Emirates NBD

Emirates NBD Q2 2013 Results Announcement Analyst & Investor Conference Call Transcript

July 22nd 2013

Corporate Participants

Rick Pudner
Emirates NBD – Chief Executive Officer

Surya Subramanian
Emirates NBD – Chief Financial Officer

Patrick Clerkin
Emirates NBD – Director of Global Funding

Conference Call Participants

Naveed Ahmed
Global Investment House

Rahul Shah
Deutsche Bank

Waleed Mohsin
Goldman Sachs

Amy Algaber
UBS

Presentation

Operator
Ladies and gentlemen, welcome to the Emirates NBD Second Quarter 2013 Results Announcement Analysts and Investors Call. If we are all ready to begin, I will pass the call over to our host, Mr Rick Pudner, CEO of Emirates NBD.

Rick Pudner
Supporting me in today's call are Surya Subramanian, the Bank's Chief Financial Officer, and Patrick Clerkin, Managing Director of Global Funding. Together we will review the operational and financial highlights for the

second quarter of 2013. We will be talking you through a presentation, which has been made available to you earlier today, after which there will be the usual opportunity for you to ask any questions.

I am pleased to report that Emirates NBD has once again delivered a robust set of results with a net profit of AED 1.8 billion in the first half of 2013, up 40% in comparison with the first half of 2012

Our performance improvement is across all business lines; however, the growth momentum in our retail and Islamic franchise is a key differentiator. The operating performance during the first half 2013 has been strong, supported by top line growth and effective management of net interest margin.

In terms of asset quality and provisioning, the experience in 2013 has been in line with our expectations. On the back of improved market conditions, the impaired loan formation was modest during the period and we have continued to boost provisions to improve our overall coverage ratio.

The first half of 2013 also saw a further improvement in our liquidity and funding position, as our loan to deposit ratio has improved to 100.6% compared with 102% at the end of 2012. We have raised Tier 1 capital of AED 3.7 billion and we continued raising medium-term debt at attractive pricing, taking the total raised during the period to almost AED 4.5 billion, including AED 2.88 billion of Tier 2 capital. We have also repaid AED 7.8 billion of Ministry of Finance deposits during the period.

Also during the period, we have successfully completed the acquisition of BNP Paribas Egypt and finally, while the global economic climate continues to remain uncertain, with our strong financial performance in the first half of this year, we aim to continue building on our solid foundations to drive the Bank forward while achieving our strategic objectives.

With that, I will hand you over to Surya to start going through the details of the presentation.

Surya Subramanian
Thank you, Rick. I will speak through slide three detailing the financial results.

Second quarter results show positive and significant revenue growth across all business lines. The Retail business and Islamic franchise continue to be a key driver for this growth with support from the Wholesale bank, which saw significant new underwriting and signature investment banking deals. Balance sheet metrics continue their positive story for a second quarter with net interest margins holding and an improved Tier 1 capital ratio.

Net profit for the quarter at AED 972 million is significantly higher than earlier quarters and reflects a year-over-year growth of 50% and quarter-on-quarter growth of 16%.

Net interest margin for the quarter at 2.48% is higher than our guidance due to an improved funding mix and the lower than anticipated EIBOR. This coupled with growth in the balance sheet has helped net interest income grow 17% year-over-year and 9 % quarter-on-quarter. Growth in non-interest income at 17% year-over-year and 14% quarter-on-quarter comes off the back of a sustained effort to grow non-credit risk based revenue, primarily investment banking fees, and some gain on property sales.

Headline Loans to Deposit ratio is 101% and Emirates NBD remains well placed to meet relevant prudential liquidity requirements.

Total Costs for the quarter at AED 973 million include one-off acquisition costs of AED 24 million for the Egypt business and other direct sales related costs, and these are within our expectations for cost-income ratio.

Provisions remain in line with our previous guidance to de-risk the book and we will talk more about that in the Q&A and in Patrick Clerkin's presentation.

Moving onto slide four on net interest income; net interest margin at 2.48% for the quarter improved by nine basis points over the previous quarter and is mainly driven by our continued success to raise current and savings account deposits and improved loan spreads on the back of a lower EIBOR. The latter we expect to correct in future quarters as loans reset.

The newly acquired BNP Paribas Egypt business will also contribute positively to net interest margins in future quarters, as it brings with it a healthy funding mix.

We retain our guidance for full-year margins to be in the range of 2.40% to 2.30%.

