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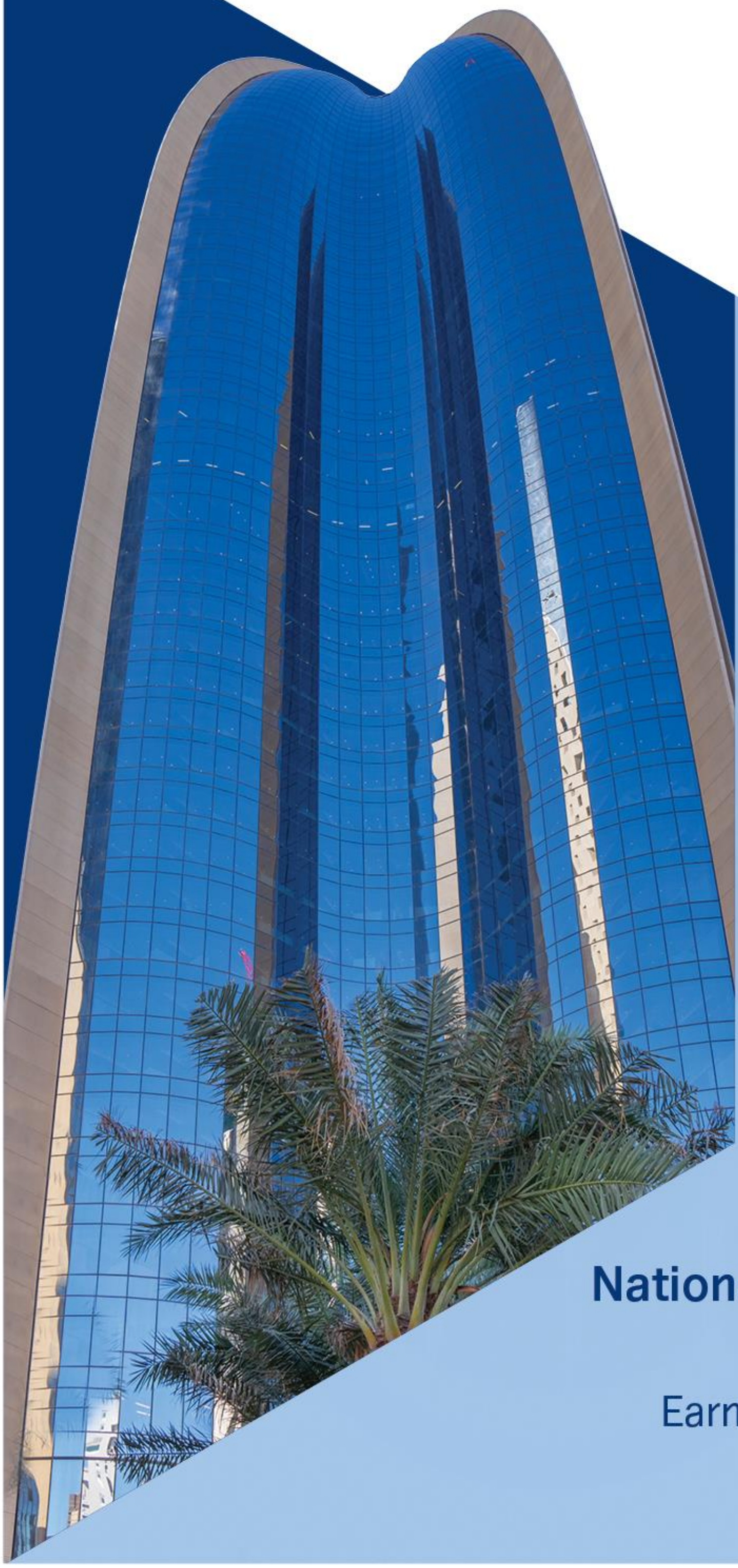

National Bank of Kuwait

1H 2024

Earnings Conference Call

18 July 2024

2Q/1H 2024 National Bank of Kuwait Earnings Call

Sunday, 21 July 2024

Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, 18 July 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 second quarter and first half 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 second quarter and first half earnings call for the year 2024.

