FAB Q1’2019 Earnings Call Transcript*

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Co-host

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HSBC

FAB speakers/participants

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Arif Shaikh
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Other participants

Naresh Bilandani
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Rahul Bajaj
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Hootan Yazhari
Bank of America Merrill Lynch

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*Edited

Operator: Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to today's FAB Q1 2019 Results conference call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session, at which time if you wish to ask a question, you will need to press *1 on your telephone and wait for your name to be announced.

I must advise you the conference today is being recorded on Monday, the 29th of April 2019.

Without any further delay, I would like to hand the conference over to your first speaker today. Aybek Islamov, please go ahead.

Aybek Islamov: Thank you. Good afternoon, good morning, everyone. I am Aybek Islamov, emerging markets bank analyst with HSBC. I am very pleased to invite you to FAB's First Quarter 2019 Results conference call.

And with no further ado, I'd like to hand over the call to Ms. Sofia El Boury, head of investor relations. Thank you.

Sofia El Boury: Thanks, Aybek. Good afternoon, good morning everyone, and thanks for joining us today to review FAB's financial performance for the first quarter of 2019.

On the call today from FAB senior management team, we have our group chief financial officer, James Burdett; our group chief risk officer, Arif Shaikh; and our group chief credit officer, Shirish Bhide. We also have our group head of subsidiaries, strategy and transformation, Karim Karoui. They will all be answering your questions at the end of this short presentation.

As we had our board meeting earlier today, you should have received the IR deck about 30 minutes ago. It contains our financial statements for the quarter, the management discussion and analysis report, the earnings presentation, as well as our quarterly series file. All these documents are currently available on the IR section of our corporate website as well as on our app.

So, with this, I'll pass it on to James for the presentation.

James Burdett: Thank you, Sofia. And good afternoon, everybody. At the outset, I'd just like to apologise for things – one, my voice because I'm on the back end of a flu, so apologies for that; and, two, we haven't given you our customary 24 hours to digest the information before hosting this call and that's for a very good reason, which is most of our senior management is off to KSA tomorrow for the official opening of FAB in the kingdom on Wednesday. So, that's a very positive step forward for us and hence the reason we needed to have the call today.

For those of you who have listened to me before, I'll go through the presentation. It's a quick presentation this time around, it's about 12 pages. I'll read through it pretty quickly and, then, we open the lines for Q&A. And as Sofia mentioned, we have a number of senior management sitting around the table that can help with any query you may have.

So, just starting with page 3, you will see that the profits for the quarter were AED 3.1 billion. That represents a record quarterly profit for us and is up 6% qoq and 4% over the prior comparative period. You see as we go through the presentation that business momentum continues.

Assets were up 8% yoy, deposits 7% yoy, non-funded income up 14% yoy. So, we are seeing good trajectory in our business momentum and also a very strong pipeline going into the second and third quarter. And therefore, our outlook remains unchanged for 2019.

We are very confident in meeting the targets we’ve put out to the market. Clearly, the balance sheet remains strong with robust CET1 ratio actually improving over the last year and the NPLs and coverage ratio remaining strong and our liquidity, of course, very strong.

So, moving to page 4, how did we perform against the guidance we put out to that market? I think you could see across most of the indicators we’re ahead of where we expected to be with the exception of revenue.

But, as I’ve said before, we’re confident of our ability to bring that back in the second and third quarters with the pipeline we have. Otherwise, if you look at return on tangible equity, CET1, cost of risk, all of the upper end of the range we’ve put out to the market.

Page 5 just talking a little bit about the strategic priorities. We talked about good business momentum with the pipeline materialising despite the competitive pricing in the market. The growth in terms of business momentum is mainly led by CIB.

Retail banking fell off towards the end of last year as we went to integration. There was a small contagion impact going into the first quarter of this year. But, we are starting to see a significant pickup in sales activity in March alone, which we expect to carry on into the foreseeable future.

I mentioned KSA. So, we are opening there on Wednesday, which is a very proud moment for the bank. And we have significantly advanced in our digital investment strategy and we started that whole process of executing our digital priority.

