National Bank of Kuwait

1Q/1H 2020

Earnings Conference Call

6 August 2020

1Q/1H 2020 National Bank of Kuwait Earnings Call

Sunday, August 09, 2020

Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, August 06, 2020 at 15:00 Kuwait time.

Corporate participants:

Mr. Isam Al-Sager – Group CEO, NBK

Mr. Shyam Kalyanaraman– Head of Group Management Accounting, NBK

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

Chairperson:

Elena Sanchez – EFG Hermes

Operator: Good day and welcome to the National Bank of Kuwait 1Q and 1H 2020 results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena Sanchez. Please go ahead now.

Elena Sanchez: Thank you and 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 1Q and 1H 2020 results conference call. It is a pleasure to have with us in the call today Mr. Isam Al-Sager, NBK Group CEO, Mr. Shyam Kalyanaraman, Head of Group Management Accounting and Mr. Amir Hanna, Head of Investor Relations and Corporate Communications at NBK. The call will begin with a presentation from management on the key highlights of the 1H2020 and then we can open the floor for Q&A. At this time, I would like to handover the call now to Mr. Amir Hanna.

Thank you.

Amir Hanna: Thank you Elena.

Good afternoon everyone. We are glad to have you with us today on our 1Q/1H 2020 earnings webcast.

Today's call will cover both, the first and second quarters since all Kuwaiti banks were exempted from publishing first quarter financials because of the outbreak of COVID-19. As our usual practice, 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. You are cautioned not to rely on such forward-looking statements. 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.

Today's presentation will be a bit longer than usual; as we go into a lot of details for both quarters (first and second quarter of the year). But once we conclude, we will start answering all your questions in the order they were received. You can also send any follow-up questions to our Investor Relations email address. Finally and for your convenience, today's presentation is already available on our Investor Relations website.

We have with us today Mr. Isam Al-Sager, our Group CEO, as well as Mr. Shyam, Head of Group Management Accounting. Unfortunately, Mr. Jim Murphy, our Group CFO, is not able to join us today as he's outside Kuwait. Now let me handover the call to Mr. Isam Al-Sager, our Group CEO, for his opening remarks.

Isam Al Sager: Thank you Amir

Good morning and good afternoon everyone. I am glad we reconvene again to discuss our results for the first quarter and first half of 2020. First, I hope you and your loved ones are all safe and healthy considering the unprecedented times we are all living through.

As you all know, we have reported our first quarter and first half results last week. Our net profits were KD77.7 million for the first quarter and KD33.4 million for the second quarter. This led to first half profits of KD111.1 million, down 47% compared to last year. Throughout the call, we will go into all the details behind the results but let me start by briefly highlighting the main trends that affected our business as a result of COVID19 outbreak and how we are coping with it and what to expect.

Over the past few months, we faced many challenges on all levels. The COVID19 virus outbreak hit us hard and took us all by surprise considering no -government or business entities were not prepared to deal with this scenario. Considering how the world economy is highly integrated today, we have seen the impact of the virus outbreak started spreading from one country to the other at a fast pace, affecting businesses everywhere. While governments around the world have taken extreme measures in an effort to control the outbreak, these measures reflected very negatively on the economic activity and business sentiment globally.

From business shutdowns to curfews and border closures, all these actions along with the change in sentiment created a severe shock to world economies with Global GDP expected to contract by 5% during the year. The impact of the pandemic in the GCC region was even more severe because of the large drop in oil prices and its impact on economic activity and budget deficits. In the first half of the year, most GCC countries have seen their fiscal positions weakening with exceptionally large budget deficits projected for 2020.

Our business was impacted in most of our locations leading to more challenging operating environment across our network. In Kuwait, the situation was not any different. The domestic economy was similarly pressured and the impact of the long period of lockdown has had its toll on our operations as well. We are expecting this year's GDP to contract by around 6% because of the expected 4% contraction in non-activity.

As you can see in the chart, the first COVID19 case was confirmed in Kuwait on February 24, this was followed by a sequence of government decisions that started with business closures on March 9th and escalated to a complete lockdown during the month of May. Kuwait started a gradual opening of the economy by the beginning of June and today we are in phase three of the five-phased plan to return to some form of normal activity.

