

Abu Dhabi Commercial Bank PJSC

Q1'21 Earnings call transcript

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ADCB



ABU DHABI COMMERCIAL BANK Q1'21 EARNINGS CALL TRANSCRIPT Monday, 26 April 2021, 15:00 UAE time

Naresh Bilandani: Thank you. Good day, everyone. It is Naresh Bilandani from JP Morgan. I would like to welcome you all to this first quarter 2021 results call of Abu Dhabi Commercial Bank, being hosted by us. We have the full management team here from ADCB with us today, and I will pass the call over to Denise to introduce the management and commence the presentation. Denise, all yours.

Denise Caouki: Thank you, Naresh. Ladies and gentlemen, welcome to ADCB's quarter one results conference call. Our results were announced yesterday and we will be referring to our quarter one earnings presentation, which can be found on our website. Today, we will provide details on the Bank's financial performance, our new five year strategy, an update in digital transformation, as well as medium term guidance on key financial metrics.

We will have a Q&A session at the end of our presentation. I would now like to introduce the co-host of the call. I am joined by Deepak Khullar, Group CFO, Keven Taylor, Group Treasurer, and Monica Malik, our Chief Economist. I will now hand over the Deepak to begin the presentation. Thank you.

Deepak Khullar: Thank you Denise. Welcome to our first quarter results presentation. If you turn to slide 5, I will start by providing you with an overview of the Bank's performance in the first quarter.

Our solid performance in Q1 is testament to ADCB's resilience in the face of the challenges posed by the global pandemic. As the UAE economy recovers from the headwinds of 2020, the Bank's strong franchise and proven ability to support customers through difficult times puts us in a strong position to build on our significant market share. In Q1, the Bank delivered a net profit of just over 1.1 billion dirhams, an increase of more than five-fold year on year, and up 11% sequentially. This translated to a return on average tangible equity of 9.8%. Bottom line growth was driven by aggressive cost discipline, a higher contribution from non-interest income and a marked improvement in cost of risk.

Our cost to income ratio has improved significantly over the last year, partly due to synergies captured through a successful integration process. We are on track to exceed our 1 billion dirham cost synergy target this year. A wider programme of cost control measures and an acceleration of digital transformation have also contributed to greater efficiencies -- and both are central pillars of ADCB's new five-year strategy. I will provide more detail on this later in the presentation. Our balance sheet remains robust, and we have continued our strategy to increase CASA deposits in order to optimise cost of funds. CASA deposits increased to account for 58% of total deposits at the end of March, up from 51% at year end.

Our loan portfolio remains diversified and well-collateralised. We continue to take a prudent approach to provisioning, in full recognition that certain sectors will take longer than others to recover from the impact of the pandemic. Nevertheless, we are encouraged by progress on restructuring at NMC, and the increasing number of customers that are successfully exiting the TESS deferral programme as well as the repayments that are coming through.

Please turn to slide 6 for details of the income statement.

An improved cost of risk was a significant factor in the increase in net profit. Impairment allowances decreased 25% sequentially, and were 63% lower than in Q1 2020, when the Bank recorded impairments of over 1 billion dirhams for NMC and Finabl.

Another positive development was the increase in non-interest income, which was 14% higher sequentially and up 17% year on year, primarily driven by higher card fees. This partially offset a decline in net interest income due to the low interest rate environment and subdued macro-economic conditions. Operating expenses decreased 20%

year on year and 1% sequentially, thanks to merger synergies and additional cost control measures, as well as continued efficiencies related to digital transformation.

On slide 7 you will find information on our balance sheet. Net loans and advances declined by 1% to 236 billion dirhams, with large corporate repayments contributing to the decrease. We have continued our strategy to rebalance the deposit base, by increasing CASA deposits and exiting time deposits. The net effect was a decrease of 5% in total customer deposits during the quarter. Total shareholders' equity was 2% lower at 56 billion dirhams mainly on account of the dividend payout of 1.9 billion dirhams.

On slide eight, Total assets decreased 4% during the quarter to 396 billion dirhams. We have reduced the excess liquidity deployed in low-yielding overnight placements with the Central Bank. Consequently, net loans and advances now account for 60% of total assets, up from 58% at year end. The loan book is well-balanced between Wholesale and Consumer Banking, and continues to be well diversified across a range of economic sectors.

We continue to actively manage sectoral concentration risk in a prudent manner. The Bank's exposure to real estate and construction was reduced to 27% of total loans, from 29% at year end, after corporate repayments of over 4 billion dirhams. The portfolio is well collateralised and heavily weighted towards completed, income generating properties, with a conservative loan to value ratio of 78%. Our Islamic financing assets stood at 42 billion dirhams and with Al Hilal Bank as a key subsidiary, we continue to strengthen our Islamic banking franchise. By geography, 57% of gross loans were in Abu Dhabi, with Dubai accounting for 27%. I'll now hand over to Kevin to provide further details on our liability base, liquidity and capital. Over to you, Kevin.

