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EMIRATES NBD Q1 2018 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
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PRESENTATION

Operator

Good day and welcome to the Emirates NBD Q1 2018 Results Announcement. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr Shayne Nelson. Please go ahead.

Shayne Nelson

Thank you, operator. I'd like to welcome you all to the Emirates NBD results conference call on webcast for the first quarter of 2018. Supporting me today as per usual, Surya, group CEO, and Paddy, our head of investor relations. Together, we will review the operational and financial highlights for the first quarter of 2018. We'll refer to the results presentation, which was made available to you earlier today, after which you'll have the opportunity to ask your questions. We move to slide three. I am very pleased to report a strong start to the year for Emirates NBD, with first quarter net profit up 27% year-on-year to AED 2.4 billion dirhams. This is a record quarterly profit and all the more satisfying as it is supported by growth in our core business. The strong operating performance was underpinned by higher net interest income on the back of loan 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, deposits costs were stable and wholesale funding costs improved. Liquidity conditions remain healthy with the UAE system-wide AD ratio at 98.5% in February.

The Bank's balance sheet remains strong with solid liquidity and capital ratios and a further strengthening in credit quality this year. The cost of risk continued to improve on the back of stronger asset quality metrics. Dubai's economy has been resilient as reflected by strong readings in both the PMI and the Dubai Economy Tracker. Tourism and hospitality in particular had a strong start to 2018 with improved hotel occupancy rates being reported year to date. We expect continued investment in infrastructure in the UAE to underpin non-oil GDP growth through to 2020, and stronger economic

growth throughout the GCC economies in 2018 as higher oil prices help bolster government revenues. This was also an opportune time to introduce VAT, which took effect in the UAE at the beginning of the year.

2018 marked the introduction of IFRS 9 for banks globally and Basel III capital standards for banks in the UAE. As evidenced from our strong capital ratios, the impact from these new regulatory standards is minimal. Our shareholders have also approved a potential rights issue during the AGM last month, providing the Bank with increased flexibility to pursue strategic initiatives in our target markets and still maintain sufficient buffers to meet any unforeseen circumstances. On the digital front, we rolled out several initiatives this year, including the Group’s first Innovation Month, aligned with the government’s UAE Innovation Month. We also introduced self-service banking initiatives for people with disabilities, as we drive financial inclusion for everyone.

We are making good progress in our one billion dirham investment to accelerate our digital transformation. Several flagship projects have already been completed including three key industry firsts in the region. With a newly defined IT organizational structure embedded within the Bank, Emirates NBD is now the first truly agile organization in the GCC. We are the first regional bank to launch our own private cloud network, leveraging similar technology as the world's leading cloud-native organizations. We have also gone-live with cheque-chain; integrating block-chain technology into issued cheques to minimize fraud. Our strong financial and operating performance, along with our pioneering approach to the digitalisation of banking, continues to be recognised through a series of industry accolades. We are particularly pleased to be ranked the UAE’s most valuable banking brand for the second consecutive year, and 71st worldwide, by The Banker, reinforcing our leading market position.

As a home grown bank, we have always championed a culture of giving back to the community and pride ourselves on being an active corporate citizen. We published our second sustainability report last month which showcases our performance across economic, social, governance and environmental practices in 2017. For this year, we are proud to dedicate our CSR activities to the Year of Zayed to honour the legacy of our nation’s founding father. Outside of the UAE, we continue to expand our international presence and opened a new branch in Jeddah last month. Our Jeddah branch is fully equipped to provide our full range of banking services to all client segments, and is part of our KSA expansion. We are on track to open a new branch in Khobar and a second branch in Riyadh, which will bring our total branch count in KSA to 4. We have always aspired to be the leading MENAT bank and our branch expansion in India, KSA and Egypt is focused on enabling the Bank to grow our share of regional trade and customer flows.

Overall I am very pleased with the Bank's strong performance in the first quarter. We delivered a healthy increase in profit whilst maintaining a strong balance sheet. We continue to enhance the Bank's digital credentials and improve the banking experience for all of our customers. I will now hand it to Surya, who will handle the details of the presentation. Surya

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Surya Subramanian

Thank you, Shayne. I'll talk through slide four, which is the quarter one financial results highlight. Net profit for the Group was a record 2.4 billion dirhams in the first quarter of 2018, 27% above the profit posted in the previous year and a 10% increase on the preceding quarter. The increase in net profit was supported by growth in net interest income, a control on expenses and an improvement in impairment allowances. Net interest income improved 20% y-o-y due to 5% loan growth and loans resetting at higher EIBOR rates. Non-interest income declined 1% y-o-y due to lower investment income from the sale of securities. Q1-18 revenue, at 4.1 billion dirhams, is a record high, which is all the more satisfying as there are no material one-off gains recorded during the quarter. Quarterly revenues improved 2% over the previous quarter as strong net-interest income growth more than offset a decline in non-interest income.