Just sort of touching on the last point around retail banking, clearly there were some teething problems after the integration, which have now been remedied, which have two impacts: one, we now have a unified platform from which to ramp up sales and service and in our – in our personal banking space. And that started to happen from March onward. But, also, after the post-integration mop-up, we are now starting to realise synergies again in the second quarter.

And, lastly, we are on track to achieve our run rate target of 1.5 billion -80% of that has been achieved to date. And we have a clear roadmap before the end of the year.

Turning to page 6. As I said before, good business momentum, strong liquidity. You can see loans and advances were up AED 6 billion in the first quarter or up AED 21 billion yoy. That's mostly CIB, trade and roughly split half-half between international and the UAE.

As I said, we have a strong pipeline. The pipeline is particularly strong in our domestic client target markets, the public sector and GREs, which is encouraging. Customer deposits as you can see, were down quarter-on-quarter mainly resulting from public sector entity and government outflows. But, a lot of that has come back already as of date. And I think it is mainly positioning towards the end of the first quarter.

Nevertheless, deposits are up AED 29 billion year-on-year. Notable improvement in CASA, which was up AED 2 billion qoq and now stand at AED 162 billion. And as I said, liquidity is strong with the Liquidity Coverage Ratio at 117% and the advances to deposit ratio at 83%.

Turning to page 7, the net interest income. If you look at the chart on the bottom left-hand side, you can see a reasonably material fall-off in the actual net interest income. Several reasons for that: mostly, it's the ECB placements as we manage our surplus liquidity which increased nearly 6 billion qoq or up something like AED 24 billion yoy. And obviously, the benefits of that whole economic trade reside in the FX and investment income line which, when we come to that slide, you'll see is up considerably over the last quarter and over the prior comparative period. A couple of other reasons – one, continued margin contraction in CIB due to competitive pressure. In PBG, we also see tightening of margin mainly due to risk repositioning and tightening some of those legacy portfolios which have a flow-on impact. And clearly, quarter 1 was a short month for us and there's a little bit of interest in suspense we have taken to be conservative.

So, all in all, most of the reasons for the fall qoq in the net interest margin is the increase in placements of the ECB.

Turning to page 8, looking at non-interest income which you can see is up considerably nearly 14% prior to comparative period and 19% qoq. Diving into fees and commissions, you can see they are up 3% qoq but down over prior comparative period mostly due to some one-offs that were recognised in Q1'18 but also personal banking due to risk optimisation.

As we got through integration, that is now starting to wind back up. And on the net FX and investment line, you can see it's up considerably, which mainly is a result of the ECB trade we talk about so often.

Turning to page 9. I already talked about cost. I guess the key thing to point out here is that BAU cost is flat qoq. That said, we do expect some synergy pickup in the second and third quarters. BAU costs are up over the prior comparative period. And that mainly relates to the depreciation of the integration asset now that we have fully integrated. But, you can see it's more than offset by a reduction in the integration costs and overall total costs are down 3% qoq.

Turning to page 10. In terms of asset quality, you can see the cost of risk at 50 basis points is relatively stable to last year resulting in net impairment charge of AED 407 million, slightly below the guidance that we put out to the market. But, we do expect a slight uptick in the cost of risk going forward because, as you well know, 2018 was an abnormally low year because of purchase price allocation and IFRS 9.

When you look at the NPLs, you can see there is a marginal tick upwards most relating to flow from personal banking. And the coverage ratio has dropped a little bit to 106%. We expect that to climb back up around 110% as we go into the next quarters. And clearly, the asset quality remains healthy with high levels of collateralisation and a good risk portfolio.

Turning to page 11. Core equity tier 1 is up over last year on a comparative basis mainly due to capital generation. You can see a notable pickup in risk-weighted assets which is mainly built up of risk-weighted assets relating to AFS credit risk-weighted assets as we deploy liquidity for optimal returns. And you can see there is a pickup in return on risk-weighted assets and the return on tangible equity remains strong at 12.7%.

