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

Earnings Conference Call Edited Script – Q3 - 2022

26 October 2022

Corporate Participants:

Mr. Tony Daher – CEO

Mr. David Challinor – CFO

Ms. Dalal AlDousari – Head of Investor Relations

Host:

Mr. Ahmed El-Shazly – EFG Hermes

[GBK Classification: PUBLIC]

Ahmed: Good morning and good afternoon, everyone and welcome to Gulf Bank third quarter 2022 earnings conference call. This is Ahmed El-Shazly from EFG Hermes; and it's a great pleasure to have with us on the call today from Gulf bank Mr. Tony Daher, CEO, Mr. David Challinor, CFO and Ms. Dalal AlDousari, Head of Investor Relations at Gulf Bank.

I will now turn the call over to Dalal.

Dalal: Thank you, Ahmed. Good afternoon and welcome to Gulf Bank's third quarter 2022 earnings call. We will start our call today with key highlights and updates on the operating environment of Gulf Bank during the first nine months of 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 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. 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 continue our positive momentum for the year 2022. I am pleased to report that Gulf Bank has achieved a net profit of KD 45.7 million for the first nine months of 2022, an increase of 66% over the same period of last year. During the third quarter, we maintained solid growth across the Bank’s activities, with a strategic focus on digitization to support the needs and requirements of our customers. The successful execution of our strategy is demonstrated by the strong financial position and robust loan growth, with our net customer loans reaching KD 5 billion and our total assets crossing KD 7 billion.

Kuwait’s economy continued to show resilience and positive signals, despite challenging global market and an uncertain economic outlook globally. The challenges include high inflation, tighter monetary policy, and the war in Ukraine, amongst others. However, the local economic stability is supported by good oil prices, recovery of economic activity specifically in the private sector, and ongoing structural reforms.

On the local macroeconomic front, the Central Bank of Kuwait has continued to tighten monetary policy, albeit at a relatively slower pace compared to the US Fed. Since the beginning of the year, the Central Bank of Kuwait has raised its key discount rate 6 times, 25 basis points each, bringing the discount rate to its pre-covid level at 3%. The slower rate hike policy adopted by Central Bank of Kuwait in comparison to US Fed, is providing additional support for the local economy.

Despite the interest rate hikes, the consumer spending remained strong in Kuwait, reflected in the year-to-date customer loan growth of around 7% according to the latest industry data published by the Central Bank of Kuwait.

On the domestic political front, the elections of a new parliament were concluded on 29th of September, and a new government was formed on the 18th of October. We are hopeful to see cooperation between the government and the parliament on major reforms and legislations in favor of Kuwait’s development aspirations.

On the Bank front, we are reaping the benefit of our Kuwait-focused strategy, and we are proactively meeting the changing needs of our customers through digital innovation and solutions. We continue to conduct several initiatives to provide our employees and community with a new skillset and opportunities specifically in the field of data science and cyber solutions, with the aim to help future generations achieve local development goals, to strengthen the economy, and contribute to our community.

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

First, our net profit grew by 66% for the first nine months of 2022, to reach KD 45.7 million in comparison to KD 27.5 million in 2021.

Second, our return on average equity increased to 9.0% for the first nine months of 2022 from 5.7% at the same period last year.

Third, our gross customer loans reached KD 5.3 billion, an increase of KD 562 million or 12% compared to the first nine months 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 the third quarter 2022 stood at 1.2%, an improvement when compared to last year's (NPL) ratio of 1.3%. Additionally, we continue to have ample provisions achieving an NPL coverage ratio of 450% including total provisions and collaterals.

Fifth, the relaxed capital regulatory minimums that were introduced in 2020 were partially restored in January 2022 and will remain at current levels for the remainder of the year. With that, our Tier 1 ratio has a buffer of 247 basis points, and our capital adequacy ratio has a buffer of 263 basis points above regulatory minimums.

