FGB and NBAD proposed merger: Analyst & Investor Webcast Transcript*

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Presentation

Operator

Good afternoon everyone. Thank you for joining us today to discuss the proposed merger between FGB and NBAD, which was announced this morning.

Please note that this call is for analysts and investors only. All media please drop off this call now. As per usual, the speakers are not to be quoted in any way in any media publication.

On the call today we have James Burdett, Group Chief Financial Officer of National Bank of Abu Dhabi and Karim Karoui, Chief Financial Officer of First Gulf Bank. We also have Michael Miller, Head of Investor, Media and Public Relations at National Bank of Abu Dhabi, and Sofia El Boury, Head of Investor Relations of First Gulf Bank. Shortly, James will start by presenting the key highlights and strategic rationale of the proposed merger, before covering some of the key financial aspects. This will be followed by a Q&A session where both James and Karim will answer any questions you might have. The investor deck we'll be using today is available through the dedicated microsite www.bankfortheUAE.com, where you will also find more information about the transaction.

Please note that preliminary pro-forma financial information included in this presentation is not audited, is subject to change and has been prepared for illustrative purposes only. Also, today's presentation includes 'forward-looking statements' based on current expectations, subject to risks and uncertainties that may cause actual results to differ materially. Please refer to the disclaimer on the first slide of the presentation for more details.

With that, I would like to turn over the call to James.

James Burdett

Thank you very much and good afternoon everyone, thank you very much for joining the call. I understand we have some 70 participants, so we certainly have a full house this afternoon, and I think it's appropriate. You would no doubt have seen the news this morning. It is a significant milestone, I think, in the banking industry here in the UAE. In fact, someone told me it's the biggest M&A deal, merger of equals, since the global financial crisis, so it is a very significant event, and what I would say is the title page of the presentation says it all. We are creating a UAE national champion and the combined entity will have a market share in the vicinity of 26%, which gives us significant punching power. Look, we believe, and the management believe, that we're bringing in two very complementary businesses together. You have First Gulf Bank, which is a leading consumer business, with a very entrepreneurial spirit, high ROE, very well managed cost base; and you have NBAD, which is a strong institution, strong balance sheet, banker to the Government, with a sophisticated wholesale bank that has an international network. What I'd say is bringing these two things together really helps bring the Abu Dhabi 2030 vision out into the highlight.

This 2030 vision envisages significant financial institutions as the cornerstone of economic development, span international borders, and really help propel the UAE business forward and we think this merger brings that and obviously to the benefit of the shareholders, the customers, and so on.

What I want to do today is … I've got a presentation -- I just want to go through it reasonably quickly. We'll start off by giving you an overview of the transaction itself, then some of the strategic rationale for the merger, and then we'll hand over for Q&A where both Karim and I are here to answer your questions, and clearly we want to make it as interactive as possible, so you get value out of it.

I'm on page 3, which is an overview of the key transaction terms, so you will no doubt note that the exchange ratio has been agreed at 1.254. This will result in NBAD issuing 5.6 billion shares and implies a discount to the three-month rolling average of 12% on FGB's share price; or if you flip it the other way around, a 17% premium to NBAD, which I think is reflective of the fact that the stocks are illiquid and are believed to be slightly undervalued. This results in the shareholding split being 52%-48% to FGB and NBAD respectively, but still implies, as you can see there in terms of the key shareholders, a very strong Government shareholding, which amounts to 37% (ADIC 33.2% and Mubadala 3.7%). The free float of 63%, of course, includes a significant chunk owned by the Royal Family as well, and I think that that symbolises the Government's will to bring these two institutions together and the fact that it's a very strong shareholding base.

The transaction is structured very much as a merger of equals. The NBAD brand will survive and NBAD will also be the surviving entity. The logic for NBAD being the surviving entity makes a lot of sense from a regulatory standpoint, where we obviously have offices in a number of jurisdictions and from a regulatory perspective in terms of change of control and changing the licences, it obviously made much more sense for NBAD to be the surviving entity.

In terms of governance, you will have seen there is a nine-member board; four from FGB, four nominated from NBAD. The chair will be led by His Highness Sheikh Tahnoon, FGB's current chairman, NBAD current chairman His Excellency Nasser Alsowaidi will become Vice Chairman, and as you know, Abdulhamid will become the CEO designate, and you will know Abdulhamid from his role currently as Managing Director for First Gulf Bank. Clearly, all of this is subject to regulatory approval and I'll talk a little bit more about the timing of the next steps in terms of getting the merger through.

