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Earnings Conference Call

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Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, 25 April 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 first quarter earnings call for the year 2024. 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 our usual disclaimer as 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 also refer to the full disclaimer in our presentation for today's call.

Today's call will follow our usual agenda. Our Vice Chairman and Group CEO, Mr. Isam Al-Sager, will start the call by 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 our presentation, there will be a Q&A session through Webex platform. If you have any follow-up questions after the call please direct it all 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 hand over 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 first quarter earnings call for the year 2024.

Global economic prospects diverged among markets year-to-date amid recent solid data in the US, weaker in the EU and decent in China. The readings show that the current interest rate levels will hold for a longer period than originally anticipated but cuts remain on the table for the remainder of the year. Nevertheless, continued geopolitical tensions and rising energy prices could prevent inflation from easing, thus supporting a cautious approach to monetary easing.

In the GCC region, growth for the year is forecasted to remain solid on the back of higher energy prices that will support public finances and boost domestic demand, while the execution of public economic diversification programs and strong capital inflows should further support the outlook.

As for Kuwait, the economy ended the quarter on a relatively soft note. In terms of historical trends, credit growth stood low while real estate activity weakened. Inflation has also eased and is trending lower on the back of cooling private demand. We expect GDP growth to witness a low-single-digit contraction on the back of oil production cuts and at a growth rate of around 2.5% in the non-oil sector.

Likewise, project activity declined significantly following an improved 2023. This could be partly explained by seasonal effects in addition to the unexpected downturn in domestic politics in the absence of a parliament. The project awards outlook for the remainder of 2024 should be better with a pipeline of KD 6.3 billion worth of projects to be awarded.

As for NBK, we continue recording solid performance and building on past years' momentum as we advance in executing our diverse strategy and leveraging our flexible business model throughout the challenging macroeconomic landscape. We reported net profits of KD 146.6 million in the first quarter of the year, growing by 9.2%.

Driven mainly by growth in core banking income, our revenue stream stems from a diverse operational mix that proved successful in mitigating risks and optimizing performance. We achieved a growth of 11.2% year on year in net operating income to reach KD 309 million.

Our success is underscored by the strategic investments that are aimed at achieving sustainable growth, enhancing customer experience, and creating long-term value to shareholders which is evident in our performance measures. Our return on average assets for the reporting period reached 1.55% whereas our return on average equity reached 15.2%.

The ongoing investments by the Group in innovation and technology will support our ability to meet the evolving needs and expectations of our clients. By such, we will further strengthen our leading franchise across all business sectors and continue to build on our trust-based relationship with stakeholders.

Our approach in Kuwait remains centered on strengthening our market position in key segments, growing our clientele through digital products, and providing exceptional customer service. From a corporate banking standpoint, we continue to lead Kuwait's infrastructure program and are well-positioned for any revival of infrastructure spend.

Furthermore, our Islamic banking arm, Boubyan Bank, along with our international operations both continue to expand their contribution to the Group aiding in our diversification strategy.

Also, and notably in wealth management, we will endorse our position and brand presence through a global network of operations with the launch of NBK Wealth. We will further solidify our value proposition in providing innovative solutions and services towards a best-in-class wealth management experience.

Similarly, as a frontrunner in the ESG space, we will continue to play a role in fostering the sustainable advancement in the communities where we operate and in being a key partner in the sustainable financing endeavors of our clients.

With that, I will conclude my comments and leave you with my colleague Sujit Ronghe, our Group CFO, to cover quarterly 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 opening quarter of 2024.

We have announced a net profit of KD146.6m for 1Q24, a 9.2% increase over the corresponding quarter of 2023. 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 the current quarter.

The continued higher interest rate regime and an overall stable operating environment in Kuwait have benefitted the Bank in general. Inflationary conditions in the USA and some other advanced economies have gradually improved, although bench-mark interest rates are generally expected to decrease only in the later quarters of the year. At the same time, geo-political developments in the region and beyond have affected the global operating environment unfavorably.

Now turning to the financial results for 1Q24.

As shown at the top left of this slide, net profit at KD146.6m reflects a yoy growth of KD12.4m i.e. 9.2%. Underlying drivers for the robust bottom-line performance are a combination of yoy growth in business volumes, higher interest rates, and a stronger operating performance. Group loans and advances grew by 5.7% year on year. Investment securities also contributed strongly to Group assets with a growth of 15.6% v March 23.

