National Bank of Kuwait

1Q 2023

Earnings Conference Call

19 April 2023

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Edited transcript of National Bank of Kuwait earnings conference call that took place on Wednesday, 19 April 2023 at 14:00 Kuwait time.

Corporate participants:

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

Mr. Sujit Ronghe – Group CFO, NBK

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

Chairperson:

Elena Sanchez – EFG Hermes

Elena Sanchez: Good afternoon everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to the National Bank of Kuwait first quarter earnings call for the year 2023. 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. Once again, we welcome you on our call today and thank you for joining us in today's webcast to cover the financial results of NBK Group for the first quarter of 2023.

We will start our presentation with the disclaimer like we always do. So for this reason, 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 refer to the full disclaimer in our presentation for today's call.

Our Vice Chairman and Group CEO, Mr. Isam Al-Sager, will start the presentation by giving some opening remarks on the operating environment and the highlights of the quarter. This will be followed by a detailed presentation on financials by Mr. Sujit Ronghe, our Group CFO. Following the management presentation, we will answer any questions received through the webcast platform. And feel free to send any follow-up questions to our Investor Relations email address. Today's presentation is already available on our Investor Relations website for your convenience.

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

Isam Al-Sager: Thank you Amir.

Good afternoon everyone. I am glad to join you today for an update on our performance during the first quarter of 2023

The overall global economic outlook continues to be very uncertain. Moreover, the recent US bank failures and the concerns of a spillover in Europe are adding to that uncertainty and creating turbulences in the banking industry across the globe.

In the region, the situation remains more stable. GCC lenders enjoy solid funding and high level of expected government support leaving them well equipped to withstand the current challenges and risks.

In Kuwait, economic activity is expected to slowdown in 2023, though will remain solid, as post-pandemic consumer spending eases, real estate and credit demands soften alongside lower oil output in accordance with OPEC plus production targets. GDP growth is forecasted to slow down to negative 0.3% in 2023 before rebounding to 3.3% in 2024. Oil GDP on the other hand is expected to contract by 3.7% in 2023 while non-oil GDP is expected to grow by around 3.8% during the year.

The government's draft budget for FY23/24 is expansionary and should support the economy in the near term. However, political gridlocks and the prospect of fresh elections later this year will likely delay the budget approval and negatively impact the previously hoped-for rebound in investment in 2023.

Moving to NBK, the Group is starting the year on a solid footing with robust results. We delivered a net profit of KD 134.2 million, growing by 15.1% year on year. The Bank's strong performance is driven by core banking activities with operating income growing by 18.4% year on year to reach KD 277.9 million; affirming NBK's success in the implementation of its strategic initiatives.

Building on the exceptional performance in 2022, we will continue to invest strategically in our talents and technologies to drive future growth. Furthermore, our diverse business model and prudent risk management will help us navigate through any potential scenarios as the uncertainty in the economic scene unfolds.

On the ESG front, we remain focused on implementing various initiatives that promote responsible business practices. During the first quarter of the year, we continued to demonstrate our commitment to integrating ESG into our strategy and operations. We started the year by announcing our commitment to become carbon neutral by 2060, a milestone step that aligns with Kuwait's pledge to carbon neutrality and reflects NBK's commitment to making climate change risks a top priority in the Group's agenda. Moreover, during the quarter we also joined the United Nations Global Compact, the world's largest corporate initiative advancing sustainable and socially responsible business practices. As pioneers of sustainability in our industry, we recognize the importance of setting an example of responsible leadership through supporting the transition of all our stakeholders.

For the remainder of 2023, we will continue to build on our healthy balance sheet as we are well-positioned to continue to evolve into the bank of the future. Leveraging our solid financial position, strong capitalization rates, and ample liquidity levels, we are confident that we will continue delivering attractive returns for our shareholders.

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

Please go ahead Sujit.

Sujit Ronghe: Thank you Mr. Isam.

Hello everyone and welcome.

I am very pleased to have this opportunity to take you through the financial results in respect of the opening quarter of 2023.

We have announced a net profit of KD134.2m for 1Q23. This is a 15.1% increase in bottom line profit over the comparable quarter of 2022. These results reflect a solid operating performance by the Group and demonstrate the continued growth in our businesses.