From day one, we have worked closely with the Government and the Central Bank of Kuwait to provide support to the economy in a quick and efficient way and to support our customers in their financial needs. Moreover, we supported the government efforts to combat the spread of the pandemic by contributing to the KD 10 million-fund set by Central Bank of Kuwait and donated KD 1 million to Kuwait's Red Crescent Society.

In an early and swift response, the Central Bank of Kuwait initiated macro-prudential measures and reduced regulatory requirements in an effort to increase the banking sector's resilience and enable it to play a more active role throughout the crisis. Most importantly, these measures included lowering the banking sector's capital and liquidity requirements and dropping the discount rate to historically low levels reaching 1.5%.

Moving on to NBK, we took proactive measures and activated emergency plans at the very early stages of the crisis, in order to protect our employees and ensure business continuity. We moved to following strict health and precautionary controls to ensure a safe environment for our staff and customers. Concurrently, we started leveraging the flexibility of our business model providing support and advice to our customers facing financial difficulties and relying heavily on our digital capabilities to maintain the level of service quality and accessibility that our customers would expect in normal times. In this context, I would like to extend my greatest appreciation to all our employees for their efforts and commitment during these challenging times.

Separately, and without jeopardizing our future business plans, we initiated group-wide cost-cutting initiatives to reduce the impact of the pandemic on our profitability.

On the customer front, and in coordination with CBK and Kuwait banking association, we participated in all initiatives aimed at relieving our customers and lifting some of the pressures they were facing. We extended support to our customers by suspension of fees on POS terminals, ATMs and digital channels for 3 months, in addition to increasing the limit for contactless payments. Moreover, we provided support to individuals by the deferment of consumer loans, installment loans and credit card installments for a period of six months for all our customers. We have also provided support financing to individuals, SMEs, and economic entities impacted by COVID19 crisis.

There is no doubt the full closure and slower economic activity, especially during the second quarter of the year, had significant impact on our operations. The drop in transaction volumes has resulted in lower fees and commissions income, whereas the low interest rate resulted in more pressure on our interest margin. Additionally, the impact of non-oil GDP contraction, the lower oil prices and the lock down period, had all increased the level of uncertainty around the cash flow outlook for many of our customers, which led to higher provision charges as initially reflected during the reported period.

Despite all these challenges, our balance sheet strength remains intact. We are very confident that our strong capital base, comfortable liquidity levels and the quality of our profits will give us great capacity to absorb the impact of COVID19.

To conclude on a positive note, I would like to point out that despite all challenges we have faced during 1H2020, the impact of COVID19 reaffirmed some of NBK's key strengths. The strategic investments we made over recent years to accelerate the development of our digital banking services, provided the bank with operational flexibility. Our digital channels delivered virtual alternatives to our branches allowing us to serve our customers in the best way possible. Additionally, we are now very comfortable with our disaster recovery and crises management practices that all proved very successful when tested during the early days of the outbreak. This all gives us more comfort as we move ahead towards a recovery phase, which we are very hopeful to see soon as the early signs were evident with some pickup in activity along with the gradual opening up of the economy.

With that, I will leave you with Shyam to walk you through the financials for the first quarter and the first half of the year.

Go ahead Shyam and Thank you.

Shyam Kalyanaraman: Thank you Mr. Isam.

Hello everyone, and welcome. I am very pleased to have this opportunity to take you through our results. Given that we did not publish our 1Q2020 results owning to the COVID 19 pandemic and in line with local regulations, this call would cover our results for the 1Q2020 and 1H2020. Therefore, for ease of reference of information in the relevant slides, I will first cover the salient features of our half-year results and then move on to the quarterly performance.

We have announced our 1H2020 profit of KD111.1m. This is a 46.9% decline in net profit over the comparable period last year.

Before going into the fuller details, I would like to highlight that during 1Q2020, the Group, through its subsidiary Boubyan Bank, increased its ownership in Bank of London Middle East (BLME) from 27.91% to 71.08% and the Group's financial results include the consolidation of BLME from 1Q2020.

Returning now to our financial results on SLIDE 1.

We will first look at the 1H2020 net profit and its constituents.

