FAB Q2/H1'23 Earnings Call Transcript*

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Operator: Hello all, and a warm welcome to First Abu Dhabi Bank's Second Quarter 2023 Results Conference Call. My name is Louisa, and I'll be the moderator for today. Joined on the call today, we have the First Abu Dhabi Bank's Senior Management team, who will discuss the Group's second quarter financial results of 2023.

This call is restricted to analysts and investors only. If you are a member of the press or media, kindly disconnect now. At the end of the presentation, you'll have the opportunity to ask questions. You may submit a written text question, located at the top left side of your screen, or you may submit a verbal question by pressing star followed by one on your telephone keypad. I now have the pleasure of handing over to your host today, Sofia Elboury, Head of Investor Relations. Sofia, please go ahead.

Sofia Elboury: Thank you, Louisa. Good afternoon, everyone. Thank you for joining us today in order to review FAB's financial performance for the second quarter and first half of 2023. Group results were announced after our board meeting last Thursday, and all our disclosures are currently available on the dedicated IR section of our corporate website as well as on the IR app.

Today's call is hosted by our Senior management team, represented by our Group Chief Financial Officer, Lars Kramer, our Group Chief Risk Officer, Pradeep Rana, and our Acting Group Chief Credit Officer, Rajesh Deshpande. They will all be here to answer your questions at the end of the short presentation. So without further ado, I will now pass it on to Lars for the presentation.

Lars Kramer: Thanks, Sofia, and good afternoon and good morning to everyone, and thanks, all, for joining today. I'd like to extend a warm welcome to all the analysts and investors tuning in, and I look forward to meeting and engaging with you all over the weeks and months to come. But first, let's focus on the Group's financial results for the second quarter and the first half of 2023, so turning to the first slide of the earnings presentation.

The Group's H1'23 net profit after tax was at a record of AED 8.1 billion. And I think this should be read in the context of a 65% increase in underlying, if you exclude the AED 3.1 billion one-off Magnati capital gains of last year. And on a reported basis, this was 1% up year-on-year.

The Group continued to deliver high returns, with an annualised return on tangible equity of 18.6% for the first half of this year, which is compared to an adjusted return on tangible equity of 12.3% for the comparative period, again excluding the Magnati-related gains. And this represents a really solid six-month three percentage point increase.

Q2 23 net profit after tax was also at a record of AED 4.2 billion, up 61% year-on-year on an underlying basis and up 7% sequentially from an already very strong quarter in Q1. These record results clearly demonstrate solid progress against the Group's growth strategy, and capitalising on a favourable regional macroeconomic backdrop which continues to represent a strong tailwind for the business, leading to a sustained commercial momentum, healthy deal pipeline execution and increased client activity across all products and geographies.

More importantly, these results showcase FAB's status as the regional financial institution of choice, and as an engine for economic growth and diversification for the UAE, which continues to strengthen its position as a global financial hub.

Looking at the drivers behind this record performance, you'll see that this was primarily led by revenue, which climbed 44% year-on-year. And this was as a result of, firstly, core growth across all business lines as the Group continues to make strategic progress and gain market share in key segments, and secondly, from continued benefits from rate hikes, and thirdly, a diversified revenue mix, underlining the consistent focus on building recurring streams of revenue across the franchise, with non-interest income contributing 34% to Group revenue.

We'll go through the Group and segmental operating performance in more detail later in the presentation. Cost discipline continues to be a key focus area even as we invest in transformation. Group cost to income was 25.2%, notably improving from 32.2% in H1'22 on the back of very positive jaws.

The Group maintained balance sheet strength across all the key metrics. For example, Group LCR and NSFR are comfortably above regulatory thresholds. The Group presents a high-quality risk profile, with healthy asset quality metrics and adequate provision coverage, above the 100% level. And the capital position is strong, with the Group CET1 at 13.6%, which is underpinned by robust organic capital accretion during the period of around 100 basis points year-to-date.

Also, the recent reaffirmation of our AA- credit ratings by Moody's and S&P speaks to the structural strength of the franchise. FAB continues to present the strongest combined credit rating among any other bank in MENA, which is a clear competitive differentiator and a testament of the Group's strength and resilience throughout the cycles, and especially a flight to safety in periods of stress and economic turmoil.

So turning to the next slide, where we can see that H1'23 net profit was AED 8.1 billion, as said, 65% up year-on-year, or AED 3.2 billion. And this is again excluding the AED 3.1 billion gain on Magnati last year. And this is the highest ever achieved by the Group in a half-year period.

