NBAD Q1’2017 Earnings Call *

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NBAD Speakers

James Burdett
Group Chief Financial Officer

Karim Karoui
Head of Subsidiaries, Strategy & Transformation

Sofia El Boury
Head of Investor Relations

Abhijit Choudhury
Group Chief Risk Officer

Stephen Jordan
Group Treasurer

Other participants

Janany Vamadeva
Arqaam Capital

Hootan Yazhari
Bank of America Merrill Lynch

Shabbir Malik
EFG Hermes

Deniz Gasimli / Waleed Mohsin
Goldman Sachs

Sameer Lumba
Landmark

Chiradeep Ghosh
SICO Bahrain

*Edited

Operator: Ladies and gentlemen, welcome to NBAD's Q1'2017 earnings conference call. I will now hand over to your host, Ms. Janany Vamadeva. Mam, please go ahead.

Janany Vamadeva: Thank you, Waleed. Good afternoon, good evening, everyone. Thank you for joining us today. This is Janany Vamadeva, and on behalf of Arqaam Capital, I'm very pleased to welcome you to the first post-merger earnings call of National Bank of Abu Dhabi. I have with me here today, from the management, James Burdett, Group Chief Financial Officer, Karim Karoui, Group Head of Subsidiaries, Strategy and Transformation, Abhijit Choudhoury, Group Chief Risk Officer, Stephen Jordan, Group Treasurer and Sofia El Boury, Head of Investor Relations.
Without any further delay, I will now turn the call over to Sofia. Over to you, Sofia.

Sofia El Boury: Thank you, Janany. Good afternoon, good morning. Thank you for joining us today to review NBAD and FGB pro forma financial information for the first quarter of 2017.
First of all, we'd like to apologize for the delay, and for postponing the call today. As you know, this is not a usual quarter and we wanted to make sure that you get the full investor deck including both NBAD and FGB standalone financial information, in addition to the pro forma financial information for Q1, and the investor presentation.
So by now you should have received the investor deck in your mailbox, and all this material is also available on the investor section of the NBAD website. So James will be taking you through the investor slides, followed by a Q&A session. So I'll turn it over to James now. Thank you.

James Burdett: Thanks, Sofia, and good afternoon, everybody. Thank you for joining the call, and once again, apologies for the delay.
So there's about 10 or 11 slides that I'm gonna quickly go through as part of the investor presentation, which is obviously based on the pro forma accounts for the combined entity, and then we'll pass it back to you for Q&A.

So, I'm on slide 3 of the presentation, and just to start off with, it's a very strong profit quarter for the bank. You can see the results at 2.92 billion, up some 12% over the prior comparative period, which is a very strong result.
You'll see, if you look through the detail of the presentation, that a lot of that growth is through growth in revenues, which are up by 8.5%, or nearly 400 million over the prior comparative quarter, and a lot of that growth, you'll see, is from investment gains we've made on our AFS book.
Moving on to operating expenses, you can see costs are up 6%. So I think it's worth calling out that that includes just over 100 million in integration costs. In effect when we take those costs out, those costs are actually down by about 2%, and the cost to income ratio ex-integration cost is around 27% which is below our target range.
The pleasing thing there is that we've already realized 75 million in synergies, which equates to 300 million full year, which offsets most of the BAU cost growth for the quarter.
Impairments are down over last year around 4%. Cost of risk is coming in at 68 basis points, and you'll see when we go through the presentation that the risk metrics are looking very strong.
Good balance sheet growth. Loans up 5% year on year, but deposits up significantly at 11% year on year, and a lot of that growth driven by government related deposits, but also good growth in CASA and some of our GRE customers.

The net impact on all of that is that the return on tangible equity came out at 16% on an annualized basis. So above our target range, and looking quite good indeed.
The balance sheet metrics is strong. We deliberately position the balance sheet in terms of liquidity and capital ratio as going into legal day one, and also ahead of the rating agencies meetings that we've had, and obviously the ratings agencies, all three agree on rating of AA.
So good, strong results.