Costs improved 2% compared to the preceding quarter on lower marketing, IT and professional fees. Costs have increased 14% y-o-y due to investment in our digital transformation and technology refresh. This planned investment is now in full flow and cost to income ratio is expected to be within 2018 guidance of 33%. Provisions of AED 440 million improved 31% y-o-y and 18% q-o-q as the cost of risk continues to normalize on the back of improving asset quality metrics. The NPL ratio finished the quarter at 6.0%, an improvement of 0.2% during the quarter. In 2018, the coverage ratio grew to 127.9% from 124.5% at the start of the year.

As demonstrated by the healthy increase in net profit, we picked up from the strong finish last year and have hit the ground running in 2018. The Liquidity Coverage Ratio is at a healthy 152.9% whilst the headline Advances to Deposits ratio, at 93.8%, remains prudently within the 90-100% target range. Following the 2% loan growth delivered in the first quarter of 2018, we expect 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 90-100% range.

Moving on to net interest income on slide five, we see that margins continued to improve in Q1-18, as rate rises flowed through to the loan book and deposit costs remained stable due to healthy liquidity conditions. There was a positive contribution from loan yields, both quarterly and year on year as recent increases in EIBOR and LIBOR rates flowed through to the loan book. Approximately three quarters of the loan book reprices within 3 months.

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Deposit costs were stable despite the increasing rate environment helped by strong liquidity and our ability to keep growing CASA. Wholesale Funding costs improved as the Bank successfully replaced maturing debt at more favourable pricing and efficiently deployed excess liquidity. Despite the first quarter margin being above our 2018 guidance range, we are maintaining our NIM guidance in the 2.55-2.65% range and will review this in the second quarter in light of rising rate expectations.

On slide six, which reflects loan and deposit trends, we see that gross loans grew 5% y-o-y and 2% during the quarter. The Corporate loan book increased by 2% due to growth in the services and trade sectors. Consumer lending advanced by 3% from growth in mortgages and term loans. The Islamic book grew 3% during the quarter from growth in manufacturing, FI, trade and services. Deposits grew 2% during the quarter. CASA advanced 6% helped by another successful marketing campaign. This allowed the Bank to retire some expensive time deposits that were booked in the run-up to year end. CASA is now 57% of total deposits.

Funding and liquidity, on slide seven, we see that the Liquidity Coverage Ratio is healthy at 152.9% whilst the Advances to Deposits ratio at 93.8% remains comfortably within the 90-100% target range. Liquid assets are 68.6 billion dirhams or 16.4% of total liabilities. These metrics demonstrate the Bank's strong liquidity and underline the value of a well-diversified stable funding base. Emirates NBD remains well placed to meet relevant prudential liquidity requirements.

In Q1-18 we raised a total of 5.2 billion dirhams of term funding in 3 different currencies with maturities out to 30 years. This included the Bank's first Formosa issue in the Taiwanese market, our first public issue in the Swiss market since 2007 and another successful 10-year Aussie Dollar issue. We see a peak in 2019 in the debt maturity profile. However, AED 6.2 billion of this 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 we have adjusted the size depending upon appetite. In the coming quarters we will again assess availability, pricing and the Bank's funding needs.

For the remainder of 2018 we have 1.6 billion dirhams of term debt maturing. This, and the maturing debt in subsequent years, is comfortably within the Bank's natural ability to raise term funding and affords Emirates NBD the ability to consider public and private debt issues on a basis, and at a time, that makes sense both for investors and ourselves.

Slide eight, on capital adequacy, shows that during Q1-18, both Emirates NBD's Common Equity Tier 1 and Tier 1 ratios remained stable as the increase in retained earnings offset the transition to IFRS 9 which amounted to 2.2 billion dirhams, less than the net profit for the quarter.