Slide five on funding and liquidity; as stated in the last quarter, the Bank's strong funding and liquidity position is a source of competitive advantage in a period of margin contraction. Our private placements and public offerings continue to be well received by the market.

Emirates NBD's liquid asset position is strong and at AED 32.2 billion, has grown in line with deposits to cover 11% of total liabilities due.

During the quarter, Emirates NBD successfully raised a benchmark Tier 1 issue of $1 billion, tightly priced at 5.75% per annum, which was then 451.3 basis points over mid-swaps. You will also recall from the first quarter call that we repaid AED 3 billion in Tier 2 funds to the Ministry of Finance in early April. We have since also repaid a further AED 4.8 billion Tier 2 in end June to bring total repayments to AED 7.8 billion for the quarter.

We continue to raise medium-term funds via the private placement market and have also been successful to raise some of these in the form of eligible Tier 2 capital.

As mentioned in previous calls, we have no target to raise funds or capital this year, but will do so as and when the market allows an opportunity for us to benefit from rates and liquidity.

Moving onto slide six on loans and deposits trends; loan growth momentum evident in the first quarter continued for the current quarter as well across Retail, SME and Islamic assets. We also witnessed new growth in Trade Finance and syndicated loans in our corporate book.

Our expectation for 2013 remains a continued asset growth percentage in the middle single digits.

Current and savings account growth continues and this now supports our stable funding base at 50% of total deposits.

With that, I hand you over to Patrick Clerkin for further analysis.

Patrick Clerkin
Thank you, Surya. On slide seven we see that total non-interest income improved by 14% over the quarter and improved by 17% year-on-year. We see that core fee income increased by 6% over the quarter and by 6% year-on-year. In addition, we also saw a very significant raise in non-core fee income such as property income, which grew by 52% over the quarter and 80% year-on-year.

Looking at the components, we see that core fee income grew for all main parts of the business. Most notable is the increase in banking fee income, which grew 15% over the quarter and 27% year-on-year to AED 384 million. An increase in both remittance volumes and FX volumes helped fuel this growth. Investment banking fees also grew, as we see Emirates NBD Capital ranked number four globally for Sukuk issuance in the first half of 2013.

Also of note is the growth in brokerage and asset management fee income, which grew to AED 47 million in Q2, an increase of 27% over the quarter and 52% year-on-year.

Property income increased to AED 116 million in Q2 and this was due to gains on the sale of properties held as inventory, and reflects the current robustness of the real estate market in Dubai.

Moving on to operating costs and efficiency on slide eight, I am pleased to report that the cost-to-income ratio has continued to improve from 35.9% in the last quarter of 2012 to 33.3% in the most recent quarter. We have successfully integrated Dubai Bank into the Emirates NBD platform, and with the Egyptian acquisition we now have 210 branches and over 900 ATMs and CDMs in the UAE and overseas, and we continue to benefit from economies of scale.

Absolute costs over the quarter did increase by AED 64 million, or 7%, and this was driven by BNP Paribas Egypt acquisition costs of AED 24 million, the inclusion of the irregular costs, and an increase in direct sales costs associated with higher volumes. The cost-to-income ratio will be managed within the longer-term target range of 34-35%.

Moving onto credit quality on slide nine; provisioning and NPL trends remain comfortably within our previous guidance. The NPL ratio fell by 0.3% over the quarter and 14.2% at the end of Q1 to 13.9% at the end of Q2. The Egyptian acquisition has helped diversify our loan book in line with our strategy. The good quality loan book from the acquisition has helped reduce the Group’s NPL ratio. It is also worth noting that for the UAE loan book we are seeing a slowdown in the growth of new NPL formation.

The main changes in impaired loans were a net increase from AED 10.6 billion to AED 11.3 billion on the core corporate book, a net increase from AED 4.7 billion to AED 5.1 billion on the Islamic book and a net decrease from AED 3.8 billion to AED 3.7 billion on the Retail book.

We continue to be conservative in our approach to provisioning. This quarter, we took a net impairment charge of AED 997 million, driven mainly by specific provisions in relation to the Group's corporate and Islamic financing portfolios. This further improved our coverage ratio by 1.3% to 52.7%.

The coverage ratio on the underlying NPL portfolio improved during the quarter by 1.1% to 74.1%.

