FAB Q1 2020 Earnings Call Transcript*

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Co-host

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Aybek Islamov: Good afternoon, good morning, good evening, everyone. This is Aybek, Emerging Market Banks equity analyst at HSBC. On behalf of HSBC, I would like to welcome you to First Abu Dhabi Bank's Q1 2020 results call. As a reminder, this call will be 60 minutes, and, with no further ado, I would like to pass this call to Sofia El Boury, Head of Investor Relations. Thank you.

Sofia El Boury: Thank you, Aybek. Good afternoon, good morning, everyone. Thank you for joining us today to review FAB's financial performance for the first quarter of 2020. From our senior management team we have on the call today our Group Chief Financial Officer, James Burdett, our Group Chief Risk Officer, Arif Shaikh, and our Group Chief Credit Officer, Shirish Bhide. They will all be answering your questions at the end of this short presentation.

As you know, we had our board meeting yesterday afternoon, and all our disclosures for the first quarter of 2020 are available on our website as well on our app. So please feel free to refer to them on these channels, to access the presentation we'll be going through today. So with this, I'll pass it on to James for the presentation.

James Burdett: Thank you, Sofia, and good afternoon, everybody. Thank you very much for joining us today, and Ramadan Kareem to everyone, best wishes. I'll go through, as usual, the slide deck at a fairly fast clip, so that we can leave time for Q&A at the end. So thank you for joining, and if you turn to page three of the investor presentation, we can get started.

So this is really just a wrap-up page to introduce the deck. Clearly, you'll be well aware of the unprecedented market disruption that we've had. We've had, I think three or four weeks back, significant liquidity squeeze, massive volatility, oil prices have fallen to extremely low levels, and I think against that backdrop we've still delivered a resilient performance in the first quarter, where profit is AED 2.4 billion, which is down 22% over last year, mainly due to the Fed rate cuts and COVID-related provisioning. Those are the two main items that have caused the 22% decline.

But notwithstanding that, we've obviously maintained a very strong balance sheet. The core equity tier 1 ratio is above 12%, liquidity coverage ratio 110%, AD ratio below 80%, and actually our coverage and NPL ratios remain pretty constant. We've gone through a significant amount of action-orientated work over the last three weeks. We've preserved liquidity to support local UAE clients, I think most of our staff are now operating from home, and we're still meeting the customer requirements through digital technology. So I think that coupled with the strong balance sheet means we're in a strongly competitive position, and I think our unique strengths, strong balance sheet, AA- rating, ability to generate significant organic capital, put us in a good position to, when we come out of this crisis, be it a U-shaped or V-shaped recovery, we should perform very well.

If you look at page four, it's just a very high-level snapshot of the evolution or the bridge between first quarter 2019 impact and first quarter 2020 impact, and you can see the two main items in force, there. So operating income down AED 376 million, that is mainly due to the Fed rate cuts. As you know, we had rate cuts in July, September and October last year, flowing through, and that's the main variant against first quarter 2020.

One thing I should point out, though, we obviously had 150 basis points cut at the end of March, that's yet to impact our P&L and obviously flow through to subsequent quarters. Looking at impairments, you can see they're up significantly, nearly 81%, or AED 331 million over the same period last year. That is mainly due to COVID overlays that we've put through, and we'll talk more about that as we go on. So those two main items resulted in profits falling by 22%, to AED 2.4 billion.

Turning to page five, I just want to hammer home the importance of liquidity, and clearly it's a moving piece. Three or four weeks ago, there was a real liquidity squeeze and credit spreads blew out considerably. Notwithstanding that, we've already raised USD 2 billion of wholesale funding at very good rates. The funding plan we initially put out to the market was AED 3 billion to AED 5 billion, but that was in response to tightening of liquidity requirements from the central bank, which has obviously been put on hold. The AA- rating is really playing in our favour. We've seen a massive flight to quality, and even in April we've seen a pretty significant uptick in our deposits. As I said, liquidity coverage ratio remains well above 100%, at 110%, and we have very strong balance sheet, which I'll talk about a little bit later.

Just looking at the business momentum, on page six, and I want to be clear here, because, as we've mentioned before, in December we had a significant one-off, which increased both the loans in advances and customer deposits by about AED 30 billion. That came in and was gone, I think, within the first week of January, so if you exclude that, we're still showing growth, sequentially, and obviously significant growth over the prior comparative period.

In fact, if you look at customer deposits over the last year, we're up AED 64 billion, or 15%, and if you exclude the one-off, we're up AED 8 billion, qoq (sequentially). And what's also pleasing to note is that we're seeing continued growth in CASA balances as we roll out our GTB platform, which grew nearly AED 7 billion sequentially. So that's great, sticky liquidity that we like. And obviously, the international network is a key differentiator for us, with those deposits growing significantly, year on year.

And as I said before, we are witnessing a flight to quality, and we've seen a further, fairly significant, growth in deposits in April. On the lending front, as you'd expect, the pipeline's a little bit slower. We are preserving liquidity and prioritising our core customers, which are the public sector entities, GREs, core UAE clients, which I think makes a lot of sense.

