Gulf Bank of Kuwait

Earnings Conference Call Edited Scrip - Q2 2018

Wednesday 25th July, 2018

Corporate Participants:

Mr. Antoine Daher – CEO

Mr. Kevin Smith – CFO

Ms. Dalal AlDousari – Head of Investor Relations

Chairperson:

Elena Sanchez- EFG Hermes

List of Participants:

1. Ajeej Capital
2. NBK Capital
3. Burgan Bank
4. National Bank of Kuwait
5. T Rowe Price
6. Franklin Templeton
7. Daman Investment
8. DICO Investments Co.
9. S&P Ratings
10. EFG Hermes

Elena: Good afternoon and good morning everyone, and welcome to the Gulf Bank 2Q18 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 second quarter and then we will open the call for the Q&A session

Dalal: Thank you, Elena. Good Afternoon and Welcome to Gulf Bank's first half 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 first half of 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 two 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 Daher: Thank you, Dalal. Good afternoon. I'm very happy to be with all of you today to share some brief highlights of Gulf Bank.

If you turn to **page 3** on the far right, you can see that we accelerated the growth in our net profit from KD 13 million in the second quarter of 2017 to KD 16 million in the second quarter of 2018, an increase of 19%. The first quarter growth rate in net profit was 15%.

For the half, we grew our net profit to KD 27 million, an increase of 18% compared to the first half of 2017 of KD 23 million.

This growth rate is an acceleration of the 12% growth rate achieved in 2017 and the 10% growth rate in the three preceding years from 2013 to 2016.

So, we are seeing an uplift in our momentum in the most recent second quarter and this resulted in very strong results in the first half.

We are also happy with our results specially the growth of our loan portfolio. Through the first half of 2018, we grew our loan book by slightly more than 2% compared with an industry trend through May which was essentially flat.

Turing to **page 4**, In terms of first half initiatives, we launched a new card line up with new designs, new segmentation, a carefully crafted on-boarding experience, and a renewed focus on what is recognized to be the best credit card rewards program in Kuwait. We launched this new line-up through a major outdoor campaign, complemented by an ongoing series of educational videos in social media.

In addition, we enhanced our focus on Salary accounts by organizing an outdoor draw event at the Scientific Center. This was accompanied by another major outdoor campaign that promoted our new program. Furthermore, we continue to support this program on social media and through in-branch communications.

Finally, we are more effectively using the facades in our extensive branch network as an important touch point to complement these campaigns.

Page 5 shows the favorable progression in our credit ratings since 2013. In the highlighted box, you can see that we are currently rated A3 by Moody's with a positive outlook, A- by S&P with a stable outlook, A+ by Fitch with a stable outlook, and A- by Capital Intelligence with a stable outlook.

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

Kevin: Thanks Tony. To start off, I would like to turn to **page 6** which shows the balance sheet progression from the 30th of June 2017 to the 30th of June 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 1-13.

On the 30th of June 2017, we had slightly more than KD 5.6 billion of assets which is shown on line 13. You can see on line 5 that 30% of these assets were held in the form of liquid assets, 65% in net loans, shown on line 8, 2% in investment securities which is shown on line 9, and 3% in other assets, shown on line 12. Over the course of the last 12 months, our total assets grew by 4% or KD 203 million to slightly more than KD 5.8 billion, and the mix of our assets changed significantly. You can see that our liquid assets, line 5 on the far right, shrank by KD 121 million or 7% while our net loans, line 8, grew by KD 362 million or 10%. So, roughly a third of our loan growth was funded by excess liquidity. However, our liquid assets are still a healthy 26% of our balance sheet while our net loans now comprise 69% of our total assets.

Investment securities, which is shown on line 9, remained at 2% of total assets.

Other assets, line item 10, shrank by KD 40 million mainly driven by selling repossessed collateral and 'other assets' now represent 2% of total assets, down from 3% a year ago.

You can see on lines 19 and 20, on the far right that, of the KD 203 million in asset growth over the period, KD 181m was funded by liabilities while KD 22 million was funded by equity. Customer deposits growth was nearly KD 300 million and this was partially offset by less reliance on funding from Banks.

Average assets and average equity are shown on line items 22 and 23, so we can calculate our first half return on assets and return on equity.

Page 7 shows our key liquidity ratios. On the left side, you can see that our average daily Liquidity Coverage Ratio increased from 262% in the second quarter of 2017 to 325% in the second quarter of 2018. The average in the first quarter of 2018 was 268%. These ratios are well above the minimum of 100% that comes into effect on the 1st of January 2019. In 2018, the minimum is 90%. In addition, the new NSFR ratio increased from 104% at the end of the first quarter of 2018 to 107% at the end of second quarter of 2018 compared with the minimum of 100% So, even though we've squeezed out some excess liquidity, we still have a buffer in both ratios.

Page 8 shows our income statement and some other key metrics. To give you context, we are showing you the full year results for 2016 and 2017 on the left-hand side as well as the first half in 2017 and 2018 on the right-hand side. In addition, for the first half of 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 halves.

As Tony mentioned, you can see from the circled percentages on line 10 that our Net profit grew by 10% and 12% in 2016 and 2017, respectively. As Tony also mentioned, the growth rate in Net profit for the first half of 2018 vs. the first half of 2017 accelerated to 18%. If you move up the income statement and look at the circled percentages on lines 3, 5 and 7, you can see that in 2016, Net Interest Income on line 3 declined by 2%, Operating Income on line 5 was flat, and Operating Margin on line 7 declined by 3% compared with 2015. You can see that this turned around in 2017 as the growth rate in our Net Interest Income went from -2% in 2016 to 13% in 2017, the growth rate in our Operating Income went from zero in 2016 to 8% in 2017, and the growth rate in our Operating Margin went from a decline of 3% in 2016 to 11% in 2017.