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

The first quarter of 2023 was very much a continuation of the recovery we witnessed during the last year. Increased benchmark interest rates, although somewhat lagging in Kuwait, have benefitted the Bank in general. At the same time, ongoing political situation both locally and internationally, inflation issues resulting in a high interest rate environment, have increased the risk of a possible recession, affecting growth prospects in general. We are however cautiously optimistic that the overall operating environment will be more or less stable during coming quarters.

Now turning to the financial results for 1Q23.

As profiled at the top left of this slide, the KD17.6m i.e. 15.1% increase in net profit compared to 1Q22 reflects a robust performance by the Group, benefitting from increased interest rates, growth in business volumes and a strong operating performance. Group loans grew by 5.7% year on year across business lines and geographies.

The top right chart reflects operating surplus i.e. pre-provision and pre-tax profit for the current quarter at KD176.4m, a growth of KD31.9m over 1Q22. Net operating income increased by KD43.2m, 18.4% whilst costs grew by KD11.4m, 12.6% over the first quarter of 2022.

Similarly, 1Q23 operating surplus exceeded that of the previous quarter by 11.8% on the back of a stronger operating income, mainly driven by non-interest income and lower costs. Higher credit provisions charge (largely precautionary) in the current quarter has resulted in the net profit remaining flat vis-à-vis 4Q22.

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

The operating income mix profiled at the bottom right hand continues to show a healthy mix with 24% coming from non-interest income sources.

Moving on now to the next slide.

Here we will look at net interest income and drivers behind its performance.

The chart at top left reflects the net interest income of KD211.8m for 1Q23, a growth of 25.5% over 1Q22, largely benefiting from higher interest rates and yoy growth in loans and other interest earning assets across segments and geographies. You would also note from the chart at the top right that Average earning assets grew by 8.3% from March 2022, to reach KD34.7bn.

As can be seen from the chart at the bottom left, average NIM for 1Q23 at 2.48% reflects an improvement of 34bps over 1Q22 driven by a higher yield, despite increased funding cost.

The Group's yield for the current quarter was 5.31%, compared to 2.95% in 1Q22. At the same time, the Group's funding cost increased to 3.16% during the current quarter compared to 0.92% a year ago. The higher funding cost primarily results from the repricing of deposits at increased market rates and longer tenor deposits sourced by the Group. At the same time, the overall stable base of low cost deposits continues to benefit the Group.

At the bottom right of this slide, we can see drivers behind the 34bps increase in NIM from 2.14% in 1Q22 to 2.48%. Loans and other assets backed by a strong year on year growth in interest rates and volumes, contributed a net increase of 123bps and 112bps to the NIM respectively. Higher funding cost negatively affected the NIM by 201bps.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD66.1m for 1Q23 was similar to that of the first quarter of 2022. Fees and commissions income contributed KD51.4m, foreign exchange activities KD8m, while other non-interest income sources (mainly investment income) contributed KD6.7m.

Fees and commissions income reported a strong growth of KD8.2m, 18.9% on 1Q22 reflecting strong contributions across business lines and geographies. Fx income for the quarter was KD2.1m lower than 1Q22, mainly due to the impact of unfavorable currency movements on our $AT1 bond issuances.

Other non-interest income decreased by KD5.9m compared to 1Q22. Included herein is the net investment income, which was adversely affected by lower market valuations.

Our fees and commissions have been solid and are from a well-diversified pool of geographies and lines of business. Also, major sources of non-interest income are core-banking activities in respect of business related factors as opposed to more volatile income from trading activities.

1Q23 non-interest income was 24.5% higher than 4Q22 mainly benefitting from a strong fee and fx income performance and relatively higher valuations gains.

Turning now to operating expenses reflected in the top right hand chart. Total operating expenses for 1Q23 at KD101.5m, although 12.6% higher that 1Q22 were 2.9% below 4Q22. A part of the cost growth reflects increased activity levels at Kuwait and across the Group’s network, in comparison to 1Q22. Other administrative expenses also included Group’s CSR donation of KD1m for the earthquake victims of Turkey and Syria.

The Group’s operating expenses reflect continued investments in key businesses initiatives, digital technologies and processes. This enables the Group to offer best in class service to its customers and optimize resources to improve operational efficiency.

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

As a result of the marked growth in operating income, the 1Q23 cost to income ratio was at 36.5% compared to 38.4% in 1Q22, and 38.2% for the full year 2022.

