Gulf Bank of Kuwait

Earnings Conference Call Edited Scrip – Q3 2018

Monday 29th October, 2018

Corporate Participants:

Mr. Antoine Daher – CEO

Mr. Kevin Smith – CFO

Ms. Dalal AlDousari – Head of Investor Relations

Host:

Mr. Karim Kekhia - Arqaam Capital

List of Participants:

Ajeej Capital DIFC Ltd
AKCB
Albilad-capital
AlShall Consulting
Arqaam Capital
BNKH
Capital Investments
Daman Investments
EFG Hermes
Franklin Templeton
Jamsons
KAMCO
National Bank of Kuwait
NBK Capital
Rasmala Investment Bank
S&P Global
SICO
The National Investor

Karim: Good afternoon everyone and thank you for joining us today. This is Karim Kekhia and on behalf of Arqaam Capital I am pleased to welcome you to Gulf Bank's third quarter 2018 earnings conference call. I have with me here today from Gulf Bank management Mr. Tony Daher, the chief executive officer, Mr. Kevin Smith, the chief financial officer and Ms. Dalal Aldousari, the head of Investor Relations. Without any further delay, I will now turn the call over to the Head of Investor Relations, Ms Dalal Aldousari.

Dalal: Thank you, Karim. Good Afternoon and Welcome to Gulf Bank's third quarter 2018 financial results conference call. My name is Dalal Aldousari from Gulf Bank's investor relations team. We will start the call today with a presentation of the key highlights of Gulf Bank's performance during the first 9 months of 2018 by the Chief Executive Officer, Mr. Tony Daher followed by a detailed presentation of our financial results by the Chief Financial Officer, Mr. Kevin Smith. After the presentation, we will open the floor for Q and A received through the webcast facility. Feel free to type in your questions at any time during the call. The presentation will be available at our corporate website, www.e-gulfbank.com, and will be disclosed to Boursa Kuwait.

Please note that we can only comment on inquiries and information that are disclosed publicly. I would like to draw your attention to the disclosure on page two of the presentation, with respect to forward looking statements and confidential information. Please feel free to reach out to our investor relations team at investor.relations@gulfbank.com.kw if you have any inquiries.

I would like to handover the call now to Mr. Tony Daher, Gulf Bank's CEO. Tony?

Tony Daher: Thank you, Dalal. Good afternoon. I'm very happy to be with all of you today to share some brief highlights of Gulf Bank.

If you turn to **page 3** on the far right, you can see that we accelerated the growth in our net profit from KD 13 million in the third quarter of 2017 to KD 16 million in the third quarter of 2018, an increase of

19%. The second quarter increase was 19% and first quarter growth rate was 15%.

For the first 9 months, we grew our net profit to KD 43 million, an increase of 18% compared to the same period in 2017.

This growth rate is an acceleration of the 12% growth rate achieved in 2017 and the 10% growth rate in the three preceding years from 2013 to 2016.

So, we continue to see an uplift in our momentum in the most recent quarter and this has resulted in very strong performance over the first 9 months of this year.

We are also happy with the growth of our loan portfolio as our net loans and advances to customers grew by 7% compared to 30 September 2017.

Turning to **page 4**, and in line with Gulf Bank's new strategy of Customer Service and Innovation, the Bank launched the Gulf Bank Cashback card, which provides cardholders up to 10% cashback on all local and international spends. The program has been built around the spending patterns of our customers and extends a new line up of cards that were introduced to all customer segments in the second quarter of 2018.

In addition, the Bank also announced the launch if a revamped website. This website was designed using the best global practices and introduces many new features to enhance the overall customer experience.

In addition, as part of our continuous commitment to our community, we are proud to host the iconic 'Gulf Bank 642 Marathon' for the fourth consecutive year on November 17th, 2018. This event is the only accredited race in Kuwait by the Association of International Marathons and Distance Races and the International Association of Athletics Federations. Last year's marathon was an unprecedented success with 6,000 attendees representing over 130 nationalities competing at the event.

Page 5 shows the favorable progression in our credit ratings since 2013. In the highlighted box, you can see that we are currently rated A3 by Moody's with a positive outlook, A- by S&P with a stable outlook, A+ by Fitch with a stable outlook, and A- by Capital Intelligence with a stable outlook.

Now I'll turn it over to our CFO, Kevin Smith, who will cover the financials. Thank you.

Kevin: Thank you Tony. To start off, I would like to turn to **page 6** which shows the balance sheet progression from the 30th of September 2017 to the 30th of September 2018. This page also shows the mix of assets and liabilities and how that has changed over the last 12 months.

First, I would like to focus on Assets which are shown on the top half of the slide, line items 1-13.