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The Capital Adequacy Ratio decreased by 0.9% to 20.3% as, with Central Bank approval, we called 2.9 billion dirhams of expensive Tier 2 debt in the first quarter.

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 are required to maintain an additional D-SIB buffer of 1.125% for 2018. This buffer will increase to 1.5% of the capital base by 2019. At the Bank's General Meeting last month, the shareholders approved the proposal to raise additional Common Equity Tier 1 capital of up to AED 7.35 billion. This gives the Bank the flexibility to pursue strategic initiatives and still maintain sufficient buffers, help maintain ratings and meet any unforeseen circumstances.

With that, I'll hand you over to Paddy to take us through the next few slides.

Patrick Clerkin

Thanks very much, Surya. Slide 9 shows that core gross fee income was flat over the quarter and improved 4% year on year due to higher fee income. Non-interest income declined 10% q-o-q and 1% y-o-y due to lower investment income from the sale of securities. Property losses in recent quarters are due to downward revaluations of illiquid inventory. Total inventory is now under 1.2 billion dirhams, compared to a peak of over 3 billion dirhams back in 2013. The focus remains on growing core fee income and it is pleasing to see an improving trend in the mix of non-interest income in recent quarters, with the bulk now coming from core fee income.

On slide 10 we see that costs improved 3% q-o-q as lower marketing, IT and professional fees more than offset a modest increase in staff costs. Costs increased 14% y-o-y but are expected to be within 2018 guidance of 33% as we continue with our digital transformation and technology refresh.

Moving on to credit quality on slide 11. As mentioned earlier, the NPL ratio finished the quarter at 6.0%, an improvement of 0.2%. Impaired loans was unchanged at 20.3 billion dirhams during Q1. During the quarter we had 655 million dirhams of write-backs and recoveries. This, along with routine provisioning, helped increase the coverage ratio to 127.9% from 124.5% at the end of last year.

We do not give formal guidance on a target for NPLs. We still expect some further modest improvement in credit quality during 2018. Our recovery unit continues to work on the existing stock of NPLs and are hopeful that they can still extract value from the remaining NPLs.

Provisions for Q1-18 are 440 million dirhams. This is 31% lower than the previous year and represents a 52 bps annualised cost of risk, which is lower than the 68 bps observed in 2017. Stage 1 and 2 ECL allowances now stand at 7.3 billion dirhams or 3.12% of credit risk weighted assets. This comfortably exceeds the 1.5% Central Bank requirement.

On slide 12, we see that Retail Banking and Wealth Management revenues improved 7% year on year. Net interest income grew 10% led by liabilities whilst fee income grew 3% supported by foreign exchange and cards and now represents 36% of total RBWM revenue. Loans grew 1% from growth in mortgages and term loans. Deposits increased 3% during the quarter led by growth in CASA supported by effective marketing campaigns.

The Retail Bank continued to lead the market in digital and innovation with the introduction of self service banking for people with disabilities. Paperless sourcing has now been extended to more products and 80% of personal loans are now via paperless sourcing. Approvals for loan applications are also now fully automated. The Bank's flagship DirectRemit had a strong quarter, with transactions up 45% year-on-year.

Total income for Emirates Islamic declined 2% year on year as strong growth in core fee income was offset by a decline in funded income and non-core fee income. Financing receivables were flat due to a slowdown in new business as Emirates Islamic tightened underwriting standards. Customer accounts grew 4% during the quarter as EI focused on improving its liabilities mix and cost of funding. As at end Q1-18, CASA represented 67% of EI's customer deposits.

On slide 13 we see that Wholesale Banking revenue improved 20% y-o-y with net interest income up 27% on the back of asset growth and improved margins, whilst fee income improved 2% due to continued focus on growing income from Treasury and Trade products. Loans grew 3% during the quarter due to growth in services and trade sectors. Deposits declined 4% as expensive time deposits sourced over year end rolled off in Q1-18. The strong performance in Q1-18 reflects the on-going progress that Wholesale Banking is making towards its goal of becoming the leading Wholesale Bank in the Middle East and North Africa.

Global Markets &Treasury revenues increased 44% y-o-y. The ALM Desk delivered excellent results as they positioned the Balance Sheet to take advantage of rate rises. Treasury sales grew on the back of higher volumes in foreign exchange due to enhanced product capability and a closer working relationship with Corporate & Institutional clients.