On slide seven, just to hammer home the importance or the strength of the balance sheet, we've put up this very simple chart, just to remind you that we're only a 46% lent bank. You can see we've had significant cash in central bank balances, a reasonably significant investment portfolio, of which a significant proportion is investment grade and above. But when you look at the loans advances and drill down, nearly 31% of those are government, government-related entities, so obviously very high credit quality. 8% is short-term self-liquidating trade loans, which we can roll off at any moment, and clearly any losses associated with those would be almost unthinkable, so we expect a very low ECL related to that part of the portfolio. And I think that 46% compares to 60% to 70% in other banks, so it's just to put out there that we have a very strong balance sheet, which I think you already know.

Jumping on to page eight, and just looking at the cost of risk, clearly impairments are up significantly. The cost of risk last year averaged about 50 basis points, jumping to 70 basis points in the first quarter. Clearly, we've been following the central bank guidelines and, from an accounting perspective, we've taken management overlays for COVID through our IFRS 9 accounts, but clearly, it's early stages and there is an expectation that we think there'll be an increased cost of risk, going forward. Bottom right-hand side of page eight, the NPL's ticked up a little bit, mainly in the retail banking space, but the coverage ratios and the NPL ratios remain broadly flat.

Jumping on to costs, page nine, clearly in response to the negative headwinds on revenue, you would expect us to do something on costs. You can see on the bottom chart, there, that we've reduced costs already sequentially by 60 million, or 4%, qoq, and we do have plans to take further significant costs out of the bank as well. We're not going to disclose how much it is, but it is reasonably significant, and you'll see that come through in subsequent quarters. And I think it's an expectation that management should take actions in this low-revenue-rate environment.

Jumping on to page ten, and just looking at the core equity tier 1, clearly it's dropped over December 2019, post-dividend, core equity tier 1 of 13.5%, which, as you know, is the target that we've put out there as the medium-term target.

One thing I'd like to point out here is other movements. You can see it's dropped by 1.54%, and the main reason for that is the blow-out in credit spreads, mainly in GCC names on our investment portfolio, have caused nearly an AED 8 billion AFS loss that's gone through other comprehensive income, and obviously impacts our core equity tier 1. But clearly, and we can talk about this later, there's a slide on this, we've got a very strong investment portfolio. 80-something per cent of it is investment grade, it's well diversified both in terms of geography and sovereigns, and in fact already in April a significant proportion of that has come back, as credit spreads have started to tighten again. Clearly, the return on equity, tangible equity, has dropped, as you would expect in response to the higher provisions and revenue headwinds from the Fed rate cuts.

So looking ahead, on slide 11, and this is, you'll appreciate, a moving piece, things are changing pretty rapidly in the market, our number-one goal was to preserve liquidity for our customers, and preserve our credit rating by making sure we're being prudent in terms of risk discipline, and in fact deploying our surplus liquidity to our core customers, deprioritising, to some extent, international growth plans, focusing on the UAE, our core customers, which I think makes a lot of sense. Clearly, we need to support our customers and we need to support the government in its efforts to provide relief to customers, and we're working very hard on that. And of course, as a backdrop to all of this, we need to make sure costs are managed in this lower-income environment, but we also need to protect our shareholders fund by being very prudent on deployment of liquidity, credit risk and so on.

So on the right-hand side of that slide, we've given you some expected outcomes, and loan growth. We put out the market mid-to-high-single-digit growth. We still think that will happen, ex the one-offs, and I think that's coming through in terms of the pipeline to our core customers. Revenue growth will obviously be down. We've already said to the market that every 25 basis point is between AED 250 million to AED 300 million of net interest income reduction, and there have been a significant number of Fed rate cuts last year, and also 150 basis points at the end of March this year. We think that'll push cost income ratio back up to 30%, notwithstanding the cost actions that we're taking. Clearly, cost of risk is a moving target. No one knows how long this crisis is going to last, how deep it'll go, whether the recovery will be U-shaped or V-shaped, so clearly we need to go through more analysis to come out with a cost of risk guidance, because it's early stages at this point in time. The core equity tier 1, we're maintaining our guidance, our medium-term guidance, at 13.5%, pre-dividend.

So to wrap up on page 12, but I do want to go into a couple of the appendices, clearly an unprecedented environment. We've focused on maintaining our balance sheet and our AA-rating, so we're focusing on the key things of liquidity, funding and capital preservation. We're using our balance sheet strength to support our local customers and I think, as a leading UAE bank, we're well positioned to take advantage of the recovery when and as it takes shape.
And despite those significant headwinds, this we think is an event that will be over in some period of time, and we're confident that we can continue to deliver shareholder returns.

Just before I hand over to Q&A, because I know some of the articles that came out from you, post our results, went behind, I just want to clarify a couple of things.

So if we turn to page 14, and just look at net interest income, I think it's worth me just highlighting a couple of things. You can see, on the chart on the top left-hand side, the net interest income for the fourth quarter was just over AED 3 billion, and actually first quarter 2020 it's actually up a little bit, AED 30 million, or 1% qoq, but down a little bit over the first quarter 2019. The main reason for that is the Fed rate cuts coming through our balance sheet, being offset by lower ECB balances.

