National Bank of Kuwait

1Q 2019 Earnings Conference Call

18 April 2019

1Q 2019 National Bank of Kuwait Earnings Call

Sunday, April 21, 2019

Edited transcript of National Bank of Kuwait earnings conference call that took place on Thursday, April 18, 2019 at 15:00 Kuwait time.

Corporate participants:

Mr. Isam Al Sager – Group CEO

Mr. Jim Murphy – Group CFO

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

Chairperson:

Ahmed El Shazly – EFG Hermes

Operator:

Good day and welcome to the National Bank of Kuwait 1Q 2019 results conference call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Ahmed El Shazly. Please go ahead Sir.

Ahmed El Shazly:

Yes, thank you.

Good afternoon and good morning everyone. This is Ahmed El-Shazly from EFG Hermes, on behalf of Elena Sanchez, welcome to the National Bank of Kuwait 1Q 2019 results conference call and webcast. It is a pleasure to have with us in the call today Mr. Isam Al Sager, Group CEO of NBK, Mr. Jim Murphy, Group CFO of NBK and Mr. Amir Hanna, Head of Investor Relations and Corporate Communications of NBK. I would like to handover the call now to Mr. Amir Hanna.

Thank you.

Amir Hanna:

Thank you Ahmed for the introduction.

Good afternoon everyone. We are happy to have you again today for our first quarter 2019 earnings call.

Similar to our previous calls, I will start by reading you a brief disclaimer while our full disclaimer will be displayed on the screens in front of you "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. You are cautioned not to rely on such forward-looking statements. 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."

For today's agenda, we will start our presentation by some opening remarks from our Group CEO, Mr. Isam Al Sager. Following that, our Group CFO, Mr. Jim Murphy, will run you through the first quarter figures in more details. After concluding our presentation, we will start addressing all your questions but feel free to type in your questions at any time during the call. We will answer all questions received, if time allows us to, any other unanswered questions or for follow-up questions, please email us on our investor relations email address which you can find on NBK Group website.

Without further delay let me hand the call over to Mr. Isam Al Sager, our Group Chief Executive Officer for his opening remarks.

Isam Al Sager:

Thank you Amir.

Good morning and good afternoon everyone.

Thank you all for joining us today for our first earnings call in 2019.

I am glad we are starting the year with a very positive set of results. Our performance in the first quarter of 2019 confirms the continuation of last year's solid trends and growing profitability. During the first quarter, our strategy continued to drive our profitability. We remained dominant in the domestic market, expanded our presence and offerings in our key geographies and further strengthened our Islamic banking franchise, Boubyan Bank.

The Group recorded a set of exceptional results in the first quarter of 2019. Our profits for the quarter reached KD 107.7 million that is equivalent to 354.1 million US dollars and growing at 15.1% year-on-year.

Domestically, the operating environment remained resilient and the outlook continues to be quite optimistic. We see the determination from the government to award and execute mega projects and increase capital spending on infrastructure development. This optimistic view supports our positive sentiment for private sector activity and credit growth outlook.

As we always confirmed, NBK will remain committed to support economic development in Kuwait through the execution of "New Kuwait 2035" vision. Given our leading market position, our balance sheet size, our capabilities and banking expertise; we will continue to expand our role, being a key player in the project finance segment in Kuwait.

Similarly, our Islamic banking arm, Boubyan Bank; provided further diversification to our profits and strengthened our dominant share in the domestic market.

Moving on to our international operations, we continued to benefit from our diversification strategy and our presence in different markets across the globe. Our international operations contributed 25% to the Group's net profits during the quarter.

On that I would like to update you on some specific markets and recent developments within our International operations.

In Egypt, we continue to focus on increasing our market share in the retail sector, relying on the transfer of our expertise in providing leading technological solutions to the region's largest market in terms of population; while in Saudi Arabia, our newly established branches became operational and concurrently we started focusing on growing the client-base and AuMs of our recently launched NBK Wealth Management Company.

Finally, in France, NBK's Paris office was converted into a full subsidiary as a conservative and long-term positioning no matter how Brexit ends up. This will guarantee the Bank's ability to continue serving clients with business ties within Europe and MENA.

As part of our diversification strategy, we will continue to invest in technology and digitization for future growth. We are investing in implementing the digital transformation strategy via various initiatives that includes all the activities and markets in which we operate.

