EMIRATES NBD Q3 2023 RESULTS ANALYSTS & INVESTOR CONFERENCE CALL & WEBCAST
26 October 2023

CORPORATE PARTICIPANTS

Shayne Nelson – Emirates NBD – Group CEO

Patrick Sullivan – Emirates NBD – Group CFO

Patrick Clerkin – Emirates NBD – Head of Investor Relations

Operator

Ladies and Gentlemen, welcome to the Emirates NBD results call and webcast for the third quarter of 2023 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 will now pass the call over to our host Mr. Shayne Nelson, Group CEO of Emirates NBD.

Shayne Nelson

Thank you, Alex, and welcome to our Third Quarter Results. I think it's the first quarter results I've ever done in the rain, so very unusual. The GCC economies have been resilient against a weaker global backdrop and higher interest rates. PMI surveys indicate robust activity across the region. Our Research team revised up their forecast for non-oil growth in the UAE to 5%.

The UAE's national energy strategy expects up to AED 200 billion of investment as it triples the contribution of renewable energy by 2030. Other economic sectors such as tourism are flourishing, with Dubai tourist numbers recovering to pre-pandemic levels. In the wider MENAT region, Egypt continues to explore asset sales reflecting their commitment to revamp the economy and Türkiye increased interest rates to help address inflation, which is a significant and positive change in policy.

The strong regional economy helped us deliver another excellent set of results. This is the third consecutive quarter that the group has delivered over AED 5 billion in profit. There are many highlights which underline our key strengths. All business units delivered higher income.

Retail lending grew 16% this year, with strong momentum across all products, including a one-third market share of all credit card spend in the UAE. Corporate lending climbed 15% as they closed landmark deals for large multinational customers. SME lending increased 34% in the UAE as we continue to support this bedrock sector of the economy.

We grew deposits by AED 67 billion, including AED 33 billion of low-cost CASA. CASA was stable in the third quarter, reflecting the high quality of our deposit base. Even when we see an outflow of deposits, it is often into our wealth management platform, which has grown assets under management by 28% this year.

We successfully rolled out the ENBD X app, which uses the latest technology, security, and user experience trends. We expanded the Digital wealth platform onto ENBD X, giving customers access to over 11,000 global equities. This propelled ENBD X to be the number one banking app in the region.

We introduced Signature by Priority Banking, offering ultra-high net worth customers unrivalled benefits, services, and privileges. We opened four more branches in Saudi, widening the branch network to 13. This has helped loan growth in the Kingdom 26% higher year on year. Fitch upgraded our unsupported rating, and we are now one of only three UAE banks to have investment grade Viability Rating.

COP28 will convene in the UAE next month, bringing the world together at a critical moment for transformative climate action. Emirates NBD is proud to be the principal banking partner of COP28. Our sustainability strategy is aligned with prominent global and national frameworks, including the United Nations Sustainable Development Goals and the UAE's Vision 2030. We are signatories to the UAE Climate-Responsible Companies Pledge and the UAE Gender Balance Pledge.

For our customers and clients, we are focused on delivering innovative financing and transition solutions, becoming the first UAE bank to offer a carbon emission offsetting solution to customers with the introduction of carbon trading. We helped customers access $11 billion of green bond financing in 2023. We collaborated with Emirates Global Aluminium to pioneer an innovative ESG-linked supply chain financing programme.

We are leading by example, reducing Scope Two emissions by 5% between 22 and 23. Our digital drive helped reduce paper usage by 84% between 2020 and 2022. We published our Sustainable Finance Framework and issued our largest ever green bond from a regional bank. Women now hold 18% of leadership roles, up significantly from 15% last year. COP28 is a big opportunity for ENBD to showcase our ESG credentials, engage with our customers and play a lead role as the national energy strategy pivots to renewable energy.

To sum up, ENBD delivered profits in excess of AED 5 billion for the third consecutive quarter as our transformational platform is successfully meeting the changing needs of our customers. The UAE's ambitious ESG national goals provide exciting future growth opportunities, and ENBD is well placed to support customers and innovative solutions.

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

Patrick Sullivan

Thank you, Shayne, and a very good afternoon to all of you. Let's go straight to the numbers on page 3. The overall headline is that we've another incredibly strong quarter, building on the first half, with almost all metrics better than Q2 and last year.

Total income of AED 32.7 billion for the first nine months is up 44% year on year. Continuing the trend this year, both NII and NFI are up substantially. Net interest income increased as our stable funding base continues to benefit from higher interest rates.

All business segments are performing well, with 8% loan growth contributing positively to interest income. Retail lending had a record performance in the first nine months, and corporate interest income is substantially higher as it closed several landmark transactions for large multinational customers.

Non-funded income grew by AED 3.3 billion year on year to AED 10.5 billion. We see a strong growth trend in client business flows such as customer remittance, FX and interest rate hedging, debit and credit card business and increased trade finance. DenizBank's non-funded income was substantially higher on increased customer transaction volumes and margin and increased income from hedges and swaps.

