Gulf Bank of Kuwait (K.S.C.C.)

Earnings Conference Call Edited Script – 1st Quarter 2022

9 May 2022

Corporate Participants:

Mr. Tony Daher – CEO

Mr. David Challinor – CFO

Ms. Dalal AlDousari – Head of Investor Relations

Host:

Ms. Elena Sanchez – EFG Hermes

Elena: Good morning and good afternoon, everyone. This is Elena Sanchez, on behalf of EFG Hermes; I would like to welcome you all to the Gulf Bank first quarter 2022 earnings conference call. It is a great pleasure to have with us on the call Mr. Tony Daher, Gulf Bank CEO, Mr. David Challinor, Gulf Bank CFO and Ms. Dalal AlDousari, Head of Investor Relations at Gulf Bank.

I will now turn the call over to Dalal.

Dalal: Thank you, Elena. Good afternoon and welcome to Gulf Bank's first quarter 2022 earnings call. We will start our call today with the key highlights and updates on the operating environment of Gulf Bank during the first quarter 2022 presented by our Chief Executive Officer, Mr. Tony Daher followed by a detailed presentation of our financial results by the Chief Financial Officer, Mr. David Challinor.

All amounts in the presentation are in millions of Kuwaiti Dinars and have been rounded to simplify the charts. During our presentation, we will try not to repeat the currency when discussing specific amounts unless that amount is in another currency other than Kuwaiti Dinars.

After the presentation, we will open the floor for Q and A received through the webcast platform. Feel free to type in your questions at any time during the call. The presentation will be available at our corporate website and will be disclosed to Boursa Kuwait.

Please note that we can only comment on inquiries and information that are publicly disclosed. I would also like to draw your attention to the disclosure on **page 11** of the presentation, with respect to forward looking statements and confidential information. Please feel free to reach out to our investor relations team if you have any questions.

Now, I would like to handover the call to Mr. Tony Daher. Tony?

Tony: Thanks, Dalal. Good morning and good afternoon, everyone, before we cover the detailed financial performance of the Bank, I would like to start with few remarks on the business and operating environment.

We started the year 2022 positively, with an increase of 26% in our first quarter net profit compared to the same period of last year. During the quarter, the Central Bank of Kuwait raised the discount rate by 25 basis points to 1.75% from its historically low level of 1.5%. The interest rate hike will have a positive impact on the topline, however we have also seen some pressure on the cost of funds building up gradually prior to the actual hike in anticipation of future hikes. Having said that, we do not see the increase in interest rates affecting consumer spending in Kuwait significantly. This was reflected in the good performance of the Bank's retail portfolio as it continued with the upward trajectory momentum. Going forward, and given the high level of oil prices, we hope to see more positive impacts on the overall economy in Kuwait with the improvement in business activities, ongoing recovery of government spending and in the same time inflation staying somewhat under control.

On the Bank front, we continue achieving notable milestones of our digital transformation strategy. We are happy to announce that we have successfully launched our new mobile application that provides fast, easy, and safe customer experience. In addition, we launched phase I of our upgraded contact center in the end of 2021 including the call center and the IVR, we aim to move forward with completing Phase II of the upgrade during this year.

In addition, our digital advisory and portfolio management platform 'Wise' continues to be successful for the fifth year in a row. Assets under management grew by 150% during the year 2021 while achieving record returns. The platform now offers additional new segments including an Islamic portfolio, which achieved returns of 19.1% and an Income portfolio, which achieved returns of 9.7% for the year 2021. This is part of the Bank's strategy to provide tailored products and services to its targeted consumer segments, including the affluent and high net worth individuals.

As for our branch network, the Bank's local footprint is one of the largest in Kuwait as we currently cover various areas with 53 branches and over 300 ATMs. In addition to the opening of a new branch at the Kuwait International Airport branch last year, we will continue with our branch network expansion in order to serve our customers in the new residential areas, all as part of our strategy to provide the most convenient services for our customers.

Moving on to sustainability, we are expanding on our commitment to drive sustainable growth and will continue to integrate ESG principles across the businesses and operations of the Bank. I am looking forward to publishing our second Sustainability report this year and start measuring ourselves against the targets that we have set.

