ADIB Q3 Earnings Conference Call

Thursday, 26 October 2023

Janany Vamadeva Good afternoon, everyone, and thank you for joining us today. This is Janany Vamadeva, and on behalf of Arqaam Capital, I'm pleased to welcome you to Abu Dhabi Islamic Bank's Q3 2023 earnings conference call. I have with me here today, from a ADIB management, Mohamed Abdel Bary, the Chief Financial Officer, Ahsan Akhtar, the Group Financial Controller, and Lamia Khaled Hariz, Head of Public Affairs and Investor Relations. Without any further delay, I will now turn the call over to the Head of Investor Relations. Lamia, over to you.

Lamia Hariz Thank you, Janany, and good afternoon to everyone on the call. Thank you for joining us today. Before we get started, I just want to remind everyone that today's presentation, and all our financial disclosures, are currently available on the IR section of our website, and on our dedicated IIR. The agenda of today is pretty much consistent with previous quarters. Mohamed will go through the key highlights of the quarter and for the first nine months, we will also give you an update on our strategic progress, and he will go into a detailed analysis of the financial performance of the quarter. We will then open the floor for some Q&A, and you will get an update and guidance for the rest of the year. Mohamed, over to you.

Mohamed Abdel Bary Thank you, Lamia, and good morning, good afternoon, everyone. Thank you for joining us on today's call. We're very pleased to have reported yet another strong set of results, with net income for the first nine of 2023 reaching 3.75 billion, which is an increase of 53% year-on-year, and which has already surpassed our full year net profits for 2022. This was also driven by strong revenue momentum, which was up 48%. Our return on equity expanded by 6.8 percentage points, reaching a high of 26.4%, which is higher than we expected and exceeds our guidance of about 22% for the full year. It's worth mentioning that in the third quarter of 2023, our net income growth was also quite impressive at 41% year-on-year, and that compared to the third quarter of 2022. So, moving on to the next slide, Lamia.

Our strategy is based on four key pillars, split into continuous innovation, segment focus, digital excellence, and sustainable future. And I will provide a progress report on each of these on the next slide. So, we are on slide number seven, and the continuous innovation, during the last quarter, we rolled out several projects. Let me just talk about a few of them. One is the salary campaign, cashback campaign, and new cash back card, introduction of digital onboarding for business banking, and the expansion of remittance programmes to new corridors. Development of all the projects gained a good pace in the third quarter of 2023, and we are quite happy with the outcome so far. We've also welcomed around 157,000 new customers, of which 52,000s were UAE nationals, in the last nine months. We maintained our strong relationship with customers, keeping our cross-sell ratio in our [unclear] at 1.5 X.

From a wholesale bank perspective, we've grown our financing book by approximately 7%, and we've grown retail assets by 14%. Our digital mobile app continues to be widely used, and the highest rated app on the store. On the ESG front, we maintain our position with a single A MSCI ESG rating. And we finalised our ESG strategy with new sustainable finance targets. Moving on to some of the key financial highlights. As mentioned, we are reporting 3.7 billion of net profits, up 53% year-on-year. Very happy with the driver, which is driven by, basically, revenue growth of 48%. Our ROE, I mentioned, is at 26.4%. Another important one, which we'll also talk about later, is our cost to income ratio has continued to improve, reaching now 32.6%. If I take you just two years back, this number was close to 48%.

Moving forward, slide number ten, on the income statement. As you can see on the top right chart, the key driver of profit growth has been on the funded income side, which was 61% up year-on-year. But we've also seen good contribution from the non-funded income side. From a segmented perspective, both retail and wholesale bank has contributed quite positively to the gross and net profit. Net profit from associates and subsidiaries was AED 149 million. Let's move on to slide number 11. On the funded income side, as mentioned, 61% up year-on-year. In terms of performance by sectors, we've seen some good improvement in margins, predominantly on the retail side, as well as on the wholesale side, capitalising on the growth in the interest rates in the market. On the funding side, we've also continued to see benefit from strong non-earning on a non-paid liability basis. As you know, ADIB is quite known for its very strong and resilient funding mix.

