الوطني NBK

National Bank of Kuwait

1Q 2022

Earnings Conference Call

21 April 2022

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Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, 21 April 2022 at 14:00 Kuwait time.

Corporate participants:

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

Mr. Sujit Ronghe – Acting Group CFO, NBK

Mr. Amir Hanna – Head of Investor Relations and Corporate 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 2022 earnings call. 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 Acting Group CFO and Mr. Amir Hanna, Head of Investor Relations and Corporate 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. We are glad you joined us today for our 1Q 2022 earnings webcast.

As our usual practice before we start, 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. Also I would like to refer you to the full disclaimer in our presentation for today's call.

We will start the call by some remarks from our Vice-Chairman and Group CEO, Mr. Isam Al Sager, followed by a detailed presentation on the quarterly financials by Mr. Sujit Ronghe, our Acting Group CFO. Following the management presentation, we will answer your questions in the order they are received. Also, feel free to send any follow-up questions to our Investor Relations email address. And for your convenience, today's presentation is already available on our Investor Relations website.

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

Isam Al Sager: Thank you Amir.

Good afternoon everyone. Thank you for joining us today for our quarterly earnings webcast.

I am glad to join you today to update you on the overall operating environment, our performance during the quarter as well as our key strategic initiatives for the remainder of the year.

On the overall macroeconomic front, global geopolitics has overtaken Covid as the key source of market worry, causing some concerns regarding the path of economic recovery.

In Kuwait, the operating environment continued to witness some signs of improvement during the first quarter of 2022, despite the ongoing political friction. This was mainly driven by the improved pace of consumer spending and the steady increase in the production and price of oil, which reflected positively on business sentiment and activity.

We forecast GDP growth for 2022 at 8.5% on the back of that rebound in oil production and prices, while non-oil growth is expected to reach 4% for the year.

On the projects market, during the quarter KD 110 million of awards were recorded. Although the figure fell short of expectations due to the slow approval process as well as supply chain issues, we expect project awards to gradually recover through the remainder of the year. For 2022 we estimate KD2.5 to 3.0 billion worth of projects that are currently scheduled for awarding in the coming months.

Moving on to NBK, we continued to capture the growth opportunities arising from the improved business sentiment; allowing us to generate healthy revenue trends, solid bottom-line growth and strengthening our market leadership position.

For the first quarter of 2022, we reported record quarterly profits of KD 116.6 million, growing by 38.3% year on year. The solid bottom line growth stems from improving revenue trends as well as continued normalization in the cost of risk.

We achieved good progress in advancing our strategic agenda towards digital transformation as well as in executing various technological initiatives. We are stepping into 2022 backed by our strong operational success during the pandemic. Our experience during Covid confirmed the soundness of the Group's diversification strategy, its flexible business model and ability to overcome crises.

Moreover, during the quarter, we advanced our efforts to embed ESG practices into our long-term strategies and business plans. In March 2022, NBK established its Sustainable Financing Framework with the aim of integrating environmental and social standards into our business practices to support the transitions to a more sustainable economy; in line with New Kuwait Vision 2035. In parallel, we also announced our target to reduce our operational GHG emissions by 25% by the year 2025, as a key environmental initiative under our sustainability commitment.

With that, I want to conclude my comments and will now leave you with my colleague Sujit Ronghe, our Acting Group CFO, who will cover our quarterly financials in more detail.

Please go ahead Sujit.

Sujit Ronghe: Thank you Mr. Isam

Hello everyone, and welcome.

I am very pleased to have this opportunity to take you through the financial results in respect of the opening quarter of 2022.

We have announced a net profit of KD116.6m for 1Q22. This is a 38.3% increase in bottom line profit over the comparable quarter of 2021. These results reflect a solid performance by the Group and demonstrate the continued growth in our businesses.

Before going into the details of our financial results, I would first like to say a few words regarding the overall operating environment for the current quarter.