As you can see on the net profit bridge, the year-on-year performance was driven by a strong uptick in operating income of AED 4.1 billion. And this comes mainly from strong NII, which increased by 37% year-on-year, or AED 2.4 billion, helped by balance sheet growth, improved margins and overall higher interest rates.

60% growth in non-interest income of AED 1.7 billion came from higher fees as well as substantially higher FX and investment income as a result of increased client activity and sales across all product groups, like FX derivatives and commodities, and was also combined with higher market-related income.

This was partly offset by a 10% increase in operating costs amid continued investments in talent and transformation, a 42% increase in impairment charges on prudent provisioning as we continued to strengthen our provision buffers and an uptick in taxes, mainly reflecting growth in international profits.

Moving to the second quarter, net profit for the Q2'23 was AED 4.2 billion, which was also up 61% year-on-year and 7% sequentially, which is also a record for the Group on an underlying basis. Drivers of the year-on-year trend are largely similar to the half-yearly trends in the sense that underlying bottom line growth of 61% excluding Magnati was driven by strong revenue momentum of AED 1.9 billion, again from higher NII and non-interest income, and partially offset by higher costs and impairments.

Looking at the quarter-on-quarter bridge at the bottom of the page, net profit growth of 7% was driven by higher revenue, again through NII and NFI, lower impairment charges as well as lower taxes. And this was partly offset by a 3% increase in opex, reflecting ongoing investment.

And then moving to the next slide, where we're looking at the underlying performance of all the businesses. And I think the key point here is that all the business lines have delivered growth in balance sheet and revenue in the first half, demonstrating the benefits of our diversified business model.

Looking at Investment Banking first, where revenue grew by 47% year-on-year, with both customer loans and deposits up 5% year-to-date. And this is on the back of strong performance in Global Transaction Banking, which saw revenue increase by 160% year-on-year, as well as deal pipeline execution across client segments and products, which include advisory, equity capital markets and debt capital markets, as well as increased levels of client activity and a strong sales and trading performance in global markets.

In H1'23, FAB maintained a leading position among regional banks across various MENA Investment Banking league tables, and it was the #1 bookrunner, lead arranger and lead agent, as well as the #1 DCM corporate manager, with FAB continuing to play a leading role in the development of regional capital markets, with the origination and execution of a number of marquee capital market transactions.

In Corporate and Commercial Banking, revenue is up 57% year-on-year. In fact, this is the sixth consecutive quarter of revenue growth for CCB, benefiting yet from rate hikes and a very strong performance in cash management, helping to offset lower loan-related fees, which compared to the prior period, H1'22, saw very strong loan origination.

During the period, the Group continued to offer innovative solutions to corporate and commercial clients in various areas, including supply chain finance and cash management, and also leveraging strategic partnerships to develop strong ecosystems.

In Consumer Banking, revenue grew by 1% year-on-year in a highly competitive market and despite tight regulation. The business maintained its focus on executing its strategy to acquire new customers, accelerate its digital transformation and delivering strong sales momentum. For example, we saw over 160,000 new-to-bank customers being acquired during the first half of 2023.

We also achieved record retail CASA sales, which were up about 124% year-on-year. And this was underlying consistent growth in the client base, led by strengthened propositions, and a very strong sales momentum across various products, like personal loans, co-branded cards and mortgages. As a result, Consumer Banking's loan book grew by 3% year-to-date, while customer deposits were up nearly 21%.

Global Private Banking revenues grew by 17% year-on-year, with a 7% growth in assets under management, sequentially, and also higher fees from client participation in IPOs and a consistent performance across all of FAB's funds. There was sizable FX and investment gains in the Treasury book as well as FABMISR, which were the primary drivers for revenue growth at the head office level.

Turning to slide seven and looking at the balance sheet, we saw total assets being up 3% year-to-date to AED 1.15 trillion at June 2023, which translated into about US $312 billion. At AED 745 billion, customer deposits are up AED 44 billion, or 6% year-to-date. And this is despite short-term or seasonal outflows at the tail end of the second quarter. And these have actually already come back in July.

The majority of this growth of AED 44 billion is attributable to CASA, which grew AED 36 billion, and this has grown consistently to another record high of AED 333 billion and is up 6% quarter-on-quarter and 12% year-to-date. As mentioned before, this increase is the result of strong performance in cash management, targeted strategic initiatives to grow primary relationships as well as to grow retail CASA. In terms of deployment, you can see that we've deployed primarily into loans, into cash and balances with banks, as well as into investments.

With regards to loan growth, we've already mentioned 5% growth year-to-date, which is AED 25 billion on a gross basis, which means we've already met our guidance for the full year. As you can see on the top right-hand side of this slide, this was driven by sustained demand from our clients in the government and private sector for about AED 15 billion, as we continued to gain market share in key segments, as well as an increase in short-term trade finance lending of about AED 14 billion. And it was partly offset by a few large repayments during the period.

