Gulf Bank of Kuwait

Earnings Conference Call Edited Scrip – Year-end 2018

Wednesday 6th February, 2019

Corporate Participants:
Mr. Antoine Daher – CEO
Mr. Kevin Smith – CFO
Ms. Dalal AlDousari – Head of Investor Relations

Chairperson:
Elena Sanchez- EFG Hermes

Elena: Good afternoon and good morning everyone, and welcome to the Gulf Bank year-end 2018 results conference call. It is a great pleasure to have with us in the call Mr Antoine Daher, CEO of Gulf Bank, Mr Kevin Smith, CFO of Gulf Bank and Ms Dalal Al Dousari, Head of Investor Relations at Gulf Bank. The call will begin with a presentation from management on the key highlights of the results of the year-end 2018 and then we will open the call for the Q&A session.

Dalal: Thank you, Elena. Good Afternoon and Welcome to Gulf Bank's year-end 2018 financial results conference call. My name is Dalal AlDousari from Gulf Bank's investor relations team. We will start the call today with a presentation of the key highlights of the Gulf Bank performance during the year 2018 presented by the Chief Executive Officer, Mr. Tony Daher followed by a detailed presentation of our financial results by the Chief Financial Officer, Mr. Kevin Smith. 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 if you have any inquiries.

I would like to handover the call now to Mr. Tony Daher, Gulf Banks 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 what we feel was a fantastic year for Gulf Bank in 2018.

The first highlight is on **page 3**. We reported a net profit of KD 57 million in 2018, an increase of 18% from the prior year. This is the fifth straight year of double digit net profit growth for Gulf

Bank and an acceleration of the growth rate from the previous 4 years.

Secondly, on **page 4**, our earnings per share increased to 20 fils per share and the Board of Directors is recommending a cash dividend of 10 fils per share for shareholders' approval at the Annual General Meeting to be held in March 2019. 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.

Third, on **page 5**, total loans to customers reached an all-time high of KD 4.2 billion at the end of 2018, an increase of nearly KD 0.5 billion or 13% over the last two years. This growth was well balanced as 57% came from our Corporate segment and 43% came from our Consumer segment.

Fourth, on **page 6**, non-performing loans reached an all-time low of 1%. This was driven mainly by the settlement of two corporate loans in the second half of 2018, one of which led to a recovery of KD 36.5 million recorded in the fourth quarter.

Fifth, **page 7** shows you that we have achieved 'A' ratings from the four major credit rating agencies. During the year, Moody's Investor Service affirmed its A3 rating and upgraded the outlook of the Bank to 'Positive' from 'Stable' Both Fitch Ratings and S&P Global Ratings affirmed their ratings at 'A+' and 'A-', respectively, both with 'Stable' outlooks, while Capital Intelligence upgraded its rating to 'A-' from 'BBB+'.

In addition to these milestones, on **page 8**, you can see some of the new product launches in our Consumer Banking franchise. We launched a new card line-up in 2018 to better serve each of our differentiated customer segments. This also included adding new features such as cash back and interest-free programs through a network of retailers in Kuwait. We also launched our new dynamic website which is proving to be popular with customers. New services such as WhatsApp and the latest interactive ATM machines were also launched.

We also moved a significant number of our employees from Kuwait City into Crystal Tower. Now we have two headquarters locations that are much closer to each other and this has resulted in an increase in morale and higher productivity. In addition, we will be opening a new branch on the ground floor of Crystal Tower and we are excited to have another distribution point to serve existing and new customers of the Bank.

On **page 9**, we've summarized the five key highlights from 2018.

Five straight years of accelerating double digit net profit growth, earnings per share growth in line with profit growth, and, over the last two years, we will be paying more than half of our earnings in the form of dividends.

Since the end of 2016, we've grown our loan book by 13% while the industry has grown 8%. Over this 2-year time frame, our Consumer Banking loans have grown 17% and now comprise more than a third of total loans while the Corporate Banking business has grown 11%.

As a result of completing the legal foreclosure process on two large legacy loans, our non-performing loan ratio reached 1%.

Finally, we now have 'A' ratings from all four of the credit rating agencies.

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

Kevin: Thanks Tony. To start off, please turn to **page 10** which shows the balance sheet progression from the 31st of December 2017 to the 31st of December 2018. 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 1-14.

Over the course of the last 12 months, our total assets grew by KD 333 million or 6% to just over KD 6 billion. This growth came predominantly from gross loans to customers, shown on line 6, which were up KD 185 million; liquid assets, shown on line 5, which were up KD 141 million; and Investment securities, shown on line 10, which were up KD 50 million

In terms of asset composition, not much change from a year ago. As of 31st December 2018,27% of our assets were held in the form of liquid assets, 71% as loans to customers, 3% as investment securities, and 2% as other assets.