We do expect coverage ratios to continue to increase towards target levels through our sustained conservative approach to provisioning. Our total portfolio impairment allowances stand at AED 3.7 billion, or 2.8% of credit risk-weighted assets, and this comfortably exceeds the 1.5% Central Bank requirement.

Slide 10 on capital adequacy shows that Emirates NBD's Tier 1 ratio improved by 1% from 13.5% at the end of Q1 to 14.5% at the end of Q2. Over a similar period, the total capital adequacy ratio declined from 19.7% to 18.5%.

The decline in Tier 2 was primarily due to the repayment of AED 7.8 billion of Ministry of Finance Tier 2, coupled with the retirement of AED 1.3 billion of callable sub-debt, and this was partially offset by just under AED 2.9 billion of 10-year non-call 5 sub-debt issued in March.

The AED 3.5 billion increase in Tier 1 was primarily due to a $1 billion, or AED 3.67 billion, Tier 1 issue in May. The AED 1.8 billion of net profit generated in the first two quarters largely offset the AED 1.4 billion dividend payment in March and the AED 592 million deduction for goodwill and intangibles relating to the Egypt acquisition.

Overall, there was a net decrease in the capital adequacy ratio, which was also driven by the 5% growth in risk-weighted assets over the quarter, primarily due to the inclusion of Egyptian assets. The impact of the Egyptian acquisition was anticipated when we first announced the transaction. Excluding this, Emirates NBD's Tier 1 and capital adequacy ratio would have been 15.5% and 19.6% respectively. As in previous years, we expect profit generation to replenish the capital ratios throughout the remainder of the year.

I am pleased to report that both the new Tier 1 and Tier 2 issues have resulted in a more cost-effective and efficient capital structure. Overall, this capital restructuring has been income positive. We have now repaid AED 7.8 billion of the original AED 12.6 billion of Ministry of Finance Tier 2 debt.

Further to the two very successful public capital issues in the first half of the year, we continue to evaluate all opportunities available to Emirates NBD in terms of improving the absolute amount and efficiency of our capital structure.

With that, I hand you over to Rick to run through the remainder of the presentation.

Rick Pudner
Thanks, Paddy.

Look at page 11; the page 11 slide provides details of BNP Paribas Egypt acquisition. We have completed the acquisition of 95.2% stake on 9th June 2013. The minority interest of 4.8% is in the process of being transferred.

The total consideration of $500 million is 1.4 times the estimated fair value of net assets acquired. The purchase price allocation is expected to complete in the third quarter 2013, and the goodwill and intangibles will be adjusted accordingly.

The next slide shows the business overview of BNP Paribas Egypt operations. BNP Paribas Egypt is a full commercial banking platform with more than 4,000 corporate and 246,000 retail clients. The Bank is very liquid and has a diversified customer base. Corporate, primarily blue chips and large corporates, represents 64% of the total loan book. The NPL ratio is low and more than fully covered by provisions. For 2012, BNP Paribas Egypt posted a profit of AED 155 million.

I'll take you through briefly the divisional performance of Emirates NBD on page 13, starting with the Wholesale bank. There is continued focus on the realignment to ensure enhanced future customer service quality and share of wallet, leading to increase cross-sell of Treasury and Investment products, and increased Cash Management and Trade Finance presentation. This has led to a revenue increase of 10% quarter-on-quarter, 19% year-on-year. Loans rose by 5% from the end of the fourth quarter 2012, as new underwriting more than offset the normal loan repayments and deposits grew by 6% from the end of last year.

On the Consumer Banking and Wealth Management, they continued to improve their position during the quarter; revenues, again, increased 4% quarter-on-quarter and 13% year-on-year. Deposits grew strongly, 5% quarter-on-quarter and 9% from the end of 2012. The loan book grew 8% quarter-on-quarter and 12% from the end of 2012, driven by the growth in personal loans, credit cards, and the SME segment. We have added nine ATM machines during the period. The branch count has been maintained, as we continued to promote our channel optimisation strategy.

Global Markets/Treasury: revenue has marginally decreased to AED 104 million in the second quarter this year from 112 million in the first quarter, mainly due to a high realisation of available for sale investments in the first quarter. After excluding one-off gains, mainly arising from the sale of certain investments in the second quarter 2012, on the like-to-like comparison, 2013 trading revenues are broadly in line with 2012. Treasury sales revenues for the second quarter 2013 are marginally better than a year ago, as volatility returned to the foreign exchange markets, which saw some hedging interests from clients. A prevailing low interest rate scenario attracted some interest rate hedging activities as well.

