Gulf Bank of Kuwait (K.S.C.C.)

Earnings Conference Call Edited Script – Year End 2021

16 February 2022

<u>Corporate Participants:</u>

Mr. Tony Daher – CEO

Mr. David Challinor – CFO

Ms. Dalal AlDousari – Head of Investor Relations

<u>Host:</u>

Ms. Elena Sanchez – EFG Hermes

[GBK Classification: PUBLIC]

Elena: Good morning and good afternoon, everyone. This is Elena Sanchez, on behalf of EFG Hermes; I would like to welcome you all to the Gulf Bank year end 2021 earnings conference call. It is a great pleasure to have with us on the call Mr. Tony Daher, Gulf Bank CEO, Mr. David Challinor, Gulf Bank CFO and Ms. Dalal AlDousari, Head of Investor Relations at Gulf Bank.

I will now turn the call over to Dalal.

Dalal: Thank you, Elena. Good afternoon and welcome to Gulf Bank's year end 2021 earnings call. We will start our call today with the key highlights and updates on the operating environment of Gulf Bank during the year 2021 presented by our Chief Executive Officer, Mr. Tony Daher followed by a detailed presentation of our financial results by the Chief Financial Officer, Mr. David Challinor.

All amounts in the presentation are in millions of Kuwaiti Dinars and have been rounded to simplify the charts. During our presentation, we will try not to repeat the currency when discussing specific amounts unless that amount is in another currency other than Kuwaiti Dinars.

After the presentation, we will open the floor for Q and A received through the webcast platform. Feel free to type in your questions at any time during the call. The presentation will be available at our corporate website and will be disclosed to Boursa Kuwait.

Please note that we can only comment on inquiries and information that are publicly disclosed. I would also like to draw your attention to the disclosure on **page 11** of the presentation, with respect to forward looking statements and confidential information. Please feel free to reach out to our investor relations team if you have any questions.

Now, I would like to handover the call to Mr. Tony Daher. Tony?

Tony: Thanks, Dalal. Good morning and good afternoon, everyone, before we cover the detailed financial performance of the Bank, I would like to make a few points about the operating environment here in Kuwait.

During the year 2021, we have seen a gradual improvement in the overall economic environment. We started last year with a surge in covid-19 cases and restrictions on travel and overall business environment, however, almost all restrictions were lifted towards the end of the year as the government vaccination efforts increased reaching about 80% of the population. This in turn allowed things to steadily go back to normal, which in turn, improved confidence, boosted consumer spending and growth prospects here in Kuwait.

We continue to accomplish significant progress against our 2025 strategy of being the leading Kuwaiti Bank of the future. We aim to provide customers with simple and innovative services to enable a sustainable growth for the Bank.

As a first step of our digital transformation journey, we have successfully launched our new MX.3 system in partnership with Murex for the development and automation of the Bank's capital markets and treasury platforms. The platform implementation is a transformative step towards developing and automating our treasury and capital markets systems. In addition, this will help us unlock opportunities, navigate capital markets and better serve our customers.

On the service front, we continue to support our clients through our seamless omni channel services, assisted by the digitization of most of our major activities. A new feature was introduced in our mobile application and online banking, enabling customers to open a bank account in just under one minute. In addition, we have launched tailored products and services to our customers. Each of these products is specifically designed to offer distinctive features for our targeted segments including women, youth, and affluent customers.

Our local footprint is one of the largest in Kuwait. In addition to the opening of our modern flagship branch in Crystal Tower, we inaugurated a new branch at Kuwait International Airport, bringing the number of our branches covering various regions of Kuwait to 53. Our presence at the airport throughout the year is part of our strategy to provide the best and easiest services for our customer.

Moving on to sustainability, we are proud of our first official published sustainability report for the year 2020. As a responsible Bank, we are committed towards our stakeholders, community, and the overall economy. We will continue to integrate ESG principles across the business strategies and the way we operate the Bank.

Now turning to Page 2, I would like to summarize our financial results with six key messages:

First, our net profit grew by 46% for the year 2021, to reach KD 42 million in comparison to KD 29 million reported in 2020.

Second, our earnings per share is up 40% to 14 fils and the Board of Directors is recommending a distribution of cash dividend of 7 fils per share, representing a 50% cash payout, in addition to 5% bonus shares, for shareholders' approval at the Annual General Meeting to be held in March 2022.