You can see on lines 20 and 21, on the far right that, of the KD 333 million in asset growth over the period, KD 306 million of that growth was funded with liabilities while KD 27 million was funded with equity. Customer deposits and Deposits from Financial Institutions led the growth in Liabilities, up KD 245 million and KD 37 million, respectively. Those numbers are shown on the far right of lines 16 and 17.

Average assets and average equity are shown on line items 23 and 24 as this allows us to calculate our return on assets and return on equity which I'll discuss later.

Page 11 shows our key liquidity ratios. On the left side, you can see that our average daily Liquidity Coverage Ratio fell slightly from 351% in the fourth quarter of 2017 to 325% in the fourth quarter of 2018, but is still well above the minimum of 100% that came into effect on the 1st of January 2019. In 2018, the minimum was 90%. On the right side of the page, our NSFR ratio increased from 107% at the end of 2017 to 120% at the end of 2018. So our liquidity ratios are strong with more than adequate buffers in both ratios.

Page 12 shows our income statement and some other key metrics. To give you context, we are showing the full year results for 2016, 2017, and 2018. In addition, for 2017 and 2018, we are showing the composition of our return on assets and those are shown under the columns marked '% of average assets' for both periods.

You can see from the circled percentages on line 12 that our Net Profit grew by 10% and 12% in 2016 and 2017, respectively. You can see on the far right that the growth rate in Net Profit in 2018 vs. 2017 accelerated to 18%. If you move up the income statement and look at the circled percentages on lines 3, 5, 7, and 9, you can see when you compare our results in 2016 to 2015:

- Net Interest Income on line 3 declined by 2%
- Core Operating Income on line 5 was flat
- Core Operating Margin on line 7 declined by 3%
- and Operating Margin declined by 3%

You can see that this turned around in 2017 as:

- Net Interest Income went from -2% in 2016 to +13%
- Core Operating Income went from 0% in 2016 to +9%
- Core Operating Margin went from -3% in 2016 to +15%
- And Operating Margin went from -3% to +11%.

On the far right for those same line items, you can see that in 2018 vs. 2017, we either accelerated or maintained the momentum as our:

- Net Interest Income was up 15%
- Core Operating Income was up 11%
- Core Operating Margin was up 15%
- Operating Margin was up 9%

This turnaround is driven primarily by the strong loan growth of 13% over the last 2 years as well as expanding net interest margins. You can see the net interest margin improvement by looking at net interest income, line 3, under the column marked '% of average assets'. In 2018, our net interest margin reached 2.61%, 25 basis points higher than 2017 of 2.36%.

This has allowed us to drive strong growth in our Core Operating Income, shown on line 5. And, by limiting expense growth to low single digits in 2017 vs. 2016 and again in 2018 vs. 2017, shown on line 6, we've been able to generate positive JAWS of 7% in each of the last two years, enabling us to grow our Core Operating Margin, line 7, by 15% in 2017 vs. 2016 and 15% again in 2018 vs. 2017.

On line 10, Provisions and Impairments in 2018 were KD 68 million, similar to the level incurred in 2017 and 1.2% of average assets, the same ratio as 2017.

At the bottom of the columns labelled '% of average assets, you can see that our return on assets of 86 basis points in 2017 improved by 11 basis points to 97 basis points in 2018. Similarly, on line 13, you can see our return on equity also improved from 8.3% to 9.4% over this same time period.

On **page 13**, our regulatory capital ratios remained strong as the Tier 1 ratio of 14.1% was 2.1% above the regulatory minimum of 12% and the Capital Adequacy Ratio (CAR) of 17.5% was 3.5% above the regulatory minimum of 14%. On the bottom right, the leverage ratio ended at 9.2%, well above the 3% minimum.

Turning to **page 14**, as you know, the IFRS9 accounting standard on credit facilities was implemented by the Central Bank of Kuwait in 2018 and we are required to compare our total provisions with total expected credit losses or ECL and use the greater of the two. As of year-end 2018, the Bank's total credit provisions of KD 312 million on our balance sheet exceed expected credit losses by KD 112 million. These excess provisions of KD 112 million represent 18% of our book equity, 250 basis points of risk-weighted assets, and 2.6% of our total gross customer loans, all very healthy ratios.

In summary, a number of factors are all coming together to drive double digit growth across many line items on the Income Statement for the second straight year:

First, strong 13% loan growth over the last two years coming from a good mix between our Consumer and Corporate businesses.

Second, higher net interest margins driven by shifting our mix towards higher yielding Consumer loans and re-pricing Corporate loans in connection with increases in the Central Bank discount rate.

Third, growing our operating expenses at a slower pace than our revenue.

Fourth, recovering cash from legacy loans that have been previously written down far below the value of the underlying collateral and our legal claims.

