EMIRATES NBD Q4 2020 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
27 January 2021

CORPORATE PARTICIPANTS

Shayne Nelson – Emirates NBD – Group CEO

Patrick Sullivan – Emirates NBD – Group CFO

Patrick Clerkin – Emirates NBD – Head of Investor Relations

PRESENTATION

Operator

Ladies and gentlemen, welcome to the Emirates NBD 2020 Full Year Results Call and Webcast for Analysts and Investors. Today's call is being recorded. Please note that this call is open to analysts and investors only. Any media personnel should disconnect immediately. I'll now pass the call over to our host, Mr, Shayne Nelson, Group CEO of Emirates NBD. Please go ahead, sir.

Shayne Nelson

Thank you Simon, and welcome everyone. Joining me as usual are Patrick, the Group CFO and Paddy, our Head of Investor Relations. I will run through the main highlights for 2020, and Patrick will discuss the results in detail and also talk about the guidance for 2021.

Well, 2020 has been a year like no other. No one could have anticipated the level or the speed of disruption that Covid-19 that brought to our personal and working lives. 2020 has been a defining year for Emirates NBD, characterised by Resilience, Support and Technology.

The Bank's 'Resilience' is evident on many fronts. Staff quickly migrated to a work-from-home culture in March before branches and offices started to re-open towards the end of Q2. The Bank's financial resilience is also evident by delivering a 7 billion dirham net profit which supports a proposed dividend similar to last year. Net interest income increased 8% as the inclusion of DenizBank for the full year helped offset against the impact of lower interest rates. Non-funded income declined by 8% on lower fee-based activity and expenses grew by 9% as DenizBank costs were included for 12 full months. Operating profit declined 29% due to lower interest rates & transaction volumes, and higher provisions. The balance sheet has remained solid with stable credit quality and strong capital and liquidity ratios.

We aligned with the Government of Dubai, the UAE Government and the UAE Central Bank to provide many forms of customer and community support. We provided interest and principal deferral relief to over 103,000 customers in the UAE, and many more in the other geographies in which we operate. The Central Bank's TESS programme proved invaluable, not just for the banking sector but for the entire economy. If you look back in history, financial crisis have not been a result of credit or capital issues, but from liquidity stress. And the swift action by the UAE Central Bank helped avoid liquidity stress and ensure that the UAE market has remained liquid throughout the year. As well as providing deferral support, we waived certain transaction fees during lockdown to ensure both customers and non-customers could use our extensive ATM network safely and conveniently with minimum travel. We increased our charitable and social donations to 90 million dirhams last year, million last year supporting many worthy causes that were affected by COVID.

The value of our ongoing investment in technology became evident in 2020. As most of the branch network closed during lockdown, Emirates NBD continued to offer a full, secure, uninterrupted banking service to customers. We experienced an increase in the number of both retail and corporate customers who use digital banking. We continued to enhance our digital offering through new product launches for both our retail and corporate customers.

Given the level of disruption the world experienced in 2020, I am pleased with the strength and versatility shown by Emirates NBD. As we look forward there are reasons to be optimistic. Vaccines are now being rolled out and with it brings hope for a safer 2021. There is greater optimism that economic growth will return to the countries in which we operate. Irrespective of what 2021 brings, I know I have a proven management team, experienced staff, agile technology and a sound balance sheet to deal with the challenges and benefit from the opportunities that will present themselves in 2021.

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

Patrick Sullivan

Thank you very much, Shayne, and a very good afternoon to you all. I will walk through the full year performance for 2020, which is set out on page 4 of the presentation and the fourth quarter's results detailed on page 5 and update guidance for 2021 as we go through.

So, starting with page 4, total income improved 4% during the year, as DenizBank added 7.3 billion dirhams of income compared to 3.6 billion dirhams for the five months in 2019 following acquisition. Net interest income improved 8% whilst Non-funded income declined by 8% on lower fee-based activity due to Covid-19. Excluding DenizBank, net interest income declined 13% due to the lower interest rate environment and non-funded income declined by 19% on lower client activity.

Costs increased 9% in 2020 with the inclusion of DenizBank for the full year, compared with only five months inclusion in 2019. Excluding DenizBank, costs improved 6% as earlier cost management actions took effect. The cost to income ratio for 2020 was 33.8%, broadly near long term guidance. This was expected given the substantial fall in income not being entirely offset by management's proactive cost actions. These combine to deliver a 1% improvement in pre-provision Operating Profit.

During 2020, the NPL ratio increased by 0.6% to 6.2%. The credit impairment charge of 7.9 billion dirhams represents a 65% increase and has strengthened the coverage ratio to by 5% during the year to 117.3%. We continue to maintain healthy coverage levels due to the uncertain credit environment. We expect the impact of Covid-19 on credit quality will not be fully evident until future quarters as deferrals roll-off, and I will elaborate on this shortly.

Turning to the quarterly results on page 5. All the quarterly results on this page include DenizBank and are unaffected by the Network International disposal, so are like-for-like comparisons. Quarterly net-interest income fell 20% year-on-year due to lower interest rates but the decline over the previous quarter was only 2%, as most of the interest rate declines have now fed through to the loan book. Non-funded income was down significantly in Q4 due to lower foreign exchange and derivative P&L from hedging and money market swaps.