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The trading desk delivered a strong performance despite volatility in markets and global trade war fears, helped by a broader product offering and enhanced distribution network. The Structured Rates business has also been launched to support flow business. The Global Funding Desk raised AED 5.2 billion of term funding through a mix of public issues and private placements with maturities out to thirty years.

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

Shayne Nelson

Thanks Paddy. In summary, we delivered a strong set of results for the first quarter of 2018 with a record quarterly net profit of 2.4 billion dirhams. The strong operating performance was underpinned by 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, deposits costs were stable and wholesale funding costs improved.

The Bank's balance sheet remains strong and we comfortably absorbed the transition to IFRS 9. We do not expect any material impact from the new Capital Standards issued in March and the cost of risk improved on the back of stronger asset quality metrics. Emirates NBD continues to be recognised as a leader in digital and innovation. Our one billion dirham investment to accelerate our digital transformation is well underway and Emirates NBD is now the first truly agile organization in the GCC.

Dubai and the UAE's non-oil economy continues to perform well. Increased investment in infrastructure is expected to underpin non-oil GDP growth in the UAE through to 2020. We also expect a pick-up in economic growth throughout the GCC in 2018.

With that, I'd like to open the line for questions. Operator, please go ahead and give the instructions.

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QUESTIONS AND ANSWERS

Operator

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

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Deniz Gasimli - Goldman Sachs

Hi, good afternoon and thank you for the call and the presentation. I had a question on provisioning during the quarter, obviously this quarter we switched to expect credit loss model under IFRS 9, and there's some changes in methodology because of that, but I just want to understand it and if you can provide some kind of comment on provision movement, because looking at the movements in provisions for loans in the statement, I see 1.5 billion of write-offs, which is higher than what was the last year and also recoveries have also increased, they're more than doubled year-on-year as well. Just trying to understand, is this because of the transitioning, or is that because of different methodology or is there an underlying increase in write-offs as well as in recoveries, and what's the driver for that?

And in general, looking at your provision trends continue to improve, asset quality needs to improve, but looking at gross NPL formation as an ex-write-offs or recoveries, what is the picture there? Do you see an uptick in provisioning without the recoveries or is it stable to improving? Thank you very much.

Surya Subramanian

Thank you for that question. This is Surya, I'll take that. A similar question has also been asked by Elena from Al Ramz on provisioning, and I think, it's fair to say that that is a general expectation that IFARS 9 would lead to some increased provisioning because it is more forward looking whereas the old standard was on incurred loss basis, which some consider backward-looking. However, there are two things you need to be aware of. One, we in Emirates NBD have been cleaning up our book for the last few years. So, to that extent, we've taken the pain, you will recall in 2010, 11, 12 and so on, and as we cleaned the book, there's not much that you can stress on a forward-looking basis when the book is clean.

The second thing is that we, all banks, not just us, took the opening adjustments to retained equity on January 1. In our case it was approximately 2.2 billion, which is about 3.6% of total equity. So to that extent, the near quarter expectation of a rise in ECL is kind of muted by the opening adjustment. The theory that you mention would probably hit us and all banks in the future. Specifically in quarter one we also had recoveries as Paddy said. We continue to have recoveries of legacy problem debt portfolio, and to a point where our net cost of risk now at about 52 basis points is probably much lower than a very sustainable average is, but we have also indicated in the past that given our mix of business

between corporate and retail, we expect our normalized cost of risk to be in the 75 bps, 80 basis points type of range. Some quarters, it could be higher than that, and some quarters like this quarter, we're lower than that. We do have some stock of legacy debt that could still give us some potential upside, but it's difficult to predict when it would happen, and it need not happen every quarter, it would be discrete.

Shayne Nelson

I think the other thing to comment on is our new problem loan formation in the corporate book has been very muted, very muted.

Surya Subramanian

There's a related question that Naresh Bilandani from JP Morgan asked about, is it safe to assume that given the forward looking nature of IFRS 9 there is no depreciation between the specific and general provisions as required by the regulator, and are banks still subject to the limits of 1.5% of credit risk-rated assets as general provisions?

So the answer to that narrative, there is a distinction between specific and general provisions. Effectively page one and page two provisions would be the equivalent of what you would term general provisions or portfolio payment impairment provisions under the old standards, and specific provisions would be stage three under the IFRS 9. At least in the UAE, the regulator has not changed the minimum requirements of 1.5% of RWA as general provisions.