Now turning to Page 2, I would like to summarize our financial results with six key messages:

First, our net profit grew by 26% for the first quarter 2022, to reach KD 15 million in comparison to KD 12 million in 2021.

Second, our return on average equity increased to reach 9.2% for first quarter 2022 from 7.6% at same period last year.

Third, our gross customer loans reached KD 4.8 billion, an increase of KD 335 million or 7% compared to the first quarter of 2021. This growth was supported by both our Corporate and Consumer segments although at a faster pace for the latter.

Fourth, the quality of our portfolio continued to be resilient as our non-performing loan ratio (NPL) in first quarter 2022 stood at 1.0%, an improvement when compared to last year (NPL) of 1.5%. Additionally, we continue to have ample provisions achieving an NPL coverage ratio of 548%.

Fifth, the relaxed capital regulatory minimums that were introduced in 2020 were partially restored starting from first of January 2022 and will remain for the remainder of the year. With that, our Tier 1 ratio has a buffer of 358 basis points, and our capital adequacy ratio has a buffer of 384 basis points. These comfortable buffers have allowed the Bank to continue its growth trajectory and support the needs of its customers in line with its strategy.

And sixth, the Bank remains an 'A' rated bank by three major credit rating agencies. Our current position stands as follows:

- Moody's Investors Service maintained the Long-Term Deposits Rating of "A3" with a "Stable" outlook.
- Capital Intelligence maintained the Bank's Long-term Foreign Currency Rating of "A+" with a "Stable" outlook.
- Recently, Fitch Ratings has upgraded the Viability Rating of the Bank from 'bb+' to 'bbb-' and affirmed the Bank's Long-term Issuer Default Rating at "A" with a "Stable" outlook.
- S&P Global Ratings has maintained the Bank Issuer Credit Rating at "BBB+" with a "Stable" outlook.

So, our performance during the first three months of 2022 has provided a strong foundation to sustainable growth and we remain optimistic about the remainder of the year.

With that, I'll turn it over to our CFO, David Challinor, who will cover the financials of the first quarter of 2022 in more depth, thank you. David.

David: Thanks Tony.

David: **Turning to page 3,** we can see the evolution of net profit from 12 to 15. The increase of 3 was driven by three positive factors. First, we had a higher non-interest income of 0.4 as a result of the resumption of economic activities in comparison to a very restrictive environment in first quarter of 2021. Second, managing expenses efficiently without hindering our transformation program allowed us to lower our operating expense by 0.7, and third, our total provisions reduced by 2.6.

You can also see our Return on Equity improved by nearly 1.6% over the same period.

Turning to page 4, we have a more detailed breakdown of our income statement by line items.

On the far right of line 1, interest income was up 1.4 or 3% in first quarter 2022 in comparison to same period of last year.

On line 2, our interest expense increased by 1.8 or 14%, from 12.6 in first quarter 2021 to 14.4 in 2022. This was the result of upward pressure on cost of funds in anticipation of potential rate hike.

On line 6, operating income remained flat reaching 41.5 in first quarter 2022, this was due to the decline in net interest income that was almost set off by an increase in non-interest income. The non-interest income improvement is mainly driven by an increase in the fees and foreign exchange income of 0.3 or 4%, due to the full resumption of economic activities.

On line 7, operating expenses have declined by 0.7 or 3% year-on-year, with Cost to Income Ratio of 47.7%. We continue to invest in our digital transformation strategy and attracting new and seasoned professionals, while advancing our human capital.

In the green boxes on line 9, you can see our credit costs declined by 3.2 from 8.3 in first quarter 2021 to 5.1 in 2022.

Turning to page 5, we can see the balance sheet and how the individual line items have moved from first quarter 2021 to same period in 2022. This page also shows the mix of assets and how that has changed over the periods.

First, I'd like to focus on Assets, which are shown on the top half of the slide.

Over the last 12 months, our total assets increased by 221 or 4% to reach 6.5 billion compared to 6.3 billion the year before. This was largely driven by a 440 or 10% increase in Net Loans, (shown on line 9) reflecting a pick-up in overall economic activity in comparison to the prior period. While, compared to the yearend 2021, Net Loans were almost flat as a result of settlements in corporate book, despite the continued growth in the consumer segment.

