

# Q2/H1 2021 EARNINGS CALL TRANSCRIPT

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# ABU DHABI COMMERCIAL BANK Q2/H1 2021 EARNINGS CALL TRANSCRIPT

**Operator:** Good day, and welcome to Abu Dhabi Commercial Bank's Quarter Two 2021 Results Conference Call hosted by Goldman Sachs. The call is intended for analysts and investors only and not intended to media. If anyone from media has dialled in, please hang up now. Today's call is being recorded. At this time, I would like to hand over the call to Denise Caouki, Head of Investor Relations, Abu Dhabi Commercial Bank. Thank you.

**Denise Caouki:** Thank you, operator. Ladies and gentlemen, thank you for joining ADCB's second quarter results conference call. Our results were announced earlier today and we'll be referring to our earnings presentation, which is available on our website. Today, we'll be giving you an overview of the bank's financial performance before opening the floor for Q&A. I would now like to introduce the hosts for the call. I'm joined by Deepak Khullar, Group CFO; Kevin Taylor, Group Treasurer; and Monica Malik, our Chief Economist. I'll now hand over to Deepak to begin the presentation.

**Deepak Khullar:** Thank you, Denise. I'd like to welcome you to this call on a good set of financial results for ADCB. Starting on slide five, I will start by providing you with an overview of our performance in the second quarter.

The Bank launched its five-year strategy earlier this year, and we have been fully focused on accelerating digital transformation and enhancing efficiencies across the Group beyond the merger synergies. These themes are coming through in our financial results in the context of a gradual improvement in the operating environment.

ADCB reported a Q2 net profit of AED 1.4 billion, a 25% increase quarter-on-quarter and a rise of 14% year-on-year. This represented a return on average tangible equity of 13.1%. We experienced a sequential pickup in net interest income and a strong rise in fee income. Net loans also picked up sequentially, while we also continued to attract CASA deposits. Our cost to income ratio continued to improve. Merger synergies are on track to exceed the AED 1 billion target for 2021. And further efficiencies are being delivered through digital transformation and disciplined cost management.

Our five-year strategy is progressing well, and our key subsidiaries Al Hilal Bank and ADCB Egypt are also pressing ahead with the implementation of their strategies to deliver sustainable growth.

Please turn to slide six for details of the Q2 income statement. Net interest income came in at AED 2.3 billion, which was 1% lower year-on-year and increased 9% sequentially, mainly due to a continued decline in interest expense to AED 522 million. Meanwhile, non-interest income of AED 840 million increased 5% quarter-on-quarter and jumped 41% from a year earlier.

Significantly, net fee and commission income increased 61% year on year, mainly driven by higher card and loan processing fees.

Operating expenses declined 1% sequentially as we continued our approach to disciplined cost management, but were 3% higher year on year on account of lower variable pay accruals in quarter two of last year. Impairment charges declined 4% sequentially to AED 678 million.

Please turn to slide seven for income statement highlights for the first half of the year. Net profit for the period rose 76% year-on-year to AED 2.5 billion, driven by a 28% rise in non-interest income, a significant decline in operating expenses and an improvement in cost of risk. As you're aware, impairment charges in the first half of last year included provisions taken on NMC, Finabl and associated companies.

Net interest income decreased 14% in the first half to AED 4.4 billion amid a challenging operating environment due to the global pandemic and declining benchmark interest rates. In this context, the Bank has taken a proactive approach to managing its cost of funds and operating costs. Interest expense dropped 59% year on year to AED 1.1 billion in H1, while operating expenses decreased 10% to AED 2.1 billion as the Bank continued to reap the benefits of the merger and additional efficiencies.

On slide eight, you'll find information on our balance sheet as of 30 June. Net loans and advances grew 1% quarter-on-quarter to AED 238 billion and were 0.5% lower year-to-date, mainly due to significant corporate repayments. Our steady loan book compares favourably to the UAE banking industry trend with system-wide net credit contracting 2% in the first five months of 2021 from January to May-end. And those are the latest figures we have from the UAE Central Bank.

Total customer deposits grew 5% sequentially to AED 251 billion as at the end of June and were 0.3% lower year-to-date, in line with system-wide contraction of 0.5%. Total shareholders' equity of AED 57 was 2% higher sequentially on account of retained earnings.

On the next slide, you will see more information on the Bank's asset mix. Total assets stood at AED 416 billion at the end of June, up from AED 411 billion in December, with investment securities rising 6% year-to-date. The Bank's loan portfolio, which represents 57% of total assets, remains well diversified with concentrations of risk actively managed.

Lending to government and public sector entities increased by AED 2.4 billion during the second quarter to account for 23% of gross loans compared to 21% at the end of 2020. During the quarter, the Bank successfully completed the acquisition of the mortgage portfolio of Abu Dhabi Finance and seamlessly transferred customers to ADCB. This resulted in an increase of just over AED 1 billion in our mortgage loan book.

