FAB Q3/9M'2018 Earnings Call Transcript*

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Co-host

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FAB speakers/participants

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*Edited

Operator: Good day and welcome to the First Abu Dhabi Bank Q3/9M 2018 earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ronit Ghose. Please go ahead.

Ronit Ghose: Great, thank you. Good afternoon from London and welcome to our guests dialing in from FAB. We are delighted at Citi Group to host this Q3/9M 2018 earnings results call. We have on the line with us from FAB, James Burdett, Group Chief Financial Officer, Karim Karoui, Group Head of Subsidiary Strategy and Transformation, and also Sofia El Boury, Head of Investor Relations. I am now going to hand the call over to Sofia to kick us off. Over to you Sofia.

Sofia El Boury: Thank you Ronit. Good afternoon, good morning and thank you for joining us today to review FAB's financial performance for the third quarter and first 9 months of 2018. A quick reminder that the IR deck we are using today is available both on the IR section of our corporate website, as well as on FAB's IR app. Also reminding you that FAB's pro forma consolidated interim financial statements as of 30th September 2018 serve as the main basis of reference and preparation for our management discussion and analysis report, as well as our investor presentation. So with this, I will pass it on to James for the presentation.

James Burdett: Thank you Sofia. Good afternoon everybody and thank you very much for joining the call. Those that have heard me speak, I think I will follow the same format which is to run through the slide deck presentation very quickly, just pulling up salient points and the key messages that we want to pass onto you and then the phones are open to Q&A. We also have with us Arif, our Chief Risk Officer and Shireesh, our Chief Credit Officer to help answer the questions. So you have a full deck on board in terms of executive members.

So for those who have the slide deck, I will start on Slide 3, which I think says it all upfront, which is, it is a great performance from the bank's perspective to record profits over the nine months at 9.1 billion, which is 12% over last year. Q3 profit is up 16% over prior comparative quarter and you know, momentum is building in the business, particularly in CIB where core revenues are up 8%. You will see as we go through the slide deck, loans are up 8% (26 billion year on year), deposit is up 20% (76 billion year on year). Fees and commissions are up 7% year on year. So real momentum building up in the business and I think representative of a strong balance sheet that we have. Fundamentals remain solid. The cost of risk is 51 basis points, The NPL is flat at 3.1% and the coverage ratio is at a 118%. So the credit metrics are looking strong.

Also with the funding franchise, the liquidity metrics remain very strong with loans to deposit ratio below 80%, and liquidity coverage ratio at 123%. I think more importantly, core equity Tier 1 is now growing at 13.6%. You will see as we go through the slide deck that we continue to execute against our strategy, so the system unification is happening and we expect customer day one to happen towards the end of this year, which would be a massive step forward for us because it obviously provides a harmonised basis from which we can sell products and services. Synergies continue at a pace. We told the market AED 1.5 billion, we are now at 60% with AED 900 million as of 30th September and we have actually commenced execution of our international strategy. So we have closed down a couple of the suboptimal countries. We have got sales on one or two others in terms of suboptimal businesses within these countries and we have commenced our activities in Saudi Arabia and we are already seeing a very strong pipeline. So I guess in summary, we are on track to exceed or meet at least at the top end of the metrics we put out to the market.

Turning to Slide 4, which is just a QoQ analysis, I wouldn't spend much time on. It suffices to say that prior comparative quarter, we are up 16% with growth of revenue, reduction in cost and reduction in the cost of risk, all contributing to that 16% above last year. QoQ, we are down 1%, but remember in the second quarter of 2018, we had AED 110 million of property gains on an international property that we sold, which didn't recur, so if you back that up, we are showing growth.

Turning to Page 5, which I think is an important slide, you can see the guidance we put out to the market and we were actually standing as of 30th September and you can see we are at the top end of the range for most of the metrics and in fact, you know, when we put the deal rationale together, we said that by 2020, the financial definition of success of bringing the two banks together with a core equity tier 1 ratio of 13.5% with a cost income ratio of 25% and a return on tangible equity of 16 - 17%. You know, we are pleased to say that we already met those targets this year in advance.

In terms of revenue, it looks a bit anemic at 1% year on year, but it's important to note that there were approximately AED 400 million of one-off gains in our AFS book in the first quarter of 2017 so if you back that out, it is up 4% year on year, but we will talk more about that later.