So, look, in summary, we are sticking to our guidance. We are confident in achieving it. We've had a good first quarter. It is a transitional quarter because, obviously there was a little bit of a cleanup effort after the post day 1 integration, and we're starting to see some good business momentum, particularly in the non-funded income, global markets, personal banking starting to pick up in March and cost of risk is being managed in line with the guidance we put out to the market.

So, look, with that – I've gone through it pretty quickly. I'll hand it over to you for Q&A.

Sofia El Boury: Julia, can we please open the line for Q&A? Thank you.

Operator: Yes. Absolutely. Ladies and gentlemen, as a reminder, if you wish to ask a question, please press *1 on your telephone keypad and wait for your name to be announced.

Please stand by while we compile the Q&A queue. This will only take a few moments. If you wish to cancel your request, please press the hash key. But, once again, that is *1 if you wish to ask a question.

And we do have questions from the phone lines. The first question comes from the line of Naresh Bilandani. Your line is open. Please go ahead.

Naresh Bilandani: Great. Thank you very much. Hi. It's Naresh Bilandani from J.P. Morgan. Thanks very much for the presentation, James. A few quick questions, please.

One on the ECB trade. I'm sure you get quite a lot of questions on this. But, as I understand, this is the euro liquidity that you raised from Europe and you swapped it into the dollar to use this liquidity for lending.

Is there any indicator that I can track on Bloomberg the swap rate of any cross-currency rate that I can track just to ensure that I am able to forecast this in my model with much more confidence going forward? That would be my first question.

Second, I think you – during the presentation, you alluded to some competitive pressure in the margins in the personal banking side. If you can please shed some more light on the same. That's the second one.

And the third one is, of course, with all the news about the M&A with ADIB – and I just want to understand – and on the Investor Day also, you alluded to increasing the FAB's overall presence within the domestic market.

Just your thoughts on M&A in general, whether at this stage FAB is ready to pursue these steps further. And if not ADIB, what kind of a profile potentially would you be looking at from an organic growth perspective? Thank you very much.

James Burdett: Hi, Naresh. Thank you for those questions. Look, your first one on the ECB – it's difficult for us to provide some guidance because of the fact that the short-term placements and liquidity move quite considerably. So, it's very hard to predict.

Suffice to say that we are taking the deposits, paying a spread to the government for the liquidity, placing out the ECB at negative interest rates. And you can – you can see that on Bloomberg or wherever. And, then, we are swapping it to dollars. So, you can look at the swap points and maybe come up with some of your own ideas about the overall economic return.

But, what I will say is it's a very profitable trade for us. There is no incremental risk-weighted asset. And as you know, we only behaviourise a very small amount as longer-term liquidity.

I think when you look at government deposits when you get a chance when you are starting to look through the financial statements, you will see that the balance of the central banks has actually fallen qoq in line with the fact that deposits have fallen qoq. But, that sort of masks the fact that we've increased our ECB deposits and reduced our Fed deposits by more than that.

To your second question on NIM, on the retail side it's not necessarily competitive pressure. It's essentially we had a bunch of unsecured portfolio dating back 2 or 3 years ago. And as they slowly wind down, there is a negative headwind that we are facing as we go into each new quarter.

But, as I said last year, I think this will be the last year you will see that because, obviously, we are starting to rebuild the portfolio again. But, most of the competitive pressure is within CIB is people chasing high-quality names and a tightening margin accordingly.

On the M&A activity, we've categorically denied the whole ADIB rumor. I think at the Investor Day what we are trying to say is local consolidation makes sense. There is significant efficiencies from consolidation in the market. Clearly, if we had a choice, we would pick local acquisition because it just makes so much more money than an international acquisition or a portfolio acquisition.

So, we don't have any specific targets in mind. It's just logically consolidation makes sense. It supports scale in our own home market. If we could, we would. But, as you know, all M&A is very difficult process to go through.

