Emirates NBD

EMIRATES NBD H1 2018 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
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Operator

Good day, and welcome to the Emirates NBD H1 2018 Results Investor and Analysts Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Shayne Nelson, Group CEO. Please go ahead, sir.

Shayne Nelson

Thank you, operator. I would like to welcome you all to joining our half-year results update call. Joining me as per usual are Surya, our Group CFO, and Paddy, our Head of Investor Relations. Hopefully, you've had access to the results presentation, which was made available to you earlier today. We'll review the operational and financial highlights for the first half of 2018, after which you'll have the opportunity to ask any questions.

If we go to page 3 of the presentation, it contains a summary of the results. I'm very pleased to report a record half-year net profit of just over AED 5 billion. This is 29% higher against the first half of last year and 30% higher than net profit reported in the second half of 2017. It is satisfying that all the business units made a significant contribution to the success, each delivering at least 17% year-on-year increase in profits. The strong operating performance was underpinned by higher net interest income on the back of line growth and improved margins and a lower cost of risk. Net interest margins have continued to improve in 2018 as rate rises flowed through to the loan book. There was a modest increase in deposit costs, but this was largely offset by an improvement in the cost of wholesale funding.

Liquidity conditions remain healthy, with the UAE system AD ratio at 96.7% in May. The bank's balance sheet remains healthy, as retained earnings strengthen the capital ratios. And the bank's liquidity and credit quality remained stable. Dubai's economy has been resilient, as reflected by the 56 reading for the Dubai economy tracker in June and a reading of 57.1 for the June's UAE PMI. These surveys report a sharp increase in both exports and domestic new orders as well as fast output growth.

We expect the UAE's GDP growth to accelerate to 2.2% in 2018 from 1.5% last year, although the recent decision by OPEC to boost production significantly in H2 produces an upside risk to this forecast.

In May, we announced we had entered into a definitive sale and purchase agreement to buy Sberbank's existing 99.85% stake in DenizBank. Following this announcement, both Moody's and Fitch affirmed Emirates NBD's ratings and outlook. We continue to work on the internal procedures whilst concurrently seeking regulatory approval in the relevant jurisdictions. These processes are ongoing.

In the first year of operation, Liv., the lifestyle bank for millennials, has attracted over 100,000 customers. Liv. is now the fastest-growing bank in the UAE and 84% of customers are new to Emirates NBD. As we reached one million fans on Facebook, Emirates NBD was named best bank in the Middle East as well as best bank in the UAE for the fourth consecutive year at the Euromoney Awards for Excellence. Many of our staff have enthusiastically embraced the Year of Zayed to honour the legacy of our nation's founding father with numerous CSR activities. I'm proud of my colleagues' selfless efforts to serve our entire community.

Overall, I'm very pleased with the bank's performance in the first half. We have delivered a healthy increase in profit across all business units whilst maintaining a strong balance sheet. We continue to advance the bank's digital credentials and improve the banking experience for all our customers.

I will now hand over to Surya, who will start going through the details of the presentation.

Surya Subramanian

Thank you, Shayne. I'll talk through both the half-year results highlights on slide 4 and the quarterly results on slide 5 of the presentation. As Shayne mentioned, the bank delivered a record half-year net profit of just over AED 5 billion. In fact, we only have to go back to 2014 to find the first time in the bank's history that we reported annual profits exceeding AED 5 billion. We also delivered a record quarterly profit, with Q2 net profit of AED 2.631 billion, 10% higher than the previous quarter and advancing 30% from the comparable quarter in 2017.

The increase in net profit was supported by growth in net interest income and an improvement in impairment allowances. Net interest income improved 20% year-over-year in the first half due to 4% loan growth and loans resetting at higher EIBOR rates. Non-interest income declined 2% year-over-year due to lower income from investment securities. In fact, non-interest income would have grown had it not been for a provision against a certain private equity investment. And we will provide more details on this shortly.

All business units, as Shayne mentioned, delivered both higher revenues and increased profits in the first half. Quarterly revenues demonstrated a similar pattern, with strong growth in net interest income, a modest decline in non-interest income and a significant improvement in provisions. Costs increased 17% year-over-year and 2% compared to second half of 2017 due to higher staff costs and IT costs relating to our digital transformation and technology refresh. Costs were also higher as a result of international branch expansion, not to mention we also had the VAT impact flowing through this year. Provisions of AED 755 million improved 40% year-over-year, as the cost of risk at an annualized rate of 55 basis points continues to be at the lower end of the 50 to 100 basis points range which most analysts would expect of UAE banks.

