Gulf Bank of Kuwait

Earnings Conference Call Edited Script – Q1 2019

1 May 2019

<u>Corporate Participants:</u>

Mr. Antoine Daher – CEO

Mr. Kevin Smith – CFO

Ms. Dalal AlDousari – Head of Investor Relations

<u>Chairperson:</u>

Janany Vamadeva- Arqaam Capital

Janany: Good afternoon everyone and thank you for joining us today. This is Janany Mamadeva and on behalf of Arqaam Capital I am pleased to welcome you to Gulf Bank's first quarter 2019 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, Janany. Good Afternoon and Welcome to Gulf Bank's first quarter 2019 financial results conference call. This is Dalal AlDousari from Gulf Bank's investor relations team. We will start the call today with Mr. Tony Daher, Chief Executive Officer, who will cover our key highlights from the first quarter. Afterwards, Mr. Kevin Smith, Chief Financial Officer, will cover our first quarter financial results. 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 2** 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.

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

Tony: Thanks Dalal. I'm very happy to be with all of you today and would like to share some of the key highlights from the first quarter of 2019.

On **page 3**, you can see the progression and growth rate in our Net Profit since 2013. To summarize, we've generated double-digit growth in our Net Profit over the last five years and that growth rate has accelerated from 10% for the three-year period from 2013 until 2016 to 12% in 2017 and 18% last year. For the first three months of 2019, our Net Profit grew by 9% to KD 11.8 million.

Turning to page 4, at our Annual General Meeting on the 11th of March 2019, the Bank's shareholders approved paying out cash dividends of 10 fils per share. With this most recent payout, cash dividends have increased from 4 fils per share in 2015 to 7 fils per share in 2016 to 9 fils per share in 2017 to 10 fils per share in 2018. Over the last three years, we've paid roughly half of our earnings in the form of cash dividends.

On **page 5**, Gulf Bank continues to be well recognized in terms of its credit worthiness and financial strength internationally as it is rated "A" by all four leading credit rating agencies.

Moody's rating on the Bank is "A3" with a "Positive" Outlook

Fitch's rating is "A+" with a "Stable" outlook.

S&P's rating is "A-" with a "Stable" Outlook

Capital Intelligence's rating is "A-" with a "Stable" outlook.

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

Kevin: Thanks Tony. **Page 6** shows the **balance sheet** progression from the 31st of March 2018 to the 31st of March 2019. 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.

Over the course of the last 12 months, our total assets grew by KD 131 million or 2.3% to KD 5.8 billion. Nearly all of that growth came from customer loans, shown on line 6, which grew by KD 70 million or nearly 2% and Investment Securities, shown on line 9, which grew by KD 52 million.

In terms of asset composition, no significant changes from a year ago. As of 31st of March 2019, KD 1.5 billion or 26% of our assets were still held in the form of liquid assets, shown on line 5, 67% as loans to customers, 3% as investment securities, and 3% as other assets.

If you look on lines 19 and 20, to the far right, of the KD 131 million in asset growth over the period, KD 102 million of that growth was funded with liabilities while KD 28 million was funded with equity.

On line items 15 and 16, you can see that 62% of our liability funding comes from Customer Deposits and 17% from Deposits from Financial Institutions. Those two sources of funds led the growth in Liabilities, up KD 41 million and KD 49 million, respectively.

On line 18, of the KD 28 million increase in Other Liabilities from March 2018 to March 2019, KD 19.7 million relates to a 100% provision against KD 19.7

million of interest income that was collected when the Bank acquired and sold the Fahaheel land for KD 90 million in the fourth quarter of 2018. This provision will be released to interest income pending a final court judgement.

Our non-performing loan ratio, as shown on line 24, came down in the second half of 2018 as a result of settling 2 legacy loans, leading to a recovery of KD 36.5 million in the fourth quarter of 2018. The subsequent increase to 2.8% and coverage decline at the end of March 2019 was mainly driven by downgrading a corporate borrower who was servicing its debt, but early warning signals triggered an opportunity for us to utilize our senior lending position and strong legal documentation to gain access to assets with significant value held by the borrower. However, since these assets aren't collateralized yet, the value of these assets can't be included in the NPL collateral, provision or ECL calculations until a settlement or legal process is concluded. Having said that, on line 25, you can see our coverage ratio on all non-performing loans still remains very healthy at 267%.

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

Page 7 shows our income statement and some other key metrics.

To give you context, to the left of the thick red line in the center of the page, we are showing our full year results in 2018, % of average assets, and the income statement line item variances compared with 2017. All amounts are shown in KD millions and have been rounded to simplify the chart.