Costs improved 18% year-on-year due to cost management initiatives and FX. Costs in the fourth quarter increased 13% due to completion of cost management initiatives and seasonality. This seasonality is expected as the Bank invests in marketing campaigns and other initiatives as we head into the new year as we have seen in prior years. Credit impairment provisions were 24% lower year-on-year for the quarter and 27% lower quarter-on-quarter reflecting having taken substantial action on provisions in the prior three quarters. As we have stated before, we have strong coverage which allows us to adjust provisions as economic activity and the health of the loan book evolves in the coming quarters.

Turning to the balance sheet, net loans have grown by 1% during 2020 and deposit balances are down 2% mainly due to lower DenizBank deposits when translated into dirhams. We are guiding for low-to-mid-single digit loan growth in 2021, in line with expectations of higher GDP growth this year.

As Shayne mentioned, system wide liquidity remains healthy as reflected through the Bank's Liquidity Coverage Ratio of 165% and the Advance to Deposit Ratio of 95.6%. We have a strong diverse funding base which we have used to support customers through these challenging times.

Just turning to slide 6. We see that we finished the year with a Net Interest Margin of 2.65%, at the top end of guidance, and as we indicated in the Q3 results call. This includes a 23 basis point contribution from DenizBank. Lower interest rates had a 140 basis points adverse impact on loan spreads. This was partially offset by a 93 basis point improvement in deposit and funding costs.

Looking at quarterly margins chart top right, we see that NIMs declined by 6 basis points in the final quarter to 2.42%. The 6 basis point fall in NIM is less than the 20 basis points decline in Q3 and the 34 basis points decline in Q2, reflecting that most of the decline in EIBOR rates happened in earlier quarters and lower rates have now largely fed through to the loan book.

Our entry-point NIM into 2021 is 2.42% and our full-year guidance of 2.35-2.45% suggests that we anticipate that NIMs will stay roughly in the vicinity of our entry-point. They may be some short-term pressure on NIMs in the first or second quarter as DenizBank liabilities re-price at the recently announced higher rates and we have incorporated this into our guidance. The rise in rates was welcome to stabilise the Turkish Lira and combat inflation, but in the near term it does compress our interest margins. Excluding DenizBank, margins would have finished at 242 basis points for the full year but the 23 basis point contribution from DenizBank lifted margins to 265 basis points.

Just turning to slide 7, we see that the Bank continues to operate with strong liquidity. We have over 100 billion dirhams of liquid assets which cover 16% of total liabilities and 22% of total deposits. The Liquidity Coverage Ratio remains healthy at 165.0% while the Advances to Deposits ratio finished the year at 95.6%.

We have not seen any material increase in EIBOR rates towards the end of Q4. Indeed, one- and three-month EIBOR rates only moved by 2 basis points during the fourth quarter. This is a good barometer of interbank liquidity and indicates that banks were not aggressively paying up for liquidity over year-end. The liquidity measures included in the Targeted Economic Support Scheme and extended by the UAE Central Bank until mid-2021, have helped ensure orderly and stable liquidity within the UAE banking sector.

We have been busy raising term funding, taking advantage of favourable conditions. In 2020 we issued 18.4 billion dirhams of term debt in seven currencies with a 9.9 year weighted average life. This included three benchmark senior public bonds and sukuks. As well as refinancing last year's maturities, it covers about 40% of this year's maturities.

We continued to refinance whilst there is strong appetite. Earlier this month, we were the first Middle East bank to access the capital markets with a $750m 5-year bond issue. With this, Emirates

NBD achieved its tightest ever spread for a benchmark issue. And in December, DenizBank successfully rolled over a $780m syndicated loan, attracting 42 investors from 20 countries.

On the bottom right of slide 8, we see that whilst deposits are down 2% over the year, this is largely due to movements in the Turkish Lira. Emirates NBD deposit base grew by 6 billion dirhams whilst, in local currency terms, DenizBank grew its deposits by 8%.

Emirates NBD's deposit mix continued to improve in the fourth quarter, with CASA growing by a further 12 billion dirhams. During the year CASA grew by 37 billion dirhams more than offsetting a 31 billion dirham reduction in fixed deposits. Our ability to grow CASA last year was a function of some specific internal initiatives and other external factors. Successful marketing campaigns and strong digital adoption helped the Bank attract new CASA. Low interest rates, strong liquidity and less spending have contributed to a market-wide increase in CASA.

As the economy recovers we may see CASA behaviour change. Increases in spending and more investment in inventory may moderate future CASA growth. CASA across the entire Group represents 52% of total deposits with domestic CASA for Emirate NBD increasing to 60%.

Gross lending increased 3% during the year. Within that, Retail gross lending grew 4% due to higher demand for personal loans and mortgages whilst Corporate lending grew by 3% and Islamic Financing growing by 7%. DenizBank's gross loans and deposits grew by 20% and 8% respectively in local currency but declined in dirham terms due to currency depreciation.

The pie chart on the bottom left shows the sector profile of the loan book, highlighting the Bank's success in improving diversification in recent years. On slide 9, as mentioned earlier, the NPL ratio increased slightly by 0.6% to 6.2% during 2020.

It is still too early to predict the high tide level that NPLs will rise to, but in anticipation of some further weakening in credit quality, we continue to maintain strong coverage levels. Coverage has risen by 5% to 117.3% in 2020 as the Bank took over 7.9 billion dirhams in impairment allowances.

Net cost of risk increased during the year to 176 basis points on higher expected credit losses from 117 basis points in 2019. DenizBank continued to boost its coverage ratio, recording a net cost of risk of 383 basis points in 2020. Emirates NBD's comparable cost of risk, excluding DenizBank, was 114 basis points in 2020 which increased from 91 basis points in the preceding year.