The net profit (profiled on the top left hand side of this first slide) at KD111.1m for the six months to June 2020 was resilient given the significant impact of the challenging environment, which saw drop in benchmark interest rates, lower economic activity affecting business volumes and elevated cost of risk. The 46.9% decline in net profit over the comparable period last year stems from 15% lower operating surplus (i.e. pre provision and pretax earnings) and higher provisions/impairments. (I will cover more on provisions/impairments later in the presentation).

The operating surplus (profiled on the top right hand side of this first slide) for the six months to June 2020 at KD260.3m is 15% lower as compared to 1H2019. Income growth in the period was -8.3%, whilst costs grew by 5.8%.

Operating income (profiled on the bottom left hand side of this first slide) for the six months to June 2020 at KD414.6m has been resilient throughout these unprecedented times; however, 8.3% lower as compared to 1H2019, primarily due to 7.5% lower net interest income and 9.1% lower fees and commissions. The decrease in net interest income was due to lower benchmark interest rates (notably 150 bps drop in Central Bank of Kuwait Discount Rate from Oct 2019 onwards), partly offset by the benefit of growth in business volumes.

The operating income mix is profiled on the bottom right hand side of this first slide. 77% of total operating income is in respect of net interest income and 23% from non-interest income sources. This mix is in keeping with the prior year.

Now, we will go into the quarterly performance, I will first cover 2Q2020 and then 1Q2020.

Net profit for 2Q2020 (profiled on the top left hand side of this first slide) was KD33.4m, 57% lower on 1Q2020 net profit of KD77.7m and 67% lower on 2Q2019 net profit of KD101.4m. The decline in net profit is primarily due to drop in operating surplus and increased provisions/impairments.

Operating surplus for 2Q2020 (profiled on the top right hand side of this first slide) was KD117.9m, 17.2% lower on 1Q2020 operating surplus of KD142.4m and 22.3% lower on 2Q2019 operating surplus of KD151.7m. As you can see, 2Q2020 was severely impacted by COVID - significant drop in benchmark interest rates (notably 125 bps drop in Central Bank of Kuwait Discount Rate in March 2020 and drop in LIBOR levels), lower non-interest income due to slower pace of economic activity and benefit of lower costs (we will see more on costs later in the presentation).

The operating income for 2Q2020 (profiled on the bottom left hand side of this first slide) was KD189.8m, 15.6% lower on 1Q2020 operating income of KD224.8m and 16.1% lower on 2Q2019 operating income of KD226.3m. As I had referred to earlier, 2Q2020 was severely impacted by COVID.

Moving on to 1Q2020 performance

The net profit for 1Q2020 (profiled on the top left hand side of this first slide) was KD77.7m, 27.9% lower on 1Q2019 net profit of KD 107.7m, impacted by higher costs and increased impairments.

The operating surplus for 1Q2020 (profiled on the top right hand side of this first slide) was KD142.4m, 7.8% lower on 1Q2019 operating surplus of KD 154.4m due to higher costs.

The operating income for 1Q2020 (profiled on the bottom left hand side of this first slide) was KD224.8m, only marginally lower as compared to 1Q2019 operating income of KD225.6m.

I would like to highlight that the year opened with much optimism and good growth was had in respect of business volumes and transaction driven business. However, the risks from COVID heightened in mid-March, where by Kuwait moved to a partial lock down similar to other regional and global markets. Later in the presentation, we will see 1Q2020 growth in business volumes.

Moving on now to SLIDE 2.

Here we will look at net interest income performance, and at the growth drivers behind the performance.

1H2020 Net interest income (profiled on the top left hand side of this 2nd slide) was KD318.5m, 7.5% lower than 1H2019 net interest income of KD344.4m. Net interest income has been reasonably resilient, given the significant drop in interest rates and this was offset in part from the growth in business volumes.

Interest earning assets (profiled on the top right hand side of this 2nd slide) averaged KD28.5bn during 1H2020, an increase of 8.3% over 1H2019. The growth in interest earning assets essentially reflected strong growth in our lending and investment volumes, the details of which we will look at shortly.

We experienced contraction in our 1H2020 net interest margin as compared to 1H2019. This was in part due to the timing effect on our book in respect of the decrease in the local discount rate that occurred in 1Q2020. I would like to add that our margins are negatively impacted relatively quickly in a declining interest rate cycle due to the repricing characteristics of our loan book whilst awaiting the lagged impact on funding costs to take effect.

