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FY 2023 National Bank of Kuwait Earnings Call

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Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, 01 February 2024 at 3:00 pm Kuwait time.

Corporate participants:

Mr. Isam Al-Sager – Vice-Chairman and Group CEO, NBK

Mr. Sujit Ronghe – Group CFO, NBK

Mr. Amir Hanna – Head of Investor Relations and Communications, NBK

Chairperson:

Elena Sanchez – EFG Hermes

Elena Sanchez: Good afternoon everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to the National Bank of Kuwait fourth quarter and the twelve-months period for the year 2023. It is a pleasure to have with us in the call today Mr. Isam Al-Sager, NBK Vice Chairman and Group CEO, Mr. Sujit Ronghe, NBK Group CFO and Mr. Amir Hanna, Head of Investor Relations and Communications at NBK.

At this time, I would like to handover the call now to Mr. Amir Hanna.

Please go ahead Amir.

Amir Hanna: Thank you Elena.

Good afternoon everyone. Thank you for joining us for today's webcast.

We will start the call with a disclaimer. So I would like to bring to your attention that certain comments in this presentation may constitute forward-looking statements. These comments reflect the Bank's expectations and are subject to risks and uncertainties that may cause actual results to differ materially and may adversely affect the outcome and financial effects of the plans described herein. The Bank does not assume any obligation to update its view of such risks and uncertainties or to publicly announce the result of any revisions to the forward-looking statements made herein. Please refer to the full disclaimer in our presentation for today's call.

Our Vice Chairman and Group CEO, Mr. Isam Al-Sager, will be giving some opening remarks on the operating environment and the highlights of the reporting period. Then Mr. Sujit Ronghe, our Group CFO will go through the financials in more details. Following the presentation, there will be a Q&A session platform. Also direct any follow-up questions to our Investor Relations email address and we will answer them at the earliest. Today's presentation is available on our website for your convenience.

Now let me handover the call to Mr. Isam Al-Sager for his opening remarks.

Isam Al-Sager: Thank you Amir.

Good afternoon everyone. I am pleased to join you today for our fourth quarter and full year 2023 earnings call.

The global economy ended 2023 better than originally expected earlier during the year, but this macroeconomic resilience will continue to be tested in 2024.

Notwithstanding the economic and geopolitical challenges globally and regionally, the GCC showed exceptional performance. This performance was supported by a positive cycle of reforms in some markets in addition to the higher oil revenues throughout the year. The growth outlook for the GCC region is expected to remain relatively robust but we will continue to be cautious as the GCC economies are exposed to the overall weaker global backdrop.

In Kuwait, the economy ended the year on a positive note, supported by some gains in credit growth, solid though normalizing consumer spending, rebound in real estate activity and an improved stock market performance. We expect Kuwait's GDP growth in 2024 to witness a minor contraction as additional oil production cuts will likely keep headline growth low despite an expected level of over 3.0% growth in the non-oil sector.

Similarly, the year 2023 marked the best performance in projects awarding in recent years, with more than KD 2.5 billion worth of awards: surpassing last year's awards by almost 300%. We see the momentum feeding into this year on a potentially improved political landscape; supporting our forecast of higher non-oil growth levels.

As for NBK, we continued to deliver solid performance supported by our diversified business model, strategic investments and flexibility in the face of various economic conditions. We reported net profit of KD 560.6 million for the year, growing by 10.1%.

On the operational front, we achieved a year-on-year growth of 15.6% in net operating income to reach KD 1.2 billion for the year. The increased momentum in the operational performance was achieved across key areas including most importantly international operations and wealth management.

We remain committed to creating value to our shareholders as our performance ratios continued to improve with return on average assets reaching 1.53% while our return on average equity reached 15.0% for the year.

The Group will continue executing its responsible growth strategy, investing in innovation and new technologies. Our digital investments are positioning the bank as a leader in advancing customer-centricity and prioritizing user experience.

In Kuwait, our strategy continues to focus on strengthening our position in key market segments, expanding our customer base through digital offerings and exceptional customer experience. While on the corporate side, we remain at the forefront of Kuwait's infrastructure agenda. Our diversification plans continue to benefit from our Islamic banking arm, Boubyan bank and our international operations, as both have continued to grow their contribution to the Group.