You will see that our impairment allowance in Q4 of 1.6 billion dirhams was lower than the average allowance of 2.1 billion dirhams for the previous three quarters. The Bank was proactive in the first quarter of 2020 in taking ECL allowances in the face of economic uncertainty and we have maintained this strong coverage throughout 2020.

So turning to Slide 10, this provides more detail on levels of Stage 1, 2 and 3 coverage. The chart on the top right shows Stage 1, 2 and 3 impairment allowances have grown by 5.8 billion dirhams during 2020 to 35 billion dirhams in total. Stage 1 coverage remained stable at 1.1% on 88% of total gross outstanding loans. Stage 2 ECL allowances increased by 2.1 billion dirhams to 5.7 billion dirhams, increasing stage 2 coverage to 21.1% on 6% of total gross outstanding loans. Stage 3 ECL allowances increased by 3.8 billion dirhams during 2020, giving a stage 3 coverage of 85.7%.

On the bottom left of that page, I have included some additional information on staging of customers who have benefited from repayment deferrals. It shows that, of the total 54 billion dirhams of exposure to customers who have benefited from forbearance, 83% is classified as Stage 1, 14% is classified as Stage 2 and 3% is classified as Stage 3. On a net basis, only 2% of customers have moved from stage 1 to stage 3 since June 2020, when we first provided this disclosure in our financials. Further information of staging and grouping is contained in note 49 of the financial statements.

At the end of 2020 we held 5.2 billion dirhams of zero cost funding, supporting 5.2 billion of customer repayment deferrals. Through the years, we provided deferrals on 9.2 billion of payments to over 103,000 customers and received 4 billion dirhams of repayments. The Central Bank continues to provide support to the UAE's economic recovery, particularly with the extension of the zero-cost funding window to June 2021 and we in turn will continue to support to customers based upon their individual circumstances.

I guess with that, I'll now hand over to Patty to take you through the remaining slides.

Patrick Clerkin

Thanks very much, Patrick. Slide 11 shows that core gross non-funded income for 2020 declined 2% compared to 2019 due to lower client activity. Core gross income for the fourth quarter declined 33% over the previous quarter mainly due to the sharp rise in interest rates in Turkey in Q4. Derivative income was also lower as the Bank took some hedging action to minimize the risks from interest rate volatility in 2021.

Following a 200 million dirham recovery in fee income in Q3, there was an 80 million dirham drop in the final quarter. Fee income is still up 12% on the Q2-low point with the small decline from Q3 a result of fewer big ticket items happening in Q4. Income from investment securities was lower as Emirates Islamic revalued its investment portfolio.

On slide 12, we see that costs for the fourth quarter improved 18% year-on-year due to cost management initiatives and an FX element from DenizBank's cost base. Costs increased in the final quarter by 13% over the previous quarter due to the completion of some cost management initiatives and seasonality. This seasonality is expected and, as seen in prior years, the Bank invests in marketing campaigns and other initiatives as we head into the new year. As a result of the seasonality in costs, coupled with lower income, the quarterly cost to income ratio rose to 41.5%.

The cost to income ratio for 2020 at 33.8%, was broadly near long term guidance. This was expected given the substantial fall in income not being entirely offset by management's proactive cost actions. So we have raised 2021 cost to income guidance to 35%, although management still focus on a lower long term target of 33%. The higher guidance is being realistic about the impact on income from a rapid fall in rates and the longer time taken to realise the impact from earlier cost management actions. The Bank remains firmly focused on efficiency and controlling costs.

Slide 13 shows that the capital ratios declined by 0.6% in the final quarter of 2020 due to allowance for the proposed dividend of 2.5 billion dirhams. The 1.3 billion dirhams of retained earnings in Q4 offset the 2% increase in risk weighted assets. The proposed dividend of 40 fils represents a 40% pay-out ratio.

After adjusting for dividends, the capital base grew at a faster rate than the 4% growth in risk weighted assets in 2020, meaning that there was a 0.3% improvement in the Common Equity Tier 1 ratio and a 0.6% increase in the Tier 1 and Capital Adequacy ratios during the year. The higher increase in Tier 1 and CAR is due to the Tier 1 capital management exercise conducted mid-year.

The reported capital ratios include an add-back for incremental Stage 1 and 2 ECL allowances as permitted by the UAE Central Bank that improves the capital ratios by 0.5%. TESS offers Banks relief on capital buffers until December 2021 without supervisory consequences. Hence Emirates NBD's current minimum Common Equity Tier 1 ratio is 8% and minimum requirement CAR is 11.5%. Even excluding the add-back, Emirates NBD's actual capital ratios are at least 6.5% higher than these new minima.

On slide 14, we see that, RBWM year on year revenue fell by 5% due to lower fee income as volumes were impacted by lower activity due to Covid-19. Customer advances grew 2% and deposits grew by 8% supported by a successful marketing campaign. Full year cost-to-income ratio for RBWM improved by 1.4% to 26.4%.

Emirates Islamic total income declined 22% year-on-year due to the impact on Covid-19 on business activity. Financing and investible receivables grew by 9% whilst customer accounts increased by 3%. EI has a healthy 68% of deposits coming from CASA accounts. EI returned to the capital markets with a successful 500 million dollar 5 year Sukuk issue during the third quarter of 2020.