The top right chart reflects operating surplus i.e. profit before provisions and tax for the current quarter at KD197.5m, a growth of KD21.1m, +12% over 1Q23. Net operating income increased by KD31.1m, +11.2% whilst operating expenses grew by KD10m, +9.9% over last year.

1Q24 net profit at KD146.6m, +13.2% over the previous quarter, benefited from a 5.8% growth in operating surplus and lower impairment losses.

The operating income mix profiled at the bottom right hand continues to show a healthy mix with 23% coming from non-interest income sources.

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

Moving on now to the next slide.

We now will look at net interest income and drivers behind its performance.

The chart at top left reflects the net interest income of KD238.1m for 1Q24, a growth of 12.4% over the first quarter of 2023. NII largely benefited from higher interest rates and growth in loans and investment securities across geographies and segments. You would also note from the chart at the top right that Average earning assets grew by KD1.6bn i.e. 4.5% from March 23, to reach KD36.2bn.

We see from the chart at the bottom left, that average NIM for 1Q24 at 2.64% reflects an improvement of 16bps over 1Q23 driven by a higher yield, despite increased funding cost. Group yield and funding cost for the current quarter was 6.25% and 4.07% 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 continues to benefit the Group.

At the bottom right of this slide, we can see drivers behind the 16bps yoy increase in NIM from 2.48% in 1Q23 to 2.64% in 1Q24. Loans and other interest earning assets backed by a strong year on year growth in volumes and interest rates, contributed a net increase of 79bps and 17bps to the NIM respectively. Higher funding cost negatively affected the NIM by 80bps.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD70.9m for 1Q24 was KD4.7m higher than the comparable period in 2023. Fees and commissions income was strong at KD53.2m; reflecting robust contributions across different lines of business and geographies. Fx contributed KD10.2m benefiting from higher transaction volumes and favorable currency movements. Other non-interest income sources (mainly investment income) contributed KD7.4m, benefiting from improved valuations.

Our fees and commissions income are 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 1Q24 at KD111.5m, were 9.9% higher than 1Q23. The cost growth reflects increased activity levels at Kuwait and across the Group's network as well as 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 increased volume of electronic transactions. We also continue to press ahead with selective product offerings in certain geographies e.g. through our global wealth management business known as NBK Wealth, 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 1Q24 cost to income ratio was at 36.1% compared to 36.5%, one year ago.

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

Total credit provisions and impairment losses for 1Q24 amounted to KD25.5m, a decrease of KD2.6m over 1Q23. KD25.3m of the current quarter's charge was for provisions for credit facilities whereas the remainder related to other impairment losses and ECL. Specific provision of KD22.7m was in course of normal business activities at Kuwait and overseas locations, whereas KD2.5m was towards general provisions. The Group remains committed to its conservative approach in managing credit exposures.

The cost of risk for 1Q24 was 44bps compared to 53bps in 1Q23.

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.

We recently enhanced the segmental analysis information (note 9 in 1Q24 financial statement) to reflect Consumer Banking results separately. Similarly, NBK Wealth, being an area of key focus, is 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 17% to the Group's net operating income and profit respectively. Similarly, Corporate Banking contributed 13% and 21% to the Group's net operating income and profit.

International Banking contributed 24% to net operating income and 21% to the Group's profit, reflecting a strong operating performance.

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD25m, up 21.2% on 1Q23 boosted by a strong growth of 15.2% in operating surplus and lower provisions for credit losses.

NBK Wealth contributed to 9% 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 41% and 23% 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 period.

As profiled on the chart at top left, the Group total assets reached KD38.3bn as of March 24, a 5.1% increase over March 2023. The recent devaluation of EGP has adversely affected the KD value of balance sheet items and resulted in lower growth percentages, especially for 1Q24.

Group loans and advances at KD22.4bn registered a growth of KD1.2bn i.e. 5.7% from March 23 and 0.5% during the current quarter. Loan growth was achieved at Kuwait in both conventional and Islamic sectors and at International operations. Similarly, investment securities reflected a yoy growth of 15.6%, to reach KD6.9bn.

Customer Deposits, i.e. non-bank and non-FI deposits at KD22.3bn, reflect a strong yoy growth of 9%. 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 period.

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 the minimum requirements of Basel III ratios.

Moving now to the next slide.

We will now look at the impact 1Q24 financial results had on certain key performance metrics.

