FGB - NBAD Merger Update*

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Speakers

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*Edited

Presentation

Operator

Ladies and gentlemen, welcome to FGB and NBAD Merger Update Investor and Analyst conference call and webcast. This webcast is restricted to analysts and investors only. If you are not an investor or an analyst, you are kindly asked to disconnect. I will now hand over to your host, Miss Sofia El Boury. Ma'am, please go ahead.

Sofia El Boury

Thank you, Walid. Good afternoon everyone and thanks for joining our call today following the successful completion of the historic merger between FGB and NBAD, which was announced yesterday. My name is Sofia El Boury, Head of Investor Relations and participating in the call today are the following executives of the combined bank, James Burdett, Group CFO, Karim Karoui, Group Head of Subsidiaries, Strategy and Transformation, Abhijit Choudhury, Group Chief Risk Officer and Stephen Jordan, Group Treasurer.

Shortly, James and Karim will be taking you through the presentation before we move onto a Q&A session. Just a quick note that today's presentation is available on the IR section of NBAD's website as well as on the merger microsite, www.bankfortheuae.com, and a replay of this webcast will be available shortly after the call.

Now, I will turn it over to James.

James Burdett

Good afternoon everybody, thank you for joining us. It is a pleasure to be here today. For those of you who have the slide deck, I am going to go through the first couple of slides then pass you over to Karim who will then pass you back to me, then Sofia says we are going straight into a Q&A session. Just to bear with us for a bit.

If you turn to page three of the presentation, the only thing I really want to say on this page is that the legal completion of the merger is now done. The first day of listing of the new shares was on the 2 April, and you will have seen that in the press yesterday, so one of the very key and significant milestones of this integration and merger is now complete as far as we're concerned.

Clearly, if you turn to page four, you will see that it has created the leading bank in the UAE where we're obviously significant in size right across the region, in terms of assets, profit, equity, market cap and so on, so it is a significant achievement for us and the bank.

Just going onto slide five and looking at the board, you will have seen this before, but obviously a very prominent set of board members led by His Highness, Sheikh Tahnoon. Board composition, obviously, comprising very significant senior people from the UAE and Abu Dhabi in particular, with a rough split of 50/50 between the old NBAD board and the old FGB board. But what I would like to say is the board has already met and validated the bank's strategy, looked at the governance structure and a number of things around the integration, which Karim will speak to later.

Moving onto slide six, looking at the senior management team, we can now confirm that the ExCo elect is now the new ExCo of the bank, and the people you see on slide six, obviously, making up a significant amount of experience and leadership from various historical paths. What I will say is we have been meeting together as a team or an ExCo elect for the last six months or so, and the team spirit, the camaraderie is very strong and we're working very well together, as evidenced by the fact that we merged legally yesterday.

With that, I will pass you over to Karim who will talk a little bit about the achievements so far.

Karim Karoui

Thank you, James. Good afternoon everybody. Since the announcement on 3 July, which is almost nine months, exactly nine months now, a lot has been achieved so far when it comes to the merger. The planning phase went extremely well, so after appointing the consultants and the integration management officer, we defined 30 work streams to cover the business integration, operating model, legal, credit policies, risk appetite, branding, IT integration, finance integration, communication, the day one, the synergies etc. A lot of efforts were put by the teams of the two banks. Vis-à-vis the external world, we finalised the board committees, the governance structure, the delegation of authority. Internally and between the two banks, we harmonised the critical policies in areas like credit, risk, legal, HR, finance etc. We put and executed a plan for the internal communication. We also and then one of the important things is the IT, so basically, we looked at the IT enterprise architecture, the operating model etc. We appointed the PMO, the system integrator for the IT. We reviewed and put in place the operating model for the international business, to ensure that we are all aligned locally and internationally.