From a non-funded income perspective on slide number 12, the dynamics of non-funded income in the third quarter of 2023 continued its positive trend from the previous quarters, where you've seen it growing 18%. I will draw your attention to the waterfall chart on the top right, which highlights the components of the movement in non-funded income. So, we've seen investment income growing 16%. Fees and commission have grown 24%. FX was quite impressively growing at 21%. And we've also seen some good control over operating expenses. Which leads us to the next slide on costs. So, our costs, it's important just to call out that for us to do a like-for-like comparison, we've taken out the impact from Egypt consolidation this year and last year, and we've normalised some of the one-offs, which show that on a year-to-date basis, we've grown cost 6%.

But if I compare quarter two to quarter three of this year, actually, the cost has been flat, which is quite impressive, given the inflationary environment, and as we continue to invest in our digital platform. Moving forward to slide number 14, impairments. Cost of risk is comfortably at 50 basis points for the nine months 2023. So, as shown on the top left chart, the net impairment charge for the increase by 62% year-on-year. Again, if one would normalise for the impact of Egypt, it is an underlying growth of 16% year-on-year, and that's quite acceptable, given our growth in financing assets, as well as some of the overlays we have taken. And moving forward to slide number 15 on non-performing financing, I think that's a very good story, where we probably need to pause a bit. We did promise, in the past quarters, that we will deal with the non-performing asset ratio. As you can see, we have fulfilled our promise.

We are bringing it down to sub 7%, so we are now at 6.6%. This trend will continue on the back of active management of our non-performing assets, whether it's aggressive recoveries, as well as writing off some of the legacy exposure. On the balance sheet side, the bank reported 25% balance sheet growth year-on-year, and if one would look at it from a year-to-date perspective, we've grown 9%. 25% year-on-year growth resulted from 15% growth in financing, as well as a 21% growth in our investment/sukuk portfolio. If one was to normalise again, because Egypt, on its own, has grown. However, due to the FX devaluation, you've seen it reducing by approximately two billion. So, on a constant currency basis, actually, we have grown our financing books by 6%, which is trending quite nicely towards our full year guidance for the year.

Moving on to slide 17, the financing book. I mentioned the underlying growth of 6%. That's important, because this is really showing the underlying business momentum. And I would even take into consideration the FX deval impact of 1.7 billion, it is still a 5% growth year-to-date. Moving forward, on the investment book, we've grown, as I mentioned, our book by 18%. It did slow down a bit in the last two quarters. Not surprising, given the external environment and where we are today. But we are maintaining our position of ensuring that the portfolio is predominantly investment grade. On the deposit side, deposits went up 10% year-to-date to AED 151 billion. The contribution has been on STIs, Wakala and CASA.

Now the impressive part to really call out is that in an environment where rates are where they are, we have still managed to grow our current account and savings account book by 6%, or almost AED 6 billion from the beginning of the year. That is driven by our success, in terms of opening new accounts, as mentioned 157,000 accounts, the targeted campaigns we have been running, and accordingly, we are getting the benefit of this very efficient funding mix. Moving forward, on our capital position, so capital position has remained very healthy. We are reporting a CAR ratio of 18%, and a CET1 ratio of 13.4%, which is higher than the same time of last year. If one would look at it, we were at 12.8 at the same time last year. We are ahead 13.4%. That's important, as we continue to build our CET1 to give us optionality, and when we start deciding on some of the distribution elements in alignment with the board and the Central Bank.

The last slide I really would like to talk about is our outlook and guidance. So, net financing increased, as I mentioned, by 6%. So, we are really within our range of meeting our 5% to 8% target as promised to the market earlier on. Net profit margins, we are currently at 4.48%. We promised 4.5%. Clearly, we are trending nicely towards that. The one thing, which I think will be quite important to note, is that the third quarter, and hopefully, also the fourth quarter, will be quite high, which will give us some really good tailwinds, as we enter the next year of 2024. Cost of risk at 50 basis points, very much in line with target. I do expect us to really fall within the range of 55 to 65 basis points, again, on the back of financing growth, but also, as we watch carefully the performance of the book.