So as you know, we have significant balances with the central banks. Previously, we've placed those balances with the ECB. The ECB pays negative rates. That flows through into our net interest income. We swap it back to dollars and the income from that comes through in the FX and investment income. Clearly, with lower ECB balances, we had less negative interest, and that's why margins have held up despite the rate cuts. And obviously, there was the reverse effect on the FX and investment income.

In terms of net interest margin itself, you can see it's down 26 basis points. That's a contraction in deposit margin of about 40 basis points, because of Fed rate cuts, being offset by lower ECB balances to the tune of about 12 basis points, resulting in a net reduction of 26 basis points with loans largely flat.

Now, one thing I want to point out is the reason for the reduction in the ECB balances, even though it's more lucrative, is simply because of the liquidity squeeze that happened, so we actually reduced our ECB balances by a significant amount, I think just over AED 70 billion, and placed within the Fed. And the reason for that was to preserve dollar liquidity when the liquidity crunch happened. Interestingly, since the liquidity's come back, I'm talking about events three or four weeks back, we've since replaced back in the ECB, which means we'll get negative interest and the corresponding income coming into the FX and investment line.

Just jumping onto non-interest income, on page 19, obviously a pretty significant drop, down 18%, year on year, to AED 1.5 billion. Fees are up, which is good, both in personal banking and our corporate banking business. We are starting to see good growth volumes in our personal banking business on the back of the integration that happened in previous quarters, ramping up sales volumes still coming through. But that was more than offset by FX and investment income being down, and there are two items there that make that. One is the reduction in the ECB balances and the swapping, that was one chunk, and the second chunk is we've made some valuation adjustments on our derivatives and global markets portfolio. We've taken credit valuation adjustments through, which again we believe will come back as and when the recovery comes through. So they are the main reasons for the fall-off there. So net interest income higher being offset by a reduction in FX and investment income, with some valuation adjustments going through.

And then, lastly, I just want to take you to slide 17, just to look at the AFS book. So you can see, there, the investment book is AED 132 billion. You can see it's well diversified by geography, with UAE, GCC accounting for about 45%. You can see on the bottom right-hand side at least half of it's in sovereigns. A significant proportion is repo eligible with the central banks. And on the top right-hand side, most importantly, you can see a significant proportion that are investment grade and above. And the reason I want to show you all this is because the AFS losses that we took through other comprehensive income, which obviously impacted our core equity tier 1 ratio, is due to the blow-out of credit spreads on that very conservative investment portfolio, which, as I said earlier, is already coming back. So with that, I want to hand back over to you for Q&A. And as Sofia's already said, we've got Shirish and Arif here, because I expect there'll be some questions on risk. But over to you, thank you.

Operator: Ladies and gentlemen, to ask a question today please press star followed by one on your telephone keypad now. If you change your mind, it's star followed by two, and when preparing to ask your question, please ensure your phone is unmuted locally. Our first question today comes from Hootan Yazhari, of Bank of America. Hootan, your line is open.

Hootan Yazhari: Hi there, and thank you for the call today. Just a couple of questions. With regards to early thinking on the dividend and any discussions you might have had with the central bank, would be grateful if you think that caution is going to win the day and you're going to reduce one of your class-leading payout ratios.

And then, the next thing I wanted to see was really regarding the areas of cost control that you alluded to. Where are we going to see these cost savings coming? And where are the areas you will maybe think about accelerating expenditure? Is that, for example, on the digital side and the like? Would just like to get some more clarity on how you see costs evolve. Thank you so much.

James Burdett: Thank you, Hootan. I'll take both those questions. First on the dividend, it's way too soon to make a call. We don't know the size and the shape of the provisions that are going to come, or how long this crisis is going to last, whether it's going to be a U-shaped or V-shaped recovery. There's been no discussion with the central bank about dividend payments being restricted, as have some other jurisdictions. What I would say is we have stressed our numbers. We still have, and believe we have, a strong ability to generate significant organic capital through profit generation. We want to maintain our AA- rating, so the core equity tier 1 ratio is absolutely all-important. So as we said before, maintain that, i.e. the rating, the core equity tier 1, our ability to generate significant organic profit, and then throwing into the mix our desire, that we've always said, to be a high dividend yield bank. All of those three things will come out as we go through the year and figure out what the final results will be. But we've stressed it pretty significantly and we're confident of being profitable, reasonably profitable, even in the utmost stressed scenario.

On your second question, costs, yes, we know exactly where we're taking the cost out. We've got a plan, we've got that plan broken down into various items with various ExCo members responsible for the delivering of it. It's about half staff costs, half non-staff costs. There are a number of initiatives going on. We are maintaining our investment in digital, because obviously we need to run a sustainable business, but we are seeing a reduction in flow in certain areas, so we're looking at that very carefully and focusing on those areas, to take out costs where the revenue has slowed down. We're also looking at some of those international countries where we're running disproportionate costs and regulatory risk, so we've got a project focusing on that as well. So it's right across the board. Nothing's been left unturned. You know how aggressive we are in terms of maintaining cost discipline, and the least we can do for the shareholders and investors is manage our costs in response to the revenue headwinds that we all know are coming.

