1Q 2018 National Bank of Kuwait Earnings Call

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Corporate participants:

Mr. Isam Al Sagar – Group CEO

Mr. Jim Murphy – Group CFO

Mr. Amir Hanna – Head of Investor Relations

Zeina Nasreddin – Arqaam Capital

Zeina Nasreddin: Good afternoon everyone, and thank you for joining us today. This is Zeina Nasreddin, and on behalf of Arqaam Capital I'm pleased to welcome you to the National Bank of Kuwait's first quarter 2018 earnings conference call. I have with me here today Issam Al Sager, Group Chief Executive Officer, Jim Murphy, Group Chief Financial Officer, and Amir Hana, Head of Investor Relations. Without any further delay, I will now turn the call over to Amir.

Amir Hana: Thank you Zeina for the introduction. Good afternoon everyone.

First I would like to thank you all for being on the call today. Before we start, I would like to read out a brief disclaimer.

Certain statements in this presentation may constitute forward looking statements. These statements reflect the banks expectations and are subject to risks and uncertainty that may cause actual results to differ materially and may adversely affect the outcome and financial effects of the plans described herein.

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In addition to this disclaimer I just read, I would also urge you all to refer to our full disclaimer on page two of the presentation, which is being displayed in front of you right now. I also want to add that following the opening comments on the presentation by our management team, we will be receiving all your questions through the webcast platform. We will make every effort to answer as many questions as possible, but in case any questions were left unanswered due to time limitations, or if any of you would have a follow up question, please feel free to contact us through NBK investor relations email address, which you can find on our website. We would be responding to all your questions in a timely manner.

Finally, you can download this presentation through the link on your screen or the full investor relation presentation from the NBK IR website.

With that, I would like to hand the call over to Mr. Issam Al Sager, our group CEO, to take you through a brief update on Kuwait and NBK.

Issam Al Sager: Good morning and good afternoon everyone. First, I would like to welcome you all to our quarterly earnings call and webcast, and hope that the details we will be discussing today would be useful and informative to you.

I would like to start with a brief review of the operational environment in Kuwait during the first quarter of the year, and give you a summary of our performance and the outlook of our operation.

I will then handed the call over to our group CFO, Mr. Jim Murphy, who will run you through our quarterly numbers in more detail. But to start, I would like to highlight that we had a very strong quarter with net profits reaching KD, Kuwaiti dinar, 93.6 million and growing at 9.6% compared to the first quarter of 2017.

This growth was driven by strong business activity, which was recollected in a healthy 5.6% year to year growth in our loan book.

All our other profitability indicators continued to be very strong during the quarter, and the outlook for the rest of the year remains positive.

That all said, let me then give you a quick update on Kuwait.

During the quarter, we continued to see a strong operational environment in Kuwait as a continuation of the positive cycle that started back in 2013. Economic indicators remain positive, supported by healthy execution of the government's infrastructure development plan. We witnessed strong non-oil GDP growth rates reached around 3.3% in 2017, which we believe is a trend that will continue to improve in 2018 and 2019.

Capital spending remained a key driver of economic activity and the recovery, and oil prices continued to have a positive impact on the country's physical position and the private sector's sentiment.

As you can see in the upper right corner chart, Kuwait continues to hold a very strong balance sheet as demonstrated by the level of sovereign assets. This is very positive for the country's financial capability to continue spending on the development of its infrastructure. Although we have seen some slow down in the projects award activity in the second half of 2017, but year to date the pace returned, and we have a strong pipeline going forward.

This all will continue to support economic growth and diversification and create demand for private credit.

Moving on the discussion to NBK, as the largest banking group in Kuwait, we continue to benefit from our dominant market position as well as our unique access to both conventional and Islamic banking markets. Thanks to our large balance sheet, strong financial performance, high credit rating, and our regional and international presence, we continue to play a key role in the government's infrastructure development plan, financing some of the key projects in the country.

Our operation in Kuwait benefited from the strong economic backdrop as we continued to see strong credit growth trends driven almost equally by all our business segments.