Finally, over the last 12 months, we have been able to build up our General Provisions by KD 50 million to KD 247 million and, as of the 31st December 2018, we now have excess provisions of KD 112 million above what's required to meet the IFRS 9 requirements on credit facilities.

Even without these excess provisions, we are well positioned in terms of our liquidity and capital ratios to continue the growth momentum going forward.

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 allow a couple of minutes to receive your questions.

Dalal: What is the reason behind the unchanged interest income and higher interest expense during the last quarter. Are you seeing pressure on NIMS during Q4. How do you see NIMs trending into 2019 expected, Kevin?

Kevin: Ok. I mean I think what we saw, I don't think it was any different from any other banks in Kuwait as you know the Fed increased a number of times in 2018, But the Central bank didn't follow on many of those times. So clearly throughout 2018, as you go quarter to quarter, we saw some pressure on the funding cost line including the fourth quarter and that created a little bit of a challenge in that three months period. Having said that given the sort of the outlook that the FED going forward and I think as we talked about with many of the investors that we don't expect nor count on any increases in the CBK discount rate this year. Having said that then we do see a tremendous amount of liquidity in the market right now. So we do not expect any further pressure on funding costs going forward right now as we see the liquidity situation in Kuwait. In addition to that within our bank we are going to continue to see an impact from repricing of consumer loans that hasn't been completely repriced, number one. And two, as long as we continue to see opportunities like we saw in 2018, to grow our retail franchise faster than our corporate franchise that will also give us an impact because the consumer business comes with higher yields versus the corporate business.

Dalal: Thank you Kevin. Next question. Benefit from loan recoveries in Q4, 2018 were offset by higher provisions. Can you please explain the reasons for the higher provisions.

Kevin: Well, I mean as we talked about we added about 50 million of general provisions in a single year in 2018. Those are general provisions. So in essence those are for unexpected losses. Ok. So do we see anything that would absorb those higher provisions, the answer is no. I think if you look at where we stand relative to the IFRS 9 standard at the end of the year, what we are saying is those provisions exceed the IFRS 9 standards as implemented by the Central Bank by KD 112 million. That 112 million, the reason we express as a percentage of risk weighted assets as well as gross loans, I think it can be thought of as potential cushion on the capital side and potential cushion as to provisioning going forward.

Dalal: Thank you Kevin. Another question. Do you expect a pick up in demand in consumer after CBK increased the limit on retail loans? Tony do you want to take this one?

Tony: Yes sure. Just to explain the regulation here in Kuwait. Consumer lending is broken down into 2 pieces....so any person with a job and a salary can take 2 loans one of them they are called consumer and housing loans, so the first one is a consumer loan where the limit used to be KD15,000 and now has been increased to KD 25,000. So the cap was a total of KD 70,000 but now with the increased limit of KD25,000 plus KD70,000 so the total new increased limit is KD 95,000. And this change took place like in November of 2018. The question is do we expect a pick up in demand? The answer is, I think the demand will remain the same in a way, in last year the growth in that segment is between 5 and 6%. There is another regulation here that keeps the cap on borrowing by consumers and that's called the 40% eye-to-eye, and that means for example if your salary is KD1000 per month that your monthly payment can not go above 40% of that which is KD 400 per month. That has not changed. And because that has not changed, I think that's the real cap on consumers borrowing money from the bank. So to answer your question I think the growth will be muted we may go from a 5-6% market to a 5-8% market. But I think that would be it. We are not expecting the market to really grow all of a sudden because the regulation changed.

Dalal: Thank you Tony. We will take the last question, since we didn't see the full impact of recoveries from Khabary land in Q4 2018, how we should look into it in terms of understanding its impact on 2018 / future earnings? Kevin?

Kevin: Ok, just to remind everybody on the call and the person asking the question, included in our 2018 results is a net recovery of KD36.5 million as a result of acquiring the land in a legal auction and selling in the same quarter which is the last quarter of 2018. In addition to that, we also disclosed there is KD19.7 million of interest income that has been appealed by the counter party and its currently in the appeal court. To be conservative, we have reserved fully for that KD19.7 million so that has not been accrued in any period in the past, of course, when an account becomes an NPL and this one became an NPL long time ago, you need to suspend interest and not accrue any interest going forward. But the first court essentially did confirm interest of KD19.7 million but that's going to be subject to an appeal and potentially the final cassation court so depending on what's the outcome of that is, we will be able to accrue or record additional income that has not been recorded in the past, KD19.7 million, when in fact and in if fact the judgment is ruled in our favor.

Dalal: Thank you Kevin.

Dalal: We tried to answer and cover as many questions as we could. We would like to conclude our call today and we thank you for your participation.
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 for your participation.