

# Q4/FY 2021 EARNINGS CALL TRANSCRIPT

Hosted by Goldman Sachs

Date: Tuesday, 1 February 2022

Time: 16:00 UAE time



# ABU DHABI COMMERCIAL BANK Q4/FY 2021 EARNINGS CALL TRANSCRIPT

**Operator:** Good day and welcome to the Abu Dhabi Commercial Bank, FY21 analyst and investor call hosted by Goldman Sachs. Today's call is being recorded. The call is intended for analysts and investors only, any media personnel on the call should disconnect immediately. At this point, I would like to pass the call over to Ms. Caouki, Head of Investor Relations. Please go ahead.

**Denise Caouki:** Thank you, Operator. Good afternoon, ladies, and gentlemen, and welcome to our call on full year 2021 results, which were announced yesterday. We'll be referring to our earnings presentation, which is available on our website. I would like to introduce to you the host of the call Deepak Khullar, Group CFO, Kevin Taylor, Group treasurer, Monica Malik, our Chief Economist, and Paul Keating, Group Chief Risk Officer. Today we'll be giving an overview of the bank's financial performance before opening the floor for questions. And I'll hand over to Deepak to begin the presentation from slide five. Thank you.

**Deepak Khullar:** Thank you, Denise. Good afternoon, everyone, and thank you and welcome to our call today. We are pleased to report a strong set of financial results for quarter four, rounding off a solid performance in 2021. The bank recorded a 44% year on year rise in quarterly net profit to AED 1.4 billion, which brought net profit for the full year to AED 5.247 billion, a 38% increase. This translates to a return on average tangible equity of 11.4% for the full year. One of the highlights of 2021 was ADCB's net loan growth of 2.2%, which was significantly higher than the overall banking sector.

In parallel, we continued the strong momentum in gathering CASA deposits. In a low interest rate environment, the bank also continued to diversify revenues. Non-interest income was up 26% in 2021, with strong growth experience across the board. The bank realized cost synergies of AED 1.2 billion dirhams, well ahead of the 2021 target of 1 billion. Continued cost discipline also contributed to 160 basis points improvement in the full year cost to income ratio. Our cost of risk halved to 77 basis points in 2021, supported by successful implementation of the test program and major progress on NMC restructuring. The bank has proposed a dividend of 37 fils per share, a payout ratio of 49%. This is subject to approval at the AGM, which is expected to be held in March.

Please turn to slide six for income statement highlights for the full year. The increase in net profit was largely driven by higher non-interest income, reduced cost of risk and greater efficiencies. Although the UAE economy made a steady recovery, the operating environment remained challenging and characterized by low benchmark rates. Net interest income declined 9% year on year, but this was partially offset by a 26% increase in non-interest income, with fee and trading income both rising. We are pleased with the 6% improvement in operating expenses as the bank continued to streamline its operating model. Impairment charges were 34% lower than in 2020, when we recorded significant provisioning for NMC, Finabl and related entities.

Please turn to slide seven for an overview of the quarter fourth Income statement. Net interest income increased 3% sequentially to AED 2.25 billion due to higher interest in suspense reversals but was lower year on year due to the low interest rate environment and a change in the composition of interest earning assets. Meanwhile, non-interest income increased 47% year on year and 41% quarter on quarter, with net fee and commission income and trading income increasing. Gains recorded on the acquisition of Abu Dhabi Finance mortgage portfolio contributed to an increase in other operating income. Operating expenses of AED 1.1 billion in the fourth quarter were 5% higher year on year and up 11% quarter on quarter. This was driven by higher accruals for compensation costs, reflecting the bank's strong performance and investment in the business.

Net impairment charges were 29% lower year on year, while the sequential rise of 12% was mainly due to a few corporate accounts. On slide eight, you will find information on our balance sheet as of 31st December 2021. Total assets were 7% higher year on year at AED 440 billion, mainly on account of a 9% rise in investment securities and increased loan to banks, which doubled. Total customer deposits stood at AED 265 billion, up 4% sequentially and 5% year on year, compared to system-wide deposit growth of 4.4% up to November end. CASA deposits continue to increase during the quarter, in line with our long-standing approach to optimizing cost of funds. Net loans and advances to customers of AED 244 billion were 1% higher sequentially and 2.2% higher on year on year, outpacing the 0.5% growth in the overall UAE banking sector up to the end of November.

On the next slide, you will see how our loan book has grown and evolved over the course of the year. Capitalizing on a strong lending pipeline, the bank extended AED 40 billion of new loans during 2021 to economic sectors, in line with the bank's five-year growth strategy. We extended an additional AED 13.4 billion in credit to government and public sector entities, resulting in exposure to the sector increasing to 26% of gross loans from 21% at the end of 2020.