On page 4 just, you know, where we stack up first quarter versus full year '17 guidance. We've said, you know, mid single digit growth in lending, low single digit growth in revenue. Cost to income ratio, we said 28% to 30%. In terms of the loan growth, we're well ahead of expectations. Core growth, once you back out the AFS gains is a bit down over the prior comparative quarter, but that's mainly as a result of de-risking.
We had, in the old NBAD, a significant SME portfolio, which we've greatly run down. Obviously, they were high yielding assets that we've re-deployed into lower yield. We've also built up liquidity to bolster our balance sheet ahead of the rating agencies on legal day one.
So core revenue growth is down a bit, but we have a strong pipeline coming into quarters two and three.
Cost of risk 68 basis points, return on tangible equity at 16% growth, ahead of target guidance.

Turning to page 5. Many of you might have joined the call after legal day one. So integration is off to a good start. We obviously had the legal day one milestone, which was a big milestone for us to achieve.
We've done a lot of work in a very short space of time. Organization structures have been agreed. The governance has been agreed in terms of board committees, sub committees.
We're well on track in terms of our operational and IT synergies. As you can see there, we've already realized 75 million synergies, and we've got one off integration costs of 100 million in the first quarter, which is a little bit front-loaded, and should moderate a little bit towards the end of the year.
The ratings came in AA across all three rating agencies, and we're launching our new brand after the GAM agrees the change of name to First Abu Dhabi Bank on the 24th of April.

Just looking at revenue streams on page 6, and I just want to spend a little bit of time here. So, obviously, the key standout is the AFS gains. Clearly we saw a good opportunity to sell. We have a very high quality liquidity book with significant market to market, and we saw it as a good time to sell at a profit.
Clearly, that's helped create some liquidity. We expect to see good opportunities coming up in the very near future for re-deployment of some of that.
In terms of net interest income in dollar terms itself, you can see it's down 165 million. That's really a runoff of the high yielding portfolio that we've had in both old NBAD and also FGB, and a little bit of rundown in the trade book as we re-deploy into lower risk government bonds, and other liquid assets that require less in terms of risk weighted assets, and therefore, capital. But, more importantly, helps us drive the risk adjusted returns on those products.
Next, fees and commissions are down. That’s mainly because we had a very strong first quarter in 2016 and a slower quarter this year in terms of fee and commission income, but we've got a healthy pipeline going into Q2 and Q3.

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In terms of the NIM itself, you can see bottom right hand side of the chart that the falling loan yield at 4.1% is off a little bit, but the overall NIM is down 30 basis points, and that's really a factor of surplus liquidity. So when you go through the presentation, you'll see that government deposits grew by nearly 17 billion dirhams, which obviously gets deployed into, you know, the fed and cash, and balances to central banks, and obviously help pushes the margin down when you look at the overall footings.
But you can see that the yield on customer loans has held up very well, despite the high yield, high risk portfolio that we've deliberately run down, and the cost of customer deposits has stayed flat at 70 basis points.

On page 7, in terms of costs, cost to income ratio, 27%, ex-integration costs, 29% including integration costs. Integration costs, as I've said, 100 million for the first quarter. A little bit front-ended. We expect it to moderate a little bit in Q2, Q3.
But, as I've said, the main story here is the cost synergies more than offset any BAU cost growth. So the cost is well under control, well on target for hitting the billion synergies we put out to the market earlier this month.

On page 8, in terms of asset quality, non-performing loans continue to moderate just below 2.5%, with the coverage ratio at 114%, and the cost of risk has come down to 68 basis points, particularly if some of those portfolios, the older portfolios that we had, the SME portfolios, the problem portfolios, start to run down.We expect that to moderate through the year.