On line item 12, between the two thick red lines, under the columns labelled ‘Q1-18’ and ‘% of Average Assets’, you can see that our Net Profit and Return on Assets for the first quarter of 2018 was KD 11 million and 0.77%, respectively.

On that same line item 12, if you look at the last three columns on the right, as Tony mentioned, you can see that we reported a Net Profit of KD 12 million in the first quarter of 2019, an increase of 9% compared with the first quarter of 2018. Our return on assets also improved from 0.77% to 0.81%, while our return on equity increased from 7.4% to 7.7%.

The net profit improvement was driven primarily by:

Significantly lower credit provisions / impairments of KD 8.0 million, shown on line item 10, offset by

lower non-interest income of KD 1.8 million, shown on line items 4 and 8,

and higher operating expenses of KD 6 million, shown on line item 6.

Nearly half of the KD 6 million increase in operating expenses for the quarter was caused by taking a one time KD 2.8 million expense provision relating to the service disruption incident that was previously disclosed.

Turning to **page 8**, our regulatory capital ratios remained strong as our Tier 1 ratio of 13.5% was 150 basis points above the regulatory minimum of 12% and our Capital Adequacy Ratio (CAR) of 16.9% was 290 basis points above the regulatory minimum of 14%. On the bottom right, our leverage ratio ended at 9.0%, well above the 3% minimum.

Page 9 shows our key liquidity ratios. On the left side, you can see that our average daily Liquidity Coverage

Ratio increased from 268% in the first quarter of 2018 to 299% in the first quarter of 2019 and is well above the minimum of 100% that came into effect on the 1st of January of this year. On the right side of the page, our NSFR ratio increased from 104% at the end of March 2018 to 115% at the end of March 2019. So, both liquidity ratios have more than adequate buffers above the regulatory minimums.

In summary, we're off to a good start with Net Profit growth of 9% in the first quarter of 2019 compared with the first quarter of 2018.

Now, I would like to turn it back over 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 send button. We will pause for few minutes to receive most of your questions.

Dalal: We noticed that there are many repeated or similar questions. We will try to group them and respond accordingly.

Dalal (Q1): We are receiving a number of questions on net interest margins, loan growth, and market share. Kevin, would you like to address these points?

Kevin (A1): Yes. At the macro level, as you are aware, in 2018, the Federal Reserve increased US dollar rates four times for a total of 100 basis points while the Central Bank raised its discount rate only one time by 25 basis points. Those additional 3 Fed increases of 75 basis points put upward pressure on funding cost. The good news is that the market isn't expecting any further fed rate increases this year. However, we expect to see continued pressure on margins as time deposits originated when rates were lower reprice at higher market rates. As long as liquidity conditions don't tighten, we would expect those margin pressures to stabilize as we move through the year. In terms of growth, we grew our Consumer Banking loans by 11% in 2018 whereas the industry grew by 6%. We continued that same double-digit growth pace in the first quarter of 2019, while the industry growth rate has remained in the mid-single digits. As for Corporate loans, over the last few years, both us and the industry have been seeing mid-single digit growth rates. In this segment, we are expecting growth to soften this year to low single-digits and for us to keep pace with industry growth.

Dalal (Q2): We are also receiving questions related to our cost of risk. Kevin, can you take this one as well?

Kevin (A2): Sure. We were pleased with our credit cost performance in the first quarter. As you can see from the details in our financial statements, our Specific Provisions in the first quarter of 2019 were KD 13 million. This is 26% below the first quarter of 2018 and 30% below the rolling average over the last 8 quarters of KD 18.5 million. In addition, we had no impairment losses on other assets in the first quarter of 2019 compared with KD 6.3 million in the first quarter of 2018.

Dalal (Q3) We are taking one last question in relation to our cost to income ratio and our expectations going forward. Kevin, would you like to cover this point?

Kevin (A3) We will see pressure on our expenses and cost to income ratio in 2019 primarily driven by investments being made to establish a central hub for our customers and employees at Crystal Tower and the one-time expense provision of KD 2.8 million booked in the first quarter.

Having said that, we were able to more than offset those cost pressures and one-time expenses in the first quarter with lower credit provisions and impairments and still grow the bottom line by 9%. Looking forward, we are expecting asset quality performance improvements to be longer lasting than shorter term margin and expense pressures.

Dalal: Thanks Kevin. We have tried to cover the majority of the topics and questions that were raised today during the call. The remaining questions are either already covered during the presentation or are forward looking. And with that, we would like to conclude our call for today.

If you have any further questions, you may visit our investor relations page at our corporate website. You can also reach us at our dedicated investor relations email.

Thank you all very much for your participation.