On the Islamic banking, you've heard, it's a robust story. Islamic banking revenues improved 32% year-on-year, 18% quarter-on-quarter to AED 379 million in the second quarter 2013; this is net of customer share of profit. Financing receivables increased 2% to AED 23.7 billion; customer accounts increased 1% to AED 25.9 billion from the end of last year. As at the end of the second quarter this year, the branches totalled 49 while the ATM and SDM networks totalled 176 machines.

On page 15 there is a snapshot of our strategic priorities showing you the building blocks.

1) Deliver an excellent customer service experience
2) Founded on building a high-performing organisation
3) Focusing on driving our core business lines
4) Running an efficient organisation
5) Driving our geographic expansion

On page 16, just to highlight one or two of the initiatives that are undertaken for each of these priorities, for example on the excellent customer experience. We have further improved our convenience, ease of access through, for example, the enhancement of our mobile banking operations and offerings. We're active in the management of social media to drive customer service and get closer to our customers.

From a higher-performing organisation, we continue as a priority to focus on driving our nationalisation efforts and running Group wide employee engagement programmes to enhance the experience of our staff.

Driving core business, I mentioned a little bit about the Wholesale banking, but from the Retail franchise, a further build-up of the current account savings account balances through the strong Retail franchise. We continue to focus on growing the under penetrated areas like the SME and Wealth Management.

From an efficient organisation focus, we continue on-goingly to review the organisational structure and streamlining the setup. We are in the process of completion of the IT Lean transformation, optimising the efficiencies in our IT network.

From a driving geographic expansion, we have mentioned the BNP Paribas acquisition, but there are on-going organic initiatives in the Kingdom of Saudi Arabia, the UK, and Singapore with additional focus of opening rep offices in selected markets, one of which very shortly will be in Indonesia.

On page 17, our view of the outlook; 2012, the UAE economy displayed resilience with an estimated GDP growth of 4.4%, underpinned mainly by the rising oil output and modest private sector expansion. There is continued strength and growth witnessed in Dubai's traditional trade, logistics, and tourism businesses; the retail sales sector is strong, and there are signs of green shots in the Dubai property market.

The external environment, in our view 2013, remains challenging in the context of continuing recessionary risks in the Eurozone, fluctuations in the US growth pattern, and then an expected slowdown in Asia. We expect the UAE to remain well positioned to enjoy robust GDP growth of 3.8% this year, driven by solid expansion now in the non-oil sectors offsetting an expected stabilisation in oil production.

Dubai growth is expected to be about 3.8% in 2013, as manufacturing, tourism, and hospitality and non-oil foreign trade continue to benefit. We feel Emirates NBD is well placed to take advantage of the strong continued growth in Dubai and the UAE.

As Surya said, our capitalisation and liquidity continued to be extremely strong, offering us the resilience and the platform flexibility. We have significantly de-risked and we continue to strengthen our balance sheet, which offers a strong platform for growth, and we have a clear strategy in place and we're focused on the relentless execution of this strategy.

On page 18, just to summarise, net profit improved significantly quarter-on-quarter, year-on-year by 16% and 50% respectively to AED 972 million. Total income improved quarter-on-quarter and year-on-year by 11% and 17% respectively. The cost-to-income ratio has improved quarter-on-quarter and year-on-year, and the NPL coverage has improved by 1.3% during the second quarter 2013.

Capitalisation and liquidity, as I said, is strong and we've made significant progress in achieving our strategic imperatives and Emirates NBD, in our view, is well-placed, has a clear strategy in place, to take advantage of the improving growth outlook.

With that, that concludes our summary of the presentation. I'd like to hand it back to the operator to open up the call for your questions.

Question and Answer Session

Operator
Thank you Mr Pudner. We will now begin the question and answer session. Please note that questions can only be asked in English. If you wish to ask a question, please press 01 on your telephone and wait for your name to be announced. If you wish to cancel your request please press 02. Once again, press 01 if you have a question.

Our first question comes from Naveed Ahmed from Global Investment House; please go ahead.

Naveed Ahmed
I have three questions. I will start with the first one. What is the current [carrying] book value per share of Union Properties? The second one is can you give some guidance on the NPLs now, because it hasn't changed I think with the last three or four quarters? The third question is regarding the consolidation of BNP Paribas. Is it safe to assume that there would be around AED 15 million worth of profits coming from BNP per quarter?