Now, although the second half pipeline is healthy, the high interest rate environment and continued uncertainties globally might impact origination in the second half. Overall, the Group enjoys a very strong liquidity and funding profile, with Group LCR at 159% and NSFR comfortably above regulatory thresholds.

It's also worth noting that FAB raised around US $2 billion equivalent of senior wholesale funding at very competitive pricing to-date in 2023. And this was during some pretty volatile markets. This included the UAE's first Dirham-denominated green issuance last week of AED 1.3 billion for a three-year Sukuk at a rate of 4.93%.

And this is a great milestone in line with our commitment to contribute to the development of the Dirham bond market in the UAE and also testifies to FAB's position as a leader in the green bond market, with total green bonds outstanding of over US $3.2 billion across about 15 issuances and six different currencies.

Now turning to the next slide, looking at NII and NIM. And here you can see, on the top left-hand side of the slide, the quarterly progression of net profit income, growing on the back of balance sheet growth as well as Fed rate hikes coming through. H1'23 NII is up by nearly 37% year-on-year to nearly AED 9 billion, benefiting from strong business volumes and improved margins.

Group NIM was at 1.67%, widening by 12 basis points year-on-year, mainly on the back of rate hike benefits, which are partially offset by the dilutive impact of higher central bank placements which, as you can see at the bottom of the slide, now represent about 39% of average interest-earning assets versus 28% as of June 2022.

In the second quarter, NII grew 1% while NIM expanded by one basis point to 1.66% as the benefit from rate hikes were once again largely offset by increased placements and heightened competition. As we've said before, every 25 basis points positive movement in benchmark rates would generate around AED 300 million to AED 350 million to the bottom line. So we would expect Group NIM to widen by year end. However, the mathematical calculation will remain sensitive to movements in excess liquidity.

Moving to the next slide. Overall, the non-interest income grew by 60% year-on-year in the first half, representing 34% of H1'23 Group revenue. So looking at the key drivers, FX and investment income grew significantly, by 131% year-on-year, to AED 3 billion. This was primarily driven by a healthy sales and trading performance and strong client activity across FX, derivatives and commodities, underlining a positive momentum in Global Markets and the Group's diversified revenue streams.

On the top right-hand side of the slide, you can see the trajectory in fees and commissions which, despite a marginal drop in Q2, continues to be healthy and shows an upward trend on a half-yearly basis. In H1'23, fees and commissions grew 5% year-on-year, mainly on the back of an increase in other fees and commissions. And these now represent 25% of total fees and commissions, and primarily from higher investment banking fees, reflecting a strong deal pipeline and the execution thereof.

By businesses, as you can see in the bridge at the bottom of the slide, the strong sales momentum in Consumer Banking, higher cash management fees and increased trade finance lending were the major contributors. And this was partly offset by lower loan-related fees in CCB due to the stronger loan origination in the prior-year period. As we continue to expand our fee-based business and to focus on cross-sell, we expect fee-generation capacity to strengthen, going forward.

So moving to the next slide, we can see cost discipline being maintained, where, for H1’23, opex of around AED 3.4 billion is up 10% year-on-year, or about AED 360 million. And this was driven by higher staff costs of AED 172 million, reflecting new hires and investments in talent. We see systems-related expenses, including depreciation, up by AED 64 million, and other G&A, including marketing and professional fees, up by AED 79 million.

Sequentially, the opex grew 3%, driven by general administrative costs, and helped by revenue growth, H1’23 cost-income ratio improved considerably, to 25.2% from 32.2% in the same period last year, again adjusting for the Magnati stake sale. So overall, Group operating efficiency is very strong, and particularly for a banking institution of our size, and we maintain our outlook for cost-income ratio for the Group to remain below the 30% threshold by year-end, despite ongoing investments.

Turning to slide 11, the Group continues to present a healthy asset quality, where NPLs were slightly lower quarter-on-quarter at about AED 18.4 billion, with subdued NPL formation overall. And this is implying a Group NPL ratio of 3.7% versus the 3.8% in Q1’23.

Impairment charges for the first half stood at AED 1.5 billion, translating to an annualised cost of risk of about 58 basis points. As mentioned earlier, the impairment charges for the second quarter were AED 676 million, or 15% lower sequentially, and this was partly helped by recoveries during the quarter. Provision coverage improved further to 103% as we continued to prudently build our provision buffers, particularly in the context of the potentially more challenging global environment over the next few quarters.