Finally, on cost to income ratio, we did say we will be below 35. We are already at 32.6. I see that success continuing. Similar to the comment I made on net profit margin, as we open up for next year, because that is a year-to-date number, I believe that we will probably show the market a number ADIB has not shown before. I guess, with that, because return on equity is quite self-explanatory, it’s where we spoke about 26.4%, we said above 22%. It really reflects a deep ability to write capital accretive business. We are not only defending on balance sheet activities, but we did promise the market that we will diversify our income sources. We have done that successfully, and the success of that is the ROE, which you see in front of you on this slide. So, with that, I'm happy to open up for any questions.

Lamia Hariz We are ready to take questions.

Operator Thank you, of course. If you'd like to register a question online, please click the raise hand icon on your screen. You may also submit your question in writing via the Q&A chat box. Alternatively, if you've dialled in by the telephone lines, you may dial star, followed by one, on your telephone keypad now. Our first question comes from Shabbir Malik of EFG Hermes. Shabbir, your line is open, please go ahead.

Shabbir Malik Hi, can you hear me?

Operator Loud and clear?

Shabbir Malik Thank you very much for the presentation. My first question is, in non-interest income this quarter, there seems to be a one-off. If you could maybe please elaborate on the drivers of that, that would be pretty useful. My second question, if I look at your NPL ratio, nice downwards trend that is visible there. And I think you've mentioned that that was partly driven by write-offs. Again, if you can elaborate on that. Is it one account specific, or is there more than one account that drove that improvement? Any colour on that would be pretty useful. And thirdly, from a deposit point of view, we've seen growth in CASA deposits, and you've talked about attracting new customers. Is it largely driven by customer service, quality of customer service, or are there other incentives, which are drawing those customers in to bank with you?

And maybe finally, on the margins. You said that you expect to end this year NIM at a higher level. But do you expect competitive pressures to start weighing in more in 2024? Is that a scenario that could play out, in your opinion? Thank you.

Mohamed Abdel Bary Thank you, Shabbir. Four questions. If I miss anything, please do remind me. So, the first question was on whether we had any one-offs in Q3. There was a one off. It's not material. I have seen your report, I think that it's not 100 million you spoke about. We have a one-off I would classify that goes up to 40, 45 million, and that's on the back of a sale and buy transaction within our Burooj entity, where we recognise some gains on some fixed assets. So, it's monetising, as you know, Burooj, the investment property, and this specific asset was sold at a nice gain, given where the market is today. So, that's around the 45 million or so. The other income is just smaller attribution, and we can maybe share with you some of the details, but I would not classify them as one-offs, they will be recurring as well in Q4.

That is only one-offs. In terms of the NPA, the reduction in NPA to 6.6 is a factor of name specific, as well as a wider strategy. So, there is a list of non-performing assets, which are being actively pursued. Some of them have been procured in Q3, and more will be procured in Q4, hence my optimism that this number will continue to improve. The one big name in Q3 is NMC. So, we have taken NMC off our NPA book, given the latest development, which happened on this name. I'm not sure how much of that is public knowledge, but there is an exit route for all the debtors who are holding NMC exposure. And hence, we were able to take off the portion, which is provided for, hence, we actually expect, in Q4, to make some money, once we are able to put a value on the exit of that specific exposure. That is on NMC.

In terms of the deposit, the driver of the gross and current account and savings account is, in fact, coming from a few factors. One is the number of accounts, which we have open. Can you please go on mute, if you are not talking? There is a bit of background noise. Sorry for that. There are accounts, which we opened, the 157,000 has definitely contributed to that. Our active campaign, which we have done predominantly on the salary cashback, has been a huge success. We've seen our onboarding, our cost ratio almost tripled in the past a few months. And then also, our mobile app, which is, I believe, market leading, has led to that, and this links to the customer satisfaction point. So, all this combined, we are able to really build on the CASA balances, and at a time where rates are quite competitive, and everybody is very price sensitive, in terms of getting some profits returned on their deposits.

The last point was on the net profit margin. So, we are reporting 4.5, year-to-date, and net profit margin, which is a combination of the gross yield of close to 6.6% and the funding cost of 1.97%. We believe that Q4 will still continue to show an improvement, because the cycle of our portfolio repricing is coming to, I would call it, an inflection point, given that now for the last 12 to 18 months, we have seen these rate hikes. What it means is that as we enter into next year, the Q4 numbers will carry forward in net profit margin, and I believe it will be very close to the 5%, as we enter next year. We don't believe that any interest rate movement in the markets will have a significant negative impact on us next year. So, far the outlook is that there won't be much reduction next year as per the Fed.

