EMIRATES NBD Q2 2023 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
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CORPORATE PARTICIPANTS

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Operator

Ladies and Gentlemen, welcome to the Emirates NBD results call and webcast for the first half of 2023 for Analysts and Investors. Today's call is being recorded. Please note that this call is open to analysts and investors only. Any media personnel should disconnect immediately. I will now pass the call over to our host Mr. Shayne Nelson, Group CEO of Emirates NBD.

Shayne Nelson

Thank you, Alex, and welcome to our first half results call. There are a few points on transformation I want to cover before running through the main highlights of the outstanding first half results. Firstly, we are now celebrating the Group's 60th anniversary. This occasion marks an incredible journey from a local bank with one branch to a major international bank with nearly 900 branches, employing over 30,000 people, serving 20 million customers in 13 countries.

As the sector transitions away from the role of a traditional banker, we are recognised as a leader in talent development, empowering staff to shape their own careers and transition into new roles. We've successfully implemented our biggest ever IT transformation. We are now one of the few banks in the world to be 100% cloud-native. Our best-in-class IT architecture enables us to launch new products and services with tremendous agility. In the last quarter, we launched ten new products and services, including carbon trading and real-time FX. We are currently rolling out our ENBD X, a complete revamp of our banking app with an enhanced user interface.

This transformation is meeting the changing needs of customers. UAE's national energy strategy expects up to AED 200 billion of investment, as it triples the contribution of renewable energy by 2030. As UAE hosts COP 28 later this year, ENBD is playing a major role, delivering ESG solutions to customers to help them meet their net zero ambitions and sustainability goals. We're shaping our ESG framework, integrating ESG best practice into all aspects of our business and aligning to national goals, including the UAE's accelerated emission reduction targets. Given the success of our transformational talent, IT and culture, it's fitting that we celebrate our 60th anniversary. Emirates NBD was named best bank in the UAE and best bank in the Middle East at the recent Euromoney Excellence Awards in 2023. The bank was also named Middle East Best for Digital and Best Domestic Private Bank by Euromoney.

In terms of the operating environment, GCC economies remain resilient against a weaker global backdrop and higher interest rates. Our Research team revised this year's forecast for UAE GDP lower, to 2.9%, on the expectation of lower hydrocarbon production, although we revised up our forecast for non-oil growth to 5%. We expect considerable investment in renewable energy in the coming years to meet UAE's ambitious targets. Other economic sectors such as tourism are flourishing, with Dubai tourist numbers recovering close to pre-pandemic levels. In the wider MENA region, Egypt made successful asset sales, reflecting their commitment to revamp the economy. And in Turkey, we saw interest rates increase and a partial unwind for regulations.

The strong regional economy helped us delivery the highest ever half-year income and profit of any bank in the region. There are many other highlights, which underline our key strengths. All businesses delivered higher income and profit. Retail lending increased by a record AED 12 billion. Corporate lending closed key deals across the region, despite intense competition, underlying our regional franchise and enabling an upward revision in loan growth guidance.

ENBD grew deposits by AED 53 billion in the first half, including a hugely impressive 37 billion of low-cost CASA. We now have a one-third market share in all UAE credit card spend and close to that level on debit card spend. Global markets and treasury delivered nearly AED 2 billion in profit. DenizBank continues to deal remarkably well with a challenging operating environment, adding 1.9 billion to Group profit.

Emirates Islamic had its best ever half year, adding over AED 1.2 billion to Group profit. ENBD's investment in technology, AI and advanced analytics is driving new customer services and products and propelling future business growth. The balance sheet surpassed the AED 800 billion milestone for the first time ever. We look forward to the COP 28 in the UAE. ENBD is delivering exciting ESG solutions to customers, as their net zero ambitions and sustainability goals drive further economic activity.

To sum up, ENBD delivered another record set of results, built on a leading regional franchise, state-of-the-art IT infrastructure and adaptable and enthusiastic workforce. We are forward-looking and well-placed to harness the power of generated AI to further enhance ENBD's operations and enhance productivity. UAE's ambitious ESG national goals provide customers and ENBD a virtuous growth opportunity. So, the future looks bright at Emirates NBD.

I will now hand you over to Patrick to go through the results in more detail. Over to you, Patrick.

Patrick Sullivan

Thank you, Shayne, and a very good afternoon to all of you. Just running down the H1 summary financials on page 2, total income of AED 21.3 billion is up 50% year on year. Within that, both NII and NFI are up substantially. Net interest income increased as our efficient funding base benefits from higher interest rates. All business segments are performing well, with strong volume growth contributing positively to interest income.

Retail lending had a record half year, and Corporate successfully closed some key transactions and saw lower repayments in Q2. Non-funded income grew by 2.1 billion to 6.9 billion. We saw a strong growth in client business flows, such as customer remittance, FX and interest rate hedging, increased local and international card business in the ENBD and Deniz and increased trade finance. Turkey also had lower swap funding costs as we've seen NFI relative to last year and the last quarter. Costs increased 34% year on year, supporting very strong business volume growth, particularly in retail and accelerated investment in our digital capabilities and international network. The cost/income ratio, at 25.6% for H1, is comfortably within long-term guidance, but more on that from Paddy shortly.

Impairment allowances are down significantly by 50% year on year. As expected, and as I signalled in the last few quarters, strong recoveries in both UAE and Turkey came through in the first half. This gives us a very strong profit before tax of AED 14.9 billion, which is just over $4 billion, up 80% year on year, and a AED 12.3 billion profit after hyperinflation and tax, which is up 130%. We have issued very clear full-year guidance on NIMs, loan growth, cost and cost of risk. Whilst we are really delighted with first half results, we did benefit from strong non-funded income and credit recoveries. Looking forward to the second half, the same level of non-funded income may not be repeated, and we expect some compression in margins from Turkey and a higher cost of risk. So, if I may encourage you to look at the full-year guidance parameters rather than simply annualising this very strong first-half profits.