Turning to slide 12, we see capital generation during the first half was one of the strongest that we’ve witnessed over any half year period post the pandemic. The Group ended the quarter with a CET1 of 13.6%, which is an improvement of about 100 basis points from December 2022 on a post-dividend basis.

And this was primarily driven by higher retained earnings, also ongoing RWA optimisation, and partly offset by asset growth during the period. The growth in RWAs, by 2.5% quarter-on-quarter as well as 1.8% year-to-date, to about AED 582 billion is in line with total asset growth of 3% year-to-date and driven primarily by higher credit risk-weighted assets. The H1'23 return on risk-weighted assets improved to 2.8% versus 1.7% for the comparative period last year.

Turning to slide 13 on financial guidance, despite the global economic headwinds, we do remain cautiously optimistic into second half, given the positive economic outlook for the region. We see both the GCC and UAE economies showcasing strong fundamentals, and all leading indicators point towards continued strength in the non-oil economy, with ongoing structural reforms poised to accelerate economic growth and diversification.

The real GDP for UAE is expected to be around 5% for the full year, with moderate inflation at around 3%. And as mentioned earlier, the high interest rate environment and globalised uncertainties could impact pipeline materialisation in the forthcoming periods. And in this context, and as we continue to be laser-focused on really enhancing Group returns, we've decided to maintain the loan growth guidance for this year at mid-single digits. Other elements of financial guidance for 2023 such as cost of risk, coverage, as well as CET1 will also remain unchanged.

Moving to the next slide and to wrap things up, you can see we've produced record underlying revenue and profits in Q2 and H1'23. The strong top line growth was broad-based across all business lines and was driven by sustained commercial momentum, a healthy pipeline execution and diverse mix of revenue streams.

While we grow the business, we also invest to transform the bank and drive further productivity and efficiency gains. We are pleased with the execution of our strategy so far, and it's a testament to the hard work of all the staff at FAB. But again, there's more to do and to execute on. But with our robust balance sheet foundation and a superior credit rating of AA-, we are indeed really well positioned to continue that work. We've got the right strategy, the right operating model and a strong team that will deliver on its commitments.

And before I conclude, as you know, I've been with FAB for just over two months now. So I just want to state that since joining, I've been really impressed with the competence of the people here, the sophistication and agility of the broad organisation and the power of the FAB brand. And this really resonates far beyond the UAE for many of our customers and stakeholders.

All of this confirms to me that FAB is firmly positioned as the long-term leading bank in the UAE and as a key powerhouse of economic growth for Abu Dhabi, the UAE and the wider region. So I thank you very much and look forward to your questions. I'll just pass over to Sofia.

Sofia Elboury: Louisa, we can open the line for Q&A, please.

Operator: Thank you and thank you for your presentation. If you would like to ask a verbal question, please press star followed by one on your telephone keypad now. You may also submit a written question, located on the right-hand side of your screen. We will pause briefly while questions are now being registered. Our first telephone question today comes from Waleed Mohsin of Goldman Sachs. Waleed, please go ahead. Your line is open.

Waleed Mohsin: Yes, good afternoon. Thank you very much for the presentation. Three questions, please, from my side. Firstly, on the fee income, if you could talk about the sequential weakness that we've seen, despite relatively robust balance sheet activity. And you talked about some of the success on the cash management side and trade finance. So is there a lag in terms of this translating into fee income, or is there anything else keeping fee income low? That would be highly appreciated.

Second question is on capital. As you noted, very strong capital generation. CET1 stands at 13.6%, one of the highest we've seen in recent times. Now, what I wanted to understand is that some of this excess capital that you hold now, is this earmarked for inorganic growth or should we view this as a buffer which will help you move towards a higher cash dividend payout, as you historically used to have?

And my third and final question is regarding net interest margin. Good to see the year-on-year improvement in NIM, but the NIM improvements have been sequentially muted. And you talked about what's happening on the asset side, and that's well understood.

However, what is a bit surprising is on the deposit side, especially for a bank of FAB's liquidity. If I look at your quarterly deposit cost, it's 3.59% for the quarter. And if I take into account that you have a 40% CASA ratio, this implies a time deposit cost of almost 6%. So I want to understand why or what am I missing on this front, and given the strong liquidity that you have in the balance sheet, with a very low loan-to-deposit ratio, why does FAB need to pay up so much for time deposits? Thank you.

Lars Kramer: Yes, hi, Waleed. Thanks for the questions. I'd say on the fee income side, if you look at it on a half-yearly basis, you can actually see still pretty strong progression across the board. I know in the quarter, the decline was really in the CCB component where we saw a decline. And I think this is, if you look at the previous year, a similar quarter. We had some very, very strong loan originations at that point, and where we earned some strong fees.

