Earnings Conference Call Edited Script – First Quarter 2024

6 May 2024

Corporate Participants:

Mr. Waleed Mandani – Acting CEO

Mr. David Challinor – CFO

Mr. Youssef Dib – Investor Relations Team

Host:

Ms. Elena Sanchez – EFG Hermes

[GBK Classification: PUBLIC]

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 of 2024 earnings conference call. It is a great pleasure to have with us on the call Mr. Waleed Mandani, Gulf Bank Acting CEO, Mr. David Challinor, Gulf Bank CFO and Mr. Youssef Dib, from Investor Relations Team at Gulf Bank.

At this point I would like to hand over the call to Mr. Youssef Dib, please go ahead.

Youssef: Thank you, Elena. Good afternoon and welcome to Gulf Bank's first quarter 2024 earnings call. We will start our call today with key highlights and updates on the operating environment of Gulf Bank during the first quarter of 2024 presented by the Acting Chief Executive Officer, Mr. Waleed Mandani 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 10** 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. Waleed Mandani. Waleed?

Waleed: Thank you, Youssef.

Good morning and good afternoon, everybody and thank you for joining us today for our earnings call.

Allow me to start with a brief preview of our operating environment to provide context on the economic landscape within which we operate.

During the first quarter of 2024, the Kuwaiti economy has witnessed notable developments related to political changes and fiscal pressures, with the banking sector playing a pivotal role amidst dynamic market conditions which has impact investor sentiment.

While interest rates remain elevated in most of major economies, current market expectations indicate that policy tightening may be close to its peak, and global inflation appears to be levelling out. However, the uncertainty over the timing and magnitude of interest rate cuts makes it difficult to quantify the impact of these changes on banks operations specially that the Central Bank of Kuwait did not increase rates at the same pace as the U.S. Fed during the 2022-23 hike cycle. Having said that, Kuwait banking sector remains a key pillar of Kuwait's economy, exhibiting strength and adaptability during evolving market conditions. Despite lingering uncertainties, the sector exhibited signs of stability and growth, supported by prudent regulatory measures and innovative strategies.

Additionally, the banking sector played a vital role in facilitating economic activities and supporting businesses through financing and lending activities, especially in support of major development projects. Overall, while challenges persisted, the Kuwaiti banking sector maintained its position as a crucial driver of Kuwait's economic progress and stability.

Moving on to Gulf Bank, I am pleased to say that our performance for the first quarter of the year 2024 reflects the resilience of our business model and ability to navigate through challenges. While the first quarter results may reflect a fall in net profit growth compared to the same period of last year, we have witnessed significant expansion in our loan book during the first three months of the year, displaying robustness and effectiveness in maintaining our market share and meeting the evolving needs of our customers. Moreover, we have improved our operating profitability lines, particularly in net interest income, operating income, and operating profit before provisions and impairments, reflecting our dedication to strategic growth and financial prudence.

While we continue our digital transformation journey, we remain consistent in accelerating business development and driving operational efficiencies. Following the completion of implementing phase I of the new core banking system during 2023, we are currently in the process of launching and implementing phase II of our core banking system. Gulf Bank is now ready to leverage these foundational changes to streamline its operations and enhance customer experience.

In addition, during the first quarter of 2024, we unveiled our latest initiative aimed at nurturing customer financial literacy and inclusion from a young age by launching the renewed highly anticipated Kids Savings Account "Neo", a pivotal addition to Gulf Bank's diverse range of banking solutions. We recognize the imperative role of early financial education and the importance of enabling a strong financial foundation for the next generation. This initiative demonstrates our dedication to providing innovative solutions that prioritizing the needs of our customers at every stage of life. Moreover, this will create a pipeline of future customer loyalty, aligning with our strategy as leaders in the local banking industry.

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

First, we have recorded a net profit of KD 12.9 million for the first 3 months of 2024, a decline of KD 4.4 million or 25.6% compared to 2023 first three months net profit of KD 17.3 million.

Second, our operating profit before provisions has increased to KD 26.6 million, representing a healthy growth of 6.5% compared to the first quarter of 2023.

Third, our gross loans and advances reached KD 5.7 billion, a year-to-date increase of KD 176 million or 3.2% compared to 31 December 2023. This growth was primarily from our corporate segment.

