoption by Consumer Banking and Wholesale Banking customers. I will now handover to Kevin who will discuss the current operating environment.

**Kevin Taylor**

Thanks Deepak. On slides 13 and 14 you will see key indicators of economic activity for the first nine months of 2020. We are forecasting a 6.5% contraction in GDP for 2020, and a 5.7% decrease in non-oil GDP due to the impact of COVID-19 on key sectors of the UAE economy, particularly aviation, trade, logistics, tourism and hospitality.

Lower oil output and prices have also contributed to the overall economic weakness. We’re currently forecasting real GDP growth at 2.3% in 2021, however, much depends on the timing and mass distribution of a potential COVID-19 vaccine, which remains very uncertain.

Slide 15 provides some detail on the leisure and hospitality sectors, highlighting the importance of a vaccine for a sustained recovery in visitor numbers. Especially from countries that are key to the UAE tourism market such as India, Saudi Arabia and Russia. The UAE hotel sector has been significantly impacted by oversupply, though there were signs of recovery in demand for rooms in August, largely due to staycations.

A vaccine will also be essential for a meaningful recovery in other sectors, such as trade and logistics. In the medium term however, these sectors will be impacted by weak global and regional growth.

Turning to slide 16, the fundamental strength of the UAE, and you can see the fundamental strength of the UAE Banking system. System-wide liquidity remains comfortable on account of decisive actions taken by the UAE Central Bank, including a relaxation of the LCR and reserve requirements.

As a result of the UAE Central Bank’s actions, banks have had access to additional liquidity, supporting their capacity to lend. GREs are driving demand for credit, and this is also reflected in the increased deposits from GREs in the third quarter.

Moving to slide 17 and an overview of the UAE property sector. Abu Dhabi residential prices have held relatively stable this year, with the government introducing transaction incentives, and developers launching new promotions.

Rental rates in the capital have held up well, reflecting a lessening of oversupply in the market. In Dubai, which has seen strong supply over recent years, both sale and rental prices have declined more steeply.

On slide 18, you’ll see some interesting proprietary data that shows a robust rebound in consumption following a steep decline during the lockdown of March and April. ADCB credit and debit card spending showed double digit monthly increases from May through to August, with monthly spending returning to near January levels. Partly due to pent up demand, and preference for card rather than cash, and a shift to online shopping.

I will now hand back to Deepak who will take you through the Bank’s Q3 financial performance, starting on slide 21.

**Deepak Khullar**

Thank you, Kevin. The loan book has been stable. I’m on slide 21. The loan book has been stable despite the challenges of COVID-19 pandemic. Net loans were up 2% sequentially, at the end of the third quarter, and 2% lower year-to-date.
The average loan balance though, for the first nine months was AED 245 billion. The Bank has continued its strategy of exiting expensive time deposits, which declined AED 32 billion in the first nine months, while we continue to increase low cost CASA deposits.

This has resulted in a 7% decrease in total customer deposits this year, to AED 244 billion at the end of September. The average deposit balance in the first nine months stood at AED 255 billion. Total shareholders’ equity was down 1% year-to-date, at AED 55 billion with a dividend payment of AED 2.6 billion, negated by retained earnings of AED 2.8 billion.

On slide 22 you will see details of our income statement for the nine-month period. Our operating profit in the first nine months held steady at AED 5.96 billion, despite the lower interest rate environment and COVID-19. We achieved a substantial 13% decrease in operating expenses, driven by merger synergies and our cost efficiency program.

While the Bank has produced a strong year-to-date operating performance. Net profit was impacted by higher impairment allowances. To date, we have recorded AED 1.38 billion of impairments for NMC, Finablr and associated companies, including 148 million in quarter three. The Bank continues to pursue a positive resolution and is working closely with the administrators of NMC to ensure repayment of debt.

On the following slide, 23, you will find details of our performance for the quarter. Q3 net profit was 11% higher sequentially, at AED 1.37 billion representing a return on average tangible equity of 12%. Operating income increased by 2% quarter-on-quarter to AED 2.99 billion. Greater diversification of our income streams has emerged as an encouraging theme. Non-interest income increased 19% quarter-on-quarter, at AED 706 million, mainly on account of higher fees.