If you look at the bottom left hand side of this 2nd slide, you will see that the net interest margin during the half-year averaged 2.25%. This compares to an average margin of 2.64% in 1H2019.

As you can see that margins have been tighter at 2.09% in 2Q2020, more so reflective of the dramatic drop of 125bps in Central Bank of Kuwait Discount Rate towards the end of 1Q2020.

On the bottom right hand side of this slide, we can see the constituent drivers that moved the average NIM downwards by 39bps, from 2.64% in 1H2019 to 2.25% in 1H2020. The NIM was impacted negatively by the decline in benchmark interest rates with 34bps attributable to loans and 47bps to other assets, whilst the lower cost of deposits favorably influenced the NIM to the extent of 42bps.

Now we will look at quarterly net interest income movements profiled on the top left hand side.

The net interest income for 2Q2020, at KD149.3m, 11.7% lower than 1Q2020 net interest income of KD169.2m and 13.8% lower than 2Q2019 net interest income of KD173.2m. As I alluded earlier, 2Q2020 has been impacted by drop in benchmark interest rates and lower economic activity impacting lending volumes.

The net interest income for 1Q2020 at KD169.2m was marginally lower than 1Q2019 net interest income of KD171.2m.

Moving on now to SLIDE 3.

I will now speak about the Groups non-interest income and its constituents, profiled on the top left hand side of this 3rd slide.

The Total non-interest income in the 1H2020 was KD96.0m, 10.7% lower than 1H2019, negatively impacted due to slower pace of economic activity following the shutdown since mid-march and the impact of market-to-market valuations on our investment book. 1H2020 also benefitted from the impact of currency movements on our $ AT1 bond issuances.

The composition of the KD96.0m total non-interest income is KD71.5m in respect of fees and commissions income, KD25.6m in respect of foreign exchange activities and a net loss of KD1.1m from other non-interest income sources. Fees and commissions income was 9.1% lower than 1H2019.

Our fees and commissions have been solid given the backdrop of the challenging conditions and is from a well-diversified pool of geographies and lines of business. It is important to note that our major source of non-interest income is from our core banking activity, more reflective of the trade flows and other consumer related factors as opposed to more volatile income from trading activities.

Now on the quarterly non-interest income movements.

Total non-interest income for 2Q2020 was KD40.4m, 27.3% lower on 1Q2020 non-interest income of KD55.6m and 23.9% lower on 2Q2019 non-interest income of KD53.1m.

Total non-interest income for 1Q2020 was KD55.6m, 2.3% ahead of 1Q2019 non-interest income of KD54.3m.

It is important to note that 1Q2020 was the strongest quarter benefitting from the impact of currency movements on our $ AT1 bond issuances, good consumer spending and trade flows and offset in part due to the negative impact of market to market valuations on our investment book. Whilst 2Q2020 was impacted by the slower pace of economic activity.

Moving now to operating expenses, profiled on the top right hand side of this 3rd slide.

Total operating expenses in 1H2020 was KD154.3m, 5.8% ahead of 1HY2019. This is a modest growth in costs, given our commitment to invest heavily in our businesses (both front & back end processes to enable the Group to offer best in class service to its customers and to optimize our resources to improve operational efficiency). The 1H2020 costs include COVID related contributions and I would like remind what I had alluded earlier that the Group has now consolidated BLME.

It is also important to note that 1H2020 includes the commencement of depreciation charge in respect of our New HQ and the fuller impact of commissioning our state of the art data center.

Moving on to quarterly operating expenses (on the top right hand side of this 3rd slide).

I would like to highlight that our total costs in 2Q2020 is 12.8% (KD10.6m) lower than 1Q2020, resulting from actions to realign costs to reflect the lower levels of economic activity, albeit cost reduction will not entirely offset lower levels of income.

Total costs for 1Q2020 at KD82.4m is KD11.2m (15.8%) higher than 1Q2019 costs of KD71.2m, primarily due to BLME consolidation, COVID contributions and impact of on-going expansions in some of our key businesses and geographies.