Paddy mentioned as you recall in his text, our general provisions are stage 1, stage 2, more specifically total to above 7.3 billion dirhams and that is about 3.2% of the RWNA in our books. So we are comfortably above that limit. We'll take another question operator from those present in the call.

Operator

We will now take our next question from Hootan Yazhari of Bank of America. Please go ahead

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Hootan Yazhari - Bank of America

Hi, there, gentlemen. I wanted to focus on costs. We saw very good cost performance in the first quarter, certainly the cost-to-income ratio coming in well below your guidance. How should we look at this, is this to say that the investments that you're making are likely to come through towards the end of the year? We didn't see having investments in Q1, or was there a base performance in your costs which was better than expected and hence even with your investments you're able to achieve a better cost-to-income ratio?

The other question I had was heading back towards asset quality side. We saw quite an escalated impairment coming through from the Islamic business. Can you give any more clarity on this? Thank you.

Shayne Nelson

Okay, I'll take on costs and Surya you take on the asset quality. On costs, we are ramping up quite considerably our cost base with the transformation project, and you're starting to see that, the majority of the increase in staff costs. A lot of that comes from IT transformation. About 50% of managers in IT now are the brand new or have been replaced. And skill sets for the transformation are quite different from how we operated historically. You know for example chief digital officer, chief data officer, quants, etc. So we have quite a different mix of people. So we're seeing a ramp-up in costs there. It's probably a little bit slower than we had anticipated because just hiring the quality of people like data scientists, etc., is not easy and it's taking us a lot longer than we would have liked. But you know, the competition for that quality of people is quite intense out there

Having said that, I suppose we also got quite a big surprise on the upside in the earnings, more so than we had budgeted, which is a nice problem to have. So I think to be fair, I think the 33% is going to be a stretch, I think in the next quarter, if we maintain the same sort of revenue momentum as to where we are. But we are continuing to invest in that IT space in particular. Also in our digital marketing we're also spending quite a lot more money in marketing, but also if you look at how we work historically, the last quarter of each year is when you really ramp up a lot of our marketing to make sure that we have a good launch pad for the first quarter. So if you look at, I'm sure living in the market you would have seen a lot of the car giveaways we've had, and that's one of the drivers to get our CASA up. So we have a lot of programs that we have come through in that last quarter, I mean, in the Gulf is when we paid for, for example in that last quarter, starting in the early on year.
So I think to be fair, I know you're trying to get what is the cost-to-income ratio going to be, it's quite a difficult one, but I think, you know, one thing for sure, absolute costs will increase on the back of the increased spend in the transformation, and some of our expansion, remember we've got VAT, we've got the Saudi branches, the next two should be opened after Ramadan, and we've got the full impact effect India for the year.

So there will be an increase in absolute costs. I think the challenge for us on the percentages the revenue growth which have been very successful in achieving in the first quarter. I know that doesn't answer the question what you really want, but that's as good as you're going to get.

Surya Subramanian

I'll take the question on the split of provisions between the conventional and Islamic, and it was a very similar question that Elena from Al Ramz Capital had. This was more an effect of IFRS9, if you look at the way we approach provisioning in IFRS 9, it is model-based. Although the model is expected to be

forward looking, it also takes input from recent history, and if you look at the recent history, if you look at 2016 and '17 or even '15, it's a fact that our Islamic bank and the Islamic portfolio suffered greater losses in the SME and micro-SME sector. So some of that then impacts the variables that go into the model, hence when the expected credit losses for stage 1 and stage 2 come up in the first quarter of this year, it shows that the natural book within the Islamic portfolio would carry a higher expected loss under IFRS 9 than it would record on an incurred loss basis in under IAS 39.

You'd also note that the opening adjustment for IFRS 9, which is also disclosed, was higher for the Islamic book compared to the conventional book. We have been managing this portfolio much better, with tighter underwriting standards. So hopefully over time these should normalize.

Shayne Nelson

I'll take some more questions now from the web, there are some very obvious questions on the acquisition strategy. Ahmed Hassan from CI Capital asks for updates on the Deniz deal, similarly Naresh Bilandani from JP Morgan Chase has a question on when can we expect the implementation of the foreign ownership limit, and Elena from Al RAmz also asks whether apart from KSA and Turkey there are other areas we are keen on, and more specifically she asks should the DenizBank acquisition not happen, will you still proceed with the rights issue?