Hootan Yazhari: Thank you.

James Burdett: Thanks.

Operator: Our next question today comes from Naresh Bilandani from J.P. Morgan. Naresh, please, go ahead.

Naresh Bilandani: Thank you, hi, it's Naresh Bilandani from J.P. Morgan. I've got bunch of questions, please. First of all, can you please share some insight into how you have accounted for or, alternatively, how you plan to account for modification losses on the P&L from all the forbearance, potentially? And how much forbearance demand have you already seen in March and possibly, if you can guide, in the month of April? That's going to be my first question.

My second question is referring to page 13 of your report, where you lay out the probabilistic assumptions for economic scenarios, and I'm assuming you shift these even for worst cases than what you have recorded or reported, can you throw some light on what was the peak cost of risk that you would have had borne in such a stress, in an extreme stress scenario?

My third one, as you, James, pointed out earlier during the call, as you mentioned you've seen some market-to-market reversal in your FVOCI book, but assuming the valuations stay depressed for a while, is there any circumstances, from an accounting perspective, where these losses have to flow from the P&L in the form of impairments? I'm trying to think of my GFC (global financial crisis) days where, if I remember right, in the AFS book, if the valuation stays below 20% for over a year's time, you had to park them via the P&L? Maybe I'm mistaken, but if you can please just guide us if that still holds true under IFRS 9?

And my final question is on the TESS funding. To what extent did you utilise, and to what extent could that help your net interest margin in the future quarters? I'm sorry for all the questions, but if you want me to repeat any, please just let me know. Thanks.

James Burdett: Okay, Naresh. Thank you, I'll take the last two and then hand the first two over to Arif. On the third one, which was about the ECL, I guess, associated with the AFS book, when you look at the comprehensive income, you'll see that that includes the market-to-market and the ECL movements for that book. But clearly, it's a high-quality book, so the ECL movements are relatively minor, at this stage.

In terms of TESS, we were allocated AED 8 billion, and we've fully used it. So it's essentially AED 8 billion of free funding. And then, Arif, if you don't mind, I'll hand over to you to talk about COVID?

Arif Shaikh: Ramadan Kareem, everybody, thank you for being on the call today. What I'm going to do is probably spend a minute in terms of explaining the background, in terms of how the banking system and we have reached where we are. Because I think that is essential to answer this, and probably other sets of questions which may come in.

Now, middle of March, as you know, the banks got together, there were various conversations with the regulator, and clearly the whole pitch was around liquidity, in terms of how the liquidity had to be managed, because we, as a system, had seen some liquidity squeeze, that subsequently, by the end of March, you had the TESS regulation which came out which raised more questions than answers. All of that going on. By early April, when the governor changed, the banking system had gone with a list of things and they predominantly revolved around liquidity, which was the key interest of all banks, including FAB, at that point of time, and clearly the central bank reacted by relaxations on the LCR requirement, relaxations on the reserve requirement, which pumped in a lot of liquidity to the system, and that got kind of taken care of.

There were a number of capital requirements which we had to adhere to by June of this year, which again were relaxed, and we kind of pushed back to the following year. In terms of asset quality, which is where Naresh's question is around, the central bank has issued a number of regulations. If you look at the number of regulations which have come up over the last three weeks or so, there are probably about ten or so which have come, including last week, a recent one, in terms of the IFRS 9 accounting rules, and what the banks should be doing.

Now, the direction from the central bank has been very clear. They are trying to protect the system. They do not want banks to be downgrading accounts, moving between stages, trying to employ factors and scenarios which may or may not be correct. So the direction is very clear, if you read the last one which came in. It talks about caution, it talks about banks looking at their portfolio and traversing the journey on a gradual basis. At FAB, this is exactly what we have done. We have looked at our portfolio. Now, almost until the third week of March, we were in the office, everybody was pretty much, COVID was around, it was BAU, and things were going on, so these numbers, first caveat is that they are as of the 31st March. We looked at our books. Clearly, from an IFRS 9 perspective, the thing which dramatically moves the ECL around is a macroeconomic forecast. The central bank has been very categorical not to apply the macroeconomic forecast, and kind of sees them, as of 31st December 2019. And this is exactly what we have done.

There have been various debates, discussions between us and the Big Four, between the Big Four and the Banking Federation, and between them and the central bank, and we've all come to this conclusion that picking one scenario compared to another scenario may or may not be correct.

So this is setting the context of where we are. For FAB, we have gone through our books really as the accounts were been closed, the TESS was kind of understood, we were using the TESS lever which the central bank gave, and we were evaluating what options were there, the obligors who wanted to apply under the TESS were really coming in.