In slide nine, so it is basically what it means for the customers on day one. For us, it is the clarity, the clarity for customers is extremely important, so we communicated already with our customers to ensure that all the information is there, so that there is no confusion at all on the personal banking area; for the customer to ensure that the product offering and the pricing is not separate for each of the banks. On the corporate and investment bank, mainly it is about the unified relationship managers for the common clients; we have unified the platform for the global markets. The communication, also, all the messages happened as we said, and from now on, we have one year and a half to two years to finalise the full integration, so you have seen that in the second half of 2016, it was about the mobilisation, the planning phase. In the first quarter of 2017, it was more about the integration design and the planning. And from now on, we will go through the integration roadmap execution, synergies, realisation, staff relocation, IT and operations integration etc. The branding exercise also will happen soon.

On the next section, in slide 12, so basically in terms of high-level strategy, it is for us a customer-focused strategy, and for that the commitment is to be the leader in delivering shareholder value, that is why we exist, and in order to keep adding value to our shareholders, we plan to be a dominant bank in the personal banking area. We plan to become a leader in the digital area. The wealth segment is an extremely important segment for us. On the CIB side, deepening the relationship, increase the share of wallet is going to be part of our strategy. The international strategy is going to be around the wholesale business, we will follow our relationships internationally. We will grow in high potential growth areas like Asia, APAC, and we will do it organically. The subsidiaries will be there to complement the businesses of the personal bank and the corporate and investment bank.

I will pass it back to James to cover the remaining part of the presentation.

James Burdett

Okay, so slide 14, we're just looking at the cost synergies, and here you can see we have made a significant revision upwards to AED 1 billion per annum realised from 2020, 100%. You will note that when we put out the initial preliminary target of AED 500 million back when the merger was announced, we have since gone through a lot of work, as Karim has just articulated in terms of detailed bottom-up synergistic work streams, around 30 different work streams, and we have got very clear details of those synergy targets, and we're now comfortable putting a figure of a billion out there. Obviously, most of the synergies you can see from the bullet points are from network and staff rationalisation, overlapping enablement functions and business functions and so on.

We have also put a figure here for revenue synergies, which I know you're interested in. This relates to funding synergies only, and we put a figure out of AED 400 million and, clearly, that is a subject to all sorts of balance sheet movement, assumptions and so on and so forth. But in particular, it is using the funding curve of NBAD for the combined balance sheet over a period of time, and yielding those funding synergies.

The cross-sell synergies will obviously start taking effect from 2018 as the businesses start cross-selling into each other and we get ourselves organised. We think the impact from that will start coming in 2018.

What it does mean, though, if you turn to page 15 is that the one-time integration costs we think will be higher. We put out a preliminary assessment of AED 600 million, we now believe that will be AED 1.1 billion, but as you can see versus the benchmark, it compares very favourably at 110% of the recurring synergies of a billion, against a benchmark of 120-140%. What I should point out is the billion of synergies that we talked about on the previous slide represent 50% of the smaller cost base, and that compares very favourably with historical transactions, which I think are around the vicinity of 30% of the smaller cost base when a merger, of course, happens. So this one-time cost is all about IT migration, is all about system write-off, various other things associated with the integration costs, which we can cover as part of the Q&A. On top of that, we have also given you a figure of strategic spend that we're looking to make, this is primarily around where we see good cost investment for the future, such as digital, transformation, automation and things of that ilk.

What that means in terms of strategic targets – on page 16 – is essentially we're looking in terms of success to the end of 2020, mid-single-digit core revenue CAGR. We expect that to deliver an increased market share and share of wallet. We obviously want to deliver the full run rate synergies as we have articulated before. We're obviously spending a lot of money on integration and Karim has talked a lot about that, but going to one platform, realising the synergies both in terms of systems and people, and delivering, we think, a sustainable cost/income ratio at or around or just below 25%. And the upshot of all of that is we believe we can deliver a return on tangible equity of between 16 and 17% on a sustainable basis going forward, assuming a core equity Tier 1 ratio of between 14 and 15%.

In terms of guidance for this year, we're expecting loan growth to be mid-single-digit, and we already have some good growth starting this quarter. We believe that will translate into core revenue growth of low single digit, a cost-to-income ratio of between 28 and 30%. We put out a range in terms of cost of risk of between 70 and 75 basis points, and all of this assumes a return on tangible equity for the first year of 14%.