On the 30th of September 2017, we had approximately KD 5.6 billion of assets which is shown on line 13. You can see on line 5 that 29% of these assets were held in the form of liquid assets, 65% in net loans, shown on line 8, 2% in investment securities which is shown on line 9, and 4% in other assets, shown on line 12. Over the course of the last 12 months, our total assets grew by 5% or KD 292 million to approximately KD 5.9 billion and the mix of our assets has been stable. You can see that our liquid assets, line 5 on the far right, grew by KD 81 million or 5% while our net loans, line 8, grew by KD 263 million or 7%. Our liquid assets are still a healthy 29% of our balance sheet while our net loans now comprise 66% of our total assets, up slightly from 65% a year ago.

Investment securities, which is shown on line 9, remained at 2% of total assets.

Other assets, line item 12, shrank by KD 56 million or 27%, mainly due to selling repossessed collateral and that balance sheet category now represents 2% of total assets, down from 4% a year ago.

You can see on lines 19 and 20, on the far right that, of the KD 292 million in asset growth over the period, KD 270 million of that growth was funded with liabilities while KD 22 million was funded with equity. Customer deposits and Deposits from Financial Institutions led the growth in Liabilities, up KD 190 million and KD 124 million, respectively while Bank funding dropped by KD 46 million. Those numbers are shown on the far right of lines 14 through 16.

Average assets and average equity are shown on line items 22 and 23 as this allows us to calculate our first nine months return on assets and return on equity which I'll discuss later.

Page 7 shows our key liquidity ratios. On the left side, you can see that our average daily Liquidity Coverage Ratio increased from 285% in the Third quarter of 2017 to 388% in the third quarter of 2018. The average in the second quarter of 2018 was 325%. These ratios are well above the minimum of 100% that comes into effect on the 1st of January 2019. In 2018, the minimum is 90%. On the right side of the page, NSFR ratio increased from 104% at the end of the first quarter of 2018 to 107% at the end of the second quarter to 120% at the end of the third quarter of 2018 compared with the minimum of 100%. So our liquidity is strong with more than adequate buffers in both ratios.

Page 8 shows our income statement and some other key metrics. To give you context, we continue to show the full year results for 2016 and 2017 on the left-hand side and you can see the first nine months performance in 2017 and 2018 on the right-hand side. In addition, for the first nine months of 2017 and 2018, we are showing the composition of our return on assets and those are shown under the columns marked '% of average assets' for both periods.

As Tony mentioned, you can see from the circled percentages on line 12 that our Net Profit grew by 10% and 12% in 2016 and 2017, respectively. As Tony also mentioned, you can see on the far right that the growth rate in Net Profit for the first nine months of 2018 vs. the first nine months of 2017 has accelerated to 18%. If you move up the income statement and look at the circled percentages on lines 3, 5, 7, and 9, you can see when you compare our results in 2016 to 2015:

Net Interest Income on line 3 declined by 2%
Core Operating Income on line 5 was flat
Core Operating Margin on line 7 declined by 3%
and
Operating Margin declined by 3%

You can see that this turned around in 2017 as:

Net Interest Income went from -2% in 2016 to +13%

Core Operating Income went from 0% in 2016 to +9% Core Operating Margin went from -3% in 2016 to +15%
and
Operating Margin went from -3% to +11%.

On the far right for those same line items, you can see that, in the first nine months of 2018 vs. the first nine months of 2017, we either accelerated or maintained the momentum as our:
Net Interest Income is up 19%
Core Operating Income is up 13%
Core Operating Margin is up 16%
Operating Margin is up 9%
Net Profit is up 18%

I've circled all those percentages on page 8, so you can see the historical trend and recent momentum.

This turnaround is driven primarily by the strong net loan growth of 7% as mentioned by Tony as well as expanding net interest margins. You can see the net interest margin improvement by looking at net interest income, line 3, under the column marked '% of average assets'. In the first nine months of 2018, our NIM reached 2.66%, 33 basis points higher than the first nine months of 2017 of 2.33%.

In terms of operating expenses, our objective is to have sufficient capacity to run the bank and fund important initiatives in the Bank in such a way as to ensure that the growth in our operating income doesn't get eaten up by a higher growth rate in operating expenses. In other words, drive a lower cost to income ratio.

On the far right of line 6, you can see that in the first nine months of 2018, expenses were 8% higher than the first nine months of 2017. This was mainly driven by costs associated with the amended labor law. Even with those higher costs this year, our cost to income ratio in the first nine months of 2018 is 33.2% which is slightly lower than the prior year and 2.2% less than the 2017 full year cost to income ratio of 35.4%, as shown on line item 14.

On line 10, Provisions and Impairments in the first nine months of 2018 were KD 53 million, representing 55% of operating margin compared to 58% for the same period in 2017.

In terms of return on assets, at the bottom of the columns labelled '% of average assets, you can see that our return on assets of 87 basis points in the first nine months of 2017 improved by 11 basis points to 98 basis points in the most recent nine months. Similarly, on line 13, you can see our return on equity also improved from 8.4% to 9.5% over this same time period.