So underlying, we are seeing some very nice, continued increase in our fees, especially coming also out of Investment Banking where we have a nice pipeline in terms of DCM and ECM mandates, and we're also seeing an improvement in credit card fees, for example, in consumer. And so ultimately, I think, in the quarter two, it is undermined a bit by the comparative number from last year on the CCB loan origination.

On the capital front, we tend to build our capital throughout the year, and we take a view as to how that capital, at the end of the year, is then deployed in terms of what is retained for organic growth, what is paid out in terms of dividends. So I wouldn't say here that you should jump to the conclusion that we're building an M&A buffer. That's not the case. We've seen a good 100-basis-point improvement year-to-date, but the decisions around deployment really get made towards the end of the year, so when we look at our future strategy into the new three-year cycle.

When it comes to NIM, here ultimately, and you can see that a bit with what happens with deposits at the end of the last month of the quarter, they are actually quite volatile. And we do have a lot of deposits that come in from the wholesale market, and the wholesale market clearly has higher pricing than on the retail market.

And this is just one of the… I guess, one of the natures of our business is that we do have a lot of government-related-entity business, a lot of large corporate business, and this helps us on both sides of the balance sheet but does affect the expenditure and the expense of corporate deposits as well, and the deposits cost overall.

Waleed Mohsin: Got it. Thank you, Lars. And on the deposit side, one would expect these deposits to continue despite your comment that some of the deposits have come back into the books in July. So we would still expect deposit costs to remain relatively elevated, as it is at this moment?

Lars Kramer: Yes, because it is clearly quite a volatile component of our balance sheet that we do have to cater for, when it comes to also providing for our net stable funding and our liquidity coverage.

Waleed Mohsin: Got it. Thanks very much. Thank you. Thank you for the answers. Thank you.

Operator: Thank you for your question, Waleed. Our next question today comes from Naresh Bilandani of JP Morgan. Naresh, please go ahead. Your line is open.

Naresh Bilandani: Hi, Lars, Pradeep, Sofia. It's Naresh Bilandani from JP Morgan. Thank you for your presentation. I have four questions, please. One is, could you please provide some insight into the solid gains that you made on the investment and derivatives book, and how should we set our expectations for the second half? It seems like a lot of these gains are being made from the FVTPL book. So it would be very helpful to know what's driving these gains. That's the first question.

Second, would you please be able to provide a confirmation on your tax rate that will be applicable to you from 2024? The third is, now, you've continued to maintain a conservative outlook on asset quality, despite your FY guidance being well ahead. Sorry, 1H performance being well head of your FY expectations.

And you did indicate during the presentation that you do foresee some risk on the horizon that leads you to maintain a conservative stance. So it would be very helpful to know exactly, what kind of risk do you foresee? Because you did also mention that the domestic conditions are actually quite favourable, and the UAE economy is growing very well. And this is a lot more pertinent to your asset quality. So it would be very helpful to know, why are you maintaining conservativism then to such an extent, despite the very good performance and asset quality in the first half?

And my fourth and final question. This follows on from the previous question that was asked. In your recent media campaigns, we've seen FAB advertising near three-month IBOR rates for new deposits. And I'm referring to your iSave product. And this is despite the very high liquidity that you have on your balance sheet. So can you please just explain what's your strategy for deploying this liquidity into higher-yielding assets, even though you probably have the best LD ratio within the MENA bank space right now. Thank you.

Lars Kramer: Thanks, Naresh. Look, in terms of going into the gains on derivatives and investments, we won't go into detail there, suffice it to say that this bucket clearly does have a component of, yes, volatile but also recurring. And I think if I look at that line item in terms of other income, FX and investments and derivatives, I would go as far as to say that in terms of modelling it, we could be somewhere between 50% and 60% recurring, so just to give some indication as to what could also be expected in the second half.

I think on the tax rate, it's still a bit early to tell. In terms of 2024, I would say we're expecting about a 9% tax rate, but this still needs to be fully clarified. And we'll come back and confirm that, and I'm hoping either next quarter or definitely in the fourth quarter.

On the loan side of things, I'm going to ask Pradeep to give a comment. But maybe before I go there, on the deposit rates for retail, I think here, you've got to look at the deposits as campaign-based and that these are effectively short-tenor campaigns, so these are not the structural costs that we would build in for the long term.

And really, this is off the back of us also trying to build the retail franchise, where ultimately, long term, we do want to attract customers. You can see we have attracted quite a large number of new customers in the consumer space. So from that perspective, I think you have to look at it more from a campaign basis and for long-term franchise build. So I'm just going to ask Pradeep to talk about the loans.