One off costs related to branch closures contributed to an 8% sequential rise in operating expenses. However, the 14% year-on-year improvement is a better reflection of the longer term, positive trend in our cost base.

The Bank reported an 18% sequential increase in gross impairment charges on loans and advances in the third quarter, reflecting current and forecast economic conditions. Net impairment charges were AED 504 million, 25% lower quarter-on-quarter, on account of higher recoveries and releases.

On slide 24, following the successful integration with UNB and Al Hilal Bank, which was completed within just 11 months of the transaction in May 2019. We have made strong progress on merger synergies. The Bank is firmly on target to exceed AED 750 million synergies this year, and reach our full target of AED 1 billion in 2021. Year-to-date, we have achieved AED 642 million of synergies. The 231 million realised in quarter three. We’re capturing efficiencies across the group through economies of scale, reduced staff cost, optimisation of the branch network as well as procurement and technology efficiencies. The Bank recorded AED 62 million, a one-off integration cost in quarter three, bringing the total to AED 619 million incurred to date, excluding capex. This remains significantly below our budget of AED 980 million.

For more detail on our balance sheet metrics, please turn to slide 26. As you can see, our exposure remains well diversified across a broad range of economic sectors, with well-balanced Wholesale and Consumer Banking portfolios. The 2% sequential rise in net loans was largely due to an increased lending to the GRE and energy sectors.

The year-to-date decline in the loan book was due to a large corporate repayment in quarter two, and de-
risking of the retail portfolio, which has resulted in a 5% drop in Consumer Banking loans since December.

In line with UAE-centric strategy, 92% of our loans are domestic and tilted towards Abu Dhabi, which accounts for 57% of the loans, while Dubai accounts for 26%. I will now hand over to Kevin to discuss our deposit and liability mix.

Kevin Taylor

Thanks Deepak. Slide 27 gives details on the composition our deposits. The combination of lower benchmark rates and our strategy to exit expensive time deposits, in favour of CASA deposits continued to reduce our cost of funds in the third quarter.

CASA deposits rose to AED 116 billion in the end of September, accounting for 48% of total customer deposits, compared to 39% at the end of 2019. This growth has been granular, with retail CASA deposits up AED 11.5 billion year-to-date.

On slide 28, slide 28 illustrates the diversity and stability of our liability base with customer deposits comprising 69% of total liabilities. Wholesale funding stood at 66 billion at the end of September, and we maintain a manageable maturity profile that is well distributed over several years.

In the third quarter, we continued to be a net lender in the interbank market, to the tune of AED 4 billion. The Bank’s main issuances in 2020 included a five-year, $300 million transaction, and a 40-year, $390 million callable interest accreting notes.

Turning to slide 29, you will see that our liquidity position remains robust. The Bank’s liquidity coverage ratio at the end of September was at 136.4%, comfortably above the reduced temporary 70% regulatory minimum put in place by the UAE Central Bank to support the economy. Meanwhile, we continue to take a prudent approach to managing our liquid assets, which are of AED 110 billion at the end of the third quarter.

On slide 30, you will see that our investment securities have increased 14% year-to-date with 99% of our portfolio in bonds. The majority of these liquid assets are in high investment grade sovereign and GRE credit, mostly from the UAE and other Gulf issuers.

If you turn to slide 31, you will find an outline of our capital ratios at the end of third quarter. Our CAR and CET1 ratios improved to 16.69% and 13.36% respectively from 16.3% and 12.93% at the end of December. These ratios are comfortably above regulatory minimum set by the UAE Central Bank.

I will now hand over to Deepak to discuss asset quality.

Deepak Khullar

Thank you Kevin, and I’d request people to just turn to slide 32. ADCB is taking a conservative approach to provisioning, given the downturn in the economic environment due to COVID-19 and the sustained decline in oil prices.