Meanwhile, the bank received AED 36 billion of corporate repayments. This contributed to reduced concentration risk to real estate, with exposure to the sector decreasing to 24% from 29% at the end of 2020. I will now hand over to Kevin to discuss our funding mix.

**Kevin Taylor:** Thank you, Deepak. Please turn to Slide 10. ADCB benefits from a healthy funding position with customer deposits accounting for 70% of total liabilities. Leveraging the bank's strong franchise, we continue our successful strategy to attract CASA deposits, which contributed to a favorable cost of funds. The pace of growth in CASA deposits was sustained throughout 2021 with an increase of AED 25.5 billion during the year, including AED 6.6 billion in Q4. CASA deposits reached AED 153 billion at December end, comprising 58% of total customer deposits, up from 51% a year earlier. Meanwhile, time deposits decreased 10% to AED 112 billion. The bank maintains a comfortable liquidity position with an LCR of 124.1% and an improved loan to deposit ratio of 92.2%.

On the next slide, if you turn to Slide 11, you will see the bank's capital ratios remain comfortably above regulatory requirements. The capital adequacy ratio post proposed dividend for 2021 stood at 15.97%, with a CET1 ratio of 12.94%. Excluding the proposed dividend, CET1 was 13.72%. The slight decline in the capital ratio from a year earlier was mainly due to changes in the credit risk weighted assets following new regulations from the central bank with regards to GCC exposures.

I'll now hand to Paul to discuss asset quality.

**Paul Keating:** Thank you, Kevin. If you could turn to Slide 12, our cost of risk in 2021 was 77 basis points, which is a significant improvement from the 145 basis points recorded a year earlier, largely due to the provisions on NMC, Finabl and related companies taken in 2020. The NPL ratio improved to 5.41% from 6.04% in the previous year. Including purchase or originated credit impaired assets or POCl, the NPL ratio is 6.87%. We're comfortable with our provisioning levels, with the bank provisioning cover ratio standing at 93.4% at the end of December and 149% when, including collateral held.

Please now turn to Slide 13 for an update on our loan deferral program and TESS. Since the early days of the global pandemic, ADCB has provided loan deferrals to customers impacted by the global pandemic, in line with the UAE central bank's TESS program. We've consistently taken a proactive approach to engaging with customers, which has resulted in a large majority resuming repayments or agreeing long term solutions. When the TESS loan deferral program expired at the end of 2021, ADCB reverted to full application of the IFRS credit classifications and staging rules, and we stopped providing TESS loan deferrals.

However, it is worth noting that a separate central bank TESS recovery program allows banks to extend new loans to customers who have temporarily lost revenue but are otherwise in good health, economic health. ADCB had provided a total of AED 873 million of loans under that program, as at the end of December, of which 219 million had been repaid.

We then turn to Slide 14. I'll briefly summarize the major progress achieved in recent months in the restructuring of NMC Group. NMC is now close to exiting administration following agreement by creditors in September of a debt restructuring plan. ADCB will receive approximately 38% of exit instruments in a \$2.25 billion Holdco facility. A debt claim that is sized to the expected future value of NMC. We will also appoint three members to the board of the new company. All net proceeds from a future sale of the business will return to the exit instruments holders, including any value in excess of the \$2.25 billion. In the meantime, we'll benefit from a cash margin of 0.5% per annum, as well as payment in kind of 2% per annum. Given this is a material progress in restructuring, the bank considers the AED 1.14 billion out of provisions and interest in suspense for NMC to be at an appropriate level.

I'll now hand over to Deepak.

**Deepak Khullar:** Thank you, Paul. And turning to Slide 15 on cost of funds, our cost of funds in quarter four was flat sequentially at 67 basis points. Looking at the full year, lower benchmark rates combined with increased CASA deposits, drove a 65 basis point improvement in cost of funds, with interest expense declining 47%. We saw a slight three basis points sequential increase in quarter four net interest margin mainly due to higher interest in suspense reversals. While the full year NIM of 2.43% declined 34 basis points, our risk adjusted NIM improved 30 basis points to 1.69%. This was a reflection of the rebalancing of a loan portfolio towards the public sector and reduced exposure to other sectors.

Please turn to the next slide, which gives a breakdown of our non-interest income. We are pleased with the continued diversification of our revenue streams, with non-interest income increasing to 28% of total income in 2021 from 22% the previous year. Net fees and commissions income grew 22% to AED 1.9 billion. This was driven by a 50% increase in card related fees, reflecting improved consumer sentiment and a 27% rise in loan processing fees, mainly for early settlement and arrangements.