Pradeep Rana: Yes. Hi, Naresh. With respect to your question on asset quality, yes, you're absolutely right. In the last presentation, we said that the UAE does remain resilient. We expect GDP growth to be around 4-4.5%. But I think we do look forward. I think based on March consensus, we do expect one or two additional rounds of interest rate hikes before we start seeing a plateau.

And with these interest rate hikes, we do further expect this to put pressure on businesses not only here within the GCC but also within our international operations as well. Now, these headwinds may drive further deterioration in the credit cycle, which may create some pressure on credit positions.

But what I would like to say is that we do still remain fully cognisant and are managing these headwinds through prudent underwriting, continuous customer engagement, portfolio monitoring, and as Lars says, we continue to build adequate provision buffers. I hope that answers your questions.

Naresh Bilandani: Thanks, Pradeep. Lars, maybe just one follow-up on the liquidity side and the new deposits side. Once again, could you please confirm your NSFR currently, at this stage? Apologies, I may have missed that during the presentation. Also, I think, the fact that you're still paying the three-month IBOR rates on your new deposit products, is that in some way an attempt to build up your NSFR at this stage, or are you happy with the NSFR levels, the way they stand currently?

Lars Kramer: Yes, hi, Naresh. The NSFR, I don't think we stated it, but it's around about 110%, and we are happy with the NSFR. If you look at the campaigns on the retail deposits, it's really a franchise-building rather than an NSFR-focused exercise.

Naresh Bilandani: Okay, got it. Thank you very much.

Operator: Thank you for your question. Our next question today comes from Rahul Bajaj of Citi. Rahul, please go ahead.

Rahul Bajaj: Hi. Thanks for taking my question. This is Rahul Bajaj from Citi. I have two quick questions, actually. The first one is again on the guidance, the loan growth guidance which has been maintained at mid-single digit despite the bank achieving 5% year till date. And I understand what Lars said earlier around high interest rates and outlook for second half.

Just wanted to understand, are there any indicators you've seen in the last 20-25 days or early 3Q that makes you believe that you're seeing big repayments on the loan book, which has resulted in the mid-single-digit guidance and no guidance upgrade? So you're basically pointing to a flat loan book for the second half of the year on the first half base. So any new indicators that you have seen, that would be very useful to know.

My second question is generally on the M&A strategy of the bank. So I understand the comment made earlier around capital levels and what it means for inorganic. But given there's some senior management changes that have taken place in the bank in the last few months, just wanted to understand, is there any change in thinking around M&A, or how are you thinking about inorganic growth over the next six, 12, 18 months? Thank you.

Lars Kramer: Rahul, hi. It's Lars here again. In terms of the loan growth, no, we're not seeing any big repayments on individual loans, but we do have quite a component of short-term trade finance lending. And that, clearly, has quite a lot of churn and turnover. So I think that's the one that we are seeing.

In terms of M&A strategy, no, nothing has changed in terms of our general M&A strategy. It stays a lever for us. In terms of our organic and inorganic, these are both very much areas that we will always use in terms of building our franchise. And that cuts across whether it is the various business lines or whether it is in various geographies or in various products. So really, we always see M&A as a way of catalysing, where required.

Rahul Bajaj: Cool. Thanks, Lars.

Operator: Thank you for your question. Our next question today comes from Shabbir Malik of EFG Hermes. Shabbir, please go ahead.

Shabbir Malik: Hi. Thank you very much. A question on fee income. So the trend that in the first two quarters has been pretty decent, can we assume this trend to largely stay intact for the rest of this year?

And second question is on, you commented on your NIM, that at least at the underlying level, you're expecting some NIM improvement in the second half. Is this largely on the back of the interest rate increases that we've seen so far or expected increases in interest rates, that the Fed might increase interest rates, let's say, another 25 basis points in the second half of this year?

And finally, maybe some more clarity on the M&A side. Would it be possible for you to give details of the geography, potential size and maybe potential focus areas of potential investments, going forward? Thank you.

Lars Kramer: Shabbir, hi. Look, on the fee side, I would say yes, this is something that I would see continuing. On the NIMs, I think here, ultimately, with a balance sheet of our size, which is pretty significant, we would still expect to see, because of Fed rate hikes and improvement… Our working expectation is that we will see at least another one, maybe two Fed rate hikes before the end of the year, so that should help feed through.

I think a caution here is a little bit depending on how much deposit inflow we have, and this really would be around more wholesale deposit inflows, we have to take a bit of a view here also in terms of how much of that we would then have to place, short dated or overnight even, with central banks. And that, in terms of a denominator effect, could dilute the NIMs.