Looking very briefly at the quarter-on-quarter numbers on the same page, net interest income is up by 1%, as loan growth and stable margins at ENBD offset a decline in DenizBank margins. NFI is up 10% from higher FX and derivative income from the DenizBank and lower swap funding costs. Expenses are 7% higher, due to business-driven staff costs, and to some extent, VAT associated with higher business volumes.

As of now, we anticipate the new UAE corporate tax that will be effective for ENBD from 1st January 2024 to be at a rate of 9%. That could increase subsequently, should OECD members' agreement on minimum tax rate of 15% be implemented in countries within our footprint. We'll keep you updated, should that change.

In the bottom summary table, you can see the balance sheet metrics are all in good shape, with assets, loans and deposits all growing. Capital, liquidity and credit quality metrics all considerably stronger than 12 months ago. Given strong loan growth in the first half, we have revised loan growth guidance to high single digits for the full year.

Now, turning to net interest income on slide 3, the bottom charts show that margins improved by 110 basis points year on year, helped by improving loan and deposit mix and high interest rates. NIMs are down 18% in the second quarter, as expected, due to lower DenizBank NIMs. The first half NIM of 3.96% is within our guidance range of 3.8 to 4.0%. I expect that NIMs will trend towards the lower end of guidance, due to a combination of DenizBank NIMs partly offset by favourable CASA behaviour, healthy loan mix and the potential for UAE interest rates to remain higher for longer. Of course, we'll keep you updated each quarter as these main NIM drivers evolve.

Slide 4 shows that fee and commission income is up by 12% year on year, with a solid trend of quarterly growth, mainly from increased local and international retail card business in both ENBD and Deniz, strong investment banking revenue and trade finance growth. Other operating income in Q2 2023 is significantly up by 54% year on year, due to higher customer remittance volumes and FX, additional corporate hedging activity and derivative income from hedging and swaps relating to DenizBank.

As I mentioned earlier, Turkey had lower swap funding costs boosting NFI, relative to last year and to the last quarter. In net P&L terms, however, this derivative funding cost has really switched to net interest income as DenizBank raised more Turkish lira deposits, rather than swapping euros and dollars to Turkish lira, which, in turn, partly contributed to lower NIMs in Deniz. Over the last 4 or 5 quarters, around 80 to 90% of FX and derivative income was client flow, but in Q2, non-client income rose with greater mark-to-market gain from market volatility around the Turkish election time. Some of this may reverse in future quarters, or at least not recur.

On slide 5, we see the growth lending increase 5% during H1, helped by a record 12 billion growth in retail and 14 billion net growth in corporate lending on strong origination with fewer repayments. DenizBank loans declined in dirham terms, due to currency depreciation, but they grew their local currency book by 24%. So, it's still strong local business momentum.

Total deposits increased 53 billion in H1, up 11%. Within that, CASA is up another 37 billion. The ability to attract and retain CASA remains one of the ENBD's core strengths. CASA represents a healthy 61% of total Group deposits, despite higher interest rates, which gives a lower cost of funding. Corporate and Government-related deposits have increased in H1, reflecting their good financial health, but this can be seasonal and may reduce in future if these deposits are deployed in projects to support further economic development.

Turning to slide 6, we see that the NPL ratio improved by 0.4% to 5.6% during the first half, helped by strong recoveries in both UAE and Turkey. These recoveries also meant the annualised cost of risk for H1 was 41 basis points, substantially lower than the 108 basis points for the whole of 2022. The gross cost of risk, excluding recoveries, was slightly lower than last year. Our cost of risk guidance of 50 to 70 basis points is higher than the actual first half, as we may not realise the same level of recoveries in H2. However, corporate recoveries can be more lumpy, and it's harder to determine exact timing. Coverage rose by 2% to 147% during the first half and slightly down in Q2, as any inflow of new NPLs typically has less initial cover, versus the higher coverage of recovered loans.

Paddy will now take us through the remaining slides.

Patrick Clerkin

Thanks, Patrick. On slide 7, we see that the cost/income ratio rose slightly to 26% in the second quarter from 25.3% in Q1. Staff costs increased year on year to deliver strong business growth and drive underlying earnings, coupled with human capital investment in digital and international to deliver future growth. Other costs increased due to VAT associated with higher business volumes, higher service, legal and professional fees and an increase in social contributions. We expect this year's cost/income ratio to be just under the 30% area.

Slide 8, Funding and Liquidity, shows that the Group continues to operate with very strong liquidity with an A/D ratio of 79% and an LCR of 217%. Given the high-rate environment, we are able to deploy excess liquidity and attractive, yielding, high-quality debt securities. As with last quarter, we make additional disclosure on page 11 of the financial statement, which shows the unrealised loss in our AED 118 billion investments, measured at amortised cost, is AED 3.3 billion. And this equates to about 57 basis points of capital. In the first half, the Group issued AED 9 billion of term debt, which more than covers 2023's total maturities of AED 8.6 billion.