Overall exposure to real estate has decreased by AED 8.2 billion in the first half to account for 26% of gross loans, down from 27% at the end of March and 29% in December. Our real estate portfolio comprises mostly completed properties and the loan to value ratio was 80% at the end of June compared to 78% in March.

The Bank is committed to supporting the SME community, particularly through the pandemic. And our outstanding loans to the sector stood at AED 4 billion at the end of June. I'll now hand over to Kevin to provide further details on our liability base, liquidity and capital. Over to you, Kevin.

**Kevin Taylor:** Thanks, Deepak. Please turn to slide 10. ADCB benefits from a healthy funding mix with customer deposits accounting for 70% of total liabilities. Leveraging ADCB's strong franchise and high levels of customer loyalty, we have sustained our strategy to attract both retail and corporate CASA deposits, which have contributed notably to the improvement in our cost of funds. CASA deposits rose by AED 14.4 billion year-to-date and by AED 4 billion during Q2 to reach AED 142 billion, accounting for 57% of customer deposits.

Consumer Banking delivered 8% growth in CASA deposits while Wholesale Banking recorded a 12% growth. This is supported by proactive customer service and the launch of new digitally powered products and services for corporates. Time deposits decreased by AED 15.2 billion during the first half to AED 108.7 billion at the end of June.

Wholesale borrowings, including Euro commercial paper, remains well diversified over a range of currencies and maturities, and accounted for 20% of liabilities. The bank maintains a comfortable liquidity position with LCR of 127.6% and the loans to deposit ratio of 94.9%.

If you turn to slide 11, you will see that the Bank's capital ratios remain robust and comfortably above regulatory requirements. The capital adequacy ratio declined to 16.32% at the end of June from 17.22% in December. This was due to dividend payments in Q1 and a change in the UAE's Central Bank regulations that led to an increase in risk-weighted assets. Our CET1 ratio remains strong at 13.2% in line with our medium-term guidance of above 12%. I would also like to remind you that our dividend guidance is for a payout ratio of 50% of net profit. I'll now hand back to Deepak.

**Deepak Khullar:** Thank you, Kevin. Please turn to slide 12, where you will see that the Bank's asset quality metrics have improved. Our cost of risk in the first half was 82 basis points, showing a marked improvement from 1.65% a year earlier. Impairment charges of AED 1.4 billion were 46% lower year-on-year, largely due to provisions for NMC, Finabl and related companies taken in quarter one of 2020.

The NPL ratio improved to 5.86% from 6.53% at March end, including purchased or originated credit impaired assets of POCl, the NPL ratio was 7.35%. Provision coverage ratio increased to 91.5% from 87.8% the previous quarter and was 145% including collateral held.

If you turn to slide 13 for an update on NMC. I'm pleased to report that the Bank continues to make significant progress towards resolution of the NMC health exposure, with the company reaching a key phase in its restructuring process.

NMC is in the final stages of obtaining creditor agreement for a plan of reorganisation, which would be implemented during the second half of 2021.

Under the plan, creditors will take effective ownership of the company through the allocation of exit instruments, which will be fully transferable. This approach allows creditors to benefit from value creation at the company as the joint administrators continue to implement a three-year business plan, which has met its financial targets to-date.

ADCB is well-positioned to receive a significant share of these exit instruments. This is partly, as a result, of the Bank's participation in a \$325 million administration funding facility for NMC, which conferred a super senior status to an equivalent amount contributed. To-date, the bank has recorded significant provisions and interest in suspense of AED 1.075 billion on NMC Health, as well as other impairment charges for Finabl and other associated companies.

ADCB is comfortable with these provisioning levels, which are in line with independent assessments on value and recoverability expected through the restructuring process.

Moving now to slide 14 for an update on customer deferrals. As a result of the Bank's successful proactive engagement with customers, ADCB has recorded a reduction of AED 8.9 billion in TESS and other deferrals,

decreasing outstanding deferrals to AED 5.3 billion as at the end of June. ADCB continues to hold significant collateral of AED 52 billion against the exposure of AED 38.9 billion to customers benefiting from deferrals.

More than two thirds or AED 3.65 billion of outstanding deferrals are classified as Group 1. These customers have been only temporarily and mildly impacted by liquidity constraints without substantial impact to their creditworthiness.

Turning to slide 15. We're pleased to report that there was an uptick in gross interest income in Q2, which increased 4% quarter-on-quarter while there was a continued reduction in interest expense. We saw net interest margin increase 18 basis points sequentially to 2.6% in quarter two, supported by the higher volumes and improved cost of funds, as well as interest in suspense reversals and fair value unwinds.

Risk adjusted NIM, which takes into account cost of risk, increased 19 basis points sequentially to 1.82%. Interest expense decreased 56% year-on-year and 14% sequentially to AED 522 million in quarter two. Cost of funds continued to improve and stood at 66 basis points in quarter two. This represented a decline of 12 basis points from quarter one and 81 basis points from a year earlier, as the Bank's strategy to increase CASA deposits continued to bear fruit.