In light of the recent divergence in economic performance globally, market expectations for the global economic outlook have varied. Higher than expected levels of inflation still exist while geopolitical tensions are escalating, indicating a cautious approach to monetary easing for the remainder of the year.

Regionally, growth in the GCC area is expected to remain solid as oil prices continue to feed fiscal positions of GCC governments and supporting strides in its diversification agendas and capital expenditure plans.

In Kuwait, inflation remains stable as consumer spending, business credit and project activity recorded moderate growth. We forecast a modest deceleration of inflation to 3.0% on average for the year as inflexibility in some price areas persists. GDP growth on the other hand is to witness muted growth on the back of oil production cut mandates by OPEC+ members while improvement thus far in consumer spending, business credit, real estate and project activity may provide grounds for optimism to non-oil growth ahead.

Furthermore, project activity rebounded significantly in the second quarter, growing at 5-fold quarter-on-quarter. This is driven mainly by activity related to infrastructure works in the construction, transport and power & water sectors. The project awards outlook for the remainder of 2024 is promising with projects valued at around KD 7 billion in the pipeline for the year.

As for NBK, we continue implementing our diversification strategy and utilizing our adaptable business model against the volatile macroeconomic environment to maintain our strong performance. We reported net profits of KD 292.4 million in the first half of the year, growing by 6.2%. As for the three months ended-June 2024; NBK posted year-on-year growth of 3.3% in net profits to reach KD 145.8 million. Moreover, NBK's Board of Directors has approved its third semi-annual cash dividend distribution of 10 fils per share.

Growth in core banking income continues to boost our performance and is well diversified across our business segments. Our diversification strategy continues to prove its success and effectiveness in mitigating risks and maximizing efficiency. We achieved a growth of 8.2% year on year in net operating income to reach KD 612.4 million.

As we continue to steadfast our commitment towards long-term value creation for stakeholders and tailored customer experience to our clients, we continued to leverage our strong fundamentals and strategic investments in technology and innovation to maximize returns and optimize costs. Our return on average assets for the reporting period reached 1.55% whereas our return on average equity reached 15.0%.

In Kuwait, we continue to focus on optimizing our market position in key sectors, expanding our customer base with digital products, and offering excellent customer service. Spearheading Kuwait's infrastructure program is our top priority as we expect financing national mega-projects.

Moreover, our Islamic banking arm, Boubyan Bank, along with our international operations both continue to support our diversification strategy with their growing contributions to the Group.

Additionally, our wealth management business continued expanding globally to position itself as a major player in the wealth management industry.

Our leadership in the ESG space was further strengthened with the recently issued USD 500 million green bonds, the first green bond issuance from a Kuwaiti financial institution. We will continue contributing to the sustainable development of our communities and providing the support for our clients' sustainable and transition finance initiatives.

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

We have announced a net profit of KD292.4m for 1H24, a 6.2% increase over the corresponding period 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 reporting period.

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 improved over time, although bench-mark interest rates are generally expected to decrease only in the later months 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 1H24.

As shown at the top left of this slide, net profit at KD292.4m reflects a yoy growth of KD17.1m i.e. 6.2%. Underlying drivers for the robust bottom-line performance are a combination of yoy growth in business volumes, relatively higher interest rates, and a stronger operating performance. Group loans and advances grew year on year by 5.4%. Investment securities also contributed strongly to Group assets with a growth of 12.3% v June 23.

The top right chart reflects operating surplus i.e. profit before provisions and tax for the current half-year at KD385.8m, a growth of KD26.6m, +7.4% over 1H23. Net operating income increased by KD46.5m, +8.2% whilst operating expenses grew by KD19.9m, +9.6% over last year.

2Q24 net profit at KD145.8m was at par with the previous quarter.

The operating income mix profiled at the bottom right hand continues to show a healthy mix with 21% 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 KD482.3m for 1H24, a growth of 11.6% over 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 June 23, to reach KD36.1bn.