Page 9 in terms of the balance sheet growth. Good balance sheet growth. 11 billion up over fourth quarter in terms of the lending side, mainly to our customer, target customer segments GREs.
The profit is showing very strong growth, and as I've said earlier, particularly over March last year. Good growth in government deposits, which are up nearly AED 17 billion to nearly USD 40 billion, and also growth over fourth quarter, with good growth in CASA, which you can see is up nearly 5% Q on Q and 8% year on year. As you know, that's a very strong product in terms of accretion to ROE. So good to see that piece growing.
Then in terms of the loan deposit ratio at 88%, you know, we targeted strong liquidity, as I said before, going into legal day one, but also into other discussions with the rating agencies. So liquidity is very strong, and well poised for growth.

Page 10, In terms of capital, common equity tier one ratio at 14.7%. Very strong. Then you can see, partially, the story around de-risking at the bottom left hand side where, you know, despite loan growth, the risk weighted assets have actually fallen off. This is part of our deliberate strategy to strengthen the balance sheet and de-risk some of those portfolios that generated higher provisions throughout 2016.
That leads to a healthy return on tangible equity, which is up around 16% on an annualized basis.

We haven't got a lot of detail around the segments. We're not publishing the segments on a combined basis yet, because we're still working through the MIS on that, and that will be a June release to the market.

Page 11, looking at a year of transition, which you're well aware of, we think the first quarter

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results are very strong. You know, we're well on target in terms of realizing our cost synergies. We've started significant work around the revenue synergies, particularly in terms of the cost to funding, which we put up for market at 400 million, and much of the focus this year is really around integration, and realizing those synergies without disrupting the customer and what we're trying to do in terms of building digital, generating customer momentum across our various businesses.

So, look, there's a bunch of appendices there, which go into a little bit more detail around these integration updates and medium terms, strategic focus in terms of the financial targets we put out to the market.
But that's all I would like to talk about, and I'd like to hand over to Q&A. I'm sure there's a lot of Q&A here, and as the moderator's already said, we've got Abhijit the chief risk officer with me, and Stephen Jordan, the treasurer, and Karim is also on the line.
So over to you.

Operator: Thank you. Ladies and gentlemen, we will now start our question and answer session. If you wish to ask a question, please press '0-1' on your telephone keypad. Thank you for holding until we have our first question.
Our first question comes from Hootan Yazhari, Bank of America. Please go ahead.

Hootan Yazhari: Good afternoon, and thank you for taking my question. I really wanted to focus on progress that's being made with the integration process. You mentioned that you've incurred about 100 million of integration costs in Q1. Can you give us a little bit of guidance in terms of what sorts of costs you have been incurring in Q1, and what gives you confidence that, in the remainder of the year, you'll see that subsiding?
Secondly, with regards to renegotiating the underlying cost base, i.e. taking the FGB book and putting it on the NBAD funding cost structure, can you give us some guidance in terms of how you expect that to play out? How long before you can start to use these superior credit ratings in order to pull your cost of funding down, and ultimately benefit NIMs.
Thank you.

James: I'll start with the first question. So on the cost side, the 100 million, you know, a lot of that was write off of systems, accrual for severance pay, various things like that, and so on. Because some of them are accrual, and we've got a high level figure that we've put out to the market over the next three years of AED 1.1Billion. 100 million for the first quarter is about right.
Some of that is, as I've said before, accrued for future cost such a severance. So we do expect it to come off a little bit throughout the remainder of the year.
In terms of the funding synergies, we put out a figure of 400 million. We haven't put out detailed guidelines around the timing of that. I guess what I would say is that the institutional depositors are the ones that reprice the soonest, and then obviously, as you go through the integration on the retail side, it would be one of the later ones.
But we've got work streams underway across all our businesses to try and align the funding curves.
You know, just to put a number out there, I think you can easily assume around 150 million of funding synergies for the first year.

Hootan: Understood. Thank you.

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Operator: Our next question comes from Shabbir Malik, EFG Hermes. Please go ahead.

Shabbir: Hi. Thank you for this. I have two questions.
Actually, the first one is on, net interest income, it seems to have come down. So maybe if you can provide some color on that compared to, it's come down relative to the fourth quarter and 1Q '16.
My other question is on non-interest income. There seems to be a strong contribution from, I think, trading income. If you could probably shed some light on that, that would be useful. Thanks.