Moreover, and In line with the Group's strategic plans to expand and offer a holistic investment and wealth management solution, NBK Wealth emerged to provide our high-net-worth clients base with tailored offerings that meet their evolving needs.

Likewise, and in line with our strategic and multi-stakeholder approach to advance ESG through achieving higher levels of integration, the Bank continues to expand its responsible banking practices to customers and all our stakeholders to support their efforts towards green transition initiatives.

With that, I will conclude my comments and leave you with my colleague Sujit Ronghe, our Group CFO, to cover quarterly and twelve-months results in more details.

Please go ahead Sujit.

Sujit Ronghe: Thank you Mr. Isam

Hello everyone and welcome.

I am very pleased for the opportunity to take you through the financial results in respect of the year ended 31 December 2023.

We have announced a net profit of KD560.6m for 2023, the highest ever in the Group's history. This is a 10.1% increase in bottom line profit over the last year. These results stem from a strong operating performance by the Group and demonstrate the continued growth in our business.

Before going on to details of our financial results, I would first like to say a few words regarding the overall operating environment during 2023.

Higher interest rate regime and an overall stable operating environment in Kuwait have benefitted the Bank during 2023. Inflationary conditions in the USA and some other advanced economies have gradually improved, although the risk of a possible recession cannot be ruled out completely. Geo-political developments in the region and beyond have affected the global operating environment unfavorably, especially in the last quarter of 2023.

Now turning to the financial results for 2023.

As shown at the top left of this slide, net profit at KD560.6m reflects a yoy growth of KD51.5m i.e. 10.1%. Underlying drivers for the robust bottom-line performance are higher interest rates, growth in business volumes and a strong operating performance. Group loans grew by 6.1% year on year across business lines and geographies. Investment securities also contributed strongly to Group assets with a growth of 22.2% v Dec 22.

The top right chart reflects operating surplus i.e. profit before provisions and tax for 2023 at KD740.3m, a growth of KD116.7m, 18.7% over 2022. Net operating income increased by KD157m, 15.6% whilst costs grew by KD40.3m, 10.4% over 2022.

4Q23 net profit at KD129.5m which reflected quarter-on-quarter growth in net operating income driven by higher NII, was however affected by higher costs and impairment losses.

I will go into the main drivers behind movements in income, margins and costs shortly.

The operating income mix profiled at the bottom right hand continues to show a healthy mix with 22.4% coming from non-interest income sources.

Moving on now to the next slide.

Here we will look at net interest income and drivers behind its performance.

The chart at top left reflects the net interest income of KD905.1m for 2023, a growth of 19.8% over 2022, largely benefiting from higher interest rates and growth in loans and investment securities across segments and geographies. You would also note from the chart at the top right that Average earning assets grew by KD2.1bn i.e. 6.3% from Dec 22, to reach KD34.9bn.

We see from the chart at the bottom left, that average NIM for 2023 at 2.59% reflects an improvement of 29bps over 2022 driven by a higher yield, despite increased funding cost. Group yield and funding cost for 2023 was at 5.83% and 3.63% respectively. The higher funding cost results from the repricing of deposits at increased market rates, a limited migration of lower cost deposits to time deposits and longer tenor funding sourced by the Group. At the same time, an overall sticky and stable base of retail customer deposits continue to benefit the Group.

4Q23 NIM for the Group remained stable at 2.68%. Group yield for the current quarter improved to 6.22%, compared to 6.12% in 3Q23. Similarly, the Group funding cost increased to 3.98% during the current quarter from 3.85% in 3Q23.

At the bottom right of this slide, we can see drivers behind the 29bps increase in NIM from 2.30% in 2022 to 2.59%. Loans and other interest earning assets backed by a strong year on year growth in interest rates and volumes, contributed a net increase of 121bps and 86bps to the NIM respectively. Higher funding cost negatively affected the NIM by 178bps.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD261.6m for 2023 was KD7.7m higher than 2022. Fees and commissions income was strong at KD196.6m; Fx contributed KD36.1m, while other non-interest income sources (mainly investment income) contributed KD28.9m.

Fees and commissions income reported a strong growth of KD14.8m, +8.2% on 2022, reflecting robust contributions across different lines of business and geographies. Fx income for 2023 was lower than previous year, which had a larger benefit from favorable currency movements, including that on assets related to NBK’s US$ AT1 issuance.

