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Earnings Conference Call

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2Q/1H 2022 National Bank of Kuwait Earnings Call

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Edited transcript of National Bank of Kuwait earnings conference call that took place on Tuesday, 26 July 2022 at 15:00 Kuwait time.

Corporate participants:

Ms. Shaikha Al-Bahar – Deputy Group CEO, NBK

Mr. Sujit Ronghe – Group CFO, NBK

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

Chairperson:

Elena Sanchez – EFG Hermes

Elena Sanchez: Good afternoon everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to the National Bank of Kuwait second quarter and first half 2022 earnings call. It is a pleasure to have with us in the call today Ms. Shaikha Al-Bahar, NBK Deputy Group CEO, Mr. Sujit Ronghe, NBK Group CFO and Mr. Amir Hanna, Head of Investor Relations and Corporate Communications at NBK.

At this time, I would like to handover the call now to Mr. Amir Hanna.

Please go ahead Amir.

Amir Hanna: Thank you Elena.

Good afternoon everyone. We are glad you joined us today for our second quarter and first half 2022 earnings webcast.

As our usual practice before we start, I would like to bring to your attention that certain comments in this presentation may constitute forward-looking statements. These comments reflect the Bank's expectations and are subject to risks and uncertainties that may cause actual results to differ materially and may adversely affect the outcome and financial effects of the plans described herein. The Bank does not assume any obligation to update its view of such risks and uncertainties or to publicly announce the result of any revisions to the forward-looking statements made herein. Also I would like to refer you to the full disclaimer in our presentation for today's call.

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

Now let me handover the call to Ms. Shaikha Al-Bahar for her opening remarks.

Shaikha Al-Bahar: Thank you Amir.

Good afternoon everyone. Thank you for joining us today for our second quarter and half-year 2022 earnings webcast.

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

During the first half of 2022 and more specifically throughout the second quarter of the year, worries about the global economic outlook have been increasing with the

continued fallout from geopolitics, soaring energy prices, high inflation, especially in advanced economies, faster policy tightening by key central banks and prolonged global supply chain disruptions. This has led the World Bank to revise down its global growth forecasts from 4.1% in January to 2.9% in June.

In contrast to that, the situation in the GCC has been relatively better on improved fiscal balances from oil price strength; with the region's forecasted GDP growth accelerating to a decade high of 6.4%.

In Kuwait, GDP is estimated to grow by 8.5% in fiscal year 2022/2023 as economic growth continues to gain traction amid a post-pandemic rebound of private consumption and accelerating corporate activity. Oil GDP growth is expected to reach 12.8% for the year, while non-oil GDP growth is expected to reach 3.7%. The government is projected to post its first fiscal surplus in 8 years, at 8.8% of GDP before FGF transfers, on the back of significantly higher oil revenues and controlled spending growth.

The improving fiscal standing and the easing liquidity constraints have already reflected on the domestic operating environment, which was evidenced by S&P's recent change of outlook on Kuwait's sovereign ratings to stable from negative. These strong signs of economic recovery and strengthening fiscal position increases our confidence that the government will continue with its commitment to spend on infrastructure projects with a bigger role assigned to private sector participation.

On system credit growth, the normalization of economic activities post-pandemic has accelerated business lending at a growth rate of 6.4% year on year, as of May 2022. While household credit remained strong recording 13.6% growth during the same period.

Building on the improved macroeconomic backdrop, NBK delivered solid performance during the six months ended June 2022, with net profits of KD 237.8 million, growing by 47.9% year on year. This outstanding bottom line growth was mainly driven by higher core banking income and a healthy improvement in cost of risk. As for the three months ended-June 2022; NBK posted year-on-year growth of 58.6% in net profits to reach KD 121.2 million, the highest quarterly profits on record for the bank. Moreover, NBK's Board of Directors has approved the first semi-annual dividend distribution of 10 fils per share. This affirms the bank's solid capital position and its ability to consistently generate profits.