Page 4 on the transaction structure is just a graphical representation of what I've already said. It's a statutory merger. NBAD will issue shares to FGB shareholders. The combined entity structure, bottom right hand pie chart just shows the shareholding split that I've already discussed previously.

Now, I want to turn you to page 6 and just go through some of the strategic rationale that management through the due diligence process believes is relevant, and I think you'll see and hear it's actually quite a compelling story. Page 6 goes through five main points and then the subsequent pages have proof points around those points, but I will just go through this page in its entirety and then move onto the following pages as we go through. Look, there is no question that this creates the number one bank in the UAE. We will certainly be the biggest in the MENA region until the QNB merger takes place. We believe the size gives us significant scale. We'll have 26% market share and when we go through the presentation, you will also see that a peer group comparison of other regional banks shows that the story is quite compelling.

Part B, we believe the combination of best-in-class consumer and wholesale business really is a value add to our shareholders and, as I've said before, First Gulf Bank has a very, very strong consumer proposition. NBAD is an internationally connected wholesale bank that has spent the last several years spending and developing product build and a distribution capability, and we believe bringing those two together and their resultant synergies is going to be very good for the customers, the consumer, the UAE businesses that want to access trade and FDI flows to and from the UAE, and we think it brings the complementary strengths and weaknesses of both businesses together for the benefit of the whole.

Point C, fit for the changing regulatory environment. We all know that there is significant regulatory headwind, more stringent capital requirements, tougher LCR requirements in terms of liquidity; we believe bringing the two institutions together gives us scale, gives us a strong capital position, gives us funding synergies in order to meet those regulatory headwinds, but we are fit for the changing regulatory landscape and we believe this will also be a competitive advantage for us.

Clearly, there are efficiencies through cost and revenue synergies. I will talk a little bit more in detail about that. We've publicly gone out and said that we're looking for synergies equivalent to 8% of the combined cost base, which amounts to about AED 500 million per annum out into perpetuity. This is a conservative estimate and we also believe that there are going to be revenue synergies, which we haven't articulated and I'll talk a little bit more about that later.

Clearly, the combined capacity from having a capital position that's double the size of the current two gives us immediate underwriting capacity both in terms of credit and liquidity, and we believe all of this is a compelling story that benefits customers, equity holders, lenders, and the UAE economy at large.

Just turning to page 7, just to give you a flavour of where we would stack up regionally; you can see we've been number one in the region, a true national champion for the UAE, both in terms of total assets and equity, and in terms of market cap, just a touch behind QNB as things currently stand. We believe that scale is obviously a huge strength in this whole consolidation process.

Page 8 on the international network market, I think it's fair to say that there is a strong international network and, in fact, with the combination of the two entities, we get a couple of more countries into the network. We still see the international network is predominantly a wholesale play, but also maybe a wealth play. We don't believe in aggressively expanding retail consumer cross-border. It's a very difficult proposition and really what we're trying to do is attack the flows to and from the UAE, and for example, instead of giving the business up to a foreign bank that has that network, we want the business ourselves, and we have built the quality people, products, and distribution platforms to enable us to attack that and compete with the best.

Clearly, from an international perspective, we want to make it very clear that we're not doing a QNB style of operation. There's no intention to go out and buy banks offshore. It really is a high quality network to support targeted and segmented set of customers around products that are more ROE accretive rather than just straight lending, and that's what we're trying to articulate in these slides.

Page 9, just to give you a flavour of where we stand versus some of the regional competitors, we haven't picked these for any particular reasons; they're just a group of banks that are similar-ish, if you like, but you can see there that the story is very compelling versus regional competitors. We have the lowest cost-to-income ratio, a very attractive return on average equity, which will actually get higher, especially if we do the return on tangible equity, which I think is probably the more correct measure, and actually a decent market cap that gives us scale versus those competitors.

Looking at page 10 just in terms of consumer, and we've put a lot of thought into this and it's a relatively simple slide, but bringing the two consumer or retail franchises together will give us significant scale, it will allow us the ability to drive investment in digital, segment our customer base so we can tailor the cost structure appropriately to the different customer segments, expand our product offering, garner synergies in terms of any duplicate channel spend, and branches and so on. I do think it gives us a strong beachhead from which we can attack Dubai, attack the rest of the market, and we believe that we have significant ability to grow in this market.