The Return on Average Equity for the current quarter improved to 15.2%. Similarly, Return on Average Assets now stands at 1.55% compared to 1.50% in 1Q23.

At 17.2%, total capital adequacy ratio remained strong and stable, well above the regulatory minimum. CET1 and Tier1 ratios at 12.9% and 14.9% respectively, remained stable similar to Dec 23 levels.

As regards asset quality, NPL ratio stands at 1.51% compared to 1.38% as at Dec 23. Loan loss coverage ratio is at 248%, reflecting conservative provisioning policy of the Group.

Moving to the next slide.

On this slide, I would 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 of March 24 was KD597m, slightly lower than Dec 23 levels.

Although IFRS 9 ECL and CBK provisions are two different regimes and should not be compared as such, as of March 24, the balance sheet provision as per CBK instructions exceeds the ECL by KD315m. 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 1Q24.

As mentioned earlier, a strong operating performance combined with a healthy balance sheet, comfortable liquidity levels and a strong capital base were features of NBK's 1Q24 results.

Looking forward, ongoing regional and international geo-politics, prospects of 'higher for longer' interest rates 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 - 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, 1Q24 NIM has improved to 2.64% benefiting from stronger volumes and higher interest rates compared to 1Q23. The general expectation is that benchmark interest rates will remain at current levels for a longer period, with rate cuts being forecasted in later quarters of 2024. We should also expect increasing competition and the funding cost to remain high, despite the Group's healthy overall funding mix. In such an environment our guidance for the 2024 NIM is to remain stable, similar to full year 2023 (2.59%).

Coming to operating expenses, the 1Q24 year on year cost growth was c.10%. This is a good indication of the expected rate of increase for the fuller 2024 as the Group continues to invest in human resources and digital technologies. Consequently, we should expect the 2024 cost to income ratio to be in high-thirties.

The cost of risk was 44bps during the current quarter. We are cautiously optimistic of a stable overall operating environment and as such expect full year cost of risk to be c.40-50 bps.

However, given the overall geopolitical and 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.

Turning now to the Q&A session. We will break for a while as questions are being received.

Please type your questions in the Q&A platform. We will answer the questions in the order they are received.

Hello again everyone. We got a few questions here and many revolve around NIMs and interest rates direction. So we will start with the first question.

What is the guidance of NIMS? I think we covered that in the guidance page. Is there any price effective July 23 hike reflected in Q1 2024 numbers? What is the view on policy rates 2024/2025? Do you expect any rate hikes going forward?

Sujit Ronghe: As I mentioned earlier that our guidance of the NIM is to remain flattish when we compare it to last year, given the great deal of uncertainty with respect to the benchmark interest rates going forward. Not only on the global front, but also when it comes to the Central Bank of Kuwait, we don't know what exactly the Central Bank would do with respect to the pace of rate cuts. However, for our guidance behind the flattish NIM, we have assumed a couple of rate cuts both on the FED and the discount rate side from the CBK, but in the later part of the year.

Amir Hanna: Along the same lines, what CASA percent in Q1 2024? Do you expect further migration to interest-bearing deposits?

Sujit Ronghe: The CASA levels remain very healthy and are still around the mid-30's as a percentage of total non-bank deposits. We have not noted the quantum of shift from CASA to time deposits that we saw in the last 2 quarters of 2023. I think the CASA deposit base has stabilized during the current quarter, when compared to the year-end position.

Amir Hanna: On Egypt, the question has two parts, can you generally shed some light on Egypt operations? The second part of the question is on provisions.

Isam Al-Sager: On Egypt, we witnessed recently signals of economic stability which is considered of the largest economies in the region and enjoys huge potential for growth. As soon as the confidence in the Egyptian economy is regained, we believe that there are substantial growth opportunities within Egypt, and we will continue to be optimistic in this regard. Speaking of our operations in Egypt, it is a main growth market for us, and we are committed to grow our operations in the Egyptian market, as one of our most profitable markets in domestic terms.

Sujit Ronghe: On the provisions, the Egyptian book remains very healthy and in terms of asset quality. The year-end cost of risk at Egypt was below 1%, actually 0.9%, and the NPL to gross loans ratio was also at 0.9%. It has been around 1% for the last year and at this stage we are not concerned about credit quality in the Egyptian books.

Amir Hanna: Moving on to capital, what is your internal target for CET 1 ratio for this year and what are the key downside risks to achieving it?

