FAB Q2/H1 2020 Earnings Call Transcript*

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Co-host

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Operator: Good day, everyone. Welcome to FAB's Second Quarter 2020 Financial Results Analyst Earnings Call. Today's call is being recorded. There will be a question-and-answer session on today's call post-management presentation. And we will be taking live questions over the phone as well as through the webcast. At this time, I will pass on the call to Waleed Mohsin from Goldman Sachs.

Waleed Mohsin: Thank you. Good morning. Good afternoon. Thank you for joining the call. It gives me great pleasure to welcome the speakers from FAB on today's call, James Burdett, Group Chief Financial Officer; Pradeep Rana, Group Chief Risk Officer; Shireesh Bhide, Group Chief Credit Officer; and Sofia El Boury, Head of Investor Relations. So, without any further delays, I'll pass on the call to Sofia.

Sofia El Boury: Thank you, Waleed. Hello, everyone. Good morning. Good afternoon, and thank you for joining us today to review FAB's financial performance for the second quarter and first half of 2020. As usual, our senior management team is here to answer your questions at the end of the short presentation. All our disclosures are available on the investor relations section of our corporate website as well as on our IR app. So feel free to refer to these disclosures on these channels. I'll pass it on to James for the presentation now. After the call, please feel free to reach out if you have any further questions. Thank you.

James Burdett: Thank you, Sofia. Good afternoon, everybody. Thank you very much for attending today. As usual, I'll go through the presentation pretty quickly, and then we'll hand back to you for Q&A. So starting with slide#3 of the investor relations deck that we put out yesterday.

Slide#3 is just a high-level summary page. And I think it's fair to say we had a resilient performance, AED 2.4 Billion for the second quarter which was flat to the first quarter which brings year-to-date profit at AED 4.8 Billion, just down 24% over the prior comparative period. Mainly for two reasons, one - the higher cost of risk, and two - the Fed rate cuts creating revenue headwinds. That said, when you look through the balance sheet as we go through the presentation you'll see that our metrics have improved. Liquidity has significantly improved. Our Core Equity Tier 1 has also improved. And whilst there's a little bit of a deterioration in the credit metrics, that's still very strong relative to our balance sheet.

As you would expect from FAB, we've managed costs very well which are down 9% over the last quarter and in response to the revenue headwinds. And I guess overall the balance sheet remains very robust. We have a significant flight to quality with regards to liquidity, a strong management team. And we think we're in a good position to successfully navigate the recovery that seems to be on its way.

Turning to the next slide, slide#4 just showing you the net profit bridge between the first quarter and the second quarter. You can see operating income is up mainly because of a one-off deal where we entered into a sale and leaseback transaction with two of our bank-owned properties which generated about AED 500 Million. That plus the reduction in costs almost was given completely away, amidst a pretty significant uptick in provisions. And you can see the impairment charges were up AED 322 million for the quarter. And the sum of all that led to a flat profit of AED 2.4 Billion over the first quarter.

The chart on the bottom of slide#4 I think is very interesting. It shows the quarterly net profit run rate in 2019 was AED 3.2 Billion. You can see first quarter 2020 and second quarter 2020 is down. And that's mainly as a result of the Fed rate cuts and the higher cost of risk leading to that 24% decline.

On slide#5, we're attempting to show you what actually happened with some of the volumes. Obviously, the markets went into a severe stress at the beginning of April. Sales activity dropped off a cliff for us in April, and significantly has started to recover in May. And you can see from the chart from the bottom of slide#5, that whilst the recovery is tentative and small and hasn't gone back to pre-crisis levels, we are seeing transactions start to come back as you would expect.

I guess the key message here is you would expect fee income in the pipeline to be lower in the second quarter because that's when the full force of the impact of COVID hits our balance sheet. But you can see it starting to come back.

How did we respond as a bank is on slide#6. As you know from previous discussions, we invested significant amounts of money into digital and into technology. And you can see on slide#6, across almost every metric that we've got a significant increase in digital-related transactions, and as you would expect a reduction in cash transactions, ATM transactions and so on. This is pleasing for various reasons, one - we're delivering what the customer wants. Two - it's obviously efficient from a cost efficiency play because most of the transactions are straight through. And three - there's a revenue productivity play where we're starting to get more and more information on our customers as they transact in digital.