Page 11, just talking a little bit about wealth, as you know, NBAD has an offshore booking platform in Switzerland and that operates the safe-haven status for some of the wealth customers in this region. We also have a sizeable and growing wealth platform here in the UAE. FGB gives us Singapore and there are those customers out there that would prefer that as a safe haven status to Europe, especially some of the sub-continent customers seem to have a preference for Singapore. We have got access now to both. We have got access to a much larger client base and clearly this part of the world goes, and the GDP grows, and the wealth grows with it and we're seen as a safe haven bank. We expect this business to grow. I think in terms of competition, we'll be the biggest by far private bank in this part of the world and have a real ability to leverage scale off the back of it.

Page 12, in terms of wholesale, we have created the number one wholesale bank with significant international reach. The strategy hasn't really changed, certainly from an NBAD perspective. It's going to be a customer focused strategy. It's targeted around flows to and from the UAE plus obviously having a dominant local presence within the UAE, and you can see we're number one in a number of areas. We will look to try to get to number one across all metrics essentially within the UAE, so deepening relationships with core clients. The strong network enables us to take some business off the foreign banks and also pick up trade FDI flows to and from the UAE. We still want to focus on industry segmentation, so we believe it's the right thing to do to have segment specialists around aviation, around energy, around these areas, so we can actually add proper value add products around flow and value add that actually enhances the bank's ROE, but also gives the customer what they want in terms of hedging. You can see the bottom chart down there, we're talking about specialised product propositions, around flow and value add, foreign exchange, DCM, originate to distribute cash management; all products that have high ROE, low capital intensity, but also decent wallet share for the customer. We think bringing the two banks together obviously enhances our customer mix, our ability to cross-sell into the various customer bases, but also brings the best of both product sets and technology platforms together.

Page 13, I won't dwell on for too long. Suffice to say, I think the strong capital and the ability to deliver strong capital generation, and the scale enables us to invest, enables us to build up capital so we can improve our capital adequacy ratio, and allows growth to continue, and I think it means we're going to be better positioned for the regulatory headwinds that are coming down the path. There is no question this bank will be the most systemically important bank in the UAE.

Page 14, on synergies, I've already articulated some of the synergies here, talking about 8% of the combined cost base. The synergies are predominantly around the business and enablement side. On the business side, FGB has 23 branches and there's an almost perfect overlap with NBAD. Each branch has AED8-12 million per annum to run, so there's significant savings there just from that area. In the wholesale bank, wherever there is duplication in the products or customer ranges, obviously there will be synergies there, and clearly an enablement; we will go through the enablement, due process around integration, I think there is significant space there. We've put it at 8%. I note some of the feedback that seems to be coming in from you, the analysts, is that it's a bit light. We have been conservative. We think there is more upside around that. We've put out an estimated cost of integration at one time integration costs around AED 600 million. We believe we can do that for less than that, so we're really talking somewhere between 475-550 million, at the upside 600 million. In terms of revenue synergies, you note we've been absent in terms of providing some quantitative numbers around that.

We're comfortable putting up the qualitative stuff at this moment, because it's obviously a very difficult thing to estimate, but there's clearly going to be funding synergies, particularly if we retain our rating for the combined entities. There's obviously pricing optimisation because of the scale and size we have of an enhanced underwriting ability with just simply a bigger asset base. We have looked at the concentration risk and actually it's very, very minor, so we think we can manage attrition very, very well on this piece, and clearly we've got a much larger population of customers to cross-sell into. We do believe there are revenue synergies. Karim and I were talking beforehand, we haven't quantified this, but maybe around the vicinity of 3%, something like that.

Page 15 and I've already talked about this, but I just want to show you graphically, left hand side of page 15 you can see the chart showing the size of the capital base at AED 63 billion. Clearly, that gives us an immediate underwriting advantage in terms of single borrower limits, concentration risk, and so on, so we believe there is significant upside immediately. On the right hand side, the funding profile remains extremely strong with the two entities, so the loan-to-deposit ratio at 94% is very strong. FGB has a very strong and sticky and long tenure funding base. NBAD has just released its cash platform and we've picked up 50 mandates already for this year, so we think we're strongly positioned on the liquidity side for growth. The bottom piece, which articulates some of the strategic opportunities I think I would encourage you to read, because all of them make a lot of sense I think in terms of adding value to our shareholders.