Beyond the quarterly results, we remained on course with our strategic priorities. In Kuwait, we expect the improved economic outlook to generate more opportunities and specifically strengthen the demand for business credit, while we gradually see a revival of project tendering and award activity. Outside Kuwait, our business diversification continues to serve us well as we continue to cross-sell our products in various markets, benefitting from the region's economic recovery and NBK's wide

spectrum of product and service offerings. We will continue to grow our international operations with more focus on key growth markets, most importantly GCC and Egypt as we target further diversification of our balance sheet and income streams and grow the contribution of international operations to the Group's bottom line.

On the Digital banking front, we continued to invest in positioning NBK for the future of banking, streamlining our operations across markets and segments and building a next generation digital banking experience. We have made great efforts in uplifting various channels with regular enhancements to the digital journey for our customers, the number of services we provide digitally, most importantly through mobile banking application, while utilizing data analytics, robotics and machine learning to improve our operational efficiency and offer personalized experience to meet the evolving banking needs of our clients. Our digital transformation efforts are group wide as we have been upgrading the digital experience of our customers across various business segments and in all our key strategic markets.

On another front, our recently launched digital bank, Weyay, has been actively acquiring new customers at a rate outpacing all planned targets and validating the market gap and the changing customer behavior.

Our efforts in the ESG space are topping the agenda of the Group. We will continue improving our ESG-related operational practices, integrating ESG into our business decision-making processes and growing our pledge to global sustainability reporting. During the period, we continued to deliver on our six pillars of sustainability and working our way towards achieving our predetermined sustainability targets.

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

Please go ahead Sujit.

Sujit Ronghe: Thank you Ms. Shaikha

Hello everyone, and welcome.

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

We have announced a net profit of KD237.8m for 1H22. This is a 47.9% increase in bottom line profit over the comparable period of 2021. At KD121.2m, the Group recorded its highest quarterly profit, with an increase of 58.6% over 2Q21. Also, NBK's Board of Directors has approved, for the first time, an interim cash dividend of 10 fils per share. These results reflect a solid performance by the Group and demonstrate 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 six months period.

The trend of overall recovery that started during the second half of 2021 has continued in the first half of 2022. Increased oil prices, fuller operation of airports and travel opportunities, improved business activity and significantly increased vaccine penetration has benefited the overall operating environment in Kuwait. Recent increases in benchmark interest rates and more expected in coming months would benefit the Bank in general. That said, an element of uncertainty still exists with respect to the ongoing global geo-politics and inflationary conditions. We remain optimistic of continued improvement in overall operating environment in the second half of the year.

Now turning to the financial results for 1H22.

As profiled at the top left of this slide, the KD77.1m i.e. 47.9% year on year increase in net profit reflects a strong bottom-line performance by the Group, driven by continued growth in business volumes, increased operating income and lower net credit provisions and impairment losses. 2Q22 net profit at KD121.2m reflected a growth of 4% over the previous quarter benefitting from lower provisions and impairments and a stronger operating performance.

The top right chart reflects 1H22 operating surplus i.e. pre-provision and pre-tax profit at KD291.8m, a growth of KD9.4m over the first six months of 2021. Net operating income increased by KD27.6m i.e. 6.1%, whilst costs grew by KD18.3m over 1H21.

Similarly, 2Q22 operating surplus exceeded that of the previous quarter by 1.9% on the back of a stronger net interest income and fee income despite the adverse impact of market valuations on net investment income.

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 27% 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 KD348.3m for 1H22, a growth of 4.4% over 1H21 largely driven by higher volumes of 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 9.4% yoy.

As can be seen from the chart at the bottom left, average NIM for 1H22 at 2.18% is 10bps lower than that of 1H21 mainly due to the growth in funding cost outpacing

the growth in yield. However, 2Q22 NIM at 2.22% is 8bps higher than the previous quarter benefiting from recent interest rate hikes.