In summary, the merger is effective. We have created the largest bank in the Middle East. A lot of work has been done on integration and governance. We are quite bullish on achieving the milestones in terms of integration going forward. We believe there are significant synergies and we have a very clear roadmap of how we're going to achieve that. The strategic plans at a high level has been agreed by the board, and Karim has given you a flavour of it today, and we are, in short, very confident that the merger will be very successful going forward.

With that, I think the best thing to do is to hand over to Q&A and Karim and I are here, as well as Steve Jordan the Group Treasurer and Abhijit Choudhury the Group Chief Risk Officer. Over to you, Sofia.

Sofia El Boury

Walid, we can take the first question please.

Question and Answer Session

Operator

[Operator instructions]

Our first question comes from Aybek Islamov, HSBC. Please go ahead.

Aybek Islamov

Good afternoon everyone, thank you for the conference call and the update. I had one question, so what led you to revise up the integration costs, it is a material positive revision there. I think secondly, you made some comments about sustainable return on tangible equity, I think you mentioned a number of 17% return on tangible equity as a sustainable number. What is the year that you are planning to achieve this 17%, so are you thinking about this 17% target as of 2019-2020? So if you can comment on that, it would be helpful.

James Burdett

First of all, in terms of the integration costs, when we set out right at the start of the merger, obviously, we had less information about each other and what was deliverable, what IT stack we would go to, what the branch footprint would look like and so on and so forth, which obviously all hangs on strategy and so on. Essentially, through the integration work stream, we have broken it down into 29 or 30 different work streams. Each ExCo member is responsible for his own area in terms of working out what can and can't be done. We have used external benchmarks and gone into a lot of detail, and that has led us to revise our synergy work stream, up to the AED 1 billion, which we understand is 50% of the smaller cost base, but we believe it is achievable. And that is achievable by 2020, and that also answers your second question, so 2020 is where we're targeting that. Obviously, it is contingent upon the other factors that I outlined on slide 14, I think, which talked about mid-single-digit growth, increasing market share and realising the full synergies over the course of the three-year integration period.

Aybek Islamov

The way to think about it, obviously, your cost synergies – you put an estimate at AED 1 billion, so there is another piece of information on slide 14 where you talk about the revenue synergy opportunity which you estimate AED 400 million which is funding cost. This AED 400 million, is it part of 1 billion, or is it something that you are planning, potentially, to achieve on top of this 1 billion.

*Edited

James Burdett

This is on top, so the 1 billion is in the cost line, the 400 million is in the revenue line.

Aybek Islamov

And the 400 million, is it contingent on certain events? What sort of certainty are you putting at 400 million revenue synergy and what does it depend on?

Stephen Jordan

I think it is a realistic objective for the organisation. We have done a full analysis of the liability base throughout 2016, the customers, the sectors, the products, rate sensitivity etc, so we have done all that analysis and then, obviously, there has been a senior level discussion and 400 million is a number that we think is realistic to achieve.

Aybek Islamov

Okay and if I may just add one more question and I will stop here. There is one slide which shows the current ratings for Moody's and S&P; they have you on creditwatch negative, right. So the rating agency decisions, well, for example if there is a downgrade decision, hypothetically, how it may impact your funding cost and revenue synergies.

Karim Karoui

We're continuously having the discussions with the rating agencies. Frankly speaking, we do not expect surprises to come, so maybe over the coming few days, you will see the rating agencies announcing their rating and then hopefully things will be okay. At this stage, no additional information since we talked last time.

Operator

Our next question comes from Janany Vamadeva, Arqaam Capital. Please go ahead.

Janany Vamadeva

My first question is on the integration process. I'm just wondering, have you chosen the headquarters, the core banking systems. Would you be able to give some colour on it in terms of what you've done so far and what are your plans, say, in the next 12 months?

Karim Karoui

Yes, we went through all the process for the integration. Specifically related to the headquarters, we have the new official headquarters in the Business Park; so basically we will keep three main buildings; the current FGB one in Khalidya, the current NBAD one in Khalifa Street, and the new one, which is in Business Park, and the idea is to move all our staff to the owned buildings, so that we don't have to pay any additional rental cost. The second one was… on IT, basically, we went through the whole process of analysing the systems, the core banking systems, and the satellite systems around the core banking, and then we selected the main systems. We identified the gaps. We appointed a system integrator to help us with the integration, and the full integration of all the IT systems started already, so this covers the core banking, the Treasury systems, the cash management, trade finance systems, and all the systems, and then things really are under control when it comes to the IT integration.