Surya Subramanian
For Union Properties, prior to the sale we carried the shares at AED 0.33 per share. Post the sale we carrying the shares at AED 0.28 per share. We have

not recorded any profit on the sale of the stake because of this adjustment in the carrying value. The current market price for Union Properties, however, is anywhere between AED 0.43 and AED 0.44 depending on the day, so theoretically if we were to sell down our entire stake, we could see a profit arising out of that transaction, but that's just a theoretical number. We haven't booked any profit from the current sale.

As far as NPLs are concerned, you are right to say that NPL formation has been relatively contained as a ratio in recent quarters. We had been seeing for three quarters, even prior to quarter two, it was in the range of 14.2/14.3. Earlier in quarter one we refrained from giving any guidance. We have now seen quarter two, as Paddy mentioned in his script, the rate of new NPL formation has been slower than before, and that is a positive sign. Also, the inclusion of the BNP Paribas assets, although relatively small adds on a pool of good quality assets helps diversify our risk base, and we have reported an NPL ratio of 13.9% for this quarter. Given that we are revising our guidance from 15-16% that we had indicated two years back, we can bring that down now by 1% to a 14-15% range for the end of this year. We will see how Q3 goes before we give any longer term guidance for the next few years.

As far as the Egypt transaction is concerned, I am not sure whether the number you quoted was in Dollars or Dirhams.

Naveed Ahmed
Dirhams.

Speaker Name
Dirhams, so let me…if you look at the presentation, in 2011 and I will refer you to slide 12 of the presentation, the net profit from the Egypt operations was AED 133 million. In 2012, the net profit is 155. In the detailed financial statements that has been filed with the DFM today, I am not sure if you have that in front of you but in Note 9 to the financial statements, and I will just read out, BNP Paribas' Egypt revenue included in the condensed consolidated interim income statement since 9th June, and that is therefore for 20 days, the revenue is AED 34.4 million, and the net profit contribution for 20 days is AED 16 million, so this is a 20-day number, this is not a full quarter number.

In line with the requirements of the accounting standard, we do add, had BNP Paribas Egypt been consolidated from 1st January 2013, the condensed consolidated interim income statement would have included revenue of AED 274 million, so that is the half year revenue, and profit of 96 million which is the half year profit.

I trust I have answered your three questions Novida.

Naveed Ahmed
Just a cross question to the first one, regarding the UPP, as you said that it is trading at around 42 or 43 Fils at the moment, and you have actually decreased your carrying value 33 Fils to 28 Fils, is there any…what is the accounting standard that was applied. Was the stake sold at something below the book value, because of which the existing shareholding was re-priced at something lower.

Surya Subramanian
Okay, first statement of fact, UP I believe closed closer to 45 Fils today, so obviously that is slightly higher than the 43/44 average of the last few days that I talked about.

Second, in terms of how we accounted for the sale of this transaction, we had close to 48% shareholding in UP prior to the sale, we sold approximately 16% leaving us a balance of 31.4% in UP. At 31.4% we are still the single largest shareholder in UP, so we have conservatively not taken to profit any gain arising from the part sale of the transaction, rather we adjusted it against the carrying cost of the entire portfolio, hence bringing our carrying cost down to 28 Fils. Now that obviously means we have a potential upside, theoretical upside of 16 Fils per share if we were to sell this entire stake.

Naveed Ahmed
Perfect, thank you Surya.

Rick Pudner
Thanks.

Operator

Thank you. The next question is from Mr Rahul Shah from Deutsche Bank, please go ahead.

Rahul Shah
Good afternoon.

Rick Pudner
Afternoon.

Rahul Shah
Actually, I had, hi; I had four questions if that is not being too greedy. The first one is on Egypt again, just wondering now that you have had a bit more time to look at the business, if you could give us some ideas as the risks and opportunities that you see for that franchise, and perhaps if you could also give a better sense of the synergies that you hope to realise.

Rick Pudner
Sorry, you were going to go through four questions.

Rahul Shah
As you wish.

Rick Pudner
Well, let's take one at a time then I think, it is probably easier.

Rahul Shah
Okay.