Moving to slide#7, this is a new slide for us. We're just trying to give you a feel for the movement in the overall balance sheet. And you can see it on the chart on the right-hand side of slide#7, the main balance sheet movement QoQ was growth from customer deposits which were up a fairly significant AED 22 Billion or 4% over the previous quarter.

Remember when we spoke at the end of the first quarter, there was severe liquidity stress in the system. We see this growth as a flight to quality. What's particularly pleasing is that our CASA balances have grown AED 15 Billion of that AED 22 Billion. And in terms of deployment, we haven't deployed too much into loans and advances. The pipeline also dried up in the second quarter as you would expect. But we do have a very healthy pipeline going into the third and fourth quarter mainly with our strategic customers, the GREs, the public sector entities, and the government.

We also deployed a little bit into high quality investments at very good prices because the credit spreads were blowing out. And the rest, we placed with cash balances and central bank balances. The other point to note here is that our liquidity coverage ratio has improved significantly. It has gone from a 110% to a 129%.

Turning on to the next slide, just looking at the capital ratios. You'll remember as of the first quarter, we had a significant AFS loss in OCI which was related to the investment portfolio which was down about AED 8 Billion. What we said at the time was that we had a well-diversified, highly-rated portfolio, and we thought the credit spreads would come back. As you can see, they have come back, and that AED 8 Billion has now reduced to AED 3 Billion loss. So, we've recovered AED 5 Billion, which plays into the 96 basis points partial reversal of the AFS reserve. So, the Core Equity Tier 1 is now at 13.6%, significantly stronger than March 2020.

The other point to note on this page is the chart in the middle, at the bottom of the page. You can see the risk-weighted assets are broadly flat. And that's in line with our policy to try and focus on our core clients which are the GRE's public sector entities which do not chew up capital, and are virtually risk free. And, so you can see the risk-weighted assets are flat despite the fact that we had loan growth since the start of the year. The return on tangible equity is down as you would expect on the back of the Fed rate cuts, and the higher cost of risk.

On slide#9, just to hammer home the strength of our balance sheet. You can see that out of our total assets on the left-hand side of the slide#9 as represented in the step bar chart, only 44% are in the form of loans and advances, which is why our liquidity is so strong. But more importantly of that 44% loans and advances, 31% are GRE's & government high quality assets, and a further 8% were into short-term trade loans which as you know are low risk historically and are self-liquidating. And it's diversified by the economic sector and a strong underlying collateral. So, what we're trying to say here is that we should outperform the market in terms of cost of risk because we do have such a strong and safe balance sheet.

Turning to the cost of risk or the asset quality slide#10, on the top left hand side, you can see a significant uptick in the cost of risk on the first quarter 2020, which is up AED 322 Million over the first quarter. And you can see the cost of risk now at just under AED 1.8 Billion representing a cost of risk of 87 basis points, but up 106% year-on-year as you would expect. The NPL formation was up about AED 1.7 Billion and you can see it in the chart on the top right-hand side that it was broadly split 50-50 between corporate and retail.

The coverage ratio deteriorated a little bit to 91% from 93% over December. But as I said before, given our conservative mix and high-quality portfolio, we're comfortable with that ratio. Slide#11, the net interest income. You can see the net interest income itself is up 7% QoQ. This is mainly as a result of lower funding costs on the back of the ECB trade that you know about. NIM itself is flat sequentially at 1.9%, but it's down 30 basis points year-on-year mainly due to the Fed rate cuts. Overall, when you look at the net interest income itself at AED 6.3 Billion, it's only down 1%. So, what you have here is the rate cuts being offset by growth and volume and lower financing costs from the ECB trade. But as you know there's an equal and opposite impact in the foreign exchange and investment income line which you'll see on the next slide.

So, turning to slide 12, non-interest income is down AED 644 Million or 17% year-on-year. Fee income is down 6% year-on-year, but you can see volumes in the second quarter were down considerably. So you'd expect a fall off in the fee income. But as I said before, the good news is we're starting to see business trickle back in, right across the board in terms of personal banking sales, CIB pipeline deals, and global market sales.

FX and investment income, I've already explained. This was the reduction in the ECB trade plus a narrowing of the spreads on the swaps that we swapped back into US dollars plus lower GM sales activity, plus a little bit of widening and bit of spreads and related adjustments.