Jumping to page 17, one of the key points that was raised in the various ratings agency discussions we have had around integration risk, and I'm sure you'll have some concerns and some thoughts around that as well. Suffice to say that we've already put some plans together. This is a high-level snapshot of the sort of timing we think we're looking like in terms of integration. We're obviously in the pre-closing stage right now. there will be an ExCo elect with a combination of people from both banks, who will be responsible for designing the integration plan, trying to really quantify the synergies both revenue and cost-wise, manage the communication and try to deliver a three-year strategic plan, so we can understand where and what the shape of the new merged entity will look like. Post-merger there is obviously all around integration, retention programmes, building strong governance, and continue merging the two entities, but we do think from a systems perspective, full integration will take 18-24 months minimum, and you all know that's likely given the IT piece.

We thought through the timings, we believe this is very realistic, and we are looking to seriously minimise any integration risk. What I should say is we do not expect confirmation of the two entities until maybe the first quarter next year, because of the regulatory loopholes that we need to go through, and in the interim, as articulated in the ADX press release, the two banks will be run independently with obviously a merger agreement making sure we don't go off and do crazy things without the other one agreeing.

In terms of corporate governance and leadership, I've already talked about this, but on page 19, you can see there the composition of the board, the Chairman, His Highness Sheikh Tahnoon, the Vice Chairman, Nasser Alsowaidi, and Abdulhamid is the CEO. In terms of governance, we've decided on three committees, which is human resources, risk and governance, and audit, which I think are the three committees you would expect to see in terms of good governance.

The last few pages, page 21, just gives some pro forma metrics around the combined entities. Clearly, these are preliminary, these are not audited, and clearly as we go through the shareholder offer process, we'll get a much robust set of pro forma numbers. From an accounting perspective, you should note that based on IFRS 3, this is a reverse takeover, so because FGB had 52% of the holding and seats on the board, and the chairman and CEO, and so on, it's deemed a reverse takeover, which means the net asset value of NBAD will be folded into

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FGB's accounts, and clearly we expect that to result in some goodwill, and the pro forma figures there do take account of the preliminary goodwill figure.

Page 22 is just a slide to show you the diversification, so from both banks' perspective, the sum of the parts results in better diversification both from the funding side and the loans side, so it's a much more balanced balance sheet, which I think is a good thing for the market and a good thing for the shareholders. The international piece you can see there; we've just put deposit mix by geography to show that the offshore deposit profile is still an important part for us. In terms of revenue composition, I think at NBAD it's around 20% of the construct, so the combination of both of them together would probably drop it to around 10% or something. You can see the operating income by customer type is a much more diversified portfolio from a combined entity perceptive, and I think that diversity is an important point for us, because if you look at NBAD's balance sheet, we are underweight consumer and I think bringing the two together and the very strong portfolio that FGB has helps both in terms of ROE and revenue.

Page 23 just gives you some of the indicative timelines heading into the expected effective merger date, so to reiterate we think it's first quarter 2017, sometime in September we expect to have the special general assembly to vote; it is subject to shareholder approval. We need 75% approval in the resolution, and then we go into the creditor objection period, which as you know under the new companies law is a potentially lengthy and onerous process, but we do think that first quarter '17 is achievable.

I guess to sum up and finish on a high note, page 24 we think sums it up. We think it is a transformational merger of equals. We think we're bringing in two highly complementary businesses together and we think the sum of the parts is significantly greater than the whole. It will benefit all stakeholders, customers, equity bondholders, employees, and society.

With that, I think I will hand back over to the operator to move onto questions and answers.

Question and Answer Session

Operator

[Operator instructions]

Our first question is from Shabbir Malik from EFG Hermes. Please go ahead.

Shabbir Malik

I have a couple of questions. My first question is on your credit rating. What does this merger do to your credit rating, because my understanding is that once this merger goes through, the ownership of ADIC into their combined entities drops to below 50%, around 30-35%, from close to 70%, so does that have any bearing on NBAD's strong credit rating? My second question is on the dividend profile of the two banks there. The two banks have quite different profiles. My question is post-merger, how do you see that changing? Thank you.

James Burdett

I will take the first one and I think Karim will take the second one. Look, on the ratings, it's a strong board, it has strong Government backing; we retain strong capital ratios, scale abilities.