Rick Pudner
From the Egyptian acquisition, yes, we have obviously had more time to have a look at the opportunities. We fully believe we have got a very good acquisition in the BNP Paribas operations there. Obviously, there are uncertain times in Egypt at the moment, which we're following closely, but I think in terms of the medium-term opportunities, certainly in the retail and

the SME areas and the chance to bring in a lot of our technology, for example in mobile banking, etc. we see very significant opportunities to grow the franchise in Egypt. The current corporate base of Egypt is a very conservative book and it is very much at the high end corporates, historically the multinational subsidiaries of French corporates, but also large local corporates, so that is a very conservative book, which we will look obviously at ways of growing, and then again looking at the UAE companies moving into Egypt, as to ways of supporting them and the current existing UAE companies in Egypt. We're looking at this, as I said, very optimistically in the sense of the opportunities that Egypt will present in the medium-term, but at the same time obviously keeping a handle on what is currently going on.

Rahul Shah
In terms of the potential of this business, you pointed to the financials on page 12 of the slide pack, and also give some sort of…well you pointed to Note 9 of the financials. In terms of the annual potential of the business, which do you think should carry more weight, because they give widely different numbers if you annualise them?

Surya Subramanian
Well, Rahul despite what is happening on the ground in Egypt, the business is a very well-run business and clearly is growing year-over-year, and that is why the numbers are different. 2012 is better than 2011, and the first half of 2013 is better than 2012 on an annualised basis. As Rick mentioned, we hope to add onto that through the opportunities we have at hand.

Nonetheless, we also have to be mindful that a portion of those revenues are in local currency and that is clearly subject to market forces impacting the economy and any view people take on the Egyptian Pound. I would say we will take a cautious view on that going forward, but it is the longer-term strategy to get value from this acquisition.

Rahul Shah
Thank you. I will move onto the second question, it is on the large exposure circular, the UAE Banking Federation submitted some proposals to the Central Bank, I was wondering if you have had a chance to sort of look at those detailed proposals that were submitted and I would like your thoughts on where you stand relative to those proposals, for example if they were implemented, you know, all those suggestions were implemented how much

flexibility would you have today in terms of your related party exposures which I note are continuing to grow.

Rick Pudner

We have obviously been in long consultation with the Central Bank, Rahul, and that is all of the banks, this is under the UAE Ban's Federation, as you're probably aware, the committee was formed to have a look at the proposals that were issued last year and then pull back for further discussion. We have had good discussions, constructive discussions with the Central Bank, and this is as I said, is the committee of the UAE Banks Federation and the UAE Ban's Federation itself sort of giving its own input collectively to the Central Bank, so I think we're all in a situation where I think all the banks are comfortable that they can adhere to guidelines that will eventually come out of the Central Bank on large exposures and I think those discussions have been very fruitful, so we're comfortable that we can meet the guidelines as and when they're formally issued by the Central Bank, and notwithstanding, obviously, issues that various banks have got, over various parts of that guideline. Obviously, the exposure issue is significant for us and one or two other banks in the UAE, but we have all had a look at these guidelines and are comfortable with the final recommendations that will come out.

Rahul Shah

I guess maybe phrasing the question differently, we have now had I guess more than a year of knowing about there is an intention to put in place some sort of limits. Is the kind of growth that we're seeing in related parties' sovereign exposure and so on and so forth, that we have seen over the last 12 months, is that something that you feel is sustainable?

Rick Pudner

Well there is obviously from our point of view specific issues, presumably on our major exposure to the Government itself, and those are obviously under discussions to look at ways of reducing that exposure, so we have got the Government exposure and the Government related exposure, and on both counts I think we're very comfortable that we can adhere to the final missive, if you like, from the Central Bank on the large exposure guidelines. Both are being discussed obviously with the Central Bank and I think both are under control as far as the guidelines, or future guidelines will be, what they will be.

Rahul Shah
Thanks for that. Moving onto the third question. Just looking at profit growth in the first half of the year, it is I think up around 40%, if we think about the trends that we have seen in H1, are there any of those trends that you feel could change in the second half, or is this a good base for us to work off.

Surya Subramanian
Rahul, I think the trends are all fairly stable trends as you have seen. No doubt a bank of our size does have some one-offs, but these are normally in the range of 100 million thereabouts affecting each quarter, and for a bank of our size, as I have mentioned before, there is always some new 100 million that is not in the trend that keeps coming each quarter, so it almost becomes a trend in itself.