The market yield curve is factoring in a reduction July 24 onwards, but even if that would hold true, it will still probably take until 25, before we see any impact, because the portfolio is built now at higher rates, and the vintage at lower rates book are coming off our portfolio. Shabbir, I don't if I answered all of your points. I'm happy to elaborate on any of them.

Shabbir Malik No, that's very useful. Just going back to your point on NMC, is there scope for potential recovery from that going into the fourth quarter, once whatever the deal is finalised?

Mohamed Abdel Bary That is the intention, and that is the ambition. Because the benefits for ADIB, and I speak only for ADIB's case, is that it's provided almost at 85%, and we've actually talked about close to 90% during this year. So, the likelihood of recovery is quite high, because if one would put an exit value on that book, I would say it's probably close to 25 to 27 cents to the dollar.

Shabbir Malik That's pretty useful. Thank you.

Operator Thank you. As a reminder, if you'd like to submit a question on the call today, please dial star, followed by one, if you've dialled in via the telephone lines. If you've joined online, please click the raise hand icon on your screen. And you may also submit your question in writing. Our next question comes from Aaron Armstrong of Ashmore Investment Management Limited. Aaron, your line is open, please go ahead.

Aaron Armstrong Hi. Thanks very much for taking the question. Can you talk a little bit about the quarter on quarter trends in NIM, please, sorry, net profit margin. I think you give a nine month number in the presentation. Could you talk a little bit about Q3 versus Q2, and then break that down between yield change and cost of fund change? And then in context around Q4 as well, please, if possible.

Mohamed Abdel Bary Sure. So, if one would look at the net profit margin quarter-on-quarter, we had reported up to the third quarter, a number of approximately 4.6. That is this third quarter on its own. So, if you go back to the half one number, we were closer to 4.4. That's the half year number. But quarter three on its own is 4.6. Hence, as we go into Q4, as well, the expectation is that this number will continue to rise. And that's why the point I made is that we are probably quite optimistic that as we enter next year, we're going to be very close, or shy, of the 5%, as well, which I think is, again, a record for ADIB's ability. Now, your question, where is it really coming from? I can tell you that the jaws for us are opening much faster than anyone else in the market, because of our funding mix. So, the funding structure is quite resilient, and does not move up as fast as the ability to reprice on the asset side. And it's shown on the slide, where we are hitting a six…

Aaron Armstrong Hi. Sorry, I've lost your audio. I don't know if you can still hear me.

Mohamed Abdel Bary Sorry, at which point did you lose me?

Aaron Armstrong Apologies. I think you were just starting to explain how the funding mix structure is resilient, and you repriced assets faster.

Mohamed Abdel Bary Fantastic, okay. So, the benefit we have is that our funding structure is quite resilient. So, if you see, given that almost 67% of our funding mix is coming from current accounts and savings accounts, hence the price sensitive portion is not very big, 30%, 32%. And accordingly, you see that the increase in funding costs moves much slower than our ability to be able to fund on the asset side. One point I would like to call out is that the 1.97 you see there, there's a big chunk of it actually coming from Egypt, because the funding cost in Egypt is quite high. Here, it is also better, but the UAE on its own, we are funding at 1.1%, which is, I think, I wouldn't say one of the best, but probably the best in the market, in terms of ability to create funding sources.

Aaron Armstrong That's great, thank you. And maybe one follow-up from me, please, if that's okay, just on the repricing side. Could you give an update on the speed of repricing on customer financing? Is that interbank rate link, and is it required every three months, six months. How much of it is mechanical versus negotiated? Just on the repricing and frequency.

Mohamed Abdel Bary Sure. So, at the portfolio level, I would say probably 45% to 50% would have been repriced in one year. And the mix is as follows. So, if one would look at our portfolio of approximately AED 112 billion, the wholesale bank on its own there is around 40 billion, and that is on an automatic repricing every three months. The entire book. So, that automatically reprices upwards. Coming to the remaining retail book, which is approximately 60 to 65 billion, you would have home finance of around 22 billion, and that's a mix between variable and fixed. But today, the majority is on a valuable basis, where the client opts for one year fixed, and then moves to a variable component. So, that also reprices quite quickly. Now, the 18 billion we have` in personal finance, and also, finances are fixed rate. And the behaviour life for both is approximately three to three and a half years.