The NPL ratio was stable during the second quarter at 6%, while coverage ratio grew by nearly 4% in the first half to 128.4%. Our liquidity coverage ratio is at a healthy 158.7%, while the Advances-to-Deposits ratio at 94.4% remains comfortably within the bank's 90% to 100% target range. Following the 4% loan growth delivered in the first half of 2018, we maintain our guidance of mid-single-digit loan growth for the full year spread across all business lines. We expect similar deposit growth as we manage the AD ratio in the 90% to 100% range.

On slide 6, we have the details of net interest income. We see that margins continued to improve in the second quarter due to the positive impact from rate rises. There was a positive contribution from loan yields both quarterly and year-on-year as recent increases in EIBOR and LIBOR flowed through to the loan book. As we've mentioned before, approximately three quarters of the loan book re-prices within 3 months. There was a modest increase in deposit costs due to the higher rate environment, coupled with a small change in the CASA to Fixed Deposit mix. Given the large CASA component in the bank's funding base, the impact from rate rises and deposit costs should be more than offset by a positive contribution from loan yields.

Wholesale Funding costs improved both quarterly and year-on-year, as the bank efficiently deployed excess liquidity and replaced maturing debt at more favourable pricing. The structure of the balance sheet is such that rate rises will continue to have a positive impact on net interest income. Given that rate expectations have increased since budgets were set last year and the continuing healthy liquidity environment in the region, we are prompted to increase the Bank's net interest margin guidance by 20 basis points to 2.75% - 2.85% range for the full year.

On slide 7, we have the loan and deposit trends. We see that gross loans grew by 4% in the first half of 2018. Consumer lending advanced by 8% from growth in mortgages and term loans. The corporate loan book also increased by 3% due to growth in the services and trade sectors, while the Islamic book grew 5% during the first half from growth in manufacturing, trade, financial institutions and

retail. Deposits grew 3% during the first half of the year, with CASA growing by 2% and fixed deposits advancing by 3%. CASA now represents 54% of total deposits, down 1% since the start of the year.

Our funding and liquidity profile on slide 8 shows that liquidity coverage ratio strengthened to 158.7%, while the Advances-to-Deposits ratio at 94.4% remains comfortably within the 90% to 100% target range. Liquid assets are AED 67.5 billion or 16.1% of total liabilities. These metrics demonstrate the bank's strong liquidity and underline the value of a well-diversified, stable funding base.

In the first half of this year, we raised AED 6.7 billion of term funding in 5 different currencies with maturities out to 30 years. Issuers have found it more challenging to access the public capital markets in the second quarter. We have already more than covered this year's maturities through our public issuances in the first quarter and the ongoing private placements in the first half of this year. Remaining maturities for this year are negligible. Looking at 2019, as we have mentioned before, nearly half the maturing debt relates to a club deal with a large number of relationship banks. In both 2013 and 2016, we have rolled over this club deal and adjusted the size depending upon appetite. In the coming quarters, we will again assess availability, pricing and the bank's funding needs. We remain comfortable with our debt maturity profile and ability to manage our funding needs. This affords us the ability to consider public and private debt issues on a basis and time that makes sense both for our investors and ourselves.

Slide 9 shows the very strong capital adequacy profile we have. During the first half of 2018, both Emirates NBD's Common Equity Tier 1 and Tier 1 ratios strengthened by 0.7%-0.9%, as retained earnings more than offset the transition adjustment to IFRS 9. The Common Equity Tier 1 ratio now stands at 16.3%, and the Tier 1 has risen to 19.8%. Capital Adequacy Ratio has remained unchanged over the half year at 21.2%, as with central bank approval we paid AED 2.9 billion dirhams of expensive Tier 2 debt. Our capital position is strong, and we are comfortably above the minimum capital ratios required under Basel III capital regulations both for 2018 and 2019.

Emirates NBD has been designated a domestically, systemically important bank. And we're required to maintain an additional D-SIB buffer of 1.125% for this year, which will increase to 1.5% of the capital base in 2019. With that, I hand you over to Paddy to take us through the next few slides.

Patrick Clerkin

Thank you, Surya. Slide 10 shows that core fee income improved 10% year-on-year and advanced 3% over the quarter, with the main driver being higher foreign exchange income. Non-interest income declined 3% year-on-year and 1% over the quarter, as income from investment securities was affected by an impairment provision during the second quarter against a legacy private equity

investment. Barring this, total non-interest income would have increased by 4% year-on-year and 6% over the quarter. Property inventory at just under AED 1.2 billion was little changed over the quarter but has declined from a peak of over AED 3 billion back in 2013. The focus remains on growing core fee income. And it's pleasing to see that in recent quarters this component accounts for the bulk of fee income.