DenizBank successfully rolled over their midyear syndicated loan and upsized it, as they attracted new investors. And they also issued another diversified payments rights transaction for over half a billion dollars, with a weighted average life in excess of four years. Capital adequacy on slide 9 shows that the common equity Tier 1 ratio strengthened to 16.6% in H1, as AED 8.9 billion of net earnings more than offset a 2% increase in risk-weighted assets. The common equity Tier 1 ratio, excluding the ECL regulatory addback, was 16.1%. RWAs only grew by 2%, compared with 5% lending growth, as new corporate lending is very high quality, resulting in a lower risk-weighted density.

On slide 10, we see that RBWM income improved 40% during the year. It was a record half year for retail lending, which grew AED 12 billion. The retail deposit gallery and engine continued in H1, adding a further AED 24 billion of deposits. ENBD X, our enhanced mobile banking app, is being rolled out, and the Liv brand is being refreshed. CIB delivered a 36% increase in income, and this, along with significant recoveries, boosted profit by 116%. CIB continues to roll out additional products and services, including new global custody services and easier access to trading on the Abu Dhabi stock exchange. Business online was extended to both India and KSA.

Emirates Islamic's results are reported in their respective Retail or Corporate sectors. However, it is worth noting the 71% increase in EI income, helping deliver a record net profit of over AED 1.2 billion. EI is a publicly listed company, and their financial statements are available on their website. Global Markets and Treasury delivered an outstanding performance, with half-year profit reaching almost AED 2 billion. Net interest income jumped on higher income from balance sheet positioning and an increase in investment income. Non-funded income was higher on a strong trading and sales performance. DenizBank income was up 15% and, coupled with significant recoveries, helped grow profits to AED 1.9 billion. We have a couple of extra slides in the Appendix, containing more granular detail and a dollar convenience translation.

With that, we'll open up the call to questions. Alex, please go ahead.

QUESTIONS AND ANSWERS

Operator

Our question comes from Waleed Mohsin from Goldman Sachs.

Waleed Mohsin - Goldman Sachs

Thank you. First, if you could comment on the direction of the net interest margin for the domestic business, is it fair to say that margins, domestically, have peaked, and from here on, we would see a gradual decline? So, that would be the first question.

Secondly, wanted to get your thoughts on capital levels at DenizBank. As you alluded, there is a change in regulation in Turkey, where some of the prior regulation's been unwound. And, as a result, rates are going up, the currency is depreciated, which all have implications for DenizBank's capital. So, wanted to get your thoughts on how you see the capital levels and if they're adequate as they stand.

Also wanted to get your thoughts on the upgrade that you made to loan growth guidance. Any particular sectors where you're seeing spends, which have led to that change in guidance? Because historically, what we were seeing was that, although the economy continued to remain strong, we were not seeing that translate into credit demand, given that corporates were relatively cash-flushed.

And my fourth and final question is on IDBI. Is there any update that you can share on that bidding process? That would be very helpful. Thank you.

Patrick Sullivan

Maybe I'll tackle the first three of those, and then ask Shayne to deal with the fourth one. Just on the direction of NIMs for the domestic business as it peaks, as we all know, the rates went up 25 basis points yesterday, so that may give some upside. You'll notice, in the details that are in the Appendix, we've actually split out the margins by ENBD and Deniz. So, you can see that, for Q1 and Q2, the margin, at just over 390 basis points, was quite stable for the first two quarters, having benefited from the rate rises through last year. So, has it peaked? There may be some upside, but also, a big dependency on that is the behaviour of CASA and whether we see more migration to term deposits.

The market's still quite liquid, so we haven't seen migration at the levels that we might have expected when we were heading into this year, but it would be quite a reasonable assumption, as rates peak, that we might see more migration, and therefore that implicitly increases the cost of funding somewhat. Capital in Deniz: from a subsidiary point of view, Deniz itself doesn't actually have a significant impact at all on the Group capital base, because as you get Turkish lira depreciation, while you might have a negative impact on the numerator, you also have a benefit from, essentially, lower risk-weighted assets in the denominator. And in fact, what we can find is that, quarter to quarter, sometimes there's a small benefit when there's a period of depreciation.

But I think, more to the essence of your question, is more domestically in the local capital base. So, they do have double-digit CET1. We keep a very close eye on that, obviously, as the Turkish lira depreciates. Any foreign currency risk-weighted assets they have, essentially increases, but they can manage that and pull on levers as and when they need to as well. So, that's well in hand.

Loan growth in corporate sectors. I think, for the first half, we have seen particularly strong growth across four corporate sectors and across pretty much all of the retail personal lending, whether it's credit cards, auto, mortgage. But on the corporate side, one of CIB's key strengths has been around transport and communication. The other is trade, financial institutions and also management companies, ie, more like conglomerates, etc. So, they're probably the standout sectors where we're seeing growth through the first half.

Shayne Nelson

I'll just add to that, Patrick. One of the things we're seeing with the property market, as we've discussed previously, is that, because the market's so strong, presales are also strong. And therefore, we're providing guarantees for the escrows, rather than funding the actual development themselves. So, that does take some of the historical loan demand we would have traditionally seen in the property sector out of the equation for a lot of the larger developers who have good brand and brand recognition and good projects.

However, the flipside of that is, those escrow accounts that we provide the guarantees for are with us, and that gives us sticky liquidity that comes with those escrow accounts. So, we lose on one side on the lending to the property sectors, but actually, on the flipside, on the CASA side, we actually get the benefit for that. So, I think, from that perspective, yes, it would be better to have it on the lending side, but actually, the flipside is, we're getting it on the CASA side.

On the IDBI question Waleed, basically we haven't made any announcement, and we're aware of what our obligations are to the DFM and the regulators. We're constantly evaluating opportunities. We obviously have the capital base and the liquidity to make acquisitions, and we continue to look into markets like Egypt, Turkey, Saudi and India, as we've said previously.