Kevin Taylor: Thank you Deepak. Please turn to slide 9. At the end of the first quarter, customer deposits comprised 70% of total liabilities, reflecting the strength of the ADCB brand and high levels of customer loyalty. Wholesale borrowings accounted for 21% of total liabilities and we maintain a manageable profile that is well-distributed over several maturities, currencies and products. A remarkable highlight in Q1 was the pace of growth in CASA deposits, which increased by 10.5 billion dirhams to 138 billion. This continuing trend has seen CASA rise to 58% of total deposits from 51% in 2020 and 39% in 2019.

Retail CASA increased by 6 billion dirhams, while our award-winning cash management platform continued to drive growth in corporate CASA deposits. In parallel, the Bank reduced time deposits by 23 billion dirhams during the quarter to 101 billion dirhams at the end of March. The Bank maintains a comfortable liquidity position, with an LCR of 139.3%, and a loan deposit ratio of 98.7%.

Please turn to slide ten where you will see that the Bank's capital ratio has remained strong, comfortably above regulatory requirements. The capital adequacy ratio stood at 16.64% at the end of March and the CET1 ratio was 13.39%, post dividend approval at the AGM. The Bank has consistently maintained a dividend pay-out ratio of 50% and our guidance is to continue with this practice. I will now hand back to Deepak.

Deepak Khullar: Thanks, Kevin. If I may request people to please turn to slide 11 for details on asset quality. In Q1, cost of risk improved significantly to 84 basis points. This was a decrease of 69 basis points sequentially and 150 basis points year on year. Impairment charges reduced to 704 million dirhams, compared to 938 million in the fourth quarter and 1.9 billion in Q1 2020.

We continue to be prudent in providing for expected credit losses for businesses that are likely to experience stress in the current environment. Last year, we took gross impairment charges of 4.3 billion dirhams, including significant one-off charges on NMC and on exposure to the real estate and contracting sector.

In addition, when we merged with UNB and Al Hilal Bank, ADCB took fair value adjustments of 5.7 billion dirhams on stage one and stage two loans, including historical ECL, at the date of acquisition. We are therefore comfortable with our provisioning levels and our provision coverage ratio of 87.9%. Including collateral held, the

provision coverage ratio was 139%. The NPL ratio was 6.5%, and 8.1% when including purchase or originated credit-impaired assets, or POCl.

If I could request people to turn to slide 12 for an update on NMC. The restructuring process has been gaining momentum since NMC Health and its UAE subsidiaries entered into administration last year. As per the administrators update to all creditors, NMC's core UAE and Oman businesses have been outperforming the financial projections in its three-year business plan, and the sale of non-core assets is progressing well.

ADCB participated in a 325 million dollar Administration Funding Facility (AFF) to pave the way for restructuring. Participation in the AFF confers super senior status to an equivalent amount contributed to the facility, placing the Bank in a strong position to maximise recoveries. Creditors have been asked to meet a 28th of May deadline to agree to a plan of reorganisation, or alternatively to pursue the sale of core assets.

To date, we have recorded significant provisions and interest in suspense of 1.7 billion dirhams on NMC, Finabl and associated companies. We consider our provisioning to be appropriate, given the information provided by NMC to creditors on potential recoveries.

Moving now to slide 13, for an update on TESS and other customer deferrals. The Bank's approach of active engagement with customers has been successful, resulting in repayments of 6.7 billion dirhams. This has reduced outstanding deferrals to 6.9 billion dirhams at the end of March.

I would like to highlight that the Bank holds significant collateral -- of over 75 billion dirhams -- against an exposure of 56 billion to customers benefitting from deferrals. The large majority -- 69% of outstanding deferrals -- were classified as "Group 1". This refers to customers that are temporarily and mildly impacted by liquidity constraints without substantial impact to creditworthiness. In terms of exposure, Group 1 represented 87% of the total.

Risk adjusted net interest margin, which takes into account cost of risk, increased 44 basis points sequentially and 65 basis points year on year to 1.63%. NIM declined 24 basis points sequentially to 2.42% due to higher fair value unwinds and net interest in suspense reversals recorded in the fourth quarter of 2020. Interest expense decreased 62% year on year to 605 million dirhams. Meanwhile, cost of funds improved by 120 basis points year on year to 78 bps in Q1, driven by lower benchmark rates combined with increased CASA deposits.

Please turn to the next slide. We are pleased with the higher contribution from non-interest income, which increased to 27% of total operating income in Q1, compared to 20% a year earlier.