The other key factors to note are probably…we are guiding net interest margin within a tight range of 2.40-2.30%, but that applies now on a growing balance sheet. We have seen balance sheet growth both in quarter one and quarter two, and we are also seeing significant pick up in fee income, and just to give you a sense of where non-funded income is growing, in 2011 the average quarterly fee income was around AED 650 million. In 2012 that same average quarterly fee income became 825, and for the first half of this year the average quarterly fee income is more like 925, and that is on the back of investment banking fees of syndicated deals, as well as a growth in banking revenue on the back of both FX income, remittance income that Paddy mentioned in his conversation. We do have a property portfolio that we acquired from Union Properties some two years back, you would recall, and that is clearly very much in the money given the movement that has happened in the Dubai property market, and you will see some realisation of that as well. Some it has already flown into the second quarter results. More importantly, the underlying banking business in retail, in Islamic, in SME, in foreign exchange is quite strong.

Rick Pudner
Just to build on that a little bit Rahul, obviously looking at the forecasted GDP growth we hope will continue in the sense of the robustness seen in Dubai so far, but if you look at personal and other, you know, sort of retail lending it is up 16% year-on-year, services is up 13%, trade is up 23% year-on-year, they are offset slightly by a continued decline, if you like, in terms of the real estate assets, so from what I described in the economic outlook

of the growth core industries, if you like, or sectors in Dubai, we see that certainly continuing.

Rahul Shah
Thanks very much, that is very helpful, and then just finally, just a question on something that Surya mentioned, and was also mentioned in the presentation, but the inventory figure, the inventory assets have increased in Q2 I think. Could you give us a better sense of why that change has taken place?

Surya Subramanian
Well this was publically disclosed by Union Properties as this was material to their own balance sheet, it is not so material to ours, but we swapped 2.23 billion worth of inventory with Union Properties to settle their debts to us, so this was similar to the asset swaps we did at the end of 2010 and 2011, if you recall. 2010 was roughly slightly under 500 million and 2011 was about 1.1 billion. Currently the total inventory we hold net of recent sales is about AED 3.2 billion.

Rahul Shah
Can you give us a sense of the book value of the assets that were sold?

Surya Subramanian
Well, that would roughly be, if you look at 0.5+1.1+2.2, you're looking at about an initial total inventory of about 3.7 billion, so we have sold about 12% of that already.

Rahul Shah
Thank you very much.

Rick Pudner
Thanks.

Operator

Thank you. The next question is from Waleed Mohsin from Goldman Sachs, please go ahead.

Waleed Mohsin
Than you, good afternoon, thank you very much for the presentation. I have just one broad question. How shall we look at the normalised state of returns for the bank, particularly fee, you make a reference to the provisioning cycle. As we have seen during the second quarter results, now the NPL coverage has been strengthened close to your target levels and your general provisioning reserves are ahead of the Central Bank guidelines. The macro backdrop also continues to improve, so I was wondering how much of an uplift do you see from normalisation in cost to risk, and when do you actually expect much of this, say, normalisation to come through. Do you think you will start seeing some normalisation coming through in the second half of this year, or is this going to be more of a 2014 story? Thank you.

Surya Subramanian
Waleed, this is Surya, I will take you back a few quarters. When we gave our multiyear guidance on NPLs and coverage, we talked about needing to de-risk the book both in specific terms and potentially to take care of tail risk in the longer-term restructuring. Although the rate of new NPL formation is tapering, and that is good news, and we are beginning also to see recoveries on past NPLs, small numbers, they continue into this quarter. We have also seen, what I call, corrections of past dues, where customers come back to repay principle or interest that is past due to regularise their account, so these are all positive trends, however, the tail risk on the long dated restructuring remains, and we will continue to take adequate provisions to cover ourselves against those tail risks.

Also, if you compare against our target, we wanted to be covered 80-85% on underlying NPLs excluding the GREs by the end of this year. We are currently only at 74% and if you work the reverse math on the numbers that are disclosed on page 9 of the presentation, you would expect to see at least another billion to a little bit more of provisions to get us closer to that level, assuming no new NPL formation.

Also, in an earlier call I had mentioned that for the complete, so-called credit deterioration cycle to play out, we said it is more likely to be by the end of this year, first quarter of next year, rather than now. What you are seeing now is a slightly different positive story, stronger balance sheet growth in assets, net interest margins maintained, both that combined to give us a more stable and higher net interest income, added to that the growth in fee income, and we have shown consistently we can contain costs, so clearly what you are seeing now is the operating profit pre-provision that had been static for a number of years in the 6.5-6.7 pre-provision per annum range, has now…what you see right now is we have done 3.6 for the half year pre-provision. If you were to just annualise that that would be 7.2 assuming the stable trend continues. That would be much higher than what we have done in previous, which was 6.5 last year, 6.4 the year before and I think in 2010 it was about 6.7, so it had been fairly static within a tight range. That is opening up, giving us greater capacity to add onto Tier 1 capital through retained earnings, giving us the ability to grow the asset book to support that through the RWAs, and giving us greater capacity obviously to manage the tail risk comfortably within current profit generation capabilities.