We have applied macroeconomic overlays to ensure continued balance sheet resilience. Net impairment charges for the nine-month period were 75% higher than last year, at AED 3 billion, partly due to the charges related to NMC Health, Finablr and associated companies.

Net cost of risk was 1.41% for the first nine months of 2020, however, excluding impairments relating to NMC and Finablr, the cost of risk year-to-date was 89 basis points.

On slide 33, you can see that the NPL ratio was 5.54% as of 30 September 2020. The NPL ratio was 6.96% when
POCI assets or purchase or originated credit impaired assets were included.

Our coverage ratio remains comfortable at 93.9% at the end of September. POCI assets totalled AED 3.75 billion as at 30 September 2020. 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 Q1 as planned.

Please turn to slide 34 for an overview of TESS. The Bank has provided cumulative total deferrals of AED 9.962 billion. We have received repayments of AED 2.24 billion to date, resulting in a reduction of outstanding deferrals to AED 7.7 billion as at 30 September. This represents 12% of the total outstanding loan balance of the customers who benefited from these deferrals, and roughly 21% of the deferrals have been repaid.

Total exposure of customers availing deferrals represented 29% of our gross loans in the UAE, and this is a decline from 34% of the loan book, as at the end of June.

For deferrals, we follow stringent credit approval process and a thorough evaluation of customer needs, past performance and impact of COVID-19 on the businesses and the credit worthiness of the client base.

Please turn to slide 36. Net interest margin for the nine-month period increased by four basis points year-on-year, supported by the improvement in the cost of funds. In Q3 NIMs continued to hold firm at 2.59%. Net interest income in the first nine months of 2020 was 4% lower, year-on-year, at AED 7.42 billion - which was relatively stable, not withstanding the 154 basis points year-on-year drop in Eibor.

The downward pressure on interest income was largely offset by lower interest expense, following the exit of expensive time deposits and an improvement in CASA balances.

Cost of funds in Q3 improved to 1.06%, 41 basis points lower than the previous quarter, and down considerably from 2.46% a year earlier. Interest expense decreased 29% sequentially and 44% year-on-year.

If you can please turn to the next slide, non-interest income contribution to operating income increased to 24% in the third quarter, from 20% in quarter two. Q3 net fees and commission income increased 21% sequentially, as consumption picked up, following the easing of the lockdown measures midyear. This was driven by a 23% increase in card related fees quarter-on-quarter, a 33% increase in loan processing fees, as well as a 13% increase in trade finance commission.

Moving to slide 38, the Bank is singularly focused on reducing its cost base to create a leaner and more nimble organisation. This is being driven through a rigorous plan to capture merger synergies, complemented by digital transformation and further efficiency initiatives introduced this year.

Excluding one-off integration costs, the cost to income ratio for the first nine months of this year stood at 34.3%, an improvement of 335 basis points from last year. During the nine-month period we booked amortisation of intangibles of AED 71 million related to the merger, compared to nil in the same period of 2019.

On slide 39, to summarise, ADCB has continued to produce a solid performance, financial performance, despite the challenging operating environment. Our loan book has held firm. Our income streams are increasingly diversified, due to higher fee and commission income, and our cost to income ratio has improved significantly over the last year.
The Bank is making rapid progress towards reaching our AED 1 billion synergy target in 2021, and we are on track to exceed AED 750 million this year. Operationally, ADCB’s digital transformation program is gathering pace and producing strong results. We have further optimised our branch network, reflecting a permanent shift in customer behaviour.

ADCB’s strong brand has served us well in this difficult year, demonstrating its value in many different aspects, from customer acquisition and the ability to attract low cost deposits to growth in credit and debit cards spending. We remain cautious on the economic outlook and the Bank maintains a prudent approach to provisioning and risk management, to build further financial strength.

By taking timely and decisive action during these challenging times, ADCB remains in a robust position to support our stakeholders and contribute to the UAE’s economic resilience. Thank you very much for your attention, and we are happy now to take any questions from the audience. Over to you, Naresh.

Naresh Bilandani

Thank you, Deepak. Nadia, let’s open the floor for questions please.