Costs have increased 31% year on year, supporting strong business volume growth, particularly in retail, and the accelerated investment in digital and our international network. We opened a further four branches in KSA, bringing the total to 13, and we're on target to add a further five or so in the coming months. Even with our investment for current and future growth, the cost-income ratio, at 25.5% for nine months, is comfortably within long-term guidance.

Impairment allowances are half of what they were this time last year as strong recoveries in both UAE and Turkey have come through and a low cost-of-risk trend continued into Q3. This gives us a very strong profit before tax and hyperinflation of AED 22.9 billion, nearly AED 10 billion higher than this time last year and an AED 17.5 billion profit after hyperinflation and tax, which is up 92%.

Looking briefly at the quarter-on-quarter numbers on the same page, net interest income is up by 8%, reflecting strong loan growth, wider margins at DenizBank and higher CPI linkers income as inflation picked up in Q3. NFI is stable against the very strong Q2. We delivered higher fee-related transaction volumes at DenizBank, offset by lower FX and derivative income as FX spreads tightened post-election in Turkey. Expenses are 3% higher due to business-driven staff costs and Turkey inflation.

Q3 profit before tax and inflation was up 6%. We did, however, see a step-up in the equity-neutral inflation adjustment in Q3. It was AED 1.8 billion for that quarter against AED 0.5 billion in Q2, which is entirely the factor reducing the group's profit from AED 6.2 billion in Q2 to AED 5.2 billion in Q3. In the bottom summary table, you can see the balance sheet metrics are in good shape, with assets, loans and deposits all growing substantially. Capital liquidity and credit quality metrics are all considerably stronger than 12 months ago.

Now turning to the net interest margin, slide 4, the bottom chart shows that margins widened by 90 basis points year on year, helped by improving loan and deposit mix and higher interest rates. NIMs are up 21 basis points in the third quarter as DenizBank's NIM widened due to improved loan pricing, following regulatory changes, higher CPI linked and indexation income, and more than offset higher funding costs and competitive loan pricing at ENBD.

The year-to-date margin of 4.0% is at the top end of our guidance range, given the higher-than-anticipated contribution from DenizBank. For the full year, we expect DenizBank margins to be the main variable as to whether we remain at this level. The repricing is positive so far, but this depends on how the monetary policy transition progresses. Another variable is the migration of CASA to term deposits in ENBD. There has been some migration, and with rates where they are, we expect more to occur going forward.

Slide 5 shows that fee and commission income is up by 33% year-on-year, with a solid trend of quarterly growth across almost all of the group's customer-driven businesses. You'll notice a step-up in Q3 per the bottom left chart, driven mainly by increased card spend volumes, particularly in DenizBank, coupled with an increase in the interchange fee rates in Turkey.

Other operating income in the third quarter is lower due to a smaller contribution from FX income. In line with expectations post-election that I indicated at Q2, we are seeing tighter FX transaction spreads in Turkey and lower gains from mark-to-market adjustments.

On slide 6, we see that gross lending increased by 8% during the first nine months, with both retail and corporate lending having seen strong growth in Q3 and year to date. DenizBank also had strong loan growth on local currency terms amidst the partial unwind regulations. It's up 33% this year in local currency, down slightly year to date in AED terms due to FX depreciation.

Total deposits increased AED 67 billion, up 13% so far this year. Within that, CASA is up AED 33 billion. We saw a modest AED 4 billion drop in CASA in the third quarter, but total deposits were up 3% in Q3 alone. We have been signaling for some time this migration may start to happen, so no surprises there. CASA, at 59% of total group deposits, is still a key component of our relatively low cost of funding. We continue to grow time deposits as we're able to deploy these profitably in liquid assets.

On slide 7, we see that the NPL ratio improved by 0.5% to 5.5% during the first nine months, helped by strong recoveries in both UAE and Turkey. These recoveries also meant the annualized cost of risk for the first nine months was 42 basis points, substantially lower than the 108 basis points for the whole of 2022. The gross cost of risk, excluding recoveries, was slightly lower than last year.

Our full year cost-of-risk guidance remains unchanged at 50 to 70 basis points. We noted at H1 that recoveries can be somewhat lumpy and exact timing harder to predict. But of course, if we see the current trend continue, then we would be at the lower end or better than this range.

We have, however, refined the NPL guidance from around 6% to less than 6%, given where we are at Q3 and from what we can see of NPL flows at this point. Coverage remains healthy, 145% during the first nine months, similar to the level at the beginning of the year.

Paddy will now take us through the remaining slides. Over to you Paddy.

Patrick Clerkin

Thanks, Patrick. On slide 8, we see the cost-to-income ratio at 25.5%. It's comfortably within guidance as continued acceleration of investment for growth is supported by higher income. Staff costs increased year on year to deliver strong business growth and drive underlying earnings, coupled with human capital investment in digital and international to deliver future growth.

IT and communication costs as well as depreciation are up slightly on the investment in technology, and this is more than offset by a quarterly reduction in other costs, on lower marketing, service, legal and professional fees, due to seasonality. We expect this year's cost-to-income ratio to be comfortably under the 30% area.