It needs to fit in the strategy, be economically viable, it needs to be agreed by the shareholders. So, getting through all those filters is a very difficult thing to achieve. So, you can place odds from that accordingly.

Naresh Bilandani: Understood. Thank you very much, James. I appreciate it.

Operator: Thank you. The next question comes from the line of Rahul Bajaj. Your line is open. Please go ahead.

Rahul Bajaj: Hi. This is Bajaj from Citi. 3 quick questions from me, James and team. So, the first one is on the non-interest income. So, I'm just trying to think about the non-interest income line and the FX and investment line.

So, overall, 20% qoq increase. What part of that or what percentage of that you think is sustainable in the second quarter of the year ahead especially on the investment gains line?

The second question has got to do with the revenue growth. And, so +1% versus mid-single-digit guidance. What lever do you think you have to get it up beyond the healthy pipeline that you just mentioned?

And, then, the final one on Saudi, if I may, please. I mean you mentioned about opening of the formal business tomorrow here in Riyadh. But, I just want to get a sense of what's your target sort of mid-term objective in terms of the Saudi business in terms of percentage of assets or revenues by 2022 or 2023? Where do you see Saudi business going? Thank you.

James Burdett: Yes. Thanks Rahul. Good questions. So, in terms of the net FX and investment income, the momentum from Q4'18 to Q1'19 was partly a recovery in the markets which I think you've seen across the board and most of the banks are disclosing results. So, we had increases in credit trading, foreign exchange, sales right across the board. But, obviously, a significant portion was the ECB trade that we talked about. So, really it depends on the liquidity and the economics of that trade and if it will continue into the succeeding quarters. My sense is it will come off a little bit from that level but certainly be above last year's average. So, very sustainable from that perspective. In terms of mid-single-digit revenue growth target, we are sticking to that. We think it's very doable. There were a couple of things I pointed out: one, retail activity did fall off quite considerably in November-December last year, which spilled over to January and February. But, there has been a pretty significant pickup in March, which we expect to continue. We've got a significant pipeline of very good business in CIB books. We have deployed some extra credit risk-weighted assets on our global market function which we expect to get higher yield from. And just right across the board, we are seeing more activity.

So, I think that, coupled with the fact that we expect the stimulus package to start kicking in, we are pretty comfortable with the mid-single-digit revenue growth.

And in terms of Saudi, look, we don't have a handle on it. And on a relative basis, compared to the size of our balance sheet, the growth over the next two or three years is going to be relatively small percentage of the total of the pie.

But, we expect it to grow quite quickly. We believe it's a big market. There's a close affinity between the UAE and Saudi and it's one that we significantly want to grow in. But, it's early days. We've just opened. We need to see how it goes, feel our way through it. But, we've already done some significant deals and we are starting our retail proposition through digital channels. So, it's looking quite encouraging. But, I wouldn't like to put a handle on it at this stage. It's too soon.

Rahul Bajaj: Thank you. Yes.

Operator: Thank you. Ladies and gentlemen, may I remind you if you wish to ask a question, please press *1 on your telephone keypad.

The next question comes from the line of Hootan Yazhari. Your line is open. Please go ahead.

Hootan Yazhari: Hi there and thanks for the call. Just focusing on the digital transformation initiative that you are alluding to earlier, in terms of the focus of this, is this mainly to procure new deposits? Is it more about reducing existing cost base through AI et cetera? And if so, has this been captured in your guidance for cost to income going forward?

And, then, moving to the Saudi business, obviously very competitive market. We are expecting it to pick up in loan growth this year. Are you finding that you have to compete on price pretty aggressively there? Or are you able to procure assets at an attractive level without having to compromise on asset quality? Thank you.

James Burdett: Yes. Thanks Hootan. On the digital side, I think there is a number of reasons for this. One is – I mean the big picture goal for us is to enhance the customer experience by improving the end-to-end processes behind any sale of products, services or distribution.