James: Yeah. I'll take the first one, and then hand the second one over to Steve on the asset gains.
In terms of the net interest margin itself, you're talking about the NII. So the dirham value coming off over the fourth quarter... Partly it's one less day over the fourth quarter, which, you know, equates to something like 40 or 50 million dirhams.
Partly it's due to lower interest and suspense than we recognized in the fourth quarter, and then the remainder really is this de-risking we talked about, where we've deliberately run down some portfolios, written off some portfolios, built up some liquidity, which obviously impacts the net interest income itself.
But if you look at it on a risk adjusted return basis, we believe it's better for the bottom line.
Then in terms of the excess gains, Steve will just talk about this

Stephen: Yeah. I think, obviously, we saw a very strong credit market in Q1. Within our global markets division they saw an opportunity to realize some gains. They felt the market had come quite a long way quite quickly, so there was an opportunistic decision to take some money off the table, basically.
That money, as James said, in terms of the impact on NII, that would be re-deployed, I would expect, in Q2, as and when good opportunities present themselves.

Shabbir: Okay. Thank you.

Operator: Our next question comes from Waleed Mohsin, Goldman Sachs. Please go ahead.

Waleed: Thank you very much for the presentation. It's Waleed Mohsin from Goldman Sachs. A couple of questions from my side.
The first question is on the fee and commission income. I mean, despite strong non interest revenue growth, we see that the fee and commission income, more on an annual basis and on a sequential basis, dropped, despite the volume growth. So I just wanted to get a sense of, how should we think about it? Was this also linked to the fact that, given you're de-risking some of the more risky portfolios, it might be linked to pricing of that. So any guidance on that would be very helpful.
My second question is in terms of net interest margin. I know you've touched upon the fact that there has been... The deployment of liquidity should help the margins going forward, but just wanted to get a sense of how do you see the normalized net interest margin for the business? On one hand, you've de-risked the book so there's more liquidity. But, on the other hand, nice growth in the CASA business, and when we compare the CASA ratio versus the rest of the sector, it seems there's some upside on that front.
Finally, in terms of risk adjusted NIMs, you talked about potential to do better on those. Would that

mean that there is some upside risk, or if it could be... That cost of risk going forward could be lower? Because, for the first quarter, you still have 68 basis points, which is roughly comparable to the 72 basis points that you had in first quarter '16, and the 70 to 75 basis points guidance that you provided on 3rd April.
So just thinking that, given that you're de-risking your portfolio, is therefore further room to see the cost to risk going down further to underpin an improvement in the risk adjusted NIM? Thank you.

James: Well, I'll take your last question first. So, yes. The answer is, we would expect the cost of risk to be at or around these levels, a little bit lower than the previous guidance on the basis that, you know, we have de-risked the portfolio. But we're comfortable to keep our guidance at 70 to 75. I think the logical conclusion is 68, and going forward, we don't see that sort of ballooning from there.

Abhijit: I just want to say that, you know, pretty much, it's also going to be a year where we expect as James had mentioned earlier on that, at the lower end in terms of the program lending portfolio which NBAD had, where there was a fair number of specific provisions, which we had to take.
That is, , along with the wholesale portfolio, provides significant opportunity for recoveries and restructuring going forward, and therefore looking at it whilst we've given that indication of 70 to 75, you know, we don't see the incidents of LTL creation going up.
On the other hand, we see a potential for higher recovery as we progress.