Please turn to the next slide, which gives a breakdown of non-interest income. The Bank's income streams continue to diversify, the non-interest income accounting for 27% of total operating income in Q2 versus 20% a year earlier.

Net fee and commission income was a key driver of this growth, increasing 13% quarter-on-quarter and 61% year-on-year to AED 501 million in Q2.

Card-related and loan processing fees more than doubled from a year earlier, reflecting an improvement in economic activity and consumer confidence, as well as the Bank's commitment to service excellence, which is increasingly digitally led. Notably, credit card and debit card spend in Q2 increased 45% and 95%, respectively, year-on-year. Trading income also advanced 13% quarter-on-quarter and 12% year-on-year to AED 174 million.

Moving to slide 17. A key achievement for the Bank is the significantly improve in our cost to income ratio, which is approaching our medium-term guidance range of 29% to 32%. Q2 cost to income ratio stood at 33.4%, an improvement of 150 basis points year-on-year and 290 basis points sequentially.

For the first half, cost to income ratio of 34.8% has been achieved despite an environment of subdued growth and declining benchmark interest rates, which resulted in a 30% decline in gross interest income. The 180 basis points year-on-year improvement in the cost to income ratio was driven by a 10% reduction in operating expenses and a 59% decrease in interest expense.

We continue to implement a wide range cost management programme as part of our five-year strategy. This involves enhanced procurement discipline, process optimisation and the reduction or elimination of discretionary spending. In parallel, with the acceleration of the Bank's digital transformation, the branch network has been reduced to pre-merger levels of 54 locations from a peak of 127 at the time of merger with UNB.

Slide 18 shows that the bank remains on track to exceed our AED 1 billion cost synergy target this year, having captured synergies of AED 661 million in the first half. Following the successful completion of

integration in April 2020, we're no longer incurring integration costs. The final total integration costs of AED 545 million, excluding CapEx, came in significantly below the original projection of AED 980 million.

I will now hand over to Kevin to provide information on our subsidiaries and progress in digital transformation.

**Kevin Taylor:** Thanks, Deepak. Please turn to page 20 for an update on ADCB Egypt and Al Hilal Bank. ADCB Egypt is making strong progress in its strategy to increase market share, particularly in the affluent segment and among corporates. The Bank reported a Q2 net profit of EGP 188 million, a 218% year-on-year increase, and representing a return on equity of 13%.

Half year net profit increased 83% to EGP 358 million. Net loans and deposits both increased 20% during the first half of the year. Al Hilal Bank is also making good progress in its strategy to deliver a leading Islamic digital banking offering for retail customers with active digital users increasing 56% in the last year.

The Bank is preparing for a fourth quarter launch of a new digital financial services platform, which has been well received by customers in its testing phase. The scalable platform will enable Al Hilal Bank to respond rapidly to evolving customer needs, with the potential to extend services to key regional markets post the successful launch in the UAE.

Moving to slide 21. I will now discuss the progress in the digital transformation programme at ADCB, which lies at the heart of our five-year strategy and is central to our vision for superior customer service experience. During the second quarter, ADCB launched eight digital releases, bringing the total to 79 since the inception of the programme. The successful implementation of our digital strategy has pushed the number of customers subscribed to our internet and mobile banking platforms through the 900,000 milestone.

Our onboarding app has brought in 76% of all new-to-bank customers in Q2 and self-service customer transactions ran at 94% of total transactions. Among recent developments, we have launched credit card loans through ADCB Mobile Banking app, and we are seeing a steady increase in loans dispersed through this channel.

Wholesale Banking has enabled bill payments and remittances on ProCash digital platforms. Usage of ProCash remains at very high levels of 96% of total transactions, while ProTrade digital transactions have increased to 78% of total transactions. I will now hand back to Deepak.

**Deepak Khullar:** Thank you, Kevin. I will now finish our presentation by discussing the operating environment and medium-term guidance on key financial metrics.

Please turn to slide 23. Strengthening oil prices and a strong vaccination record are continuing to support the UAE's economic recovery, with over 75% of residents having received at least one dose, the UAE has one of the highest vaccination rates globally. We expect UAE business sentiment and consumer confidence to gradually improve in the second half and a significant increase in ADCB credit and debit card spending so far this year provides a positive indicator.

Dubai's hosting of EXPO will support the recovery in external-facing services that have been particularly impacted by the travel restrictions imposed by the global pandemic. However, it is clear that certain sectors are still facing significant challenges, and industries such as aviation will take a number of years to fully recover.

Turning to slide 24. I would like to remind you of our guidance of key financial metrics for the medium term up to 2023. We are aiming to deliver mid-single-digit annual loan growth as we roll out a five-year strategy amid an improving operating environment. Meanwhile, a continued focus on efficiencies will contribute to an improvement in the cost to income ratio to the range of 29% to 32%.