The Group continues to invest in various digital initiatives, select product offerings in certain geographies such as our Wealth Management business in Saudi and continue to improve our operational efficiencies through new IT initiatives that derive long term/sustained value to the Group. The payback from our digital investments was evidenced during the crisis as our digital channels played a vital role in servicing customers, with electronic transactions reaching record highs. We do continue to press ahead with expansion of our Islamic banking operations at Boubyan Bank and our operations at NBK Egypt

Therefore, to conclude on the subject of costs, I can say that our cost to income ratio (as profiled on the bottom left hand side of this 3rd slide) is at 37.2%, impacted by the lower income resulting from the rapid drop in interest rates and negative impact at the total income level from lower non-interest income.

Moving on to provisions and impairments profiled on the bottom right hand side of this 3rd slide.

Total provisions and impairments in the 1H2020 is KD126.6m, which is 88.7% increase on 1H2019, reflecting KD27.4m impairment provisions, notably charge in respect of our investment book to cater for the effects of volatility that may arise in anticipation of worsening macroeconomic factors due to the impact of COVID and in respect of our operations in Lebanon. Credit provisions at KD99m include Kuwaiti corporates, Kuwait retail portfolio, and a well-known international corporate customer at UAE (NMC Healthcare that has been fully provided for) and in part, covers accelerated charge in anticipation of worsening credit quality due to the impact of COVID.

The aggressive credit provisioning for the six months to June 2020 at KD99m vs. charge of KD67.1m in 1H2019 led to increase in our cost of risk to 112bps from 82bps at the of June 2019.

The charge for 2Q2020 was KD75.1m vs. KD51.5m in 1Q2020 and KD35.7m in 2Q2019. Increased charge in 2Q2020 reflects higher credit provisions as elaborated earlier.

The charge for 1Q2020 was KD51.5m vs. KD31.4m in 1Q2019 due to higher impairment charges relating to our investment book and for Lebanon.

I would like stress that despite the elevated levels of provisions/impairments, the Group's Balance Sheet remains strong with stable credit quality and capital. NBK's capital base along with an ability to generate healthy operating profits provides a strong credit loss absorption capacity – we will shortly look at the capital ratios in the subsequent slides.

Moving on now to SLIDE 4.

We will now review earnings diversification at the Group.

The operating income at our international operations for 1H2020 was KD108.7m, broadly on par with 1H2019. You will see from the pie chart on the top right hand side of this 4th slide, that the contribution to Group operating income from our International operations was 26%, slightly up on the 24% of last year.

The operating income from International has been resilient despite the unprecedented challenging times. However, the contribution from our international operations reduced to 9% from 26%, essentially due to increased provisions/impairments, which I had referred to earlier i.e. provisions in a respect of the international corporate customer at UAE and impairments in respect of our investment book and for operations in Lebanon. As a result, the profit contribution was 81.2% below last year's corresponding number, which is profiled on the mid left hand side of this 4th slide.

The Group's Islamic banking subsidiary Boubyan Bank were also impacted by provisioning, and delivered profits of KD17.1m, 40.6% lower than 1H2019 net profit of KD28.9m. However, I would highlight that the operating surplus at Boubyan Bank has been strong with only a 3.1% drop vs. 1H2019. Boubyan's share of assets increased to 21% of Group benefitting from growth in loan and investment volumes, plus the consolidation of BLME.

Finally, on this slide, we see that the profile of assets was such that 44% of Group assets were held at our conventional Domestic operations in Kuwait, 35% at International and 21% at Boubyan Bank.

Although we see elevated levels of provisions/impairments, I would like to stress that operating income is from a well-diversified asset mix, which is unique to NBK amongst Kuwaiti banks in terms of its geographical spread of operations, and due to its ability to conduct business in both conventional and Islamic banking. This diversification gives a significant degree of resilience to Group earnings and provides what we consider as a strong competitive advantage to the Group.

Moving on to SLIDE 5.

On this slide we will look at some of the movements in key volumes during the period.

Total assets as at June 20 reached KD29.7bn. This is a 6.5% increase on June 19 driven primarily by strong growth in loan and investment volumes.

Group lending is profiled on top right hand side of this 5th slide, increased to KD17.6bn, a year on year increase of KD1.4bn (+8.4%). This increase reflects growth at Boubyan bank and our international operations. A significant part of this loan growth occurred in 1Q2020. The loan book grew by 6.2% since the end of 2019.

Also, note that Group loans include the KD150m day 1 modification loss on consumer loan deferral for 6 months (I will revisit this with more details under our discussion on "Capital").