Page 9 shows the progression of our non-performing loan ratio. On the 30th of September 2018, the ratio was 1.5%. As you can see, this ratio has dropped considerably over time.

On **page 10**, our regulatory capital and leverage ratios remain well above their respective minimums. The reduction in the ratios from the first nine months of 2017 is a result of the numerators, that is, Tier 1 and total capital, growing at 3% after 55% of our net profit was paid out whereas the denominator, which is risk weighted assets, grew at a faster 7% pace, mainly driven by our 7% net loan growth over this period. Please keep in mind the KD 43 million in first nine months of 2018 Net profit is not included in Tier 1 or total capital in the third quarter 2018 ratios as that happens at the end of the year. Doing so would add approximately 100 basis points to both capital ratios. Tier 1 capital still comprises nearly 80% of our total capital.

On the bottom right, the leverage ratio decreased slightly from 8.37% at the end of September 2017 to 8.20% at the end of September 2018, but remains well above the regulatory minimum of 3%.

In summary, the turnaround in the growth rates in Net Interest Income, Core Operating Income, Core Operating Margin, and Operating Margin in 2017 vs. 2016 has continued into the first nine months of 2018 vs. 2017. In addition, we have sufficient liquidity and capital to support continuing that momentum.

Now I would like to hand it back to Dalal for the Q & A session.

Dalal: Thank you Kevin. Now we are ready for Q and A. if you wish to ask a question, please type your question into the ask a question text area, then click the submit button. We will allow a couple of minutes to receive your questions.

Dalal: Loan growth was lower in Q3 18. Was this because of the unusual high level of repayments. Could you provide corporate loan growth vs retail loan growth in Sep 2018 vs December 2017? Kevin?

Kevin: Ok thanks Dalal. I think what we were seeing at least lets start with the industry. The industry growth rate has been fairly slow. Latest data we have is through the end of August from Central Bank of Kuwait. It is hovering around sort of 2% through the first 8 months. When I compare that with how we are doing on both the corporate and retail side, at the corporate side has been also pretty sluggish as far as loan growth. Having said that we see a strong pipeline and the way we define pipeline is essentially two pipelines – one is sort of a credit pipeline which is those deals that are waiting credit decisioning and the second pipeline are those deals that have already been credit approved but are waiting drawdowns. And the strong pipeline we are seeing is actually in the second bucket which is good news because obviously these deals have been credit approved. On the retail side, we are also seeing a bit of slowdown in the industry in the first 8 months but the good news is from our banks perspective we are actually growing our retail loans faster than the pace of the industry. And we have actually gained market share as a result over the first 8 months of the year.

Dalal: Next question. What is driving the improvement in the NIM that we have seen this year? Kevin?

Kevin: Ok Thanks Dalal. I would say there are three principal drivers of that. One is obviously the Central bank is increasing rates and with the latest increase in rates obviously our corporate portfolio reprices immediately. Our retail portfolio reprices over time just with new volume. So obviously, we are seeing an impact which all banks are seeing for the most part in Kuwait as a result of Central Bank following the Fed in March of this year. That's no.1. Two is, if we continue which is the case of the first 8 months of 2018, to drive retail growth faster than corporate growth, our yields on our retail portfolio are higher than our corporate loans. So therefore the mix has a positive impact on margin. No2. No 3 is again we are starting to now see the impact of repricing the entire retail portfolio to a closer rate that would approach sort of a 6% count now which is 3% Central bank rate plus 3% in terms of the maximum amount which you can charge over and above the CBK discount rate. So those 3 factors that are really driving the NIMs.

Dalal: The next question. I would like to understand the movement in repossessed collateral going forward. We have seen an impairment of KD 6.6 million on a year to date basis. Can you please provide some guidance on whether we can expect this to continue? Any update on Khabary land? Kevin?

Kevin: Ya. I mean we have seen a dramatic decline in the other assets category mainly driven by reduction of repossessed collateral as we continue to dispose off collateral that is associated with loan defaults. We do not expect that to get too big over time because obviously the goal is to sell those collaterals that is not part of our strategic bank if you will, in terms of our strategy. Having said that Khabary land is expected, we are expecting to acquire that land at that point in time until we sell it they would obviously been uptick in the repossessed collateral. We have up to 3 years per CBK rules to sell real estate assets after it is repossessed. So that's the major driver in that category right now.

Dalal: Any further clarity on land deal? Title transfer and sale of land? Kevin?

Kevin: Thank Dalal. We are still in the process of transferring the title deed to the land but obviously that is just based on the government process so we can't predict when is that going to happen, but it's well underway but I'm not going to predict which quarter that will happen.

Dalal: We tried to answer and cover as many questions as we could. We would like to conclude our call today and we thank you for your participation. If you have any further questions, you may visit our investors relations page at our corporate website. You can also reach us at our dedicated investor relations email investor.relations@gulfbank.com.kw. Thank you for your participation. Back to the operator.