Third, our gross customer loans reached another all-time high reaching KD 4.8 billion, an increase of KD 454 million or 10% compared to the end of 2020. This growth in 2021 came from both our Corporate and Consumer segments.

Fourth, our asset quality remained resilient, as our non-performing loan ratio (NPL) in 2021 stood at 0.9%, an improvement when compared to last year (NPL) of 1.1%. Additionally, we have taken ample provisions and now have a coverage ratio of 615%.

Fifth, the relaxed capital regulatory minimums that were introduced in 2020 remain in place until 31 December 2021, allowing the Bank to have additional buffers over the minimums. Our Tier 1 ratio has a buffer of 496 basis points, and our capital adequacy ratio has a buffer of 522 basis points. These comfortable buffers have allowed the Bank to grow its businesses in line with its strategy.

I would like mention here that during 2021, we successfully completed the redemption of our existing KD 100 million subordinated Tier 2 bonds and issued a new KD 50 million Subordinated Tier 2 Bonds which was oversubscribed. This issuance optimizes the Bank's capital adequacy, in compliance with Basel III frameworks, and supports our overall investment

plans towards making Gulf Bank the leading Bank of the Future.

And sixth, the Bank remains an ‘A’ rated bank by three major credit rating agencies. Our current position stands as follows:

- Moody’s Investors Service maintained the Long-Term Deposits Rating of “A3” with a “Stable” outlook.
- Capital Intelligence affirmed the Bank’s Long-term Foreign Currency Rating of “A+” with a “Stable” outlook.
- Recently, Fitch Ratings has changed the Bank’s Long-term Issuer Default Rating to “A” from “A+” and revised the “Negative” outlook to Stable in February 2022.
- In addition, S&P Global Ratings has changed the Bank Issuer Credit Rating to “BBB+” from “A-“and revised the “Negative” outlook to “Stable” during 2021.
- Both credit ratings downgrades of S&P Global Ratings and Fitch Ratings followed the downgrade of Kuwait Sovereign ratings by these credit rating agencies and is not related to Gulf Bank’s Viability position or credit quality.

With that, I’ll turn it over to our CFO, David Challinor, who will cover the financials of the year 2021 in more depth, thank you David.

David: Thanks Tony.

David: **Turning to page 3,** we can see the evolution of net profit from 28.8 to 42.1. The increase of 13.3 was driven by three positive factors. First, we had a higher net interest income of 7.5 as a result of loan growth and decline in cost of funds. Second, as economic activity regained momentum, so did our fees and foreign exchange income which improved by 4.9, and third, our total provisions reduced by 16.5. However, these positive drivers were partially offset by a 14.3 increase in operating expenses, which I will cover later on.

You can also see our Return on Equity improved by nearly 2 percentage points over the same period.

Turning to page 4, we have a more detailed breakdown of our income statement by line items.

On the far right of line 1, interest income was down 23.4 or 11% mainly due

to re-pricing of assets and booking new loans at a lower rate following the 125-basis point rate cut in March 2020, and lower yields on liquid assets.

On line 2, our interest expense declined by 30.9 or 37%, from 84.6 in 2020 to 53.7 in 2021. This was the result of re-pricing the liability book as well as the full redemption of our 100 million subordinated Tier 2 Bond and replacing half of it with a lower cost.

On line 6, operating income grew by 7% to 170.1 compared to 158.3 in 2020, this was due to the outpace decline in interest expense in comparison to interest income and also, an improvement in the fees and foreign exchange income of 4.9 or 16%, driven by the resumption of economic activities.

On line 7, operating expenses have increased by 14.3 or 22% year-on-year, however, they only increased by 1% when compared to the third quarter. Furthermore, the Cost to Income Ratio fell each successive quarter during the year. The year-on-year increase is predominantly driven by the continued investment in our digital transformation strategy and low operating expense base reported in 2020 due to the reduced economic activity and receiving of government subsidy. There were also some non-recurring items in the first half of 2021.

In the green boxes on line 9, you can see our credit costs declined from 59 in 2020 to 43.9 in 2021, resulting in a full year Cost of Risk of 95 basis points.

Turning to page 5, we can see the balance sheet and how the individual line items have moved from 2020 to 2021. This page also shows the mix of assets and how that has changed over the last 12 months.

First, I'd like to focus on Assets, which are shown on the top half of the slide.