Janany Vamadeva

Just one more question; NBAD already has the lowest cost of funding and I just see on the slide another 400 million coming from lower funding costs in terms of revenue synergies, so how do you plan to grab market share and grow your loan book? What sort of strategy do you have going forward for the new entity?

James Burdett

I think the strategy is very clear that we now are a dominant market leader in the region. I think the size and scale gives us the ability to attack those segments properly, to invest in digital, to look at our branch footprint and make sure it's optimal in terms of Dubai versus Abu Dhabi, and so on and so forth. So we will have a lower cost of funds, but as you know, the spread on the assets side is mainly driven by competition and service level. So being a dominant player, being able to scale up, being able to attack those areas that we've been traditionally weak in, we believe there is upside opportunity.

Janany Vamadeva

Just one last question; I kind of find myself thinking that you have some opportunity, because I thought that integration process going on when FGB and NBAD merge, so growth is going to be affected during that phase. Do you have any particular plan that you grow the book while you focus on integration? Would you be able to give some colour on that?

James Burdett

Sorry, you broke up, I didn't quite catch that.

Stephen Jordan

The growth, yes, so during the integration…

Karim Karoui

Yes, yes, so definitely there are teams which are fully focused on the integration, mainly this is driven by the back- and mid-office people, and the businesses, they have their own targets and they are totally and then entirely focusing on bringing the business and harmonising the products, working together, so definitely we plan to grow. And then as per the guidance, which has been given, we have all this in mind, so we will continue on growing the business based on the opportunities available in the market locally and internationally.

Operator

[Operator instructions]

We have a question from Shabbir Malik, EFG Hermes. Please go ahead.

Shabbir Malik

I have a couple of questions, the first one on your revenue synergies. You talked about revenue synergies of 400 million. Can I get a sense of when these synergies will be realised and is it something that can be realised in 2017? My second question is on your dividend pay-out. When you look at your historical blended pay-out ratio for both FGB and NBAD, it's around close to 60%. Is that the level that you're likely to maintain going forward? Thank you.

James Burdett

Your first question, just to clarify, the revenue synergies are actually only funding synergies. There's obviously other revenue synergies that we'll be looking to target, but in terms of funding synergies of 400 million, we expect to realise that broadly evenly over the strategic – over the period, we've articulated in this document, which is until 2020.

Karim Karoui

And for the dividend one, Shabbir, you know the standard answer for this one, so we are here, we are paid by the shareholders, we are here to make money for our shareholders, and of course in all this we take into consideration the growth potential, the level of capital, and then all this, and also we take into consideration the expectations of our shareholders from this merger, so definitely we will see how the performance will go this year and then the board I'm sure will come with the appropriate dividend policy for the shareholders.

Shabbir Malik

If I may ask one more follow-up question, I think you mentioned for 2017 you are looking at a cost of risk of 70 to 75 basis points. Is this, you think, likely to be a normalised cost of risk level for the bank or is this something that you're considering for 2017?

Abhijit Choudhury

No. This is our indication for 2017.

Shabbir Malik

And your normalised levels are going to be lower… is going to be in line with this, your normalised…?

Abhijit Choudhury

Look, I mean, 2018, I don't know how many risk managers around the region would be willing to do crystal ball gazing into 2018 at this stage. We know the weak sectors which we've spoken on previous calls, which we continue to be very mindful of – retail being one, the SME sector etc. I think as far as both banks are concerned, our practices are conservative. I think the number which we have given to you is a sort of number which blends between the two books. There are significant… as we speak at this point in time, there are significant synergies which will come up as well in terms of end collection efforts, not just at the retail end, but also at the wholesale end, which could actually improve the number, but at this point in time, I would leave the guidance at the 70 to 75 level.

Operator

[Operator instructions]

Our next question comes from Sandeep Srinivas, FIM Partners. Please go ahead.