Net trading income also increased 22% to 676 million on account of higher FX and derivative income. We also booked a gain of AED 166 million on the acquisition of the mortgage portfolio from Abu Dhabi Finance. Moving to Slide 17 and 18, where we discuss OpEx and synergies. Operating expenses decreased 6% in 2021 as the bank continued to effectively manage the cost base and realize substantial merger related synergies. We achieved a 160 basis points improvement in the cost to income ratio to 34.7% for the full year, despite a 21% decline in gross interest income. The bank captured AED 1.2 billion of cost synergies in 2021, exceeding the AED 1 billion target set for the year. This included AED 207 million billions of synergies realized in quarter four. This has been a significant accomplishment for the bank. If you recall, the original cost synergy target announced with the merger in 2019 was AED 615 million. So, we have achieved double that level.

I will now hand back to Kevin to provide information on our subsidiaries and progress in digital transformation. Over to you, Kevin.

**Kevin Taylor:** Thank you, Deepak. If you turn to Slide, 20 ADCB Egypt delivered a strong performance in 2021, expanding its customer base and significantly increasing its loans and deposits. The bank's growth was underpinned by the introduction of a digital transformation program, which has enhanced internal systems and processes upskilled employees and digitised over 100 services.

Under IFRS, the bank reported a full year net profit of 413 million Egyptian pounds, a 32% increase and representing a return on equity of 9%. Net loans increased by 28% and deposits grew by 42%. Meanwhile, Al-Hilal Bank continues to make strong progress in its strategy to deliver a leading Islamic digital banking offering for retail customers. Active digital banking users increased 43% in the last 12 months, and the bank is set to launch a new cloud based digital platform that will offer a wide range of financial and lifestyle services through an ecosystem of partnerships.

Moving to Slide 21, I will now discuss the digital transformation program at ADCB. We have seen a strong rise in engagement on our digital platforms over the last year, and digital subscriptions have now reached one million in January 2022. We are maintaining a sustained pace of digital releases with seven in Q4, bringing the total to 93 since the inception of our digital transformation program. Key initiatives include the launch of WhatsApp banking for retail customers in Q4 and further self-service capabilities to wholesale banking customers. We have also introduced additional security features on ProCash Mobile and automated statement analysis for SMEs. Our digital onboarding app has been an overwhelming success, accounting for 76% of all new customers in the last year.

Turning to Slide 23 for information on the operating environment. We saw a rebound in consumer sentiment in 2021, which is illustrated by the significant increase in ADCB credit and debit card spending and merchant acquiring volumes. As for the banking sector, credit demand was largely driven by GREs. However, there was a pickup in the private sector demand towards the end of the year. In 2022, the UAE economic recovery is likely to continue supported by cyclical recovery from the impact of COVID, high vaccination rates, as well as strong oil market fundamentals. Further, increased global travel, Expo and the potential boost from Qatar hosting the FIFA World Cup are also supportive factors for externally facing services. We also see stronger project activity within Abu Dhabi.

I'll now hand back to Deepak for closing remarks.

**Deepak Khullar:** Thank you, Kevin. I would now like to wrap up with the summary on Slide 24, where you will also find a reminder of our medium-term guidance. ADCB delivered a strong operational and financial performance in 2021 as we continue to progress with a five-year strategy. The bank achieved broad based loan growth led by higher lending to GREs and other targeted economic sectors. This provides a solid foundation for the mid-single digit loan growth outlined in our medium-term guidance. We also continue to improve our cost to income ratio, driven by synergies and sustained focus on additional operational efficiencies. As is the case for many parts of the economy, we are seeing wage inflation and other cost increases, and we are hopeful that rising benchmark rates and revenues will help cushion some of those increases.

The bank is taking the prudent approach to provisioning, and a cost of risk is in line with the guidance of 80 basis points. Our digital transformation program is progressing well, driving customer acquisition and high levels of engagement. This remains at the core of the bank's strategy to gain further market share. Thank you. This concludes our presentation, and I'll now hand over to the Operator or Waleed to open the floor for questions.

**Operator:** Thank you. If you would like to ask a question, please press star one on your telephone keypad. Please ensure that the mute function on your phone is switched off to allow your signal to reach our equipment. If you find your question has already been answered, you may remove yourself from the queue by pressing a star two. Again, please press star one to ask a question. We will take it the first question from Naresh Bilandani from JPMorgan.

**Naresh Bilandani:** Thank you. Hi. It's Naresh Bilandani from JPMorgan. Just four questions from my side, please. First, how should we think of the interest rate sensitivity? And it would be very helpful if you can please guide how many interest rate increases from the Fed are you building into your budgets in this year and next year, if possible? That's the first question.