Other non-interest income increased by KD12.2m compared to 2022, mainly due to a higher net investment income, favorably affected by higher market valuations and distributions.

Our fees and commissions income is from a well-diversified pool of geographies and lines of business. Also, major sources of non-interest income are core banking activities in respect of business-related factors.

Turning now to operating expenses reflected in the top right-hand of this slide. Total operating expenses for 2023 at KD426.5m, were 10.4% higher than 2022. The cost growth reflects increased activity levels at Kuwait and across the Group's network. Other administrative expenses also included NBK's CSR donations of KD2.8m towards humanitarian causes.

The Group's operating expenses reflect continued investments in key businesses initiatives, digital technologies and processes. This enables the Group to offer best in class service to its customers and optimize resources to improve operational efficiency.

NBK's digital channels and products continue to play a vital role in attracting and servicing customers, with increasing volume of electronic transactions. We also continue to press ahead with selective product offerings in certain geographies e.g. Wealth Management business, expansion of Islamic banking through Boubyan Bank and by leveraging our overseas network.

As a result of the marked growth in operating income and controlled cost growth, the 2023 cost to income ratio was at 36.6% compared to 38.2% in 2022.

Moving on to provisions and impairments profiled on the bottom right-hand side of the slide.

Total credit provisions and impairment losses for 2023 amounted to KD103.1m, an increase of KD57.7m over the last year. You would recollect that 2022 was characterized by significant specific provision recoveries, which were not expected to repeat in the current year. KD81.8m of the 2023 charge was for provisions for credit facilities, in course of normal business activities at Kuwait and overseas locations. Specific provision was KD44.5m, whereas KD37.2m was towards general provisions, a significant component of which was precautionary general provisions. The Group remains committed to its conservative approach in managing credit exposures.

The cost of risk for 2023 was at 36bps compared to 3bps for 2022, which benefited from provision recoveries as explained earlier.

Other impairment losses of KD21.3m are mainly related to the impairment of KD20.2m of goodwill in respect of NBK Egypt.

It is worth noting that the Group's Balance Sheet remains strong with a stable credit quality. NBK's capital base along with the ability to generate healthy operating profits provides a strong credit loss-absorption capacity.

Moving now to the next slide.

On this slide, I would like to expand on the matter of earnings diversification of the Group through different lines of business.

NBK Group continues to benefit from its unique position amongst Kuwaiti banks in terms of geographical spread through International Banking and the ability to conduct business in both Conventional and Islamic Banking.

The segmental analysis (note 3) in current year's financial statement has been enhanced to reflect Consumer Banking results separately. Similarly, NBK Wealth, being an area of key focus and attention by the Group, is now disclosed as a separate business segment. NBK Wealth provides asset management, brokerage, lending, deposits and other customized and innovative offerings to high-net-worth individuals and institutional clients, further advancing the Group's diversification agenda.

You would note that NBK's Consumer Banking contributed 20% and 18% to the Group's net operating income and profit respectively. Similarly, Corporate Banking contributed 14% and 25% to the Group's net operating income and profit.

International Banking's contributed 24% to net operating income and 23% to the Group's profit reflecting a strong operating performance.

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD80.4m, up 39.2% on 2022 aided by lower provisions and stronger operating performance.

NBK Wealth contributed to 10% and 11% of the Group operating income and profit respectively.

NBK's business segments serve as main pillars of diversification, providing a strong competitive advantage and a significant degree of resilience to Group earnings.

Finally, chart at the bottom right corner, you will note that International Banking and Boubyan Bank contributed 43% and 22% respectively to Group's total assets enforcing the diversification agenda of the Group.

Moving to the next slide.

Here we will look at some of the movements in key volumes during the year.

As profiled on the chart at top left, the Group total assets reached KD37.7bn as of Dec 23, a 3.7% increase on Dec 22.

Group loans and advances at KD22.3bn registered a yoy growth of KD1.3bn i.e. 6.1%. Loan growth was achieved at Kuwait in both conventional and Islamic sectors and at International operations.