Other income, up considerably as you can say QoQ and year-on-year. And that's mainly as a result of the one-off gain on sale and leaseback of office premises which generated just over AED 500 Million.

Slide#13 just drills into costs, costs down 9% year on year – sorry 9% QoQ on the back of significant management actions taken in response to the income headwinds that we talked about earlier. I guess the key message here is and we're putting it out in our guidance is that we're looking to keep the cost to income ratio below 30%, notwithstanding the reduction in revenue because of the Fed rate cuts.

So in terms of the penultimate slide, slide#14 - our guidance for you is that we still expect to do mid to high-digit asset growth. This is based on a significant pipeline that I talked about earlier. Revenue growth is obviously going to be negative on the back of the Fed rate cuts. And that lower activity that we saw in the first quarter, we expect it to recover partially in the third and fourth quarter. And therefore, we're looking to keep the cost to income ratio below 30% for the full year. Core Equity Tier 1 as we've always said, we want to maintain above 13.5%. This is important for our rating, and we can manage it with the pipeline that we have. And then lastly cost of risk and coverage ratio, respectively - we're looking at a 100 to 120 basis points and 90% coverage ratio. Now clearly we need to caveat this. This is on the assumption that we're getting this gradual recovery that we're starting to see in the market, and no further significant deterioration via the second wave or whatever the case may be.

So that leads me to the final slide. We believe we had a resilient performance. We think the foundation is very robust. We've outlined the flight to quality, significant liquidity, a strong pipeline in our core segments that we're targeting. And our competitive strength, low cost to income ratio, our ability to generate organic capital I think puts us in a very good position relative to our peers. And the strong balance sheet means versus our competitors that we should have a lower cost of risk, and continue to deliver those sustainable shareholder returns that you all expect and love.

So with that, I'm finished and we'll hand over to you for Q&A.

Sofia El Boury: Anita, we can open up the Q&A session. Thank you.

Operator: Thank you. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star one to ask a question on the phone.

Additionally, if you would like to ask a question via the web interface, simply type your question in the Q&A box and click send. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And now we'll take our first question from Amit Mamtani from Goldman Sachs. Please go ahead.

Amit Mamtani: Hello, hi. Good afternoon. Thank you for hosting the call. I had one question on margins. Where do you see sustainable NIMs for the bank given the current loan growth pipeline, and rates backdrop? And also, can you please provide a bit more information on the interest in suspense reversals? Thank you.

James Burdett: Yeah, hi Amit. It's James here. I'll answer that question. So in terms of NIM, we expect it to remain broadly in line with current levels about 1.9% going forward into the third and fourth quarter as a full year average. In terms of the interest and suspense, we don't disclose that, but what I can tell you it is relatively immaterial.

Amit Mamtani: Thank you. That's fair.

Operator: Thank you. And now we'll take our next question from Shabbir Malik from EFG Hermes. Please go ahead.

Shabbir Malik: Thank you very much. Well, two questions from me. First of all, I want to kind of discuss with you the cost of risk guidance that you've given. The cost of risk guidance that you've given is comparable to probably the Global Financial Crisis period if I look at both banks combined. I would argue that in some way things are better. There's a TESS program, the lending practices of banks would have improved, and the regulatory environment is more robust. But I just want to hear your thoughts on what kind of the key assumptions that you made in your cost of risk focus.

And my other question is on just going back to the point on margins. As per your sensitivity, a 25 basis point reduction in NIM reaches to about AED 270 Million impact on NII roughly. The rate movement obviously has been much more significant compared to last year. What have been the factors that have enabled you to kind of offset this huge headwind, and still maintain like a relatively robust NII in 2Q? Thank you.

James Burdett: Hi, Shabbir. It's James Burdett. I'll take the second question, and then pass to Pradeep for the first question. So in a nutshell, and remember we've talked about this many times because we only behaviorise a very small amount of liquidity for longer-term, we're forced to put a lot of that into the central banks. What we've been doing in previous years is placing it into the ECB at negative spreads, and then swapping it back to dollars. The swap income was going into the FX and investment income line, and the negative yield on the ECB placements was dampening our margin. Now what's happening is the Fed rate cuts are coming through dampening our margin as you would expect. But that's been more than offset or not more than offset, but that's been partially offset by the fact that the ECB trade has now diminished as we put more into the Fed. And two, the spreads, the whole financial spread on that transaction has reduced considerably. So what you'll find is if you look at the FX and investment income line, you see broadly an equal and offsetting amount from the net interest income line. And that guidance of AED 270 Million is correct. And as you know, we've done 225 basis points rate cuts. If you add last year's rate cuts plus the rate cuts that happened in March this year, and that's the full year impact, right. So that's starting to flow through. So if you look at our half yearly results, the 150 basis points cut in March only really impacted us for this quarter, not a year-to-date figure. So, over to Pradeep for the cost of risk.