Customer Deposits, profiled at bottom left hand side, at KD17.6bn, are KD2.1bn (+13.6%) ahead of June 19 and show a KD1.6bn (10.3%) growth in the six months to June 2020 - and just for purposes of clarity please note that customer deposits as defined here do not include deposits from financial institutions. This is in keeping with the presentation of customer deposits in our published financial statements.

I would also like to draw your attention to an important underlying message is that within the headline numbers we continue to see a favorable movement in the Groups overall funding mix. We experienced strong growth in core franchise deposits, noting in particular excellent growth in deposits at the retail & private banking arm of the Group in Kuwait, both conventional and Islamic.

The growth in retail deposits reflects a sustained focus on the deposit gathering aspects of our business in recent times, leveraging NBK's long standing ability to capitalize on the Groups strong brand, customer appeal and credit rating.

The Group's overall funding mix is profiled on the bottom right hand side of this 5th slide. Customer deposits comprise 70% of the total mix, which is higher than June 2019's 66% driven by strong growth as indicated earlier. I would like to highlight that a part of this significant growth stems from the limited spending opportunities for a major part of this half-year and the consumer loan-installment deferral. Further, the Group also retired relatively expensive institutional deposits, whilst maintaining strong liquidity levels.

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

Moving now to our penultimate SLIDE.

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

The Return on Average Equity in the opening half of this year was 6.3% reflecting the impact of our lower profit in first six months of the current year vs. 13.2% in 1H2019 and to 12.3% for the FY 2019.

Similarly the Return on Average Assets was 0.75% vs. 1.53% in 1H2019 and 1.42% for the FY 2019.

Profitability ratios have been impacted by unprecedented drop in margins, curtailed fee income opportunities, given the lower levels of economic activity and elevated cost of risk.

The total Capital Adequacy Ratio (profiled at bottom left hand side of this 6th slide) at June 20 was 16.8% vs. 17.8% at year-end December 2019, noting that current year earnings are not factored into the computation of interim period ratios. The T1 capital ratio at June 20 was 14.9%, whilst the CET 1 ratio was 12.6%.

The capital ratios was also impacted by KD115.4m charge recognized in other comprehensive income during the six months to June 2020, being the net change in fair value of debt securities measured at FVOCI.

As regards Capital, it is important to draw your attention to our consumer loan deferral program. All Kuwaiti banks implemented a program to postpone instalments on consumer & other instalment loans and credit cards for a period of six months effective April 2020 with cancellation of interest resulting from this deferral. The instalment deferral resulted in a loss of KD149.9m to the Group from the modification of contractual cash flows.

The Central Bank of Kuwait instructed banks to adjust the Day 1 modification loss through Equity. The equity charge in respect of this stood at KD130m after adjusting the Group's holding in Boubyan Bank. This charge will be phased out equally over 4 years starting 2021 for Capital Adequacy Ratio calculation purposes.

As regards asset quality, the NPL ratio increased from 1.10% in Dec 19 to 1.77% at June 20 given the aggressive credit provisioning that I had referred to earlier. The loan loss coverage ratio at end of June 20 at 185.5% is at comfortable levels.

Before concluding, allow me to make a few comments as to how we expect the fuller 2020 to unfold.

Generally speaking, the operating environment is challenging and is tough to conclude as regards guidance on the key metrics. Of course, the guidance is after due consideration as regards timing and other factors, which will get refined overtime.

As regards loan growth. Loan growth in the six months to June 20 was 6.2%. We expect to see mid to high single digit growth for the twelve-month period.

The net interest margin averaged 2.25% in 1H2020 with the 2Q2020 closing at 2.09% and we expect NIMs to be tighter for rest of the year.

Our cost to income ratio averaged 37.2% in 1H2020. We expect this ratio to remain around similar levels, influenced by a challenging rate environment and the macro landscape, together with the continuation of our investment program in support of various group initiatives. We therefore guiding a cost to income ratio in the range similar to that of 1H2020.

Guidance on Cost of Risk is not included as we are still waging through the throws of the pandemic and we are of the opinion that it is not prudent to give guidance.

That ends my presentation.