We still benefit from the rebound in consumer sentiment, which was reflected in strong consumer confidence index and robust point of sale spending data. In addition to defending and growing our market share in Kuwait, our strategy as most of you would know, puts a special emphasis on diversification, and we do pride ourselves of having a very diversified offering, not only by products but also by geography.

Outside Kuwait, our international operation delivered very strong results during the first quarter of 2018, Contributing 27% of the groups profits. We operate in 15 countries on four continents and have a well-diversified balance sheet and several income streams.

Our operation in MENA region are still our growth focus with special emphasis on Egypt and the GCC. In Egypt, we continue to see very strong outlook as the economic and political backdrop improves. We have delivered very promising results in Egypt in 2017, and we expect our operation there to continue to grow, increasing its overall contribution to the group. In the GCC, 2018 will see our growth in Saudi, in the Saudi market, as we plan to open two new branches. One in Riyadh, and one in the eastern province, to bring our total branches in Saudi Arabia to three branches.

We are also expanding the wealth management as we've received Saudi CMA approval to operate a wealth management entity in the Kingdom supported by investment banking and private banking capabilities within the group.

A further step forward, our diversification in our Islamic banking subsidiary, Boubyan Bank. Boubyan Bank is another area of strength and uniqueness for NBK as it allows us to strengthen our market position in Kuwait. Being the only bank in Kuwait with access to both conventional and Islamic banking markets, Boubyan continues to deliver strong growth and we have seen it growing its profits 18% during the first quarter of 2018, and the outlook for its operation remains very positive with improved contribution to Group's earnings.

With that, I conclude my briefing, and I would like to hand the call over to Mr. Jim to take you through our quarterly results and answer any questions you may have.

Jim?

Jim Murphy: Thank you Issam. Good afternoon everyone. Or good morning, as the case may be.

I'm very pleased to have this opportunity to run you through our numbers for the quarter. We are very pleased with the outcome. It's a very strong set of numbers, and I think it's important to mention that the context for the quarter was a very solid run-in through the year of 2017. The preceding year was an excellent year for the group, and we're very happy to see the momentum that picked up last year continue into Q1.

Just as a point of order, I will refer to numbers as they appear in the presentation. So for instance, when I talk about profits for the quarter, I will refer to 94 million as opposed to 93.59 million, so just to be clear on that.

So to talk about the 94 million profit for the quarter, which is 10% ahead of the comparable quarter last year. The backdrop of the 10% increase is very supportive operating environments in all of the markets in which we are active. There are challenges of course, and competition is very robust. We face strong competition locally and overseas, but have performed very well regardless.

Our own performance is supported by the rise in interest rates, both local and international. This is very supportive to a bank with our configuration of balance sheet.

Another feature of our performance is, as Issam has referred to, the very solid performance across all of our businesses and all of our geographies. I'm very pleased to say that our lines of business in Kuwait, without exception, have had a very solid quarter. Our geographies, ie our international operations have had an excellent quarter. Boubyan Bank, our Islamic subsidiary, also had an excellent quarter.

So if I move ... move up the income statement, if you like ... if I move from profit to operating surplus, we can see that operating surplus increased from 134 million last year to 149 million this year. That's an 11% increase. We witnessed a 9% increase in income, and a 5% increase in costs.

Moving up further into operating income, we can see that operating income rose from 195 million a year ago to 213 million this quarter, which is a 9% increase. Essentially fueling the growth in operating income is an excellent performance on the net interest income line, and I'll return to this in subsequent slides, and a very solid growth in fee income. Our fee income grew period on period by 10%.

And before going into the detail, I'll just draw your attention to the composition of our operating income. You can see on the bottom right hand side, that our net interest income comprised 77% of total income, with 23% attaching to non-interest income, which is more or less in line with the prior year.

Moving to the next, page 10, slide number 10, I'll talk a bit about the drivers behind our net interest income performance. You can see that net interest income grew by 10.9% year on year, that's 148 million rising to 164 million. This is a function, of course, of margins and volumes. If I talk about the margins first, you can see on the right hand side that our net interest margin increased by 8 basis points from 2.55% last year to 2.63% in the current year. We were able to harness the opportunities presented by rising interest rates and also by working on our mix of liabilities such that we saw our funding costs increase by 40 basis points to 1.5% for the group, and the yield, the commensurate yield increasing by 44 basis points to 3.97%. So net net, an 8 basis points increase to 2.63% in the opening quarter.