Pradeep Rana: Yeah, hi. Thanks, James. With respect to the cost of risk, I mean obviously as expected in the aftermath of COVID, our cost of risk for quarter two, for the first half has increased. And depending on how this develops, our anticipation is that in cost of risk going forward will go up especially if there is a second wave, and if there is a prolonged lockdown.

What I would like to say is that with respect to our ECL models, as per the central bank guidelines, there have not been updated. But what we have done, right, is that we have looked at our scenarios, some of them we have increased, some of them we have decreased. And on the back of that, we have put a – what I say a COVID overlay of AED 550 Million on to our net impairment charge of AED 1.8 Billion.

And as James said, assuming there is no material deterioration going forward, we do expect our cost of risk to be in the range of a 100 to a 120 basis points for the rest of the year.

Shabbir Malik: Thanks for that. Just what kind of assumption are you factoring in terms of a recovery? Do you expect things to kind of normalise in 2021, or do you expect this to be a longer, more drawn out process?

James Burdett: So Shabbir, the guidance we've put out there assumes a gradual and steady recovery. Clearly if there's a second wave and there's a market meltdown, that's something we don't have a crystal ball on. But we're assuming in this guidance that we put out there that there is a gradual recovery which we are to be honest starting to see come through the numbers.

Shabbir Malik: Thank you very much.

Operator: Thank you. And now we'll take our next question from Chiro Ghosh from SICO. Please go ahead.

Chiro Ghosh: Hi, this is Chiro Ghosh from SICO, Bahrain. I have two very quick questions. The first one, I wanted to get a sense of the ground reality. So how is the retail market doing? How is the real estate market doing? And how are you seeing the GREs? I mean are they struggling with their finances, or things are improving?

And my continuation question related to that is how is the appetite from these three sectors? Again, how is the consumers appetite being for fresh loans and similarly for the GREs and real estate construction sector? These three things if you can throw some light on?

James Burdett: Yeah, a good question. So look when you look at the consumer spending on the ground, I think it's fair to say that there's a pent-up demand. We're not fully back to where we were at pre-crisis levels. But if you go out to restaurants, hotels these sorts of things, they're invariably full. So people are starting to spend again. We're starting to see as you could see on one of the slides in our presentation, I think six or seven, quite a substantial uptick in credit card spending starting to flow through. But I think people are cautious as they should be because of the overhang of losing their jobs and things like that.

But it feels to me that it's almost business as usual. And as someone who just flew in from New Zealand a couple of days back, I was surprised to see Dubai airport quite full, queues at immigration a very smooth process and lots of activity. I think in terms of your question on the GREs, what you have seen if you look at our disclosure statements is a reduction in government deposits, and an increase in deposits from our GREs and public sectors such as Mubadala and so on and so forth.

So that is what you would expect. I think you would expect to see the government continue to spend as part of their stimulus packages and reforms. I think you'll see that money going into the strategic projects which will boost the GDP. And I think that's already starting to happen, and we're starting to see some of that come through in our pipeline. So I think that's my perspective unless Shireesh wants to add something.

Shirish Bhide: Hi, this is Shirish. Just from our own response to the three sectors you mentioned which is real estate, retail, and GREs, our response really or the way we see it is a function of the way our portfolio is crafted. And I think on all three counts, our portfolio presents certain natural mitigants to the evolving situation given that we are more heavily skewed towards sovereign GREs, and that too within that Abu Dhabi sovereign GREs.

And our retail book as a proportion is smaller than the CIB book which is obviously a larger part of our loans and advances is CIB. And our real estate portfolio is also more heavily skewed towards Abu Dhabi and Dubai. So on all three counts, I think our own view of the future is a function of our own bespoke portfolio that we carry on our balance sheet, which gives us certain natural mitigants which are actually unique. Thanks.