Let me start with the foreign ownership limit and move on to the acquisitions. There's no doubt as change of the foreign ownership limit and that subject of regulatory approval, and there's quite a number of processes that have to actually run through, such as seeking the central bank's approval for the changes to the Articles of Association. The recent incidence that we're seeing with other organizations DIB, DIC, taking three to four months. So I've got no further update on that, except that it stays in the process.

On DenizBank, I really can't give you any updates than the transaction is still in progress and when we get something meaningful to inform the market, we will inform the market. With that, the question on if, should Deniz not happen will you proceed with the rights issue, I'm sure if you look at our capital you'll see that we certainly don't need a rights issue unless we're doing a significant acquisition. We're strongly capitalized and there would be no point in that at this point in time.

We can still use the flexibility because we've had it approved by the AGM, should something else come along that does interest us. And on the question "Are you looking at outside of Turkey?" the answer to that is we're always looking within our region. The region that we are interested is in the MENA region, Middle East and North Africa, Turkey, we do also look on the East Coast of Africa, and we continue to search at all times. But we also have walked away from many transactions due to price. An example of that is, there's no secret, we walked away from the Barclay's transaction because we didn't believe it was an attractive price. So given that we've got quite a lot of capital, we get a lot of investment banks knocking on our doors with lots of ideas.

A couple more?

Patrick Clerkin

Yes excellent, absolutely. Another question from Naresh on the NSFR and is there any impact in the medium term on margins. If you look at our funding strategy, we've had 1A on the NSFR really for some time now. And we've been positioning our funding model really in sympathy to the NSFR, and actually would have seen as well, you know, we have been issuing quite a lot of term funding and weighted average life of that continues to lengthen. We, of the transactions we've done in the first quarter we've issued a ten-year deal at 30-year non-call five-year, and private placements between two years and ten years, and this is very deliberate in terms of looking to lengthen the maturity profile, really with one eye on the NSFR.

Operator

We will now take our next question from Harsh Oza from Shuaa Capital, please go ahead.

Harsh Oza - Shuaa Capital

Hello, everyone, thanks for taking my question. I have two questions. First of all, on IFRS 9 ECL, now if you can just give some understanding about how you are doing it, you know every quarter it'll be for what time period as you believe for 12 months or slightly longer we are than that. And also if you can provide some break-up of that 2.3 billion which you have booked this quarter.

The second question is related to value-added tax. How you are dealing with the VAT regime and is it given the good performance on the cost side, I mean, are you passing all the cost to the clients? Or is there any strategy to do so if you are not doing it?

Surya Subramanian

Okay, on IFRS 9, we have to assess the book for every reporting period. Since we report on a quarterly basis, we will assess the book every quarter. As risks emerge, this could be changes in economic factors, it could be future expected changes in economic factors, it could be changes in industry dynamics, future changes in industry dynamics, it could be employment rate, price of oil, these are all some of the variables that go into the various models.

So it's something that'll happen every quarter, and that will be reflected in your stage 1, stage 2 and stage 3 expected credit losses. The 2 billion that we took to adjusting the opening equity under the IFRS 9 transition provision, if you'll remember in our annual results when we announced the 2017 results, we had also given an indication of that number. There is a small delta as we revised and fine-tuned the data and the expectations, but it's broadly I would say if you look at data both around the

region and globally, we are broadly in line with where most banks are in terms of the opening adjustment.

There were certain balances in IAS 39, like cash and deposits of central banks, due to banks, which would never get a credit loss, but under the IFRS 9 model you do need to reflect something for an expected credit loss on that. Similarly, a lot of lending that we do with banks under IAS 39 you would never record anything because we rarely lost any money on banks. But under IFRS 9, you model it and there is an expectation.

Apart from that, there is the methodology difference on the normal corporate book between IAS 39 and IFRS 9 which leads to that number. That is a one-time adjustment to equity, everything else will flow through the P&L going forward. Our expectation is there shouldn't be any fundamental difference between the recent charges we have had in IAS 39 and the recent expected charges we've had under IFRS 9 because as I mentioned earlier to the question before, we have cleaned up our book.

Moving on to VAT, as a bank we cannot recover the entirety of the expense that we have. As you know, net interest income, funded income for Islamic banks, net interest income for conventional banks is exempt from VAT. Hence there is a portion of our VAT that would always remain irrecoverable, this is normal and standard for banks all over the world. We have estimated this last year to cost us about 120 million dirhams at the maximum. That is already in our first quarter run rate and has been absorbed in the results that you see.