In terms of the major components of total assets (shown in bold), you can see that the mix is essentially unchanged from a year ago.

On line items 15, 16, and 17, you can see that nearly all our funding comes from Due to Banks, Deposits from Financial Institutions, and Customer Deposits. We were able to improve the CASA ratio from 37.4% in first quarter 2021 to 41.0% in 2022 which is on line 27.

On line item 18, in May 2021 we fully redeemed our 100 million subordinated Tier 2 Bond and replaced it with a 50 million Subordinated Tier 2 Bond at a lower rate. In addition, we secured 195 million of mediumterm funding.

Moving on to asset quality, our non-performing loan ratio, shown on line 25, was 1.0% at the end of March 2022, down from 1.5% for the same period last year. Our coverage ratio on line 26, remains exceptionally strong reaching 548% at the end of March 2022.

Now, turning to Page 6 you can see in the chart on the left that as of 31 March 2022, the Bank has 116 of excess provisions, representing 39% of total provisions. This was as a result of a decline in the IFRS 9 ECL by 17 to 180 as of 31 March 2022 in comparison to 197 at the same period of last year.

Looking at the pie charts on the top right of the page, you can see that our stage 1 loans are above 90% for both periods, while Stage 2 declined from 5.9% to 4.5% as of 31 March 2022 and Stage 3 declined from 1.6% to 1.0%.

The first chart on the bottom right side of the page shows the IFRS 9 ECL Stages composition. Stage 1 increased to 22.9%, from 20.5% a year ago, Stage 2 increased from 39.7% a year ago to 47.0% as of 31 March 2022 and Stage 3 reached 30.1% improved from 39.8% a year ago.

The second chart on the bottom right of the page shows the IFRS 9 ECL coverage for our total credit facilities. As of 31 March 2022, it was 0.6% for stage 1, stage 2 was 17.7% and stage 3 was 76.1%. However, our overall coverage is much higher since we have provisions of 116 over the IFRS 9 ECL requirement of 180.

Turing to page 7, on the top left, our Tier 1 ratio was 14.1%, which is well above our current regulatory minimum of 10.5% and our pre-COVID-19 regulatory minimum of 12%.

On the bottom left, our Capital Adequacy Ratio of 16.3% was well above our current regulatory minimum of 12.5% and our pre-COVID 19 regulatory minimum of 14%.

Our risk weighted assets, shown on the top right, grew by 4% mainly driven by year-on-year growth in the loan book.

On the bottom right, our leverage ratio as of 31 March 2022 reached 9.3%, which was lower than 9.4% for the same period of last year, and well above the 3% regulatory minimum.

Turning to page 8, we can see our key liquidity ratios. On the left side, you can see our quarterly average daily Liquidity Coverage Ratio was 284%, and on the right side, Net Stable Funding Ratio was 108% as of 31 March 2022. It's worth noting that both ratios are still well above their respective current minimums of 90% and pre-covid minimums of 100%.

Also, during the fourth quarter of 2021 the Central Bank of Kuwait communicated that it will gradually start withdrawing the relaxed regulatory limits for the Liquidity Ratios and Capital Adequacy Ratio and restore them back to the pre-covid levels by beginning of 2023.

With that, I'd like to turn it back over to Dalal for the Q and A session.

Dalal: Thank you David. We are now ready for Q and A. If you wish to ask a question, please submit your question into the designated questions text area. We will pause for few minutes to receive most of your questions.

(Pause)

Ok, we will go through the questions.

Dalal (Q1): Please provide more color around your loan growth in the quarter and what segment drove this growth? How does the pipeline look for 2022?

David (A1): Yes. If we look at the customer loan growth for Q1 we can see it was flat year to date. However, what we saw was strong growth in the consumer book that was offset by a contraction on the corporate side.

In terms of consumer, we saw a 3% growth for the quarter which was very strong and in line with our pace of growth we saw last year. When you compare our growth to the system, as per the CBK data, we saw to the end of February a 1.2% growth. So, we're trending ahead of the market in the consumer segment and would expect this to continue.