We see from the chart at the bottom left, that average NIM for 1H24 at 2.69% reflects an improvement of 17bps over 1H23 driven by a higher yield, despite increased funding cost. Group yield and funding cost for the current half year were 6.25% and 4.02% respectively. The higher funding cost relative to 1H23 results from the repricing of deposits at increased market rates and a limited migration of lower cost deposits to time deposits. However, the funding cost has trended downwards recently, when compared to the last two quarters. Also, 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 17bps yoy increase in NIM from 2.52% in 1H23 to 2.69% in 1H24. Loans and other interest earning assets backed by a strong year on year growth in volumes and interest rates, contributed 75bps to the NIM. Higher funding cost negatively affected the NIM by 58bps.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD130.1m for 1H24 was KD3.7m lower than the comparable period in 2023. Fees and commissions income was strong at KD101.1m, reflecting robust contributions across different lines of business and geographies. Fx income was stable at KD17.5m, whereas other non-interest income sources (mainly investment income) at KD11.5m reflected a year-on-year decrease due to lower valuations, relative to previous year.

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 side of this slide.

Total operating expenses for 1H24 at KD226.6m, were 9.6% higher than the previous year. 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 now 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 1H24 cost to income ratio was at 37% 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 1H24 amounted to KD42.7m, a decrease of KD5.3m over 1H23.

KD46.6m of the current six month's charge was for provisions for credit facilities. Specific provision of KD36.0m was in course of normal business activities at Kuwait and overseas locations. KD10.7m was towards general provisions which included a component of precautionary provisions. The Group remains committed to its conservative approach in managing credit exposures.

The Group wrote back a net amount of KD4m towards ECL and other impairment losses, due to lower net provisions requirement for non-credit financial assets.

The cost of risk for 1H24 was 40bps compared to 44bps in 1H23.

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.

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

You would note that NBK's Consumer Banking contributed 20% and 16% to the Group's net operating income and profit respectively. Similarly, Corporate Banking contributed 13% and 19% to the Group's net operating income and profit.

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

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD49.6m, up 20.2% on 1H23 boosted by a strong growth of 10.5% 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 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.

Finally, chart at the bottom right corner, you will note that International Banking and Boubyan Bank contributed 40% and 24% respectively to Group's total assets enforcing the diversification agenda of the Group.

Moving to the next slide.

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

As profiled on the chart at top left, the Group total assets reached KD37.7bn as of June 24, a 4.4% yoy growth. The recent devaluation of EGP in March 24 has adversely affected the KD value of balance sheet items and resulted in lower growth percentages.

Group loans and advances at KD22.7bn registered a growth of KD1.2bn i.e. 5.4% from June 23 and 2% during the current half year. Loan growth was achieved at Kuwait and International locations, in both - conventional and Islamic banking. Similarly, investment securities reflected a yoy growth of 12.3%, to reach KD6.9bn.

Customer Deposits, i.e. non-bank and non-FI deposits at KD21.8bn, reflect a yoy growth of 7.6%. 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.

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 68% 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 1H24 financial results had on certain key performance metrics.

The Return on Average Equity for 1H24 remained steady at 15%. Similarly, Return on Average Assets now stands at 1.55% compared to 1.53% in 1H23.

At 16.8%, the total capital adequacy ratio remained strong and stable, well above the regulatory minimum with CET1 and Tier1 ratios at 12.5% and 14.5% respectively. It is important to note that regulatory capital does not include interim profits, but the interim dividend of KD83m (at 10 fils / share) is deducted for capital adequacy ratio calculations.

As regards asset quality, NPL ratio stands at 1.52% compared to 1.38% as of 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 June 24 was KD617m, similar to Dec 23.

Although IFRS 9 ECL and CBK provisions are two different regimes and should not be compared as such, currently the balance sheet provision as per CBK instructions exceeds the ECL by KD314m. 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 1H24.

As mentioned earlier, NBK's strong operating performance with a healthy balance sheet, comfortable liquidity levels and a strong capital base continued in 1H24 results.