Customer Deposits i.e. non-bank and non-FI deposits at KD21.9bn, reflect a strong yoy growth of 8.8%. The Group has continued to benefit from its strong base of core, franchise retail deposits. As can be expected in a rising interest rate scenario, we noted a limited migration from lower cost deposits to time deposits during the year.

NBK's stable deposit base reflects a sustained focus on the deposit gathering aspects of our business, leveraging our longstanding ability to capitalize on the Group's strong brand, customer appeal and credit ratings.

Customer deposits comprise a healthy 69% of total funding mix of the Group.

I want to highlight that the Group continues to maintain healthy liquidity levels & comfortably exceeds minimum requirements of Basel III ratios.

Moving now to the next slide.

Here we will look at the impact 2023 financial results had on certain key performance metrics.

The Return on Average Equity for the current year improved to 15.0% from 14.3% for 2022. Similarly, Return on Average Assets now stands at 1.53% compared to 1.48% for 2022.

At 17.3%, total Capital Adequacy Ratio remained strong and stable, well above the regulatory minimum. CET1 and Tier1 ratios were 13.0% and 15.0% respectively, remained stable in comparison with 2022.

As regards asset quality, NPL ratio stands at 1.38% compared to 1.42% as at December 2022. Loan loss coverage ratio is at 271%, reflecting conservative provisioning policy of the Group.

Moving to the next slide.

I would now like to discuss Expected Credit Losses (ECL) on credit facilities as per 'IFRS 9 calculated in accordance with CBK Guidelines'. As per the regime adopted by CBK, Banks calculate the credit provisions required (i.e. the amount in the balance sheet) as per CBK instructions and compare it with the ECL on credit facilities as per 'IFRS 9 in accordance with CBK guidelines'. Consequently, the charge to income statement is based on the higher of the two balance-sheet amounts.

It is important to note here that CBK guidelines for calculating ECL on credit facilities as per IFRS 9 are on a more conservative basis compared to the original accounting standard.

The key chart on this slide at the bottom right reflects that ECL provision required as at Dec 23 was KD616m, slightly higher than Dec 22 levels, mainly resulting from volume growth in credit facilities.

Although IFRS 9 ECL and CBK provisions are two different regimes and should not be compared as such, as at Dec 2023, the balance sheet provision as per CBK instructions exceeds the ECL by KD287m. This provides ample cushion for the Group to withstand any possible adverse effect of prevailing uncertainties on ECL provision requirements.

Now to the final slide in this section.

Before concluding, allow me to summarize our financial performance in 2023.

As mentioned earlier, benefits of a higher interest rate regime, a strong operating performance combined with a healthy balance sheet, comfortable liquidity levels and a strong capital base were features of NBK's 2023 results.

Looking forward, ongoing regional and international geo-politics, prospects of lower interest rates coupled with possibility of recessionary conditions, are likely to result in a macroeconomic environment which is less conducive to growth. We however remain cautiously optimistic that the overall operating environment, although challenging, will remain generally stable during 2024.

Now turning to the guidance for the year ahead.

As regards loan growth, the Group reported a loan growth of 6.1% during 2023. Given the current geo-political and the general macroeconomic situation, we continue to expect the overall loan growth for 2024 to be in the mid-single digit range.

Now turning to the NIM. As mentioned earlier, 2023 NIM has improved to 2.59% benefiting from higher interest rates and stronger volumes compared to last year. The general expectation is for the current environment of higher interest rates to come to an end, with rate cuts of varying degrees being forecasted for 2024. We should also expect increasing competition and the funding cost to remain high, despite the Group's healthy overall funding mix. In such a lowering interest rate environment our guidance for the 2024 NIM is to remain broadly stable, similar to that of full year 2023.

The 2023 cost to income ratio was 36.6%. Given the Group's continued investments in human resources and digital technologies, we should expect the cost to income ratio to be in the range of high thirties during 2024.

The cost of risk in 2023 was 36bps. We are cautiously optimistic of a stable overall operating environment and as such expect the cost of risk to remain in the range of 40-50 bps. However, given the overall macroeconomic uncertainties, it would not be prudent to give specific guidance on earnings / capital adequacy. We are hopeful of maintaining capital adequacy ratios in line with our internal targets above the regulatory minimum.

That ends my presentation.

Thank you very much for your time.

Back to Amir.