On slide 15, we see that the Corporate and Institutional Banking income fell by 5% year-on-year due to a 4% decline in net interest income on lower interest rates that was partially offset by growth in lending activity. Non-funded income declined 7% y-o-y as higher investment banking activity partially offset lower lending fee and trade commission income. Loans grew 2% and deposits increased by 13%.

Global Markets & Treasury revenue declined 170% as net interest income was adversely impacted by lower interest rates. Non-funded income was also lower as the Bank took action to minimize the risks from interest rate volatility in the coming years. The credit trading desk delivered a strong performance and the Sales desk have worked closely with customers to explore beneficial opportunities for customers in this low interest rate environment.

Slide 16 shows that DenizBank contributed 7.3 billion dirhams in revenue and 1.4 billion dirhams of net profit to the Group's performance. As Patrick mentioned, DenizBank continues to take significant provisions to boost its coverage levels with a 383 basis point cost of risk last year.

Margins were broadly stable during the fourth quarter of 2020 at 4.27%. However DenizBank may see some margin squeeze in the first quarter, possibly in second quarter, as recent rate hikes feed through to the funding book, before loans eventually reprice. The improvement in DenizBank's NPL ratio during the year is partly due to loans growing by 20% in local currency terms and the credit performance on newly originated business remains healthy.

With that I will pass you to Shayne for his closing remarks.

Shayne Nelson

Thanks Paddy. The bank delivered a net profit of 7 billion dirhams and a dividend of 40 fils per share is recommend, representing a 40% payout ratio. The positive income contribution from DenizBank helped offset a decline in net interest income from lower interest rates and lower fee income due to the impact from Covid-19.

The 2020 NIMs closed at 2.65%, at the top end of guidance. Q4 NIM was 2.42% and we expect NIMs to finish 2021 at similar levels in the 2.35% to 2.45% range. Non-funded income declined during the year due to lower client activity. However we did see gradual an improvement in volumes. In 2021 we expect low-to-mid single digit loan growth. We have maintained strong coverage levels throughout 2020. So far, the risk profile of those customers receiving support has not seen a material deterioration.

I expect to see a higher cost to income ratio in 2021 due to the rapid decline in interest rates and a more gradual impact from previous cost management exercises. The cost to income ratio should revert to lower levels in subsequent years. Credit coverage ratios remain healthy and both liquidity & capital ratios remain strong. We have provided support to over 103,000 customers in the UAE, and many more in the other geographies in which we operate. In addition, we have waived certain fees to help individuals and business cope with the disruption.

We have experienced an increase in the number of customers who use our digital platform, as the investment in technology continues to bear fruit. and finally, we are well positioned to support our customers to take advantage of anticipated growth opportunities in the coming year.

With that I would like to open the call to your questions. Thank you

QUESTIONS AND ANSWERS

Operator

Our first question comes from Mr Rahul Bajaj of Citi. Please go ahead.

Rahul Bajaj - Citi Bank

Thank you. So firstly, I see that the Group 2 loans, which are under deferral, have grown quarter-on-quarter in 4th quarter by almost 60%, and Group 1 loans are – the exposure of – the graph exposure is flat quarter-on-quarter. So just wanted to understand why are Group 2 exposures going higher as Q-on-Q? I mean, are there new loans which are being deferred in the 4th quarter? Or how should we think about it? So that's my first question.

The second is on the dividend policy. And we've seen good jump in the dividend pay-out ratio this year in 2020. How should we think about going forward? I mean the 40% kind of pay-out ratio that we've seen in 2020, should we think about it as the new normal going forward? And does it – I mean, given the fact that the management team is now comfortable with the sort of capital buffer that Emirates NBD has reached? So any comment there would be useful. And I mean, if you have handy, I recall you mentioned about coverage ratio for the Turkish business during the previous calls. Just wanted to understand where we are at the end of the full year in terms of the DenizBank coverage issue? And what's the target there? Thank you.

Patrick Sullivan

So, it's Patrick Sullivan here. I'll take the first one. So that's on Group 2, then dividend policy. So just on your Group 2 point, I think you're looking at note 49k page 109, where the corporate Group 2 went up from about AED 0.6 billion at Q3 in total and has gone up to AED1.4 billion.

So that really – the Group 2, that is the migration and has an equivalent migration of NIMs into Stage 3 as well. So you can see even on an IFRS 9 basis, and perhaps it's perhaps more useful to look at the IFRS 9 staging of it, because that then ties right back into the accounts. And you can see our Stage 3 did go up a billion in the quarter for the actual allowances made against the AED1.4 billion increase in Stage 3 loans.

So, and that's set out on page 9 of the deck we have just been through. So that's substantially what that movement is. So, the central bank grouping is another way of looking at the staging. So Group 1 is all of our IFRS Stage 1 and Group 1 also then includes an element of our Stage 2 under IFRS, where there's been no credit deterioration since the deferral period started, whereas the Group 2 splits that Stage 2 and includes an element of Stage 2, where there's been a credit deterioration since the deferral period started. So in other words, something that was in Stage 2 has then gone down to Stage 3, which is also in Group 2 as well. So you've got that sort of migration dynamic happening.

Just on your second point on the dividend. We don't have a dividend policy per se. We have earnings per share of exactly AED1 per share this year. The Board is proposing a dividend to 40 fils, which is say 40% dividend payout ratio. Last year, the dividend payout ratio was a bit lower given the bottom-line profit included the gains from the Network International sale. And as I think if you look back at our dividend history, you can broadly see what the payout ratios have been in the past. But the dividend decision itself is one from year-to-year that the Board and then the shareholders approve at the AGM.