Look, on the integration risk, I think we've covered that off with you in the sense that we're managing it in a very robust way. In terms of the ownership, our contention is that it is still a very strong Government proposition and the Royal Family make a material difference to the shareholding. I don't know where they will land on it, but the feedback I would give you is the rating agency feedback was positive overall.

Karim Karoui

I would add also that in the end, the Government of Abu Dhabi is giving the blessing for this transaction, so definitely it is going to be the strongest bank for the Government of Abu Dhabi, so definitely the support will be there and then the rating agencies will take that into consideration.

Regarding the second point on dividend, so basically, we are going to work together between FGB and NBAD on putting the policies for dividend in place. In general, our thinking is the same. It is about the capital which is available to us now, it is about the growth in the future. It is about the capital which is required for the regulatory requirement in the future. Based on that, we will define the new policy. We would not expect a major change from what we are having for the time being. Yes, there would be a few things to be discussed between the two institutions, but definitely, the arguments will always be around the excess capital and the return on equity which are the key things here in this discussion.

James Burdett

What I would say, Shabbir, though to be clear is, this year's dividend policy for both institutions will be decided by the respective institutions and I wouldn't expect our policy to change that dramatically or Karim's to change that dramatically. Clearly, the new board would need to take a view on the 2017 dividend paid and 2018.

Karim Karoui

The bigger picture behind that is that we are merging two strong institutions which would complement each other. Definitely there would be synergies there. There would be more profit to be distributed to the shareholders, so you can only look at it from a positive angle. Thank you.

Operator

Our next question is from Jaap Meijer from Arqaam Capital. Please go ahead.

Jaap Meijer

Congratulations on the merger. A few questions on my side. How did you arrive at the swap exchange rate, because its implied valuation is about 1.3 times book for NBAD, about 1.7 for FGB and our numbers suggest a slight dilution of about 2% for NBAD shareholders? Obviously, that is quickly made up with synergies. I just wanted to know how you arrived at this particular exchange rate. Second of all, the cost reductions, if you could provide any granularity on the background within the retail, wholesale and head office functions, perhaps an indication of the financial synergies, which, I think, could be quite substantial given that the NBAD brand and hopefully credit ratings as you alluded to will stay for the most part. You alluded to revenue synergies of 2-3%, is this in terms of total revenues or in terms of earnings, because that is obviously a very different magnitude. Finally, is there a risk of an additional capital charge as a domestic systemic important bank under Basel III, beyond, potentially, the 1% charge which could be in the cards? Thanks.

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James Burdett

Hi there, how are you? I will take the first question on exchange ratio and then I will pass… yes, and then we will see how we go.

On the exchange ratio, clearly, both banks had investment bankers and advisors. They went through a number of various valuation techniques, all the way from a market base to a full DDM model and, clearly, there was a range of outcomes that came about, but what I would say is this is a merger of equals, and as you know, merger of equal transactions don't have any significant discount or premium to them, because you're talking about sharing management, retention of the name in NBAD's case, slightly better shareholder optics for FGB. Anyway, the board sat down and deliberated over it, both felt comfortable enough to recommend to shareholders that the transaction overall is extremely positive for the economy, extremely positive for the shareholders of both banks. We expect to generate significant synergies, and becoming the national champion with still international connectivity brings best in class from both sides together. I think you're right that the significant synergies mean we expect EPS accretion very quickly.

Our initial analysis suggests that we're broadly EPS neutral before synergies, and the synergies should really tip us over the line.

Karim Karoui

Then adding to that, basically, the major shareholders of both entities looked at the long-term picture, so for them it made a lot of sense to come to this agreement. As mentioned by James, a lot of discussions happened, the due diligence process highlighted a lot of things, and then after that, it came to the negotiation and then we ended up with this ratio of 52/48. Then we believe it is fair, it is validated by the two investment banks, they issued a fairness opinion on this for the shareholders, and we are all happy with this outcome.

James Burdett

In terms of synergies, these are very preliminary numbers at this stage, but of the half a billion, roughly 40% is from retail branches, about another 30% would be the wholesale integration, and another 30% is the enablement to merge. Then there are some other things we have obviously factored in, but there are also some costs that we have built in to be conservative, but we do expect it to be higher. We note that the market average on these sorts of mergers is around 8%. We have decided to go with that, but I will say that we think that that is a very conservative number.