The Group's average yield for 1H22 was 3.14%, compared to 3.00% in 1H21. The Group's funding cost averaged 1.08% during the current period compared to 0.82% in 1H21. 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, a strong and stable base of low cost deposits continues to benefit the Group.

The Group's yield for the current quarter was 3.32% and funding cost at 1.23%.

At the bottom right of this slide, we can see drivers behind the 10bps decline in NIM from 2.28% in 1H21 to 2.18%. Loans, backed by a strong year on year growth, contributed a net increase of 12bps to the NIM. Higher funding cost however, negatively affected the NIM by 23bps.

Moving on now to the next slide.

As we can see at the top left of this slide, total non-interest income at KD131.9m for 1H22 reflected a strong growth of KD13.0m i.e. 10.9% over the first half of 2021. Fees and commissions income contributed KD90.2m, foreign exchange activities KD30.2m, while other non-interest income sources (mainly investment income) contributed KD11.5m.

Fees and commissions income was 10.8% higher than 1H21 reflecting strong contributions across different lines of business. Fx income for 1H22 was KD14.3m higher than previous year, benefitting from the impact of favourable currency movements on our $AT1 bond issuances and stronger transaction volumes.

Other non-interest income was lower than that of 1H21, mainly due a lower net investment income, affected by the recent drop in market valuations. 1H21 also included a one off gain on sale of assets, reflected as other operating income in the income statement.

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

2Q22 non-interest income at KD64.0m was 5.6% lower than 1Q22, affected by lower market valuations, despite higher fee and fx incomes.

Turning now to operating expenses reflected in the top right hand chart. Total operating expenses for 1H22 at KD188.4m were 10.7% higher than 1H21. A part of the cost growth reflects increased activity levels at Kuwait and across the Group's network in comparison to 1H21. The Group's operating expenses also reflect continued investments in key businesses, digital technologies, processes and the human capital necessary to deliver these initiatives. 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 the continued high levels of electronic transactions. We also press ahead with selective product offerings in certain geographies e.g. the Global Wealth Management business, expansion of Islamic banking operations through Boubyan Bank and our operations at NBK Egypt.

As a result, the 1H22 cost to income ratio was at 39.2% compared to 37.6% in 1H21, but remained below 39.6% for the year 2021.

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

Total provisions and impairments for the current six month period amounted to KD21.0m, a 78.4% decrease from KD97.2m in 1H21. KD8.5m was charged towards credit provisions, whereas ECL (non-credit) and other impairment losses were KD12.5m. Specific provision was a net release of KD124.9m, resulting from recoveries of amounts provided towards credit losses during prior years. At the same time, the Group has taken provisions in ordinary course of business for retail and corporate customers in Kuwait and overseas locations. The Group remains committed to its conservative approach in managing credit exposures and has hence set aside precautionary provisions, which are included in the General provision charge of KD133.4m.

The cost of risk for 1H22 was 8bps compared to 63bps for full year 2021. This lower cost of risk has resulted from significantly lower credit provisions, which benefited from loan recoveries as explained earlier.

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

Moving now to the next slide.

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

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

As you can see from the charts on the left hand side, operating income from the Group's international operations at KD117.8m, reflecting a yoy growth of 4.6%. Net profit at KD45.8m has increased by KD13.3m i.e. 40.8% benefiting largely from lower

credit provisions and ECL. International operations continue to contribute a healthy 25% and 19% to the Group's operating income and net profit respectively.

The Group's Islamic banking subsidiary Boubyan Bank delivered a net profit of KD33.1m, up 54.2% on 1H21 due to lower provisions and stronger operating results, which benefited from continued growth in business volumes.

Finally, on the chart at the bottom right corner, you will note that International operations and Boubyan Bank contributed 39% 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 KD34.3bn at June 2022, an 8.6% increase on June 2021 and 3.1% on December 2021.