Slide 9 shows that the group operates with very strong liquidity, with an AD Ratio of 80% and an LCR of 190%. Given the higher rate environment, we are able to deploy excess liquidity in attractiveyielding, high-quality liquid assets. In the first nine months of 2023, the group issued AED 14 billion of term debt that fully covers 2023 maturities. ENBD issued the largest ever green bond by a regional bank, reinforcing our ESG commitment. DenizBank further diversified funding through the issue of a US $230 million and €50 million Murabaha term financing agreement.

Slide 10 shows the Common Equity Tier 1 ratio was strengthened to 16.9% as AED 14.6 billion of net earnings more than offset a 7% increase in RWAs. The CET-1 ratio, excluding the ECL regulatory add-back, was 16.4%. RWAs grew by 5% in Q3, reflecting 3% lending growth and higher investment security holdings at DenizBank. As Shayne mentioned earlier, the strong balance sheet helped ENBD become one of only three UAE banks to have an unsupported investment grade rating from Fitch.

On slide 11, we see RBWM income improved 36% during the year. It was a record performance for retail lending, which grew by AED 15 billion in 2023. The retail deposit-gathering engine continued in the first nine months, adding a further AED 29 billion of deposits. ENBD group has a one-third market share of all credit card spend in the UAE. ENBD X, our enhanced mobile banking app, has been successfully rolled out and is now the number one banking app in the region. AUMs grew by an impressive 28% in 2023, reflecting ENBD's full-service platform on the back of our Digital wealth platform expansion.

CIB profitability jumped 104% due to significant growth in revenue, on increased lending activity, higher cross-sell and strong recoveries. Corporate lending closed a number of landmark lending facilities for large multinationals, reflecting our presence throughout the region. EI's profits are reported in the respective retail and corporate sectors. However, it's worth noting the 56% increase in EI's profits to over AED 1.6 billion. EI is a publicly listed company. The financial statements are available on our website.

Global markets and Treasury delivered an outstanding performance, with profit exceeding AED 2.75 billion for the first nine months. Net interest income jumped on higher income from balance sheet positioning and an increase in investment income. Non-funded income was higher on strong trading and sales performance.

DenizBank's profit is up 63% year on year to AED 1.9 billion. We have a couple of extra slides in the Appendix containing more granular detail and a Dollar convenience translation.

With that, we can open the call to questions. Alex, please go ahead.

QUESTIONS AND ANSWERS

Operator

Our first question for today comes from Nida Iqbal from Morgan Stanley.

Nida Iqbal – Morgan Stanley

Thank you very much for the call. Firstly, if you could comment on the margins. We saw about a 20 BPS sequential increase in 3Q margins, which was very impressive. But UAE margins were down 24 BPS quarter-on-quarter. So just want to understand that a little bit better. Is this decline being driven by an increase in funding cost, or is there any pressure on loan spreads, given competition?

Secondly, linked to that, the repricing linked to rate hikes so far, is that all reflected into asset yields already, or is there more to go? Just trying to understand better how to think about the UAE margin trajectory from here. And then, secondly, Turkey margins this quarter are clearly very impressive. Is this sustainable? What do you see as the normalized margins for Turkey, looking forward?

My final question is on capital. So CE-1 as of nine months is 16.9%, well above minimum regulatory requirements. Yet ENBD's dividend pay-out is around 30% typically. So how is management thinking about deployment of excess capital? Are you open to M&A? And if so, what regions are of interest? Thank you.

Patrick Sullivan

Maybe I can have a go at the first couple, and maybe Shayne will add something as well. Just on your NIMs in the UAE coming down 24 basis points, that was set out there on page 4 in the walk, it's a combination of factors.

At Q4 last year, ENBD excluding DenizBank had been at about 3.48%, then for Q1/Q2 this year, around the 3.94%, and then, yes, it has come down 24 basis points. So, we were benefiting from the rate flows coming through from the rate rises through last year and into the early part of this year.

And then a couple of things that we had seen in the dynamic. On one hand, there has been some competition on loan pricing, and I think for probably more than a year now, I've been indicating that we are starting to see that there's a lot of liquidity in the market. It's obviously better to deploy that in loans and advances, helping the real economy. There is competition for that, and there has been some tightening of pricing on that as well. Nonetheless, the overall yields and returns are far superior if you have proper loans and advances versus liquid assets on the bond book.

And then the second component really is the dynamics and the mix of the funding. There's been only a very small reduction in our overall CASA. We were at 60% in Q2, 59% now, so it's still very strong by any industry standard. We have overall, though, grown total deposits by 3%. Therefore, that means most of the growth is in term deposits. That costs more, and that's really changing the cost of funding in the overall mix as well.

Having said that, there has been some offset from the investment book. It's known that yields on bonds are reaching all-time highs now, so we have benefited from that. And that's what we mean about being able to continue to raise deposits and still profitably be able to deploy those, even if it's not all going into loans and advances. So given loans and advances demand has been strong in the third quarter, we're definitely finding a good home for that funding as well.