The positive trend in net fee income since mid-2020 was also sustained, rising 3% year on year to 443 million dirhams. This was primarily on account of card-related fees, which increased 29% from a year earlier to 124 million dirhams, reflecting improved consumer sentiment.

Trading income increased 11% year on year to 154 million dirhams due to higher derivative income. Meanwhile, other operating income stood at 205 million dirhams, up 77%, driven by retirement of hedges and higher net gains from disposal of investment securities.

Moving to slide 16, one of the Bank's key achievements in the last year has been our drive for greater efficiencies and synergies. Operating expenses decreased 20% year on year, with the cost to income ratio improving by 180 basis points to 36.3% in Q1. Our wide-ranging cost management programme includes procurement discipline, process optimisation and reduction or elimination of discretionary spending and at the same time ensuring significant investments in our digital projects.

Acceleration in digital transformation has been accompanied by a reduction of the branch network to pre-merger levels of 54 locations, from a peak of 127 at the time of merger with UNB.

On slide 17, you will see that the Bank is on track to exceed our 1 billion dirham cost synergy target this year, having captured synergies of 917 million dirhams last year and 242 million in the first quarter. We successfully completed integration in April 2020 and are no longer incurring integration costs. The final total integration costs of 545 million dirhams (excluding capex) came in significantly below the original projection of 980 million. I will now hand over to Kevin to discuss our new strategy. Over to you, Kevin.

Kevin Taylor: Thanks, Deepak. In the next section of the presentation starting from slide 19, we provide information on our new five-year strategy. The objective of the strategy is to create significant shareholder value through sustained and profitable growth in market share. The strategy will deliver significant efficiency gains beyond integration synergies, deepen customer engagement, enhance governance and risk management, and drive the Bank's digital transformation journey.

It involves reshaping the operating model of the Bank, and addresses all aspects of our operations, including employee empowerment, optimising funding and liquidity, and efficient deployment of capital.

We have a clear and detailed road map for each business segment and subsidiary, which is being closely monitored by a dedicated steering committee chaired by the CEO and also at the Board level by the BREC (Board Risk and Executive Committee) to ensure smooth execution.

Turning to slide 20, you will find a summary of the strategic aspirations across our core businesses and subsidiaries. Consumer Banking is focusing on growth in market share, particularly through mortgages and credit cards, enabled by a revamped digital value proposition. Wholesale Banking aims to offer a wider range of fee-generating services, broaden its reach to new customer segments.

We will continue to attract CASA deposits from retail and corporate customers as an important pillar of our funding mix. And in Treasury, we will broaden the parameters of our investment portfolio by focusing on longer tenor bonds and increasing trading income.

Please turn to slide 21, for details of our strategy for ADCB Egypt and Al Hilal Bank. ADCB Egypt has also adopted a five-year strategy and a new operating model to accelerate growth, focused on the affluent segment. The subsidiary plans to launch a new digital banking platform to increase share of digital transactions and enhance customer experience. The strategy is already delivering positive results. ADCB Egypt reported a 28% year on year increase in net profit to 170 million Egyptian pounds in the first quarter, delivering an RoE of 22%.

Al Hilal Bank, our retail-focused Islamic banking subsidiary, is also making good progress. The Bank is preparing to launch a new cloud-based digital platform in the fourth quarter of this year. The platform will be agile and scalable, enabling Al Hilal Bank to respond quickly to evolving customer needs and extend its services to key regional markets in future. It will also provide a data-driven ecosystem that allows partners to deliver non-banking financial solutions. The Bank is achieving higher digital engagement levels, with active users almost doubling in the last year to over 41,000.

On slide 22, you will see how we plan to evolve our operating model to enhance efficiencies further and ensure an agile organisation primed to deliver growth. We are embedding aggressive cost discipline in the five-year strategy, while investing in technology to drive productivity in internal processes. The Bank will also continue to streamline its branch network as digital transformation advances further.

On slide 23, you will see that the digital transformation programme is at the heart of our five-year strategy. Our aim is to provide a market-leading engagement and banking experience to drive revenue growth through cross-selling and increased customer acquisition. ADCB envisions a totally digital customer journey driven by data and insight from product sales and automated self-service, to a broad ecosystem of digital partnerships and innovative products.

On the next slide, you will see that our digital transformation programme is making a strong impact. In Q1, the bank welcomed over 38,000 customers through the “Hayyak” onboarding app, accounting for 73% of all new-to-bank customers, compared to 57% a year earlier. The app has now brought in over 200,000 customers since its introduction in February 2019. We have launched 71 digital releases since the inception of our digital transformation programme. In the first quarter, credit card loans were launched through the mobile app and a new portal facilitated digital KYC processes. Wholesale Banking enhanced a number of self-service capabilities for customers, helping to decrease operating costs. We are also seeing increased engagement through our platforms. The volume of digital transactions in Q1 was up 9% year on year, with fund transfers through the mobile app doubling. Let me now pass back to Deepak.