We saw that 2021 was a year of recovery on the backdrop of very challenging periods during the year 2020. Increased oil prices, fuller operation of airports and travel opportunities, improved business activity and significantly increased vaccine penetration in Kuwait continued to benefit the overall operating environment in 1Q22. The interest rate cycle has commenced its rising trend, which is expected to benefit the Bank in the coming quarters. That said, an element of uncertainty still exists with respect to the resurgence of Covid-19 pandemic in certain parts of the world and the ongoing geo-politics. We however remain optimistic of continued improvement in overall operating environment in the coming months.

Now turning to the financial results for 1Q22.

As profiled at the top left of this slide, the KD32.3m i.e. 38.3% year on year increase in net profit reflects a robust performance by the Group, driven by continued growth in business volumes, increased operating income and lower net credit provisions and impairment losses. Group lending in particular, registered a strong growth of KD330m, i.e. 1.7% during 1Q22.

The top right chart reflects operating surplus i.e. pre-provision and pre-tax profit for the current quarter at KD144.5m, a growth of KD5.1m over 1Q21. Net operating income increased by KD15m, 6.8% whilst costs grew by KD9.9m over the first quarter of 2021.

Similarly, 1Q22 operating surplus exceeded that of the previous quarter by 8.9% on the back of a stronger operating income and marginally lower costs. As a result, the 1Q22 net profit increased by KD9.1m, 8.5% vis-à-vis 4Q21.

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 29% 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 KD168.7m for 1Q22, a growth of 3.9% over 1Q21 largely driven by higher volumes of loans and other interest earning assets across segments and geographies.

As can be seen from the chart at the bottom left, average NIM for 1Q22 at 2.14% reflects an improvement of 3bps over 4Q21 but is 12bps lower than 1Q21.

The Group's yield for the current quarter was 2.95%, compared to 3.01% in 1Q21. At the same time, the Group's funding cost increased to 0.92% during the current quarter compared to 0.85% a year ago. The higher funding cost primarily results from the repricing of deposits at increased market rates and longer tenor deposits sourced by the Group.

The growth in low cost deposits that we witnessed last year has continued to an extent in the current quarter. The Group has also booked longer tenor deposits in light of the expected increase in interest rates, which is already reflected in inter-bank rates such as LIBOR.

At the bottom right of this slide, we can see drivers behind the 12bps decline in NIM from 2.26% in 1Q21 to 2.14%. Loans, backed by a strong year on year growth, contributed a net increase of 3bps to the NIM. Movements related to other assets and a higher funding cost negatively affected the NIM by 9bps and 6bps respectively.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD67.8m for 1Q22 reflected a strong growth of KD8.7m i.e. 14.7% over the first quarter of 2021. Fees and commissions income contributed KD42.2m, foreign exchange activities KD13m, while other non-interest income sources (mainly investment income) contributed KD12.7m.

Fees and commissions income was 7.1% higher than 1Q21 reflecting strong contributions across business lines. Fx income for the quarter was KD4.9m higher than 1Q21, benefitting from the impact of favourable currency movements on our $AT1 bond issuances and stronger transaction volumes.

Other non-interest income grew by KD1.1m compared to 1Q21. Included herein is the net investment income, which grew by KD3.9m, largely due to improved market valuations. 1Q21 included a one off gain on sale of assets, reflected as other operating income in the income statement.

Our fees and commissions have been solid and 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 as opposed to more volatile income from trading activities.

1Q22 non-interest income was 16.9% higher than 4Q21 mainly benefitting from higher valuations gains.

Turning now to operating expenses reflected in the top right hand chart. Total operating expenses for 1Q22 at KD92m, although 12.1% higher that 1Q21, were in line with the trend seen in recent quarters and marginally below 4Q21. A part of the cost growth reflects increased activity levels at Kuwait and across the Group’s network, given the more optimistic outlook in comparison to 1Q21.

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.

Our digital channels and products continue to play a vital role in servicing customers, with electronic transactions reaching record highs. We also continue to press ahead with selective product offerings in certain geographies e.g. our Global Wealth Management business, expansion of our Islamic banking operations through Boubyan Bank and our operations at NBK Egypt.

As a result, the 1Q22 cost to income ratio was at 38.9% compared to 37.1% in 1Q21, but remained below 39.6% for the year 2021.