On slide 11, we see that costs were 7% higher quarter-on-quarter and 20% higher year-on-year due to an increase in staff and IT costs related to the digital expansion and technology refresh that we had signalled earlier. Other costs also increased due to a rise in costs associated with the acquisition opportunity in Turkey. And occupancy costs rose, as we worked on expanding our international branch presence. The cost-to-income ratio for the first half was 31.3%. And we remain confident of managing this within the 33% management target.

Moving on to credit quality on slide 12. As mentioned earlier, the NPL ratio was unchanged at 6% during the second quarter. During the first half, we had AED 840 million of write-backs and recoveries. And these, along with routine provisioning, helped increase the coverage ratio to 128.4%, an improvement of nearly 4% since the start of the year. As you know, we don't provide formal guidance on a target for NPLs. We expect some further modest improvement in credit quality in the coming quarters, as our recovery unit continues to proactively manage the existing stock of NPLs and look to extract value where possible.

Provisions for the first half were AED 755 million, which is 40% lower than the first half of 2017 and a 22% improvement on the preceding half year. This represents a 55 basis point cost of risk annualized, which is lower than the 73 basis points observed in 2017. Stage 1 and 2 ECL allowances now stand at AED 7.2 billion or 3.1% of credit risk-weighted assets, and this comfortably exceeds the 1.5% central bank requirement.

Moving on to divisional performance. On slide 13, we see that in the second quarter retail banking and wealth management revenues improved 13% year-on-year. And net interest income grew 10%, led by liabilities, whilst fee income grew 19%, supported by foreign exchange and cards and now represents 36% of total RBWM revenue. Loans grew 5% on increased demand for mortgages and term loans, whilst deposits advanced 3%.

In Q2, we celebrated the first anniversary of the launch of Liv., the country's first digital bank targeted at millennials. Liv. has acquired over 100,000 customers, of which 84% are new to Emirates NBD and is the fastest-growing bank in the UAE. Emirates Islamic revenue advanced 7% year-on-year in Q2, driven by a 15% growth in fee income and a 4% increase in funded income. Financing

receivables grew 3% during 2018, helped by growth in manufacturing, trade and FI and retail sectors. Customer accounts grew 2% over a similar period, as EI continued to improve its liability mix and cost of funding. As of the end of June, CASA represents 70% of EI customer deposits.

On slide 14, we see that Wholesale Banking revenues improved 14% year-on-year, with net interest income up 24% on the back of loan growth and improved margins. Fee income declined slightly in Q2 due to a quiet period for investment banking activity, but this was partially offset by growth in non-funded income from Treasury products. Loans grew 3% during the quarter due to growth in services and trade sectors, whilst deposits declined 3%, as expensive time deposits sourced over year-end were allowed to roll off. The strong performance in the first half reflects the ongoing progress that Wholesale Banking is making towards its goal of becoming a leading wholesale bank in the Middle East and North Africa.

Global Markets & Treasury revenue increased 48% year-on-year. The ALM desk delivered excellent results, as they positioned the balance sheet to take advantage of rate rises. Treasury sales witnessed higher volumes in foreign exchange and derivatives due to enhanced product capability and a closer working relationship with corporate and institutional clients. Trading delivered a strong performance, with significant contributions from both the Rates and FX desks. As mentioned earlier, net interest income was affected in Q2 by an impairment provision on a legacy private equity investment. Global Funding Desk raised AED 6.7 billion of term funding in 5 currencies through a mix of public issues and private placements with maturities out to 30 years.

And with that, I'll hand you over to Shayne for his closing remarks.

Shayne Nelson

Thanks, Paddy. In summary, we delivered a record set of results, a net profit of AED 5 billion for the first half of 2018. The strong operating performance was underpinned by a higher net interest income on the back of loan growth and improved margins and a lower cost of risk. Net interest margins improved in 2018 as rate rises flowed through to the loan book. This has enabled us to increase our NIM guidance by 20 basis points. The Bank's balance sheet remains strong with stable liquidity and credit quality, whilst the Tier 1 ratio improved by 0.8% during Q2 on the back of retained earnings.