Turning to Slide 6, which just talks about our strategic execution and around integration, as I said, we are on track to integrate at the end of this year subject to further testing. We don't expect any adverse financial implications from that, but we do believe it is a key enabler, particularly in our retail franchise to move onto one platform and it obviously is a key enabler for a combined and harmonised products and service proposition. Clearly, the franchise continues to show good growth in Saudi Arabia. We have executed our first DCM opportunity, so the CMA license that we set up earlier this year, we expect to commensurate our commercial operations this quarter. We already have a significant pipeline, which is quite encouraging.

In terms of some of the other international areas, we have now wound down Malaysia because obviously with the acquisition, we got Singapore and Hong Kong to leverage off. We are also in the closing stages of negotiating the sale of some of the suboptimal retail businesses in the EMEA franchise as well, so that is proceeding according to plan. Cost synergy we've already talked about and obviously the next cut off the ring next year is of IT here as we go to one platform so we are very confident of achieving the AED 1.5 Billion that we put out to the market for the integration.

And I guess more importantly and it is not reflected in the cost numbers you see, but we have started to invest considerably to drive a digital proposition around customer experience so that we can drive revenue growth into next year and that has already started and we are investing in the business.

Turning to Slide 7, I talked about this, but business momentum continues to be extremely strong and you can see loans are up AED 26 billion year on year, which equates to 7%. Most of that growth is in CIB, some of that growth in Asia and also in trade. So good growth potential and a very healthy pipeline going into the rest of the year as well, particularly with the addition of Saudi. Looking at customer deposits, you can see that growing a whopping AED 76 billion, mostly attributed to the Government of Abu Dhabi deposits which as you know, we place into short-term placements with the FED or the ECB at a considerable return.

We have also shown growth in CASA, which is encouraging, up 7% to AED 155 billion, which is obviously a strategic comparative of ours and provides very good liquidity, which is a good fit into our liquidity position which is very strong with LCR at 123%. So strong balance sheet metrics driving the business momentum. Looking at net interest income, you can see it is flat year on year in terms of the dollar value. If I take you to the bottom right hand side of Slide 8, you can see the cost of deposits is up about 50 basis points from last year. And remember, the FED hikes have been about 125 basis points, so our cost of deposits hasn't risen at the same pace because of funding management, because of our CASA balances and so on.

Now you can see the performing loan yield has flattened off over the last two quarters and that is really the retail business where the risk appetite tightening on the legacy SME unsecured portfolio is really starting to run off now and we think that will abate by the end of the year and going into next year, we should start to see growth. Also although not to the same extent, we are seeing some pressure on CIB margins coming through. In terms of the calculation of NIM, falling about 8 basis points qoq, 16 basis points of that is entirely due to the excess liquidity so our Central Bank placements grew by 31 billion QoQ mainly due to an increase in government deposits. As you know, we place that with the FED or the ECB. We swap it into dollars in the FX market and the income on that whole trade is profitable with zero risk-weighted assets, but the income part of it goes to FX and investment income, which you can see is up considerably year on year when you back up the one-offs.

Moving to Slide 9, total non-funded income year on year is up 3%. If you exclude the one-off I alluded to earlier, it is more like 12% up year on year. Total non-funded income is down qoq mainly due to the gains on property sale that we had in the second quarter for AED 110 Million. When you look at the different components, you can see fee and commission income up about 7% year on year and the CIB is actually up 17% year on year with growth in loan related and trade related activity at 14% and 5% respectively. That's offset partially by lower fees and commissions in retail banking as we tightened risk appetite as we talked about before.

Looking at the FX and investment income, again, it shows a drop of 3% year on year. Again, if you back up those opportunistic gains, that is actually up nearly 20%. Again, a lot of that income coming from the ECB activity and the FX swaps relating to it, but also a good and healthy pickup in client activity in our global markets business.

Turning to Page 10 on cost, you know the story, BAU costs are down 9% YoY, which has generated close to AED 400 Million of yoy gains. On the back of synergy realisation, cost income ratio, excluding integration costs and amortisation of intangibles are actually now below 25% and we have achieved AED 900 Million of our AED 1.5 Billion that we put out to the market, so that is 60% of the target. The next wave of synergies as I said start next year with more branch closures via some IT optimisation and then we begin the whole digital transformation. Integration costs well under control and we expect to finish the year under the guidance of AED 330 Million that we talked about and clearly, they would drop away substantially next year if we are successful in delivering customer day one by the end of the year.