Waleed Mohsin - Goldman Sachs

Got it, thank you very much. That's very helpful. Maybe just to follow up on the DenizBank comment, so on your base case, as things stand, despite reversals from the regulations, rates going up, lira weakening, on your base case, do you have a scenario of any need to inject capital into DenizBank as it stands or for DenizBank to raise capital?

Patrick Sullivan

We're very aware of all the different variables that can increase their capital base and may decrease it, and we're aware of the sensitivity, both locally and at a Group level. And we manage that through a business-as-usual basis.

Shayne Nelson

Waleed, on Deniz, the Group attends their ALCO session every month, and part of that is the capital management, and the biggest impact you're always going to see on Turkish capital is the foreign exchange loans. We're very tight on foreign exchange loan growth in Turkey, for the obvious reasons. One is around the currency, and two is around the capital. So, yes, we do a currency sensitivity, given the loan mix we have, as to where it will be, plus, obviously, loan growth. So, we monitor that very closely, and at this stage, no requirement.

Operator

Our question comes from Naresh Bilandani from J.P. Morgan.

Naresh Bilandani from J.P. Morgan.

Just a few questions from my side. So, one is, the scope for continuation of strength in FX and derivative income. Now, this is currently 20% of your total revenue, so quite a sizeable number for us, from a modelling perspective. Keen to know, how should we think about this, going into second half? You did mention that it, with a similar strength, may not continue, but I'm just trying to understand, if you could, please… During the presentation, you did provide some insight on what drove the strength. And you said that a bigger push in that did come from mark-to-market gains in Q2.

Would be very keen to understand, to what extent should we think of this as being correlated to a depreciation in the TRY, and is that a fair way of thinking, and any insights that you can provide on what could be a number or the size, going into the second half. That would be super-helpful. That's the first question.

The second one is on your RWA density, and you did mention that the growth has been towards high-quality corporate loan growth, but then, all the factors that one could think of would intuitively tell you that the risk-weighted assets density should be increasing because your sovereign book is maturing, loans are growing in both the corporate and the retail book.

So, clearly, there should be an increase, intuitively, in the RWA density, but actually, it's decreasing. So, if you can, please, give some insight on what is helping this reduction, again, that would be great.

And the third question is on your outlook on the sovereign repayments. Have we reached the bottom of the repayment cycle, or do you reckon there could, potentially, be, still some risk again on this line, assuming the tax collection effort kickstarts on a greater size starting early next year? If you can, please, share some insight there, that would be great. Thanks.

Patrick Sullivan

Let me see. I'll tackle those from the top. Just on the NFI, let me unpack that a bit. We've switched back to slide 4. You're right, it's been a significant step up in the last couple of quarters. I think, pretty much, every quarter that I've been doing this presentation, there's been a weighted attribution of the variability to DenizBank and the last two quarters, probably not too different.

What I want to emphasise though, is that underlying those numbers is a really strong client flow business. In ENBD, we're seeing strong FX, customer-driven flow business, quarter to quarter growing. And even in Turkey, their client FX business has been very strong as well, and actually, in Q2, around the time of the election, the spreads on spot FX transactions just got wider and wider. They probably have narrowed a bit more, so we don't expect to see that again through the second half.

But I did say, earlier in the opening remarks, that typically, in the last year or so, the average quarterly client income has been 80 to 90% of that FX, that dark blue FX and derivative income line in the presentation. So, and then in Q1 this year, that was probably between 80 and 90% of the 1.4 billion, was client flow-related. And then, what we saw in the second quarter was a step up on some of the gains in Turkey, particularly as there was a sharp depreciation of the lira around the time of the elections as well. So, that's one of the things where banks, typically, if they're positioned correctly, will make money in that sort of event.

So, there was quite a strong pop-up on any open position that we would have had in Turkey. So, I think, out of that 2.1 billion, between 60 and 70% of that would have been underlying client flow, so if you want to use that as your base, it's not a perfect guide as to what might happen in the second half, because you may still see some upside or even downside reversals from any previous quarter mark-to-market gains from Turkey. So, it might then diminish that a bit. But that should give you an idea of what a reasonable underlying client business looks like.

Just on the second point, risk-weighted asset density, it's a mix of a lot of moving parts in there. So, for example, when the CRR went up, so the reserve requirements went up in April, that meant assets switched out of risk-weighted bonds into zero risk-weighted Government bond. When we originate new corporate business, the weighting on that's going to depend which end of the PD curve you are at. If you are at the strong end with the GREs that might be risk-weighted at 20% or other private companies that might be at 100%. So, it's really going to be quite a mix as well, and another substantial part of that for this quarter was the Deniz FX translation. So, I think that was down 10 billion as well, following the 28% appreciation of the Turkish lira. So, lots of moving parts in there.

As for sovereign repayments, you can see consistently, since Q1 2020, that the trend has been downwards. There was a small increase in Q1-23, which was just the timing of cashflow, but you can see, on page 5 of the presentation, 113 from Q4 end of last year, went up to 116, and is now back to 112. So, that trend seems to be continuing. But we can't give specific guidance on whether we think it'll be up or down. You just need to judge that on the trend you're seeing. I think that was your three questions.

Naresh Bilandani - J.P. Morgan.

That is correct. Just the point on the tax collection, do you reckon that could still, potentially, continue to be a risk on this line?

Patrick Sullivan

Well, the Government finances are in very strong shape, so it's up to them what they then do with that, whether it's investment or debt reduction, etc. So, I can't really otherwise comment on that.