In terms of your question around capital… I think from an NBAD perspective, we were already going to be a systematically important bank. I suspect FGB would have been there or thereabouts as well, so I don't expect a differentiation between us as a big bank and any other bank.

Karim Karoui

Yet to have the discussions with the Central Bank on this, so now when we will go to the Central Bank for their approval of the transaction, definitely we will have the discussions and then at this stage, the regulator sees that the capital for both banks is more than appropriate.

Jaap Meijer

In terms of synergies, the 2-3% is in terms of earnings or revenues?

Karim Karoui

That is the revenues.

Jaap Meijer

Revenues, yes, so the bottom line that could be double-digit.

Karim Karoui

… which would be coming from the cost of funds, from the cross-selling opportunities, rationalisation of the business models etc, so we expect, at this stage, it is quite premature to go for all the details on the revenue synergies, but this is the high-level guidance which we would give at this stage.

Jaap Meijer

I am a bit surprised by S&P, because I think both entities get a three-notch uplift, right, from the support from the Government versus baseline credit, so I would expect the other rating agencies at least to maintain the credit rating following the same logic.

James Burdett

Maybe I gave you the wrong impression, I think the call with all three rating agencies was very positive. We're obviously optimistic about retaining the rating for our combined entity respectively and it was just that one point around ownership that they said they would need to take into consideration, but we will see, and we will see very shortly.

Karim Karoui

Yes, exactly. I don't think we should speculate on the outcome of the rating agencies' report. We will wait maybe one or two weeks and then we will see how things will be picked up.

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Jaap Meijer

Excellent, thank you very much.

Operator

Our next question is from Mohammed Khallouf from Citi. Please go ahead.

Mohammed Khallouf

Hi gentlemen, thank you for having us on the call. My questions are two, actually. One is higher level, in terms of strategy, FGB is known more as a UAE-centric bank, while NBAD has been working on international expansion. What should we expect going ahead from the combined entity? My second question is on the branch point that you raised. You said you had maybe 20 FGB branches, 10 million each that could go because of overlap. What portion of the branches is Emirati in terms of payroll, and would that prove to be stickier?

James Burdett

In terms of the strategy, we have tried to give you a little bit of colour around the consumer business and the wholesale network business. Obviously, the new board needs to form and validate the strategy at some point in 2017, but my sense is you would expect more of the same. In other words, FGB and NBAD combine to become a national powerhouse in terms of a retail distribution footprint, generating more customer growth and ROE in this region, and the wholesale network strategy to remain. We're garnering liquidity to recycle into this environment where we see good relative opportunity, but also to pick up flows. It is not about trying to build an HSBC, it is about… if Mubadala tries to do a deal offshore, instead of that business going to a foreign bank, it should come to this new combined entity. I believe we have built up in terms of costs over the past three to four years a decent distribution platform and a very competitive product offering that is as competitive as the foreign banks. Really, it is more of the same, but it is not about going down market, down the risk curve internationally, it is about balance sheet, just lending balance sheet to anyone, it is about really trying to generate shareholder return and give the customers what they want, so I think it is more of the same to be honest.

Karim Karoui

Nothing to add on that one. On the branch point, so yes, both banks have branches in the UAE, the majority of the branches are in the UAE. We will see the locations of each of the branches and then we will decide which ones would be maintained. Usually, internationally, we have one branch in every country, that is the model which we are having, and then like in Singapore, in India, in Hong Kong etc, it is a wholesale branch, so we can build on the efficiencies there.

We didn't get your question exactly on the…

Mohammed Khallouf

In terms of payroll, what portion is Emirati? Would that be stickier? You would be unable to layoff, in a sense, would that be a fair assumption?

James Burdett

No, we're very clear that the combined entity will maintain, as its central priority, the whole Emiratisation agenda, so that is attracting and developing high performing UAE nationals. That is a state objective of the entity.

Karim Karoui

There has to be a balance at the end between expats and Emiratis.

Mohammed Khallouf

Okay, so just in terms of the number you gave, 8-12 million, how much of that is payroll maybe, Emirati payroll or non, is there anything you can give us there?

Karim Karoui

It depends on each branch and each of the banks and then each of the models, which we are using. It will always be a mix. We cannot get into that granularity at this stage. It is too premature. Maybe in the next quarter etc, once we sit together and then we have details on each of the branches' models used, then we can go and ask and respond to this type of question.