Second is, on the POCI assets, I observe that they have increased slightly over the quarter by roughly about AED 3-400 million. Shouldn't these in theory, be decreasing as the portfolio matures? And it would also be very helpful to know how do you view the risks to asset quality in the in the year '22 and '23 from higher interest rates.

And the third question would also be on asset quality. If you could please share some reasoning behind the increase in the write offs that we saw in 2021, which is quite a material increase compared to the year 2020. And my fourth and final question is related to the news yesterday from implementation of corporate tax. To what extent would it worry you from an asset quality perspective? And would you factor that into your IFRS 9 impairment modeling into the medium term? Thank you.

**Deepak Khullar:** Thank you, Naresh. I'll take the first few questions and then I'll hand over to Kevin to talk about interest rate sensitivity. But let me first speak about the POCI assets increasing over the quarter. So POCI assets, the way they reflected, are net of fair value adjustments. And every year we do a reassessment of the cash flows on these POCI assets. And if there is an improvement or a deterioration in the estimation of these estimates of cash flows that may be realized from these POCI exposures, then obviously that gets adjusted. So, the fact that POCI assets have gone up typically indicates that there has been some release of fair value adjustments, as well as the estimates of cash flows have improved.

So, in light of the renewed information resulting in improvement in probability of realizing contractual cash flows and as required by the accounting standards, we carry out a reassessment of these cash flows every year and that is what causes the movement up and down. And if you look at it from December 2020 to September '21, I think on Slide 21, you'll see a decrease. That's also sometimes due to the write off of certain POCI assets. So, where we see no further estimate of recovery, we obviously write them off. So that's why you would see some variation in this POCI asset number.

In terms of significant write offs in 2021. Yes, our policy for write offs is split into two, for retail assets and corporate assets. Retail assets, typically follows a formulaic approach after X months of being in the 90-day category. Those are written off. Mortgages are written-off after a longer period of time because we hold significant collateral. But unsecured lending follows a very programmatic and formulaic approach to write off. So, there's no change in that approach from 2020 to 2021.

In terms of corporate assets, it depends on a case by case evaluation and where the bank feels that there is no further chance of recovery on the asset then we will write them off. So that's exactly what's happened. So there has been no change in our policy approach to writing off, it's just a question of the estimate and the assumptions behind that in terms of whether there is recoverability or not. And I'll also request Paul, if he wish, wishes to add later on to that.

In terms of economic impact from the corporate income tax, yes, we knew that this is coming in. 136 nations globally have signed off on this global tax piece that is likely to come through next year in the UAE, kick off in 2023 June. And yeah, there would be an impact in terms of lower distributable profits, which is not necessarily post-tax. And in terms of how it would impact asset quality, there will be impacts on corporate customers as well in terms of cash flows, etc. And that is something we will factor into our future outlook and IFRS 9 impairment modeling, etc. So, we're watching this space closely as the full the law is released, I think by the middle of this year is when they expect to release that we will assess that and obviously give the market more information.

With that being said, I'll hand over to Kevin to talk about interest rate sensitivity, and then Monica if you want to add anything on this on the corporate income tax. Thank you,

**Kevin Taylor:** Sure. Thanks, Deepak. Hi, Naresh. Our interest rate sensitivity to a 50 basis point rise is about AED 230 million. So put another way, at the start of this year, if rates went up 50 basis points across the curve and stayed there for the entire year on the balance sheet that we had at the start of the year, all things being equal and net interest would increase by that amount. So, we have a positive sensitivity. And I've said this in your way, many times most banks due to rising interest rates, they traded off at different points in time.

In terms of rate increases, I think we all know it just depends who's talking in the market because the market adjusts its expectations almost every day. But whether it's four, whether it's five, whether it starts in March or a month earlier or a month later, I don't think it matters. Rates will go up. They'll probably go up around 1%. Maybe a little more if the lead indicators don't start turning down, but I think 4, 25 basis points, 1% for the year. But there is a lot of liquidity to come out of the system as well from the tapering. So, I think the Fed will be watching that quite closely.

**Naresh Bilandani:** Got it. Thank you very. These answers were very accurate, so thanks a lot.

**Operator:** We will now take the next question from Nida Iqbal from Morgan Stanley.

**Nida Iqbal:** Hi. Thank you for the presentation. I have a question on the cost side of things. Your guidance of 29-32% cost to income ratio, can you just give more details around planned initiatives for further cost rationalization, please? And then secondly, in terms of loan growth outlook into 2022-23, again, if we can get some more details on which sectors you think will be the drivers of the loan growth. Thank you.