Waleed Mohsin
Thank you very much Surya.

Rick Pudner
Thanks, bye.

Operator
Thank you. The next question is from Amy Algaber from UBS, please go ahead.

Amy Algaber
Hi, this is Amy Algaber from UBS, thanks very much for the presentation. I just have one question on your international expansion plan. You have mentioned in previous calls that you're targeting, I think it was 20% of revenues from outside the UAE in the next five years. What sort of timeframe are you thinking for your next international expansion? Can we expect to see something before the end of this year, or will you wait until you have fully integrated BNP Paribas? Thanks.

Rick Pudner
Thanks, Amy. Yes, we have stated 20% of revenue within five years. I think the Egyptian acquisition gets us to about 8.5% of revenues of the Group now outside of the UAE, which is obviously important. We continue to focus on this, this is very important to diversify away from one country, if you like.

Obviously, it is not just inorganic opportunities, there are organic opportunities as well, we are continuing to focus expanding in the Kingdom of Saudi Arabia, we are looking at really building our UK operations, our Singapore franchise, as well as the Egyptian one, and we have opened as you have seen I think, rep offices – well we have got rep offices in India and we opened in Beijing last year, we're opening up a new rep office in Indonesia shortly, and we will continue to look at that side of the opportunities as well to enhance our ability to take advantage of flows from Asia to the Middle East through to Africa, so it is a combination.

There is nothing on the table at the moment in terms of another acquisition. These things come up sometimes when you least expect them, but we're ready to take opportunities, it is just nothing concrete on the table at the moment.

We have got a lot plans. We're obviously bedding down the Egyptian acquisition and focus on growing that, but it is also focusing on our current organic operations.

Amy Algaber
Okay, thank you.

Surya Subramanian
Rick, I have here a written in question from Sanyalak Manibhandu from National Bank of Abu Dhabi. He is listening on the call on a mobile phone but in order not to disturb all of us he has sent in a written question in advance. His first question is how did the average cost of funding move down so sharply? What happened to passing on declining cost to loan customers?

The answer to that is, the average cost of funding is being managed by the bank through an improved funding mix. As I mentioned in my presentation, current and savings accounts now account for 50% of the total deposits of the bank.

In terms of what gets passed onto customers and this was also asked in the earlier media call, it depends on how we contract the rates with customers. Corporate and wholesale customers typically tend to be more closely batched to market rates and as EIBOR moves up and down, they will reset depending on the contract, every three months, or six months, depending on the re-pricing they have chosen. However, for the retail and SME clients they don't tend to be so closely linked to market movements. They are typically off cost of funds or some other base rate that does move in step with EIBOR, however it doesn't have the – what I would say – shorter period volatility that corporate and wholesale customers may have. We must bear in mind that when people talk about passing on the benefits of a lower rate to customers, it also means that customers would get hit if the rates were to go up on the other side if it is structured that way.

It really depends whether you are corporate wholesale or a retail customer.

The other question that he had was, loan growth momentum was much stronger than guided back in April, what is the explanation? Is it due to the Egypt acquisition? Increased loans to individual to participate in the UAE capital markets etc.?

The answer to that is, it is a bit of all of the above. We have seen broad based growth. Quarter-on-quarter net loans grew by about 5%. The Egypt acquisition only added 1.68% of that 5, the rest of it all was within our broader customer base here, and just as a small clarification, the bulk of the loans in BNP Paribas are corporate and wholesale, less of retail at the moment.

He also had a few other questions, which I believe have been answered through the Q&As raised by others in this call.

Operator
This concludes todays Q&A session. 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 will also be available on the Emirates NBD website tomorrow. Ladies and gentlemen, at this point we will be handing the call over to Mr Rick Pudner for his closing remarks.

Rick Pudner
Thank you, and just to thank you all very much for attending the conversations and the questions today, so we look forward to talking to you again soon. Thank you very much.

Emirates NBD