And forgive me, what was the third part of your question there?

Rahul Bajaj - Citi Bank

The third part was on the DenizBank's NPL coverage. What was the coverage at the end of the year? And additionally, do you want to bring it further up, or you think you have done pretty much in terms of topping up in NPL coverage?

Patrick Sullivan

Yeah. Okay. And so each quarter that we've been reporting out through this year and indeed since the DenizBank acquisition, we have been indicating quite clearly that we're very comfortable running a higher cost of risk in DenizBank. We wanted to bring up their coverage ratios.

The coverage ratios in our external accounts becomes a little bit more complicated because of the acquisition accounting that offsets their pre-acquisition provisions against the opening carrying amount that we book. But they have indeed been building up their coverage ratios and they've made a very good progress over the year. So we're getting quite comfortable with DenizBank and they should be able to run a slightly lower cost of risk through the coming year.

Shayne Nelson

I think the question online is similar to that, so maybe I'll answer that one, which was around the coverage ratios. And I think you can all actually pull out DenizBank's numbers because that they published as a requirement from the central bank. It's been a topic when you do your comparison of Deniz now compared to when we acquired. It's very close to, if not, industry leading coverage ratios there as we have here. I mean, we're the leader in coverage ratios in this market by a long way.

And Deniz would be at the top of that tree, pretty close to it, I think when we end up getting the comparisons for the industry there. So I think we also had the capacity to do that. I mean, it's fair to say that Turkey was a rollercoaster this year, the Lira, interest rates in the economy, etc.

But at the end of the day, the business they had delivered of that just close to AED1.4 billion of profit. So a very good result in digital circumstances. But because their revenue was so strong, we pushed the coverage ratios much higher than we actually anticipated when we did the budget because they have the capacity to do it. So I think it's in a good place.

Will I see coverage ratio? What I see, I need to increase them other than as required by deterioration. I don't see that it will need to do substantial amount of increase in coverage going forward on them. The book there, I think I made the comment last quarter. What we found in the due diligence pretty much reflects what the result is right now, except that the ones that we knew were a problem have got probably a bit worse given COVID in the economy and lack of tourism there.

So I think, we had identified the majority of the problems by far, and some of it we just need to top up from what we originally envisaged

---

Operator

Our first question comes from Mr Chiro Ghosh from the SICO Bank. Please go ahead.

Chiro Ghosh - SICO Bank

Hi. I have couple of questions. So, my first question is, so when the interest rate cycle goes up, how long does it take for you to pass it on in your Turkey operation? And if you can give a perspective versus how long does it take in UAE market, just to get a better sense. That's my first question.

Second one is there were media reports that the ENBD is were looking to take additional position in Egypt through BLOM Bank or Bank Audi. I don't know whether you can comment on that or not, but I want to get a sense whether you are still looking for more opportunity in the Egyptian market? These are my two questions. Sorry, and the third one is a short one about the foreign exchange income. So did you say it was low because of the Turkish operations?

Patrick Sullivan

Okay. Perhaps I'll take the first and third question and then hand over to Shayne in respect of Egypt. Just on the repricing in the portfolios when rates change. Yes, very different dynamics between

Turkey and the UAE. In Turkey, you may recall if you had been joining our previous calls as interest rates were falling in Turkey, in the short-term that was improving their interest margins because their cost of funding was reducing faster than the loan repricing downwards. There has been a significant rate rise in Q4 going from 8.25% to 17% through the 4th quarter.

And so the converse is true, where the cost of funding goes up quite sharply. And that is a very sharp rise in anyone's books. And yet it then does take some time for the assets to reprice up and cover that off. So there is a timing difference. So we will see that impact really come through – partly it's already come through in the Q4 results when you see DenizBank's non-funded income was down significantly, but also then through the first half of next year – or sorry, this year in 2021 we will see that come through.

As the assets then reprice through various vintages through H1, it should then turn around. And in the long-term higher interest rates are better for banks. There are wider spreads, etc. But that will take time. And so we really only see that benefit come through in the second half of the year.

In the UAE with our very strong CASA base, as you have seen in our top line, as interest rates cut really significantly at the end of Q1 and then the market rates coming down through Q2, that comes through very quickly to our portfolio because of the pricing profile on the liabilities, where once it's gone – there's no rate to cut when you've got a lot of your deposits are in CASA, whereas your asset then repricing relatively quickly down as well. So it's quite two different dynamics there.

So maybe I'll hand it to Shayne for the Egypt question.

Shayne Nelson

Just to add onto what Patrick was saying before, I mean, if you look at it the way our liquidity is positioned and the growth of CASA, that if rates start to increase at the tail end of '21 or into '22 with US recovers, and we think it should. And we started getting inflationary pressures it's – there's a significant upside for us given our deposit mix as US rates translated into EIBOR here. So I think we are positioned for that. The last cycle we increase our profitability financially because of that. Unfortunately, conversely when Brexit drop like a brick with COVID, it does have a material impact on our profitability.

On Egypt, I would say this is the third time we've been bidding for assets or bank in Egypt since we bought Banque Nationale de Paris, we've made no secret that we are very interested in bulking up in Egypt. It's – for us, it's been a very good market. The returns that we've had on that acquisition have been very strong. We're very happy with that economy and the management we have there and the customer base we have there.

But if you look at Egypt, it’s a very fractioned market. I mean, there's not many banks that had more than 2% market share. And there's a lot of banks. We would like to be part of that consolidation play that we think is necessary there over time. However, we are also very disciplined about what we’ll bid for and how – at what price we'll pay. Three times we’ve walked out because of the price that we've offered has been insufficient against other players. We’ll continue to be disciplined.