**Deepak Khullar: Sure.** Thank you for the question. In terms of the cost to income ratio, the bank continues to focus on efficiencies and streamlining operations. Having said that, we've already delivered synergies of AED 1.2 billion since the time we combined the three banks and we've also had other efficiencies come through, which is now flowing through the cost base. But as I mentioned earlier in my remarks, going into 2022, we've seen inflation across the board, whether it is general and admin expenses, whether it is rental expenses or insurance expenses, etc., all are going up. So, the idea is that we will have some inflation coming through, but we'll also have efficiencies coming through and being reinvested in the business. So, what we wish to do is to move the income line up and hopefully the higher interest rates will help with that.

So more the cost income ratio in the future is likely to be driven by the income line. Not to say that there will be no other initiatives on the cost side. Those initiatives will continue. And what you see on our digital agenda is exactly that. So, it's not just delivering a better customer service, which is actually the prime reason why we deliver digital, but it also helps with the cost base.

In terms of loan growth. I think we still optimistic about mid-single digit loan growth in 2022 and going forward. I think the economy is starting to recover and we hope that 2022 will be a much better year than 2020 and 2021, and we're seeing that across the board. This year, we saw a 2.2% increase in just the lending to our customers. If I include the lending to banks as well, we grew by 6.2% or 6.6%. So that's pretty significant. So, we hope that'll continue.

And in terms of sectors, as you can see, most of our lending is in the corporate sector and within the corporate sector we see that growth coming in the GREs and the government sector entities.

So having said that, Paul, if you wish to add anything, please do.

**Paul Keating:** Nothing further from me Deepak, you've covered the question well.

**Deepak Khullar:** Thank you.

**Operator:** Thank you. We will now take the next question from Rahul Bajaj from Citi.

**Rahul Bajaj:** Hey. Thank you for the call. This is Rahul from Citi. I have two quick questions, actually. The first one is on lending to banks. And you talked about doubling of lending to banks over 2021. Just want to understand the kind of economic dynamics here and why the focus on lending to banks? Is it purely because you're finding limited opportunities outside the banking space or -- I mean, what's the economics there? I mean, and also in terms of margins or risk adjusted margins, how should I think about lending to banks versus lending to a corporate or a GRE, from a risk adjusted margin perspective? So that's my first question.

The second question is I see your guidance on medium term outlook. But if you could please provide some specific guidance for 2022 what you're thinking in terms of cost of risk and growth you just mentioned mid-single-digit, say CIR or some other items that could be useful. Thank you.

**Deepak Khullar:** Okay. Let me go to your last question first, in terms of guidance for 2022. We have provided only a medium term guidance over the three-year period and we'd like to stick to that rather than give a quarterly or a half yearly or a yearly guidance. But I think that's what we would be working towards to deliver this over the medium term. And quarter on quarter, there could be some variations. In terms of lending to banks, it comes off a very small base as well. If you see our base in 2020 with just AED 10 billion and it moved to AED 20 billion. So, it's off a smaller base and these are typically shorter term lending to banks. And obviously, the margins are much lower than it would be to lending to corporates because typically to higher credit. So that's what it is. So, we look at our total loan book is 244 billion, net loans, lending to banks is only 20 billion. And so that was the answer to your question.

And in terms of cost -- Sorry, your question was around cost of risk for 2022 or?

**Rahul Bajaj:** Yes, general guidance on cost of risk?

**Deepak Khullar:** So, yeah, I mean, look, we've said 80 basis points is what our medium-term cost of risk is. I don't think -- we think that things are improving in the marketplace, and we stick by that medium term guidance of 80 basis points.

**Rahul Bajaj:** Understood. Thank you.

**Operator:** We will now take the next question from Chiro Ghosh from SICO

**Chiro Ghosh:** Hi. This is Chiro Ghosh from SICO Bahrain. Three very quick question. First one is regarding the EMTN program, so it can see a big amount will be overdue this year. So, if you can give some idea of at what percentage would you be able to replace them, so would it be beneficial or not?

Second one is about the NMC one. So, if you can please remind us the total amount that is outstanding related to NMC, and it's right now classified under which category, I mean, and under what circumstances would it be upgraded.

And the last one is a small doubt I have on slide nine it since the consumer banking net loan is around 100 billion, but -- so what exactly is under this 100 billion? Because in the financial statement, I think it is around 50 odd billion. So, if can please throw some light on this one.

**Deepak Khullar:** Okay, so on the EMTN program, I'll probably hand over to Kevin to answer that. Kevin, would you like to take that?