Group loans and advances at KD20.1bn, reflected a yoy growth of 8.8% and 2.1% on Dec 2021. Loan growth was achieved in both- conventional and Islamic customer segments. Although the timing of booking has affected 2Q22 growth, the Group's loan pipeline remains strong cross customer segments and geographies.

Customer Deposits i.e. non-bank and non-FI deposits at KD18.9bn reflect a yoy growth of 8.7% and 3.5% from December 2021 levels. Non-bank FI deposits increased by 20.3% during the first half to reach KD3.8bn at a level similar to 1H21. The Group has continued to experience growth in its core franchise retail deposits- both conventional and Islamic. 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 65% of total funding mix of the Group.

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

Moving now to the next slide.

Here we will look at the impact 1H22 financial results had on certain key performance metrics.

The Return on Average Equity for 1H22 improved to 13.6% from 9.2% for the comparable period in 2021. Similarly, Return on Average Assets now stands at 1.42% compared to 1.05% for 1H21.

At 17.3% total Capital Adequacy Ratio remained strong and stable. CET1 and Tier1 ratios were 12.6% and 14.9% respectively. Kindly note that capital adequacy ratios are calculated after giving effect to the proposed interim cash dividend of KD75.5m. Also, 1H22 profit was included in the regulatory capital only to the extent of interim cash dividend amount, with the remainder not considered eligible for interim capital adequacy calculation.

As regards asset quality, you would note that the NPL ratio was at 1.24% compared to 2.45% as at June 2021 and 1.04% as at December 2021. The year on year drop in NPL ratio stems from the improvement in credit quality of certain exposures and write offs.

Resulting from lower NPLs and continued precautionary provisions, the loan loss coverage ratio has improved to 311% in June 2022.

Moving to the next slide

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

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

The key chart on this slide at the bottom right reflects that ECL requirement as at June 2022 increased to KD519m from KD462m at December 2021. Changes to certain macro-economic factors, which form inputs to the ECL model have resulted in an increase in the required amount compared to the previous year-end. The current amount of ECL required however remains significantly lower from 1H21 levels of KD631m.

Although IFRS 9 ECL and CBK provisions are different regimes and the two should not be compared, as at June 2022 the balance sheet provision as per CBK instructions exceeds the ECL by KD319m. 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 1H22.

Continued improvement in underlying operating drivers, strong asset growth, lower provisions and impairments, a healthy balance sheet, comfortable liquidity levels and a solid capital base were features of NBK's 1H22 results.

Now turning to the guidance for remainder of 2022.

We remain optimistic of continued improvement in the general operating environment notwithstanding global economic factors and ongoing geo-politics. Benchmark interest rates are set to increase further in coming quarters. Although, the Bank's net interest income has generally benefitted from rising interest rates, the extent to which increases in local interest rates would follow international benchmarks remains uncertain.

As regards loan growth, the Group reported a net loan growth of 2.1% during 1H22. Given the strong pipeline of loans, our expectation for full year growth remains at a high single digit.

With respect to the NIM- as mentioned above, quarterly NIM has reflected an increasing trend, benefiting from volume growth and increase in benchmark interest rates. At the same time, the headwinds of increased cost of funds and competition have affected the NIM growth. While international benchmark interest rates are set to increase further, the timing and extent of local interest rate hikes remains uncertain. In light of above considerations, we expect the full year 2022 NIM to be closer to that of 1H22.

The 1H22 cost to income ratio is currently at 39.2%. In continuation of our investment program in support of various Group initiatives, we expect the cost to income for 2022 to remain largely similar to 2021 i.e. near the 40% mark.

Given the lingering uncertainties of the global economics the ongoing geo-politics, it would not be prudent to give a specific guidance on cost of risk and consequently on earnings / capital adequacy. Cost of risk was 63bps in 2021. Credit recoveries in 1H22 resulted in a lower cost of risk at 8bps, which is not representative of what we expect for the fuller year. We are however optimistic of a favorable cost of risk in 2022 materially lower than 2021 levels. We are also hopeful of maintaining capital adequacy ratios in line with our internal targets above the regulatory minimum.