Operator

Ladies and gentlemen, if you would like to ask a question, please press star, followed by one, on your telephone keypad. If you are joining us via the web, please click the request to speak flag icon. If you do change your mind, please press star, followed by two. When preparing to ask your question, please ensure your phone is unmuted locally. We have a question from Rahul Bajaj, from Citi, so Rahul, please go ahead.

Rahul Bajaj

Hi, good afternoon. Thanks for the call. Three quick questions from me, if I may. The first one is on the write-back that we have seen in the third quarter. I just wanted to understand, is this one particular big account where you saw the write-back, which sector it was, and any colour you can provide around the write-back. And the exact size of that one big chunky number, that would be useful too, for us to model the gross provision better.

The second question is, on page 29 of your report, you have kindly provided an interesting table around the probability of default for group one and group two accounts, and I see that the probability of default for group two accounts, basically ranges between 15 and 20%. I just want to understand if you are comfortable with this range, 15 to 20% probably of default for group two accounts.

I would have assumed maybe a slightly higher number in terms of group two accounts where there is a prominent loss of credit worthiness. So, probability of default would probably be higher, but 15 to 20%, on the face of it, appears low to me. So, any feedback there would be very helpful.

And finally, a quick one on slide 16, where you show your card print on a monthly basis. We see a negative number in September, so any colour there? Why has consumer spending slowed down in September? Are you seeing any trends, negative trends in September and after that? So, those are my three questions, thank you.

Deepak Khullar

Sure, thank you Rahul. I think let me pick up the last one first, in terms of the consumer spend in September. A, this is a month-on-month impact. Let me just pull up the slide- slide 16 is what you referred to, right? Or was it slide 18 I think, yes. So, ADCB credit and debit card spend. This is a decline of 4% over the previous month.

So, it is not to say that it is totally a negative number, but it’s a decline over the previous month, and driven primarily by... I think in the month of September we saw an increase in the number of cases in COVID-19 in the
country, and as a result, there was a lesser tendency to go out and spend. But again, I think, as you see trends in October, those are starting to pick up. So, it is not a trend that we see continuing.

In terms of probability of default for the group two accounts, yes, these are based on our internal models. These are based on past historical data. These are tested very well, and are updated on a constant basis every quarter. So, the numbers that we presented there, we are comfortable with those. These are not dated numbers, from a year or two ago. So, the numbers that we presented there, we are comfortable with those.

In terms of the write-back, this is primarily coming from our unfunded facilities and the calibration of the credit conversion factor on those facilities, and how we account for that. So, I think we have quite a significant increase or a buffer in the credit conversion factors, which we have now adjusted in this quarter, to bring it more in line with what we expect to see as losses, based on historical loss rate of what we have experienced over the last two or three quarters. So, it is not one large corporate account, but it’s more a calibration of the credit conversion factor of the unfunded facilities.

Rahul Bajaj

All right, thank you.

Operator

Our next question comes from Waleed Mohsin from Goldman Sachs. So, Waleed, please go ahead.

Waleed Mohsin

Yes, thank you very much for the presentation. Two questions from my side please. The first is on cost synergies. As you mentioned, a very strong take up on your digital offering and resulting in more than a 50% reduction in your branch footprint since 2019. I was wondering if you see upside risk to your 1 billion synergy target for 2021? That’s my first question.

And then secondly, on provisions. Given that management now has a better sense of how some of the deferred exposures are behaving, I was wondering what outlook you would provide for both gross and net cost of risk for next year? Thank you.

Deepak Khullar

Thank you, Waleed. So, when you said an upside risk, you meant presumably an upside opportunity there, that we exceed the 1 billion mark? Is that your question?

Waleed Mohsin

That’s correct. I was wondering if you could exceed that, given that the pace of branch reduction has been faster, and the digital offering has been growing quite rapidly.

Deepak Khullar

Yes, so we’re working quite aggressively towards that number, and I think as you see on slide 24, we have said we’d hit 750 million this year. But as you rightly noted, we have fast tracked some of our closures of the branches and expect to end at more around the 850 mark this year. And this will then obviously flow into next year as well.