Business volumes is the other contributor of course, and we were very active and very successful in again working both sides of the balance sheet. We see that our net average interest earning assets in the period grew from 23.4 billion last year to 25.2 billion this year. That's a 7.5% increase year on year.

As Issam has mentioned, our loan book grew by 5.6%, to KD14.8 billion. I'll return to this in more detail later on. We also saw an increase in some of our treasury holdings, Kuwait treasury holdings, which also contributed to our operating performance during the period.

On the bottom right hand side we see a profile of how our non interest income comes together. KD48 million last year increased by 2% to KD50 million in the current quarter. The salient point to draw attention to in this part of our performance is, of course, fee income. Fee income increased by 10%, from KD34 million last year to KD37 million this year. We regard fee income as a very important barometer of how the bank is currently performing. It tells us how the various lines of business are doing today. Driving our fee increases were increases in our cards business, our trade finance business, and also our asset management business. So collectively, a 10% increase period on period I think is very good.

Another salient point to draw your attention to is largely the absence of investment income. NBK is very much a bank that relies on core banking activities for income. Our earning drivers come from the business. There is minimal investment income in our performances period on period.

Moving now to the next page, 11, chart number 11, I'll talk about the costs side of the equation.

Cost management is a very important matter on the management agenda at NBK. And those of you that track NBK, you will know that costs are very well contained on an ongoing basis. Evidence, for instance now we're looking at a 5% increase in costs year on year from KD62 million last year to KD65 million this year. I should mention that, whilst 5% demonstrates a very respectable management of our cost base, within this cost base we have two thriving subsidiaries, which Issam mentioned. We have growth operations in Boubyan Bank, our Islamic subsidiary, and we have growth operations in Egypt. Both of these entities are running ahead of the run rate, if you like, for the group.

So within this modest 5% increase, we are also supporting continued growth in our active subsidiaries.

I would also mention our capital expenditure program, which is not evidenced here. NBK invests very heavily in technology. We invested many years ago in regenerating the IT infrastructure of the group, and we also replaced many of our core banking platforms. We have sustained the level of investment in IT, but this time we're moving to the front end, the digital agenda if you like. Mobile and E banking etc. The efficiency to be had from our earlier investments in IT is carrying through to the cost line these days.

I would also mention, for the benefit of those of you that are tracking our performance quarter on quarter, so maybe to anticipate a question later on, you will have noticed most likely that we had a large drop in costs versus quarter 4 last year. The primary reason for that is we had some exceptional costs at the end of last year. As with all banks in Kuwait, there was change in labor law pertaining to what we refer to as the legal indemnity for certain employees. We therefore took a once off hit at the end of last year.

So to the cost to income ratio. Aggregating our income increase of 9% and cost increase of 5%, our cost to income ratio came down from 31.5% last year to 30.2% in the first quarter. I would also mention here that 30.2%, not only being a very good evidence of efficiency in our business, is the group ratio. Our operations in Kuwait run at a cost to income ratio materially below the 30.2%. The 30.2% reflects our geographies and our Islamic subsidiary Boubyan Bank.

Moving now to provisions, on the bottom left hand side. Provisions last year were at KD38 million ie. provisions and impairments. This increased to KD42 million this quarter. Now I know a lot of people were expecting IFRS9 to have a bearing on our results for the quarter. You will know by now that the Central Bank of Kuwait has partially adopted IFRS9, not fully adopted IFRS9. So what we're looking here is an amalgam of the IFRS9 ECL provisioning attaching to our investment book with the provisions in respect of our loan book arrived at under the mechanics of the earlier precautionary provisioning regime. The Central Bank therefore for the current quarter, is holding with the earlier regime for loan loss provisioning. At NBK we understand the approach taken by the Central Bank and we respect this position. I think this is a matter of prudence that will clarify in the quarters ahead.

As to the asset quality ratios resulting from the KD42 million provision charge, I will look at that further down the presentation.