That ends my presentation.

Thank you very much for your time.

Back to Amir.

Amir Hanna: Thank you Sujit.

Thank you everyone for listening.

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

Hello everyone, we are back. We've got a few questions, so we will start with a question on the competition on the retail market and how the intense rivalry is. So the question is asking for some clarity on pricing mechanisms and how this will

evolve in the second half of the year and first half of next year till the mortgage law comes in.

Shaikha Al-Bahar: Well, basically let me start with the competition in consumer loans and where we are going with it.

As we started seeing the recovery of post pandemic growth, the competitive landscape in retail lending became more aggressive.

As banks started competing on acquiring market share we witnessed an increased focus on price competition which is relatively new to that space.

As the market leader and one of the largest players in the retail sector, we opted to defend our market share through offering zero interest loans in the market earlier this year.

In practice, this is a mixed rate loan that leads to lower effective rate on retail loans compared to previous market norms.

With our diversified and low cost funding base we can afford to aggressively defend our market share through lower pricing and we have been extremely successful in doing so in recent months.

This is not an ideal operating landscape as it puts some pressure on margins in the short term especially considering the current environment of increasing rates but we will continue to defend our market leadership with focus on customer acquisition.

Well talking about WEYAY and the digital banking, as you know our core markets have young population (Kuwait, GCC and the Arab world in general) so this required special attention to the youth. So we are well established across our markets and there is a lot of upside potential for us to drive from our presence in the region, so we thought the digital banking is the right attacker to this market and we successfully launched in December 2021 WEYAY and were and still are targeting the youth.

The achievement so far is way beyond the targets, it is very successful and we are offering products and soon it will be a comprehensive platform for our clients. This will be replicated of course and doubled in other markets. Digital banking is the future and we are investing heavily in technology and IT investments and so on.

Amir Hanna: A few questions on yields, NIMS and cost of funds, so we'll try to cover them all.

First question is asking about share of CASA and do we expect more gathering of long time deposits.

Sujit Ronghe: CASA deposits have been a significant component of our funding for quite a while now. The typical share of CASA deposits to the non-bank funding is in the range of mid to high 40s. We have seen this in the past few quarters as well and we see the trend continuing. Also, despite the fact that we increased our long term deposits

from a funding perspective, the CASA deposits have also in turn grown, keeping the ratios around mid to high 40s.

Amir Hanna: On the same topic could you remind us of the repricing frequency of your assets and funding for rate hikes? How much of your loan/assets denominated in US dollar?

Sujit Ronghe: The repricing is different for consumer loans and corporate loans in Kuwait. The KD corporate loans reprice immediately on the change in CBK discount rate. However the interest rates on consumer loans are locked in for a period of 5 years and they reprice only at the fifth anniversary. For example, loans that were granted in 2017 would get repriced in 2022 and so on.

As regards the foreign currency loans, they are typically LIBOR based loans which would reprice, based on the repricing frequency of 3 months or 6 months depending on the loan contract.

Amir Hanna: Again on the same topic, to what extend rate hikes on the second quarter were built into second quarter numbers, is it fair to assume the second quarter NIMS is a new base on which the second half 2022 NIMS will build? Are there one offs in second quarter NIMS? Why half year dividends? What does this mean for full year?

Sujit Ronghe: We saw 3 rate hikes during the since March 2022 and if you recollect our conversation in Q1, we were not very sure to what extent CBK would follow the Fed rate hikes. As we can see in the central bank's discount rate increased only by 75 bps whereas the Fed rate increased by 150 bps. We do not see any clarity emerging on this and CBK would consider local conditions when taking rate hike decisions.