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

Total provisions and impairments for the current quarter amounted to KD12.5m, a 70.6% decrease from KD42.6m in 1Q21. Almost all of the 1Q22 charge was for provisions for credit facilities, with a small amount towards ECL on other financial assets. Specific provision was a net release of KD40.5m, resulting from recoveries of amounts provided towards credit losses during prior years. At the same time, the Group has taken provisions in ordinary course of business for retail and corporate customers in Kuwait and overseas locations. The Group remains committed to its conservative approach in managing credit exposures and has hence set aside precautionary provisions.

The cost of risk for 1Q22 was at 24bps compared to 63bps for full year 2021. This lower cost of risk has resulted from significantly lower credit provisions, which benefited from loan recoveries as explained earlier.

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 through the International and Islamic banking arms of the Group.

NBK Group continues to benefit from its unique position amongst Kuwaiti banks in terms of geographical spread of operations and the ability to conduct business in both conventional banking and Islamic banking. This diversification provides a strong competitive advantage to the Group and gives a significant degree of resilience to Group earnings.

As you can see from the charts on the left hand side, while operating income from the Group's international operations remained similar to 1Q21, net profit at KD20.2m has increased by KD10.5m benefiting largely from lower credit provisions and ECL. International operations continue to contribute a healthy 24% and 17% to the Group's operating income and net profit respectively.

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD17m, up 34.4% on 1Q21 due to lower provisions and stronger operating results, which benefited from continued growth in business volumes.

Finally, on the chart at the bottom right corner, you will note that International operations and Boubyan Bank contributed 38% 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 period.

As profiled on the chart at top left, the Group total assets reached KD33.7bn at March 2022, a 8.7% increase on March 2021 and 1.3% during the quarter. It would be pertinent to note that the devaluation of Egyptian Pound did not have a material impact on the consolidated financial statements, considering NBK Egypt's size relative to the Group.

Group loans and advances at KD20.1bn, registered a strong yoy growth of 12.3% and 1.7% during this first quarter. 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 although similar to December 21 levels of KD18.3bn, have grown by 7.4% year on year. Non-bank FI deposits increased by 12.3% during the quarter to reach KD3.5bn. The Group continued to experience a measured growth in its core franchise retail deposits- both conventional and Islamic, albeit at a lower rate than the previous year. The overall funding mix remains stable and favorable for the Group.

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

Customer deposits comprise a healthy 64% of total funding mix of the Group.

I want to highlight that the Group, despite the continued relaxation offered by Central Bank of Kuwait, was able to maintain originally mandated liquidity levels & Basel III ratios.

Moving now to the next slide.

Here we will look at the impact 1Q22 financial results had on certain key performance metrics.

The Return on Average Equity for the current quarter improved to 13.4% from 10.4% in the comparable quarter of 2021. Similarly, Return on Average Assets now stands at 1.41% compared to 1.13% for 1Q21.

At 17.8% total Capital Adequacy Ratio remained strong and stable, marginally below 18.1% in December 2021. CET1 and Tier1 ratios were 13.0% and 15.4% respectively. Kindly note that interim profits are not factored in the computation of 1Q22 Capital Adequacy Ratio.

As regards asset quality, you would note that the NPL ratio was at 1.12% compared to 1.68% as at March 2021 and 1.04% as at December 2021. The year on year drop in NPL ratio stems from the improvement in credit quality of certain exposures and write offs.

As a result, the loan loss coverage ratio has improved to 302% in March 2022.

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 requirement as at March 2022 increased to KD504m from KD462m at December 2021. Changes to certain macro-economic factors, which form inputs to the ECL model have resulted in an increase in the required amount compared to the previous year-end. The current amount of ECL required however remains significantly lower from 1Q21 levels of KD589m.

Although IFRS 9 ECL and CBK provisions are two different regimes and should not be compared as such, as at March 2022, the balance sheet provision as per CBK instructions exceeds the ECL by KD232m. 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 1Q22.