So my submission to you is that this is too early now. We can look at scenarios and we can look at more scenarios, but the fact of the matter is that obligors who are under stress and who need help are still coming in and asking for help, and we are assessing this. To pick one situation and do an estimation, I think, at this point of time, is quite risky, and we have not done that. The central bank, in its last circular, also talks about the overlay, it talks about governance around the overlay, and it says that you should sensibly apply it, if you read between the lines. And this is exactly what we have done. We have looked at the books, we have seen, where are the stresses coming from, which are the obligors which have come in, and we have applied an overlay. Is this mathematically the best thing we could have done? The answer is probably no. Probably, we could have looked at other stuff and relooked at it and relooked at it and come up with different numbers. But in the wise decisioning of the bank, this was the best thing we could have done. Do you think we should be taking more provisioning as we go through the year? Definitely, yes. If the situation demands, we will look at it in different ways and shapes and forms.

And as for page 13 and the scenarios that concern, we have done exercises where we have moved these on a downward basis. We did not want to get into the details of this because I still believe this is still quite academic at this stage. Once we have really looked at our books, looked at the obligors who have come in, assessed what they are really doing, I think by the second quarter and third quarter, by the end of the second quarter, we would be in a better position to really judge the impact of COVID-19. I hope, Naresh, I've answered your question.

Naresh Bilandani: Yes. Just so that I understand it right, the assumptions that went into IFRS 9-related ECL calculation in the first quarter are still based on macroeconomic assumptions which were present as of end of 2019, and what you essentially did was just enhance the probability of the bear case scenario, based on those assumptions.

Arif Shaikh: Yes.

Naresh Bilandani: Going forward, as I understand, what will happen is you may take bear into your model the new reality, which would put an upward pressure, overall, on the cost of risk. Is that fair to understand?

Arif Shaikh: Yes, I think that would be fair. And clearly, I think from your perspective, FAB has the appetite, if it needs to take more provisioning, as we go through. And we have a fair assessment of where our book actually is and what we need to do. So we get updates from Moody's every couple of months, is it right? is it not right? What's the COVID stress? How do we apply the COVID stress?

I think these are all very, very nascent at this point of time. We are learning, so is the market learning, and to state that this is right and this wrong, we are not really getting into that debate. I think we have applied wise decision-making and judgment in coming up with the COVID number, and I think, second quarter, by the end of the second quarter, we should really have a grip on this in terms of what we really want to do with the provisioning number or the ECL number. The central bank regulation is very clear. We have discussed this with the central bank, we have discussed it with KPMG, and everybody seems to be happy that this is where we should be, at this point in time. Is it going to change? Definitely it's going to change in the second quarter.

Naresh Bilandani: Okay, my final question that I have, in accounting, and if you could translate for how you accounted for the modification losses on the P&L? And to what extent, if you can guide please, how much forbearance demand did you see in March, and possibly, we are at the end of April, if you can show some broad guidance, that would be super-helpful.

Arif Shaikh: I think James can answer the academic question. In terms of the demand, I think it is still unclear, as I said, and we should have some assessment of where we are in the next couple of months.

James Burdett: And can I just add, Naresh, first of all it's a highly volatile environment. Secondly, we will always remain prudent with our provisioning. And thirdly, going back to one of those slides I presented, we've got a very high-quality portfolio, so we've got only 46% lent bank, where a significant proportion of it is government or government-related entities. So I think the way the bank's treated it, and what Arif has said is absolutely spot on. You had a technical question? Yes, we'll follow up, after the call. We'll follow up after the call on that.

Sofia El Boury: Hi, Naresh. You had a question about the forbearance? Shirish, maybe you can take the question, about the forbearances?

Shirish Bhide: I thought that was answered already. I think it was addressed earlier.

Sofia El Boury: Okay, thank you. Perhaps we can take the following question. Naresh, is that fine?

Naresh Bilandani: It's fine. My question, is mainly on the size of the forbearance demand, and Arif mentioned it's still a work in process. I assumed you want to provide a number at a later stage, so that's fine, we can take that in a follow-up, no worries.

Sofia El Boury: Okay, perfect. And we can take it offline.

Arif Shaikh: One minute, so we both on the CIB side and PB side, in terms of the relief. And clearly, as we speak, there are obligors who are approaching us. Please give us some time. This will crystallise, I think, within the next couple of months.

Sofia El Boury: Thank you. Todd, we can move on to the next question.

Operator: Thank you. The next question comes from Rahul Bajaj from Citi. Rahul, your line is open.

Rahul Bajaj: Hi, gentlemen, thank you for the call. I have two quick questions, actually. First, on demand for loans, just so I understand, how is the demand for loans post-COVID as we're in April. My thought process there is that, yes, there is lockdown, so there would be a disruption in demand, but then there would be demand for short-term liquidity from stressed corporates. Where are we, and how is FAB approaching the demand for loans?

And the second one, a quick one on the balance sheet. What is the jump, in due to banks, just wanted to understand what's driving that qoq jump. Thank you.

James Burdett: Yes, that's a good question, Rahul. So the second question first. It's a simple one, it's just increase in collaterals posted on the back of the volatility and market on both sides of the balance sheet, right across all the banking industry. That answers that almost entirely.