Over the last 12 months, our total assets increased by 443 or 7% to reach 6.6 billion compared to 6.1 billion the year before. This was largely driven by a 528 or 12% increase in Net Loans, (shown on line 9). While, compared to third quarter, Net Loans grew 168 or 4% and total assets grew by 226, reflecting a pick-up in overall economic activity.

In terms of the major components of total assets (shown in bold), you can see that the mix is essentially unchanged from a year ago.

On line items 15, 16, and 17, you can see that nearly all our funding comes from Due to Banks, Deposits from Financial Institutions, and Customer Deposits. As a result of growing our customer deposits and attracting more short-term bank funding, we were able to reduce the deposit mix coming from financial institutions over the last 12 months which is on line 16. As well, we were able to marginally improve the CASA ratio from 37.4% in 2020 to 38.5% in 2021 which is on line 27.

On line item 18, in May 2021 we fully redeemed our 100 million subordinated Tier 2 Bond and replaced it with a 50 million Subordinated Tier 2 Bond at a lower rate. In addition, we secured 165 million of medium-term funding.

Moving on to asset quality, our non-performing loan ratio, shown on line 25, was 0.9% at the end of December 2021, down from 1.1% for the same period last year. Our coverage ratio on line 26, remains exceptionally strong reaching 615% at the end of December 2021.

Now, turning to Page 6 you can see in the chart on the left that as of 31 December 2021, the Bank has 112 of excess provisions, representing 37% over and above total provisions. This is the fourth consecutive year end since IFRS 9 was introduced where the Bank's excess credit provisions exceeded 100 million.

Looking at the pie charts on the top right of the page, you can see that our stage 1 loans are above 90% for both years, while Stage 2 and Stage 3 remained around similar levels in both periods, with Stage 2 being 6.2% for 2021, while for Stage 3 it was 1.0%.

The first chart on the bottom right side of the page shows the IFRS 9 ECL Stages composition. Stage 1 was 22.1%, moving from 23.8% a year ago, Stage 2 increased from 43.7% a year ago to 51.0% as of 31 December 2021 and Stage 3 reached 26.8% moving from 32.5% a year ago.

The second chart on the bottom right of the page shows the IFRS 9 ECL coverage for our total credit facilities. As of 31 December 2021, it was 0.6% for stage 1, stage 2 was 18.7% and stage 3 was 73.4%. However, our overall coverage is much higher since we have provisions of 112 over the IFRS 9 ECL requirement of 189.

Turing to page 7, on the top left, our Tier 1 ratio was 14.5%, which is well above our current regulatory minimum of 9.5% and our pre-COVID-19 regulatory minimum of 12%.

On the bottom left, our Capital Adequacy Ratio of 16.7% was well above our current regulatory minimum of 11.5% and our pre-COVID 19 regulatory minimum of 14%.

Our risk weighted assets, shown on the top right, grew by 5% mainly driven by year-on-year growth in the loan book.

On the bottom right, our leverage ratio as at the end of 2021 reached 9.5%, which was lower than 9.9% for the same period of last year, and well above the 3% regulatory minimum.

Turning to page 8, we can see our key liquidity ratios. On the left side, you can see our average daily Liquidity Coverage Ratio was 222% as of 31 December 2021, and on the right side, Net Stable Funding Ratio was 107% for the same period. It's worth noting that both ratios are still well above their respective current minimums of 80% and pre-covid minimums of 100%.

Also, during the fourth quarter of 2021 the Central Bank of Kuwait has communicated that it will gradually start withdrawing the relaxed regulatory limits for the Liquidity Ratios and Capital Adequacy Ratio and restore them back to the pre-covid levels by beginning of 2023.

With that, I'd like to turn it back over to Dalal for the Q and A session.

Dalal: Thank you David. We are now ready for Q and A. If you wish to ask a question, please submit your question into the designated questions text area. We will pause for few minutes to receive most of your questions.

(Pause)

Ok, we will go through the questions.

Dalal (Q1): **We saw that loan growth was strong in 2021. Can you provide some color on the drivers of the growth and what is the outlook for 2022?**

David (A1): Yes, loan growth was very strong in 2021 particularly in Q4 which was the highest growth quarter in the year. I was guiding high single digits earlier in the year and we came in at 10.4%. When you look at the split of growth between corporate and consumer it was fairly balanced but obviously corporate is a larger part of our book so in percentage terms, we saw consumer grow faster, just over 12%, which almost mirrored the market growth for the sector.