Continued improvement in underlying operating drivers, strong loan growth, lower provisions and impairments, a healthy balance sheet, comfortable liquidity levels and a solid capital base were features of NBK's 1Q22 results.

Now turning to the guidance for remainder of 2022.

We remain optimistic of continued improvement in the general operating environment notwithstanding the recent surge in number of Covid-19 cases in some countries. Benchmark interest rates are set to increase in the current year. The Bank's net interest income has generally benefitted in a rising interest rate scenario. That said, the timing and extent to which increases in local interest rates would follow international benchmarks remains to be seen.

As regards loan growth, the Group reported a loan growth of 1.7% during 1Q22. Our expectation for loan growth for 2022 continues to be at a high single digit.

With respect to the NIM, in a base case scenario, without considering any further increases in benchmark interest rates, we are expecting NIM to be broadly at similar levels with a slight declining trend, when compared to full year 2021, due to possible head winds on funding costs. However NII and consequently NIM is poised to benefit from interest rate hikes.

The 1Q22 cost to income ratio is currently at 38.9%. In the base case interest rate scenario and in continuation of our investment program in support of various Group initiatives, we expect the cost to income for 2022 to remain largely similar to 2021.

Given the lingering uncertainties of the pandemic and the ongoing geo-politics, it would not be prudent to give a specific guidance on cost of risk and consequently on earnings / capital adequacy. Credit recoveries in 1Q22 resulted in a lower cost of risk at 24bps, which is not representative of what we expect for the fuller year. Cost of risk was 63bps in 2021. We are cautiously optimistic of a favourable cost of risk in 2022 similar or slightly lower to 2021 levels. We are also 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 Sujit.

Thank you everyone for listening.

We'll pause for some time to get some questions and start answering them in groups for the sake of time.

We got a relatively big list of questions we'll take them in order, but also we'll try to group topics for the sake of time.

First question is asking if the Bank foresees a scenario where the CBK doesn't increase the discount rate? But increases the benchmark for deposits; hence leading to a market squeeze. Sujit.

Sujit Ronghe: The manner in which CBK would react to consistent rate increases internationally, is not very clear at the moment. In the first instance last month, CBK followed the increase in Fed rates and the expectation would be this continues in the short-run. At the same time, CBK has not necessarily followed all international rate hikes when it comes to an increasing interest rate trend.

Amir Hanna: The second question is a bit repeated on the cost of risk outlook. How do you see cost of risk going forward? Will general provisions still be needed? Also what's the pool of specific provisions you look forward to release?

Sujit Ronghe: As I mentioned earlier, the first quarter's cost of risk is not what we are expecting for the full year. The cost of risk is expected to normalize for the full year and close to the levels recorded last year; maybe with a slight declining trend, but definitely not at the levels we saw in the current quarter.

From a point of view of general provisions, the Bank has always been conservative with respect to its provisioning policy and we would expect that to continue in the future.

As regards to specific provisions, we are not looking to release any specific portion of that pool unless there are recoveries as we saw in the current quarter.

Amir Hanna: Why is corporate credit growth still slow despite recovery in business activity? How do you see corporate credit growth for the rest of the year?

Isam Al-Sager: Well, corporate credit is not slow and has been picking up and we are still in the beginning of the year. There is potential growth already in the pipeline. We hope that by the next quarter or by the one after to witness a robust recovery reflected in our numbers.

Amir Hanna: When do you expect the recent investments on digital channels to lead to a better cost to income ratio?

Sujit Ronghe: The Bank has recently launched Weyay Bank and we are in the initial stages of our digital banking journey. In such initiatives, the cost benefit comes at a later stage; once we progress and mature to a certain extent. I don't think we should expect any improvement in the cost to income ratio because of digital investments during this year.

Amir Hanna: Can you share some figures on deposits mobilization and customer acquisition for the new digital bank Weyay?

Isam Al-Sager: Weyay is doing well, but we are still in the early stages to share figures. Numbers are better than originally expected and we will update the market in due course.

Amir Hanna: Another question on cost of risk, what should be considered as a normalized cost of risk level for the bank?