Deepak Khullar: Thank you, Kevin. I would like to finish our presentation by discussing the operating environment and medium-term guidance on key financial metrics. Please turn to slide 26. The UAE’s economic recovery is expected to gather pace this year and in 2022, supported by the strengthening oil price and one of the highest vaccination rates in the world. The latest figures show 103 doses per 100 people as at 24 April.

Economic activity is gaining momentum and consumer confidence has strengthened, as illustrated by the chart showing increased ADCB card spend. The expected launch of Expo is also expected to contribute to improved performance by externally facing service sectors, which have been affected by global travel restrictions.

On slide 27 we provide guidance on key financial metrics for the medium term, up to 2023. As we implement our new five-year strategy, we aim to deliver mid-single digit annual loan growth. The Bank also expects its continued efficiencies to improve the cost to income ratio in the range of 29% to 32%. Having taken significant impairments charges in 2020, we believe that provisioning levels will be lower over the next two years compared to 2020. Our guidance for cost of risk is around the 80 basis point mark, barring any exceptional changes in the operating environment.

ADCB maintains a robust capital position, and we expect the CET-1 ratio to remain above 12%. The Bank’s financial strength will allow us to continue our practice of providing a dividend payout ratio of 50% of net profit.

Please now turn to slide 28 to wrap up. I would like to highlight that the Bank has delivered a strong start to the year, with earnings growth driven by improved cost of risk, a lower cost to income ratio and higher non-interest income. The strength of the ADCB franchise has proven key to our resilience over the last year. This has been reflected by the reaffirmation of the Bank’s credit ratings in the first quarter, with S&P changing its outlook to “stable”.

We are very excited about the new five-year strategy and believe it will fundamentally reshape our operating model, drive efficiencies beyond merger synergies, and deepen customer engagement. We are focused on conducting an effective implementation process to bring in a new phase of growth and create further shareholder value.

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

Operator: Of course. Ladies and gentlemen, if you wish to ask a question, please press star, followed by one, on your telephone keypad now. And if you're joining us online, please click the request to speak flag icon. If you choose to withdraw your question, please press star, followed by two, and when preparing to ask a question, please ensure that your phone is unmuted locally. As a reminder, that's star, followed by one, to submit a question. Our first question comes from Edmond Christou of Bloomberg Intelligence. Edmond, your line is now open.

Edmond Christou: Hello and thanks for the call today. Just a question on the mid-term guidance on the 50% dividend pay-out. When I look at the capital generation for the Bank, it is around 37 basis points. I think this should improve with more cost saving coming in and the deploying of your balance sheet. What do you believe is the run rate for the capital generation under the new strategy? And if this is going to improve, the 50% pay out indication of capital build-up, are you anticipating any change in the Basel requirement?

The other question I have is on the deployment of liquidity. I see that you have improved your cost of funding significantly and you are indicating more CASA to come onto the balance sheet. How are you balancing the loan to deposit ratio? What level are you looking at and how much priority are you giving to deployment to investment, compared to lending on this aspect? Thank you.

Deepak Khullar: Thank you for those questions. I think there were a number of questions in there. I will go first with the mid-term guidance and capital generation, and the dividend pay-out. As you will see, we have been paying out roughly 50% dividend pay-out over the last several years, and I think we will continue with that. This is the first time giving formal guidance around that. Yes, there are changes coming into the Basel requirements from the middle of this year in terms of increasing risk rates, etc. So, that has been factored into this.

And ploughing back 50% of the net profit into internal capital generation, I think, is prudent, because we are also targeting loan growth in the coming years, and that capital will go towards that. So, on balance, our strategy to maintain a CET1 above 12% pay out shareholder returns of 50% pay-out ratio, and to keep enough capital for future growth, is just the right approach.

In terms of cost of funds, CASA and our liquidity ratios, we are running fairly strong liquidity ratios of over 137%. And we have always been, as a Bank, very focused on liquidity. If we go back in time when the three banks were about to merge in 2019, we gathered up far greater liquidity, anticipating some attrition to happen on the deposit base, and were pleasantly surprised that that attrition did not happen.

Therefore, some of the excess liquidity that we had gathered then was in letting go of, primarily, in terms of term deposits. CASA is another good story and we have been focused on CASA, gathering over several years now. Just going back two years in time, the CASA ratio was below 40%, so around the 39% mark. It moved to around the 50% mark last year, and now it is at 58%. Again, this is a very conscious strategy and having the right product mix, in terms of our wholesale bank and the cash management solutions to drive that.

