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

Earnings Conference Call Edited Script

Q3- 2023

25 October 2023

Corporate Participants:

Mr. Waleed Mandani – Deputy CEO & Acting 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 third quarter 2023 earnings conference call. It is a great pleasure to have with us on the call Mr. Waleed Mandani, Gulf Bank Deputy CEO and Acting CEO, Mr. David Challinor, Gulf Bank CFO and Ms. Dalal AlDousari, Head of Investor Relations at Gulf Bank.

At this point I would like to hand over the call to Ms. Dalal AlDousari, please go ahead.

Dalal: Thank you, Elena. Good afternoon and welcome to Gulf Bank's third quarter 2023 earnings call. We will start our call today with key highlights and updates on the operating environment of Gulf Bank during the third quarter of 2023 presented by our Deputy Chief Executive Officer and Acting CEO, 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, Dalal. Good morning and good afternoon, everyone. Thank you for joining us today as we discuss our financial performance and key developments over the past months. We continue to closely monitor the global, regional and local economic and geopolitical environment. Although global economic growth has proven more resilient than expected so far in 2023, the outlook for next year

could be weaker as the impact of tighter global monetary policy feeds through.

Locally, core inflation stabilized at 3.4% year-on-year, still trending above the 2014-2019 annual averages, supported by solid consumer spending and expansionary fiscal policy. This has positively impacted the household lending, that continues to increase modestly during 2023. On the other hand, the overall domestic credit continues to slow down, driven by a fall in business lending across all sectors, which will likely remain muted for the remainder of the year.

We acknowledge these industry-wide challenges and have proactively taken steps to navigate this environment effectively. Our set strategy is working, by focusing on growing consumer banking market share, while supporting the youth, women and affluent client segments, and promoting selective growth in the corporate banking with prudent risk management to ensure we maintain a stable and sustainable growth.

Now, let's turn our attention to Gulf Bank's performance. I'm pleased to report that we've had another strong quarter, continuing our trend of robust financial performance. During the first nine months of the year, we have successfully capitalized on the opportunities presented by the evolving market dynamics, which has contributed to our solid results. We continued to invest in our people, products range, and technological infrastructure to better serve our clients. Our focus on operational excellence and customer-centricity has been instrumental in this achievement.

In addition to our strong financial performance, I would like to announce the successful launch of our brand-new mobile banking application, which is set to revolutionize the way our customers interact with our services. The new mobile application offers a seamless and user-friendly experience, enabling our customers to manage their accounts, conduct transactions, and access a wide range of financial services conveniently from their smartphones.

We have invested heavily in cutting-edge technology to ensure that our mobile app is not just secure but also packed with innovative features to meet the evolving needs of our customers in this digital age. This aligns perfectly with our commitment to providing modern, accessible, and secure banking solutions. We believe it will further enhance customer engagement and drive growth in our digital banking segment.

On another note, during the third quarter, Gulf Bank obtained the Central Bank

of Kuwait's and Capital Market Authority approvals to increase the Bank's issued and paid-up capital through a public offering with rights issue of 260,869,565 new shares at a nominal value of 100 fils in addition to a share premium of 130 fils for each share. The total proceeds will result in an increase in the Bank's capital base by about KD 60 million. The opening date of subscription period will start on 29th of October 2023 and ends on 12th of November 2023.

The rights issue will boost the Bank's Capital Base and Regulatory Capital Ratios, enhancing the Bank's ability to pursue future growth opportunities in line with its strategy, with the aim to generate a strong and sustainable long-term value to all our stakeholders.

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

First, our net profit grew by 18% for the first nine months of 2023, to reach KD 53.8 million in comparison to KD 45.7 million reported for the same period in 2022.

Second, our return on average equity increased to 10.0% for the first nine months of 2023 up from 9.0% at the same period last year.

Third, our gross loans and advances reached KD 5.5 billion, slightly contracted when compared to the same period of last year.

Fourth, the quality of our loan book remains resilient, as our non-performing loan ratio (NPL) as of 30 September 2023 is at 1.2%, coupled with a strong NPL coverage ratio of 470% including total provisions and collaterals.

Fifth, as of 30 September 2023, our Tier 1 Ratio was 13.6% achieving a buffer of 160 basis points above regulatory minimums of 12%, and our Capital Adequacy Ratio was 15.8% achieving a buffer of 180 basis points above regulatory minimums of 14%.

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

- Moody's Investors Service maintained the Long-Term Deposits Rating of the Bank at "A3" with a "Stable" outlook.
- Capital Intelligence affirmed the Bank's Long-Term Foreign Currency Rating at "A+" with a "Stable" outlook.