Mohammed Khallouf

Okay, thank you.

Operator

Our next question is from Chiradeep Ghosh from SICO Bahrain. Please go ahead.

Chiradeep Ghosh

Hi, thanks for hosting this call. My first question is on page 22, where you see the return on equity of FGB is 20.7% and NBAD is around 14.9%, while the combined entity's ROE is less than that. Please help me understand if I am missing something. Why should it be lesser than that? Is it something to do with the reverse model, which you just said? That is my first question.

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James Burdett

Yes, I think that is because of the goodwill upon consolidation is diluting both, so I think a better metric for you is return on tangible equity, which is approximately, in the middle of both, it is 17%.

Chiradeep Ghosh

My second question is… as we understand from outside is very, very different work culture for the two banks. Do you see high integration risk, which the bank might face… I mean, would it be as smooth as you are foreseeing at this stage, is this possible?

James Burdett

Look, I think, NBAD, there is no question, has gone through pretty significant change over the past three years. I think it is clear that FGB have a high entrepreneurial spirit and culture within the organisation. I think NBAD is heading towards them and they are sort of heading towards us a little bit. I think the clash of culture, again, is a little bit overstated and I think we can work well together.

Karim Karoui

It is a matter of leadership, so if you have the right leaders to handle this new entity, definitely, the culture will be adopted and then mixed between the two entities.

Chiradeep Ghosh

And the last one, I don't know whether you would be willing to share this information or not. You said a 63% free float; tentatively, can we get an idea how much of this would be from the Royal Family, approximately.

Karim Karoui

It is approximately 33%, slightly less than ADIC.

Chiradeep Ghosh

That is all from me, thank you very much.

Operator

Our next question is from Yavuz Uzay from Merrill Lynch. Please go ahead.

Yavuz Uzay

Hi, thank you very much. One of my questions is about the goodwill, which I understand is going to be around AED 20 billion, is answered, because we calculate based on last 12 month earnings and the return on tangible equity of the combined entity will be more like 16.2%, and you calculate post goodwill ROE to be around 14%. Now, you said that we should be looking at more like 17% return on tangible. Can we take that 17% as a 2017 or 2018 expected return on tangible for the combined business, or that 17 is your estimate of the pro forma last 12 months return on tangible. In relation to that question, I also have another question. Can you give us a preliminary two years out steady state profitability level or return on tangible equity level for the combined entity, if everything goes according to plan. Thank you very much.

James Burdett

In response to your first question, the 17% figure we put out there is the estimated pro forma return on tangible equity for the last 12 months.

So your goodwill figure is a bit high from our initial calculation. What I would say is in terms of the go-forward, look, that would be premature for us to give an indication, but I am pretty sure shareholders of the bank will want it to be a very high ROE accretive bank, so I would suggest that we don't envisage dilution. This still is a premature comment in terms of us trying to understand the strategy and what we're trying to do.

Karim Karoui

As long as we are above the 15%, 16%, so that should be fine, so this should be the target at initial stage for such a large entity, until we do the exercise of the synergies, on the revenue side, on the cost side etc, and then definitely we will target an appreciated level of return on equity.

Regarding the goodwill, definitely we are going into an intensive exercise of calculating the goodwill, identifying the intangible assets etc. It is too premature now, so this task will be sorted out over the coming maybe two to three months, and then we will see. Then the exercise is quite complex and then every year the impairment of the goodwill is assessed etc. At the end, as long as the banks are having a kind of market value higher than the book value, you won't expect an impairment of the goodwill. At this stage, frankly speaking, we are not worried about the impact of the goodwill on the P&L of the bank.

Yavuz Uzay

Okay, you were saying that in the factsheet, $24.5 billion equity translates to roughly AED 90 billion, and if you add the equity of the two banks based on first quarter numbers, you have AED 70.4, so roughly 20 billion is your preliminary estimate of goodwill that goes into your calculation, right?

James Burdett

I think you might be forgetting the AT1 in your calculation.

Yavuz Uzay

True, so… okay, so that is why the return on tangible goes up to 17%.

James Burdett

Yes and your goodwill is overstated.

Yavuz Uzay

Thank you.

Operator

We have no further audio questions. Dear speakers, we can now take the web questions.