In terms of loan to deposit ratio, it is a ratio we don't run the Bank through a loan to deposit ratio. We run it through the LCR and NSFR ratios, which are prescribed in Basel III. But again, we're below the 100% mark on the loan to deposit ratio as well. I hope I've answered all of your questions, but if I've missed anything, please do come back and ask me again.

Operator: Our next question comes from Waleed Mohsin of Goldman Sachs. Waleed, your line is now open.

Waleed Mohsin: Thank you very much for the presentation and especially for the medium-term targets and the update on the five year strategy. My first question is on net interest margins. Positive trends on the cost of

funding, especially with increasing CASA balances. But the asset yields continue to remain under pressure. I wanted to get a sense of where you see asset yields and net interest margin normalising, and when you expect that to happen. That's my first question.

Secondly, on asset quality. We saw a 50 basis points increase in the NPL ratio sequentially. So, if you could please talk about this? And linked to this, when I look at your medium-term cost of risk guidance, based on your calculation, you're looking at 80 basis points. And when we see the first quarter, it's around 84 basis points. I just want to get a sense of why you think there is relatively limited room for cost of risk leverage over the medium-term.

And my third and final question is on operating expenses. We are very pleased to see the medium and target cost income ratio guidance of 29% to 32%, which is substantially lower than the first quarter level of 36%. But I'm curious to hear how you intend to achieve this, given that your loan book guidance is mid-single-digit. And if we assume that revenue growth is in that ballpark, then there would need to be substantial cost cuts to get to that 29% to 32% range. So, if you could explain that, that would be very helpful. Thank you.

Deepak Khullar: Thank you, Waleed. I will try and answer the first one, which is around the NIM. You will see our NIM for the first quarter of 2021 was 2.42%. This is on slide 14 of the deck. And we are also looking at our risk adjusted NIM, and you will see this metric being put across going forward as well. Because it's not just the pure NIM, but it's the risk adjusted NIM that matters as well, which is at 1.63%. And risk adjusted NIM is nothing but the gross NIM, less the impairment charges on loans and advances to customers, banks, and other investments.

So, where do we expect NIM to land? I think if we maintain it at the current levels in this 2.4 to 2.5 range that would be a good outcome. And that's a result of what we've seen on the interest rate environment. So, the interest rate environment, again, on slide 14, when you see, as you rightly pointed out, that the asset yield dropped and they were at 5% in quarter one 2020 and dropped to 3.99 and the major interest rate cuts came on, I think, the 3rd of March and 15th March 2020.

And it took a while for the repricing of assets to happen before that trickle down into the yield. But I think we've seen some compression and some competition on the yield. I think we expect to be above the 3% mark on yields. And on the second question you had around the 50 basis points increase in our NPL ratio. Yes, we had a few corporate accounts that moved into stage three, and that's basically the driver of that NPL ratio increase.

On operating expenses, this is a medium-term strategy to try and bring it down into the range of 29% to 32%. We do realise that this is a fairly ambitious target, but this is not something that we cannot assume. If you look at the ADCB standalone cost to income ratio before the merger of the three banks, it was in that 32% range. And we will see some variance, quarter-on-quarter, but it's not just about cost sales. We'd like to see revenue go up as well.

And part of the reason our cost income ratio is at these levels today is also because the top line revenue has come down because interest rates have come down. But there is a full strategy behind this to try and bring it down into that range that we've put out in the income guidance of 29% to 32%, around both getting better efficiencies in our existing pathways and improving the top line growth as well. So, those are the three elements. And I think you had a question on medium-term cost of risk as well.

We are at 84 basis points in the first quarter, and as you know, things move differently. There is still some stress in the sectors because of COVID and the impact it's had on businesses. Over the medium-term in the next three years, we expect it to be around this level, the 80 basis points. It was 145 basis points last year and it's come down fairly significantly from that level. I hope I've covered all of your questions.

Waleed Mohsin: Thank you very much. That's very helpful. You've covered everything. Just one last follow-up. Your long-term cost to income guidance incorporates rates going up globally. Is that incorporated in the cost income guidance?

Deepak Khullar: There is some element of that that we expect interest rates, not this year, but in the coming years, to move up. If you just took out cost base of quarter one 2021 and you took out the revenue base of quarter one 2020, before the rate cuts came through, our cost income ratio was at 30.3%. So, there is some element of higher interest rates being built in there as well.

Waleed Mohsin: Perfect. Thank you so much, Deepak. Very helpful.

Operator: Ladies and gentlemen, as a reminder, it is star, followed by one, on your telephone keypad to submit a question. And if you're joining us online, please click the request to speak flag icon. Our next question comes from Rahul Bajaj of Citi. Rahul, your line is now open.