Our guidance for cost of risk is for approximately 80 basis points, barring any exceptional changes in the operating environment.

The Bank continues to maintain a robust capital position and expects a CET1 ratio to remain above 12%. Finally, ADCB's financial strength will allow us to continue our practice of providing a dividend payout ratio of 50% of net profit.

Please turn to slide 25 to wrap up. ADCB has delivered a strong financial performance in the second quarter. Highlights have been an uptick in lending; the strong increase in fee income; continued improvement in the cost to income ratio and sustained growth in CASA deposits. We are firmly on track to exceed the AED 1 billion target for cost synergies this year, and we continue to implement an additional cost management programme. This, in combination with our digital transformation, will result in further efficiencies across the Group.

The Bank's cost of risk improved significantly in the first half, and we are confident of a positive resolution on NMC in the coming months as the company moves forward with its restructuring plan. This set of results reflect the solid progress we have made in implementing our five-year strategy, which aims to deliver growth in a sustainable manner.

Thank you. And this concludes our presentation. Operator, you may now open the floor to questions.

**Operator:** Sure. Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow a signal to reach our equipment. Once again, please press star to ask a question. We will take our first question from the line of Rahul Bajaj from Citi. The line is open now. Please go ahead.

**Rahul Bajaj:** Hi. This is the Rahul Bajaj from Citi. Thanks for taking my question. A very good set of results indeed. I have three quick questions, if I may, please. The first one is around mortgages. Deepak, you mentioned that you've acquired AED 1 billion kind of size portfolio (mortgage portfolio). If you could share with us to the extent what is the economics of this portfolio as in what's the kind of transaction that has happened? What has ADCB paid in return? And just on the mortgage point, beyond this portfolio, what kind of growth are you seeing in the mortgage side of the books? Because anecdotally, obviously, several banks have been talking about pretty solid mortgage trends on the ground. So anything you could share there that would be helpful? That's my first question. The second question is on the fee income growth. As I understand, it has been driven primarily by card fees and loan origination fee. Just wanted to understand what are you – I mean, is this a sustainable level where you are now in the second quarter? Should we, from a modelling perspective, think about this as back to normal and model from these levels? Or you think there was a level of maybe a one-off or non-occurrence in the second quarter fee income line? So that's my second question. And maybe a quick one on Al Hilal Bank. I was surprised to see on the slide on Al Hilal bank. You mentioned about regional expansion. So any colour you would share there, what markets are you looking at and, what kind of strategy you're thinking about in terms of Al Hilal Bank's regional expansion that would be very useful. Thank you.

**Deepak Khullar:** Thank you, Rahul. Let me take your questions in order, mortgages. In terms of the acquisition of the Abu Dhabi Finance portfolio, roughly AED 1 billion. We have not disclosed the purchase consideration, but it's primarily a residential mortgage portfolio. There's a little bit of commercial mortgages as well, but primarily residential mortgage portfolio, which is well performing and at a good yield as well. And we have not paid any premium for it. So that's one thing hopefully that should give you some idea.

In terms of growth on the other mortgage portfolio, yes, we are active in this marketplace and we are seeing some growth coming through, but we will work both organic and inorganic routes to see how we can grow that book. And the acquisition of ADF portfolio is just one example of that.

Fee income growth. Yes, it's been driven a lot by the credit card and debit card spend, so we've seen card fees due to interchange fees, FX processing and cash advance fees on the back of increased spends of about 45% for credit cards. Again, similarly, debit card fees higher due to increase in interchange fees, FX fees and again on account of higher spend of 95% compared to the same period last year.

I would also caution that the same period last year was a much more subdued environment and quarter two of 2020 when things – COVID had just broken out and there was a complete lockdown, etc., so we see some of that uptick as a result of that as well. We expect the market sentiment to continue to improve in the second half of this year. And hopefully, we see those kind of levels to continue.

In terms of loan origination fees, while you see that the overall loan book has remained flat, there has been a significant amount of new credit extended. We've also seen repayments come through. So when you see the net balance at the end of the quarter, it seems that there's very little growth. But in terms of new credit extended, that has been significant. And that's why you see the loan origination fees going up as well. And some even in terms of attrition where we've seen in terms of refinancing, we still have a loan kind of fee that we charge there as well. So some of that comes because of that.

AHB regional expansion. Yes, those are in our plans. We haven't yet announced anything to the market in terms of where. We first want to launch the product in the UAE, settle it a bit and then look at regional markets in terms of where we can take this product and offering to. So that would be more a 2022 event. I hope I've answered your question, Rahul.

**Rahul Bajaj:** Got it.

**Deepak Khullar:** Thank you.

**Rahul Bajaj:** Yeah. Thanks Deepak. Just one quick follow-up, if I may, please. On the card sort of fee, you mentioned interchange – and please correct me if I'm wrong. To my understanding, the UAE Central Bank last year lowered the interchange on debit card fees that banks get – I mean, can charge too much. And so, I mean, intuitively speaking, I was expecting interchange to compress as we move into 2021 versus 2020. Has that not been the case you're seeing or maybe my interpretation of the UAE Central Bank regulation is different to what is happening, actually?