Following the announcement in May that we entered into the definitive SPA to buy a 99.85% stake in DenizBank, both Moody's and Fitch have affirmed our ratings and outlook. We continue to work on the internal procedures whilst concurrently seeking regulatory approval in the relevant jurisdictions, and these processes are ongoing. In the first year of Liv., we attracted over 100,000 customers. It is now the fastest-growing bank in UAE and we've reached one million fans on Facebook and named the

‘Best Bank in the Middle East’ and the ‘Best Bank in UAE’ for the fourth year by Euromoney. Regarding the operating environment, Dubai and the UAE non-oil economy continue to perform well as evidenced by the strong survey readings from both the PMI and Dubai Economy Tracker.

And with that, I'd like to open the call for further questions. Operator, please go ahead.

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QUESTIONS AND ANSWERS

Operator

We will now take our first question from Shabbir Malik from EFG Hermes. Please go ahead.

Shabbir Malik - EFG Hermes

Congratulations on a good set of results. I have a couple of questions. I wanted to hear your thoughts on the UAE's economy. Export-related spending will eventually taper off. Where do you think the next wave of growth could come from for the UAE? Also, are there any signs that credit quality is weakening for your customers?

The other question I have is on the announcement - or actually, since the shareholder approval, it's been a while, and we haven't heard anything on raising foreign ownership limits and issuing of rights. I just want to understand what is causing this lag. And what is the expected time line for the FOL increase and the rights issue? And my final question is on -- related to the second one. So your profitability in the first two quarters has been quite robust. And could this mean that the actual rights issue that you've outlined of $2 billion the size of that rights issue potentially be lower?

Shayne Nelson

Okay, let me take the rights issue and the foreign ownership limit first because I think I'll probably get 150 questions on that because obviously both, and particularly the foreign ownership limit, are priced into this. So I'll tell you what I can tell you and I won't what I can't. As you know, we have the shareholder approval at the AGM for both the rights issue and for the foreign ownership limit to increase.

We obviously had the board approval. Otherwise, we couldn't have taken it to the AGM for approval. But we must state, and we've stated it numerous times, the linkage of both the rights issue and the foreign ownership limit and the acquisition are not linked. We have enough capital to make the acquisition of Deniz without the rights issue. From our perspective, the board will decide when to do the rights issue and when to increase the foreign ownership limit, but bear in mind it is our fiduciary responsibility for both the board and management to maximize the value for our existing shareholders. And we will time it to maximize that. On the UAE economy, and I'll link that with the credit quality, I am pleasantly surprised where our loan losses are at the moment.

In fact, I do think it's too low and compared to the rest of the market. At 55 bps, we'd expected to be higher than that. We are - if I look at the months of April, May, June, very strong months in new bookings of credit cards, personal loans and housing loans within the bank. We are taking market share. I would expect, like any retail bank, as we grow that cost of risk will flow through into the 55bps that we've got at the moment. I'd expect that to grow. Also remember in the cost of risk that we had recoveries in the quarter which actually lowered the cost of risk year-to-date. So we've actually had quite a bit of recoveries to offset some of the provisioning that we've had.

On the economy itself, I do have some concerns around the property markets, and we are looking at that very closely. Our risk team continued to stress our property book. And the reasons I am concerned is, one, we're not getting much population growth. There is quite a bit of supply coming in the market at the moment. We are seeing increased vacancy rates in most categories of property, which is leading to reduced rents and therefore reduced yields.

And on top of that, we're having to follow U.S. interest rates, which are somewhat out of sync with where the UAE economy is. So I think I'm concerned about where price will go on property given that scenario. Now the flip side of that is both in the UAE and Dubai stimulus is going into the economy, with Abu Dhabi announcing 50 billion, a lot of loosening of fees, etc., coming into Dubai. So I think the government does realize that they need more people and loosening up the way we do business to make it easier.

So we remain confident, the GDP number looks pretty good, but there's no doubt when I talk to my customers a lot of them are experiencing a reduction in margins in many industries. And they're basically keeping their volumes by dropping their margins. So I think we're seeing very soft employment growth right across the country. So I think, yes, there's impetus coming through from Expo 2020, but I think at the moment I'm cautious about where the economy is going. And our risk profile and the way we're managing our book reflects that. Is there anything else I forgot?

Shabbir Malik - EFG Hermes

Thanks for the comprehensive response. Just a quick one on the rights and the FOL, if I may. So is it fair to assume that you can -- right now your focus is completing the acquisition of DenizBank and this is -- the rights increase in foreign ownership limit is not your top priority?

Shayne Nelson

One of the things I said upfront was I'll tell you as much as I can. And I know you're going to ask me more questions on them, but I'm not going to answer them, I'm afraid.

Operator

We will now take our next question from Lemer Salah from Barings Bank. Please go ahead.