Chiro Ghosh: And how is the borrowing demand from these three sectors?

Shirish Bhide: The borrowing demand on the retail front is slow because obviously there's a lot of turmoil – there's more turmoil at the individual level in terms of whether it's anticipation or fear of job losses or salary cuts. That been said, we're also – we've tightened the screws on retail lending because we're paying close attention to the salary cycles. Obviously, since April, we've had the benefit of seeing April, May, June, and very soon the July salary cycle as well. So we've been recalibrating our stance to retail lending by focusing more on the UAE nationals, thereby creating a natural hedge against skip risk and so forth. So we've tightened the screws as well, and so that's a bit slow.

The GRE pipeline actually as James alluded to earlier is quite strong. And certainly in the second half, we expect a lot of the disbursals for approvals already provided to happen. And that's going to see a large deployment or a significant deployment in the government/GRE space in the second half.

On the real estate front as well, we see some real-value transactions which are pretty decent, well-structured particularly in Abu Dhabi where people with deep pockets are realising high-value deals and good values, value for money deals. And those are the ones that we are cautiously evaluating for second half of 2020. So on balance, we see a pretty decent second half pipeline.

Chiro Ghosh: Thank you very much. That's quite helpful. And I see that there is a lot of liquidity on your balance sheet. I hope you would be able to deploy it in the second half of the year. Thank you very much.

Operator: Thank you. And now we'll take our next question from Hootan Yazhari from Bank of America. Please go ahead.

Hootan Yazhari: Thank you so much for taking the questions, and James welcome back. The first question I had was regarding your provisioning. We've seen that when we look at provisions over your POCI plus your stage three loans, around the 66% level, is that something that you're comfortable with, or do you see the need for further sustained high cost of risk beyond 2020 in order to get more coverage there?

The second question I have is really staying in the same vein. I wanted to understand how you've changed your ECL assumptions, well, the underlying economic model? What sort of economic growth are you now factoring in? And are you comfortable today with the assumptions that you're running through or do you see the need for further adjustments there?

And the last question, if you could give us any thinking around dividends and what your preliminary thoughts are around the outlook for a 2020 dividend would be grateful. Thank you.

Pradeep Rana: Yeah. Hi, this is Pradeep. In terms of your first question on our stage three exposure, I mean as we've disclosed, our stage three + POCI outstanding (net of IIS) is around AED 15.6 Billion. We are fairly comfortable with that. And just to give you a sense in terms of what our collateral coverage is, on stage three we're talking around 75%. So in that sense, I think from a stage three perspective, we do feel fairly comfortable.

In terms of the ECL models, obviously we have taken a very consistent approach which is in line with the UAE Central Bank guidelines. We will be updating our ECL models in the next quarter. But what we have done is that we have taken very much a two-pronged approach aiming at ascertaining what the impact would be on our current positions. And there are two things that we have done. Number one is that obviously we have gone through our corporate and retail portfolios. We have done a systematic review on them. And we've also used obviously judgmental overlays based on the assessment for a range of new scenarios. In terms of these scenarios, what we have done is that we've updated the weightings on these scenarios to estimate the additional ECL for COVID-19. And what we have done is that on the base case scenario, we have reduced it from 40% to 35%. The upward scenario, we've reduced from 30% to 10%. And the downward scenario, we have increased from 30% to 55%. And on the back of that, we've come up with a COVID overlay of AED 550 Million.

James Burdett: Hi, Hootan. It's James. I'll answer the dividend question. So as always, if we are committed to delivering high shareholder expectations in terms of dividend yield, we're still committed to that. As usual, we're also committed to our rating which means the key benchmark for us will be the Core Equity Tier 1 ratio. But as you can see, we are capable of generating significant organic capital. And we have a healthy pipeline, and things are starting to recover. So yes, dividends we're not putting out a range, but obviously we've committed to generating – being a high dividend yield player.

Hootan Yazhari: Understood, thank you.

Operator: Thank you. And now we'll take our next question from Aybek Islamov from HSBC. Please go ahead.

Aybek Islamov: Yes. Thank you for taking my question. So I've a couple of questions. In your disclosures, there's some interesting information about the loan TESS benefit, and the total ratio is 13% as a percentage of the total loan portfolio. So my question is what will happen to these loans with TESS benefit? After the TESS support program expires, I believe it's the end of the year. And when you're guiding the cost of risk are you guiding on the basis – hello can you hear me?