**Deepak Khullar:** Rahul, I'll have to get back to you on that. Yes, you're right. There has been a proposal whether that's been implemented or not, are still in discussion. It's something I'll need to just check back and come back to you on that.

**Rahul Bajaj:** No problem. Thank you.

**Operator:** Thank you. We will take our next question from the line of Chiro Ghosh from SICO. The line is open now. Please go ahead.

**Chiro Ghosh:** Hi. This is Chiro Ghosh, and thanks for hosting the call and congratulations for a great set of results. So my two questions are, the first one is, of course, related to NMC Health. So things look fine. In the previous calls, you were saying in a favourable circumstances you might actually see some recoveries. The provisioning is more than enough. If you can throw some light on this at the current situation. That's my question one. Question two is more of a conceptual question. So let's assume a company – you are guaranteeing a loan for a company in UAE, which is a, say Turkish based or a European company. Now if UAE based company accused of a default, would you have to pay it? Or you usually have standing with a bank of the – the companies – local bank branch?

**Deepak Khullar:** Okay. I think it's the second question, I understand it correctly, you're saying if the bank is giving a guarantee outside of the UAE, do you give it directly or you'll give it through another bank in the country where the operator is operating? It depends on the local conditions and varies on a case by case basis.

**Chiro Ghosh:** No, my question was, say, let's assume company X who is based out of the UAE is come to UAE and doing some projects in UAE. And of course it needs a guarantee which, let's say, ADCB giving. Now if there is a case of a default and an allegation of a default by another UAE-based company who finally gave the project to this company. So is the liability for the compensation is on ADCB or would it usually have a back-to-back structure with another bank from the home country of this company? So that's my question.

**Deepak Khullar:** It depends. Again, there's no one single answer to that. So you could have a back-to-back arrangement with another bank, or if it's your client, you give the guarantee based on your evaluation of the project and the client financials and various other metrics. And you may not have a back-to-back arrangement as well. So each case is individual and it's different.

So on NMC Health, yeah, you can see that the reorganisation or the plan of reorganisation is moving well. We expect that to conclude in quarter three. And this is basically a three-year plan to reorganise the business, get the EBITDA up and then prime the business for sale at the end of three years and hopefully then derive a much better value of these assets than what you can extract today.

And therefore, people who have participated in this through these exit instruments, they stand a better chance of recovering a higher value than they would recover today. Our evaluations – we continually evaluate our provisions every quarter and we feel that these are adequate, these are prudent. And we do not expect any material deviation to the numbers that we have today, which is roughly about AED 1 billion on the NMC Health provision.

**Chiro Ghosh:** Thank you. That's it from my side.

**Operator:** Thank you. We will take the next question from line of Shabbir Malik from EFG Hermes. The line is open now. Please go ahead.

**Shabbir Malik:** Hi. Thank you very much. Just a few questions from my side. I think you've discussed this in your previous calls, but recently a news came up about Saad-Al Gosaibi again. If you can remind us about your exposure there and how much provisions you've taken? And is there any update which you think would suggest that there could be a provision release on this account? Second question is, I think during the call you mentioned some changes in regulation which had an impact on your RWA calculations. I was wondering if you can quantify that in terms of CET1 impact. Also, I noticed quite a strong deposit mobilisation this quarter with decent term deposit growth. Just wanted to understand what motivated you to go for this growth. Is it because of expectations of pickup and loan growth in the coming quarters or it was just basically clients placing money with you and basically temporary deposits being placed with you? And if you may, maybe one final question. I think in terms of the consolidation of the mortgage book, would it be possible for you to kind of give us a revenue impact of this consolidation in the first quarter like what's – how much was – how much of that contributed to the NII line or the fee income line, etc., that would be very useful as well. Thank you.

**Deepak Khullar:** Okay. Let me go first to Saad-Al Gosaibi, this exposure we had several years ago and is virtually written off for us. There's nothing significant that we have today. If anything, obviously we still pursue plans to recover the amount. So if anything comes back, it'll be positive to the income statement. And so that I don't have further details on the news item you're referring to, Shabbir. But the item has been fully written off as far as we're concerned.

In terms of the regulations on risk-weighted assets, yes, this is obviously the Central Bank has changed some of the risk weightings on especially investment securities held in GCC bonds, etc., and that have had roughly an impact of mainly 35 to 50 basis points for us. And deposit mobilisation, yes, it's always something we consider in line with our expectations of loan growth. So we'd always like to see deposit growth proceeding loan growth. We do have a healthy pipeline of loans. And therefore, we looked at mobilising deposits in anticipation for Q3 and Q4 growth.

And the mortgage book of ADF. There was no impact of that in Q1. It came through only in April – actually May of 2021. So it's had a minimal impact. But hopefully next quarter we'll get the full analysis of the income statement impact of that.