Sujit Ronghe: As I mentioned earlier we should expect something a bit lower than what we saw last year. Last year's cost of risk was at 63 bps and somewhere in that range with a lowering trend could be considered as normal.

Amir Hanna: Why is guidance for NIMs stable if there was already rate hike?

Sujit Ronghe: There was a rate hike in the month of March and we have considered that rate hike in our base scenario. At the same time, we have seen some additional increase in funding cost. You would see that FED rate hike was 25 bps but the LIBOR has gone up significantly. Today, 3 month LIBOR is more than 1%, actually close to 1.15%, while at the beginning of the year it was 25 bps. That is why we are a bit conservative when it comes to the expected increases in the funding cost and hence the guidance on NIMs remains as stable.

Amir Hanna: A question on deposits, do you expect higher government liquidity due to elevated energy prices to flow to deposits in the bank's balance sheet, would that help mitigate potential rise in cost of funding.

Sujit Ronghe: The bank does not depend on any specific source of funding for its liquidity management. The bank has various sources; it has very strong core deposits in place in form of retail deposits and also has deposits that are gathered through its international networks. So without necessary dependent on government deposits, any inflow from the Government is of course welcome and considered good for the bank but only if it is at the right cost. If there are Government deposit inflows at the cost that we are willing to pay, they would be welcomed.

Amir Hanna: Do you think political uncertainty can push the proposed mortgage law further into the future?

Isam Al-Sager: Well you as you mentioned there is a lot of political uncertainty in Kuwait now and there is a lot of tension between both the government and the Parliament, but we maintain our view that both laws (debt law and mortgage law) will eventually be passed despite the recent improvement in financial position due to higher oil prices but generally speaking the political tension has negative effect on economic reform and diversification but the government is in a very challenging position and has very limited alternatives leaving no choice but to pass several important laws like mortgage and debt laws. So in a nutshell growing we are positive that these laws will be passed soon as there are no choices for the government but to pass these 2 laws.

Amir Hanna: Couple of questions on NIMs as there was a bit of misunderstanding, the question is asking for clarification on flat NIM guidance with even the expected rate hikes? Is that because of expected higher funding costs or I misunderstood?

A similar question asking to put some guidance on NIM assuming 6 to 7 rate hikes.

Sujit Ronghe: The guidance we have provided is on a base case scenario of no further rate hikes on Fed. If we are talking about 6 to 7 Fed rate hikes we will definitely have a positive impact on the P&L through the net interest income and the NIM of the bank. However, it remains to be seen how many of those Fed rate hikes would be followed by local CBK discount rate hikes. But to give you a flavor of what to expect, the impact of 25 basis points increase on the NIM, for a full annualized period and assuming a similar shift in assets and liabilities rates, will benefit the NIM by 4 to 5 basis points. You can use this as an underlying driver for the impact of CBK and Fed rate hikes.

Amir Hanna: Another question on project and what to expect going forward?

Isam Al-Sager: As mentioned before there has been a slowdown in project awards in the past due to conflict between the government and parliament. But now, and despite the government resignation, the improved health situation and the easing of restrictions from the pandemic have lifted corporate activity in 2021, where project awards reached KD1.5 billion. We expect more projects to be awarded in various sectors including education, healthcare, communication, petrochemicals, as well as other sectors. We should see a pickup in tendering and awarding activity in 2022 with an estimate of around 2 to 3 billion KD of projects to be awarded for the rest of the year.

Amir Hanna: Question on CASA, What is the share of CASA of total deposits in March 2022 versus December 2021?

Sujit Ronghe: The CASA deposits for the bank has been very stable across the years, we are looking at near to 50% as the share of CASA deposit to total non-bank deposits (customer and FI deposits together) and this amount was more or less similar to what we saw in December 2021.

Amir Hanna: I think we are getting more questions on the mortgage law which I believe we addressed before.

I think these are most of the questions we have, unfortunately there are couple of questions that unfortunately we can't address because of disclosures but otherwise there are no more questions in the list.

If you have any follow up questions or if you have more questions on any topic, send us those question on our investor relations email address and we will be happy to address it.

Thank you very much for joining us today.