Sofia El Boury: Yes. Now it is better.

James Burdett: Yeah, we missed all of that. Sorry, can you please repeat?

Aybek Islamov: Apologies. I'll repeat very quickly. So my question was about your loans with TESS benefits. So the ratio of these loans is about 13% as per your disclosure. So I'm wondering what will happen with these loans with TESS benefits when the government support programs expires, which I believe is end of the year? And how are you guiding your cost of risk? Is this on the basis that there's government support program as TESS scheme expires at the end of the year? So that's my first question.

The second question is you obviously give a breakdown of TESS loans into group 1 and group 2. So the majority is group 1 which is loans with temporary liquidity issues. So how soon do you expect the quality of group 1 loans to improve, yeah, when you look at your clients? And that's all.

Shireesh Bhide: Hi, this is Shireesh. I'll take a stab at the question. I think if I understood you right, your question is what is likely to happen once the TESS relief scheme ends, and how will the portfolio behave after that for our clients. So I think a good question because we really – nobody I think around the world seems to know exactly how economies are going to come out of COVID-19 in general. Having said that, I think we benefit greatly from the approach of the Central Bank of the UAE, where they have clearly – their outlook has been to preserve and protect the banking system in the UAE, and to ensure that there are no shocks that go through the system. The top priority that's been evinced and evidenced by that action has been to protect the banking system from any shock. So to that extent, I think the TESS scheme was well crafted, and timely. And as I think I alluded to, a large part or the larger part of our allocation of TESS relief has gone towards group 1 clients who by the very definition signify very temporary effects of COVID-19.

So the assumption is that as long as the economy slowly though steadily continues to recover, a larger bulk of the clients who are benefiting from TESS relief will actually come back, and revert back to normalcy over time. This is really how we see it at this stage. We of course judgmentally recalibrate the situation month on month and quarter on quarter as we progress out of COVID-19.

Aybek Islamov: Okay, all right. And on your cost of risk guidance, if I may, to repeat this again, do you guide on the basis that the TESS program will run out of time at some point? And how would you answer that?

James Burdett: Yeah, the cost of risk guidance that we put out there is irrespective of TESS and so on, looking at individual customers and assessing their individual credit worthiness.

Aybek Islamov: Okay, all right. Thank you.

Operator: Thank you. And now we'll take our next question from Alok Nawani from Ghobash Trading & Investments. Please go ahead.

Alok Nawani: Good afternoon, gents and thank you very much for the call. My question is mainly on your operating expenses. Obviously, we've seen a very good improvement year on year in the second quarter. I was just wondering if you might be able to offer some sort of guidance if what we've seen in the second quarter is more or less sustainable for the rest of the year, or do you have a more aggressive target for 2020 and 2021?

James Burdett: Yes, that's a good question. So obviously a significant reduction QoQ. We anticipate a further reduction in the third quarter and in the fourth quarter. But obviously, the reduction will slow down. It won't be as aggressive as it was in the second quarter. We're looking to finish the year about with costs down about 10% over last year give or take. And the cost to income ratio is under 30%.

Alok Nawani: Great. Thank you.

Operator: Thank you. Once again ladies and gentlemen if you would like to ask a question on the phone, please press star one. And we'll take our next question from Shabbir Malik from EFG Hermes. Please go ahead.

Shabbir Malik: Just one follow-up question. What's your latest headcount number for the bank, and how much of that staff is in UAE and how much is outside the UAE?

Sofia El Boury: Shabbir, can I – we can come back to you on this later. I mean headcount is around 8000 employees, including outsourced staff. And you can see it in our disclosure, in the annual reports, but I can come back to you on that if you want more details about the breakdown for the UAE and international?

Shabbir Malik: Yeah, no worries. Thanks.

Operator: Thank you. Our next question comes from Waruna Kumarage from SICO. Please go ahead.

Waruna Kumarage: Hi. Just one question from me. Can you give some kind of guidance on how non-interest income is going to pan out in the next two quarters for the rest of the year?

James Burdett: Yeah, so I guess taking each of the buckets that we disclosed. Firstly, the other income, that won't be repeated. We're not expecting any more share of leaseback transactions or one-offs. The fees and commissions, we're expecting a steady increase on the back of increasing activity. So we're expecting a pickup over the second quarter. Second quarter was obviously rock bottom on the back of the crisis.