So, yes, possibly there could be a little upside to that, but we haven’t flagged that as yet, but we’re well on our way to definitely hitting the 1 billion mark.

In terms of deferred exposures, so we’re seeing different reactions there. Like you said, we’ve extended 9.9 billion. We’ve seen 20% of that coming back to be paid, so roughly 2.24 billion has been repaid already, and there are a number of customers... So, some customers have taken this one deferral of instalment, some have taken two, some have taken three, so there are varying behaviours in each of those classes of customers.
So, cost of risk for I think at least the coming quarter, we expect it to be in that 90 basis points to 100 basis points mark, like we had identified earlier. So, the 90-basis points mark is where we would think we would end up, barring anything unusual coming through on large corporates. Because on large corporates, when you have something, it’s not a small amount. It typically is a larger amount than retail.

**Waleed Mohsin**
Got it, thank you very much, Deepak.

**Deepak Khullar**
Thank you.

**Operator**
Our next question comes from Aybek Islamov from HSBC, so Aybek, please go ahead.

**Aybek Islamov**
I wanted to ask you about your net interest margins, so how you feel about your ability to reduce funding cost further, and what do you see the direction because of the asset yields, I would say over the next 12 months? And secondly, I wanted to ask you about the... Again, going back to TESS looks like there’s good progress, repayments have been made.

But this is a hypothetical question, what if TESS program disappears? What will be accounting considerations you will do with regards to loans which are still under deferral? What could be the classification of these loans which are under TESS? They’re not strictly in stage two at the moment, stage three at the moment, right. How would you describe that mechanism?

**Deepak Khullar**
So, let me take the TESS question first and I’ll let Kevin respond to the NIM question.

On TESS, yes, if you were to suddenly withdraw the TESS support, then obviously clients who are impacted by COVID-19, whose businesses are impacted by COVID-19, will definitely feel the pain.

And the whole reason for the government introducing this TESS program was that banks should support the businesses, and this is what we’re actively doing. And therefore, we’ve classified the deferrals into group one and group two. Group one with the much less impact on the credit worthiness. Group two will be more impacted.

But to answer your question, the group two accounts will be more impacted, if we were to withdraw the TESS, but that is not our intention. That is not the government’s intention. The intention is to support. So, again, it becomes a hypothetical, as you rightly said.

And on the NIM question, I’ll hand over to Kevin. Perhaps Kevin, if you want to take that?

**Kevin Taylor**
Sure, I must admit not hearing all the question, but I’ll assume it’s what is the outlook for NIM in the current environment.

**Deepak Khullar**
Yes.

**Kevin Taylor**
Right now in Q3, our net interest margin was 2.59%. It’s interesting to look back and see the nine months in 19. It was 2.77 and now it’s a little bit higher than that, notwithstanding the decline in interest rates which all banks frankly suffer from and have a negative disposition to.

We’ve been able to offset a lot of the decline in interest rates, just in terms of, in particular, our tactical actions, such as growing our CASA balances, which is something which continues to be a key goal for the Bank. As well as moving around, pivoting between different types of fixed deposits, as well as structured funding that we use, such as repos or indeed reverse enquiry fixed income.
And all those provide an opportunity to try and offset the contraction that you see through falling interest rates, and we’re being quite successful in doing that. I think there still some opportunities, as we go through the next couple of quarters, to do that as well. And I think we said in the previous earnings, if we had continued to keep our net interest margin above that 2.5% level, we’re going to be very happy.

Aybek Islamov

Understood, and just one follow up on group one, group two. What percent of these loans are now already sitting in stage two, for example, or stage three, if you can comment?

Deepak Khullar

Sorry, Aybek, you line is not very clear, so I couldn’t catch the question. Could you repeat?

Aybek Islamov

I apologise, yes, I’ll repeat my question quickly. What percent of loans that the TESS support are group one or group two loans? What percent of them is already in stage two or stage three loans?

Deepak Khullar

I think very little in stage three. It’s in our Notes to Financials, but a very small amount, and I’ll just pull that up and respond to that. But moving into stage three is a very small number. Stage two, which is again in our Notes to Financials and I’ll come back to that in a few minutes, once I pull that up from the financial statements.