Issam spoke about diversification. Diversification is very important to NBK. We constantly make the point, and I'll make the point again, that we are uniquely diversified as a Kuwait bank. We have substantial presence overseas, and derive 25% to 30% of earnings from our overseas operations. Plus we are increasingly driving the contribution to the group from Boubyan Bank.

Our anchor subsidiaries, if you want to look at it that way, our bank in Egypt, grew its profits by 77% last year, and our Boubyan Bank subsidiary increased its bottom line by 18% in the first quarter. I think this is very welcome evidence that our diversification continues to bear fruit.

Moving to the next page, if we just look at some volumes in the business, total assets grew from KD24.8 billion in March '17 to KD26.8 billion in March '18. That's a 7.8% increase period on period. Very importantly, within that we are looking at a KD0.8 billion increase in our loan book over a 12 month period. So from March '17, our lending book which stood at KD14 billion, closed March '18 at KD14.8 billion. This is a substantial increase in our book, and I'm very pleased to be able to say that the growth was evidenced in all of our operating locations. Kuwait saw healthy increases, notwithstanding well publicized settlements that happened in Kuwait during the year. Allowing for that, Kuwait had an excellent performance.

We had a very solid growth in our loan book at our international locations. And our subsidiary, Boubyan Bank, had a very impressive 13% increase in lending. So again, this is a matter of diversification. It's a matter of not relying on any one single driver for growth. It means that the sum of the parts generated a very respectable 5.6% increase period on period after settlements.

Looking on the other side of the balance sheet, customer deposits grew from KD13.2 billion Q1 last year to KD14.3 billion in Q1 this year. That's a KD1.1 billion increase year on year, an 8.6% growth.

We had well balanced growth across our operating areas. Kuwait, overseas, and Boubyan all experienced significant growth. If we look at the nature of the growth by another dimension, I'm very happy to highlight the level of growth that we had in retail deposits. Our core retail deposits increased significantly during the period. Partly due to continued emphasis on that side of the balance sheet, and also through product innovation, which has been active in recent quarters especially at the Kuwait side of the business.

Moving now to the funding mix, you will see that at the end of March 18, 61% of our funding mix is in respect of customer deposits,and 33% due to banks and other financial institutions. Plus we introduced a new source into the mix. We established a 3 billion dollar GMTN program, with 750 million dollars issued last year. We brought added diversification to our existing tier 2 bonds, quarter on quarter.

Notwithstanding the addition, you will see that the dependence on banks and FI's reduced from 36% to 33% and customer deposits increased from 59% to 61% of the mix.

We are pleased to draw attention to the competitive advantage that the group enjoys on foot of it's very diversified and very stable funding base.

Moving forward now to page 13, we can look at the performance ratios resulting from the earlier numbers. Our return on average equity for the quarter March '18 was 13.2%. That compares with 12.5% for the opening quarter of last year.

Return on assets increased to 1.44% in the current quarter. That compares to 1.41% in the opening quarter of 2017. Our capital ratios show a very comfortable head room implicit in the 17.3%. I would like to draw your attention to the fact that the cap ad ratio computed for an opening quarter such as March '18 is not directly comparable to the 17.8% in the closing quarter of 2017. There are a couple of factors at play. One is the fact that the Q118 calculation does not include interim profits for the quarter. Therefore we had balance sheet growth, growth in our risk weighted assets, without a commensurate increase in equity. We also had an approximate 0.2% impact due to the IFRS9 transitioning adjustment in respect of our investment book.

Therefore 17.3% is a very solid number with those considerations in mind. Our asset quality ratios following on from the provisioning that we saw earlier, the KD42 million, show very healthy ratios. The loan loss coverage ratio is 273%, ie nearly 300%, against an NPL ratio of 1.38%.

So really that's it. I think it's been a very solid quarter. Solid momentum is in the business. We are optimistic that this momentum should continue, and we are looking forward to whatever the remainder of 2018 will bring.

I should now thank you for your attention and I will hand over to the operator.

Operator: Thank you. Ladies and gentlemen, we will now start our Q&A session. If you wish to ask a question, please participate in our written Q&A by typing your question into Ask a Question text area. Then hit the submit button. Thank you for holding until we have our first question.