I would also like to take this opportunity to update everyone on our credit rating position. Our credit ratings remained unchanged with AA- from Fitch, Aa3 from Moody's and A+ from standard and Poor's. All our ratings carry a stable outlook and remain the highest in Kuwait and among the top in the region.

With this I conclude my comments and would leave you with Jim Murphy, our Group CFO, to run you through the first quarter results in more details and to address your questions.

Jim …

Jim Murphy: Thanks Isam.

Hello everyone, and welcome. I am very pleased to have this opportunity to take you through our results in respect of the first quarter of 2019.

We have announced a profit of KD107.7m for the quarter to March 2019. This is a 15.1% increase in bottom line profit over the comparable quarter last year. These results reflect a solid performance by the Group and demonstrate the continued growth in our businesses. We are pleased to see that the growth in profits was driven by strong performances across our portfolio of business lines, and across the various geographies in which the Group operates.

The profit of KD107.7m compares with a prior quarter profit, i.e. quarter four 2018, of KD98.3m. This is a quarter on quarter increase of KD9.4m, a 9.6% increase.

Before going into the details behind our results I would first however like to say a few words as to the overall trading environment so far this year.

Operating conditions have remained broadly favorable, and have been conducive to a strong start to the year. That said, whilst good business opportunities are to be had, competition is strong and keenness in pricing is ever present. Overall however the underlying directional trend is encouraging and demonstrates a continuation of the good momentum that has been in evidence from earlier periods.

Progress continued as regards implementation of the government's multi-year development plan. You may recall that the pace of project awards and execution rate last year was below expectations and below levels of earlier years. Whilst it is too early in the current year to confirm, we remain of the belief that this was a matter of a time shifting to future periods and in this regard we expect to see a pick-up in activity as the year progresses.

The implication for the banking sector remains therefore that the consequent cascade or ripple through effect associated with the execution of the development plan will continue to offer good business prospects and financing opportunities over time.

Returning now to our operating performance and financial results for the period.

The strong 15.1% growth in profits reflects solid performances across the Groups range of operations i.e. across our various lines of business domestically within Kuwait and also at our international operations.

We saw continued strong growth at our Islamic Banking subsidiary Boubyan Bank. Boubyan Bank delivered an excellent 16.4% year on year increase in profits, to KD14.6m in the opening quarter.

Our international businesses also continue to perform strongly. We will see later in this presentation the materiality and importance of our fuller diversification agenda when looking at the contributions to total Group earnings made by the various banking footprints enjoyed by the Group.

As regards operating income, the operating income for the current quarter was KD225.6m. This compares to KD213.4m in Q1 2018, a 5.7% increase.

The operating income for the final quarter of 2018 was KD221.4m.

The primary driver behind the 5.7% year on year growth in operating income was a 4.7% increase in net interest income. This increase in net interest income was due primarily to strong growth in loan and investment volumes, together with a slight improvement in the net interest margin.

The Groups operating surplus (i.e. pre-provision pre-tax earnings) was KD154.4m. This is a 3.7% increase on the Q1 2018 operating surplus. Total income grew by 5.7% as already mentioned, whilst growth in costs was 10.3%.

The KD154.4m operating surplus compares to KD147.2m in respect of quarter four last year. This is a quarter on quarter increase of KD7.2m, i.e. a 4.9% increase. Whilst total income is 1.9% ahead of the prior quarter, costs fell by 4.1%.

I will go into the main drivers behind the movements in income and in costs in later charts.

The operating income mix is profiled on the bottom right hand right side of this first slide. 76% of total operating income is in respect of net interest income, and 24% from non-interest income sources. This mix is broadly in keeping with the prior year.

Moving on now to chart number 2.

I will examine our net interest income performance, and also the growth drivers behind the outcome.

Net interest income at KD171.2m in opening quarter of this year compares to KD163.6m in Q1 2018. This is a 4.7% increase, primarily reflecting as already mentioned a strong growth in lending volumes together with a slightly higher net interest margin.

Net interest income however was lower than that in Q4 18. This is largely due to the lesser number of business days in the opening quarter of a year, but also due to an increase in funding costs due the lagged impact of earlier interest rate increases on longer term deposits.

Interest earning assets averaged KD26.2bn during the opening quarter of this year. This is a year on year increase of 4.0%. The growth in interest earning assets essentially reflected strong growth in our lending and investment portfolios, the details of which we will look at shortly.

Coupled with the solid growth in interest earning assets, the Group also enjoyed the benefit of a small increase in its net interest margin.