So, that's why the average of the whole portfolio, 45% by year one, probably, in year two, you would have 67% to 69% completely repriced, and the rest beyond two years. And hence, I was saying that we are now at an inflection point where the majority of our book is now benefiting from higher rates, and the advantage of lower rates is starting to come off.

Aaron Armstrong That's great, thank you. And on the funding cost side, are you paying zero on CASA? Completely zero?

Mohamed Abdel Bary Current accounts are paid at zero. Saving accounts, we are paying approximately 30 basis points, which you call profit distribution.

Aaron Armstrong That's great. Thanks very much for taking the questions. Thank you.

Operator Thank you. We'll now move on to the written questions. The first is as follows, competitive pricing and low pass through to borrowers, it seems that asset yield expansion may continue to soften in the coming quarters, and risk of cost of funding to pick up, as the rate stays higher for longer. Does that mean that your margin may not hold at this level in 2024? Your CASA held very well, despite the elevated level of interest rates. Do you see that most of migration in the industry has happened, or there could be more in the fourth quarter, as the rate stays higher for longer?

Mohamed Abdel Bary So, I will start with a second part. I do believe that there could still be a bit of uptick, in terms of the cost of funds. It's very natural, because we take the client interest also very seriously. And it's only fair to compensate, particularly our more corporate clients and preferences clients with market rates. So, I do think that there will be some uptick there, but not significant. The ability to reprice on the asset side, on the financing side, I think will still continue to happen. But as mentioned, the 6.61, you see that is the year-to-date, number. And if you were to look only for the third quarter, this number is bigger. Going into next year, I think it will stabilise at this level, because the majority of the book would have repriced.

And accordingly, we are also quite sensitive, in terms of ensuring that we don't overburden our clients, even if we have to hold back some of the pass through on the asset side. Because at the end of the day, if you push your clients too hard as well, it will have an impact for you down the line, in terms of your ECL and delinquencies.

Operator Perfect, thank you. The next question, what is your effective tax rate expectation for 2024 and 2025?

Mohamed Abdel Bary So, we've been working on the maths, and we believe that at this point, it is probably going to be 11%. And please don't quote me on this number, because we are still going through the exercise. We still have a few more weeks to sort it out. But we believe, given the structure of ADIB's financial and balance sheet, effectively, the audits, we will move from a quarter rate of 9% probably to an effective rate of 11%. Only once we start really applying all the rules and regulations, in terms of applying tax, then we will have a better number. But for now, I would probably recommend …

Operator Perfect, thank you. Our next question here, can you please provide guidance for 2024? Can you please shed some light on losses on amortised cost of securities? Do you have any guidance for dividend payouts in 2023?

Mohamed Abdel Bary For 2024, we don't usually provide forward looking statements into next year. But I believe, from the story you've seen so far, ADIB is a very predictable and sustainable bank, building a resilient portfolio and hence, it's not a very volatile performance. So, if you use that as a proxy, you can probably assess how next year will look like. But at this stage, I really don't want to comment on next year's numbers, until we are in maybe in a position to make some more formal disclosure on that. Sorry, what was the second part of the question?

Operator Do you have any guidance for the dividend payout of this year, 2023?

Mohamed Abdel Bary Again, I think the ADIB policy, in terms of business, has been very, very consistent over the years. The bank has always been paying, the lowest [unclear] was probably 38.9%. 39% of net profit, the highest we've reached was 50%. By the end of the year, once we finalise the numbers, we will make a recommendation to the board and the AGM, and with the approval of the Central Bank, we will recommend the number, taking into consideration shareholders interest, but also, our ability to create internal equity to support future growth into next year.

Operator Perfect, thank you. As another reminder, if you wish to submit an audio question on the call, please click the raise hand icon on your screen. And if you're joined via the telephone lines, please dial star, followed by one. Alternatively, you can submit your question in writing. And we have three questions here. What prompted you not to raise the net interest margin or ROTE guidance for the full year? Second, your loan growth this year is lagging some of your local Abu Dhabi peers. Is it because of loan mix, or is it something else? And the third, how big is the Saudi growth opportunity for you?