We want to generate shareholder value. And the best way to destroy shareholder value is actually overpay for acquisitions. As we demonstrated, when we Deniz, we bargained like hell for a long time to get the price that we could deliver value to our shareholders, and we'll continue to do the same in Egypt. But I would confirm, Egypt remains an attractive market for us, and we would like to be bigger in Egypt.

Chiro Ghosh - SICO Bank

Thank you. Just the last one about the FX income was weak in the 4th quarter. Was it due to the Turkish operation?

Patrick Sullivan

Okay. Now just on that, that is very much connected to the sharp rise in rates in Turkey in the 4th quarter. So, in DenizBank, we have a very strong foreign currency deposit base. We do use some of that to then fund Turkish Lira lending. When you swap those over and the rates go up, you essentially get that increase in funding costs.

And because you're doing it through derivative, that – essentially that cost of funding differential then goes through your non-funded income line and derivatives, etc. So that's really what's driven that in the 4th quarter. Okay, Paddy, should we move onto some of the questions that I think we have coming through online there?

Patrick Clerkin

Yeah, certainly, Patrick. There is a question which I'll pass over to Shayne, but before – the question is on whether we intend to start our own payment processing company after the disposal of our share in Network International? I think there’s also a question that if you could answer on reserves and the potential for release from those.

Before you answer those, I just going to clear a couple of the other questions. So there's a question on why there's a difference in balance between or exposures on page 109, page 111? That's due to one of them being defined exposure default. Patrick mentioned that before. Exposure defaults are outstanding balances after taking a kind of limits, credit conversion factors, unexpected drawdowns. So there is a slight difference between current actual exposure and exposure of default.

Another question on the coverage ratio, including collateral. Including collateral coverage ratio is at 204%. Question on why the Common Equity Tier-1 ratio dropped by 60 basis points? That's on aligned for the proposed dividend. I mentioned that there was a AED1.3 billion of retained earnings, which offset the increase in risk-weighted assets. So that the 60 basis points you see there is effectively the allowing for the proposed dividend.

A couple of more questions before I pass back to Patrick and Shayne, in terms of ESG disclosure. We do publish an Annual CSR Report and our marketing team are working on further – doing further work in terms of ESG credentials. Obviously, that is a bank-wide and a group-wide effort rather than driven by one individual department. So that is a considerable exercise that is going on within the bank.

And then a couple more questions on DenizBank's non-funded income. Patrick's already addressed that. And a question – one more, the percentage of deferral portfolio, which is likely to turn into Stage 3 versus Stage two2 Patrick has mentioned – he gave those – on page 9, he gave some information about that. So far, we've actually – so for the first – for the last 6 months, we've actually seen a modest migration from Stage 2 to Stage 3.

Okay. So Shayne and Patrick, if you want to answer those other questions?

Shayne Nelson

On the payment processing company, as we disclosed in the Network International prospectus with their IPO, we are contractually obliged to Network International. So the contract was fully disclosed there. So starting a payment processing company, no is the answer.

Revisiting our payment strategy we are doing at the moment, because I think as we move forward, there's a difference between processing and a difference between actually payments themselves. So I think we are doing a strategic review of payments because for me payments in effect and the facilitation of payments are critical to managing our cash flow, so the customer's cash flows for CASA. So we're certainly doing a big strategic review of our payments versus processing.

And if you look at most banks in this country, they may be acquirers, so they may acquire customers, but the processing is done by someone else. It's a rarity that the banks are actually doing the processing themselves. It's an economies of scale game payment processing. And there's particular companies around the world that just specialize in this and they're very good at it.

Patrick Sullivan

Okay. Thank you, Shayne. There is a question online headed around the IFRS 9 reserves that we've grown significantly through the year. When would we think we'd be able to release some of these provisions? If this is after the expiry of TESS a possibility as this is still a key uncertainty?

Look, we build – we've been quite proactive about our provisioning through the year. There are really two parts to that. One is that Stage 1 and 2 modelled ECLs or expected credit losses. And the second part is Stage 3.

Just on the first in Q1, we actually had a very strong overlay at a point when banks weren't really able to do update all their macroeconomic variables. We have since done that and returned to a modelled approach for that, as some of those macroeconomic variables go up and down. You then see sometimes charges and sometimes releases. So that depends on things like GDP, oil prices, the housing market, employment, etc. So that's a modelled and that will go up and down. That's just a part of living with IFR 9 is that volatility.

On the Stage 3 part, we have a very good track record of maintaining strong coverage for that. We would only rarely release those provisions when you – when we have recovered the un-provisioned elements and then working through that. So it is not like we have built up provisions that can then just be released at one go. There was that point about some of the uncertainty about what will happen when TESS comes off.

TESS itself is the zero-cost funding, but we are then providing that support to our customers and clients. And yes, we will get a better idea on the corporate side as we work through the first half. But I should point out, as I noted earlier, we have provided about 9.2 billion of support and all of that had a substantial 4 billion coming back. So we'll just – we will update when we come back to Q1 and Q2 on that. And that will be more a function of how the NPL formation is looking.

Shayne Nelson

There was a question on Emirates Islamic. Can we comment on its performance in 2020? I think that's really two factors here. You remember that in the public records, so I can disclose it, that Emirates Islamic was the entity that had our NMC exposure in it. And we've been quite conservative on that exposure. Obviously, you can't talk about provisioning levels, but we have been conservative on it.