However, before handing back to Amir I would like to summarize by saying that we are satisfied with the results for the opening half of 2020. Resilient operating income from Domestic and International Operations, upbeat lending in the opening quarter although impacted in 2Q2020 due to the slower pace of economic activity, good growth in core franchise deposits, reasonable cost growth, comfortable liquidity levels and solid capital base.

The Group continues with its strategy of investing in its people and in emerging technologies and selectively into reinforcing its geographic footprint in order to best protect the bank into the future.

Looking ahead, we are hopeful that momentum will be back as restrictions are eased in a phased manner and we remain optimistic of Kuwait's ability to lead a fast recovery, notwithstanding the various challenges and uncertainties.

Thank you very much for your time.

Now back to Amir.

Amir Hanna: Thank you Shyam.

We know that the presentation was expected to be a bit longer than usual but we wanted to explain both quarters clearly. We will pause for a minute as we have received different themes of questions and we will try to put them all together for the sake of time in order to answer as many questions as possible.

We got a big list of questions and similar ones but there are few questions on the modification losses that are being deferred. That is basically the impact from the postponement of the retail portfolio so I will read one of the questions and leave it to Shyam to explain in more details what happened with the accounting treatment.

The question is asking to elaborate on the modification loss reported under the equity base. And if there is any impact on NII or the drop in 2Q is only the result of asset yields declining. So we will explain that in more details with the exiting impact on equity and how that fits in the NII line.

Shyam Kalyanaraman: Thank you Amir.

With respect to the modification loss, all Kuwaiti banks introduced a program to postpone the instalments on consumer/other installment loans and credit cards for a period of 6 months. This would require banks to compute the present value of loan, which resulted in a modification loss of KD150m. The modification loss as instructed by the central bank has been charged to equity and not to the P&L, so the net interest income is not impacted. Our equity charge has been booked, after adjusting for our holding in Boubyan, which is KD 130M and this will be phased out in the capital adequacy ratio calculations over four years starting from 2021.

As regards drop in yields that we talked about stems from the dramatic drop in interest rates. In 1Q2020, we had two instances of decline in the central bank of Kuwait discount rate, 25 bps initially in the first week of March, and 100bps in mid-march. This is one of the major reasons which led to the drop in NIM, and as explained earlier, the loan book reprices immediately while we expect a lagged impact on the funding cost.

Amir Hanna: A Question on NIMs. What is driving 47 bps drag on margin that you mentioned, this is due to other assets with extremely low yield in international investments?

Go ahead shyam.

Shyam Kalyanaraman: Yes. This is mainly driven by wholesale assets, notably our investment book, which is hedged, and with respect to our wholesale activity in treasury.

Amir Hanna: Another Question on ECL. Question says is the ECL charge KD 28mn covering NMC exposure fully?

Shyam Kalyanaraman: NMC exposure is covered fully, not within ECLs but charged under credit provisions. As explained earlier the ECL charge relates to the macro economic conditions with respect to the investment book, and also with respect to our operations in Lebanon.

Amir Hanna: A couple of questions on guidance and where do we see that going; I think we covered that in the presentation. There is limitation on giving guidance on cost of risk at this point considering how the operating environment is evolving and how the situation is unclear yet. So hopefully in the coming quarters we will have a clearer view on cost of risk by year end.

A question on dividends asking if NBK has a position to pay dividends at this point and the previous comments that were published in the market and the disclosures related to that.

Isam Al-Sager: Well, on the dividend part, I think it is too early to have a well-informed discussion on whether we will distribute any dividend or not as we are still in the half year. Dividend is a function of earnings and capital and normally this happens at year-end after we asses our closing capital position and future capital needs.

Our priority will be to maintain our solid capital position with the proper buffers similar to what we have maintained over the years.

The earlier announcement around the suspension of dividend distribution were all clarified by the Central Bank and were mainly focused on banks that would benefit from the temporary lower regulatory requirements set by CBK in response to COVID 19. Otherwise, the decision for dividend distribution should follow the normal approach being part of capital planning at year-end.

Amir Hanna: We are pausing again to group themes of questions as they keep repeating.

Another question on the increase in provisions in 1H. Was this driven by some clients failing to pay their obligations? Clarify the number of them and who they are if possible. Is NMC one of them if not can you comment about NBK disclosure on NMC? Do you expect NBK to continue similar level of provisions In Q3 and Q4?