Lemer Salah - Barings Bank

The first question is with respect to your funding strategy going forward. You've got two perpetuals. One is in - has its next call date in 2019, the other one in 2020. I mean these are Basel II styles of perpetuals. I assume you don't mean especially for the first one since it's past the six year lock up, you're going to call it that next call date. I was just wondering what kind of funding strategy you have going forward.

And my second question is with regards to your recent acquisition in Turkey. I just want to understand how you financed it since it's the 4 billion and I think potentially you could issue another bond. And I think, I mean correct me if I'm wrong. And the third question is with respect to the real estate sector in the UAE. And could you please elaborate on the NPL ratios in the real estate sector? And that's it.

Patrick Clerkin

I'll take the first question on the additional Tier 1. Yes, we have $1 billion additional Tier 1 which is callable in 2019 and another $500 million additional Tier 1 which is callable in 2020. And we will not make any decision on about calling until much nearer the call date.

As you know, if we were to give any indication on whether or not that would be called, there could be repercussions from its inclusion within the existing capital calculations. So we will look at the capital and economic circumstances closer to the call date, which is in May 2019, for the $1 billion. And we will make a decision regarding that closer to that point in time.

Surya Subramanian

On your second question, relating to funding of the acquisition. There's clearly going to be a capital impact to the acquisition, which, as Shayne mentioned earlier, we are comfortable to absorb the capital impacts without raising any fresh capital, but funding itself is a matter of liquidity. Our balance sheet is very well positioned and liquid. Our LCR ratios are quite high. The Advances-to-Deposit ratio is at 94%. And in any given year, we raise $4 billion to $5 billion in public and private placements, so the ability to write a check itself is not dependent on raising fresh funds. I'll pass over to Shayne for the question on real estate.

Shayne Nelson

On real estate, I don't want to sound like I'm Dr. Doom on real estate. I'm not, but I don't see that there's going to be, given the dynamics that I outlined, that we're going to see a spike up in property prices in the near term. And I think unless we get some population growth we're going to see declines as we have in the last few years, would be my view. I'm not a property expert, but we certainly finance a lot of property. My view is we're going to see the gradual decline until we start seeing an increase in job creation. Once we start seeing increase in job creation and the population starts to grow again, I think then we'll see recovery in the prices.

Lemer Salah - Barings Bank

The reason why I asked this question is because your NPL ratios is somewhat higher than the rest of the sector at 6%. So I just want to know the real estate NPL number. And with respect to the CAR, I think 21.2% is …. But I mean what is your internal target in terms of minimum CAR?

Shayne Nelson

We don't give a minimum target on CAR. If you look at the NPL ratio where it is, if you've been following us for a while you know that that's declined from the peak of the crisis and its legacy within that book. And when you say that, yes, we are higher than the average of the market at 6% that is true. But we're also massively higher on average on our gross loan coverage, yes. So I could write it all up tomorrow and still have money in the bank, yes.

Surya Subramanian

And new problem loan formation has been very low.

Shayne Nelson

Yes

Surya Subramanian

There is a question on the web from Elena at Al Ramz Capital. She asks, what is the impact of the new retail regulations? And a separate question on how much of the bank's book will reprice in coming quarters. So on the reprice, I did mention during my earlier conversation that approximately 3/4 of the loan book reprices every three months. So it is pretty quick. On the impact of the new retail regulations, I presume you are referring to the fee caps that the central bank announced a while back.

That is in fact, I would say, positive in some respects that it's brought clarity to the issue of whether or not VAT is included or excluded from the fee caps.

We had some confusion at the end of the year as we were transitioning to VAT. The central bank has now clarified that their caps do not include VAT, so banks are allowed to charge over and above that. And if you compare with the fee cap circular they had issued in 2011, there have been some tweaks. They've added a few items. They've clarified a few items. They've changed a few items, but in arriving at this list, the central bank had actually conducted a benchmark study across other jurisdictions and markets. And we found that the UAE market is fairly in line with those benchmarks.

So all in all, those tweaks weren't material. They were cosmetic in some instances or filled some gaps in some instances, but the P&L impact of that to us, or indeed I will say the industry, is very minimal. But it brings clarity to both the consumer and the banking industry in terms of what we can do and definitely eliminates the confusion on VAT chargeability.

Patrick Clerkin

There's one further question on the webcast from Stefan regarding the FOL and whether we can share some thoughts with shareholders regarding the board's current thinking on timing. I think Shayne has already addressed when he said...

Shayne Nelson

Well, not addressed it.

Patrick Clerkin

Yes. Well, when you said that you'll provide all the information that you can. So there's nothing further to add on that.