Turning to Page 11, looking at the credit quality cost of risk of 51 basis points, two reasons you know about, one is PPA where we fair valued the legacy assets of NBAD, and secondly, IFRS9 which was essentially a very conservative approach to day one implementation of the IFRS9 ECL model, which was passed through retained earnings. So cost of risk of 51 basis points being marginally flat over the last three quarters. NPL is at 3.1% with a coverage ratio of 118%, so very strong credit metrics.

Turning to Page 12, just looking at capital, considerable capital generation from organic profit growth, 62 basis points with both core equity Tier 1 to 13.6%, against a floor of 10% from the Central Bank. The other thing I would draw your attention to is risk-weighted assets; you can see a broadly flat qoq, which is a result of some of the RWA optimisation initiatives, which we have talked about previously. So all of that has led to a significant uptick in return on tangible equity, which is at 16.5%.

So turning to Slide 13, just to wrap up, strong nine month results, on track to meet the higher level of target guidance we gave you of 10% in terms of profit. Strong fundamentals with good balance sheet, drive us in a position for growth next year. We do expect good tailwinds next year with most commentators forecasting of GDP uplift in the UAE and in fact, Abu Dhabi, but also a significant stimulus package that was announced by the government. We are really looking forward to customer day one, where we can really unlock the potential of our client base by offering a harmonised set of products and service proposition to our customers, so you know, well on track to continued sustainable growth going into next year. And look, with that I will hand you over for Q&A. Thank you very much.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question over the telephone, please signal by pressing star one on your telephone keypads. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions. Our first question today comes from Chiradeep Ghosh of SICO. Please go ahead.

Chiradeep Ghosh: Hi. Thanks for hosting the call. I have three quick questions. My first one is related to your strong deposit growth. So I understand it is coming from the government, but that these might not be very sustainable. So I just wanted to get a sense of what would be a comfortable loan to deposit ratio for you going forward? That is my first one. Second one is, I see that out of the AED 10 Billion of loan that you have dispersed, a big chunk of it, like roughly around AED 7 Billion has gone to the real estate sector. If you can throw some light on why have you increased the exposure? And third is if you can help me understand that your interest in suspense formation is on an upward trend, if you can throw some light at that.

James Burdett: Okay, look, good questions. So the Government of Abu Dhabi's deposits as you know has considerably increased year on year and, as you know, we have placed it with the ECB, swapped it back to dollars and made a nice economic profit on it. If the government deposits were to go down, there would be a small negative impact on our net profit because obviously, there are no RWAs associated with it. Now, loan deposit ratio is less of a concern. Our liquidity coverage ratio which as you know, behaviourises the Government of Abu Dhabi deposit and behaviourises core liquidity at a very small amount, which is why we do place it with the FED or ECB as opposed to putting it out for tenure. So our liquidity coverage ratio already reflects that in the mix over 120%. So essentially, if the government were to withdraw those deposits, it would have no material impact on our liquidity coverage ratio, because we are already behaviourising it as such; we treat those accounts as a true operational account.

The second question, which has to do with the loans, the real estate. Largely it has to do with the reclassification between the services sector and the real estate. So you shouldn't read too much into it, and then the last question on the interest in suspense -

Arif Shaikh: So I think that there was a reclassification for potentially one account, which has caused the movement in IIS.

Chiro Ghosh: Okay, just one quick question on the second one, about the real estate. So we are not reading very positive articles about the real estate sector in UAE. So I just wanted to get some more clarity. Which sector is it related to, commercial real estate, retail or residential?

Arif Shaikh: Yeah, so on real estate, you know, we have obviously read all the reports predicting a "doomsday" case scenario. I think before I answer your specific question, if I were to just back up in terms of what we do in real estate. We look at real estate as part of a larger corporate relationship. So if there is a larger relationship and there is a demand for a piece of real estate, then we would look at it, so we don't do standalone real estate. The second point is that most of the real estate that we do or we lend against real estate, the management of that property is with FAB, i.e., we collect, you know, all the cash and this cash collection actually runs into billions. What it gives us is, it gives us first charge over, you know, collecting our principle and interests as we go on.

Now, in terms of your question on real estate, we have been very, very careful. The earlier question was in terms of the movement. There is a reclassification, there is a couple of real estate which was lent within Abu Dhabi to projects related to GREs who have kind of borrowed this money and that is about it, that was the question. Anything else?

Chiradeep Ghosh: No, that is quite clear. Thank you very much.

Operator: Ladies and gentlemen, as a reminder, to ask a question please press star one. We will now move to a question from Shabbir Malik of EFG Hermes. Please go ahead.