There was the part on Turkey, what's the normalised rate. Yes, there, you have benefited from an increase in yield on the CPI linker bonds that they have. Inflation did step up in Q3 significantly. It was somewhere between 25-30% just for the quarter alone compared with Q2. Had been around the 5-6% in Q2. With that delta, you do get a more significant add-on to the margin. So, we had been down at, what, 3.5-4% at Q2, and with the add-on, with the CPI linkers, some indexing, and combined with some positive repricing, that means we had seen that big tick-up.

I think the important thing with the margins in Turkey though is the change in the regulation and the ability now to price much higher. We've seen the base rates go from 8.5% to 30%, and therefore, we are able to price quite a number of categories of loans of up to 1.8 times a reference rate of something like 38%. So technically, you can reprice up to 70%. That will take time to come through in the margins.

When you ask about sustainability, I think that's exactly why we have a range in our overall margin guidance, because there may be some upside, but the cost of funding may also increase, and there may be some downside. If inflation is lower in the fourth quarter, then the yield on CPI linkers would be a bit lower as well. But I think if you step back and look at the overall guidance we continue to give, we are still confident in the 3.8% to 4% range.

On capital, yes, you're right. We're operating with a very strong capital base, and by the way, also delivering a strong return on the tangible equity of around 27% year to date. So even with that surplus capital, definitely a good return.

Now, I think it's a pretty recent phenomenon with the strong earnings that the capital base has built up so much. It might be a bit premature to say exactly what we are going to do with that today. There may be other growth opportunities that arise. And when it comes to dividends, that's a decision that is with the board, come the year end.

Shayne Nelson

I'll add on M&A side, Patrick. I'd say exactly what I said last time. We're still very interested in our core markets, Saudi, Turkey, Egypt, India, for acquisitions. But in 11 years, we've done two deals, and we've looked at many.

So, if we can get the right acquisition for the right price, and as I have said before, we will not do an acquisition unless we have control of the board, with at least 51% control and can consolidate. If we can get acquisitions going, that's great. But it's always a long-term process. I can assure you; we know every bank in every country back to front, upside down that is a potential target.

Operator

Our next question comes from Waleed Mohsin Goldman Sachs.

Waleed Mohsin - Goldman Sachs

Thank you for the presentation. Four questions from my side, please. First, if you could please provide an update on any changes, if any, in the large exposure regulation. I understand there have been some. And if you could also give us an update on how you're doing in terms of compliance.

Secondly, on corporate tax, as we head into corporate tax next year, I wanted to understand if the income earned or the capital gains from local bonds would also form part of taxable income.

Thirdly, on loan growth, you seem to be tracking better than guidance, with an 8% already versus high single-digit guidance. And this is despite public sector growth remaining muted. You had almost 4% domestic growth on a sequential basis. If you could please talk about the growth that you've seen on the private sector, which sectors are driving it. From our perspective, it seems there's upside risk to your full year guidance.

And my final question is on your cost-income ratio. I understand this 33% target was put as more a medium-term target, but you're clearly way, way below that 33% at this moment, at around 25.5%. Any commentary around that would be helpful. Does the 33% target still hold? And how should we think about the guidance that you have of 33%? Thank you.

Patrick Sullivan

Maybe I can just take those in reverse order. Just on the cost-to-income, just as Paddy had said, that we expect to be well under the 33% longer-term cost-to-income ratio. It's definitely a lot lower than many international banks and broadly aligned with the local market.

Shayne Nelson

Waleed, I think one of the things, when I look at cost-to-income ratio, the target of 33%, and I get your point that we're delivering massively below that at the moment, but for me, it's an important benchmark that as we look forward, when the rate cycle goes the other way, that we're making sure that we're delivering below that percentage.

For us, it's an important metric internally as well as to how we invest, going forward, and what effects, when rates start to fall, they have on that cost-to-income ratio. So, I appreciate your comment about where we are, but also, for us, it's an important yardstick as to where we're going to be when we get a situation where rates start to fall.

Patrick Sullivan

On your loan growth point, yes, 8% year to date, 3% in the quarter, we did update the guidance at the half year to high single-digit. We've kept it at that level. We're taking some caution on loan growth. In Q1 we saw on the corporate side, around AED 11 billion origination but we had AED 10 billion of repayments. So, we only saw a net AED 1 billion growth. There haven't been a lot of corporate or government repayments in Q2 and Q3, so that's another variable that we need to factor into the guidance for over the rest of the year. If it does go slightly above that, then I guess that's an upside risk to loan growth. But we remain pretty happy with maintaining current guidance rather than changing it every quarter through the year.

Shayne Nelson

Waleed the new large exposure regulation is 150% of Tier 1. And we're miles below that. So, we're very compliant within the new central bank guideline of 150% of Tier 1.

Patrick Sullivan

Just on tax, yes, the 9% will come into the next year, and then we're expecting 15% from 2025. I think you asked specifically about capital gains on bonds. Yes, they will be taxable, is the short answer for that.

Waleed Mohsin - Goldman Sachs

Also, the interest income on these bonds, right? Including the interest income on bonds. So capital gains, interest income, everything is taxable?