With corporate, there were some major settlements, one of which was deferred from fourth quarter, and these caused the book to contract despite doing some fresh deals in the quarter. Most of those accounts were sitting in stage 2, so the good news is these settlements were a positive for our overall asset quality.

Having said that, we've seen that the system growth in corporate was exceptionally strong for the first 2 months, and we have a healthy pipeline of deals and are expecting to return to growth in the second quarter.

Dalal (Q2): Could you highlight on NIM's trend? We have seen cost of funds growth outpace the interest income, despite having 1 rate hike coming during the first quarter. Do you see pressure on asset yield and what forces are affecting it?

David (A2): Thanks, Dalal. As I said on the yearend 2021 investor call, we expected a margin drop in Q1 and that's what we saw. The cost of funds rose during the quarter as expectations of future rate rises fed through. And also, we saw top line yield pressure as the market continues to be very competitive, particularly on the retail side, where we are seeing some very tight pricing dynamics play out.

In terms of the rate rise, yes that had some positive impact, but as you know it came late in the quarter, so we won't see the full impact of this one until Q2.

Dalal: **Thanks David. We will pause for few minutes to receive more questions.**

(Pause)

Dalal (Q3): **Did Kuwait Central Bank follow the latest 50 basis points increase?**

David (A3): No, they increased 25 basis points.

Dalal (Q4): **Credit costs were very low in first quarter of 2022, can we expect this rate to continue? Where there any recoveries in the first quarter of this year?**

David (A4): Yes, credit costs were very low and translated to only a 43 basis-point cost of risk. To put that in perspective we had 95 for the full year 2021, and 131 basis points for the year before, so everything is moving in the right direction. I think from quarter to quarter we can see some variability, but the overall trend is that we are confident we could remain below the normalized level of 1% for the remainder of this year.

Looking at NPLs. The percentage remained broadly stable at 1% at the end of Q1, and we've seen a reduction in the percentage of accounts in stage 2, its only 4.5% now, which is very low when you compared to other banks in the system. So, all the asset quality indicators are very positive, which is why we think 2022 will be a sub-normalized cost of risk year.

In terms of recoveries, we did have some solid recoveries in the quarter, but in terms of P&L presentation these were reduced by write-offs we took on settlements.

Dalal (Q5): **What percentage of your retail book would reprice within 3 to 6 months for rate movements?**

David (A5): When you look at the rate movements in the repricing on the corporate side it reprices straight away. On the retail side, we would be repricing all the new business and also any loan on the book that was greater than 5 years old.

Dalal (Q6): **Regarding the news on the investment subsidiary of the Bank, could you please provide us with some color? Tony, would you like to take this one?**

Tony (A6): Sure. During the 2021 AGM, Gulf Bank obtained the approval of the shareholders to add to its activities the ability to be an investment advisor and practice all advisory services in accordance with the laws and regulations of the Central Bank of Kuwait and the Capital Markets Authority the CMA. Subsequently, the Bank obtain the CBK approval to establish the fully owned investment subsidiary. Now, we are in the process of obtaining the CMA approval, and then will proceed with the rest of the establishment procedures.

So, the investment subsidiary activities will be focused on asset management and advisory services, both will be complementary activities to the Bank, where it will enhance customer offerings predominantly towards the private banking clients and the corporate segment. We believe this complementary business will improve the fees and commission income overtime for the Bank. However, it's still early in the process and will initially have no material impact on the Bank's financials.

Dalal: Thank you, Tony.

Dalal: I believe we have covered the majority of the topics and questions that were raised today during the call. Having said that, I would like to draw your attention to page 10, that summarize some of the guidance points that we have covered during the Q&A session:

1. For loan growth, our strategy is to grow faster than the market.
2. For our Margins, we expect a short-term downside, until interest rate hike fully materializes. Then Margins will expand.
3. Our cost to income ratio is expected to improve.
4. The cost of risk will likely be under the normalized level of 100 basis points.
5. And finally, non-performing loans ratio is expected to remain under 2%.

And with that, we would like to conclude our call for today.

If you have any questions, you may visit our investor relations page at our website or reach us at our dedicated investor relations email. Thank you all very much for your participation today.