And then the FX and investment income, we expect to see a pickup. And the logic to that is we're starting to see more global market sales. We're starting to see spreads tighten and that sort of predictable volatility plays into the hands of the trading desks, and the dealing room that we've got. A significant portion of that income is market sales, derivative sales, swap sales, these sorts of things, and they're all starting to come back. So we're expecting that to pick up.

Waruna Kumarage: Okay, thank you.

Operator: Thank you, and now our next question comes from Naresh Bilandani from JP Morgan. Please go ahead.

Naresh Bilandani: Thank you. Hi, it's Naresh from JP Morgan. Just two quick questions please. So first was – and sorry to come back on this, it's on the coverage. Now I was quite hoping to see a pickup on the coverage in stage two and stage three given that I think it's becoming a focus area for investors. Now my understanding is that the central bank is also providing you a COVID filter on your capital. So I'm just keen to hear your thoughts on whether you're going to use this opportunity to build up coverage further on these portfolios, because frankly I think in the current environment, there's only one way for these portfolios to go and that is towards the deterioration side. So as you approach further into Q3 and Q4 and I know you did provide some color on the collateral, I'm just keen to hear your thoughts if we will see a pickup in the coverage on stage two and stage three from the current levels which are frankly looking much lower as compared to your peers. So that's my first question.

My second question is on the modification. It would be very helpful if you can just provide some insight into the impact that the modifications have had on the net interest margin. My understanding is that the way you account for these and that's in the UAE banks that you are carrying this loss over the life of the loan compared to say Saudi and Kuwaiti banks that are taking these losses upfront. If in some form, you had to take these losses upfront given the elongated TESS program that we have in the UAE, is there any estimation that you can provide on what these losses might potentially be?

James Burdett: Yeah, hi Naresh. It's James, good to hear from you. So on your second question on the modification, the fact of the matter is it's relatively immaterial. And it's captured through the effective interest rate and IFRS accounting. On the coverage, I'll pass you over to Pradeep. But three points I'll make, one is on the cash coverage. Two, we have a fortress balance sheet as we've been laboring to point out to you. Three, we have significant collateral and I think Pradeep mentioned that previously. And yes, we will start building up the coverage ratio as we start to increase the cost of risk at those levels. You saw the cost of risk in the first quarter was relatively low. It's significantly increased in the second quarter. And we've been consistent all the way through. I'll just pass you over to Pradeep.

Pradeep Rana: Yeah, I mean if I could just add to that I think that the first thing which I really do want to hammer home is that our balance sheet is very different from any bank in the UAE and in the region in terms of both stability and structure. And as James said early on is that only 44% of our total assets are in loan and advances. And out of that, 31% is we've lent out to government and GREs.

In terms of the coverage ratio, I mean as I said we are fairly comfortable with our coverage ratio of 90% due to the collateral that we have. What I would like to add also is that we do look at stage two and stage three. I mean when we do look at our stage two net outstandings, what I could say that we have a collateral coverage of around 90% which is fairly high. And when we look at stage three, it's around 75%. So in that sense, I think we are quite comfortable.

Naresh Bilandani: Got it, understood. Just as a follow-up please, while I realise the strength of the balance sheet, I don't think so anybody doubts that, I'm just trying to understand whether the usage of a COVID filter, that is allowed by the BIS and the UAE Central Bank probably gives you an opportunity to add to the coverage currently, simply because it won't have an immediate impact on capital, and probably covers you for any potential losses next year, because what you're seeing right now is a sustained demand impairment in the UAE. So frankly, thinking of a scope for recovery into the second half of the year probably is a very optimistic point to start with. So I'm just trying to see if usage of such filters gives you a strategic opportunity to minimise any potential impact that you may have on the P&L given the fact that we are going to live in a low interest rate environment for a while, and that gives you some buffer for 2021?

James Burdett: No, I think what we're saying is we're quite confident of building up our portfolios in the third and fourth quarter based on the pipeline. We expect to land the cost of risk in line with the guidance that we've put out there. If you do the math behind that, that implies a pickup in the cost of risk over the first quarter for the remaining two quarters, right. You can do the math on that. So that does imply a buildup of the coverage ratio, and does imply a buildup of provisions. And against the backdrop of our significant exposure to government GRE, where we expect zero cost of risk, I think we're comfortable. And we've been consistent all the way through.