Shayne Nelson

Well, I think most of you live in Dubai, and you see the strength of the economy at the moment. It's firing on all cylinders everywhere, and that's translating into our results, so I think the Government's financial position is obviously strong in the UAE and Dubai itself.

Operator

Our next question comes from Chander Kumar from Al Ramz Capital.

Chander Kumar - Al Ramz Capital

So, my first question is related to, ENBD recorded 6 billion of profits in second quarter, while the increase in equity was only 2.6 billion. So, if you can, please, provide some insight into this notable difference between equity and net profit. It seems like a positive impact of, like, DenizBank operation on P&L, has been offset by higher currency translation losses on balance sheet. Please confirm if my understanding is correct.

Patrick Sullivan

I would point you to page 4 of the financial statements after the call. Yes, we have our P&L earnings, and then, in the other comprehensive income, we also have the impact of FX depreciation on our structural investments in both Egypt and Turkey, so that reduces the net equity contribution, amongst a number of other things that are also showing in there along with hyperinflation and what not.

Chander Kumar - Al Ramz Capital

Yes, fine. And my second question is related to DenizBank NIMs. So, if you can provide the guidance on DenizBank NIMs, especially in the context of monetary tightening. We have seen a sharp increase in interest rate from 8% to 17%, and expectations are that it's going to further increase. So, if you can provide some colour on DenizBank NIMs, that would be really appreciated.

Patrick Sullivan

Page 12 of the presentation shows the ENBD versus DenizBank NIMs. So, we exited last year with Turkey having NIMs just under 9% at Q1 this year. They came down to around 4.5 or 4.6, which was very similar to Q1 last year, and now it's come down to 3.4. Now, that is the impact of a number of things. On one hand, there's been the regulations on the pricing of assets. So, there were certain penalties for lending at rates over certain amounts. So, that compressed the gross yield on the asset side. There was also requirement to have a 60% Turkish lira funding base, so there was competition for deposits. That pushed the cost of funding up.

Also, any CPI linker income with lower inflation through the first half also meant that income was a little lower in the first half as well. So, the monetary policy, at the moment, is transitioning, and some of the regulatory rules have been adjusted. We've already seen that the ability to price the assets higher is starting to come through. The requirement on the Turkish lira deposit base is starting to be lowered as well.

So, for the next quarter, I would expect the margins in Turkey to continue some further compression, and it does take time. Even if you get into a positive situation where your asset pricing is higher than your cost of funding for new vintages of origination, it can take time for that to come through in the overall margins as well. So, there may be, if the monetary policy continues along its current trajectory, some margin pickup towards the end of the year.

Shayne Nelson

And certainly, we have the new Economic team, making adjustments to interest rates, and the maximum we can charge has gone up to, from 25%. So, we're seeing that the negative spread in NIMs that was there for a while has contracted significantly. So, you've also got a situation where the new government just announced their forecast for inflation, which, for the first time, has been stated over 50%. So, that also helps on our inflation-linked bonds, which will actually flow through to NIMs as well.

Patrick Clerkin

Just one more point. As Patrick mentioned when he was talking about the NIM guidance, that's all baked into the guidance of 3.8 to 4%, but with the expectation that we will land at the lower end of that range.

Chander Kumar - Al Ramz Capital

So, this overall Group forecast for NIM is already incorporated for DenizBank compression?

Shayne Nelson

Yes, that's correct. It's a consolidated view.

Chander Kumar - Al Ramz Capital

Okay. My last question is related to corporate tax. As you mentioned, corporate tax will be, like, 9% for ENBD, starting from beginning of 2024, and it will gradually increase to 15%, in line with global practice. So, for modelling perspective, how much, in corporate tax, we incorporate in the medium term?

Patrick Sullivan

So, for next year, it's more likely to be around that 9%. For it to be 15%, the OECD countries have to have actually implemented that.

Shayne Nelson

And I think the biggest stumbling block at the moment, my understanding is that it's stuck in the US Senate for ratification. In fact, I think some candidates are saying they're going it alone, so for it to get a global OECD agreement, they need the US politicians to agree, which, as you know, in the US, it's not an easy thing to get an agreement on anything. But I think, at this stage, we're looking at 9%, but I would think it would be quite normal to have an expectation in the UAE that, when an OECD does go to 15%, the UAE, for multinationals and companies like ourselves, will move to 15%. That would be my anticipation and in the background of our mind for our forecasting.

And the reason I would say that is because, if a multinational doesn't pay 15%, if they pay 9% here, they'll have to pay the top-up somewhere else. So, the UAE might as well get the tax revenue for where that income is earned, rather than have another jurisdiction pick up that difference between the 15 and the 9.

Patrick Sullivan

And just to add to that, the European Union wouldn't be implementing this, in any case, until 2025, or the UK, and that's part of our footprint, so I would be thinking about 2025 at the earliest. But of course, if it is earlier, we'll be sure to let you know at the quarterly updates.

Operator

Our next question comes from Rahul Bajaj of Citi Group.

Rahul Bajaj - Citi Group

The first question is on your unfunded exposures. I see, last couple of quarters, we've seen, decent pickup in provisioning for unfunded exposures. In fact, almost equal for Q1 and Q2. Just wanted to understand what is driving it, and is there a change in how the bank provisioned for this particular item. Linked to this, on your cost-of-risk guidance and when you said you expect the pickup in the second half, I just wanted to understand, to what extent the pick-up in the second half on cost of risk is driven by less recoveries, versus any specific stress that you see coming out of higher interest rates. So, is that also a factor for you not changing your cost-of-risk guidance? So, that's my first set of questions.