Aybek Islamov

Thank you, that’s all from me.

Operator

Our next question comes from Edmond Christou from Bloomberg Intel. So, Edmond, please go ahead.

Edmond Christou

Good afternoon. Just follow up on the deferred book. Just trying to understand what will happen by the end of the year, going into January. So, I looked at the disclosure you provided, which is excellent disclosure. There is additions, which I believe it will continue to see addition till the end of the year, since the program has been extended and settled. So, should we think about it that this settled is the runoff for the book going into January, and everyone has to repay by January, or this could be phased over a period?

That’s one thing. The second question I have is on the group two. There is sizeable exposure on a grade seven. Should we take the probably of default, being mentioned earlier on the call, as a percentage of what the probability of a non-performing loan formation on this? Just trying to think the best way to model it, going into January. That’s it, thank you.

Deepak Khullar

Thank you Edmond. So, on the repayments, I think these are the clients who have regularised their deferrals, so they have taken on deferrals several months ago, whenever it was, in April, May, June, and during the course of the second or third quarter, they have regularised their loans. They ask just for one deferral or two, and they’re back into the normal scheme of things and repaying. So, that is what those repayments reflect, and those are runoffs in fact.

In terms of group two, if these move, some of them may move to stage three under our IFRS, and we’ve seen a very tiny amount move into stage three for clients who were offered the deferral in the first quarter of this year. Because they’ve had a much more severe impact on their business, and we feel that the ECL on that or that probability on default on that has moved into a stage three level.

So, yes, we’ll see how this moves forward. Everything depends on how the economy works, how things in the economy bounce back. So, it can start to improve reasonably quickly, obviously, we will feel much lesser
impact on these businesses, should things obviously macroeconomically not work so well, then we’ll see it
different... It’s difficult to predict at this stage, what will move. And until we know how things are going to
move, in terms of tackling the COVID-19 situation, and when the vaccine will come out. When will
international air travel resume? When will the economy start kicking on all cylinders? So, those are some of
the factors, based on which is dependent. So, it’s very difficult to answer that question.

Edmond Christou       Okay, thank you, and deferred payment should be settled by the end of the year,
fully?

Deepak Khullar       Yes, unless the scheme is also expanded. And we’re seeing a pretty good repayment
schedule coming through. 21% have already repaid in the first few months of taking the deferral, and we hope
that this trend continues.

Edmond Christou       Thank you.

Operator       Our next question comes from Hootan Yazhari from Bank of America, so Hootan,
please go ahead.

Hootan Yazhari       Thank you all for the call. Just reverting back to asset quality. We saw your stage three
coverage. Now, I understand that the stage three coverage, you’re comfortable with the levels. It might seem
a little bit low, particularly versus some of the other banks, but you also have a lot of collateral against those.
But what I’m trying to understand is, how often are you revaluing those collaterals, given the repricing of
assets in this market? How comfortable are you with the collateral element that you have against those loans?

My second question is again something looking at the TESS program. If we do see the TESS program extended,
and you continue to see some of your stage one borrowers continuing to defer, putting it simplistically, how
much do they have to defer, or how many times do they have to defer before you start to think of this as a
weakening in their credit quality, and then they have to get reclassified as stage two?

Last question is, any comments or guidance you can give on the dividends, I would be very grateful, thank you.

Deepak Khullar       Thank you Hootan. So, when we offer deferrals, it is not that every application or
every client who requests for a deferral will get that. It has to be based on a very strong case and impact on
the businesses, impact on the individuals, either salary or pay cut etc. So, there is a whole process behind how
these are approved, which I mentioned earlier on.

The group credit department evaluates that, and it’s not a question of just pushing something down the road
and saying, we give another deferral and another deferral and another deferral. Obviously, we have to see
improvement. A, of course we do wish to help the community, but if that is likely that this is not likely to be
repaid, then we’re not going to further extend that as well. So, that’s one piece.