Fourth, the portfolio continued to be resilient as our non-performing loan ratio as of 31 March 2024 stood at 1.2%, with a strong NPL coverage ratio of 458% including total provisions and collaterals.

Fifth, as of 31 March 2024, our Tier 1 Ratio was 14.7% achieving a buffer of 270 basis points above regulatory minimums of 12%, and our Capital Adequacy Ratio was 16.8% achieving a buffer of 280 basis points above regulatory minimums of 14%.

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

> Moody’s Investors Service has affirmed the ‘A3’ long-term deposit ratings of Gulf Bank and changed the outlook to “Positive” from “Stable” during 2023.
> Fitch Ratings has maintained the Bank’s Long-Term Issuer Default Rating at “A” with a “Stable” outlook and a Viability Rating of ”bbb-“.
> Capital Intelligence maintained the Bank’s Long-Term Foreign Currency Rating of “A+” with a “Stable” outlook.

So, looking forward, we remain focused on continuing to improve our performance while executing our strategic priorities to create long-term value for our shareholders.

With that, I’ll turn it over to our CFO, David Challinor, who will cover the financials of the first three months of 2024 in more depth, thank you. David, over to you.

David: Thanks Waleed.

David: **Turning to page 3,** we can see the movement in net profit from 17.3 to 12.9. The decline of 4.4 is mainly attributed to higher credit costs of 4.2 which primarily came from the retail book. We also had much lower recoveries, mainly from our corporate business, than we had in Q1 23. There was an increase of 2 relating to the General Provision, which is driven by loan growth, which was very strong in Q1 24 versus Q1 23, where we saw a degrowth in our loan book. In addition, there was an increase in net interest income of 3.6 due to asset growth and margin expansion and a decrease in non-interest income of 1.7.

Turning to page 4, we have a detailed breakdown of our income statement.

On line 1, interest income was up 13 or 15% for Q1 24 compared to last year. This was primarily due to a combination of margin expansion and 7% asset growth.

On line 2, interest expense increased by 9.4 or 19%. It's worth noting that the growth in interest expense has significantly slowed down from the full year 2023 where we saw a 115% increase.

On line 3, net interest income grew 10% year on year to reach 38.4 and this compares favorably to the full year 2023 growth in net interest income of 6%.

On line 4, non-interest income decreased by 1.7 or 15% compared to Q1 23. In fact, you can see that Q1 23 was the highest quarter for non-interest income in the 2023 year and this was due to a one off relating to our cards business. However, the Q1 24 level of non-interest income is broadly in line with what we saw in Q4 23.

On line 5, operating income increased by 1.9 or 4%.

On line 6, operating expenses have increased by 0.3 or 1% versus last year but are down 1% when compared sequentially to Q4 23. You can see across line 6 that operating expenses over the last 5 quarters have been kept in a fairly narrow range from 21.4 to 22 as we have tightly controlled costs.

In addition, the cost to income ratio for Q1 24 has improved by 1.2 percentage points from the same period last year. Also, the operating results show positive Jaws as the operating income growth has exceeded the operating expense growth by 3 percentage points.

On line 7, operating profit before provisions and impairments has increased by 1.6 or 6%. This is the second highest quarterly operating profit the bank has posted since before Covid.

On line 8, you can see our credit costs increased by 4.2, to reach 11.4 in Q1 24. This is the highest credit cost the bank has seen since Q2 21. The majority of the credit cost has come from the retail book but the level of recoveries, which act to net against the specific provision, is also much lower than in Q1 23.

On line 9, general provisions increased by 2 due to very strong loan growth in Q1 24 versus a degrowth in the loan book in Q1 23. A 1% charge is required to be taken as a general provision as per CBK regulations mainly against non-government loans booked in the quarter.

On line 12, looking across the quarters, we can see that the Q1 24 profit of 12.9 is the lowest in the last 5 quarters. And this has been primarily due to the highest credit costs on account of the retail book coupled with the highest general provision, due to very strong loan growth.

Turning to page 5, we can see the balance sheet.

On line 8, Net Loans and Advances of 5.4 billion increased by 5% year on year and 4% year to date. The growth achieved in Q1 is a promising start for 2024, after a very slow year in 2023 where net loans and advances increased by only 1% for the full year.

On line 13, Total Assets increased by 7% year on year to reach 7.3 billion and 1% year to date.