Patrick Sullivan

Yes. There are very few exclusions for income in the tax rules, if any.

Waleed Mohsin - Goldman Sachs

Thank you much. Very helpful, all the comments, especially on the compliance with the regulation, as well as the cost-to-income. Just one last follow-up was on the sectors, which I might have missed, you might have touched upon. But sectors in particular where you're most constructive in terms of loan growth from here on the private sector corporate side?

Patrick Sullivan

Actually, good point. Just within the AED 13 billion increase in the corporate side, we did see a noticeable step-up on the private sector origination. I think about three quarters of that growth was on the private sector when, in prior quarters, the growth had been more skewed towards GREs and commercial GREs. So that was good news. Whether that continues at that pace or mix is to be determined.

But just from a segments point of view, we do set out the details of the segments in Note six in the accounts that can tell you quarter-to-quarter and year-to-date, but I guess the transport and communications probably being the standout sector for a year-to-date point of view and for the quarter. So that's up over AED 12 billion this year already.

FIs has been strong, just under AED 5 billion, and management companies is just under AED 10 billion for the year and almost AED 7 billion in the quarter alone. Trade is also noticeable, but also, let's not forget on the retail side, just the personal lending is up just under AED 13 billion this year and AED 5.6 billion or so for the quarter as well. A pretty good mix in there.

Shayne Nelson

And I'd say, Waleed, you may think, living in Dubai, that there must be a lot of increase in property finance. But the reality is that there's not a huge demand in property finance at the moment. But most of the big developers are selling off plan. We end up giving an escrow guarantee on their financing through the cash that's sitting in the escrow account. Despite what you see with the supply pipeline with property, we're not seeing a lot of increase in real estate financing.

So, it's very good signs for the market at the moment, because we're just not seeing the developers, as we have historically, needing lots of funding to complete their projects. They're self-funding through the escrow accounts, with a guarantee from us. Having said that, we also have a big build-up of escrow balances. That's also very positive for us on the deposit side.

Operator

Our next question comes from Naresh Bilandani from J.P. Morgan.

Naresh Bilandi – J.P. Morgan

Just a few questions from my side. So, one is, can you please throw some light on what portfolios have led to an increase in the impairment charges in the UAE segment?

On asset quality, there seems to be some steady pick-up in the pace of write-offs year to date. Currently, they're at AED 1.95 billion versus AED 1.9 billion for the whole of 2022. Could you please share some composition on the sector and geography where these write-offs are coming from? That's the second question.

The third is, could you please, and kindly, repeat once again the drivers of trend in the fee income in the Turkish business? You mentioned some points. Apologies, those went quite fast. If you could please shed some light on that, that would be great.

And my fourth and final question is, within the economic segments of the loan book, there seems to be sizable growth coming from what is defined as management of companies and enterprises in the current quarter. Could you please throw some light on that, on what that composes of? Thank you.

Patrick Sullivan

Let me just see if I can work down through those. On impairment size and which portfolio if you look at the segmental analysis in the accounts and Note 23, that shows all the impairments and the movement between stages, I would say we're seeing very strong recoveries on the corporate side. With about AED 27 billion of non-performing loans and with the property market where it is, we've had a lot of recoveries coming through from property collateral.

We have also been building the provisions on the retail side. We are a leader in the market on retail and we've been growing very quickly. And also, with IFRS 9 and the ECL model, it means you have to build in forward-looking factors. Rising interest rates are a factor.

So that partly explains the build-up in the flow of provisions being made in Q3. That was a trend that we saw from Q1 through to Q2 as well. So, you know how we operate. We like to cover any potential risks like that as early as possible and then move on from that.

About Stage two, if it's in the retail book, if you go over 30 days, then you move into stage two. And then it will go to stage three after 150 days. But then, within 30 days, you have either got a recovery or a charge-off. So, it's a part of the natural sequence, going through the stages. And hopefully, you can then see that in the detailed notes to the accounts. Also, with retail, you get a much faster write-off as well.

And about the write-offs year-to-date, we also have very strong recoveries. And you can see that in the notes to the accounts. So that's what's reducing the non-performing loan balance, predominantly the recoveries. And then we have flows through into that stage three mostly offsetting those recoveries as well.

Shayne Nelson

I must add my normal comment Patrick, no gain without pain. When you've got stage three coverage in the high 90s, as we have, and we've built that up over many years, we're getting those recoveries because we took the pain upfront. So, they're flowing because we took our medicine early, and with the strength of the property market we've got now, now we're getting the gains back. So that's helping us quite a bit.

Patrick Sullivan

And on the geography part, Naresh, Turkey saw strong recoveries in Q1 and has been relatively neutral since then. A lot of their provisions are getting offset by further recoveries, albeit at much less of a pace. So, they've got a net credit of AED 400 million or AED 600 million for the year to date. Any of the increases are really coming through in the UAE. But likewise, substantially, all the recoveries for the third quarter have also been coming through from the UAE as well.