Amir Hana: Yes, our first question is asking if Islamic banks in Kuwait, eating into conventional banks, are you seeing strong competition from them?

Generally we've seen over the past decade that there's a general attrition towards Islamic banking, and we've seen that market share moves, not just in Kuwait, but actually most of the markets in the region. And that's actually what drove us, or made us very keen to make part of our strategy going into Boubyan Bank. Give us that access, and we have a controlling stake back in 2009, and we currently own 58.4% of Boubyan Bank. And this strategy has continued. Boubyan is a key part of our strategy, for our growth strategy. We've seen Boubyan growing fastest within banks in Kuwait, and actually there was a strong confirmation of that Islamic banking trend, and that is confirmed through what we've seen in terms in Boubyan Bank.

Generally from a market share point of view and competition, there is a general competition yes, from Islamic banks. Again, normally with a typical market trend that the easier, lost market share comes from the weaker side. So conventional banks are strong enough to defend the market share, but again, the general attrition or the general direction is that Islamic banks are growing a bit faster than conventional banks.

And this is where Boubyan fits in in our operations.

We see another question. Do you believe there is a seasonality in the project awards in Kuwait showing stronger growth in the first half of the year?

Not necessarily. The whole idea of project awarding has few things into it. One is the general direction, the legislation, the paperwork, the timing of tenders and awards, so it's not a seasonality trend, it's more of when big projects happen, one quarter or the other. When we were referring earlier to in the second half of last year there were slower project awards, that was mainly because of government resignations. So the process got delayed a bit. So then that's why with Q1 numbers, we've seen a very strong trend in terms of tendering and awards.

And just to confirm in terms of the numbers, we've seen so far around 2.4 billion dinars worth of projects that are closed in the Q1, and that's obviously a move from the slower second half of last year. And that just confirms that it's not necessarily seasonality, it's more of the process, the timing of the tender and the awards.

Jim Murphy: Another question here pertains to earnings and balance sheets guidance for 2018. I think suffice to say that we, I'll just repeat what I've said in the earlier session, are looking at continued momentum in the business. The drivers for earnings are expected to remain. The pipelines are good, and we expect good growth in loans. Margins are increasing. If the fed interest rate increases are followed by the Central Bank, that will obviously feed through to our earnings line.

Provisioning will be a matter of interest. We're not really sure exactly what to expect in light of the fact that we haven't fully migrated to IFRS9, so I'd be reluctant to give anything by the way of guidance. But certainly the momentum, I think coming back to this one, the momentum and the trends that are in evidence for the opening quarter, we see no reason to expect a decline in that momentum.

Jim Murphy: Okay, there's another question here, Which is -

Amir Hanna: Do you want me to read that?

Jim Murphy: Yes.

Amir Hanna	What the question says; Expansion plans into Egypt and Saudi. Also, mentioned during the presentation was 25% of earnings are from overseas operations. Can we expect this to continue going forward? Or reducing or increasing?
Jim Murphy:	Okay, well probably I think what we're looking at is a continuation. Egypt is on a growth trajectory, so in local numbers I think it will outpace the group. Of course in terms of its relative size its contribution should be broadly similar.
Issam Al Sager:	Yeah, I think as we mentioned earlier, Egypt will continue to grow. We have a new strategy, we've been growing in double digits for the last two years and we expect that to continue in the years to come.
Jim Murphy:	So the contribution from international, I did say, tends to constitute 25 to 30% of our group earnings. That will continue. Our expansion into Saudi will not make a change to our overseas earnings in the immediate term as you can imagine, while we establish the wealth management company and build it. But I think just to summarize again, Egypt will outperform the group and the overall contribution from international will remain in familiar territory. Now I'm being asked ... sorry, we're just waiting on the next question to come through.
Amir Hana:	Okay, next question is what percentage of your balance sheet is floating rated? Would all of them get re-priced with rising interest rates or would there be negotiations with corporates?
Issam Al Sager:	Well I would say that the majority of our loans are on floating basis and we re-price it very regularly.
Jim Murphy:	Yes, with the exception of our consumer book, most of our, the vast majority, almost all of our corporate book would re-price within three months. But consumer loans, for those of you that are familiar with Kuwait, you will know there is a re-pricing rule attaching to that particular product.
Amir Hana:	Alright, the next question -
Jim Murphy:	I think we had the question, what was our CET1 ratio for the quarter compared to December '17. Okay, our CET1 ratio in March was 13.8%, and that compared with 14.2% at the end of 2017. But note again, we were affected in the first quarter for the reasons that I mentioned earlier on attaching to the way the cap ad ratio is calculated.
Amir Hana:	Next question is, which line of business can we expect to see most growth from?