They had the lion's share of NMC exposure. There was very little in the consolidated – I'm sorry, in the main bank. So that does fit into line there. And additionally, we took it quite a big impairment on their investment portfolio. We took the opportunity to write that down quite aggressively. The underlying performance, especially in the retail bank was actually pretty good and mirrors the performance of the retail bank and private bank. That was quite a strong performance in 2020, given the circumstances. And I think that continued to grow market share in that Islamic space in retail, private banking, and the priority banking equivalent.

So I think the underlying is much stronger than the results, but it's largely because of those two factors: the NMC provisioning and the write-down on investments.

Patrick Clerkin

Before we take some more questions from the call, there's a question here on whether we expect the NPLs to – any increase to be biased in the second half, really with the roll off of TESS? And also S&P are expecting higher provisions for UAE banks in 2021. Given Emirates NBD's provisioning buffers, we do expect our cost of risk to be below last year's cost of risk, or should we wait to 2022 for this to be lower?

Patrick Sullivan

Just the NPL part of bias between H1 and H2 for 2021. With IFRS 9, as and when a customer or client has a downgrade, we then do move that through the staging, so if something is in Stage 1 or 2 now and there is a credit event and we assess that, and if need be, that will then go down to the NPLs in Stage 2.

In the corporate space, to the extent corporate does not have to make a repayment that was scheduled or altered the ultimate TESS bills whether or not they will repay is seeing the cash. So there will be an element of that where the NPL formation through into the second half will be more of a function of what happens after some of that TESS support comes off.

Having said that, the TESS support is rarely helping to prevent credit losses and that it does give our customers and clients, both in retail and in the corporate space, time to repay. And some of that time reflecting an improvement in the economy and let their businesses get back up on their feet as well. So if the support was cut off either straightaway when payments were due last year or even now, that would have a more negative impact. So it really is a positive thing but some of that support continues to be given to our customers.

Just on the cost of risk, we have been quite aggressive on the cost of risk through this year, both in DenizBank and in the rest of our footprint portfolios as well. There should be no surprise, most banks internationally are doing that. We hope we have done enough at this point in time for the events that we know of. So all things being equal, we would be looking for a lower cost of risk next year, but still somewhat higher than, say, in 2019 level where we landed around at 117 basis points.

Operator

Our next question will come from Naresh Bilandani from JP Morgan. Please go ahead.

Naresh Bilandani - JP Morgan

Hi. Good afternoon. Just two questions please. So first of all, thank you very much for providing the extra colour on asset quality. I'm just keen to understand, say, Patrick, as you just mentioned that 2021 cost of risk could potentially trend slightly lower compared to 2020, but say higher compared to 2019. That's kind of like – it's actually saying that there will be some level of moderation this year. So if I look through a bit more into the medium term, I'm just keen to understand what the ENBD strategy be.

If in case we see an elongation of the credit cycle, the credit asset quality stress beyond the current expectation, would you, from a strategy perspective, make use of the excess provisioning for a bottom line or an ROE perspective, or will coverage be your first target, and you will continue to maintain an elevated level of coverage despite the comfortable collateral that you have as compared to your peers? So just trying to understand whether we will see a reduction in the overall coverage levels over your peers, or you will maintain an ample coverage level, even if we continue to see a stress on the asset quality cycle? That's my first question.

My second question is mainly on the digital banking side or on Liv. If we could please have an update of what was Liv's performance through the course of 2020, mainly from market share or customer acquisition perspective?

And just keen to hear from Shayne also with the fact that there's rising competition in this space, we have about to see the emergence of the new player from Abu Dhabi. Just trying to understand what will Liv's strategy be through the medium term for growth or a market share perspective? Thank you.

Patrick Sullivan

Shayne, maybe I'll take the first one, if you want to take the second one. So Naresh, I think what you were asking is in a year or two, are we likely to see a great big release of provisions if the book doesn't get any worse? And we'll then give a boost to capital and returns, etc. Correct me if I'm wrong in that.

Look, for the time being, thinking beyond a year or two from now, I think that's perhaps a bit premature. I think we need to work through what's in front of us today. But we are working to form where there are credit events, and we have some concerns about a name we will make the appropriate provisions. You then have to put that through to the recovery teams and work those loans through. That can take some time to do that.

Yes, Paddy has noted before that actually our coverage, including collateral, is also very strong. And that is factored in, in the recovery process as well. Also over time, the mix of the book will change, so we will recover some and then there'll be some more of it may need to go into Stage 3. Obviously, we keep you updated quarter to quarter.

But at this point in time, and just with the uncertainties out there, we're not sitting on large surplus provisions that would be releasable in a year or two. We will be delighted if eventually that became the case, but that is not the expectation at this point in time

---

Shayne Nelson

I think you said to that, Patrick, I would say. When you're looking at security is an interesting one, but we – I wouldn't say we ignore it, but we significantly ignore it, given you're in a market where property is not easy to sell at a reasonable price, and you're doing an NPB on those property values. Hence why you end up taking a significant amount of in coverage ratios if you're being prudent.

So I think that – do I see us dropping our coverage ratios to meet the market? Frankly, I would hope that I'll see other banks increasing their coverage ratios to close the gap on us because I think we're being very prudent how we've managed it on.

On Liv., it's now got over 400,000 customers. I won't tell you how much money it makes, but it does make money. So just to be profitable for a digital only bank is just about exceptional globally. Where do I see it growing? We have launched in Saudi. We would love to launch it in Egypt. We are investigating to launch in Egypt.