You asked about fee income in Turkey. It might be helpful to take everyone back to the NFI page in the deck there to illustrate that. On fees, elaborating on what I was saying earlier, on the bottom left-hand chart, you can see that the fee and commission income has stepped up from AED 1.6 billion to AED 2.0 billion. A substantial amount of that is coming from Turkey. With the inflation, the actual value of card spend, etc. is going up very quickly, yet the FX depreciation at a lesser rate, when you bring that back to Dirhams. And at the same time, with the rising monetary policy rates, the regulator is also allowing higher interchange rates.

Underlying all of that is good quality fee and commission income, which we would expect to be sustainable, with the slight caveat that it depends on the rate of card spend and inflation that we might or might not see in Q4 for Turkey. I think that answers your question for that one, Naresh, if that’s where you were focused.

And just on the FX side of that, I might as well cover that off while I’m on that page, I did indicate at Q2 that the AED 2.1 billion had a lot more valuation gain that we had been seeing in Turkey around the time of the election. That included widening spreads on spot FX and strong volumes in spot FX in Turkey as well. And so post-election, those volumes have really come down.

That’s the main driver of the return to AED 1.8 billion. At Q2, I gave an indication of how much of that is client flow versus trading. At Q2, it was around 60% to 70%, and I would say Q3 is around that 70% is client flow and stable income that we’re seeing.

Even within the trading book in Turkey, they have a core of regular, recurring trading gains. And then their variable is some of the interest rate hedges, net open positions and their swap funding costs, etc., that we’ve been through many quarters over the last couple of years as well. So that’s the dynamic that’s going on there.

And there was a fourth question about the definition of management of companies and enterprises in relation to split by loan books by segments. So, they are principally holding companies or conglomerates for both multinational large corporates but also some of the large multinational domestic corporates as well.

Operator

Our next question comes from Shabbir Malik from EFG Hermes.

Shabbir Malik – EFG Hermes

Firstly, about any early indications that you can give on 2024, particularly on loan growth and on asset quality, or at least, what kind of factors would you be considering when you’re thinking about next year?

And secondly, I think just on Turkey, I just want to get to understand the NIM dynamic. If I remember from the earlier calls, sharply higher interest rates tend to be short-term negative for margins. Does that dynamic still hold for DenizBank?

Patrick Sullivan

On the loans and advances for next year, let's go through the fourth quarter, and we will come back with our view for that and our guidance in January, I think is probably safest for that one.

And on Turkey, yes, in the past, when you had rate rises, the deposits typically repriced up faster than lending did. Across the banks in Turkey, including DenizBank, the duration on the asset side has shortened, so there's a better matching between the timing of repricing liabilities and the asset side as well.

We hope to see some of the net benefit of that come through in the fourth quarter, but I think it'll be something more for updating in our guidance in January as well. There are quite a number of variables, we'd really have to see how that monetary policy transition evolves.

Shabbir Malik – EFG Hermes

Last question on the geopolitics. Do you think that it could play out negatively or do you see any signs of that playing out negatively for your business in the UAE?

Shayne Nelson

I think that's a pretty difficult question. However, if the events remain isolated to where they are geographically at the moment, I don't think we're going to get much effect at all. Obviously, you would all have noticed, as it unfolded, equity prices plunged across the region and somewhat recovered, but not to where we were. So obviously, there is some nervousness from foreign investors about the region, and you saw that through equity values. At this stage, we're not seeing any effect on our business, and inshallah, we won't.

Operator

Our next question comes from Rahul Bajaj of Citi Group.

Rahul Bajaj - Citi Group

The first question is on UAE margins. In response to a previous question, you talked about the drivers of margin trends in 3Q and why they've been subdued. I just want to build your thought into the future.

If I think about a higher-for-longer environment over the next six/nine months, how should I think about margins in the UAE, given asset repricing, to my understanding, would be largely done by now? So, it is basically cost-of-fund movements which will impact NIMs going forward if that thinking is correct.

The second question is on the Other segment in your segmental disclosure. The Other segment seems to have seen a big jump in profit this quarter. Just wanted to understand what is there in this Other segment and why the profit of the other segment has gone up so much in 3Q over the preceding couple of quarters.

Third and final question on Turkey. We've been seeing these write-backs in Turkey. But now that interest rates have gone up or are going up quite steeply in Turkey, is it fair to assume that we'll revert to a normalized level of cost of risk in Turkey over the next few quarters? And what that normalized level would be. You used to have cost of risk in Turkey, I think, upwards of 200 basis points. Will that be the new normalized level, or the new normalized level will be somewhere between 100-150? Any thoughts there would be most useful. Thank you.

Patrick Sullivan

Maybe I can just take that one last. I think it's a bit too early to determine what the new normal is in that sense. They've had strong recoveries this year. We haven't seen too much of NPL flows through this year. They're maintaining strong levels of stage three cover. DenizBank were at around 50% cover when we acquired them. I think they got up towards 80%, but with their strong recovery, that has come down a little bit.

But from a cost-of-risk point of view, historically, in the first year of acquisition, it was around 4% or 400 basis points. And we knew, consciously, that we would have, for the first couple of years, that high level of impairment coming through.