The second one is on DenizBank. Just quickly, if I look at the AD loan and asset sequential trends, they're down quite meaningfully. How should I think about the strategy at the local level? To what extent is this FX related, or is there a strategy to go slow on the DenizBank business from the top? Any thoughts there would be appreciated. Thank you.

Patrick Sullivan

Sure, Rahul, let me pick those up. Just on your point about the unfunded provisions, just to give everyone else on the call a point of reference, I think you're talking about note 15, which just shows that we booked 536 million in the first half. We also discussed this in Q1 as well, but it has gone up from Q1. It was about 290-odd million, and it has gone up a bit. So, look, the increase for that is the combination of a few things, partly updating of our ECL models, which I noted last quarter, plus the growth in our unfunded exposure and the composition and mix of the portfolios and factors as well. You've got to remember, these models are forward-looking, so it's not just about looking at buoyant economies today. It has a number of variables that get factored in for some years in advance. So, that's a factor as well.

You'll also notice, in our accounts, that contingencies and commitments have also been growing in the last few years. At the end of 2021, we're at 116 billion. We're now at 131 billion. We do count that 536 million as part of our overall cost of risk in the 41 basis points, just so you know, so we haven't excluded that in the risks that we're facing. And then I think that segues into, you're question about the guidance for the full year cost of risk. So, the main driver is indeed expected lower recovery levels. So, in the detailed accounts, in note 23, you can see that we recovered 2.2 billion in the first half, and that compares with 1.1 billion in H1 of last year.

So, the P&L charge went down from, 1.9 billion last year to 0.9 billion for the first half of this year. So, even with the guidance we've given of 50 to 70 basis points, if you took 60 as the mid, mathematically, you can calculate that the guided cost of risk for the second half is around 80 basis points. Not too bad, considering the pattern that we were showing for the previous three years. And that would also imply an H2 charge of something like 1.8 billion, which would be similar to last year's H1.

Shayne Nelson

And I'd just add that one of the things that, I suppose, is a bit unusual about our bank, compared to some of our competitors, is that we're so highly covered with Stage 3 coverage in high 90s, that anything that we work through, basically, we're getting a write-back. So, with the way the property market is, and obviously, some of these problem loans have property collateral, we're pushing our workout teams to close out some of these problems as quickly as we can.

Given how robust the property market is and where prices are, we're pushing to get these things finalised. Now, the problem, as you know, with problem loans is, you don't know when a property's going to sell. You don't know when you're going to get the legal approval to dispose of it. So, there is a bit of a time drag, so the timing is pretty unpredictable.

Are we hopeful that we could get some more recoveries in the second half? Of course, we are. Are we pushing for them? Of course, we are. But we wouldn't bank on that when we're giving you guys what our cost of risk is.

Operator

Our next question comes from Shabbir Malik of EFG Hermes.

Shabbir Malik - EFG Hermes

So, this year, UAE is hosting COP 28, and we're seeing a lot of, you've talked about real estate sector, but also, you're seeing a lot of construction activity taking place, so are these emerging as growth teams for the Bank? Are you seeing any increase in demand for sustainable financing, demand from the construction sector for loans? Is that something that you're seeing in your business?

Shayne Nelson

I'll take that first, So, I'd say, on that, certainly in the power side, we are. You're seeing quite a lot of stuff that's happening in Saudi and the UAE, and also the demand going forward, that the UAE's announced 200 billion of additional investment. So, from that side, yes, sustainable finance will grow quite substantially. Both from Saudi and from the UAE, we see, clearly, a pipeline there. On construction, not so much at this stage. We are seeing some green buildings, and in fact, ourselves, we've got Gold Lead ratings on a few of our branches. So, we are seeing improvements in client expectations and behaviour, when it comes to making their buildings more green.

But would I say, in the construction industry at the moment? I'd say no. We, as a country, and we, as a bank, and our customers, need to do a lot more work in the building and construction area, given the emissions that come out of the steel components and the cement going into these properties. So, I think there's still more work to do from ourselves, from Governments and from contractors and developers.

Shabbir Malik - EFG Hermes

Thanks for that. What I meant with the construction sector is that, generally, the activity, for example, there were some reports of restarting the Jebel Ali Palm, so broadly speaking, the construction sector, I think there's some anecdotal evidence of pick-up in that space. So, is that translating into loan growth for the Bank, not just green construction, but generally speaking?

Shayne Nelson

Contractors for us, as an industry, we obviously do contracting finance. We have quite a few contractors on our books, but we're also quite, I wouldn't say risk averse, but we're risk cautious on that sector. Contractors, historically, in both Saudi and the UAE as a risk profile, have not been a great experience for the banking industry as a whole. Not just for us, but lots of other banks, whereas the margins have been, historically, very thin.

What we are seeing now, I think, with the contractors, is a better management of their margins. And because there are fewer contractors around now, I think they have the capacity to price far better than they have historically. So, I think we are seeing some loan growth in that sector, but would I say it's huge? No, because we're quite cautious on what we'll do. It's not a sector of industry that we would take a massive amount of risk on because, historically, it hasn't been a good sector from a return on risk for us.

Shabbir Malik - EFG Hermes

Great. A question on mortgages. So, mortgages in the UAE are floating rate, and we've seen interest rates go up so sharply. Now, I appreciate that property prices have gone up, but how are you managing, potentially, cashflow issues for the client, because interest rates have gone up too much and maybe it's becoming a bit more challenging for them to repay their loan? Are you seeing that in your portfolio, and if there is this case, then how are you managing that?