Amir Hanna: Thank you, gentlemen.

Thank you all for listening an attending our call, we will break for a while as questions kick-in to group questions to answer them based on themes.

Thank you everyone for waiting with us through that break. We will start taking questions and if you have more questions just feed them into the platform.

First question is on margins and interest rates. How should we look at margins for 2024 estimates given the uncertainty around timing of rate change, what is your outlook for margins?

Sujit Ronghe: With the CBK discount rate currently at 4.25% and the Fed at 5.5%, there are differing expectations talks about the pace of reduction in benchmark rates. Also, we have seen during the rate increase cycle, rates in Kuwait did not increase in the same pace as the Fed. In such an uncertain situation it is rather difficult to pinpoint the precise NIM behavior during 2024. On the assumption of a few rate cuts, at different points of time during the year, the projected NIM remained broadly stable. NIM averaged 2.59% during 2023 and would still be around the same level, assuming a few rate cuts during 2024.

Amir Hanna: How do you expect credit costs to trend in 2024? Can we take 2023 as a base?

Sujit Ronghe: On the background of 2022, 2023 was a much more normal year for the bank on the provisions front, with the cost of risk averaging 36 basis points comprising both specific and general provisions, including the precautionary provisions. We can expect 2023 to be a good base for guiding the cost of risk. With the overall operating environment remaining stable, we can expect cost of risk for 2024 to range between 40 and 50 basis points.

Amir Hanna: Question on housing law, any update on the housing law?

Isam Al-Sager: With regards to the housing law, there is progress as there are some ongoing discussions involving all relevant stakeholders to improve the draft law and address the residential housing challenges. We see this as great progress so far.

But of course, it will all depend on the government and their initiatives. There are some signs of cooperation between the parliament and the newly appointed cabinet. As they get more cooperative I am sure there will be some more hopes to see more progress on both the housing as well as the debt law too.

Amir Hanna: Which takes us to the next question which is partially answered. Your view on the new cabinet and the development in the political arena in terms of impact on the banking sector growth and outlook.

Isam Al-Sager: Of course, there are a lot of positive signs with the appointment of the new prime minister and his newly appointed cabinet. As you know Emir Sheikh Mehsaal just took the oath following the death of late Emir. There has been some progress in the form of appointing the new prime minister. Also the recent engagement and cooperation between the parliament and the cabinet of minister is positive and will lead to improvement in executing so many things that have been delayed mainly the mega projects that we feel will go ahead once there is better understanding between the two sides.

Amir Hanna: Another question on NIMs but also talk about loan and deposit growth in 2024.

Sujit Ronghe: We have already answered the part related to NIM. The loan growth during the 2023 came mainly from corporate related activity in Kuwait and across our overseas locations. During the year we noted an increased demand credit in Kuwait, regionally and also in our locations in the western world. That said, considering the combination of geo-politics and macroeconomic factors both regionally and globally, we have given a guidance of a mid-single digit loan growth for the full year of 2024. The Group has a strong and well diversified pipeline of credit facilities including amounts that are already approved but pending drawdown, which will support the guidance.

Amir Hanna: Further on loan growth, comments on retail loan growth.

Sujit Ronghe: The retail loan growth was muted for the fuller banking sector during the year and with the current levels of interest rates we don't see any incentive for the customer to borrow. As interest rates start declining, we would expect the retail demand to increase. It will all depend on pace decrease in the CBK discount rate.

Amir Hanna: Outlook on fee income and cost to income for 2024 and 2025

Sujit Ronghe: The fee income of the bank was very robust during the year and very well supported across different products, business lines and geographies. We expect a mid to high single digit fee income growth during the year. With regards to the cost to income ratio, the higher level of income has benefited the ratio in 2023. The income behavior in 2024 will be determined by the interest rate environment going forward. That said, and having priced in few rate cuts, we expect the cost to income ratio to be in high-thirties during 2024.

Amir Hanna: A couple of questions on CASA representation, changes in deposit trends, share of CASA in total deposits and expectation of further migration.

Sujit Ronghe: We ended the year 2022 with CASA deposits near the 40% range when compared to total non-bank deposits. This percentage experienced a downward trend during 2023, with CASA deposits reaching levels of mid-30s of total non-bank deposits during the last quarter.