In terms of demand, I'll get Shirish to jump in specifically, but the pipeline is, as we originally expected, so our traditional client base, Government, GRE. The government was embarking on a stimulus plan, we think they will continue to do that. If anything there's even more of a requirement to push the economy along, so we think our traditional client base will continue. We said mid-single-digit growth, and that's why we think we're well positioned to outperform the market when the recovery takes place, because we know the government's going to stimulate the economy, we know that's our traditional client base, and that's where we're seeing some of the pipeline.

Rahul Bajaj: Thank you.

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

Shabbir Malik: Hi, everyone, thank you very much for this presentation. In terms of fee income and loan growth, and if you look at the coming quarters, I think Q2 is going to be more impacted by the COVID-19 lockdown, how do you see fee income and, generally, loan growth in the second quarter for the bank? And maybe if you don't want to talk specifically about the bank, more generally in terms of the industry, how do you see Q2 shaping up for the sector?

And secondly, you've obviously talked about your NPL ratio, in terms of stage 2, has there been any noticeable changes in the first quarter that you would like to highlight?

James Burdett: I'll take the first one. So on fee income, clearly volumes have dropped considerably in April, in response to COVID, particularly in the personal banking business. There's a lot less activity going on in the branches, a lot less activity going on, basically, in general, so yes, I think there will definitely be an impact, but I think it'll come back slowly, as the market comes back.

I think just offsetting that, in the personal banking space, we've had reasonably significant uptick in business in personal banking, from the integration days. The sales model seems to be working, the digital platforms are growing, and, in fact, we're getting more and more business from that. In the corporate banking space, I think you'll see some pent up demand and, pretty quickly, we'll be looking to roll out balance sheet growth as companies get confident to start spending again. And obviously, the fee income on the back of that will come through.

The FX and investment income, we've mainly put some fair value provisions aside, as negative revenue, on our positions there. I think that'll come back as credit spreads tighten. As we place back in the ECB, you would expect to see that income roll through in the FX and investment side with the corresponding reduction in net interest income, but overall more profitable for the bank.

The other desk that took a bit of a hit, the equity trading desk, and some of those other desks, I think you'll start to see come back as volatility becomes manageable. So I think, overall, it's too soon to make a call where non-funds income will end up, but there's no question March took a hit.

Shabbir Malik: In terms of your stage-two loan, has there been any noticeable uptick in stage-two loans? Maybe the first quarter is still early, but any early indicators of what the rest of the year could look like?

Arif Shaikh: Hi, Arif here. So yes, you're absolutely right. As I said, we were in office till the end of the third week, and it was quite BAU. So in terms of the stage-two, and I'm looking at the numbers as I'm talking to you, there has not been any noticeable moment. There is a slight uptick in terms of the flow, which comes from the personal banking side. On the CIB side, we have really not had any large, major loan fall-off, or somebody approach us or we have seen deterioration in real quality for the moment, in stage two.

So the PB flow, there has been a slight PB flow in the first quarter, not much in the CIB side in the first quarter. In the second quarter, I think, as I said, we are now getting in the applications for debt relief from the retail customers, and I would imagine that there would be an uptick in stage two in the second quarter. CIB, there is nobody who is falling over the cliff, but there are people with cash flow issues who are coming in now. So I think, as I said earlier, this is all being debated and evaluated through a governance process in the bank, and we should have more clarity by the end of this quarter. But nothing dramatic as far as the first quarter is concerned. Second quarter, again, personal banking flows, probably we'll see an uptick.

Shabbir Malik: Thank you. If I may, can I ask two more follow-up questions?

James Burdett: Sure.

Shabbir Malik: In terms of your CET1 ratio, I think you've reported a 12% CET1 ratio, that's comfortably above the minimum requirement set by the central bank, but when we talk about credit rating agencies, is there a hard level for them, where you should not drop below that level for you to maintain your credit rating? Is that something you're aware of, or what do you think would be a comfortable level for the credit rating agencies?

And my second question is in terms of OPEX, you talked about potential realisation and further synergies, but in terms of your variable compensation, I'm sure there is a part of your staff costs that influence the variable compensation that, I'm assuming, would be lower this year than last year. What proportion of your total staff base would be variable comp in 2019?

James Burdett: In terms of the core equity tier 1, clearly it's very important for the rating agencies that we maintain a strong capital buffer. We had a meeting with the rating agencies, all three actually, on Sunday, just for the pre-meeting, to run through the results, and all of them stressed the same three things. Liquidity, funding and capital. And I think we're strong across all three measures. None of them come outright and said this figure or that figure, so we couldn't comment on that, but what I will say is we're comfortably above the regulatory minimum. The regulatory minimum, which was 11%, has dropped to 8% as a temporary relief. Most of the reduction in our core equity tier 1 is just our AFS book, and widening of credit spreads on those names, which I think we all expect to come back over time. So no, we're quite comfortable with that, and we're quite comfortable with our ability to generate organic capital.

As to your second question on variable compensation, I don't think we've disclosed to the market exactly what it is, but that is definitely one of the items that's been cut and it's being cut quite significantly, as you'd expect in response to this.