In the first half of 2018 vs. the first half of 2017, we accelerated the growth rate in our Net Interest Income to 21%, maintained the 8% growth rate in Operating Income, and Operating Margin growth was also 8%. I've circled all those percentages on page 8, so you can see the historical trend and recent momentum.

This turnaround is driven primarily by the strong net loan growth of 10% previously mentioned 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 the first half of 2018, our

NIM reached 2.7%, 40 basis points higher than the first half of 2017 NIM of 2.3%.

In terms of operating expenses, shown on line 6, our objective is to have sufficient capacity to run the bank and fund important initiatives in the Bank in such a way as to ensure that the growth in operating expenses doesn't outpace the growth in our operating income. In other words, drive a lower cost to income ratio over time.

In the first half of 2018, expenses were 8% higher than the first half of 2017. This was mainly driven by cost associated with the amended labor law. Even with these higher costs this year, our cost to income ratio in the first half of 2018 remained at 33% which is 7% less than the 2017 full year cost of income ratio of 35.4%, as shown on line item 12.

On line 8, Provisions and impairments in the first half of 2018 were KD 37 million, relatively flat compared with the first half of 2017.

In terms of return on assets, at the bottom of the columns labelled '% of average assets, you can see that our return on assets in the first half of 2017 of 83 basis points improved to 94 basis points in the most recent half. Similarly, on line 11, you can see our return on equity also improved from 8% to 9.1% over this same time period.

Page 9 shows the progression of our non-performing loan ratio. On the 30th of June 2018, the ratio is at 2.1% compared with the 31st of March 2018 of 2.2%. You can see this ratio has come down dramatically over time.

On **page 10**, our regulatory capital and leverage ratios remain well above their respective minimums. The reduction in the ratios from the first half of 2017 is a result of the numerators, that is, Tier 1 and total capital, growing at 3% after 55% of our dividends were paid out whereas the denominator, which is risk weighted assets, grew at a much faster 9% pace, mainly driven by our loan growth over this period. Please keep in mind the KD 27 million in first half 2018 Net profit is not included in Tier 1 or total capital in the first quarter 2018 ratios as that happens at the end of the year. Doing so would add more than 60 basis points to both capital ratios. Tier 1 capital still comprises nearly 80% of our total capital.

As you can also see on the bottom right, the leverage ratio increased slightly to 8.44% at the end of the first half in 2018, and remains well above the regulatory minimum of 3%.

In summary, the turnaround in the growth rates we saw in Net Interest Income, Operating Income, and Operating Margin in 2017 vs. 2016 continued to drive momentum for us in the first half of 2018.

Now I would like to hand it back 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 submit button. We will allow a couple of minutes to receive your questions.

Dalal: Ok, we have a question. When we will see the impact of Fahaheel land?

Kevin: Yeah, I will take that one, its Kevin Smith…. We've cleared the last legal hurdle as the Cassation Court ruled in favor of Gulf Bank on the awarding of land in an auction that took place on the 16th of January 2018. So, we have started a process of transferring the land in the name of

Gulf Bank. In terms of the financial impact of this transaction, that will be determined after the ownership of the land is effectively transferred and disposed of during the legally prescribed period based on CBK regulations.

Dalal: We have the next question. When do you expect implementation of IFRS9 in Kuwait and what will be the day 1 impact on equity of Gulf Bank? Kevin, would you like to take this one?

Kevin: The Bank already adopted IFRS9 effective on the 1st of January 2018 with the exception of credit facilities where the Central Bank of Kuwait retained the existing guidelines on provisions. Given the fact that the implementation of the accounting standard was effective on the 1st of January, we have already had the day 1 impact reflected in our financials, the opening equity adjustment effective 1/1/2018 was a very very small reduction in equity of roughly KD426,000, very very small.

Dalal: H1 2018 is the first time in many years where earnings growth has been in high double digits. Should we expect this to continue for the full year of 2018. Or could the Central Bank push for higher precautionary provisions in the second half? Kevin?

Kevin: yeah..the only thing I can really make a comment on is the second part of the question as far as precautionary provisions just by stating that at the end of the first half we have general provisions on the balance sheet of KD 214 million, at that level, if you were to look at how that compares to the rest of the banks in the industry, we would be sort of one of the highest watermarks as far as that as a percent of our book capital or that as a percent of our gross loan balance so we feel that we are in a pretty good position in terms of having a healthy balance sheet.

Dalal: Another question, why did NPL ratio increased to 2.1% from 1.7%? annualized cost of risk is around 170bps in H1 2018. What will be the normalized cost of risk going forward? Kevin?

Kevin: let me try to cover that in two aspects; number one, is because our NPL ratio is now so low, and we have proven in the market that we can actually get our collateral back though our legal process, sometimes it's to our advantage to actually take legal action which triggers an automatic NPL especially in the case where we have a strong collateral position and that's exactly the case of why the NPL ratio went from 1.7% to 2.1%. That's the first part of the question. In terms of normalized cost of risk going forward, the only thing I can really comment on is again back to this earlier question about the Khabary land, once again we get the title to that land, that will have a material impact downwards on the NPL ratio.

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 investors relations page at our corporate website. You can also reach us at our dedicated investor relations email investor.relations@gulfbank.com.kw. Thank you for your participation. Back to the operator.