So as a platform, it's proved very good for us from a customer acquisition. And remember one of the reasons that we've launched Liv: because we had a missing demographic in our customer base. We had a shortage of youth up and coming executives, etc. We did have that demographic heavily in our portfolio. So there is still that gap. Well, I think the next progression for us is really getting striked through loans onto Liv. I think that's an important thing. If you look up a lot of the digital banks around the world, the issue they have is they hit deposit heavy and loan light, and therefore their capacity to make money is inhibited. And certainly that's what we're doing with Liv. We're starting putting a lending propositions on there.

And that's actually quite interesting because to me, what we want to achieve at Emirates NBD as in here and at Liv. and at EI is a lot of strikethrough digital loans. And I think that is – that sounds easy, but actually until you get the digital transformation that we're going through at the moment that is not so easy because customers want – they want to pay in their own loan information, and they want an answer immediately and they want the funding immediately.

That's not an easy technology piece or risk piece to do. We're quite advanced in getting some of this stuff done. But I think it also makes a huge difference to your cost base. Now, you think about what banks traditionally do around the world is the market starts improving. The economy starts moving forward. Customer demand becomes part. We all go out and hire a whole bunch of new salespeople, the middle office, the back office, and then the economy turns and we – and then we fire, fire, fire to get back to the required cost income ratio, economy improves. It's just like a wheel with comps. We keep going round and round in circles.

Well, digital loans will that to do. And some of the best banks in the world are doing like 50% onboarding. That will be able to, one, reduce their cost structure, and two, give us their financial flexibility and how we invest. So I think the next drive for us on digital is really going to be around loans.

Deposits are much easier, obviously. But I think the important thing for me on Liv was besides the demographic and the customer acquisition, it was the experimentation capacity that it offered us. So online accountant, I think started with Liv. A lot of the chat bots we use, we started with Liv.

So it gives us a really good experimentation platform to youth that understand this stuff and are probably a lot more sympathetic to it than some of our other client base. So I think we're very happy with how its progressed. Competition, we're always open for competition. We do have a headstart on the competition. We'll see what offerings they've got when they come along.

But we have built – we're now about 85% cloud native, right? By the time we get to the year-end, probably in fact the third quarter of this year, we should be a 100% cloud native. That gives us the same capacity as a digital start-up or fin-tech. And that's why we've been driving this transformation. We're just about finished. We've probably got 9 months to go.

And that's going to give us a lot of capacity to do different stuff, including – I often describe to the Board. I say we build a car, so we've got an engine. We haven't got the wheels and the steering wheel yet. And what that gives us the capacity to do is then start building those ecosystems that we want to build. It's start giving us the capacity to do a lot of work in advanced analytics that we haven't been able to do.

So the next legs of our growth journey around digital are going to be quite different to building the infrastructure of what we've done historically. That was a long answer to one short question. Sorry.

Patrick Clerkin

Thank you Shayne. I'm conscious of people's time here. There's a few more questions, which I quickly want to clear on the – coming in on the wab, and then we'll see if there's any further questions. But so let me just run through these.

In terms of fee income, we don't give guidance on fee income. And Patrick has outlined the guidance that we have given. So in terms of the margins and the expectation of low to mid single digit loan growth. You can infer from that the expectations around net interest income for 2021.

There was a question on, are we de-risking hospitality just because that we just landed the hospitality services. You can see in our financial statements that where we have increased, where we have decreased. The lending we do is risk-based and risk – priced on a risk basis. So we're not negative on any sectors. We look at it and charge the relevant and appropriate cost of risk.

There was a comment about lower recoveries. Again, you will have seen that there were recovery. It's fair to say that we do – we look to exhaust every means possible to extract value. Only way off that we believe that there is no further value to be extracted from a loan

---

Shayne Nelson

But we would certainly like more recovery.

Patrick Clerkin

Absolutely

Shayne Nelson

And we're working hard on it. And as that someone else pointed out earlier, we do have quite substantial collateral loan on many of the stuff. But again, typically in both here and in Turkey, the collateral is real estate and shifting real estate to decent part of the money is not that easy.

Patrick Clerkin

And then just a final question on the ramp about the – how the pandemic has accelerated digitisation? And do we see fewer branches in future? We did conduct an exercise, a branch review post the closing of branches temporarily and looked at how people's and customer behaviour has changed. And there were some branches that were closed last year and did not open when others did open. And we can continue to review the demand for the branches

---

Shayne Nelson

But I would add to that, that I think the nature of branches is changing from transactional to more virtual driven as we go forward. So footprints are shrinking. Numbers are shrinking as we go forward.

If there's no further question, I'd like to thank you all for your participation in today's call. Hopefully, we've answered all your questions satisfactorily. Tough year 2020, but I think we came through with a very strong capital, strong liquidity, and importantly, strong coverage ratios for any future events. So I think we're extremely well positioned, in my opinion as well as any bank in this region. And I think we're in pretty good shape for any recovery that comes forward.

And again, thank you for your time. Thank you for joining the call. Thank you for your interest in Emirates NBD. Cheers.

Operator

Thank you, Mr Nelson. Ladies and gentlemen, for any further questions, please contact our investor relations department, whose contact details can be found on the Emirates NBD website and on the results press release. A replay of this call and webcast will be available on the Emirates NBD website next week. Ladies and gentlemen, that does conclude today's conference. Thank you for your participation. You may now disconnect.

END