Shabbir Malik: Hi, thank you everyone. I have two quick questions. The first one is, I just want to go back on the point about government deposits. Why has there been a recent uptrend in government deposits coming into FAB? Is it because of high oil prices and do you expect this to be an early indicator of a pickup in government spending in Abu Dhabi? My second question is on your non-performing loans. There was an increase as per your presentation of 5% in non-performing loans and the personal banking group. Just wanted to hear your thoughts on this, what is driving this deterioration? Is this a trend that will continue in the coming quarters or do you expect this to be the deterioration to be peaking at this time? Thanks.

James Burdett: Look on your first question, yes, I think the increase in government deposits has been likely due to the uptick in oil prices. I think you are right that if you were to see a withdrawal of those funds, it would be positive for the economy because it would mean the government is starting to invest again, starting to spend under the stimulus package and so on and so forth. So you know, I don't know when that is going to begin or how it is going to begin, but I think whichever way you look at it, it is very positive for the economy.

As for question 2, the NPLs, I will pass you on to Shireesh.

Shireesh Bhide: Yeah, so on the NPL, on the personal banking side, I think we discussed it on at least two previous calls in terms of the tightening of the risk appetite in that space. Now, really what we are seeing at this point of time is the back end of the provisioning cycle on the personal banking space and we will from here onwards, we are actually looking at growth. For us, this is normal BAU activity. The NPLs, you know, move a little bit here and there. I wouldn't read much into it. 5% is fine. I think in terms of going forward, we actually see a positive upward trend from here onwards, not on the NPL but on the business.

Shabbir Malik: Thank you for that.

Operator: Once again, to ask a question, please press star one on your telephone keypad. Our next question today comes from Yugesh Suneja of ADCB Securities.

Yugesh Suneja: Yes, hi, good afternoon. Thank you for the call. I have two quick questions. Firstly, one of the key areas highlighted in stimulus package by Abu Dhabi government was SME lending backed by government guarantees. But looking at your recent focus on risk optimisation, would you look actively to participate in this area? And secondly, on loan book growth, if we exclude the international loan book, UAE loan book growth stands at about 4%. So what is your outlook for growth on credit side in UAE specifically? Thank you.

Arif Shaikh: On the SME lending, I think the program you mentioned has not been formalised as yet. We have been selective on the SME side in 2018, but we are revisiting the parameters as we, you know, slightly open up the risk appetite for 2019. I think once it is formalised at FAB, as one of the leading banks in the country, will definitely participate to the extent its risk appetite allows it to do so.

James Burdett: And as to your second question, it's a really difficult one to answer, but all commentators are suggesting a GDP uptick next year to 3.5%-3.6%. So you will expect to see the domestic market grow at least or as a leverage and play on that a little bit more. As we said in the past, we know the government is going to come to the market and start spending again. They are a traditional client base. So we would like to think that we can outperform that market. In terms of the Asia growth, with the arrival of the international growth, which was very robust this year, I think you will see it moderate a little bit and the focus start to move more domestically on the back of that stimulus package and on the back of more robust GDP this year.
I just wanted to say one more thing. I mean the wild card here is Saudi and we are seeing a really robust pipeline. So you know clearly that forms part of the international business. Sorry, what was your other question?

Yugesh Suneja: The last question is on your credit cost. So in nine months, it has been well contained, but for the last quarter, do you expect it to be maintained at this level or do you expect some increase in the last quarter?

James Burdett: Yes, I think the cost of risk we expect to contain is at or around these current levels, but I think it is important to note that, you know, as we go into 2019, we are looking at the risk appetite parameters of our retail business. Our retail business, as you know, we really tightened risk appetite to get rid of some of the "unwanted loans" that we had from the previous SMEs rollout and so on and so forth. And we are now looking to expand again in the retail space, especially when we go to customer day one. Now, clearly, that generates superior returns, but obviously there will be an uptick in the cost of risk associated with that.

Yugesh Suneja: Okay, thank you.

Operator: Ladies and gentlemen, as a reminder, to ask a question, please press star one on your telephone keypads. And if you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment.

Ronit Ghose: While we wait for more questions from the line, this is Ronit Ghose from Citi group, let me jump in and ask a couple of questions. We might have some more from perhaps the line. Could we talk a little bit about the margin trends please? You have in the third quarter some margin decline, you also expect some of those headwinds to be behind you. It would be great if you could elaborate a little bit more about what those headwinds were in Q3 and why are they going to dissipate or reduce looking forward into 2019? Thank you.