Operator

We will now take our next question from Vijay Raghavan from ARENCO. Please go ahead

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Vijay Raghavan - ARENCO

Hi, Shayne, Surya, and Paddy. Thanks for highlighting the headwinds on the real estate side. Any other sector where you feel we are going to have tougher time in quarters ahead? That is my first

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question. And second will be in regard to the takeover of the Turkish bank. Are we still aligned to the time line originally mentioned towards the fourth quarter, and so the full year results could be a consolidated one?

Shayne Nelson

I suppose the other area that I'm seeing a bit of pressure is on hotels. We're certainly seeing - although occupancy is still at reasonable percentages, certainly the room rates have come back. And as you know, the RevPars have come up on a lot of hotels quite considerably. But I think the hotels differ quite substantially depending where they are. The beachfront still seems to be doing quite well both from an occupancy and a yield basis.

The downtown area seems to be doing pretty well. I think others -- the other areas are struggling. And we're seeing a lot more competition with a lot more rooms coming on. So I think - as much as I think occupancy is holding, RevPAR is an issue for hotels. I don't see, I mean retail, obviously, a combination of rentals where they are and VAT etc., I think, has certainly impacted retail. But again, it depends on are they up-market, middle or lower-market net retail space. We're seeing more negative effects in the top end than we are on the bottom end of the retail spectrum.

So I think it depends where they are. Property developers, I think you're obviously seeing the results of Emaar, which is doing very well, but others aren't doing so well. So I think it depends exactly how they're positioned in the markets. Any other industries that you can think of that I haven't covered? Auto. I mean auto, I think everyone knows auto sales are down substantially right across the board. It doesn't matter what brand, yes.

Vijay Raghavan - ARENCO

And the lack of growth of population or actually the fall of population is also impacting the educational and the health care sector too.

Shayne Nelson

Yes. And I think we're waiting to see after the summer what impact that would have on the school system.

Vijay Raghavan - ARENCO

True

Surya Subramanian

On your question, Vijay, on timing of consolidation. When we made the announcement, we said typically the regulatory approvals and this whole process takes six months, which means we were looking at a May to November kind of a time scale, which means if it all happens as efficiently as planned you could see a year-end consolidation including DenizBank. However, obviously, the timing is not controlled by us. It's controlled by the various regulators. And if there are changes in the regulatory timeline, given that it is so close to the year-end with November, it could just slip over the year-end as well. So I wouldn't hazard any guesses.

Vijay Raghavan - ARENCO

The timing is not - I mean it's not in 2018. It can be in 2019. But should I get happy every time I see that the shares are going down, from an acquisition price understanding point of view?

Surya Subramanian

We haven't gotten to the dynamics of the price. When we announced the transaction, we announced the price in Turkish lira. However, as in any transaction, there is a mechanism that is fair to both parties. So this is not the time for me to comment on that. But when we do get to our acquisition accounting, you would see -- you would have some clarity on what exactly happened.

There is a question from the web from Waruna of SICO. What is the reason for increase in OpEx, especially staff cost? This is pretty much, as we say, the investments we are making both on our product lines and especially in the retail businesses across conventional and Islamic these are sales staff who are direct revenue generators. And for the digital and technology transformation, clearly we've had to hire new capabilities into the organization. So it's a mix of the two. That's on the staff costs. The non-staff OpEx is clearly linked to the fact that we have irrecoverable VAT in the banking industry.

Shayne Nelson

And the expansion of branches and staffing..

Surya Subramanian

Internationally.

Shayne Nelson

Internationally in Saudi. And we get a full year effect of India as well. I think the other thing just to note on, as we - on the IT side, if we look at the staffing there, 15% of managers are being replaced with different skill sets, so there's a lot of new people coming into the organization. Additionally, a lot of contract staff we had in IT historically have been - those roles, they've either converted those existing people to permanent staff or they're being replaced if they weren't up to scratch. And a lot of the programmers we replaced, and they've come to permanent staff. And the reason for that is better control. An example I would give you is if you have a contract staff working on a project, are they incentivized to finish the project on time? Or are they incentivized -- these are people who work themselves, are they incentivized to actually drag it out? So for us, it was a strategic decision to actually embed those costs into our headcount rather than amortize them in project costs.

Operator

We will now take our next question from Deniz Gasimli from Goldman Sachs. Please go ahead.

Deniz Gasimli - Goldman Sachs

I had just a follow-up question on your planned upcoming acquisition of DenizBank in Turkey. I understand that there isn't much details you can provide at this stage but just looking kind of on any thoughts you can give or any kind of view you can give us at this point. I mean, since your planned acquisition was announced, the environment, the operating environment, in Turkey has been - has shifted more to the more negative outlook given the 15% Lira depreciation in second quarter, inflation past 15%.