James: To get to your second question, which was around net interest margin, just looking at page 6, the bottom right hand chart, I think it's worth really trying to clarify this, because I remember the old NBAD, that we struggled with explaining this... But I think if you look at that graph, and you see the yield on performing loans, it's held up relatively well despite some de-risking, which implies that we've done some repricing as well. And you can see the cost of funding is 0.7%, also remained relatively stable.
The NIM line itself, going from 2.4 down to 2.1, is simply a matter of significant government liquidity coming in, which we behaviorize as a true operational account, and therefore it needs to be available for the government if and when they need it.
Therefore, it's placed in the federal, central banks. It balloons up the balance sheet footings, and causes a mathematical calculation of NIM to do exactly what you see there.
I think you're asking more about a forward looking view of NIM and, you know, there's a whole bunch of factors that come into play, such as, when will the fed hike our ability to realize the cost of funding benefit that we've put out to 400 million over a timeframe... The ability for us to reprice, the ability for us to push the price we pay on customer deposits down. You know, what happens with interest and suspense, which obviously follows the credit cycle.
So all of those factors combined, you know, it's very hard for me to make a prediction. But we're comfortable with our overall guidance of mid to low single digit revenue growth.

Waleed: Understood. Thank you very much. Just a follow-up... Given that, I mean, as you look to the slide, given that the return on risk weighted asset continues to do quite well, 2.5% versus around 2.1%, which really reflects the return on the underlying risk underwriting is doing better. We've also seen that positive flow through to the capital.

Just curious on your targets of 14% to 15% CET 1 which, I mean, if you compare against other emerging market banks, that's extremely on the top end of where some of the emerging market banks are paid. So just curious to hear why the target was set at such high levels, and you're effectively operating very close to the top end of the levels, even after one quarter of profitability this year.

James: Yeah. I think partly it's due to, you know, we're waiting for the Central Bank to come out with their guidelines around the core equity Tier1 ratio. There's no question that will be a domestic CET, and obviously there will be a capital tax in the results of that.
All of these factors need to be evaluated, so I think we're comfortable with strong CET1 ratios right now. Once these regulations come out and we've had some history, we may decide to revisit it.

Waleed: that's it thank you very much.

Operator: Our next question comes from Sameer Lumba, Landmark. Please go ahead.

Sameer: Congratulations on, you know good set of results, the question I had, really, was on credit growth. So when you look at retail and corporate, how do you see things going forward? Clearly the mood in the economy seems to be getting better. So I just wondered your outlook on loan growth for retail , SME and corporate.

James: Yeah. We put out to the markets you know, mid single digit loan growth for the year. I think we're comfortable with that.
I will say that, you know, we see a pretty healthy pipeline building up into the second quarter just from the deal activity meetings that I attend.
In terms of growth, I think, you know, we've gotta be cognizant of our risk appetite around SMEs and various other things. We're obviously pushing for good risk adjusted revenue growth, but with being cognizant of the risk associated with it.

Abhijit: Yeah. I think the only thing to add is that, obviously, I think there is still a significant amount of weakness, some of it spilling over into the retail sector, and you really see the true effects of it in the third quarter.
You know, after people return from their vacations, etc, you see there's lots of job losses, and all of that. So I think the lower end still continues to be weak. As far as retail, the personal loan sector as also SME in terms of sub contractors, etc. So that's where we need to be mindful.

Sameer: Okay. Okay. Thank you.

Operator: We have no other questions at this time. Ladies and gentlemen, I would like to remind you, if you have any further questions, please press '0-1' on your telephone keypad.

Janany: In the meantime, if I may, just a follow-up question on the SME. We understand from some of the Dubai banks, the SME situation has improved. So is that different from Abu Dhabi, and how are you seeing it in Q1? Like, do you still see the same level of stress as, like, in Q4, or do you find it has improved now?

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Abhijit: I think, as far as the stress, which we've seen in 2016, within the SME sector, primarily related initially with traders, if you recall... And that's where, you know, the system-wide SME sector, I think, various numbers, which were floated, which were mentioned in the region seven to nine billion, which was reported. Thereafter if you were aware, and reported in the media as well, of sort of an informal solvency arrangement, whereby if banks would collaborate to help that critical sector.
So I think, as far as that sector is concerned, that part of the portfolio has pretty much plateaued.
The component which I was referring to, where there is the potential for further weakness, is relating to the construction sector in terms of civil construction at the lower end, particularly in terms of sub-contractors, particularly when certain projects have been taken off the table. So it's the follow on effect of that, which I think will take a little bit of time for it to in time stabilize till such time there's further investments coming into the market.