However, in light of the ongoing regional and international geo-politics we remain cautiously optimistic that the overall operating environment, although challenging, will remain generally stable during the remainder of 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, 1H24 NIM has improved to 2.69% benefiting from stronger volumes and higher interest rates compared to 1H23. The general expectation is that benchmark interest rates, especially the US Fed, will start declining from Sep 2024. In such an environment, we expect the full year 2024 NIM to be stable, possibly a few basis points above the 2023 NIM of 2.59%.

Coming to operating expenses, the 1H24 year on year cost growth was 9.6%. 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 40bps during the current half year. We are cautiously optimistic of an overall stable 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.

We will break for a while as questions are being received through the Q&A platform.

We will resume to respond on questions that will come through.

So the first question talks about international operations, can you share some more information on your international operations such as Egypt and how do you see them perform going forward? So we'll start with Egypt and then cover the rest of the question.

Isam Al-Sager: The Egyptian economy benefitted recently with the government closing several foreign investment deals and reaching grounds with the IMF Program. This reflected positively on the efforts to restore some confidence in the Egyptian economy and specifically on the currency. Reforms including sale of governmental assets are ongoing in an effort to continue attracting further foreign inflow to the market.

In domestic terms, operational performance in our Egyptian subsidiary remains among the most profitable with promising returns. We remain committed to grow organically in the market and would seize the opportunities to grow its contribution to the Group, which currently stands at less than 5% of our total assets.

Sujit Ronghe: International operations of NBK have been a very important pillar for the bank's diversification strategy as mentioned earlier. International Banking Group has typically contributed c.24-25% to the Group's total income and profit. International Banking contributes around 40% of the total Group assets. Hence, International operations is very much an area of focus for the Group.

Our presence in the region or in UK, Europe, US etc. is a very important driver not only from the point of view of booking assets, but also serves as an important franchise for collection of deposits and diversifying our funding sources.

Overall, we see International operations as a growing contributor to Group's assets and profits.

Amir Hanna: The second question is on NIM's, so based on your guidance do you expect a ten basis points decline in NIMs in the second half of 2024? Is that solely driven by lower USD rates, and how many rate cuts do you assume by the fed and by the CBK?

Sujit Ronghe: NIM is expected to be stable and possibly a few basis points higher than the 2.59% we saw for the last year. In this projection we have factored 1-2 interest rate cuts both for US Fed and CBK. Important to note is that on its way up, CBK did not match the increases in discount rates in line with the Fed.

There is uncertainty regarding the extent and pace at which CBK would reduce interest rates, impact of which remains to be seen in coming quarters.

Amir Hanna: Question on capital, how do you look at the group excess capital buffer and what is your internal minimum level?

Sujit Ronghe: NBK is well capitalized in terms of the minimum regulatory requirement and also our internal buffer. Typically, we consider a 1.5%-2% above the regulatory minimum CAR as a normal buffer, especially at the year-end.

Amir Hanna: Are you seeing any change in trends with regards to retail lending demand?

Sujit Ronghe: The demand or the customer appetite for retail loans remains to be somewhat muted, and we are not expecting this to change in the short term because the interest rates have not moved. Once interest rates start declining, we could possibly see an uptake in the demand for retail credit.

Amir Hanna: As part of a previous question, do you foresee more active international expansions?

Isam Al-Sager: NBK will continue to be competitive in the domestic market. On the international scene outside Kuwait, MENA and specifically the GCC remain our focus markets, especially Saudi Arabia. We are tapping the Saudi market at all fronts as we complement our growing operations with the opportunities that align with our strategic goals.

Similarly, the wealth management business is of great importance for our strategic ambitions as we continue to expand with the launch of NBK Wealth brand.

Amir Hanna: On the cost side, the cost to income ratio is the highest for NBK across Gulf peers, part of it is driven by strategic investments in technology. Do you have a medium-term target with the efficiencies expected to show improvement trend?