But the working expectation is that we do get an increase. And ultimately, the level of increase, I think if you take it as a base from last year, which was running at around 155, we're looking at anywhere between 10 and 15 basis points' uptick year-on-year on that front.

And on the M&A, look, I'm not going to comment on specific M&As. M&A is ultimately for us a lever. We are very circumspect about M&A in terms of when we make decisions as to what to do, where to do it. And ultimately, one of the key deciding things here is it has to be very much shareholder accretive, and it is very, very focused on -- is it giving us the right returns? That for me is an absolute key measure. It has to generate return.

Shabbir Malik: Yes, thank you very much.

Operator: Thank you, Shabbir. Our next question today comes from Aybek Islamov of HSBC. Please go ahead. Your line is open.

Aybek Islamov: Yes. Thank you for the conference call. Very informative, as always. Yes, three questions from me. The first one is about your asset coverage ratios. Your stage 2 coverage, coverage of stage 2 loans by stage 2 reserves is just under 20%.

Given that almost one third of your loan book is to the GREs and government sector, do you think that stage 2 coverage is too excessive? Obviously, your coverage of stage 3 loans by stage 3 reserves is about 44%. What do you think on your coverage ratios, keeping in mind your heavy gearing towards the public sector lending? That's my first question.

Second question. What do you think about net interest margin in a falling interest rate scenario? And I think, given that we get a lot of questions around NIM sensitivity to rates and given your balance sheet structure, changing patterns of deposits, do you think it makes strategic sense to have your margin neutral to changes in interest rates? What would be your thoughts on this? That's my second question.

I think, thirdly, on your surplus capital, yes, your core Tier 1 picked up marginally in the second quarter. So how would you think about your core Tier 1 ratio? Would you say you've got to be accumulating core Tier 1 or just keep it at close to your guidance, core Tier 1 ratio guidance and manage payout ratio accordingly?

Lars Kramer: Aybek, hi. So maybe I'll take the last two, and Pradeep can come back on the asset coverage. In terms of the NIM, clearly we do have a way of managing the balance sheet which is pretty dynamic. And we do take a look at ultimately what the expectations are in terms of the Fed cycle. And at the moment, as I said earlier, we do still expect some increase.

So we have previously talked about our sensitivity to interest rate drops of 25 basis points, and the number there was also around AED 365 million. Now, ultimately, that is as we stand today, without any further management actions. And as we stand today, we are still expecting an uptick, so we want to benefit from that uptick. But as we get closer to a much higher probability of a downtick, we will of course take the necessary actions to try and either stabilise the NIM or lock in a NIM level which is not that sensitive to interest rate movements.

And then on the surplus capital, ultimately we do talk about having a minimum of 13.5% on the CET1, which is pre-dividend. So that is really the number we continue to work towards. And then we do assess, well, on an ongoing basis, but pretty much annually, how much do we then have in excess? What are we going to do in terms of dividend payout? What are we going to do in terms of retention for organic growth?

So that is a decision which we'll give you more clarity on as we go into the second half of the year, and probably more in the fourth quarter. And Pradeep, maybe on the first one in terms of asset coverage.

Pradeep Rana: Yes. Aybek, elaborating more on stage 2 flows between the quarter and outlook for the rest of the year, stage 2 exposures increased by AED 1.3 billion in Q2'23. And this was mainly due to past-due flows in our normal course of business. Much of these movements, the increase of movements were with respect to some increases in our real estate exposure and on construction, but there was also a reduction within FIs and also within the service industry.

And what I would like to say is that, look, we continue to monitor our stage 2 exposure for any signs of deterioration, especially in lieu of the high interest rates which may potentially impact repayments and increase stress on valuations.

With respect to on stage 2 and our ECL ratios, stage 2 average ECLs dropped to 34.5% on the back of new flows during Q2'23. And also, when we look in terms of coverage of stage 2, which is provisions and collateral, including the impairment reserves, this has also improved sequentially, reflecting our prudent provision approach, increase in collateralisation and is also reflective of the largely low-risk portfolio, with large concentrations in government and the GRE sector.

Aybek Islamov: Ok, thank you.

Operator: Thank you very much. Our next question today comes from Chander Kumar of Al Ramz Capital. Chander, please go ahead when you're ready.

Chander Kumar: Hi, good afternoon, and thank you for taking my question. My question is related to CASA. CASA deposits currently stand at 45%, which is lower than many of your competitors. So are there any specific targets or initiatives in place to improve this ratio in the near future?

Lars Kramer: Chander, hi. Ultimately, as a bank, we are a unique bank as well, also relative to any peer group comparisons. As I've been speaking about earlier, we do attract a lot of effectively large corporate and government and government-related-entity deposits, which, from a CASA perspective, we are continuously looking at improving, and hence I think also what I was saying earlier in terms of running campaigns on retail CASA, because this is something that builds out the franchise.