Shyam Kalyanaraman: As regards to NMC, it is a very repetitive by now and is a publicly disclosed exposure through Boursa and as I said earlier, it has been fully provided. With respect to fuller amount of provisions, we did see the cost of risk in the previous year normalizing to around 82bps. Given the impact of COVID, we do see some provisions with respect to some of our Kuwaiti corporate and retail portfolios and in addition to some precautionary charges. We are still in the middle of the pandemic so we expect some deterioration in the retail portfolio, which has been catered for. There are no big issues with respect to credit quality. What we see today is a reflection of liquidity issues with our corporate customers but we have not seen any deterioration in credit quality.

Amir Hanna: Questions on the losses of FVOCI and the modification losses of KD149.8 million on deferral of loan installments been reflected in CET1? And another question, Why did your international segment net income decline by 81% YoY. We answered that but you can elaborate on it as well.

Shyam Kalyanaraman: The losses that we see with respect to FVCOI on the debt portfolio is drop in prices of bonds which is factored into our CET1. While for the modification losses have been exempted from the CAR calculation as per Central Bank of Kuwait, this is an allowance whereby it will be factored into the capital calculation starting 2021 over a period of four years (2021 to 2024).

As regards international segment, the net income decline by 81% as I explained earlier, is mainly due to the impact of impairments/provisions that we booked with respect to our international bond portfolio and with respect to Lebanon and includes provision charge for NMC, a well-known international corporate customer based in the UAE. This is the reason why we see a drop in the net income from international.

Amir Hanna: Another question on costs. You have mentioned implementing Group wide cost saving initiatives; can you please elaborate more on this?

Isam Al-Sager: Of Course. Since the early days of the crisis, we realized that the virus spread and the control measures implemented by governments around the world would have a negative impact on the bank's profitability. We immediately introduced some cost-savings initiatives to be implemented across the Group in an effort to ease the pressure on the bottom line.

Our main target was to cut costs without affecting our strategic initiatives, our growth plans, and our business execution capabilities. The most important initiatives were focused on:

1. Freezing the headcount across all Group locations
2. Reviewing the remuneration structure with more focus on the variable element
3. Reviewing all third party vendors and suppliers contracts as well as the priority of the various planned projects

Those are the main initiatives that we took to control costs

Amir Hanna: A question relating to NIMs again. Will the lag regarding the deposit rate ease some margin pressure from 2.09 level going forward?

Shyam Kalyanaraman: The deposits that we have are stable and do expect some benefit from the repricing in the coming quarters. However, we have given a very cautious approach as regards NIM as we are still in the midst of the pandemic.

Our liquidity levels are strong and most of our liquidity ratios are higher than what we closed in December. We do expect some benefit with respect to funding costs that will accrue to the Group in the next few quarters.

Amir Hanna: We are waiting for more questions to come in.

A question on the news about the intended government cut in its budget by 20% and how that will affect capital expenditure and if there are any cancellations or delays on expected mega projects.

Isam Al-Sager: As we mentioned earlier, Kuwait as well as other GCC countries, will feel the pressures not only from the spread of COVID 19 but also because of the drop in oil price as Oil GDP and oil receipts remain a significant contributor to the country's GDP and to budget revenues.

The immediate response to that would be budget cuts and rationalization of spending. Unfortunately, Capital expenditure will be among those planned cuts and accordingly we do expect some project delays and/or cancellations and have witnessed already.

Despite that negative trend, we still saw some activity with the value of projects awarded in 1H2020 totaling some KD 900 million. We are also hopeful that we can see some rebound in activity on both the execution side as well as the awards with the planned gradual opening of the economy.

Amir Hanna: Another question on NIMs but I believe we covered most of these questions. Question on NMC again and how the provisioning works for it and if it is 100% covered, so we will try to address that again.

Shyam Kalyanaraman: NMC has been fully provided and forms part of the credit provisions.

There is also a question on provision coverage falling below 200%, what kind of provision coverage are you comfortable with?

The coverage ratio currently is very comfortable at 185.5%.

Amir Hanna: We are going through a big list of questions but most already covered. We do not see any questions that are out of our response in previous questions.

We will pause again for a minute if there are no questions then we will just conclude the call.

Operator: This concludes today's call.

Thank you for your participation. You may now disconnect.