If you look at the bottom left hand side of this chart you will see that the net interest margin during the quarter averaged 2.65%. This compares to an average margin of 2.63% in Q1 2018.

You will see that the current NIM remained broadly in line with the preceding quarter, as the impact of earlier rate increases settles down.

The Groups funding cost averaged 2.17%, as compared to 1.50% in Q1 2018, and with 1.95% in Q4 2018.

The Groups yield averaged 4.57%. This compared to a yield of 3.97% in Q1 2018. The yield in the final quarter of last year was 4.40%.

On the bottom right hand side of this slide we can see the constituent drivers that moved the average NIM by 2bps, from 2.63% in Q1 18 to 2.65% in Q1 19. The NIM was impacted favorably by 59bps due to the combined movements attaching to loans and other assets, whilst the higher cost of deposits impacted the NIM to the extent of 57bps.

Moving on now to chart no 3.

I will talk about how the Groups non-interest income performed.

Total non-interest income in the opening quarter of this year was KD54.3m. This is 9.0% ahead of the comparable period last year. When compared with Q4 18, non-interest income was 18.1% higher.

The composition of the KD54.3m total non-interest income is KD37.5m in respect of fees and commissions, KD10.0m in respect of foreign exchange activities and a net KD6.8m from other non-interest income sources.

Fees and commissions income was 1.1% ahead of this time last year, and 4.8% ahead of Q4 18.

The sources of fees and commission income are well spread across our various business lines and geographies. Our retail banking, lending, credit card, Trade finance and asset management businesses continue to produce strong fee income on the back of solid operating performances.

As always, the bulk of our non-interest income came from core banking activities. The Groups non-interest income is sourced primarily from fees and commissions and from income in respect of foreign exchange activities. Earnings in respect of non-core banking income streams remains very small.

Turning now to operating expenses. Total operating expenses for the opening quarter was KD71.2m. This is 10.3% ahead of last year but KD3.1m less than Q4 18. The increase when compared with Q1 18 is the result of a number of factors.

Factors included the commencement of our new wealth management operations in KSA together with the enlargement of our branch footprint in that country, and also the expenditures associated with the continued expansion of our Islamic banking operations at Boubyan Bank and our operations at NBK Egypt.

We also incurred Brexit related costs on foot of converting our former branch in France into a full subsidiary of the Group as a means of safeguarding business continuity post-Brexit.

Another factor at play is the fact that year on year costs are impacted by the annual staff cost increments cycle which takes effect between the opening quarters of any year.

Staying on the subject of costs, a new accounting standard took effect on January 1st this year, IFRS 16. The standard impacts on accounting treatments in respect of leases. This new standard requires an entity to recognize leases on balance sheet at amounts that recognize or value the right of use to an asset for the term of each lease, together with the associated liability in respect of future lease payments.

The salient part of the standard as regards its impact on our income statement is the recognition of the depreciation and interest expense associated with the relevant stock of leases, in lieu of rental expenses being included in other administrative expenses. The substantive impact in quarter one of this year has been an increase in depreciation and reduction in other administrative expenses of approximately KD2.3m - essentially therefore a reclassification between expenses categories.

In addition to the driving forward with the normal business of the bank, we of course remain committed to maintaining appropriate and additional investment into those areas of operation that drive long term and sustained value to the Group.

We continued our ongoing programme to invest heavily in IT. The global banking model is facing significant challenges, not least from digital disruption within the industry and from FinTechs. In this regard the Group invests heavily in selectively developing and deploying the latest business enabling technology solutions, in refreshing its IT infrastructures and in ensuring first class cyber security resilience and capabilities.

We direct investment towards technologies that serve to improve the banking services that customers experience and also to those technologies that improve the long-term efficiency and effectiveness of bank office operations.

And finally on the subject of IT, I can advise that we are very well advanced in the building of a new state-of-the-art Data Centre in Kuwait City and expect to see this come on stream in the months ahead.

The cost to income ratio for the quarter remained in line with last year's overall ratio, at 31.6%.

Moving on to provisions and impairments.

Total provisions and impairments in the opening quarter of this year amounted to KD31.4m. This KD31.4m charge was solely in respect of provisions for credit facilities, and compares to a total charge of KD42.3m in Q1 18, KD2.4m of which was in respect of impairment losses re investments in associates primarily held at or through our subsidiaries.

Total provisions and impairments in Q4 18 amounted to KD34.3m, a reduction this quarter therefore of KD2.9m.