For the 2Q numbers, there were no one offs for the second quarter NIMs and we expect 2Q or more realistically the 1H NIMs to continue into the future. This is primarily because of the uncertainty I talked about with respect to the KD discount rate increases and with respect to the increases in cost of funding. Deposits booked during last year at lower rates would come for repricing or maturity during these 6 months. This would probably put a strain on our cost of funds and be a drag on the NIM from the growth context. That is why we are giving a guidance of NIM remaining broadly stable. Any pick up in KD interest rate hikes would potentially help the NIMs going forward.

Shaikha Al-Bahar: The Bank's dividend policy is determined, in view of capital requirements amongst other factors. The bank has always had a very stable dividend policy as we have always targeted a payout ratio in the range of 50 to 60%.

Our Capital ratios remain very strong in line with our internally set targets and buffers and this allows us to continue to maintain a healthy payout ratio despite the strong growth outlook for RWAs.

Our interim dividend distribution is not an indication of any changes to our divined policy and the year-end distribution will follow the same guidelines in the context of our specified dividend policy.

We have opted for interim distribution following the changes made in our articles of association and getting the regulatory approvals.

We are comfortable in the Group's capacity to continue to generate profits as well as our confidence in the bank's solid financial position.

Amir Hanna: What is the driver of mark to market investment losses, and based on market trends currently do we expect more losses in the second half?

Sujit Ronghe: The Bank does not have a very big portfolio of FVPL investments and what we see in the accounts is purely reflective of market conditions. The FVPL investments recorded very good growth last year, but during the current year the markets have shown a drop in valuations and the same is reflected in lower investment income. How things pan out in future would entirely depend on how markets behave going forward.

Amir Hanna: Can you remind us of the share of dollar in the funding and lending mix.

Sujit Ronghe: Broadly, the composition of the balance sheet on the asset side is 50/50 for assets in KD v/s those in foreign currency, with a big chunk of the foreign currency assets in US dollar. The same thing would go for our liabilities, just above 50% come from non-KD currencies. In terms of loans, it is more of 60/40 ratio, with 40% of loans in foreign currency based.

The dollar-based assets would reprice on repricing date after the rate hikes. Similarly, for liabilities, deposits also would reprice on maturity or when we accept new deposits, they would be at new rates.

Amir Hanna: Cost of risk, do you find the current normalization in credit costs sustainable as Q2 looks very low. What would you consider as normalized cost of risk for NBK?

Sujit Ronghe: As I mentioned during my presentation, second quarter or first half-year cost of risk is in no way an indicator of what could happen in the future, because it was a fallout of recoveries made during the period. Last year we saw the cost of risk about 63 bps and it was trending lower. We expect this year to benefit from the recoveries we saw in the first six months and I would say the cost of risk would be materially lower than what we saw last year.

Amir Hanna: Give the expected higher inflation reported in Kuwait versus the other GCC countries, how will this impact expenses, like talent costs especially with NBK's big digital spending plans, and what is the outlook for cost to income ratio?

Sujit Ronghe: The inflation in Kuwait is slightly higher than what we are seeing in the rest of the GCC countries. However, we make specific efforts to achieve operational efficiencies when it comes to cost management. As far the digital investments go, part is CAPEX, which would be capitalized and depreciated as and when the product goes live, while the OPEX amount is being tightly managed. With respect to cost to income

ratio, we are targeting a cost to income ration of lower than 40% in line with what we saw last year.

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

A question on loan growth. Why is Q2 loan growth lower and to what extent is this FX devaluation driven in EGP?

Shaikha Al-Bahar: This is mostly a timing issue as we saw our loan growth very strong during the first quarter as a result of closing some deals ahead of Q2.

Similarly, some of the transactions we were expecting to book in Q2 have now moved to later quarters of the year.

So overall and if we normalize the lending activity over the four quarters we still expect growth in the high single digit region for the full year and that's is evident when we look at the year on year loan growth which reached 8.8% as of June-end 2022.