James Burdett: Yeah, I think it is, I think if you are talking about NIM, it is all down to the government deposits, right, which get placed with the Fed and ECB and dilute the mathematical calculation of NIM. If you back that out, and in fact our NIMs have held flat, whereas some banks have gone up on the back of FED rate hikes. The reason that it hasn't happened for FAB is quite simple. In our retail business, we have very high risk, high yield SME portfolios that almost turned a 100% NPL and therefore bad, that we have run down and so year on year, you have a headwind from that. If you back that out, actually the NIMs are looking quite favorable for the bank. That said, I would say that in CIB, we are seeing increased competition. So in other words, people are fighting for, you know, limited asset growth and there is a tight competition on that, so I would expect a bit of tightening there. But it can all be explained in those three dynamics. We have the benefit of significant funding, significant government deposits that dilute the NIM calculation mathematically, but it is profitable trade for the bank overall and you are seeing a massive run-off in retail high-yield portfolio which were, you know, had NPLs and cost of risk associated with it and we have always simply wanted higher risk-adjusted returns for the business. And I think you can see that come through on our return on tangible equity numbers.

Ronit Ghose: Great, thanks for that. Operator, are there any other questions over the line?

Operator: Yes, we have a question from Sahil Kumar of Moody's Analytics. Please go ahead.

Sahil Kumar: Hi, this is Sahil from Moody's. Thank you for the call. Actually, Ronit already asked my question, but I have one more question on the cost side. In the last quarter of 2017, we had seen an uptick in the staff cost, on a quarter on quarter basis. Can we expect the same trend to continue on in the last quarter of this year as well or how should we think about the staff cost of the last quarter, I just want to understand it.

James Burdett: Yes, what you are seeing is a little bit of uptick in staff costs as we go through to customer day one and build staff costs around there. I think what you are also seeing is business starting to invest the growth that we anticipate next year, but it is nothing significant. So I wouldn't read too much into it. At the end of the day, we expect to finish the year within guidance, which is cost income ratio between 25% and 26%. We will deliver more on the synergies. Obviously, we have another quarter to go, but not a lot more because a lot of focus is on customer day one, which will happen on the back-end of the year and then we expect to have more synergies next year, which will be broadly offset by investment in digital and things like that.

Sahil Kumar: Okay, got it.

Operator: We currently have no further questions in the queue.

Ronit Ghose: Sure. It is Ronit from Citi again. I would just like to maybe pick up while we wait for more questions to come in from the queue. Could we switch gears a little bit and talk some more about the technology transformation project please and customer day one. Is there any sort of further color or update you can give us on how that is going in terms of dress rehearsals, planning, processes and looking ahead to 2019, how are you thinking about the sort of up phase to your business from that?

James Burdett: Yeah, look, I will give the big picture, you know, I think it is probably not prudent to go into detail around how we are going through it, but yes, there are dress rehearsals. Yes, we have integrated testing. Yes, we have dry runs. We have put close to AED 300 Million into the integration project this year. We have got governance with first line, second line, third line of defence and what I would say is we are getting an increasing confidence that we will be successful at going to customer day one towards the end of the year, but it is still subject to more work.

Next year, the reason we believe it will be very beneficial, particularly for our retail business is that we go to one platform, there is one CRM system and you know, there is an increased ability therefore to cross sell into our existing customer base. Plus the system we are going to - i.e. the target stack - is a much better system than the legacy NBAD system in terms of efficiency controls and so on. So you know the reality is, it will be a huge step forward for the bank and I think you know, there needs to be an understanding that having two legacy platforms and operations throughout this year means we have had two lots of people doing two lots of finance and two lots of credit processes and two lots of whatever and that will go down to one. So it is a huge step forward in terms of efficiency and then it creates a base from which we can build digitally, for a better transformation going forward, but I think, all in all, it is a really positive step forward for us to go to customer day one.

Ronit Ghose: Great, thank you for that. Operator, do you have any more questions over the line?

Operator: We currently have no questions on the phone line.

Ronit Ghose: Okay, if there are no further questions, Sofia, I would like to hand it back to you for a wrap up please.

Sofia El Boury: Thank you Ronit and thank you to everyone who participated in the call. I mean obviously if you have any further questions or queries, you can reach out to us anytime. So, Abhishek and I are here to help out, as well as the rest of the IR team. Thank you to James, Arif, Shireesh, Karim and everyone on this call and we will talk to you soon.

James Burdett: Great, thank you and goodbye.

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