Sujit Ronghe: As regards capital ratios, we generally keep an internal target of the total capital ratio to be between 1.5 to 2% above the regulatory minimum, especially at the year-end. However, we also monitor the CET 1 ratio closely and our year-end target for the CET 1 is also to be around 1.5%.

Amir Hanna: What FED rate changes are you assuming for 2024 in your guidance? I think that was covered in the NIM discussion earlier. And then a question on cost to income ratio; the first quarter cost to income ratio is 36.1%, high 30's or should we assume it goes higher than this for the rest of the year?

Sujit Ronghe: The cost/income ratio is a function of both income and the cost side. We should also consider the declining interest rate scenario as we go ahead into the further quarters of 2024. So, we do expect the cost/income ratio to increase slightly, but it should be below the 40% mark that we have seen previously. Cost/income ratio for 2024 would be between where we are currently and 40%.

Amir Hanna: Back to NIMs again. A question asking what is the current CASA figure, I think we covered that already. What is causing QoQ compression in NIMs? Are we seeing competition on deposits locally?

Sujit Ronghe: As regards to QoQ compression in NIMs, we have seen a small drop of 4 bps compared to the last quarter. This compression reflects higher funding cost and as the previous quarter benefitted from certain one-off interest rate recoveries that we haven't witnessed this quarter.

At the same time, as a nature of the Group's international network, we remain well positioned to attract deposits at competitive rates while the local competition doesn't impact NBK's to the extent it does to other local banks.

Amir Hanna: Again around NIMs and rates, could you share your base case on CBK's monetary policy? Could rate cuts be delayed relative to Fed's cuts?

Sujit Ronghe: If you trace back to the beginning of the interest rate hike cycle of the Fed against CBK, the latter didn't match them. In fact, in the earlier stage of the cycle, CBK was lagging behind the Fed to a larger extent.

Given historical trends, we don't expect CBK to match the Fed over the next few quarters whenever the Fed's monetary easing cycle starts.

However, it would be unwise to have an opinion on the outlook or assume any indication regarding how will the CBK conduct its rate cuts. We have to wait to see that.

Amir Hanna: Another question on loan and deposit growth. If we look at NBK's standalone, we have seen a slight contraction in both loans and deposits; what was the cause?

Sujit Ronghe: As mentioned earlier, the Egyptian devaluation impacted the assets and liabilities growth in KD terms for the current period.

Basically, if you refer to our financial statements, our year to date loan growth (Dec-23 to March-24) reached 0.5%. This growth rate includes a significant amount of Egyptian assets on a consolidated basis on the balance sheet. Once adjusted, we would be close to a loan growth of 1.4% for the quarter.

Similarly on the deposits side, we have seen a contraction as a reflection of the devaluation of EGP and accordingly a contraction in Egyptian operations contribution to the Group's balance sheet.

Amir Hanna: What is the outlook on corporate loan growth for 2024 if interest rates remain elevated? What is the outlook for the NIM for the rest of the year?

Sujit Ronghe: Corporate loan growth has been promising in the past twelve months and a renewed appetite by corporates emerged in our domestic and international locations. For that, growth in loans for the upcoming quarters will mainly stem from the growth anticipated in corporate loans.

As far as NIM is concerned, if there is no change in interest rates, we can expect the NIM to be increasing by few bps. However, the interest rate outlook remains uncertain; and hence of a guidance of flattish NIM.

Amir Hanna: Do you have updated guidance from the authorities on corporate tax implementation?

Sujit Ronghe: There is no formal update from the Ministry of Finance of Kuwait. We know that Kuwait has signed up for being part of the Inclusive Framework in November 2023. Media reports have informed that the ministry is in process of putting a corporate tax law in place before 2025.

Amir Hanna: Are there any additional capital requirements by CBK for Kuwaiti banks with operations in Egypt? If yes, then what are the requirements?

Sujit Ronghe: As of now, there is no change with regards to capital requirements as per CBK regulations with respect to Egyptian operations. It is status quo.

Amir Hanna: What sectors and segments are behind the increase in NPL ratio?

Sujit Ronghe: The increase in NPL ratio can be attributed to different customers, both retail and corporate, within Kuwait and across our international locations.

Amir Hanna: Thank you very much for listening. I think that we covered all the questions for today.

As I mentioned earlier in the call, if you have follow up questions, please email us at our investor relations email address and we will reply at our earliest.

Thank you to NBK's management and thank you Elena for the call.

Elena Sanchez: Thank you very much.