Rahul Bajaj: Hi. Thanks for the call. This is Rahul Bajaj from Citi. I have two quick questions. The first is on the real estate portfolio. We have seen a decline in the portfolio, as you mentioned in the presentation. There has been some repayments coming on the real estate side. I just want to understand, is that an intended direction you want to go in terms of your real estate mix? You want to reduce that portfolio? What would be the final end state that you are targeting, with respect to your portfolio mix? Or this is a client figure repayment and it may not continue going forward?

So, just on that, that was my first question. My second question is around NMC and provisioning around NMC. The first quarter of 21 is, for me, the first quarter after four or five quarters where we do not have NMC related noise in the financial statements. So, that is good, but I just want to understand, going forward, will you expect, with all that is happening with regards to resolution of NMC etc., is there a scope for writebacks from the provision that you have already taken with regards to NMC? Those are my two questions. Thank you.

Deepak Khullar: Thank you, Rahul. Let me take the first question on real estate. I think we have consistently said to the market that we would like to bring down our real estate exposure and not increase it from the levels we were at. And we are doing that, we did have a repayment and it worked out well, and this was a fairly large repayment as well, and that's brought down the exposure from 29% to 27%.

So, the piece that you're asking is what is the final percentage that we want to land on? I don't think there's a definitive number I would give, but around this, the levels we are at, we'd like to keep it there, plus or minus a percentage point. And there will be a quarter or two when we might see a little bit increase or decrease going further. But we wouldn't like to see a significant increase in the percentage to the total loans that we have.

On NMC, yes, you are right. When we took the first provisioning in quarter one of 2020, the news had just broken out on that. Now we're one year down the line and as you can see, last year, with every quarter, as developments were taking place, we upped the provisioning where required, especially on Finabl. And now we feel fairly comfortable with the developments that have taken place and we have put out a full update on the NMC restructuring process on slide 12 that gives you in-depth analysis of where we see this going forward.

If things work out well and NMC has been outperforming its financial projections, the sale of assets go through, etc., and the restructuring goes well, yes, there could be, in the future, some scope for reassessing these provisions downwards.

Rahul Bajaj: Got it. Thank you.

Operator: Our next question comes from Aybek Islamov of HSBC. Your line is now open.

Aybek Islamov: Thank you. Three questions I would like to ask. The first one, you mentioned during the call that this year, you will see the increase in risk rates, according to Basel III. And obviously, in the first quarter, your risk weighted assets to asset ratio jumped up quite a bit. It's now 79% up from 75% during the previous quarter. Can you elaborate on what is affecting the risk rates? Which segments of the loan book or the asset book? That's the first question.

The second question, I wanted to ask you about the digital transformation you mentioned several times during your presentation. I believe it's not easy to transform a bank of your scale on the digital side. You have many old IT infrastructures, which probably don't talk to each other. Now we have two new, or probably three, digital banking licenses in the UAE. They will probably have some late mover advantage. Do you see them as a competitive threat, in particular, in retail banking in the long-term?

And the third question is on NMC, there are quite a few questions. I wanted to ask you are you comfortable with the current coverage of your NMC exposure? And that's it. Thank you.

Deepak Khullar: Thank you, Aybek. Let me take your questions. RWA increase, a couple of reasons why we've seen that RWA increase. That's due to a substitution effect that we may have collateralised assets that got repaid and you put on new assets that are not similarly collateralised. A drop in the value of collateral, as well, is one of the elements that goes into the RWA. That is also one of the impacts for the credit RWA to go up during this quarter.

In terms of digital transformation. You're right, it's not easy to just turn around and switch on and switch off, and I'll let Kevin comment on that later. But the fact is that we've been working on the digital transformation for a couple of years now and coming up with some good releases. If we look at slide 24 of our deck, we've had about 71 digital customer releases since we launched our programme in early 2018. And what is brilliant is that 93% of all retail transactions are now done through self-service portals. So, that is a pretty good number to have.

If you remember from previous years, we were saying that our customer acquisition numbers were still very low in terms of coming through digital channels. But we've seen that come up as well. 73% of all new customers we onboarded were through the Hayyak app, which is fully digital. We do have legacy systems, but it's not as if they are as old as some of the other large banks globally.

Most of our systems, are probably in that eight to ten year legacy period. And wherever we have to move them around, we do that, if you remember Aybek three years ago, probably three and a half years ago, we completely upgraded our core banking system, and that was a major initiative. And that was in readiness for this entire digital programme that we wanted to undertake. A lot of stuff is now going into the Cloud and we are very pleased with the adoption rate of that going into the Cloud.