Arif Shaikh: If I can just add a little on CET1, our requirement now, if we were to use the central bank relaxation, would be about 8%. I don't think we really need to use that. We're still quite comfortable as far as CET1 is concerned. If I were to extremely stress this number as well, which is what we did with our December numbers, I would still be pretty okay, maybe very, very close to the threshold. So I think with the 300-basis-point buffer, which the central bank has given us, it is actually quite comfortable for us.

Shabbir Malik: Thanks, Arif. Thank you very much.

Operator: We now have a question from Alok Nawani from Ghobash Trading and Investment. Alok, your line's open.

Alok Nawani: Good afternoon, gents, and thanks very much for the call. I just had two small questions. The first one relates to your impairment charge of AED 738 million this quarter. How much of this would you say is attributable to the management overlay that you discussed?

And my second question is if you could just shed a bit more light on your outlook for your FX income in the coming quarters. I just wasn't very clear on how the ECB aspect of that comes into play in the coming quarters. That's it from me, thank you.

James Burdett: Yes, the FX income, obviously, we don't disclose that, we just put out a figure for total revenue growth, but you can see the trend if you turn to page 15 of the presentation. You can see FX and investment income has been hovering around the, what, AED 800 million mark. AED 800 million, AED 900, AED 1 billion, AED 800 million. And it dropped to AED 600 million. The main reason for that drop was the ECB placement.

So, we had I think something like AED 70 billion or AED 80 billion sitting in the ECB earning negative spreads, swapped back into dollars, where the income on the whole swap piece was going through FX and investment line, so that reduction of those balances, by taking it out of the ECB and putting it into the Fed, accounted for a large part of the reduction in FX and investment income in the first quarter 2020.

Since the liquidity crisis has possibly been averted and people are more relaxed, we've gone out of the Fed and back into the ECB, because it gives us a higher yield, and so that, essentially, FX income on the swap will come back through into P&L and show and increase in subsequent quarters, unless of course liquidity gets tighter again. And then, on the impairment side, the overlays were the main drivers of the increase. Correct, Arif?

Arif Shaikh: Yes. I don't think we are discussing that at this point in time, because it's premature. And, as I said, there'll be more clarity in the next quarter. And I'll just take you back to what I said in the earlier question in terms of the stress, our stress which is the adverse scenario, we have looked at it and we have assessed the book as it is, and I think we are quite comfortable.

Alok Nawani: Great, thank you very much.

Operator: Our next question is from Vijay Harpalani from Al Tayer Group. Vijay, your line is open.

Vijay Harpalani: Good afternoon, gentlemen. Thank you so much for taking my question. I've got a couple of questions. One is on the AED 7.9 billion market valuation loss reported in the OCI line. To help us, please, can you share some more details on the investment book? Is it fully managed in-house or is it managed via third-party asset managers? And maybe a bit more detail on structure of the debt?

James Burdett: Hi, Vijay, let me…
Vijay Harpalani: Sorry, can I ask one more question?
James Burdett: Go ahead. Please, go ahead, sorry.

Vijay Harpalani: My second question is with reference to deposits. Given that we are in a challenging macroeconomic environment, do you see withdrawals in government deposits in the coming quarters? If yes, then how that impacts the liquidity position, thank you.

James Burdett: So to the first question, yes, we manage the portfolios in-house. We have that expertise in our global markets and our group treasury function. In terms of the composition of the portfolio, if you go to page 17 of the investor presentation, you can see there the various buckets. Investments by type, investments by rating, and you can see it's a highly-rated portfolio. Investments by geography, you can see, on the bottom left-hand side of page 17, that it's well diversified.

And you can see it significantly in sovereigns or GREs or supranationals, so it's a very good portfolio, and it's really there to manage liquidity. A lot of it is repo-eligible with the central bank and the jurisdiction that we hold the security, so yes, it's a good portfolio.

In terms of the deposits, yes, if you look at the statutory accounts, you'll see there's been an outflow of government deposits and an inflow of corporate deposits. That's logical. You'd expect government deposits to outflow on the back of lower oil prices, as they did back in 2014 and 2015. From our perspective, in terms of liquidity and balance sheet management, we only behaviourise a very small amount of the government deposits for longer-term liquidity, and therefore we keep a lot of the balances liquid, either in the ECB or the Fed. Which means, from our perspective, as the government deposits go down, it simply means we have less balances with the central banks, so it doesn't affect our liquidity ratios at all.

Arif Shaikh: James, if I can add, because I can see a lot of questions around the AFS reserve, if you were to just look at the middle of April, clearly beyond the period we're talking about, more than half of that number's already been reversed, just looking at my dashboard in front of me, just to give you an indicator.

James Burdett: Yes, credit spreads blew out considerably and they've come back considerably, so our core equity tier 1 will go back up, and the AFS loss will turn into a AFS gain in the second quarter.

Vijay Harpalani: Sure, thank you. Thank you very much.

Operator: The next question comes from Lemer Salah from Barings. Lemer, please, go ahead.