**Shabbir Malik:** Thank you very much. If I may, one last question from my side. In terms of the Opex, I noticed that on a year-on-year basis there was increase in staff costs and some other costs. Maybe if you can touch upon that, what drove that increase? Is it because of investment in your business, which is leading to this increase?

**Deepak Khullar:** Yeah. So one of the things we have a very strong culture about is to deliver on growth for the management teams and the entire bank. And as you know, in quarter one of last year, we had a major impairment related to NMC, Finabl and obviously overall net profit was down. We saw that coming. And therefore, variable pay was also equally impacted. And therefore, we adjusted the accrual for variable pay in quarter two of this year. So we brought that down. As we move into a more recovery mode, things are looking better for us. The first half of this year, obviously, we don't have a similar write-back on the accrual

for variable pay. That's one key item. And the second item is, yes, we're continuing to invest in the business, in the franchise and build in compliance in cyber security. So all those investments are still going in the business. And despite that, we have delivered the cost to income ratio decline of 180 basis points. So you can see that we are investing in the business.

**Shabbir Malik:** Thank you very much. Wish you a good break.

**Deepak Khullar:** But the year-on-year is primarily driven by the variable pay of last year, which took a hit.

**Shabbir Malik:** Okay, perfect. Perfect. Thanks a lot.

**Operator:** Thank you. We will take the next question from the line of Kate Carpenter from Morgan Stanley. The line is open now. Please go ahead.

**Kate Carpenter:** Hi. Thanks for taking my question. Just following up on the cost to income ratio. I believe last quarter you mentioned that the medium-term guidance incorporated certain assumptions around rate hikes. But just given the decline that we've seen this quarter and your outlook for further synergies to exceed expectations, do you still feel that your rate hikes need to be factored in, in order to meet the medium-term cost to income guidance? And then my second question is on the TESS deferrals. There's pretty impressive improvement in the settlements this quarter. So just curious if you can give any colour around customers benefiting from TESS, whether the deferral settlements that we saw was driven by improved performance at those customers or whether those customers have refinanced loans and are now able to pay it with more prolonged payment periods or something like that. Just curious what your outlook is for the pace of deferral of settlements going forward. Thanks.

**Deepak Khullar:** Thanks, Kate. So on the cost to income ratio, a lot of the decline or the medium-term target that we expect to achieve has to do with an improvement in the top line as well. There's only a limit to which you can keep reducing your cost base, otherwise you will starve the business of required investment, which is not what we intend to do whilst we intend to get more efficient as we go along.

But the top line growth needs to be there. We've seen some of the top line growth coming through on the fee income side, but on the interest income side as well. And that will be driven by rate hikes. When they'll happen is more a late 2022 event in our view. But I'll probably let Kevin as well comment on that. So that's the piece on the cost to income ratio.

On TESS, yes, we're seeing the deferrals improving, repayments coming through. And in terms of some of the refinancing also happening and you can see the deferrals by economic sector on slide 14 in the bottom right hand. It's primarily around the real estate segment for us. And this is something we're working with our clients to see how we can manage that better. But I think the TESS deferral expires by the end of this year. And so we're working very actively with our clients for the second half of this year to make sure that they move out of this. Kevin, would you like to add anything to that?

**Kevin Taylor:** Yeah, we – obviously, some customers – as Monica would say, to speed the economy, some customers have come out of the malaise that the global economy much more quickly than others.

Some require a little bit longer period to do that. We have a tracking process in place. It's monitored by our risk committees and the relationship managers have and continue to work very closely with their customers because everybody is focused on producing the best outcome for the customers, the best outcome to the Bank and the best outcome for the economy. Thank you.

**Kate Carpenter:** Perfect. Thank you.

**Deepak Khullar:** I think there was a question earlier on interchange regulation for debit cards. And yes, that got implemented in February of 2021. Our interchange income is higher purely due to higher spends.

**Operator:** Thank you. We'll take the next call from the line of Hootan Yazhari from Bank of America. The line is open now. Please go ahead.

**Hootan Yazhari:** Hi there, gentleman. A couple of quick questions. We saw in the second quarter, a big uplift in your synergy realisation. Can we get a little bit of colour on what was behind this sudden surge in the run rate in the second quarter? And what we could expect on synergies in the second half? I mean, I know you've guided that we're going to go through the billion mark. But at this stage, can you give us any clarity, how much above that billion mark we're going to go? Now equally on the integration costs, you're indicating that you're running well below your guided levels. Looking into the second half, how much can you expect on the cost side, on the integration cost side? Are we going to see a marked drop-off in costs on the integration side or to the extent something quite similar? And then the last question I have with regards to your NPL ratio, again, another big improvement sequentially. If you can maybe talk about behind the dynamics of why we're seeing that NPL ratio coming back and looking forward into the second half, how do you think the dynamics of your NPL ratio are looking at this stage? Thank you.