And I think the benefits you get from that are, one, you improve customer services. Two, you improve efficiency because, obviously, the cost go down when you take out manual intervention or human intervention. And then, lastly, it is a true digital proposition that we are putting up there. So, we expect a reasonably material pick up in sales productivity on the back of it because, obviously, a digitised proposition is dependent on the behaviours of the customer. So, to answer your question, yes, the cost-to-income ratio guidance encapsulates this. But, what I would say is that we are slow off the mark. We spent 2017 doing a merger, 2018 doing an integration. We know we're behind the curve. We know it's going to take some time to build this digital proposition. We have embarked on the top sort of five or six customer journeys this year. And if we nail that, we expect significant improvements in efficiency.

And on the Saudi side, yes, you are right that the pricing is tight. So, you're competing with banks from the ground that have the benefit of significant pools of retail deposits and the wholesale curve. This time, there's a lot of competition. But, what we are finding is our key differentiator is our position in the UAE, the relationship between the two countries.

We've already done some DCM activity, which is relatively low on risk-weighted assets and high on yield. And in the retail space, we are looking to go quite aggressively into mortgages where the pricing is very favorable and there is a lot of demand.

So – but, I think you're right. On the CIB side, it's just banking on reasonably good-quality assets. You are going to see quite tight competition. So, we are very mindful of that as well.

Hootan Yazhari: Understood. Thank you.

Operator: Thank you. And the next question comes from the line of Denis Gasimli. Your line is open. Please go ahead.

Denis Gasimli: Hi. Good afternoon. Thanks for the presentation. I have one question. It is – that would be regarding the real estate exposure of the bank.

I mean around 29% loan book was to real estate and construction segment. I mean based on the numbers, I think around half of that is to the UAE corporate real estate sector. I just wanted to ask your comments – if you can give more color on this? If you can talk about to which companies – I mean broadly speaking, I know you can't mention specific names. But, how comfortable are you with the quality of that portfolio? And I mean do you plan to reduce the exposure going forward? Thank you very much.

Arif Shaikh: Yes. Hi. Thanks for your question. In terms of the distribution by geography, we have predominantly Abu Dhabi followed by Dubai and then other markets. We have some real estate exposure in the U.K. also, which is kind of sovereign-related. Now, rather than getting into a number, I think there is a philosophy behind real estate. We spoke about this at the Investor Day and for your benefit I will repeat it again. It is that we do not do standalone real estate. Real estate for us has to be part of a larger relationship with the customer. And real estate happens to be one piece of that.

The second is, therefore, most of the things that we do we ensure that the cash flows to us. So, in terms of property management activity and so on and so forth, making sure that we have control over the end use of the cash.

So, this is the philosophy on real estate. It is widely distributed in terms of the segments that we lend to. These are the prime names. The government also plays a role. The government is also a borrower in the real estate side. We cater to the government as well.

So, it is something – it is a real segment in the UAE. We have seen three cycles in the UAE of boom and bust. We know how to handle this. And as I said, our property management business is controlling the cashflows, which is a key element we look at when we look at real estate in this market.

Denis Gasimli: Understood.

Operator: Thank you. Once again, ladies and gentlemen, please press *1 if you wish to ask a question. We have no further questions from the phone lines. Please continue.

Aybek Islamov: Thank you, operator. This is Aybek. So, perhaps if we have no further questions, may I just add one from my end.

I think looking at the first quarter results, the net interest income performance – I mean you said it really well. It's a bit of a surprise. And when I look at the balance sheet dynamics, the government deposits dipped in Q1 and the fact that you started to do more ECB placements, how do we correlate – is there any correlation between the government deposit behaviour and how much is placed with the ECB? I guess I will kind of phrase the question this way.

And I think, secondly, it does sound like – and you explained it in the past where you do get other revenue in your FX and investment income line where you generate basis points on your currency forwards against the euro and I was thinking how much of the NII dip quarter-on-quarter was compensated through the currency swaps that you've booked? Can you give us a rough idea? And that will be very helpful. Thank you.