> Fitch Ratings affirmed the Bank’s Long-Term Issuer Default Rating at “A” with a “Stable” outlook, and a Viability Rating of ‘bbb-‘.

Looking ahead to the fourth quarter and beyond, we remain committed to innovation, resilience, and client-centricity. We will continue to navigate the ever-changing landscape, seeking new opportunities for sustainable growth, and enhance our competitive edge.

With that, I’ll turn it over to our CFO, David Challinor, who will cover the financials of the first nine months of 2023 in more depth, thank you. David, over to you.

David: Thanks Waleed.

David: **Turning to page 3,** we can see the movement of net profit from 45.7 to 53.8. The increase was mainly driven by 7.3 in net interest income as a result of margin expansion. In addition, there was an improvement of 2.7 in total provisions and impairments which was partially offset by an increase in operating expenses of 2. However, operating expenses increased only 3% year on year.

You can also see Return on Equity improved by 1.0 to reach 10.0%.

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

On line 1, interest income was up 104.2 or 63% in the first nine months of 2023 compared to the same period of last year. This was due to nine CBK discount rate hikes totaling 275 basis points since March 2022 coupled with a relatively stable loan book.

On line 2, our interest expense increased by 96.9 or 154%. The growth in the cost of funds has slowed from Q2 as compared to the growth rates seen in prior quarters.

On line 3, net interest income grew 7% on a year-on-year basis to reach 110.4, and it grew by 5% when compared to second quarter 2023. This represents the second consecutive quarterly growth in net interest income.

On line 4, our non-interest income increased by 0.5 or 2% compared to the same period last year driven by an increase in foreign exchange and other income.

On line 5, operating income increased by 7.8 or 6%.

On line 6, operating expenses have increased by 2.0 or 3% year-on-year, while the cost to income ratio has improved significantly in the first nine months of 2023 down to 46.3% from 47.5%. In addition, the first nine months results have shown positive Jaws as the operating income growth has exceeded the operating expenses growth by 3 percentage points.

On line 7, operating profit has increased by 5.8 or 8%. In fact, the Q3 Operating Profit of 25.9 million is the highest operating profit since Q4 2019.

On line 8, you can see our credit costs increased by 3.2, from 16.1 to 19.3 in the same period of 2023. Our cost of risk was 47 basis points this year versus 40 basis points last year. This low level of cost of risk is a result of our prudent risk management and the quality of our loan book that continues to remain very resilient in this higher rate environment.

On line 11, you can see our Q3 2023 net profit contracted slightly from Q2 2023 but still remains the second highest quarterly profit since Q4 2019.

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

On line 8, Net Loans and Advances of 5.2 billion as at 30 September 2023 declined by 2% year on year but were up 1% year to date. Specifically, our consumer segment continued its strong growth trajectory and grew by 4.3% year on year and 3.2% year to date, gaining market share in both periods.

On line 13, Total Assets contracted 1% year on year but year to date grew 2%.

On lines 15 & 16, Total Deposits of 5.1 billion declined by 155 million or 3% year on year. We also saw our CASA ratio decline to 32.3% versus 34.3% last year. The decline is due to some migration to term deposits due to the higher interest rate environment.

On line 17, we have increased our medium-term borrowings by 68% 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 September 2023, which was the same as last year. Also, we continue to have significant NPL coverage ratio of 470% including total provisions

and collaterals.

Now, turning to Page 6 you can see in the chart on the left that as at 30 September 2023, there are 120 of excess provisions, representing 39% of total provisions.

Looking at the pie charts on the top right of the page, you can see that both stage 2 and stage 3 has fallen versus last year and are 4.4% and 1.2% respectively.

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 both Stage 2 and Stage 3 remain low and stable compared to previous quarters which is a very pleasing outcome given the higher rate environment.

Turning to page 7, on the top left, our Tier 1 Ratio was 13.6%, which is above our regulatory minimum of 12%.

On the bottom left, our Capital Adequacy Ratio of 15.8% is above our regulatory minimum of 14%. And both ratios were higher than a year ago.

Our risk weighted assets, shown on the top right, declined by 3%, mainly driven by a slightly lower loan book when compared to last year coupled with RWA optimization.

On the bottom right, our leverage ratio as at 30 September 2023 was 9%, in comparison to 8.7% at the same period of 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 250%, and on the right side, you can see the Net Stable Funding Ratio is 106%. Both ratios continue to be well above regulatory minimums of 100%.

Now, I will 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 see repeated questions and we will try to group them.