Sandeep Srinivas

My question is regarding this one-time integration cost, so I see that you'd be spending around 385 million in 2017. I just want to understand how much of this is already spent by now and what is outstanding?

*Edited

James Burdett

Yes, look, this is part of the integration work stream. We have agreed a very clear IT strategy, very clear branding strategy, and so on and so forth, so this is a summation of all of those costs over the next three years, but as to what we've spent to date, it's premature for us to talk about that in Q1.

Karim Karoui

Yes, just to add that in our Q1 disclosures, we will show separately the integration costs, so then you can see so that you can identify the non-recurring items.

Sandeep Srinivas

Just the next one and last question from me is on the ethos of the combined entity, because FGB and NBAD is a very different entity; it used to be a very different entity before in terms of lending, in terms of risk management. Going forward, what will be the policy? Will it be more of FGB or more of NBAD?

Karim Karoui

You see, we started as two different banks. That was until 3rd July. Since then, we are one bank, we have one leadership, we think as one bank, and then you could see also from proposing a new name for the bank, First Abu Dhabi Bank, is just to remove the legacies, so that people don't identify themselves as FGB or as NBAD, so that's the whole story of the merger, and we are already one bank and then definitely we put all the policies together, the risk appetite together etc, and then we are doing the best for the new bank.

Abhijit Choudhury

Just to add to the difference on risk management, also you'll see that, you know, during this whole process for the last eight months or so we have harmonised our rating models, we have looked at any kind of harmonisation which is required in terms of risk appetite, so it's clearly been studied. We have a clear idea in terms of our combined exposures. We have a clear idea in terms of all of our regulatory thresholds etc, so it's one approach moving forward.

Operator

Our next question comes from Maria Elena Ponceca, Al Ramz Capital. Please go ahead.

Maria Elena Ponceca

I would like to ask about the goodwill. What is your plan going forward? Do you plan to depreciate it and, if so, what then would be the depreciation schedule? Thank you.

James Burdett

Look, the goodwill hasn't changed that much since the early indications that we put out back when the merger started. In the second and third quarter, we plan to go through a proper PPA process, probably with some external help, particularly in regards to valuations. Once we've gone through that whole process, we will articulate the strategy going forward.

Operator

[Operator instructions]

Our next question comes from Phillip Koenig, Goldman Sachs. Please go ahead.

Phillip Koenig

I just want to ask about given the changing regulatory landscape and upcoming implementation of IFRS 9 and new Basel III capital rules, do you have some maybe guidance to give or some initial thoughts on how this can impact the dividend pay-out for the merged entities. Thank you.

Abhijit Choudhury

I can give you some idea in terms of IFRS 9. We are very comfortable that there is going to be hardly any impact, if at all, as far as IFRS 9 is concerned and both banks were already on an expected loss model, and as you've seen from the numbers in terms of our provision coverage, it's very, very healthy, so we do not expect any impact as far as IFRS 9 is concerned, and we will meet the regulatory deadlines in terms of submission of our requirements to the Central Bank as far as IFRS 9 is concerned for the combined bank. I'm going to pass this to Stephen.

Stephen Jordan

Yes, in terms of the regulatory capital framework in the UAE, as we know the Basel III is being rolled out, naturally we are expecting to be designated D-SIB. We will have to wait to see what the additional buffer requirements will be on us, but given the guidance that we've given in terms of core equity Tier 1 for the new entity being between 14 and 15%. I think that's the level where we're at, at the moment. That will be well above the regulatory requirements, so as Karim touched upon, the dividend is really going to be driven by a number of different factors, but obviously the level of capital we have is going to be important.

Operator

We have no further audio questions. Ms El Boury, back to you for written Q&A.

Sofia El Boury

I think we have covered all the written Q&A actually. We have covered Basel III, IFRS 9, and so if there are no further questions, we will just end the call. Obviously, if you have any further questions, Abhishek and I will be here to answer them, or if you need any further clarification, we will be here to answer your questions, so please feel free to reach out to us directly and thanks very much for your time today. In fact, a full transcript of this call will be available soon, as well as the replay of this webcast.

Thanks again very much and have a great day.