Sofia El Boury

Okay, we have a question from Elena Ponseca from Al Ramz Capital about the timeline. What is the timeline of the proposed merger?

James Burdett

I think you will find that in one of the slides, I can't remember which number, but we're expecting confirmation in the first quarter '17. It is on slide 23.

Sofia El Boury

Let's take the next audio question please, it is going to be the last one.

Operator

Our next question is from Waleed Mohsin from Goldman Sachs. Please go ahead.

Waleed Mohsin

Thank you very much for the presentation. Congrats on achieving this milestone. A couple of questions from my side. The first question is a follow-up on the question around strategy, so I was wondering how shall we think about the new entity's role in consolidation in the sector which has been talked about, and especially given that there are a number of banks which are still owned by ADIC, and there are a number of smaller banks in the market which trade at below book. I want to understand how you would think about the role of this combined entity in any future consolidation in the sector. Secondly, James you touched upon the strategy of the bank, you mentioned that the bank will be very, very focused. It is not going to be a play on going dramatically inorganically across the globe. I just want to get a sense of how shall we think about the strategy, how much of the growth or the drive from the bank is going to be focused on growing market domestically and looking at opportunities within the domestic circle. How much of that would be a focus on looking at opportunistically at any options that are available in the broader MENA space. That is question number one.

Then secondly in terms of question number two on cost of funds, if we look at the opportunity, you mentioned that there could be some on the cost of funds side as well, and if you compare the two banks, I think the major differences are in credit rating, which you obviously discussed in detail, and the second part is in terms of the low cost – deposit cost or deposit mix where, obviously, NBAD has had an advantage, 30% versus 20%. I was wondering if you keep the rating aside, what are the opportunities? How much can you actually push [costs] for the combined entity going forward. Is that a real opportunity that the management sees.

Finally, just a question linked to this, the credit rating, you discussed, that is obviously the rating agencies' decision, but I believe that some of the existing bonds issued by National Bank of Abu Dhabi also has a clause which requires NBAD's ownership by the Government at 50%, so that falls below. Do you see any impact on the existing bonds and how that would impact cost of funds going forward? Thank you very much.

James Burdett

That is a comprehensive set of questions. Starting with your first one in terms of consolidation domestically, my sense is we have got enough on our hands bringing these two great institutions together, to think about folding in more institutions in the current timeframe, I think would be very difficult to envisage, but you never rule these things out. What I would say though is I do believe consolidation will continue to happen in this market. I think it makes a lot of economic sense. We have always thought it was a matter of when and not if, so I think you will see more consolidation.

To your question about consolidation offshore, we have no intention at this stage to a QNB style of acquiring banks offshore. I think we have got enough to manage here and I think our prime focus is to build an integrated bank in the UAE and really target growth in the UAE and really using the scale, the complimentary strength to build off that and take business off our competitors.

In terms of your question around cost of funds, yes, there is no question that we enjoy a lower cost of funds. I still believe our CASA balance is, particularly in the wholesale and the SME space is underweight. We have only just rolled out a cash platform. FGB have a very strong consumer franchise which is also CASA based. We believe if the ratings are maintained, there is significant revenue synergies to be had by, essentially, applying the new entity's cost of funds across the entire balance sheet. That is an absolute fact. We have done estimates obviously around the size and shape of that, but that is something we're not prepared to disclose, because it obviously depends on a whole number of factors when we consummate next year.

In terms of the credit rating, you're right, we do have change of control clauses in some of our bonds and EMTN programmes, and if they are below par, we would fully expect them to be cashed in. We have accounted for that in the M&A. We understand the liquidity requirements and, clearly, this is something that happens upon confirmation, so it is next year and we have got plenty of time to build a funding base. Long story short, I think we have got a lot of upside in terms of funding and liquidity. NBAD's distribution network plus rating garners deposits offshore, FGB's strong consumer franchise is obviously related to deposits and we're rolling out cash platforms now which we can use to really attack the corporate and SME market locally.

Was that all of your questions? I think I have…

Waleed Mohsin

Yes, thank you so much, that is very clear, thank you.

Operator

Thank you for your time today, if you have any follow-up questions, please feel free to contact Michael or Sofia directly. Please note that the replay of the webcast will be available on a dedicated microsite, www.bankfortheuae.com from tomorrow moaning 9am UAE time. A full transcript should be posted as well within the next few days.

Thank you, you may now disconnect.

End

*Edited