Lemer Salah: Gentlemen, thank you very much for taking my questions. I've got two questions. The first one is with regards to your CET1 ratio, which I think is very comfortable. In the next couple of weeks, you do have an AT1 due for a call, which is roughly 56 bps of your tier 1 capital stack. I just want to understand the rationale here. Based on what kind of metrics do you make that decision to call or not call this? Because your capital buffer seems to be totally fine, and also, when I look at the other movements in that CET1 slide, slide ten, I presume the 154bps of a decline was triggered by the AFS adjustment, correct me if I'm wrong, but what kind of magnitude of other movements do you expect for the second quarter?

And my second question is with regards to the interest rate break on your potential loan book, on the back of COVID-19. What are your expectations, assuming your existing mix is still in place during the second quarter? How much of an interest rate break do you expect on your total loan book? Thank you.

James Burdett: So in terms of the AT1, you're correct that it's coming due. As we've said, and we continue to say, it's a decision we'll take closer to the time, but the fact is we'll take into account the core equity tier 1, and, as you rightly point out, we're very comfortable there. We'll also take into account our reputation and standing in the market, the expectations of the market players, all of those things we'll take into account. We'll also take into account the cost to re-issue, and come out with a strategy. But all of this needs to be taken in due course, and now is not the time to make decisions on that because the markets, as you know, are extremely volatile.

Your second question, on the AFS movements, yes, you're right, the whole 154 basis points was AFS losses on the investment portfolio. And as Arif has said, already half of it's come back in April, so you would expect to see roughly a 70 basis point increase from a 154 basis point reduction. So yes, we're quite comfortable with our capital ratios and we're quite comfortable with our investor portfolio.

Lemer Salah: Thank you. And just on the final question, could you please elaborate on the interest rate break magnitude of your loan book?

James Burdett: Yes. Arif, Shirish, can I pass that to you, please? I'm not sure if…

Arif Shaikh: I don't think we have an assessment of that. If I understood your question correctly, in terms of the COVID situation, what is going to be the impact on interest, is that correct?

Lemer Salah: Yes, that's correct. Yes.

Arif Shaikh: I don't think we have an assessment of that. To just give you some background, when liquidity was tight there was an uptick in terms of the pricing within the market, so we do, our FI unit, checks in the market in terms of, from Northern Emirates onwards and what's really happening there, so we have seen a bit of an uptick at that point of time, but that normalised in April. Or potentially, I would say, and I'm purely covering this from a pricing perspective, we would probably see a little bit of uptick in terms of pricing, in case… at least in case of the new loan book. As the new loan book evolves and people come back to borrowing, there'll be an uptick, but I don't think we have an exact dimension in terms of how the pricing is going to move and what's going to be the impact on our book. I don't know if, Shirish, you have something?

Shirish Bhide: Yes, just to add to what you said, Arif, you're right, in terms of any new loan requests that come our way for clients that we are happy to look at, pricing has actually gone up a bit, because it is now reflective of the current market state, and all the other factors that go into pricing a loan. So actually, new loans are probably going to go at a slightly higher rate, if at all. And on the rest of the impact, I think it's a bit early to assess, the weighted averaged impact on the book, it's a bit early.

Arif Shaikh: Yes. And one more thing on capital, because there are a lot of questions on capital, I work with the Banking Federation and we talk to the central bank, none of the banks in the UAE are today even talking capital. Because of the regulations from June being pushed into 2021, and the fact that the government has always been supportive, and I take you back to the 2008/9 crisis, when it happened for people who were there in terms of what the government did at that point in time. So the initial discussions were all around liquidity, there was never any discussion on capital. No bank in the system actually asked for any capital help from anybody, other than deferring the regulation and the capital standards that are due in June of this year. Just to give you a systemic comfort in terms of what the banks are thinking. I think the issue on the table is probably going to profitability. It's not going to be liquidity, capital. And asset quality to some extent, but to the extent the central bank has been helping the banks, it will normalise over a period of time.

Lemer Salah: Thank you very much, yes, that's very helpful. From my perspective, when you're assessing the global development of your peers, from Asia to LatAm, capital is not an issue. I totally agree with you. So that's why I pointed out your capital buffers are quite healthy, as of today. NPLs are going to be smoother for the next couple of quarters, probably, NIMs might come down, but… loan book, and your non-interest income is kind of significant as well. So your entire credit profile is pretty strong and, for a AA-minus rated company, you're very well positioned to potentially call that bond. So that's why I asked that question, but I think the feedback you have given is very helpful. Thank you very much.

James Burdett: Thank you.
Operator: We have no further questions, so I'll hand back to you, Aybek.

Aybek: Yes, thank you, operator. So at this point, I'd like to thank the management of First Abu Dhabi Bank for taking this conference call and providing all the insights which were extremely useful. And I'll hand over back to Sofia for any closing remarks. Thank you, everyone.

Sofia El Boury: Thank you, Aybek. Thank you, everyone. And if you have any further questions, you know what to do, you simply reach out to us, and me and Abhishek are here to answer any follow-up questions. So thank you for your participation, and keep safe and speak soon. Thank you very much.

Arif Shaikh: Bye. Be safe.
James Burdett: Thank you. Bye.
Arif Shaikh: Thank you. Thank you.