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

Total provisions and impairments for the current quarter amounted to KD28.1m, an increase of KD15.6m on 1Q22. You would recollect that 1Q22 and the fuller year of 2022 was characterized by significant specific provision recoveries. KD28.8m of the 1Q23 charge was for provisions for credit facilities, with a small release towards ECL on other financial assets. Specific provision was KD2m, whereas KD26.8m was towards general provisions including a significant component of precautionary general provisions. The Group remains committed to its conservative approach in managing credit exposures.

The cost of risk for 1Q23 was at 53bps compared to 24bps for 1Q22 which benefited from provision recoveries as explained earlier.

It is worth noting that the Group’s Balance Sheet remains strong with a stable credit quality. NBK’s capital base along with the ability to generate healthy operating profits provides a strong credit loss-absorption capacity.

Moving now to the next slide.

On this slide, I would like to expand on the matter of earnings diversification through the International and Islamic banking arms of the Group.

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

As you can see from the charts on the left hand side, operating income from the Group's international operations reflected a strong year on year growth of 28.7% in 1Q23. Net profit at KD43m has increased by KD22.8m benefiting largely from a strong operating performance and lower credit provisions and ECL. International operations continue to contribute a healthy 26% and 32% to the Group's operating income and net profit respectively.

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD20.6m, up 21.6% on 1Q22 due to a stronger operating income and business volume growth.

Finally, on the chart at the bottom right corner, you will note that International operations and Boubyan Bank contributed 41% and 22% respectively to Group's total assets enforcing the diversification agenda of the Group.

Moving to the next slide.

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

As profiled on the chart at top left, the Group total assets reached KD36.5bn at March 2023, an 8.2% increase on March 2022.

Group loans and advances at KD21.2bn, registered a strong yoy growth of KD1.1bn i.e. 5.7% and c.1% during this first quarter. EGP devaluation against the US$ has adversely affected the KD value of loan growth since 1Q22. Loan growth was achieved at Kuwait – in both conventional and Islamic sectors and at International operations.

Customer Deposits i.e. non-bank and non-FI deposits at KD20.4bn, reflect a strong yoy growth of 11.6% and 1.3% during the current quarter. Non-bank FI remained at December 2022 level of KD3.7bn and registered a growth 5.1% since March 2022. 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. However, the overall funding mix remains stable and favorable to the Group.

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

Customer deposits comprise a healthy 66% of total funding mix of the Group.

I want to highlight that the Group continues to maintain healthy liquidity levels & comfortably exceeds minimum requirements of Basel III ratios.

Moving now to the next slide.

Here we will look at the impact 1Q23 financial results had on certain key performance metrics.

The Return on Average Equity for the current quarter improved to 15.0% from 13.4% in the comparable quarter of 2022. Similarly, Return on Average Assets now stands at 1.50% compared to 1.41% for 1Q22.

At 17.1%, total Capital Adequacy Ratio remained strong and stable, marginally below 17.4% in December 2022. CET1 and Tier1 ratios were 12.6% and 14.8% respectively. Kindly note that interim profits are not factored in the computation of 1Q23 Capital Adequacy Ratio.

As regards asset quality, you would note that the NPL ratio was at 1.55% compared to 1.12% as at March 2022 and 1.42% as at December 2022. The loan loss coverage ratio stands at 245% reflecting the conservative provisioning policy of the Group.

Moving to the next slide.

I would now like to discuss Expected Credit Losses (ECL) on credit facilities as per 'IFRS 9 calculated in accordance with CBK Guidelines'. As per the regime adopted by CBK, Banks calculate the credit provisions required (i.e. the amount in the balance sheet) as per CBK instructions and compare it with the ECL on credit facilities as per 'IFRS 9 in accordance with CBK guidelines'. Consequently, the charge to income statement is based on the higher of the two balance-sheet amounts.

It is important to note here that CBK guidelines for calculating ECL on credit facilities as per IFRS 9 are on a more conservative basis compared to the original accounting standard.

The key chart on this slide at the bottom right reflects that ECL requirement as at March 2023 was KD580m, similar to December 2022 level. Changes to certain macro-economic factors, which form inputs to the ECL model have resulted in an increase in the required amount compared to 1Q22.

Although IFRS 9 ECL and CBK provisions are two different regimes and should not be compared as such, as at March 2023, the balance sheet provision as per CBK instructions exceeds the ECL by KD295m. 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 1Q23.