**Deepak Khullar:** Thank you, Hootan. So let me take the NPL question first. The decline sequentially is primarily driven by a write-off of fully provided loans. And so obviously that does not mean that we do not pursue our claim on those loans. But it's just – there's no point carrying fully provided for loan. So this is a net improvement as a result of write-offs. I don't think there's been any significant moving back into stage three to stage two, if that's what we're looking for.

In terms of integration costs, that's over. It's done with, dusted. And integration costs stopped after our integration finished in April of 2020. So that's more than a year ago. There's a little trickling of integration costs that came in Q2 and Q3 of last year. But we are incurring no more integration costs. So I would just say that the project is over. It's closed as far as the integration is concerned.

In terms of synergy realisation, yeah, so there's not a linear path as to how synergies will come quarter on quarter. It depends on when a particular initiative has started and the full impact of that flows through in which months. So if it started something in quarter two of last year and the full impact is coming in quarter two of this year, you'll see that higher impact coming through. But I think one of the key elements was also the discontinuation of some of the systems on the – of UNB that was sort of just we switched them off, so obviously all the AMC and other costs relating to that suddenly disappeared as well. So – and we had to carry on those systems for a while in terms of archiving its central data. So that's one big piece. But again, I wouldn't take a look at a quarter-to-quarter linear path. In terms of guidance on over a billion, you can already see we've done 661 million in the first half. I think we'll be roughly about in that 1.1, 1.2 range would be my view.

**Hootan Yazhari:** Take care. Thank you so much.

**Deepak Khullar:** Thank you.

**Operator:** Thank you. We will take the next question from the line of Edmond Christou from Bloomberg Intelligence. The line is open now. Please go ahead.

**Edmond Christou:** Hello. Thanks for the call today. Just follow up on the synergies. This is correct, my understanding that there will be escalation in digital investment, especially with the launch of Al Hilal platform. And if that is true, then the net synergy impact should be lesser in the second half versus the first half. The second question is, I was a bit surprised on the 110 impact on the CET1, because you mentioned 35 basis point impact from the GCC exposure. So what is the rest? What make up the difference? Because when I look at your loan by sector, quarter-on-quarter, it looks like you are de-risking, you are getting benefits from the repayment on the real estate. But that should help your RWA on the credit side. And also just in line with this question, as we see the reduction and the real estate and hospitality exposure and increase in the government, which is capital efficient and good for your risk profile. How do you see this into the next mid-term within your strategy? What is the sector allocation you would be targeting in the near-term? Yeah, I think that's it. Thank you.

**Deepak Khullar:** Okay. So thanks for those questions. On synergies, yes, I'm talking about overall synergies, not the net cost base of the company. So we will expect to realise the number over a billion, whether it's 1.1 or somewhere in that range. We'll see. But that doesn't mean that will all come into the income statement or the cost base, because you're absolutely right, we will be making investments in digital, especially Al Hilal Bank, improving Egypt's current base as well. So those investments will continue to happen.

So but that doesn't mean that we haven't realised the synergies. We've realised the synergies and then chosen to invest in areas that we see or deem that need investment. So this creates the space for us to invest. So the net impact could be a different number than what the cost synergies are. I hope that I clarified that piece.

**Edmond Christou:** Definitely.

**Deepak Khullar:** In terms of CET1, I think – in terms of the CET1, the impact of the new regulations is the number I gave you, 35 odd basis points. The balance is increased lending and it is not just lending to customers. You will see that our investment portfolio has gone up. Our lending to banks has gone up by 6 to 7 billion just on the banks. And similarly, investments have also gone up, which again consumes RWA. So that's the balance difference on where the CET1 is going.

Sorry, you had a third question, which I've probably didn't write down. Would you mind repeating that please?

**Edmond Christou:** I think there are further question which is in line with the previous one. It's the allocation of the loan by sector. It looked to be improving your risk profile. You have less exposure to real estate, less exposure to hospitality, more pick up on government and public sector entities. So I would expect by

definition that capital consumption on the credit to come down. And also, what is your view going forward? Are you trying to de-risk on this sectors with long COVID impact?

**Deepak Khullar:** So hypothetically, what you said is absolutely correct. When you swap out of real estate into government, your RWA should improve, but that is assuming that your real estate RWA is completely unsecured and you're substituting it via an unsecured government entity.

So if that is the case, your assumption – your presumption is correct. It should result in a decline. But if you have an RWA exposure that is secured and I'm not saying secured by real estate, but secured by cash and secured by investment that is a credit risk mitigant for capital calculation purposes. And you may not see the exact like to like decline. So it depends on the composition of the book, how it's being swapped out. But overall, what you say is correct.