We've seen an improvement in overall CASA levels. I think we were at 40% a quarter ago, and we're now at 45%. So ultimately, from the stable funding perspective, yes, we would like to continue to see it grow. But we do have quite a lot of volatility in this space, so to set absolute targets or targets relative to other banks is not something that ultimately we give guidance on.

Chander Kumar: Okay, thank you. And my second question is regarding FX income, which increased significantly during this quarter to AED 1.2 billion. So I was wondering if you could provide detail on how much the fixed income portfolio contributed to this amount.

Lars Kramer: Chander, this is something that obviously, from an internal perspective, we do have the details of that, but externally, we don't want to get into breaking this down and drilling into all of it. I think what I said earlier, whereby if you want to get some sense of sustainability or recurrability of this line item, the number to look at is somewhere between 50% and 60%, if you want to model it and also look at it going forward.

Chander Kumar: 50% to 60%?

Lars Kramer: Of the recurring level of basically investment, derivative and FX and other income.

Chander Kumar: Ok, thank you so much.

Operator: Thank you. Our next question today comes from Alay Patel of Barings. Alay, please go ahead.

Alay Patel: Hi. Good afternoon, Lars, Pradeep. Can you hear me okay?

Sofia Elboury: Yes, we can hear you, Alay.

Alay Patel: Ok, good, thanks. Look, to be honest, I only had two questions. The first one I don't think I'm going to get more granularity on since the last caller and Naresh earlier asked on the FX gains and gains on any investment book.

So I guess, can I just then say, you say 50% to 60%, Lars, and you did AED 3 billion in the first half. That AED 3 billion is a normalised level for you, is that what you're saying going forward? Here, what I'm doing is clubbing in the foreign exchange gains of AED 1.5 billion and the net gains of investments and derivatives, AED 1.5 billion. That totals AED 3 billion annualised, fixed. So shall I just, what, take AED 3 billion going forward?

Because it's quite difficult to really understand where a lot of this comes from. Half of it, of course, comes from the FX portion and the other half from the investments and derivatives book, but I practically actually don't understand where really it comes from.

Lars Kramer: In terms of, let's say, your numbers or extrapolation, yes, if you're saying the AED 3 billion for the first half, and then of which 50% to 60% is the recurring basis for the second half, I think that would be a conservative number to use in the second half.

Where it comes from, ultimately, what we have in there is clearly quite a lot of client flow business which covers commodities, it covers derivatives and it covers FX. And this is recurring income where we actually facilitate business for our customers. And that really is probably the most significant part of the recurring element.

After that, yes, there is a component of trading and prop, and there is also churn that goes on. And clearly, one of our specialisations in global markets is really our expertise in terms of also understanding the markets and being able to make trading gains and proprietary gains. So there is a component of that, that you could also see as recurring. But look, let me stick to that 50% to 60% as an indicative. I think this is something more than we've talked about in the past, so let's also see how that can be back-tested, going forward.

Alay Patel: Okay, thanks. My second question is how you're thinking about dividends now. So if we look back historically, you did a… I think it was a 2/3rd cash, 1/3rd scrip in 2021, rationale being preserving some capital for future growth. And in 2022, it was all cash, but a drop in the payout ratio to 55% from historically in the 70s. So how would you think about it now, this year?

Because on the one hand, you don't increase the loan growth guidance and potentially expect repayments, so it's not going to be for preserving capital. And on the other hand, you maybe want to keep some dry powder for M&A. So anything you could say on how you're thinking about that, please?

Lars Kramer: I'd say, in terms of dividend, it's a bit what I said earlier, which is we do take a look at this very clearly in terms of decision in the last quarter. But ultimately, we do still see FAB as an entity that is a high dividend-paying entity. So from that perspective, we'll see how much of this accretion we have by the end of the year, and then we make a decision off the back of that.

Alay Patel: Okay, thank you.

Operator: Thank you. As a reminder, for any follow-up questions, please press star followed by one on your telephone keypad. I'll now turn to Sofia to take any chat questions today. Thank you.

Sofia Elboury: Thank you very much, Louisa. Actually, I think we've answered most of the questions that I see on the chat. But if there is any one missing, we can always follow up individually with the analysts and investors after this call. So I guess it's time, I guess, to thank you all for joining this call today. And like I said, if you have any further questions, queries, you know what to do. Feel free to reach out to the IR team or to give us a call directly. So thanks again for your time and speak to you all very soon. And more importantly, enjoy your summer.