Dalal (Q1): **We received few questions related to the loan growth. What is the loan growth mix between retail and corporate? And what is the expectation for the remainder of year?**

David (A1): I think it's fair to say that customer loan growth in the system this year has been much lower than we all anticipated at the beginning of the year. When you look at the CBK data to the end of September, the total loans have only grown 1.4%. And last year this number was 7.7%. So, we're operating in a market that's very slow. Interest rates have curtailed some of the growth, but I also think the excess growth we saw in 2022, when the system grew 9%, has maybe caused an overhang for growth this year.

In terms of our total loan book, in Q3 we saw a slight contraction of 17 million and year to date we are up 28 million.

But in terms of the business mix, we continued to see good growth in retail. We saw this in Q1 and Q2 as well. So, the situation is that year to date we grew just over 3% in retail versus the system to the end of September which was 1%. So, we've grown 3 times faster than the market this year in retail albeit in a market that's very slow. We're aiming to continue this outperformance in retail for the remainder of the year.

In terms of corporate, we booked some high-quality transactions in the quarter, but we continued to see customers repaying debt which offset the new deals and caused a small net contraction in growth of around 10 million. Having said that, we do have a good pipeline, so are hopeful we can return to growth in corporate for the last quarter.

Looking ahead for next year, we expect the growth to improve from 2023 but I think likely to be much less that what we witnessed in 2022.

Dalal (Q2): **Next, we have couple of questions on cost of funds, CASA and margins. What is the outlook for the rest of the year?**

David (A2): Thanks Dalal. We saw another quarter of margin expansion. In Q2 it was 8 basis points and in Q3 another 6 basis points. So, the Q3 margin now stands at 221 basis points.

If we look at the cost of funds first. I said on the Q2 call that the growth in cost of funds had slowed down and we continued to see this dynamic play out in Q3. In fact, the rate of growth halved from Q2 to Q3. So, we saw only a 10-point increase in our cost of funds in Q3, versus a 20-point increase in Q2. And the increase from Q4 last year to Q1 this year was about 80 basis points. So, you can see how its significantly slowing. And also, when we take into account there was a 25-point CBK rate rise at the end of July, to then increase the cost of funds by only 10 basis points is a good outcome.

The other point is that the cost of funds growth has slowed significantly in a quarter where the level of CASA deposits in the system has fallen. So, if we look at Q3, we saw the system drop for CASA deposits by 5.2% just in one quarter. Which is more than double the drop we saw in the entire first half. We've been maintaining our market share in CASA, but the key point is that this level of drop is already built into our 10 basis points rise in cost of funds for Q3.

On the asset side, we saw yields continue to expand. Particularly in the corporate business which effectively reprices straight away, and we had a rate rise in July, but also in retail where new loans are priced at the new higher rates and loans crossing 5 years also reprice higher.

If we look year to date, the margin is 214 versus 204 last year. We gave guidance at the start of the year that 2023 would see an expansion and that played out correctly. I think going forward, and in the absence of any further rate rises, the margin will most likely be relatively stable in the short term but given all the moving parts it's very difficult to predict longer term at this stage.

Dalal: Thanks David. We will pause to receive more questions.

(Pause)

Dalal (Q3): **Can you give us some color on the credit cost and asset quality? David?**

David (A3): Credit costs continued to be relatively low at 7.2 million for Q3. This is a cost of risk of 52 basis points. For the full year 2022 it was 49 points, and a year earlier it was 95 points. So, I'm happy with the way the portfolio is performing so far this year and in fact the underlying NPL generation, which I think is a key metric to look at, for the first 9 months this year, is actually lower than what we saw for the first 9 months of last year. So even though interest rates are much higher from one period to the next, the underlying NPL generation is less.

When we look at Stage 2, the percentage is only 4.4%, which is the lowest it's ever been since the introduction of IFRS 9 in Kuwait back in 2019, and much lower than where the system is at.

The NPL ratio is still very low at 1.2%, which was where it was a year ago. Total provisioning continues to be very high. Our total coverage including collaterals is running at around 470% so we're happy the way the metrics are trending around asset quality.

Dalal (Q4): **I can see questions on operating expenses and expected efficiencies? David?**

David (A4): Total OPEX was up 3% year to date versus last year. At the half we were up 4% and last year for the full year it was 10%. So clearly the cost growth has slowed down significantly.

We've also seen income grow at 6%, which is double the cost growth, so that's led to a further drop in the cost to income ratio. For Q3 its 45.8% which is the lowest it's been in the last 7 quarters. And this is despite ongoing costs relating to our transformation program. On the other side, we've obviously had lower volume related costs than last year given the market we're currently in, but nonetheless the slowdown in costs is positive.

I've said before we'll be looking to extract further cost efficiencies when the transformation is complete some point next year, so we'd be looking to drive the cost to income lower.

Dalal: Thanks David. I believe we answered the majority of the questions. The remaining questions are either repeated or already covered during the presentation. 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.