There was a - and the rates are higher, around 500 basis points, since the start of the year. So I think the expectations for the Turkish economy and the operating environment for banks are more muted in terms of margin that is called and so on. So how does that, I mean, how does that like put you in terms of the planned DenizBank acquisition? Are you comfortable with what's happening in the environment and how it will impact DenizBank? I mean I'm also asking because in terms of capital levels DenizBank's consolidated CET1 is at 10%, which is below peers. And I mean the Turkish banks are vulnerable to Lira moves in terms of capital, so what are -- I mean if you can give us any colour on what have the recent volatility and kind of negative events in the Turkish space how has that maybe changed your view or maybe hasn't change your view towards the DenizBank acquisition?

Shayne Nelson

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The first thing to say is that we've been operating in the Turkish market for a number of years, lending to mainly FIs but also some corporates, and so we understand the volatility of the market. What I would say, if you look at the price to book we were paying and we will pay on a total market price when you see the numbers in the end, we've got a, I think, a very attractive price for the quality of what we're acquiring. A bank - we acquired this bank, private bank, in Turkey with substantial market share in areas that we like.

There is no doubt that there is volatility in the market, but also there is no doubt that we wouldn't have got the price that we've got it for if there hadn't been that volatility and outlook. And certainly when we modelled the price that we would pay for it, we modelled substantial Lira depreciation, and we modelled substantial increase in bad debts. So what I'd tell you is we're still happy with the Turkish Lira amount that we have set for the price of the book. And we're still happy with the long-term economic outlook for Turkey given the demographics, given the - I mean it's a large economy.

It's nearly double the size of the UAE, with a population approaching 90 million, strong use coming through, so we think that the market is attractive. The management team there are very good. They've demonstrated numerous times that they've been able to manage through adversity. And they've outperformed the market in growth for a number of years. So I think we are still very happy with what we're buying. And we understand why people would be nervous about the market itself, but we operate in Egypt. We've been operating in Turkey for a long time, and we're used to volatility.

Deniz Gasimli - Goldman Sachs

And just a quick follow-up, if I may. And are you able to comment on DenizBank's capital levels? I mean, do you think you will be comfortable with the capital levels? Or they might be a need for some capital raise or capital injection? Or you -- if you're able to comment.

Shayne Nelson

It's a publicly listed company, and it's pretty difficult for me to comment on their capital levels. That wouldn't be right. But what I would say is that you're right in -- the volatility risk to me is not in the profit and loss of DenizBank. It's the capital translation risk is the biggest risk in the acquisition.

Because if you look at our profitability, it's so strong and the growth which has been so good, to me it's not about the P&L. I made $500 million. Of course, I want to make that $500 million, but the greater risk in the transaction is managing that capital translation as it comes across in consolidation of our balance sheets.

Operator

We will now take our next question from Naresh Bilandani from JP Morgan. Please go ahead.

Naresh Bilandani - JP Morgan

Thanks a lot for the presentation. Just three quick questions, please. The first one was on your new digital offering Liv. I know it's early days, but can you just provide some colour on the size of the contribution that it has made it into the balance sheet? And where do you see this franchise growing as a portion of the book over the next, say, three to five years? And also, are there any major competitors here in this space? Like, how does this offering compare to the digital offering of Mashreq Neo in terms of products or target customers etc.? My second question is on the risk-weighted assets.

And in the past few quarters, despite the increase in the loan growth year-to-date, there's -- we have seen RWAs relatively flat. I know this is dependent on numerous factors, but if you can please guide us on how should we think about the RWA development through the medium term, that would be very helpful. And finally, Surya, my apologies if I missed this in your comments, but you highlighted you will share some further info on the provision that you have made against the PE exposure that you recently released to the market. Do you have any more comments to share on the same? Thank you.

Shayne Nelson

Okay, I'll start with Liv. We don't disclose its profitability, as we don't disclose the profitability of even our retail bank, for example. What I would say is that it's acquiring more new customers per month than our main bank. So not many more but a few more. So I think it's from attracting the target market we want, it's spot on. And I think the big advantage with Liv is, one, its cost-income ratio is about half of the retail bank. So it's still in its development phase, and it's still in half of the development phase. But I think what it gives us is not just a bank in its own right.