Shayne Nelson

And remember, that was us pushing Turkey to get up to the levels that we have at group at 80 because they were substantially below what group would normally be.

Patrick Sullivan

And, over the years, that come down to the mid-300s. And then, in 2022, they closed out at around 250 basis points as the cost of risk. I think the big variable here is the impact of the higher interest rates. Sure, we can price higher, but what will that do to their companies, and the credit quality is something that has yet to emerge.

So, I really wouldn't be able to give you a proper answer on what a new normal is. But I think when we get to January and we update our guidance for cost of risk, we will factor that into the overall group cost of risk.

Just on Other segments, in our segmental reporting, we've got a column called Others. It has about AED 2.7-2.8 billion of income for the nine months, year to date. But the short answer to that is that's what we charge the businesses for their use of the group's capital.

We've got about AED 105 billion of group capital. So that's what we charge them for using that. It's free funds. And then when we do the segmental, we're just not allocating that back to the businesses. There are some central costs in there as well, whether it's certain head office costs and certain IT costs that aren't business-specific that then don't get allocated. So that's really what's in that.

And then your first question, was the UAE NIMs. Yes, I think the rate rises will work themselves through on the asset book. That doesn't take too long to do, so I think you're right on that. The main variable will be the mix of funding and increasing term deposits, which is obviously at a higher rate.

But a third variable is whatever the yields on the bond portfolios. We have about an AED 150-billion bond book, yields have been very strong on that for the last year or so and increasing. But if that starts reducing, if there's a forward view that rates will come down, that's another variable in the overall margin that we need to factor in.

Shayne Nelson

I just would add that we are seeing pressures on corporate spreads. There's no doubt about that. There's a lot of liquidity in the system, and there's not a massive amount of new loan formation in the corporate sector. There's a lot of refinancing, and that normally means lower spreads. We have seen pressure on spreads in corporate.

And in certain pockets of retail, we've also seen a contraction of spreads. Home loans is a good example. I'm sure a lot of you who are based in the UAE would see that there's some offers out there that, frankly, are lower than your equivalent cost of funds. There are institutions working hard in market share, especially in mortgages.

For us, mortgages have never been a big product. We certainly do mortgages, but it’s not been one of our key anchor products. And the reason for that is that the traditional factor around mortgages was it used to be a very big hook product.

But as markets mature, mortgages do not become a hook product, because they’re shopped around to the lowest common denominator, because the rate is important financially for individuals, and if they can move and get half a per cent, they’ll move. But that doesn’t mean that your main banking relationship moves. That’s more complex, moving away from the app you know, the payments that you’ve loaded up, the credit cards you use, migrating to another institution. I think for us, it’s been a case of, yes, we offer customers mortgages, but it’s not really a massive push product for us versus cards, personal loans and car loans.

Rahul Bajaj - Citi Group

Thank you. Just last question on the recoveries in UAE. Just wanting to understand what is driving these recoveries. I understand, in Turkey, the recoveries are coming on the back of inflation and salary adjustments, so you’re probably getting paid back on some of these loans. But what is driving these recoveries in the UAE?

Patrick Sullivan

For Q3, the vast majority of the total recoveries of about AED 1.3 billion was in the UAE. And it’s more a function of the property market which connects back to the collateral. It doesn’t mean it’s necessarily a recovery from the property sector per se.

But you’ve seen the size of our NPL book, currently at AED 27 billion. We’ve been working through those with our recovery team. When the property market is at this point in the cycle, it’s a good time to execute recoveries, and it’s actually easier to execute when the market is as buoyant as it is. So that’s the main factor.

Shayne Nelson

As I have said previously, that now is the time for us to push hard on these recoveries, because where property prices are, now is the time to get out of these issues that have been hanging around for quite a long time.

Operator

Our next question comes from Olga Veselova from Bank of America

---

Olga Veselova – Bank of America

I have two remaining questions. One is again about domestic net interest margin. So, my question is, is this intentional strategy to go for volume growth, compete by pricing and sacrifice margins? And the reason I'm asking this is because your margin erosion was significant in the third quarter. So, I'm wondering, is this intentional or not? And, in which segments is pricing competition more severe in the UAE?

My second question is about corporate income tax. You mentioned that you expect 15% corporate income tax in the UAE from 2025. How certain is this, or this is still TBC? And the reason I am asking this is because many other local businesses say that there is still uncertainty, while you sound pretty confident. Do you have any insights from talking to the tax authority?

And the last point on the taxation. Am I right that the corporate income tax in Turkey also goes up from 2025 to 30%, from 25%? Will this be valid for DenizBank or not? Thank you.

Patrick Sullivan

Why don't we just do that tax one first. Yes, the Turkish corporate rate has actually gone up to 30%. That was retrospective back to January as well. Our effective tax rate for Turkey in Q3 was a bit higher than normal for exactly that reason. So that's already come in.

Just for the rest, from a group-wide point of view, the reason we're expecting 15% from 2025 is because there is an EU directive that is scheduled to implement that for 2025. And the UK, is also drafting legislation, I'm not sure if it's enacted, that they too would also be planning to implement that OECD agreement in 2025.