In terms of dividends, the UAE Central Bank has come out with the set from how dividends are to be paid this
year. And that is more or less similar to what it was last year. Certain conditions to be satisfied in terms of
capital, in terms of provisioning, in terms of a few other points, which hopefully will be fulfilled. We would
look at that in quarter four or quarter one of 2021 to comply with that, and then pay the dividend.

Coming back to the questions that were asked on stage three, in terms of stage migration. So, from stage one
to stage three, we had about a 55 million movement there, that’s on Retail Banking. So, it’s about 78 million
on Retail Banking, and 9.8 million on Wholesale Banking in stage three. That’s in notes for financials.

Hootan Yazhari  Sorry Deepak, I was referring more to the totality of your loan book, because I was looking at the stage three growth loan exposure 14.6 billion and the allowances of 5.7 billion. And [overtalking].

Deepak Khullar  Okay, sorry Hootan, I didn’t answer your question. I answered a previous question on stage three, you’re right. So, we’re comfortable with our level of provisioning on stage three accounts. We do have a lot of collateral against these accounts. These collaterals are valued at least annually, and at least at every annual renewal, if the client has renewed, their limits are renewed annually.

At that stage the collateral is valued again. This is done by external valuers. We’re very conservative in terms of providing a haircut on these valuations, and based on that, then we compute our ECL. So, we’re comfortable with the level of provisioning we’ve got on these accounts.

Hootan Yazhari  Thank you very much.

Deepak Khullar  Thank you.

Operator  Our next question comes from Alok Nawani from Ghobash Trading and Investments. So, Alok, please go ahead.

Alok Nawani  Good evening everyone, and thanks very much for the call. Just two questions from my side.

The first one is on your group two exposure. I see that you have about an 11% provisioning coverage ratio on this. I was just wondering how can we draw comfort in that level of provisioning that you have on group two. And perhaps if you could just give us some sort of colour on what kind of collateral that you also might have against the group two exposures that you have.

And secondly, I was actually just wondering, you have a note in your presentation, which explains how you take some adjustments to arrive at your NPL coverage. If you could just explain what it is that you’re doing there, it’d be very useful, thank you.

Deepak Khullar  Sorry, Alok, can you repeat the second question, on the notes that you referred to?

Alok Nawani  Sure, could you please explain what adjustments you take to arrive at your NPL coverage ratio which you have mentioned on slide 33 of your presentation.

Deepak Khullar  Okay, fine, we can go through that. So, group two, which was your first question, yes, group two is different from stage two under IFRS 9. And this is a classification that the UAE Central Bank has required us to classify these accounts. So you can have a group two in a stage one account under IFRS 9. You can have a group two in stage two account. So, if we look at the total group two accounts that we have, roughly 1.4 billion in stage one for Wholesale Banking. Exposure of 4.5 against which we hold an impairment allowance of roughly half a billion.

And similarly, for Retail Banking, group two exposures. We’ve got 252 million payment deferrals, exposure of 874 million. We’ve got an impairment allowance of roughly 139 million against those. So, these, on the retail side, this is more a formulaic approach in terms of the flow through, 30, 60, 90 days exposure, which we
follow even for our regular book.

We’re comfortable with those levels of provision on the retail book, and even on the Wholesale book. It depends also on what kind of collateral you hold on those books. So, our Wholesale book is fairly well collateralised, overall, as I responded in the previous question by Hootan. So, very collateralised on the Wholesale book, especially in terms of commercial real estate lending.

Coming back to the coverage ratio. One second, let me just pull this up please, this slide. Just bear with me one second. Yes, it’s on slide 33. So, what we consider for our coverage ratio is the NPLs divided by the individual impairments, collective impairments and the fair value adjustment that we have on stage one and stage two accounts that we took over at the time of UNB and Al Hilal Bank.

So that’s, if you see on slide 33, you’ve got three elements there, 5.6 billion, 3.8 billion and 4.1 billion. That’s the total. So, that’s your resources of coverage for the 14.6 billion of NPL. We don’t take into account the POCI assets, yes.

Alok Nawani: Okay, thanks.