And sixth, the 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 "A3" with a "Stable" outlook.
- Capital Intelligence affirmed the Bank's Long-Term Foreign Currency Rating of "A+" with a "Stable" outlook.
- Fitch Ratings has upgraded the Viability Rating of the Bank from 'bb+' to 'bbb-' during the year and affirmed the Bank's Long-Term Issuer Default Rating at "A" with a "Stable" outlook.

So, our performance during the first nine months of 2022 has provided a strong foundation for 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 nine months of 2022 in more depth, thank you. David, over to you.

David: Thanks Tony.

David: **Turning to page 3,** we can see the movement of net profit from 27.5 to 45.7. The increase of 18.2 in the first nine months was mainly driven by the decline of 16.1 in total provisions. The Cost of Risk was only 43 basis points compared to 104 last year which shows the overall improvement in the quality of our book. We also saw higher net-interest income of 4.5 supported by loan book growth and the impact of recent rate hikes, as well as higher non-interest income of 2.2.

You can also see our Return on Equity improved by 3.3% and we are now generating similar levels to the pre-covid period.

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

On line 1, interest income was up 28.2 or 20% for the first nine months of 2022 in comparison to the same period of last year. We saw a significant jump of 28% in interest income from Q2 to Q3 reflecting the 3 rate rises from the CBK in the quarter.

On line 2, our interest expense increased by 23.7 or 60%. The cost of funds is rising faster than increases in asset yields but despite this we were still able to generate an expansion in net interest income which grew 12% from Q2 to Q3 and 5% year to date versus last year.

On line 6, operating income increased by 6.8 or 5%. This was mainly due to the increase in net-interest income of 5% and non-interest income of 8%, driven by fees and foreign exchange income.

On line 7, operating expenses have increased by 3.8 or 6% year-on-year. The cost to income ratio fell for the second consecutive quarter in 2022 and stands at 46% for Q3. We are continuing with our digital transformation journey and human capital investment but believe there are cost efficiencies to be extracted once transformation is complete.

On line 9, you can see our credit costs declined by 19.2, from 35.3 in the first nine months of 2021 to 16.1 in 2022. Cost of risk was 43 basis points in the first nine months, declining from 104 basis points last year. This was a result of improvement in the operating environment in Kuwait, strong recoveries, and the overall high quality of our loan book.

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

Over the last year, our total assets increased by 726 or 11% to reach 7.1 billion. This was largely driven by a 601 or 13% increase in Net Loans, reflecting a pick-up in economic activity in comparison to last year.

Loans and Advances to customers grew 12% year on year and 423 million year to date or 9%, which is the strongest loan growth the bank has experienced in recent history.

On line item 17, Customer Deposits grew 8% year on year to reach 4.5 billion.

On line item 18, we have increased our medium term borrowing from banks by 114% year on year which improves our overall duration.

Moving on to asset quality, our non-performing loan ratio, shown on line 25, was 1.2% at the end of September 2022, down from 1.3% for the same period last year. Our coverage ratio on line 26, remains exceptionally strong reaching 450% at the end of September 2022.

Now, turning to Page 6 you can see in the chart on the left that as of 30 September 2022, the Bank has 109 of excess provisions, representing 35% 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 93.7%, Stage 2 has declined to 5.0%, and Stage 3 also declined to 1.3%.

The chart on the bottom right side of the page shows the evolution of Stage 2 and 3 percentages over the past five quarters. We can see that both our

Stage 2 and stage 3 remain very low and stable

Turing to page 7, on the top left, our Tier 1 ratio was 13.0%, which is above our current regulatory minimum of 10.5%.

On the bottom left, our Capital Adequacy Ratio of 15.1% was above our current regulatory minimum of 12.5%.

Our risk weighted assets, shown on the top right, grew by 11%, mainly driven by the strong year-on-year growth in the loan book.

On the bottom right, our leverage ratio as of 30 September 2022 was 8.7%, which was lower than 9.4% for the same period of last year, but 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 Liquidity Coverage Ratio was 220%, and on the right side, Net Stable Funding Ratio was 104% as of 30 September 2022. It's worth noting that both ratios are still well above their respective current minimums of 90% and pre-covid 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 will go through the questions.