**Kevin Taylor:** Sure. Thanks, Chiro. Yes, we do have some funding maturing this year and actually in the 2023 as well. We've already made a good start on it, to be honest, in terms of what we've done so far this quarter from reverse inquiry. We see actually through last year, we stopped facilitating reverse inquiry. Frankly, we just wanted to hold off from the market because we were sitting on so many customer liabilities. And you can see that through our loans, the deposit ratio, because we actually tasked the business to grow liabilities concurrent with customer assets because we do not want to be overly dependent on capital markets. That said, the funding plan that we present to the board typically has one or two capital market transactions embedded in it. This year that was the case, and we would expect to be in terms of public trades, probably one or two this year. Why? We haven't -- we don't have a benchmark issue out there. We've been able to satisfy demand through, as I said, organic growth of liabilities as well as reverse inquiry. But I would think that we'll definitely do one, if not two, transactions. And I would hope that one of them will come on a very green type format.

**Chiro Ghosh:** And the interest rate comparison, I mean, with the one which is maturing versus the rate at which you believe you can raise?

**Kevin Taylor:** Well, almost all of the debt we raise are swapped back into floating. Why? Because most of our assets are floating rate. And it also we use that depending -- we might use that to tweak the overall sensitivity of the balance sheet. But right now, virtually all our debt is floating rate, which is representing where our customer assets are as well. So, it's relative to the floating benchmark. Spreads right now are very, very positive, and the rates that we have from reverse inquiry are very, very competitive as well, well below the levels of where public issues.

**Deepak Khullar:** Thank you, Kevin. On the NMC piece, NMC is classified as a stage three account, and in terms of provisioning the whole roughly AED 1.1 billion of provisioning as a 31st of December, we disclosed an exposure of about 981 million to NMC in April of 2020. Since then, we also have certain AFF facility extended to them, some of which also got repaid. But overall, it's in that ballpark range of about a billion US dollars. Was there another question that I missed? Sorry, Chiro?

**Operator:** Chiro you're on mute.

**Operator:** Thank you. We will now take the next question from Edmund Christou from Bloomberg Intelligence Research.

**Edmond Christou:** Good afternoon, and thanks for the call. I have a few questions on the margin sensitivity if I understand correctly, 50 basis point is AED 230 million. This is still I think around the lower end of your [inaudible]. When I look at the pricing of the loan books [inaudible] largely within a short period on the deposit margin within a short period. CASA has improved, so I don't understand why the let's say 50 basis point was about around a modest margin expansion, around six basis point for 50 basis points. So, if you give me some clarity, maybe it's something I'm missing on some of the funding side.

The second one on the TESS program. So, I do understand that the TESS program has ended, and banks don't have access to a zero cost repo fund. I just want to understand that you have part of this program or the exposure that we voluntarily deferred into this year. I'm hearing from other banks that there would be some voluntary deferment, whereby [inaudible] the dues from the corporate or small businesses. So, I just want to understand this.

The last one is on your cost of risk. I do understand that you're going to leave the guidance as such, which should be expected that you [inaudible] more coverage buildup. And if you see coverage building up or accruing further, what are you targeting in mind? Thank you.

**Deepak Khullar:** The line was very sketchy. I could catch some parts of your question, so please I apologize if I don't get it exactly right but let me start with the margins first. I think he was saying or asking that why is the sensitivity so modest? I think what Kevin mentioned earlier is it is a parallel interest rate movement and the net interest in impact of that. So, assuming both assets and liabilities get repriced at the same level, all of them at their repricing dates of maturity, the impact is 116 million for a 25 basis point or for 50 basis points twice that. So, this is assuming a parallel interest rate shift, assuming all assets and all liabilities get repriced at that level. In practice, as you know, that is never the case. All things never remained equal. And that's the job of the management to maximize what comes out of that. But this is where we are.

In terms of TESS, I will probably defer to Paul to take that question. And in terms of cost of risk, I think the question was, why is it around 80 basis points or -- could you kindly repeat the cost of risk question? Are we looking to increase the coverage?

**Edmund Christou:** [Inaudible] targeting build up? Yes, exactly. Are you envisioning buildup of the coverage that's why you keep it at [inaudible]?

**Deepak Khullar:** No, it's not -- We never target a coverage ratio that we will build up to this level. For us, it's always the case that whatever the loan demands, we will take that particular impairment charge. So, if it is a fully secured loan with the loan to value ratio of, let's say, 50%, obviously the provisioning on that will be much lower than if we had a totally unsecured loan where you would expect a higher provision coverage to come through. So, it's a case by case as to what flows into the NPL. What we're looking at is we're still coming out of the COVID crisis. And yes, we're starting to see improvement and we hope that this improvement continues and therefore we're just being a little cautious on that. And if things pick up really well, then obviously we will revise our cost of risk going forward as the quarters move on and then give revised guidance on that. So that was on the cost of risk. But I'll also defer to our CRO who may wish to add and -- Paul, do you want to take the question on the loan deferral program or the TESS?