On lines 15 & 16, Total Deposits of 5.4 billion increased by 342 million or 7% year on year and 1% year to date. We did see our CASA ratio decline to 30.5% versus 35.3% last year. There is a system wide decline in CASA due to the higher interest rate environment, but despite this we still managed to improve our overall CASA percentage from Q4 23.

On line 17, we've increased our medium-term borrowings by 14% year on year which resulted in further diversification of our funding profile and improvement in overall duration.

Moving on to asset quality, our non-performing loan ratio, shown on line 24, was 1.2% at the end of March 2024, which was higher than the same period last year but in line with the level as at Q4 23. Also, we continue to have a significant total coverage ratio of 458% that includes total provisions and collaterals.

Now, turning to Page 6 you can see in the chart on the left that as of 31 March 2024, we have 130 of excess provisions, representing 43% of total provisions.

Looking at the pie charts on the top right of the page, you can see that our stage 1 loans have increased to 95.3%, Stage 2 has declined to 3.4%, and Stage 3 increased to 1.2% when compared to same period of last year.

The chart on the bottom right side of the page shows the evolution of Stage 2 and stage 3 percentages historically. We can see that Stage 2 declined to 3.4% in Q1 24 primarily due to the settlement of a corporate account whose facilities were classified in Stage 2. Stage 3 continues to remain very low and relatively stable which is a very pleasing outcome given the higher rate environment.

Turning to page 7, on the top left, our Tier 1 ratio was 14.7%, which is well above our regulatory minimum of 12%.

On the bottom left, our Capital Adequacy Ratio of 16.8% was well above our regulatory minimum of 14%. It's worth noting that both ratios don't include Q1 24 profits and are after the payment of the annual dividend.

Our risk weighted assets, shown on the top right, increased by 5% year on year, in line with our loan book.

On the bottom right, our leverage ratio as at Q1 24 is 9.3%, a similar level to last year, and well above the 3% regulatory minimum.

Turning to page 8, we can see our key liquidity ratios. The chart on the left side shows our quarterly average daily Liquidity Coverage Ratio, which is 263%, and on the right side, you can see the Net Stable Funding Ratio is 110%. Both ratios continue to be well above regulatory minimums of 100%.

Now, I will turn it back over to Youssef for the Q and A session.

Youssef: Thank you, David. We are now ready for Q and A session. 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 now.

Youssef (Q1): **I can see a number of questions related to credit cost and asset quality; and to provide more color on the 14.7 million charges in first quarter loans recovery net of write offs and the guidance of full year credit cost of 50 to 70 basis points does it still stand? David?**

David (A1): Credit costs for Q1 came in at KD 11.4 million which was an increase from the Q4 level of KD 9.9 million. In fact, quarterly credit costs have been steadily rising since Q2 last year, and we are now at the highest point we've been at in almost 3 years. To provide more color on the underlying trends I'll consider retail and corporate in turn.

So, if we start with retail first. I said on the Q4 investor call that the main driver of the Q4 total credit costs was the retail book. And we saw this trend continue into Q1 where about 85% of the total credit costs relate to retail. In terms of new NPL formation in the retail book, Q1 24 is running around 13% higher than the average quarterly formation we saw in 2023. So not a hugely significant increase but enough to warrant our close attention. And over the last few quarters, we've been working to strengthen the collection mechanisms and have also ceased underwriting in segments where we have identified poor asset quality outcomes. But these measures typically take some time to feed through to positive results but may nonetheless lead to improvements over time.

On the corporate side, the good news is we had almost negligible underlying new NPL generation in Q1 which is a continuation of the trend we saw throughout 2023 where new NPL formation was less than KD 4 million for full year.

However, during the quarter we executed a large settlement with a client whose facilities were classified in stage 2. And whilst we had built up a provision in prior years that covered most of the anticipated write-off upon settlement, there was still a remaining portion which formed part of the Q1 credit costs.

When we look at the asset quality indicators, we can see they are still holding strong. NPL percentage remains at 1.2% which is the same level as Q4 23, and the stage 2 percentage is 3.4% which continues to be very low.

In summary, I think on the retail side the Q1 credit costs were higher than we had anticipated at the start of the year, and even though we have taken remedial actions they may continue to remain elevated for a while. On the corporate side, we've had excellent performance in terms of the very low level of new NPL generation, but we are nonetheless monitoring a couple of stage 2 accounts closely.