And if Europe or the UK implements it, because we have businesses there, then we're essentially caught by that. We are making a presumption, that the government here would prefer to tax us at 15% instead of us paying 15% to another government. But the OECD agreement has not been enacted in the UAE. But that's the basis of our assumption when we say 15% by 2025. And if it doesn't come through, that's nice too for the UAE Government.

Just on the NIMs, I think what you were first alluding to, is are we pursuing growth domestically through margin competition. The segment you have asked is more around large corporates.

Shayne Nelson

I think the only segment that I see under pressure in retail is mortgages. I think that's the one area where there is market pressure, where there's fixed-rate mortgages being done at pricing that, frankly, it's loss-leading. I think if you look at cards, personal loans, car loans, I don't think there's much pressure there.

The other pressure which I said earlier is really around the corporate space, where refinancing, given the liquidity in the market, there is strong competition for loan growth in that area. We are seeing margin contractions within the corporate space, no doubt. And that really depends on the counterparty, what risk profile they've got, as to what price you put it down to.

Patrick Clerkin

I have some questions on the web, I'll just run through some of the questions that have come through on the web. Question about the cost of risk at Emirates Islamic in terms of the stage two?

Shayne Nelson

The Emirates Islamic is pretty similar to the flow that you've seen in the consolidated, as we've built that credit card book up.

Patrick Clerkin

There's a question on latest NSFR. We disclose NSFR in our Pillar 3 report. We don't disclose it on a quarterly basis, but if you look at that at the end of 31 December 2022, it was 121.4. It was 121 the year before that. And you can see that the bank still remains very liquid, so a strong NSFR.

Also, a question on retail profits only up 15%, so much less than the jump in profits on other parts such as CIB and Treasury, which are both up over 100%. Again, just to make the point there, if you look at the recoveries, that have come through, corporate, we've actually seen a 1.5 billion delta. There's actually a net credit this year in corporate, whereas there was over an AED 1 billion charge for provisions last year. So that's one of the main drivers of why we're seeing a bigger delta in profit for corporate. And for Treasury, of course, the investment book has grown. Yields have grown as well. So, Global Markets & Treasury is a beneficiary of that.

Let me see what else we have. A question on credit exposure, how much is below investment grade and how much of sovereign is non-investment grade? In terms of investments, most would be HQLA, and only ones such as Turkey and Egypt government bonds would be below investment grade. Most of the other HQLA would be above investment grade.

And then a few other questions. One on what percentage of the retail loan book is mortgages. That's just under a quarter.

We have already covered all the other Webcast questions.

Alex, is there one more audio question? We have time for one very quick question.

Operator

There is a final audio question from Chander Kumar of Al Ramz Capital.

Chander Kumar – Al Ramz Capital

My question is related to FX and derivative again. ENBD is consistently reporting higher gains every quarter. So, should we expect this trend to continue or this trend to subside in the future? And just want to know what unique strategy ENBD employs to set itself apart from other banks when it comes to achieving higher FX and derivatives gains as spoken earlier, because, every quarter, we see around AED 2 billion every quarter on these gains. If not mistaken, you mentioned that 50% to 60% is the normalized level, right? But we see, every quarter, it's persistently going up.

Patrick Sullivan

I think I probably answered that question earlier, where 70% is seen as underlying client flow type and there is the variability. So, you need to factor that in. Gains from this quarter may reverse next quarter.

Shayne Nelson

The majority of that flow is client flow. we're not a big trading bank. We do get some bits and pieces of flows from Deniz, with their positioning. But our trading position is quite small. Our market risk on that is super low.

Chander Kumar – Al Ramz Capital

One last question. We saw a sequential increase on DenizBank margin. And you attributed this to higher income from CPI linked bonds due to higher inflation. So just wanted to know whether higher inflation is good for DenizBank margin or is detrimental.

Patrick Sullivan

Well, we would prefer a low inflation environment and better quality of earnings. But the CPI linked bonds essentially provide something of a hedge against that inflation charge that we take each quarter. It is real income, whereas the inflation charge is actually reversed back through equity. So that income also goes through to supporting the capital base as well. But I know how much the inflation next quarter will be as much as you do. It's a pretty important variable when it comes to their earnings and margins as well.

Shayne Nelson

I think my last comment on that one would be we can't wait for the day when Turkey comes out of hyperinflation and has just bottom-line earnings rather than a deduction for hyperinflation. And hopefully that's in the next couple of years, that we get back to normalization there on inflation. So, I think the answer for us is we want inflation to be lower in Turkey. Because any benefit that we're getting out of those inflation-linked bonds is being more than offset by the hyperinflation adjustment.

Patrick Clerkin

Thanks Shayne and Patrick. There are no further questions.

Shayne Nelson

Well, if there's no further questions, I'd like to thank you all for participating in today's call. ENBD delivered a very strong set of results, delivering over AED 5 billion in profit every quarter this year. Our investments have positioned us for growth, and we are well placed to support our customers and our innovative ESG solutions. And with that, I would like to hand you back to Alex. Thank you all for participating.

END