Operator: Our next question comes from Harshjit Oza from SHUAA Securities. So, Harshjit, please go ahead.

Harshjit Oza: Hello everyone, thanks for the presentation. I have two questions. First question, if you can provide some colour on, again, a follow up on grade exposure and asset qualities, especially on the real estate sector. I think it’s around 30% of the gross loan. So, can you share, in terms of your net loans, how much it will be. And in terms of your real estate exposure, if that includes any construction or contractor related exposure, which has a high risk. That was my first question.

The second question on Egypt. Very recently UNB was rebranded in to ADCB, so where do you see your Egypt franchise within the ADCB group. It is a strategy entity, very likely to invest for growth, or your focus remains on the UAE markets only? Thank you, these are my questions.

Deepak Khullar: Okay, I’ll probably answer the asset quality and real estate exposure, and then perhaps Kevin can pick up the Egypt piece, and I can then add onto that as well.

So, in terms of real estate exposures, yes, we do have roughly... 29%, and this includes real estate investment, this includes contracting etc., so all of that is in there. And most of this exposure is to completed properties, which are income generating.

So yes, there has been an impact on the real estate sector, both in terms of even income generation, high vacancies, lower rentals, which will have some impact on that. But this remains a very heavily collateralised book, roughly 70 odd percent loan to value ratio on the commercial real estate lending. So, that’s performing reasonably well.

In terms of under construction, very little is under construction. Whatever we have is also fairly significantly completed in terms of under construction properties. So, in terms of asset quality, as I mentioned in the previous discussions, we expect cost of risk to be around the 90 basis points mark for the next couple of quarters, unless something significant moves, but that’s our expectation as of today.
Egypt, Kevin would you want to add something on Egypt?

Kevin Taylor

Sure, and it’s still a bit philosophical if you like. We’re closing branches in Qatar, Kuwait and China now. The reason that we’ve chosen to be UAE centric, it’s a function of the experience of the management team in the Bank.

If you go to a location, how many years does it take you to build to a critical mass? How do you source your workforce? You end up with a mercenary work force. Do you fully understand the markets? And then all the regulatory issues that come with, while you’re doing the bills and the regulatory obligations that keep going up year on year.

Now, Egypt on the other hand, you have… When we merged with QNB, we end up with a business there that has 50 odd branches, a decent distribution, but actually just lacking in investment in terms of the brand which, as you’ve said, we’ve now changed, the infrastructure, the people.

And so, we look at that and say, well hang on, this is slightly different outcome, and we have a to value. We believe we can add to this. As well as that, on top of that there are obviously links between the UAE and Egypt as well, which we believe we can help exploit. So, we look at this as a growth opportunity. That’s how we view this.

Harshjit Oza

Thanks. Just follow up on the asset quality, especially on the construction sector. As you know, there are a lot of issues going on with the construction companies. So, my question was, hopefully we’ll not see any further surprises on your books. I’m not asking specifically for any names, like Arabtec or anyone, but we have seen a lot of issues in the sector and degradation has been happening. So, are you comfortable with your book right now?

Deepak Khullar

Well, we evaluate this on not just a quarterly basis, but we do very detailed stress testing of the portfolio. And because of COVID-19 as well, we had a very thorough review of the book over the last several months, wherever we thought we need to increase the ECL coverage. We’ve done that. We’ve added macroeconomic overlays. So, this is a continuing piece of work, and all we can say is that wherever there is further provisioning required, the Bank is not going to be shy to take that provisioning and move on. So, we are conservative when it comes to provisioning.

Harshjit Oza

Thank you. Thanks Deepak. Thanks Kevin.

Operator

That was the final question of the call. I will now hand over to Naresh.

Naresh Bilandani

Thank you. Thanks a lot. I appreciate everybody joining us on this call today. Thanks a lot to the ADCB management team today, and thanks again to all the participants for joining in. I hope you all have a good day ahead. Thank you.

Deepak Khullar

Thank you all.

Kevin Taylor

Thank you Naresh. Thank you everyone.

Denise Caouki

Thank you.