Janany: Do you feel it's different in terms of Dubai and Abu Dhabi, or it's the same across the UAE, like, in terms of these other sectors.

Abhijit: You know, I would say it's a system-wide... It would be a reflection of projects, which have been taken off the table in 2016 across the UAE. Non-priority projects.

Janany: In terms of your -- maybe this is for Karim or James -- in terms of your growth, loan growth pipeline, how are you seeing it in terms of Abu Dhabi and Dubai or is it, like, the same across the UAE?

James: Oh, I don't think I have that level of granularity to top of mind, but what I would say is, you know, our concentration is mostly in Abu Dhabi and Dubai remains an area of strategic importance for us in terms of growth. But, you know, the healthy pipelines that we're currently seeing, I couldn't tell you the split at this point in time.

Janany: Well, thanks James.

Operator:: Our next question comes from Deniz Gasimli, Goldman Sachs. Please go ahead.

Deniz: Yes, hi. Just a follow-up. If you can please elaborate what cause the decline of 15% lower year on year I mean, you might have addressed this. In the presentation you say that it's driven by lower corporate finance fees, but if there's any further color you can provide on this, it would be much appreciated. Thank you.

James: Yeah. I think the answer is we had a very strong first quarter, particularly in old NBAD, and particularly in the DCM business. But also at that point in time we were going very aggressively into trade finance and various other things.
This quarter we... Well, actually, over the last successive quarters, we've deliberately run down part of that portfolio, again, for risk adjusted return reasons. You know, it's a fine sprint versus the competition, which is mainly the global banks that also require the 1.5% general provision.

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So we decided to run down in favor of building up the risk adjusted returns, and that's obviously the fee income attached to that.
But as I said, I think whilst we had a slowish start to this year, we are seeing a pipeline that looks reasonably healthy going into the second quarter.
So I think it's a combination of both a strong first quarter last year, a slower first quarter this year. Part of the change in business mix. But, overall, we're quite confident with our mid to late single digit revenue growth.

Deniz: Thank you very much.

Operator:: Ladies and gentlemen, as a reminder, if you would like to ask a question, please press '0-1' on your telephone keypad. Our next question comes from Chiradeep Ghosh, SICO. Please go ahead.

Chiradeep: Yeah, hi. I think there was some disturbance in the line so I think I missed this point. What exactly comprised of the strategic investments, which are disposed in this quarter? If you can throw some light on that..?

Stephen: That's right. Understood. It’s fixed income disposals. So it's come from a fixed income portfolio that we had within the organization. As I said, we saw some good opportunities to realize significant gains. But, as I said, we will be looking to re-deploy that liquidity as and when good relative value opportunities present themselves.

Chiradeep: Okay. Perfect. And I understand these were higher yielding ones, right?

Stephen: No, I wouldn't say so. This is quite a high quality fixed income portfolio that's just performed very, very well over the last 12 months, particularly in Q1.
We made a conscious decision that the market has come a long way, and we wanted to take some gains.

Chiradeep: Okay. Oh, that's all for me. Thank you very much.

Operator:: Ladies and gentlemen, as a reminder, if you wish to ask a question, please press '0-1' on your telephone keypad. We have no further questions. Ms. Sofia, back to you for the conclusion.

Sofia: Thank you, Waleed, and thank you everyone for participating in this call. If you have any further questions, obviously both Abhishek and I will be here to answer them. So please reach out to us directly. We understand that there is a lot of information to digest this quarter between the standalone financials and the proforma information. So feel free to reach out any time.
Again, just to remind you that all of the material related to Q1 results is currently available on the investor relations section of NBAD website, and will be showing on the exchange websites tomorrow morning, as it was just uploaded a couple of hours ago.

So thanks very much for participating in this call, and have a great evening. Thank you.

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