Just to give you an example, our entire procurement process is in the Cloud, end-to-end, including reverse options, etc., that happened. And this has not started today. We have been doing this for the last five to six years on procurement. Everything is in the Cloud, end-to-end. So, yes, it's a big engine to move around, but I think we are making good progress around that. Perhaps, Kevin, if you would like to add anything to that.

Kevin Taylor: Thanks, Deepak. It's an interesting space. If you look at the numbers that we mentioned in our presentation, Q1, 38,000 customers welcomed through the Hayyak onboarding app. We're evolving all our digital offerings over the last couple of years, with 71 releases. But what I think is bringing people to the Bank is largely its reputation, its branding for customer service.

And the fact that we're providing more and more functionality, broadening our ecosystems, all those sorts of buzzwords that you hear, but it starts with brand reputation, service, these things. So, if you start out from scratch, and there are disrupters in the new entrants, but if you start out from scratch, you don't start with much of that. So, you've really got to have the ultimate killer app, or ecosystem, or something else, because banks that are already in place start off with some level of brand loyalty.

And scar tissue from developing that and maintaining it, and building out strong cyber security platforms, and KYC, and AML, like many of the people on this phone call. So, I would rather be starting in our situation and building out a really, really strong proposition predicated on great customer service and a very, very strong franchise than the opposite.

Deepak Khullar: Aybek, you also asked a question around a couple of other digital banks being launched in the UAE and do we see them as competition. Yes, of course, we do see them as competition. And we do not discount any player, big or small, in the marketplace. I think that would be foolish to do. But we're confident with our offering, what we're developing, some of the unique and innovative features we're trying to build in.

And as the quarters go by, you will see more of those releases come through, both from ADCB and Al Hilal as well. And in Egypt as well, which was lagging behind when it came to digital. But we're putting a lot of investment now into Egypt as well around this.

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

Shabbir Malik: Thank you very much. My first question is on non-growth. We saw a very weak trend in the first quarter. I just wanted to hear your comments on that. What are corporates doing or how are they behaving after the pandemic, or basically, compared to last year? And linked to that, I think ADCB acquired a mortgage portfolio. I believe I saw that in the news a couple of weeks ago. Was the incorporated into your first quarter loan growth?

And what are your thoughts, generally, on M&As? Maybe not big M&As, but small portfolio acquisitions. Do you see more of that coming through going forward as organic growth seems to be a bit more challenging? One more question, and this is in context with the Abu Dhabi post guarantee. Generally, how do you treat guarantees that are called what kind of milestone do you look at to downgrade them to non-performing and taking provisions against them? Any colour on that would be very useful. Thank you.

Deepak Khullar: Let me try and address your questions and perhaps Kevin can also pitch in. Weak trend in loan growth for Q1, yes, it's been 1% decline. But if we look at the overall UAE banking sector, and we have results only for the first two months from the UAE Central Bank, I think the net loan book declined by 0.2% or 0.3% overall. So, yes, the overall market is weak and we particularly had large repayments as well from a few corporate accounts.

What are corporates doing? I think there's a little bit of wait and see at this point in time, before making major investments, to see how, overall, the market improves. We do expect loan growth to pick up, more so in half two than in Q2. And that would be dependent on what happens with the overall vaccination trend, which is very encouraging in the UAE, so 103 doses per 100 people. But still, we are interconnected with the global economy. You can see what's happening in India today, and that's not very helpful.

Your second question on mortgage portfolio. No, that is not incorporated in our results for Q1. I think we did mention, in our press release, that we expect the transaction to close in quarter two. So, you will see that number being incorporated into our Q2 results, both on the asset side and then, obviously, on the income side as well. In terms of M&A, are we open to doing small portfolio acquisitions? Yes. It's something we've always looked at and if it is the right fit for us, we will do that.

We did that several years ago with the book of RBS and that was quite a long time ago. After that, we bought a book from GE Mubadala and that was about five or six years ago. We've looked at other divestments that other banks were making, we made bids for those. But we're disciplined to stick to a price that we thought was reasonable and not overpay for those books. So, the Abu Dhabi finance book, the transaction, is inked and it just needs to be completed, and this will happen this quarter.

On the guarantee and how we deal with guarantees, obviously, when a guarantee is called, when you make a payment, it becomes a funded exposure. And then depending on whoever the customer is, one of the rating or rating of the customer is we will rate that funded exposure along similar lines. In terms of guarantees, that may be under dispute for whatever reason. It will not become a funded exposure because the Bank would not have paid out. But we would consider that separately more akin to a funded exposure and take provisions accordingly, depending on the underlying circumstances of the case.

Shabbir Malik: Thank you very much.

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

Jagadishwar Pasunoori: Thanks for taking my call. I have a couple of questions. I believe you said that M&A synergies are well beyond the AED 1 billion. So, have we reached a peak? Is there further chance for increasing synergies? That's one question. And the second question is [unclear] that loan growth could pick up from the second half onwards, depending on the vaccinations and how the global economy is doing. My question is where do you think this growth will be coming from?