Dalal (Q1): **We have few questions on NIM's. Do you expect further NIM expansion from current level assuming further rate hikes? Or do you expect funding cost pressure to offset higher asset yields? David?**

David (A1): Thanks Dalal. I said in the Q2 call we should expect an expansion in margin in Q3 and that's what we saw. The Q2 margin was 201bp and this expanded to 213bp in Q3 which was pleasing. But we are seeing a lot of upward pressure on cost of funds, particularly at the longer tenors. In effect, liabilities have priced by more than assets. We've also seen a fall in our CASA percentage, which has contributed to the pressure, but such falls are to be expected in a rising rate environment. But, in terms of absolute levels of CASA we are flat to where we were a year ago.

In terms of interest rate hikes, our view is potentially 2 more 25bp hikes for the remainder of the year.

Dalal: Thank you David.

Dalal (Q2): **We have more questions on loan growth. Could you elaborate more on your loan growth and the driving factors for outperforming the system? David?**

David (A2): Thanks Dalal. We saw a 2% loan growth, which was almost 100m, in Q3. So, this brings the year-to-date growth to 9%. The system, to the end of August, was 7%. The guidance we gave at the start of the year was that we would outperform the system, and so far, we've achieved this.

Retail continues to grow very strongly. And most of our growth in Q3 came from retail. We grew about 80 million in Q3 which was 4%. So far retail has grown nearly 13% year to date versus a system number of 7% to the end of August. So almost double the system growth. And we've delivered market share gains every single quarter this year which is very pleasing given this is core to our strategy. So, we'd be looking to continue this sort of momentum into Q4, but we're cognizant that the market remains very competitive and there are signs that at the total system level things are starting to slow down. So, if we look from the end of May to the end of August the total system grew just 1%. So, the rapid growth we saw in the earlier part of the year has dissipated. This makes sense given the higher cost of borrowing. The CBK discount rate is now at 3% which is double where it was at the start of the year.

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

(Pause)

Dalal (Q3): We have a question on the cost of risk. How sustainable are the current levels of Cost of Risk and what would you consider as normalized cost of risk for the Bank? David?

David (A3): Credit costs were 8 million for the quarter which brings them to 16 million year to date, so that's a 43 bp cost of risk versus last year which was 104bp.

We have no real concerns and are very pleased with the way the portfolio continues to perform. I think credit costs should stay low for a while, but from quarter to quarter we can see some variability. So, whilst the second half will be higher than the first, as I said on the Q2 call, there won't be any cause for concern, and we will continue to remain well below the normalized number of 100bp.

But obviously in a sharply rising rate environment some stresses will inevitably surface but we think we're well positioned to manage these given the current shape of the balance sheet, which is excellent. We look at stage 2 formation very closely and that's continuing to remain very low at 5%. It was 5.6% a year ago. The system average is closer to double digit. And then when you look at coverage, its exceptionally strong. We're at 450%. NPLs' have continued to remain very low and stable. We are at 1.2%, which was in line with the number a year ago, and well below the 2% ceiling we gave for the guidance at the beginning of the year. So, all the metrics continue to trend very well.

Dalal: Thanks David. We will pause for few minutes.

(Pause)

Dalal (Q4): Another question. When do you expect most of the investment cost in digital transformation to end or to slow down? David.

David (A4): Yes, we are probably looking around Q4 next year where we can expect the completion to be.

Dalal (Q5): **We have a question on OPEX. Can you share some guidance on OPEX? The digital transformation is an ongoing theme, but will inflation result in higher wages?**

David (A5): Total operating expenses were up 6% year on year, but they remained flat from Q2 to Q3. And because we saw an increase in operating income (which was largely margin driven), we saw the Cost to Income ratio fall from 49% to 46%. This is still above where we want to be, but we have made a significant investment in our staff, and we are still on our transformation journey. There's also been exceptional growth in our retail business, and this has a variable cost element. I think there will be opportunities to reset the cost base once the digital transformation is complete later next year and we start seeing the return on the investment.

Dalal: Thank you David and thank you Tony.

I believe we answered the majority of the questions. 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.