Shayne Nelson

We're still seeing a quite robust demand for new mortgages within the portfolio. But as you know, in the UAE, 60 or 70% of transactions seem to be cash, so the demand for mortgages versus the demand for property is less. I think the good thing at the moment in the UAE is, if clients are in distress, there's an easy solution. They can sell, and they're selling for profit. It's not that they're selling and losing money on the transactions.

So, I think we're in a privileged position where there is an easy way out with clients with stress, but we're not seeing substantial stress in our mortgage portfolio at all. Would you ask me if it was surprising? And my answer would be, yes, I think it's actually quite surprising. But we are not seeing that stress within our mortgage portfolio at all.

Shabbir Malik - EFG Hermes

Yes, thank you. And finally, if I look at your capital position, it's become exceedingly strong. Are you comfortable having a relatively bloated capital base, let's say, if you don't find the right deal at the right price, or would you be open to maybe paying out a bit more in cash dividends?

Shayne Nelson

It's hard to say yes after you've described it as a bloated capital position, isn't it, Shabbir? But, look, I think the reality is, we obviously have a very strong capital base. We obviously have an increased capacity to pay dividends, and I think this level of capital base could eventually impact our return metrics. Even though our return on equity is extremely high, even with our "bloated" capital base, certainly it is not at the level that we would like to maintain going forward if we don't find something to acquire or if the Board decides to increase dividends at the end of the year.

Operator

Our question comes from Aybek Islamov from HSBC.

Aybek Islamov - HSBC

Hi, one area I just wanted to ask about is retail segments. And in the retail segment, what I see, it looks like you are really boosting your provisions. At the time when you're reversing or recovering your provisions in the corporate, you are boosting your provisions in the retail, and the cost risk, if I'm correct, close to 3% in retail.

At the same time, there's a slowdown on retail loan growth. Can you explain to me what's happening in the retail segment? Do you feel that the segment is at the peak and you're just taking the opportunity for cautious countercyclical provisioning in retail? That's my first question.

Shayne Nelson

Yes, I think I'd say, on that one, all of the above. We did, in the first half, see 12 billion of growth in retail, so we're not seeing a slowdown in growth in retail. We're seeing an acceleration of growth in retail, and we're taking market share. And also, obviously, the population's growing, which is helping us substantially. But also remember, when you're doing ECL models, we're very heavy credit cards. So, given the nature of risks in credit card, if you're building up that revolver book, your ECL, being forward-looking, is going to build as well as you grow that book.

And as I said earlier, one third of UAE credit card payments and nearly a third of debit card payments are with Emirates NBD cards. So, that book is big, and as we keep growing it, which we have, that has an ECL translation. And it also has a charge. Because, do we have losses on that credit card? Yes, but the spreads on credit cards are so large that the risk-adjusted yield is very, very strong. So, you are seeing, as we're growing, that ECL, and are we being conservative? Absolutely. You know we have always been very conservative on how we provision.

Aybek Islamov - HSBC

Okay, very helpful, thank you. And the next question I wanted to ask you about, the real estate sector. So, you mentioned on the call that you're guaranteeing escrow accounts, escrow deposits, which are coming in as prepayments/payments for the new projects, under-construction properties. So, where else is the strong real estate activity is manifesting itself in your balance sheet, apart from council deposits, apart from the strong deposit inflow? Any other areas?

Shayne Nelson

Well, I think, on CASA growth, it's been pretty much across the board. We're obviously seeing strong CASA growth in Corporate. We're seeing strong CASA growth in GREs, and we're seeing strong CASA growth in retail and SMEs. So, it's pretty much across the board. We have got a situation in the UAE where the economy's robust. We're getting population growth, and we're benefitting from that. And we'd like to think we're the go-to bank, certainly in Dubai, for the new population moving into the country, new businesses being established, and we're continuing to see very strong results.

Again, if you'd asked me, would we have seen more switch into term deposit, well, we are seeing switch into term deposits from existing customers, but we're also growing our customers at a faster rate than that switch. So, we're benefitting from that, because even FDs now, we can make them profitable with our investment side. So we're benefitting from the strong liquidity in the country and our capacity to attract that liquidity. And this is not like it's happened by accident. We've been talking about our focus on CASA now for years and years because we always saw it as, once rates went up, we would be the beneficiary of that.

And, yes, it's not without cost. We pay our staff sales incentives to grow that CASA and to get new accounts that develop CASA for us. So, it's not an accident that it just walks in the door. It's also a lot of feet on the street, marketing, plus, obviously, our digital capabilities now. Ease of opening accounts makes it that we do attract CASA from other banks and also from new population growth.

Aybek Islamov - HSBC

Super, excellent. And one last question. You spoke about construction, that you are cautious on lending to the construction sector, if I understood you correctly. Now, obviously, there are developers who are Government-related entities. Would you be still cautious in this case?

That's one part of the question, but, secondly, you could also be lending against projects, construction projects, which are guaranteed by the Government. So, are you lending to developers, or there could be projects where developers can guarantee them, and these projects are exacted by the construction companies? So, there could be two ways to participate in the construction boom. One is funding projects, which are guaranteed by developers, but done by the contractors, and the second one is, lending to contractors directly. I understand you are not doing lending to contractors, but what about project finance?

Shayne Nelson

Okay, if you look at our numbers, our exposure to real estate lending is down. It's about from 48 billion to 45 billion. So, that's coming down, and some of that is, from what I said earlier, that the big developers of this world are preselling things like hotcakes, and they're using the escrow account to fund the development. And we provide the guarantee to the developer. Contractors are a different piece of the puzzle. The contractors are the ones doing the work, building all the villas so that, to us, is the more risky piece. And historically, that has been because margins in that sector have been rock-bottom.