James Burdett: Yes. So, I think the answer to your question is the difference between month-end balances versus average balances. So, yes, you're right. The (government deposits outflow) right at the very end of the first quarter, but most of them came back in April. And, so, in terms of income generation, you need to base it on averages, and the averages were high until the end of the first quarter. So, that's the answer to that. And in terms of the second question, I'll pass you to Sofia.

Sofia El Boury: Hi, Aybek. I just wanted to basically take you through – I mean the dynamics in terms of the deposits. The outflow happened at the tail end of the quarter. So, the balances that you have that have an impact on NII are actually taken – do not take into consideration those outflows.

So, technically, what you have in the NII is the net – the interest expense component that's related to those ECB placements. So, you only have the negative impact.

The positive impact is – you can find it basically in the FX and investment income. And if you go to note 23 of our financial statements, we actually also provide a disclosure whereby we mention the negative interest income that's coming from the ECB placement. So, the negative interest income related to those ECB placements was AED 84 million in Q1. And basically, from that, you can even imply what – the volume of ECB placements that we are talking about based on the negative interest rate. I'm happy to take this with you offline to provide you with more information.

Aybek Islamov: OK. That's very helpful. Thank you. Thank you for your answers.

Operator: Excuse me. We do have another question from the phone lines. Would you like to take the question?

Sofia El Boury: Yes, of course. Yes.

Operator: Yes. The question comes from the line of Naresh Bilandani. Your line is open. Please go ahead.

Naresh Bilandani: Great. Thank you. And apologies for just one more question. Just a quick one on asset quality, please. And I apologise I haven't had a chance to go through the numbers yet in detail.

I was just going through the asset quality numbers and it looks like that the – although it's not alarming at this stage, there has been a slight pickup in the NPL. And if I take a look at on slide number 10 on the bottom right chart, the coverage ratio consistently seems to be coming off.

In just – in this regard, could you please explain what is the key reason for a steady decline - (a) on the overall coverage rate? (b) if you could please provide some update on what is the level of collateralisation on the book currently.

And you mentioned that the NPLs were sequentially led by retail and a few corporate accounts. Any further color that you could provide on what sectors this comes from?

And any further risks that you could provide on – any risks that you might think on the asset quality side– what would be the key areas of concern within the different economic pockets in your view at this stage? Thank you.

Arif Shaikh: Naresh, thanks. A lot of questions. I'm not sure I got all of them. But, I will try to answer whatever I can.

The first quarter number, both in terms of the uptick in the cost of risk and the coverage. This is more of a mathematical calculation rather than you reading any trend into it.

These are various numbers which we do calculate so on and so forth. And this is just an outcome. And as James said in his presentation, we probably see these improving in the next quarter as we go forward.

In terms of the retail flows, yes, the retail flows are there. On a quarter-to-quarter basis if I were to do a comparison, they are lower than the previous quarter. So, we see a lot of stability coming as far as they are concerned. But, clearly, that's an item we will continue to watch as the situation evolves.

In terms of CIB, which I think which is one part of your question, we have had those – the usual suspects which we have been tracking for some time. We will continue to track them through the year-end. But, clearly speaking, the asset quality profile is very healthy. It's underpinned by strong cash provisions and high levels of collateralisation. I don't have an exact number for you in terms of the collateralisation. Maybe Sofia can take that offline.

And outlook for the remainder of the year is stable and more positive. Clearly underpinned by the positive macro news that we see and the healthy pipeline, both from the government of Abu Dhabi and other private names.

Naresh Bilandani: Understood, Arif. Thank you very much.

Operator: Thank you. And there are no further questions. Please continue.

Aybek Islamov: Well, I think if there are no further questions, Sofia, I'd like to perhaps hand over the call to you again for any closing remarks.

Sofia El Boury: Yes. Thank you very much, Aybek. I understand that it's not ideal to get financials and everything just a few minutes prior to this all. So, please, if you have any further questions, don't hesitate to reach out to me, Abhishek and the rest of the IR team later today. So, thanks very much for your attention and speak to you soon. Thank you.

Operator: Ladies and gentlemen, that does conclude the conference for today. Thank you for your participation. You may now disconnect.