Mohamed Abdel Bary We didn't think the guidance, because I think we are at the guidance, so the high profit margin guidance is at 4.5, around the 4.5 number. I don't think the year-to-date number was significantly changed. When I mentioned that there is an upside, it's because of the Q4 number on its own, which will carry us into next year. But for the full year guidance, I would really like to keep it at this level for now, and we will obviously update the market, if there are any further changes. In terms of our financing growth, we've grown, year-to-date, close to 6%. I believe that is a fairly healthy number to have. Year on year, we've grown 14%. But we have always, from the very beginning, indicated to the market that our guidance will be 5% to 8%. We have not changed our underwriting standards or risk appetite. We follow a very strict rule on that front, and it has worked very well for us.

I can't comment on the other institutions, what they have announced, but this is our guidance. But if I were to look at the Central Bank data, in terms of the financing growth in the sector, itself, I believe the announcement was a 5% number. So, we are actually very much in line with what the average market has reported.

Operator Thank you. Could you please elaborate on why other income is so high for the period?

Mohamed Abdel Bary So, other income was a question answered, when Shabbir asked. There is an element of 45 million or so of a one-off transaction coming from our Burooj entity from a divestiture of an investment property, our investment efforts.

Operator Perfect. Another two questions here. The first, how big is Egypt as a percentage of net profit? Going forward, could you give your view on how you expect NIM to trend between the domestic business and the Egypt business, especially as rates eventually come off? And the second on asset quality, NPL has decreased, but so has the cash coverage ratio at 70% in third quarter 23, which screens relatively lower versus some of the peers. Can you please explain why you remain?

Mohamed Abdel Bary I think the first one was Egypt. Egypt contributes around, so of the 3.75 billion, we had AED 300 million odd also coming from Egypt. So, that is probably 8%, 9% contribution from the Egypt franchise. In terms of our commitment to Egypt, I think it's a very important market for us, and we continue to be very committed to the market. The bifurcation between net profit margin between us and Egypt. Clearly, the net, actually, is not very different. The main differentiator is the funding costs, whereby clearly, given the Egyptian pound funding, and where the rates are in Egypt, it's much, much higher, but at a lower volume level. We are at 1.1% funding costs in the UAE. The Group combined is at 1.9. So, the delta between the 1.1 and 1.9 is basically Egypt's contribution of the funding costs.

Operator Perfect, thank you. What is the level of write-off during third quarter that helped trim the NPL ratio?

Mohamed Abdel Bary So, the amount we have written off at approximately AED 850 million to AED 900 million.

Operator Thank you. Can you share some insight about amortised cost of securities?

Mohamed Abdel Bary So, our securities are predominantly investment grade. Probably, the only element there would be if there are any pressure points. We do hold Egyptian dollar sukuks, and given the downgrades, we have taken the impact on that. For us, in the bigger scheme, it's not big. We are holding 23 billion of investments, and Egypt, which is, I think, the only one that now is not investment grade, is really a fraction of that number. So, it does not really create any maturity for us.

Operator Thank you. On asset quality, NPL has decreased, but so has the cash coverage ratio at 70% in third quarter 23, which screens relatively low versus some of the peers. Do you see any potential segments where there could be some asset quality pressure? And do you want to build this cash coverage level higher?

Mohamed Abdel Bary Yes. I think it's natural. When you do some write-offs, and you utilise some of the provisions you have, your provision coverage ratio will naturally decline. It's still at 70%, so we have not moved far away from where we are. Do we want to build it? We are selectively building on that coverage ratio, but the comfort we're getting is that including our collateral value after [unclear], we're still at almost 131% of coverage. Having said that, we will continue to be looking at that number, and building it over time.

Operator Thank you. We currently have no further questions registered via the call, so I'll hand back over to the management team for any further or closing remarks.

Lamia Hariz Thank you. Thank you very much, everyone. As usual. If you have any follow-up questions, you can always send them via email, or call us. Thank you. Have a good afternoon. Bye.

Mohamed Abdel Bary Thank you very much.