Jim Murphy: Okay, well for all parts of our group, we expect to see growth. Boubyan Bank, the Islamic subsidiary, continues significant double digit growth. We have talked about Egypt on a few occasions, there's a lot of emphasis on, and we put a lot of time and effort into pursuing, significant growth at Egypt. And that growth trend, if you like, should continue. We feel very optimistic about Egypt and Boubyan Bank going forward.

Within Kuwait, all of our businesses are doing well. Our consumer bank is doing well, our corporate bank is doing well, As is NBK Capital, and our private banking business ... so currently, all parts of the group are doing very well, but I think we will see added growth, an added spurt, at Boubyan Bank and at Egypt.

Issam Al Sager: Exactly.

Jim Murphy: Right, so the question here. How much does a 25 basis points increase in the discount rate affect your NIMS?

Jim Murphy: We would guide around KD10 to KD12 million to NII, annualized. So if there was a rate increase on the 1st of January, the impact would be KD10 to KD12 million approx. for the whole year.

Amir Hana: There's another question that says, may I ask you how much is the result of Q1 variance from your budget expectations?

Jim Murphy: Yeah, okay. Good question. We are slightly ahead of plan. We hadn't expected the buoyancy in the business volumes that came to pass. Margins were a little bit healthier than we had expected. Costs were more or less on plan. So net net, we are marginally ahead of plan.

Boubyan, there's another question here. What does Boubyan ... no, Boubyan contribute to our profits, Boubyan contributes 8% to group profits.

Well, we have a question here. Why do we have such high NPL coverage? That's really a legacy. It's a legacy from the Central Banks prudent approach to provisioning over the years. You will know, if you're familiar with Kuwait, and with NBK, that all banks in Kuwait were mandated over recent years to set aside precautionary provisions in respect of a provision pool additional to the specific and general provisioning that a bank would ordinarily do. So over the years, we've built up this provision pool, hence the high coverage ratio.

Amir Hana: Someone's asking for guidance on NIMS, loan growth, cost of funding, cost to income ratio, and we're just, usually, we'll mention here that we do give general guidance but we are not ... there are no specifics on guidance in terms of numeric. So we can definitely talk about trends.

Jim Murphy: Yeah. Taking it from I think, NIMS, we expect NIMS to widen. We are suitably confident that rates will increase in the quarters ahead. The number of increases is a matter for debate. We are confident we will see margins increase.

In terms of loan growth, we would expect to see, we would guide a mid to high single digit increase based on the pipelines as we have them. All of that is subject to maybe unplanned settlements or other events.

Cost to income ratio, cost to income ratio we've been asked what, I think broadly in the range where we're at the moment.

NSFR, compliance with NSFR, how did this impact on our cost of funds. We sourced some longer term deposits. With it came a bit of an increase in cost, but as you know, as rates continue to increase, the cost of locking in some appropriate additional funding in fact does not become an issue.

Amir Hana: Just for time purposes, we'll take one more question. And then, as I mentioned earlier, anything that's left unanswered, we'll get back to you in a timely basis, and you can just send us more questions under our Investor relations address basically.

I think the questions are just repeating themselves. So that's basically it. We'll take it back to the operator.

Operator: You have no further questions. Speakers, would you like to have a few words before the closing?

Issam Al Sager: Well, we just want to thank you for giving us the opportunity to answer your questions. Hopefully we look forward also to be together on the second quarter. After our second quarter results.

Operator: This concludes today's conference call. Thank you all for your participation. You may now disconnect.

Amir Hana: Thank you.