**Edmond Christou:** Okay. Sorry, I'm really apologising for this. Just to add one other question is on the collateral value, when I do the calculation, it seems it's falling again in the quarters. Just I want to understand with that. We hear a lot of rebound in real estate. I don't know how do you see the rebound with the data you collect on your portfolio. But if we really see a strong rebound, how much of that is positive or influential to your cash allocation, to provisioning. How much – if you're feel comfortable with now and to the 80 basis point guidance in the near term? If we see stronger rebound in real estate? I think this is positive correlation just to understand the philosophy behind that. Thank you.

**Deepak Khullar:** That is correct. So collateral valuation or collateral – real estate collateral does factor into your ECL calculations. And with an improvement in collateral values, your ECL should come down. And we are seeing some improvement in collateral valuation. But it all doesn't happen in one quarter because the valuations are on a rolling basis.

Every quarter, there'll be a certain segment of clients who are coming up for renewal and we will revalue that. So we don't do 100% of the book at every reporting period. It's just not practically feasible to do that, so every quarter you will see that. If the trend continues in terms of improved collateral valuation, you'll see that impact coming through on the ECL.

**Edmond Christou:** Thank you. Very useful.

**Deepak Khullar:** Thank you.

**Operator:** Thank you. We will take the next question from the line of Naresh Bilandani from JP Morgan. The line is open now. Please go ahead.

**Naresh Bilandani:** Hi Deepak, Kevin. Good evening. It's Naresh Bilandani from JP Morgan. Three quick questions, please. One is – sorry to go back to your number on write-offs. It's uncomfortably huge compared to the recent trend that we have seen. So it would be very helpful if you can throw some more light into what sectors were these NPLs formed off. I'm just trying to see if there was any skew from – within these written off loans from any single name exposure, which I know you can't disclose, but at least if you can just show some broad guidance, if that was indeed the case, that was that would be very helpful.

That's one. Second is I'm just trying to think, how should we think of the discount – the bulk of discount unwinds because these – the pace in the first half of the year, as I think, it has halved compared to what you had at this point last year. Is there a number you can kind of like quantify that over the next three to five years, say 500 million, 600 million probably in that range should be a number that we should think of as discount unwind? That would be great. And my third and final question is on, I think, we've seen the reporting on ADCB Egypt, I guess, for the first time. Please do correct me if I'm wrong. How should we read into this? Is there a strategic plan for growing that business? Or are you open to selling it off to a willing seller at this stage? Thank you.

**Deepak Khullar:** Okay. So write-offs, let's go with the first one. Yes, there has been a significant amount of write-offs. And again, I would reiterate these were fully provided loans that we were carrying on our books and that we decided to write-off against the provision that we hold.

And, again, and by no means diminishes our legal claim against those, those will continue. But we've decided – yes and there were a few large names and exposures without getting into names, over half a billion as well, certain exposures. So we decided to write those off. But again, we continue to pursue our legal claims and should we get something that should be a positive later on if something comes through.

In terms of discount unwinds, again, this is – because it's comprised of not one single client base like you saw in the case of the Dubai World when we had it, you could easily compute that and had a very solid number saying should the client perform along the following lines, then this is the writeback that you took, which was I think 1.1 billion. And by maturity, you should have returned or written back that discount unwind of 1.1 billion over that six, seven-year period. That's an easy one to do.

On – at a portfolio level, again, it'll depend upon how the portfolio is performing. Some – and if they don't perform well, then obviously you will not have a discount unwind on those. And if it performs well, then you'll have a discount unwind. This is something I'll take away and consider for Q3 that if we can give a portfolio level, if all things remaining equal, what would be that number, etc., and then we can probably consider disclosing that to the market. But as of now, I can't give you a number right away.

**Naresh Bilandani:** Yeah, that would be helpful.

**Deepak Khullar:** Yeah. In terms of Egypt, this is the second quarter we are reporting the results on Egypt. We did that last quarter as well. And the management's aim, the board's aim is to invest in Egypt in our franchise and to really realise the full potential of that. So it's part of our overall five-year strategy. And so Egypt has its own five-year strategy linked to ours. So we want to make investments in that franchise. We want to build it up. We think it's under-leveraged today. We think it's under-invested today and we're making those investments and this is going to be continuing for us. So this is not a preparation for us.

**Naresh Bilandani:** Thank you, Deepak. That was clear.

**Deepak Khullar:** Thank you.

**Waleed Mohsin:** Thank you very much. In the interest of time, Deepak, Kevin, Monica, Denise, if you have any final comments, otherwise we'll close the call.

**Deepak Khullar:** No, that's it. Thank you, Waleed. I think we've covered a lot of ground here and if people do have any further questions, please drop us an email and we'll be happy to come back to with your queries.

**Waleed Mohsin:** Perfect. Thank you so much, Deepak. Thank you to the ADCB management team for taking the time. And thank you to all of those who dialled in. Eid Mubarak and happy holidays. All the best. This concludes today's call. Thank you for dialling in.

**Deepak Khullar:** Thank you. Eid Mubarak. Thank you.

**Denise Caouki:** Thank you, Waleed.

**Waleed Mohsin:** Thank you.