In terms of the 50 to 70 basis point cost of risk guidance we gave at the beginning of the year, I think a couple of points to note, first that was a full year guidance we were not guiding for the following quarter. I think at this stage it's too early to change that guidance and a lot obviously depends on how the retail book performs and the extent of recoveries.

Youssef: Thank you, David.

Youssef (Q2):We can see questions related to Margins and trends going forward? David?

David (A2): For Q1 the margin was 214 basis points which was up 7 points from a year ago. However, the margin for the full year in 2023 was 217 points so we've seen a drop in Q1. Theres clearly a lot of complex dynamics at play but if we turn to the cost of funds first. I said on the Q4 earnings call that the cost of funds may be nearing a peak, and this seemed to occur around the middle of Q1 after which we saw the cost of funds start to fall. However, it wasn't enough to counteract the cost of fund increase in the first half of the quarter, so effectively the overall cost of funds in Q1 was similar to Q4.

In terms of the asset yields, we did see a drop from Q4 to Q1 due to a slightly changed business mix, the timing of the strong Q1 growth and a one-off adjustment.

In terms of the outlook, the local market has healthy liquidity and new fixed deposits are being repriced lower than in previous periods, however we have seen some upward pressure on the cost of dollar funding primarily due to expectations of rate cuts being pushed out. So overall we could expect margin to be relatively stable if current dynamics continue. Obviously, the longer-term view on margin is going to be a function of benchmark rate moves but the timing and quantum's continue to remain very uncertain.

Youssef: Thank you, David.

Youssef (Q3): Okay, we received a question on Operating Expense, and outlook for Cost to Income Ratio? David?

David (A3): Q1 Operating Expenses were KD 21.7 which was lower than the Q4 number of KD 22 and only 1% above where we were in Q1 last year. In fact, over the last 5 quarters operating expenses have been managed in a relatively tight range, between 21.4 to 22, as we continue to closely manage costs, although we continue to see increases in IT related expenditure in relations to our transformation program. We would expect this to drop in the second half leading to an improvement in the cost to income.

In terms of the Cost to Income ratio it now stands at 44.9% which is lower than Q1 2023 which was 46.1%, and lower than the full year 2023 which was 45.6%. So, it's all heading in the right direction in terms of it dropping. We also had another quarter demonstrating a positive Jaws ratio, as the operating income growth exceeded the operating expense growth by almost 3 percentage points.

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

(Pause)

Youssef (Q4):Okay, we have a question what are the drivers for loan book growth during Q1 2024? David?

David (A4): Thanks, Youssef. Q1 was a very strong quarter for loan growth and a great start to the year. Total gross loans and advances grew by circa KD 180 million or 3.2%, which is the strongest growth the bank has seen in almost 2 years. In comparison, the full year growth in 2023 was 1.2%, so we've already significantly outpaced last year's growth in just one quarter.

If we look specifically at customer loan growth (which excludes lending to banks) this was up 2.6%, with the vast majority coming from our corporate business. I did say on the Q4 call we had a significant pipeline of high-quality corporate deals and we saw these being booked on the balance sheet in Q1. The pipeline continues to be strong so we should have another good loan growth performance in Q2. When we compare to the CBK data for corporate we can see that the market grew by 3.8% to the end of March whilst we grew 4.4% which is a great result.

On the retail side, our growth was relatively flat at 0.3% year to date and even though we were expecting a pickup in the sector we haven't yet seen that as growth at the system level was also 0.3%.

Youssef: Thank you, David.

Youssef (Q5): There is an additional question on Non-Interest Income, and why it's down from last year and areas of improvement? David?

David (A5): As I said during the earlier presentation, the Q1 2023 comparative represented the highest quarter (in the 2023 year) for non-interest income due primarily to a one-off fee we received in relation to our cards business. Our Q1 24 number is broadly in line with Q4 and also higher than Q2 and Q3 last year. Nevertheless, we are continuing to focus our efforts to improve this line item and our ongoing investment in transformation will allow for an expansion in new fee generating products and services. In addition, we have now established GB Invest, the banks wholly owned investment platform, which should help to drive fee income higher.

Youssef: Thank you, David.

I believe we have covered the majority of topics and questions raised today during the call. If you have any further 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.

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