Customer behavior towards migration to time deposits is difficult to gauge at this point in time. It is dependent on how long the current higher interest rate environment lasts, but overall we don't expect a significant migration from current levels.

Amir Hanna: A question on strategy, what your plans for branch expansion in KSA and the outlook of business growth there?

Isam Al-Sager: We continue with our successful execution of our strategy and expansion in growth markets including the Saudi market which is a key component of it. We operate currently in KSA through 3 branches, in Riyadh, Jeddah and Eastern Province and target to expand in the Saudi market on the corporate banking front and wealth management; leveraging on the solid base we established in those areas of business in KSA, especially on the wealth management front.

Globally, we are also implementing our strategy to be in key markets with more focus on GCC as well as other international locations.

Amir Hanna: A couple of questions on changes expected in the tax regime and its impact in 2025.

Sujit Ronghe: It is worth noting that implications of pillar 2 income taxes are disclosed in note number 9 in our annual financial statements for 2023.

To give a background, under Pillar 2, multinational entities with revenues exceeding EUR 750 million are liable to pay corporate income tax at a minimum effective rate of 15%. The jurisdictions in which the Group operates have joined the inclusive framework, including Kuwait which became a part in November 2023.

The Group expects to be liable for global minimum tax under Pillar 2 starting the year 2025. As far as Kuwait is concerned, the Ministry of Finance is preparing to introduce a corporate tax law in some shape or form. The details of such a law are awaited and we are to see a draft prepared by the ministry.

We expect that the draft will be in line with the requirement of Pillar 2, with a 15% effective tax rate. The intention of such an alignment would be to prevent Kuwait from losing tax revenues to other countries starting 2025.

Amir Hanna: Do you expect further impairment of goodwill related to NBK-Egypt? What is the outlook on operating costs which increased by 10% in 2021 and 2023?

Sujit Ronghe: We have already answered the question regarding operating costs. With respect to goodwill, we have written-off the entire amount related to our acquisition of NBK Egypt. Hence there will be no further impairment charges on this account in future.

Amir Hanna: Questions are repeating now on margins and taxes. We will pause again for 20 seconds till we receive further questions.

We received more questions, the first asks how much does USD loans and deposits account from total loan book and total deposits?

Sujit Ronghe: Loans and non-bank deposits in foreign currency form c.35% to c.45% of the total; a big portion of which is denominated in USD.

Amir Hanna: A question on capital. Can you share what is the target level of CET 1? At what levels you will be comfortable in 2024? Can you also share your issuance plans for this year on seniors, ESG labeled and subordinated paper?

Sujit Ronghe: With respect to the total capital ratio, the bank targets to maintain a buffer of 1.5-2.0% at the year-end; over the minimum regulatory capital requirement of 15%; targeting a capital adequacy ratio of 16.5-17%. We expect some flexibility of lower thresholds for CET1 and Tier 1 ratios but expect to be in the range of 1.5% over the minimum at the year-end.

Amir Hanna: There are a couple of questions on how the new mortgage law product would be structured and the details of it.

It is too early for this, There is no details that we have at this point.

There is a question also on projects. Is there an improvement in new project awards? How do you see project awards in 2024?

Isam Al-Sager: As mentioned in my opening remarks earlier, the year 2023 marked the best performance in project awards in recent years.

The value of projects awards in 2023 reached more than KD 2.5 billion. In the meantime, because of the backlog of awards from pandemic time and the weakness in the project market in post pandemic years; last year represented a good rebound.

The value of projects awards almost tripled year-on-year in 2023 to reach the levels beforementioned.

There is optimism for this year that the value of project awards would be doubled in 2024. forecasts point to more than KD 5-6 billion worth of project awards, mainly in the energy and oil sector.

With the appointment of the new government, we are optimistic that it will remain committed towards accelerating the awards pipeline across various sectors.

Amir Hanna: That concludes our call for today as we have covered all questions.

The list was quite exhaustive and as our usual practice, if you have follow up questions or any further details are required, please email us at our investor relations email address and we will reply at our earliest.

Thank you all for listening and for attending the call today.

Back to Elena.

Elena Sanchez: Thanks to NBK's management for the presentation today and insights provided.

Thank you everyone for joining the call.

This concludes the call.