As mentioned earlier, benefit of increased benchmark interest rates, a strong operating performance combined with a healthy balance sheet, comfortable liquidity levels and a strong capital base were features of NBK's 1Q23 results.

Looking forward, ongoing politics both locally and internationally and an increased risk of a recession could possibly result in a macroeconomic environment that is less conducive to growth, than before. We however remain cautiously optimistic that the overall operating environment will be more or less stable during coming quarters.

Now turning to the guidance for remainder of 2023.

As regards loan growth, the Group reported a loan growth of c.1% during 1Q23. Given the current local political and the general macroeconomic situation, we are expecting the overall loan growth for 2023 to be in mid-single digit range. Any improvement in the overall operating environment will be a positive to loan growth.

Now turning to the NIM. As mentioned earlier, quarterly NIM has improved to 2.48% benefiting from increases in interest rates and stronger volumes compared to the last year. The general expectation is that benchmark interest rates will probably increase once, before beginning to plateau in the next few months. That said the timing and extent of changes in local interest rates remains uncertain. We should also expect increasing competition and a higher funding cost, despite the Group's healthy overall funding mix. In light of these considerations, we expect 2023 NIM to remain broadly stable, somewhat similar to 1Q23.

The 1Q23 cost to income ratio was 36.5%, compared to 38.2% for the full year 2022. In continuation of our investment program in support of various Group initiatives, we expect the cost to income for 2023 to remain closer to 40%.

Given the current macroeconomic uncertainties, it would not be prudent to give a specific guidance on cost of risk and consequently on earnings / capital adequacy. The cost of risk in 1Q23 was 53bps given significant precautionary general provisions. We are not expecting significant credit recoveries like in 2022 to repeat in the current year. We are cautiously optimistic of a favourable full year cost of risk in 2023, similar to or slightly lower than 1Q23 levels. We are also hopeful of maintaining capital adequacy ratios in line with our internal targets above the regulatory minimum.

That ends my presentation. Thank you very much for your time.

Back to Amir.

Amir Hanna: Thank you Sujit.

Thank you Mr. Isam.

Thank you every one for listening.

We will pause for sometime to group the questions. If you have any question, kindly type it in the Q&A section in the platform. We will get back to start answering questions as they come in.

The first question is on NIMs, could you throw some color on NIM drivers in Q1 2023 mainly the small sequential extension and how do you see it trending in the coming quarters.

Sujit Ronghe: Although 1Q 2023 NIM benefited from higher yields due to repricing of loans and assets, the growth was limited due to competition and a relatively higher funding cost both in Kuwait and at overseas locations. The funding cost growth was mainly due to longer tenure deposits booked at cheaper rates last year, renewing at higher rates and sourcing of additional longer-term deposits at current market rates.

Amir Hanna: A couple of questions on politics and its impact on the business, so given the recent political events how do you see loan growth for the year versus 2022.

Isam Al-Sager: If you look closely to the political scene in Kuwait in the recent months the political scene has become more volatile. Of course this isn't a supportive environment for any economic or legislative reforms or for the long awaited for capital spending program.

Generally, from business perspective, this means a delay in Kuwait's economic diversification efforts especially considering today's high oil prices and the expected budget surplus. There is still some pressure.

The impact on loan growth, I think we are looking for a mid single growth during that period.

Sujit Ronghe: Carrying on from what Mr. Isam said, because of the local political situation and the global economic environment, we are revising our guidance for 2023 loan growth, from a mid-high single digit to a mid-single digit.

Amir Hanna: Could you please elaborate more on the impact AT1 Issuances, what is your target on capital buffers and how do you plan to boost that from some dip that we saw in the quarter. How is the decision of a call on AT1 approached by management?

Sujit Ronghe: The Bank's AT1 issuances are denominated in dollars. The fx conversion of the asset side of these issuances impacts our P&L, based on the KWD/USD rate. A stronger dollar is a positive to our income and a weaker dollar means a negative, which is what happened during the current year compared to the last year.

With respect to the capital buffers, we have mentioned earlier that we target a buffer of 1.5% on the CAR and with some flexibility at CET1 or Tier 1 levels, especially during the quarters when the interim profits are not included in

CAPAD ratio computations. Hence, this buffer should be considered at a more year-end level.

On the decision to call on AT1, we have been in the market for a few years now and the Bank's management always takes investor friendly decisions when the time to call or have a fresh issuance comes, as was evidenced by our last issuance. However, when the time comes, the Bank will definitely consider all factors and take a decision, which is right for both investors and the Bank.