In total, the market grew 6.6% and we grew 10.4%.

Looking at the sector growth in the market, we saw consumer grow just over 13% and corporate just over 3. And, in terms of how we were placed, we grew almost in line with the market in consumer but grew almost 3 times the market in corporate. So, in corporate we were successful in building back about half of the market share that we lost in 2020.

When you look at where the growth came from in our corporate business. In terms of the loan book mix, we saw increases in the oil and gas, manufacturing and financial sectors and decreases in both real estate and construction. So together real estate and construction were 21.6% of gross loans in 2020 and now they have reduced to 19.6%.

I think during 2021, the second deferral scheme, pent up demand and record low rates enhanced the system growth. Looking forward into 2022, I think growth will probably slow in the system, particularly in the retail sector, but the potential mortgage law could be a game changer, however the timing is uncertain.

Dalal (Q2): **Just a few questions on asset quality. What's the outlook for credit costs from here and what was the level of write offs you did during the year? I see that the past due but not impaired number has increased from 107 million to 137 million.**

David (A2): I was really pleased with the performance of the portfolio this year. The credit costs came in at 44 million down from 59 million last year. And if you look at the cost of risk, we saw 110 points in the first half drop to 80 for the

second. I said after the Q2 spike in credit costs that a normalized number is probably around 100 points, and we came in at 95 for the full year.

We also saw the NPL% come down to under 1% for the first time. And when we look at write offs which were done in the year, they were 43 million. So even without any write offs the NPL% would have only been around 1.75% which is still very low and below our target of keeping under 2%. So, the underlying NPL generation was low and has slowed down from what we saw in 2020. When you look at 2020, we had 81 million in write offs. So even though our write off level has halved from one year to the next we still managed to get under 1%, which is a strong result. It's worth mentioning that the accounts written off are treated the same in terms of the recovery effort and their legal status. I think in 2022 we'd like to see more recoveries as they were relatively flat from one year to the next. And I think we have the possibility of booking credit costs in 2022 at lower than the long-term normalized rate of 100 points.

In terms of the past due but not impaired category. Yes, we saw that move up 30 million and that was primarily in the retail space. But when you look at the 60-90 day bucket, in other words the pre-NPL stage, we only have 12 million in that this year versus 32 million last year. So, I'm relatively comfortable with that position coming into 2022.

Dalal: **Thanks David. We will pause for few minutes to receive more questions.**

(Pause)

Dalal (Q3): **What's the outlook for NIMs and the impact on the Bank of a 25bp rise? Do you think the CBK will follow the Fed with rate rises?**

David (A3): I've said a few times in 2021 that I think the outlook for NIMs was going to be broadly stable. And that's what we saw last year. Q2 and Q3 were both stable quarters at 209 points, and we only lost 1 basis point from Q3 to Q4. But what we are seeing is the expectation of rate rises is causing some upward pressure on rates and this is obviously feeding into our cost of funds. And that dynamic seemed to gather some pace in Q4, so I think to lose only 1 point from Q3 to Q4 was a very good outcome.

I think for Q1 22, if this pressure continues, which I think it may do, we could lose more. So, I think some short-term downside is possible before any rate rises which will then kick off a new cycle of expanding NIMs.

In terms of will the CBK follow the Fed? That's not for me to speculate. But when you look at history, I think we can see that in most cases this has been what's happened. And certainly, rate rises would be good for the banks' earnings, and we are very well positioned. The corporate book will reprice immediately and all new retail loans also. In terms of the impact, which we disclose, for each 25bp rise the total impact to NII is around 3 million KD annually.

Dalal: Thank you, David.

Dalal: I believe we have covered the majority of the topics and questions that were raised today during the call. Having said that, I would like to draw your attention to page 10, since we get asked a lot about some guidance, we decided to present a guidance slide that summarize some of the points that we have already covered during the Q&A session:

1. For loan growth, our strategy is to grow faster than the market.
2. For our Margins, we expect a short-term downside, until interest rate hike materializes. Then Margins will expand.
3. Our cost to income ratio is expected to improve.
4. The cost of risk will likely be under the normalized level of 100 basis points.
5. And finally, non-performing loans ratio is expected to remain under 2%.

And with that, we would like to conclude our call for today.

If you have any questions, you may visit our investor relations page at our website or reach us at our dedicated investor relations email. Thank you all very much for your participation today.