**Paul Keating:** Sure, Deepak. So, on the TESS piece, this was very much an early intervention sponsored through the central bank in terms of, as you said, a zero cost access for the banks. And during the high level of uncertainty for our customer base to offer them deferrals. So that took place in 2020 and to some degree into '21. But with the wind down of that program formally at the end of 21, we also wound down the offering of deferrals and actively worked with customers in terms of repayment arrangements and restructuring the facilities to cope with their revised cash flows going into 2021 and into 2022. So, we're now adopting our normal staging rules and normal rules as it regards to a significant increase in credit risk, whereas before the central bank gave us, I guess, alternate rules to work with these customers in terms of the staging and the approach to it. So, we're now back to a normal pre-COVID approach to customers in terms of seeking support or assisting them at this time. But we're not actively, I would call not actively encouraging a deferment program. No.

**Edmund Christou:** Okay. So, the repayment has been -- the payment has been resumed on all customers?

**Paul Keating:** In majority of cases, absolutely, and even some under the recovery bucket. As I said, over 200 million were paid through that recovery program as well in 2022, late '21.

**Deepak Khullar:** Thank you. And where they haven't and they fall under the IFRS 9 staging rules of one stage one, stage two and three, so they've reverted back to the IFRS 9 staging models.

**Edmund Christou:** Thank you.

**Operator:** We will now take the next question from Raj Purswani from International Securities.

**Raj Purswani:** Hi. Thanks for taking my question. I broadly have two questions. One on the pre-impairment profits broadly from 2022 to '21, the pre-impairment profits were more or less flat. What I want to understand is which would be the growth driving factors for 2022. Is it going to be interest income, non-interest income or how those are going to pan out? So a view on that?

And second, on the restructuring of the loan book I understand there was some de-risking done in 2021. What I want to understand is basically it's all done, or we should be expecting some more restructuring, trying to reduce risks further in 2022 as well?

**Deepak Khullar:** Okay. Thanks for the question. In terms of pre-impairment profit that you see '21 versus 2020, I think it was a pretty good outcome to just have a 2% decline or virtually flat, considering that the first quarter of 2020 had interest rates higher by 150 basis points. And by the time the asset book repriced down, we had the benefit of at least half of the year of 2020 of the higher interest rates. So, the fact that we've delivered a pre-impairment profit in '21 similar to 2020 means we've made up for a lot of that decline in benchmark interest rates. And you see that coming through primarily on non-interest income, which was up 26%.

So, in terms of where do we go into 2022? It depends also on the interest rate rises. We expect that to boost the net interest income because we are positively positioned towards a rising interest rate environment. And depending on the number of rate rises, whether it's three or four, that will impact the interest income. We wish to continue the growth in our non-interest income through other sources and other initiatives as well, which will continue.

In terms of restructuring the loan book, I don't think there's any sort of major restructuring in 2021. Yes, we saw some decline in certain areas. We saw a lot of repayments coming through in the real estate sector, but that was also something we wanted to reduce our concentration risk on that. So, growth will come primarily from the corporate sector lending to GREs and government entities. And as sentiment picks up in the marketplace, even from the retail sector, we hope that will pick up in terms of growth.

**Raj Purswani:** Very clear. Just on the structuring of the loan book. What I wanted to understand is into 2022, can we expect a little more de-risking or the bank will be willing to take up the risk because the economy is expected to grow faster? So, what is going to be the bank's approach primarily into 2022 in this respect?

**Deepak Khullar:** Sure. So, I'll just give you a headline statement, and then obviously, Paul can comment more. We have a very clearly defined risk appetite for the bank, and this is approved at a board level. It has caps at segment level, industry level, concentration, risk levels, etc. And we assess that on an ongoing basis. So, whether it is a downturn or it is an uptick in the economy, we always constantly look at that. And I think the mid-single digit growth is not too aggressive as well as the market picks up. We've got a 15% market share in the in the UAE, and we expect to have our market share plus a little bit more. But Paul, if you wish to add on that.

**Paul Keating:** Yeah, no, I agree with your comments. I think the other thing just adding to the risk appetite is that, yes, we do have economic sector limits in terms of looking at where we do want to grow and caps for those sectors. So, it is also, I guess, controlled with an appetite in terms of the growth and where we want to grow.

**Raj Purswani:** Got it. Thank you.

**Operator:** Thank you. We will now take the next question from Amit Mamtani from Goldman Sachs.

**Amit Mamtani:** Thank you for the call. I have two questions. Firstly, can you please explain the potential impact of the new central bank regulation on the capital treatment of real estate exposures? And secondly, can you please provide some clarification on the NMC active instrument and how this will feed into the income statement and balance sheet and the potential for any recoveries? Thank you.