Amir Hanna: A question on loan stages. What was the reason behind significant decrease in stage 2 loans in 1Q2023 compared to fourth quarter of last year?

Sujit Ronghe: There were few reasons for the drop in stage 2 loans compared to Dec 2022, but the prime ones are benefit of improved credit ratings for some obligors and cancellation of certain limits during the current quarter.

Amir Hanna: Back to NIMs and cost of funds, could you please explain the reasons behind funding cost pressures? How much CASA mix do you have? On a different topic, how should we think of cost of risk in future quarters?

Sujit Ronghe: With respect to funding cost pressures and CASA deposits, the Bank continues to have very healthy and well-diversified funding profile. CASA deposits are around the 40% mark of non-bank deposits, which is not materially different from the last quarter. This benefits the bank in managing funding cost to a large extent.

However, we have seen increases in rates locally, regionally and internationally. Longer-term deposits which were booked in the early quarters of last year came for renewal and repricing this quarter. This has impacted the cost of funds during the current quarter.

We expect the cost of funds and NIMs to remain broadly stable during the coming period, given interest rate hikes are expected to be smaller than before before, with a plateauing of rates in the next few quarters.

Speaking of cost of risk, in 1Q23 we recorded 53 bps compared to 34 bps in 1Q22. As mentioned earlier, we do not expect significant loan recoveries similar to that of 2022 during this year. The 1Q23 credit provisions are mostly precautionary in nature. Hence, while being cognizant of the global uncertainties that lies ahead, we are expecting our baseline cost of risk to be materially lower than the 60s levels witnessed in 2021. We could look at cost of risk around the same level or somewhat lower for the coming few quarters. That said, the Group's loan book is well diversified and continues to exhibit a sound credit quality.

Amir Hanna: A couple of questions on retail vs. corporate trends in credit growth; currently and within the guidance.

Sujit Ronghe: With respect to retail credit growth, we saw a very significant increase last year and now it appears that the credit appetite of retail customers is slowing down. It could be attributed to increased interest rate levels. This is one of the factors why we are revising our guidance to a mid-single digit.

The corporate credit growth is also rather muted, given the political scenario evolving in Kuwait and the resulting uncertainty with respect to projects. The trickle down impact and translation in to corporate credit depends on the implementation timeline of such project awards.

Amir Hanna: There is a question on the investment book. Can you talk about the investment securities portfolio as of Q1 HTM vs AFS as a percent of total assets?

Sujit Ronghe: The Group's investment securities are about KD 6.0 billion and the significant majority of that comprises FVOCI and FVPL, which means they are carried at fair value through the P&L or through other comprehensive income. The remaining book, roughly KD 900 million, is at amortized cost. These are mainly government securities whose carrying value is not materially different from their fair value.

Amir Hanna: What are the main drivers of operating expenses going forward based on your guidance and the implied guidance figures?

Sujit Ronghe: We are looking at an increase of roughly 10-11% in operating expenses for the FY2023. These expenses stem from our spend on resourcing, our initiatives with respect to digitalization and new products, as well our focus area like Boubyan Bank, Global Wealth Management etc.

Amir Hanna: Back to politics and growth, would you see a more stable political scene in Kuwait is a prerequisite to a more meaningful corporate lending growth going forward.

Isam Al Sager: Yes, definitely I see a more stable political scene needed for more growth. If you look at the political scene in Kuwait the more the stability the higher the growth. That said with all the circumstances that are still happening awarded projects for 1Q have increased by 332% year on year 78.3% quarter on quarter to reach KD 527 million awarded already.

It is still so early as we are only three months into the year but for us we are well diversified so we grow across all markets but with a concern on domestic growth.

Amir Hanna: Can you please confirm the status of the recovery of KD 142 million receivable from the government with regards to modification loss booked on loan deferral.

Isam Al-Sager: Well that is confirmed. After postponing these loans during COVID, now the government has paid the receivables in full to all banks including NBK.

Amir Hanna: These were all the questions we received. Thank you again for joining us today and for listening to the presentation and the questions.

If there are any follow up questions or any inquiries drop us an email on investor relations email address and we will respond to you.

Thank you so much and now back to Elena.

Elena Sanchez: Thanks to NBK's management for the presentation today and thank you everyone for joining the call. Have a great day.