Like retail, corporates, or any particular segments or sectors that you see? How is your Government or GRE, or the corporate pipeline looking? So, I was wondering if you can pick up some loan growth from these pipelines. If you could elaborate more on this. Thank you.

Deepak Khullar: I'll take the synergies question and then I'll request Monica to comment a little bit on the overall macroeconomic environment, in terms of growth, etc., in half two. And perhaps Kevin and myself will address the pipeline. In terms of synergies, we have said that last year, we achieved over 900 million of synergies, 917 million last year.

This year we expect it to hit the one billion target that we set ourselves, and we are well on our way and we feel pretty confident that we will exceed that one billion target. There are still some actions we took, let's say, in Q4 of last year. The full impact of that will be felt in full year 2021. So, you only saw a partial impact of that, let's say, in 2020, maybe one quarter or two quarters, in fact, you will have seen 2020. You will see now the full benefit of that flowing through in 2021. So, that should probably answer that question. In terms of loan growth...

Jagadishwar Pasunoori: Can you quantify the synergies?

Deepak Khullar: We don't want to revise the target once again because we've done it from 600 to a billion. I think we're saying we will exceed the one billion mark and we feel reasonably confident of achieving that. In terms of loan growth, we've got a good pipeline, roughly over 20 billion of commitments to extend credit. And you can see that in our notes to financials. And some of that will get drawn in the coming quarters.

But in terms of the overall macroeconomic environment, I'll let Monica give a little bit of colour on what she sees in the macroeconomic environment. Then perhaps Kevin and I can address the split between retail and corporate growth, where is it likely to come from. Over to you, Monica.

Monica Malik: Thank you, Deepak. Good afternoon, everyone. As Deepak mentioned, we think it's going to be a multispeed recovery, depending on the sector and the areas of the economy. So, what we've seen so far in the data already is consumer spending has rebounded quite strongly, despite the expectations of population decline. Part of this was due to more spending happening domestically in the economy as people were travelling less.

But of course, the lower interest rates, government support measures and reforms, have also been support factors, including for the real estate market. There's been a shift in the UAE, as well as globally, for people looking for more space and move towards villas. And we've seen property prices starting to increase in the villa space, both sequentially and on a year-on-year basis. And if we tie that back to credit growth data, we've seen retail credit demand going up on a month-on-month basis steadily from the second half of the year.

And it's up, year-to-date, as well, by, I believe, 0.4%, well fitting generally more positivity on the retail side. I think on the corporate side, it's going to be more mixed, depending on which are of the business you are in. As Deepak mentioned, domestic vaccinations are very important, but UAE is a very externally facing economy and we're continuing to see new ways in lockdowns and different paths of the growth. We've seen a lot of the externally facing service sectors, ample capacity, so investment in those areas aren't expected in the near term.

A lot of project awards related to areas like Expo have been completed. However, a number of GREs are continuing to progress with their development plans. There's been a lot of focus on developing the next phase, moving ahead with the next phase, of the economic development, which is going to be more technology based, more knowledge based, more advanced industry based. And a lot of that is going to be developed by GREs.

Aramco is also looking to progress with its hydrocarbon plans, particularly on the gas side, and we've seen, over the last few years, they're tapping the market more to increase their leverage and unlock value in their businesses. So, we think there are areas of movement. Other areas will be slower. GREs have been a key driver of credit growth over the last year, both driven by Abu Dhabi, Dubai, and the other Emirates. And we see that being a positive trend.

Deepak Khullar: Thank you, Monica. I'm very conscious of time and that we're taking up people's time, so we've overrun the one hour. But before closing, I just thought I'd highlight one other element that has come up in discussions in the past around our TESS exposure. You will have seen, on slide 13 of the deck, we have now given some more colour on this, both in terms of wholesale bank and retail bank. We've now shown the provisions against each of these in group one and group two.

And additionally, we're also now putting out the collaterals that we hold against the overall TESS deferred clients. So, the TESS deferral amount is 6.9 billion and the exposure to these clients is 56 billion, against which, we hold collateral of 75 billion and provisions of 1.5 billion. I just thought I'd highlight that to people. Naresh and Charlie, over to you, because I'm conscious that we've overrun our time.

Operator: Yes. Exactly that. Thank you, everyone, for joining today, and I'll hand back over to Naresh for final closing statements.

Naresh Bilandani: Let's end it here, in the interests of time. Thanks a lot to Deepak, Kevin, Monica, and Denise for speaking with us today. And thanks to all the participants for dialling in. I wish you all a good day ahead. Thank you.