**Deepak Khullar:** And on the new central bank exposures, Paul, do you wish to comment on that?

**Paul Keating:** Surely, Deepak. So, in 2022, the central bank is going through what they call a monitoring period. And so, they're looking at each bank to submit information through the BRF returns on real estate assets in terms of a credit risk RWA number over overall total RWA. And they're looking at basically communicate to the industry that they would like to see each bank be under a 30% ratio as they go forward. If a bank goes above that 30%, then there'll be further engagement by the central bank during this monitoring period of '22 and potentially into '23. They may then say if you're above that 30% or revise number, they may request that bank to set aside additional capital. At this stage, we are under the 30% in terms of that new calculation.

In the past, the central bank had linked its real estate exposure definition to customer deposits. So, from our perspective, this sort of makes better sense in terms of the numerator and denominator. And that sums up the position at the moment.

**Deepak Khullar:** Thank you, Paul. And in terms of NMC, we've explained this earlier, but basically what's happening is that the group is going to come out of restructuring – sorry, out of administration and enter into a restructuring plan and creditors will receive exit instruments and the Holdco facility is valued at about \$2.5 billion. ADCB is expected to receive approximately 38% of this. This is a debt instrument which will earn interest. And the net proceeds from a future sale of business will return to the holder of the exit instruments. And anything over and above that realization of the value of this Holdco facility will also return to the creditors at a later stage, which is -- this is expected to happen over the next three years or so. And so, this is where we stand on NMC. And once it comes out of administration and moves into its restructuring plan, ADCB will have the opportunity to appoint three of the seven non-executive directors on the board of NMC and hopefully realize its full value and potential.

And over and above that, if there are any possibilities to benefit from any recoveries, from potential ongoing litigation that will also return to the creditors. So that kind of sums up the position on NMC. But if you want to get into the detail instruments and all of that, I think it's very well explained on NMC website and a number of the investor presentations that they done. So, there's a whole lot of detail on the instruments and how they're being managed.

**Amit Mamtani:** Thank you. That's helpful.

**Deepak Khullar:** Thank you.

**Operator:** It is now five minutes to the schedule in time. Do you wish to take one more question?

**Deepak Khullar:** Sure. One last question, if there is.

**Operator:** We'll take our last question from Shabbir Malik from EFG Hermes.

**Shabbir Malik:** Hi. Thank you very much. Just, I think more of a macro question this announcement of the corporate tax. What do you expect the government to do with the money? Would you expect them to deleverage at the sovereign level?

And related to that from a banks perspective, do you have any levers to kind of offset the negative impact on your profitability? For instance, reviewing your cost base, or maybe I think you mentioned that it could affect credit risk profile of customers, so meaning there could be an expansion of loan spreads. Do you expect any such changes to, if not completely, but partially offset the impact of corporate tax? Thank you.

**Deepak Khullar:** Monica, do you want to take the macro level question, please?

**Monica Malik:** Okay. Thank you, Shabbir. Thank you, Deepak. Shabbir, I think. Of course, there hasn't been an official announcement, but from a macro point of view, I see the starting of corporate income tax as very, very positive. It's a significant development in the tax base and the fiscal framework. I think if we look also at the trends between when the UAE has had a consolidated surplus and the trends to credit growth, yes, you see at times of deficit, more demand for bank borrowing, but the government still continues to borrow at times of surplus as well. It depends on different issues as investment strategy, liquidity strategy, interest rates and so on. So, I think that we have to see how the trend develops. I see this more as a fundamental strengthening of the macro framework and reflecting a more diversified economy. So, I do not think that at this point, it's easy to extrapolate one to the other. And if I can hand over to Deepak at this point.

**Deepak Khullar:** Thank you, Monica. Yeah, so in terms of assessing the impact on corporates, etc, obviously we will do that. There will be some impact on cash flows, but not all negative as well. Corporates will have to now learn to live with this. It's the new reality. But it'll also add increased transparency in terms of at least the SME sector, where every SME, anybody make more than AED 375 thousand will have to have a tax return, etc., which again helps banks in that kind of transparency. So, the two years to go, we will assess this and come out to the market with more detailed evaluation on this in the coming quarters. And factor this into our IFRS 9 models as well.

We were nearly at the end of our time. Just before we call it to a close, I and on behalf of all my colleagues here today, I wish to thank all of you for being present on this call and for the engaging questions. So, thank you very much indeed.

**Waleed Mohsin:** Thank you, Deepak. I would like to take this opportunity to thank you and the ADCB management team for your time and insights and thank you to all participants for attending. This concludes today's call. Have a good day and keep well. Thank you.

**Speaker:** Thank you. Thank you.

**Speaker:** Thanks, guys. Thank you.

**Operator:** Thank you. This concludes today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.