What it gives us is a mindset change and innovation. An example I will give you will be account opening. With Liv., you open an account completely online. And we basically validate your KYC when we deliver your plastic to - at your home by grabbing your ID card and putting it through a tablet. This is not done by a bank staff member. This is done by a courier. They basically get your ID card. They put it through the tablet. And then we ping it through your ID to validate the card. Obviously, we pull the information off either, and then we fingerprint you to make sure it's you. And we bounce back.

So we've built quite a lot of innovation within it if you look at how it's very much lifestyle, etc., in it. So I think what it's giving us is not just the financials of that entity itself. What it's giving us is innovation that we're now migrating to the main bank. What it gives us is the capability to take that sort of model to

both Egypt and Saudi as we expand our capabilities there. So I think -- if I said is Liv a success financially? It will break even pretty shortly. Is it successful from the innovation it's developing and enhancement it will spread across the organization? I think, absolutely. I'm very, very happy with it. Competitors, who?

Surya Subramanian

You asked about the RWA dynamics, and you asked about my comment on the private equity investment. I thought nobody will ask that question. In recent days, in Dubai it should be quite evident which private equity investment we are talking about. Nonetheless, since the regulators have asked us to make a specific disclosure, you will find it in page 24 under Note 8 to the -- sorry, Note 6 to the financial statements. We have marked down the value of our investment in Abraaj Holdings. We had an original investment of AED 78 million. That is now carried at 0. We have other investments in three Abraaj funds which we are carrying at a mark-to-market value of AED 52 million.

We do believe that there is value in these funds. These are not the funds that are impacted by some of the recent discussions within the Abraaj investor communities. These are legacy funds that date back to many years. On RWAs, there are really 3 or 4 moving parts to the story, Naresh. The first is natural volatility in the balance sheet when are liquid we have investments in the interbank market. And the due from banks carries an RWA, albeit at a lower level than a normal corporate or retail exposure. You'd notice that we have scaled that down in quarter two over quarter one and indeed compared to the year-end as well.

Apart from that, which creates some RWA volatility, we also look internally at RWA optimization all the time. We restructure limits to come up with the most efficient RWA. And in some instances, we have enhanced the type of collateral we take so that it gives us RWA offsets. So these are ongoing exercises that we keep doing in any case.

Naresh Bilandani - JP Morgan

So when I look at this from an RWA density purposes, so at this stage I think the RWA density as a percent of your assets is close to about 57% or so and has been consistently coming down each quarter based on the efforts that you just mentioned. Is there -- what could be a sustainable number through the medium term? Because looking at your capital is of key focus, especially going into the M&A. So how should we think of the RWA density going into the medium term, as the percentage currently stands at 57%?

Surya Subramanian

See, Naresh, as with all these exercises, the low-hanging fruit is what you get first, and then it becomes more difficult. So for the first 1 year, for example, you'll get some fruits of labor. After that, it becomes more difficult. On the legacy book, although anything new that you book you book under the new philosophy of making it RWA efficient to the best possible extent given what the market will bear, I would say that for a business like ours RWA will continue to grow, which it will grow as we grow the retail book because that's typically one to one.

It will grow because we are getting into a lot of new products in Treasury, as we get into new derivative sales structures. Also, in our Emirates Islamic bank we have a push for Treasury capabilities. That would lead to an increase in RWA on the market risks side. Although if you look at the presentation, the market risk RWA component is relatively small compared to credit risk, but these are areas that generate high fee revenue, and certainly there's a push in the organization for that. I think the regulators obviously have had concerns in the past. We don't obviously operate on the internal models basis, unlike some of the other market, Western markets that did.

So for us, you wouldn't see those kind of significant shifts in RWA because of use of models, etc. Nonetheless, the central banks all over the world are talking about imposing leverage ratios. The UAE Central Bank also talks about imposing leverage ratios. And I think that will be a catch-all in case anybody's RWA becomes too efficient. So you wouldn't necessarily see the balance sheet going haywire merely because RWAs are different.

Operator

There are no further questions over the audio.

Shayne Nelson

And there's nothing on the web. Okay. Well, thank you very much for joining us on today's call. Again, apologies that I can't be more specific on the rights issue and the Foreign Ownership Limit. I know it's one question you really want an answer to, but I cannot give you, but I'm sure you will be very happy with the results that we announced today. We certainly are. We are certainly happy. And certainly, the outlook for us at the moment is very strong. We are well positioned for interest rate increases as they come along. And we have at this stage quite a benign risk outlook given we're just not getting that flow-through of problem loans at the moment.

So thank you very much for joining the call. And I look forward to reading, hopefully, your good write-ups on our results for the first half. Thank you all.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect

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