We have good visibility on our transactions pipeline for the third and fourth quarter and it is looking very healthy.

We also foresee activity picking up across various sectors of the economy and in different markets both domestically and internationally as well as in Islamic finance.

Regarding the EGP, the amount is immaterial; 5% of the total. Moreover, the devaluation effect was taken care of since last quarter.

Amir Hanna: A couple of questions on cost of risk and cost of risk normalization. Buffers strong on local vs IFRS provisioning, but general provisions have been increasing notably. What is driving it and where do you see cost of risk normalizing.

Also a question on cost of risk guidance and where do you see cost of risk from where we are today?

Sujit Ronghe: First, speaking of IFRS9 provisioning- As explained earlier, credit provisions are calculated as per CBK instructions and compared with the ECL as per IFRS9. As long as the CBK provisioning levels are higher than ECL as per IFRS9, the latter becomes secondary. A healthy buffer helps the Bank to not only comply with CBK provisions, but also for any ECL challenges going forward.

As regards the tightened credit provisioning, judgmental or precautionary general provisions has been a feature of our provisioning regime since the global financial crisis 10-12 years ago, so there is nothing new about it. Even previously, NBK used to have significant amount of judgmental general provisions. Our provision coverage ratio even in earlier years was higher than 300%. This is not recent occurrence and we have seen this pattern in earlier years, which is in line with the Bank's conservative credit provisioning policy.

Amir Hanna: A question on projects. Any update on project awards? What is driving the pickup in corporate loans this year?

Shaikha Al-Bahar: The improved health situation and the ease of restrictions post pandemic have lifted project activity in 2021 where project awards reached KD 1.5 bn.

With the recent hike in oil prices and the expected surpluses, we expect the government to continue with its commitment to spend on infrastructure and accelerate project tendering and awards to compensate for the slower execution during the past 2 years and the impact of the pandemic.

Most planned projects are of significant importance to close the infrastructure gap; and we expect a bigger role for the private sector in Kuwait's infrastructure development plan going forward.

Recent discussion and engagements with various government agencies along with the discussed tenders affirms the government's intensions to give a bigger role to the private sector in future development projects.

This of course creates opportunities for banks to lend across different models of financing; being a PPP or a BOT project. For that, we are optimistic about the projects pipeline and its outcomes.

Amir Hanna: Couple of questions on capital, Why did capital drop in the second quarter and what's the outlook for the rest of the year. Also what is the minimum buffer that you would like to keep above regulatory requirements?

Sujit Ronghe: The drop in capital adequacy is a function of two things; the increase in risk weighted assets because of the business booked during the current year and the fact that interim profits were not fully included in the six months regulatory capital amount. Interim profits, only up to the amount of the dividend declared, i.e. KD75.5 million were allowed to be considered as an addition to the regulatory capital. The ratio was impacted because of we had an increase in risk weighted assets that was not supported by any addition to capital increase. This is a regular feature and we see capital adequacy ratio dropping through the first three quarters and when the full year profit gets added to the regulatory capital, the ratio returns to its normal level.

On the other question regarding the buffers, typically we have said we target a buffer of 1.5% to 2.0% above the minimum regulatory requirement and that remains the same.

Amir Hanna: Are you able to pass through fully Fed rate hikes into the repricing of your dollar lending, the 40% proportion?

Sujit Ronghe: As of now, we are not seeing any challenges in passing through the interest rate hikes into our dollar lending but as the rate hikes become more aggressive, that is something that we would need to watch out for.

Amir Hanna: Considering the time constraints, we will conclude the call for today. We have answered all questions and they are repeated questions. If you have any follow up or more questions please send them to our Investor Relations email address and we will be respond to you as soon as we can. Thank you very much for today's call, thank you Elena and back to you.

Shaikha Al-Bahar: Thank you.

Sujit Ronghe: Thank you very much.

Elena Sanchez: Thank you very much for the answers provided and the presentation.

Thank you everyone for joining the call.