This is a cost that we observe, we do not pass this on to our customers. We haven't really changed our tariff of charges or anything. However, on the existing tariff of charges, our customers are obliged under the VAT laws to pay 5% more for eligible services.

Operator

We currently have one more question, it comes from Ryan Ayache of Deutsche Bank. Please go ahead.

Ryan Ayache - Deutsche Bank

Thank you. Good afternoon. The fees and commission income appears to be slightly more volatile, or perhaps the trends are less firm. If you can comment on what's driving that, and I'm also interested in the change in income. Just generally, the whole NIR. While the numbers are really good across the board,

NIR was a little bit weaker than expected, so you know does that reflect market conditions, what's the outlook and what's the guidance? Thank you.

Patrick Clerkin

Yeah, Ryan, thanks for the question. If you look at the build-up in core fee income, we've been able to grow that by 4% year-on-year, and we do see some seasonal effect from that. I think that the pleasing thing from the bank's perspective is that you know, the contribution from more volatile aspects such as property income and investment security income is less of a proportion of the total aspect. If you look at Q1 for example, the investment security income was lower both quarter-on-quarter and year-on-year. That's because we, in Q4 for example, there was an exceptional number in there as we disposed of an equity stake in a financial institution in the region. And so you know the previous number has been flattered by exceptionals. Overall for us the trend is one, we've invested to grow the non-interest income component and that's reflected in the trend that we are seeing for quarterly income.

Operator

We will now take our next question from Sahil Kumar of Moody's Analytics. Please go ahead.

Sahil Kumar - Moody's

Hi good afternoon, thank you for the call and the presentation. I have one question on your cost of funding. So how you see your cost of funding going forward for this year considering the current interest rate environment? And just one clarification, what percentage of your loan book will reprice in the next three months?

Patrick Clerkin

Yes, just in terms of the loan book, about three-quarters of the loan book reprices in the next three months, and in terms of the cost of funding, Surya walked through the interest margins. What you do see there is the loan book benefited from the rise in rates. We've been successful in holding steady the cost of funding and that's really a function of a number of features. One is the ability to continue to grow the CASA element, and we've also been able to retire more expensive term funding that we could own two, three, five years ago as the credit quality or the credit perception of Emirates NBD has continued to improve. And so we benefited from that. So probably the biggest factor is really the fact that 57% of the deposits are CASA, and those are not really sensitive to any increase in rates. So we've been, you know the cost of funding has held steady over the last quarter.

Operator

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

Naresh Belandani - JP Morgan

Hi, thank you, it's Naresh again from JP Morgan. I'm sorry for asking one too many questions. Shayne, you kindly clarified on the call that should the Deniz deal not happen, you probably don't foresee a need for the rights issue at this stage. But could you please also clarify if this is also someway linked to the foreign ownership limit? Say, for example, if the acquisition does not proceed as planned, the FOL increased process shall not stop at this stage and you will apply for increasing the FOL in line with what is, in what is happening currently?

Shayne Nelson

Good question and I think I'll pop up that one off and say it's got to be a board decision over time.

Naresh Belandani - JP Morgan

So you mean to say you will sort of like go back to the board and check with them whether they are keen to see the FOL increase?

Shayne Nelson

I answered the question.

Operator

Our next question comes from Vikram Visnawatham of NBK Capital, please go ahead.

Vikram Visnawatham of NBK Capital

Many thanks for the call. I have a question on the VAT. Some of the fees which are related to the consumer banking are actually capped by the Central Bank, right? So was there a decision taken on the, on how to deal with the VAT on the fees which has capped?

Surya Subramanian

There have been a lot of industry discussion with the Central Bank. You'll be aware that in Saudi Arabia, SAMA has indicated that for those capped fees, VAT will be applicable over and above the capped fees, and in UAE also we have eventually come to the same conclusion.

Operator

At this time we have no further telephone questions.

Shayne Nelson

If there are no further questions, I'd like to thank you all for your participation today. I'll hand you back to the operator, who will provide details for any follow-up questions with the call, and given our excellent results I hope you will all write up nice things about us. Thank you very much, cheers.

Operator

Thank you. This does conclude the Emirates NBD Q1 2018 results presentation. We thank you for your participation today, you may now disconnect your line.

END