They've been too low, and a lot of the contractors were relying upon variations to make good profitability out of the development, rather than the base margin of the development itself. That works well if everyone agrees on the variations. If they don't agree, that might not work out so well for the contractors. So, are we banking contractors? Absolutely, we bank contractors, but we are also very risk cautious on which contractors we will bank and what developments we would back them into. And obviously, the pay master is one of the key issues for us. Have they got the right paymaster, the developer, with that contractor?

Aybek Islamov - HSBC

Thank you.

Patrick Clerkin

I have some questions on the web, I'll just run through some of the questions that have come through on the web. Turkish Central Bank normalisation of rates, is that going to hurt DenizBank NIMs?

Patrick gave a very clear answer. There is some further DenizBank NIM contraction baked into our overall guidance trending towards the lower end of guidance.

Can you confirm the proportion of corporate and real estate loans are backed by property collateral? Certainly, for Retail mortgages within retail, these are backed by property. In Corporate, some of the loans will have property collateral backing them. If you look at our coverage ratio, for example, our coverage ratio, including collateral is closer to 200%. So, of course, there is property collateral there, but it will be on a case-by-case basis.

Guidance for cost/income ratio for 2024. We've issued no guidance yet for 2024.

Given the high capital, would you consider increasing the dividend payout ratio in years to come? Again, that is a decision for shareholders and the Board and reviewed closer to the annual dividend declaration.

And, following the recent UAE-Turkey agreement worth over $50 billion, do you expect more business for ENBD, thanks to DenizBank? Yes we do absolutely see it as an opportunity, and we very much welcome increased trade ties and flows between Turkey and the UAE.

Shayne Nelson

And I think, on that one, if any UAE investor is looking to invest in Turkey, who do they talk to? Us, because we're the go-to bank for those discussions, because we have a substantial investment in Turkey, and we know the market well, and we have an excellent Management team there to assist.

Patrick Clerkin

In terms of mark to market impact on DenizBank's investments, that's something that we look at and monitor. Again, do we anticipate a temporary relaxation of regulations in respect of that mark to market? We have seen an unwind of some of the regulations. The regulators there are cognisant of the number of regulations, and as interest rates have increased, we have seen a partial unwind. So, that DenizBank is in good shape, as we said, in terms of capital.

A couple more questions. Patrick, maybe you could help me with this one. More colour on the provision reversal in Turkey. There's been a provision reversal for two consecutive quarters. Any more colour on that?

Patrick Sullivan

Yes, so you can see in the accounts, we have the 2.2 billion of recoveries for the first half. About 0.8 billion of that relates to Turkey, but they have a credit of 0.6 billion. So, net-net, they took 200 million of charges otherwise.

Shayne Nelson

I'd say, on that, from memory, from the last time I looked at the peer comparison in Turkey, we had the top coverage for Stage 3 in the market. And again, the financials for DenizBank are transparent. They published them on the website, if anyone wants to have a big dig into the financials of DenizBank.

But I think, certainly, being so highly provided helps when it comes to, especially, property collateral in Turkey, because in dollar terms, for a good-quality property in Turkey, prices have doubled if you were in Istanbul or Bodrum, those sort of areas. Property's doubled in price in dollar terms, so that also helps with our recoveries in that market.

Patrick Clerkin

Thanks Shayne. And then, in terms of the impact on a potential drop in interest rates, are we doing anything to protect against that? Of course, predominantly, we are a floating-rate bank, but on the periphery, we have been taking action. If you look at the Treasury income, for example, with the investment book, they're able to invest in longer-dated securities, particularly at these higher rates, and hedge as well, to some extent. But we are over a $200 billion or AED 800 billion balance sheet, so we can't hedge the whole balance sheet, and again, given the high levels of CASA, ultimately, we are benefitting from that, in a higher rate environment.

Then the last question we have is in terms of potential M&A activity in Turkey, given that our Turkish acquisition has done so well. Is that something that we would look at further? And I'll let Shayne answer that.

Before Shayne answers that, the very final question. In terms of the movement from Stage 2 to Stage 3 does it relate to one specific credit? There's transition movement throughout all the different stages, even though we have had significant writebacks and recoveries. Of course, there will be some new movement. These credits are quite granular. I wouldn't say it relates to one specific case.

So, Shayne, just back to you, in terms of M&A activity, is Turkey something you would consider?

Shayne Nelson

I think the answer for Turkey is, if there were a small or medium bolt-on, yes. I don't see it at the moment. It would be doable if it made sense financially for us. But I think I'd rather focus on Egypt. We're too small in Egypt, which I've said to the investor community before. It's quite a small place for us. We'd love to grow more or find acquisition in Saudi, but I think the issue for us on Saudi is that that 40% foreign ownership threshold in Saudi is a difficult one for us. We are very clear that we must have board and management control and be more than 51% and the right price before we consider any acquisition, and that 40% does provide an inhibitor for a Saudi acquisition.

And then India, we've talked about. It's a market we've been growing in. We've opened another two branches last year. Up to three now, and that market has been good for us. And we also get a lot of cross-border business from India. And there's no Saudi banks, for example, in India and no Indian banks in Saudi, so that gives us that capacity as well. So, cross border, and we're seeing good growth in India to Turkey, India to Egypt, for example, as we'll be working those cross-border pipelines a lot better these days.

Well, if there are no further questions, I'd like to thank you all for participating in today's call. We delivered a very strong set of results, and we, even better, are very excited about the opportunities in the coming quarters.

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