Naresh Bilandani: Okay, understood, James. Finally, sorry just to come back to the point on modification. You mentioned, I think the impact on the NIM is minimal. I kind of got a same sense from some of your peers. I believe, there's a difference in the accounting. But I'm just trying to understand, if I had to take the numeric amount of the size of the loss that you've built up on the modification irrespective of whether you're booking it over the period of the loan within your net interest margin, would this be comparable? Because what you've seen in Saudi Arabia and Kuwait, these losses on the portfolio are somewhere in the range of around 250 basis points of the portfolio. Is that like a fair understanding of what the modification impact could potentially also be within the UAE? I do know some of these deferrals that have been awarded say for example in Kuwait have been a bit more aggressive. But if I was to think of on similar lines in the UAE, is there number that you can share on what could potentially be these upfront losses?

James Burdett: Look, I'm not that familiar with what's happened in Saudi. I have heard about it. I did see that there was some issues there. Our impacted book is very small, and the deferrals are very short dated. And the whole thing is relatively immaterial even if we took the whole lot out right now. So for us, it's immaterial. As for the other banks, I don't know. You have to ask them.

Naresh Bilandani: Okay, all right. Okay. Thank you very much. I appreciate the facts. Thank you.

Operator: Thank you. We have no questions over the phone at this time.

Sofia El Boury: If there are no questions on the phone at this time, perhaps we can take a few questions from the web that we received. Some of these have already been covered, but we can take perhaps this one coming from Edmond from Bloomberg Intelligence. There was migration in stage two and three that reduces the coverage for this category. Is it related to some legacy problem or COVID related?

James Burdett: Yeah, I mean in terms of the movement from stage two to stage three, yes, it's a combination of both COVID and it's a combination of our – yeah, a deterioration in the book.

Sofia El Boury: Sorry, we're taking another question on the risk-weighted assets growth from Alay Patel. Risk-weighted assets growth has been lagging loan growth for a very long time now. In 2019, loan growth was 16%. Can you please explain this dynamic, and comment on regulatory changes on risk weightings to governments and GRE exposures?

James Burdett: And just as we've said before on many occasions, that's just our focus on core clients which are the GREs and public sector entities, the government. We're in a privileged position as a banker to the Abu Dhabi government. We're focusing on a strong Core Equity

Tier 1 ratios, and a strong earnings profile. And it makes sense to have a very high quality portfolio. And I think the fact that our risk-weighted assets has remained flat despite the recently significant loan growth says that we're being successful in that space.

Sofia El Boury: The follow-up question is on dividends. A lot of the GCC banks have been suspending dividends. What is the current discussion with the central bank on paying out dividend?

James Burdett: The central bank has not discussed this with us. As far as we know at this stage, it's subject to the normal internal policies. And as we said before, we want to be a high dividend yield player subject to maintaining a strong Core Equity Tier 1.

Sofia El Boury: Thank you. I think we have another question on the call, Anita.

Operator: Yes, ma'am. We'll take our next question from Rahul Bajaj from Citi. Please go ahead.

Rahul Bajaj: Yeah, hi. Thank you for the call. Hi, it's Rahul from Citi here. I've two quick ones. First is on the sale and leaseback transaction. Just wanted to understand what if any impact will this have on future cost line? So that's my first question. And the second one is just a quick clarification. When you said costs for 2020 would be down 10% year-on-year, is it underlying costs or reported costs or what are you referring to here? Thank you.

James Burdett: Yeah for your second question, it's 10% on total operating costs. In terms of the sale and leaseback, there's no material change to the cost of the lease. It's just our strategy to slowly divest from commercial properties. And on top of the cost initiatives that we're looking at, one is obviously with this greater working from home ability that came out of the COVID crisis. We're looking if anything reduce office premises as more and more people start working from home, and we introduce flexible working.

Rahul Bajaj: Thank you.

Operator: Thank you. We have no further questions at this time.

Sofia El Boury: So thank you. If there are no further questions, we'd like to thank everyone for joining this call. If you have any further questions, Abhishek and I are available to answer them later on. So thank you for joining the call and Eid Mubarak to all.

James Burdett: Thank you, guys.

Pradeep Rana: Thank you.

James Burdett: Have a good weekend.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.