Sujit Ronghe: A lot of the Group's spend is to improve digitalization of the bank and offer more digital products across our network. The focus is more towards additional capabilities in terms of customer service, which may not necessarily bring the efficiency component as much in the short run.

In the medium term, we are expecting our cost to income ratio to be in a similar range, especially with the income growth possibly being affected in a lower interest rate cycle.

Amir Hanna: Question on government projects, with regards to large government projects, do you expect some of these to be initiated in 2024 or more in 2025?

Isam Al-Sager: As mentioned earlier, project activities rebounded significantly in the second quarter, and we believe it will continue in 2024 and 2025. After dissolving the parliament, the decision making is in the hands of the government, which makes decision making much easier.

This has driven implementing and pushing mega-projects significantly, and we felt that recently in various sectors, the projects awards outlook for 2024 is promising with projects valued at KD 7.0 billion in the pipeline till the end of the year. There will be further awards in 2025, but it is too early to give certain numbers at this point in time.

Amir Hanna: Does international segment include loans and asset by branches in the GCC? UAE, Bahrain and KSA.

Sujit Ronghe: Yes, that's right. The international segment includes loans and assets through our branches in the GCC and our international operations in the UK, France, US, Singapore, China etc.

Amir Hanna: Are there any updates on the debt law, mortgage law and corporate taxes?

Isam Al-Sager: Speaking of the debt law, no material development on the topic took place but the government acknowledges its importance while focusing more on reforming the budget as a step to adjust imbalances.

On the mortgage law, the late parliament passed underlying laws and initiatives pertaining to housing, and we see more chances for this law to be passed with outstanding housing applications approaching 100k putting more pressure on the need for a housing finance mechanism.

Amir Hanna: On the corporate tax side, Sujit?

Sujit Ronghe: On the corporate tax side, Kuwait has signed up to be part of the Inclusive Framework of the OECD. We understand that a corporate tax law is being actively drafted by the Ministry of Finance, Kuwait and we expect the same to be in place by the end of this year.

Amir Hanna: Fee income in the first half was broadly flat when compared to last year. What are the drivers of the slowdown?

Sujit Ronghe: During the current six months period, we noted that although fee income remains a stronger contributor to the top line, the year-on-year growth was somewhat muted. This can be attributed to timing differences, one-offs in the previous year and also a lower rate of growth in consumer spending. We are however hopeful that fee income growth for full year 2024 would be in the mid-single digit range.

Amir Hanna: There is another question on projects and I believe we covered most of it, but the follow up on the question is mainly news of capping government expenditure.

I think the point here is that we believe that the capping of expenditure will be mainly focused on current expenditure rather than capex. We see that the government is awarding large mega-projects and are hopeful that we witness capping on the current side while expansion on the capex side going forward; which will definitely feed into non-oil GDP growth outlook.

Amir Hanna: What is your target loan growth rate in Saudi Arabia or any target as share of total business activities? Sujit?

Sujit Ronghe: Saudi Arabia remains an important location in terms of growth in our international operations. That said, we maintain our conservative approach with respect to extending credit facilities to specific sectors or corporates in KSA. Our target loan growth will be in keeping with our risk management practices.

Also, we are pressing on the growth of our wealth management business in KSA through NBK Wealth. Our subsidiary in KSA is expected to expand customer offerings through funds and other wealth management services.

Amir Hanna: If the government may look at fiscal reforms and potential cuts to current spending, do you see this potential as negative to consumer spending and consumer credit?

Sujit Ronghe: I believe there are several aspects to this question. With regards to consumer spending, it may not be directly impacted by potential cuts to Government spending. In fact, with implementation of project awarded, the overall spending could increase as there would be a trickle-down effect along the way. Similarly, it would give rise to increased demand for consumer credit in future.

Amir Hanna: At this point we don't have any more questions as we have answered all the ones we received through the platform.

Thank you so much for attending the call.

Back to Elena.

Elena Sanchez: I would like to thank NBK's management team for the presentation and responses provided today.

Thanks to all participants for joining us today.