Credit provisions in the current quarter amounted to 20.3% of pre-provision pre-tax earnings, significantly below the preceding periods as you can see on this chart. This is naturally a very welcome development.

I will take this opportunity if I may to remind you that the Central Bank of Kuwait had earlier determined that the provisioning regime applicable to banks in Kuwait is such that the provision for losses on credit facilities be determined as the higher of expected credit losses under IFRS9 as per Central Bank of Kuwait guidelines, and provisions as computed in accordance with CBK rules and instructions.

As the latter instance prevailed, we therefore computed an ECL charge in respect of non-credit financial assets only, the income statement impact of which was immaterial in the period.

Moving on now to chart no 4.

I would like to return to the matter of earnings diversification at the Group.

You will know that one of the primary strategic objectives at NBK has long been an imperative to diversify the Groups base of operations and also therefore to diversify the sources and stability of Group earnings. The ongoing execution of this strategy continues to drive forward this competitive advantage for the Group.

As mentioned earlier we have established a new CMA regulated Wealth Management company in KSA and are currently in the course of opening two additional commercial banking branches in that country.

We have also recently created an overarching Group level Private Banking structure that is tasked to grow and coordinate our private banking business across our international network.

The Group has not escaped the headaches and costs associated with Brexit, and its implications for our international operations. In order to best protect our business presence in Europe, we converted our operation in France into a fully-fledged subsidiary of the Group, from its earlier status as a branch of our UK subsidiary NBK International plc.

Returning now to the chart - the purpose of this chart is to demonstrate the impact of our diversification agenda on the Groups financial results.

Looking firstly at diversification by geography. NBKs International operations contributed KD26.5m to Group profits in the opening quarter of this year, broadly in keeping with last year. The operating income at our international businesses however grew by 6.9%.

You will see from the pie chart on the top right hand side that the contribution to Group operating income from our International operations was 24% in the opening quarter of this year, slightly up on the 23% of last year.

The contribution to Group profits however in respect of our international operations reduced to 25% from 28%, essentially due to the falling cost of risk at Kuwait.

NBK is currently present in 14 countries outside of Kuwait, including of course in Egypt. NBK Egypt increased its number of branches in the period, from 45 to 49.

In addition to geographic diversification, NBK remains unique amongst Kuwaiti Banks in being positioned to operate in both conventional banking and Islamic banking. The Groups Islamic banking subsidiary Boubyan Bank continues to perform strongly, and delivered profits of KD14.6m in Q1 of this year. This compares very favorably to a KD12.6m profit in Q1 18, representing as it does a strong year on year increase of 16.4%.

And finally on this chart, we see that the profile of assets was such that 48% of Group assets were at our conventional Domestic operations in Kuwait, 35% at our International operations and 17% at Boubyan Bank.

Moving to chart number 5.

On this slide we will look at some of the movements in key volumes during the period.

You will recall that our net interest income increased by 4.7% on last year. A big contributor to this increase was a solid growth in business volumes during the period.

Total assets reached KD27.4bn. This is a 2.4% increase on the comparable period last year. The increase was driven primarily by strong growth in the lending portfolios.

Group lending increased to KD16.0bn, an increase of KD1.2bn in the twelve month period to March 2019. This represents a very solid year on year growth of 8.1%.

A significant part of the twelve month growth occurred in the opening quarter of 2019. We have seen a very strong start to the year in this regard, with the loan book growing by 3.5% since the end of 2018.

In addition to the quantum of the overall growth that we have been experiencing, it is encouraging to note that strong underlying growth was had in all of the Groups key lending markets i.e. Domestic, International and Islamic.

Customer Deposits, at KD14.7bn, grew by 2.8% over the comparable period last year, and by 2.0% when compared to December 2018 - and just for purposes of clarity please note that customer deposits as defined here do not include deposits taken by the Group from financial institutions. This is in keeping with the presentation of customer deposits in our published financial statements.

We are very pleased to see a continued favorable movement in the Groups overall funding mix. We experienced strong growth in core franchise deposits, noting in particular excellent growth in deposits at the retail banking arm of the Group here in Kuwait.

The growth in retail deposits reflects a sustained focus on the deposit gathering aspects of our business in recent times, leveraging NBK's long standing ability to capitalize on the Groups strong brand, reputation and credit ratings.

The Groups overall funding mix is profiled on the bottom right hand of this chart. Customer deposits comprise 64% of the total mix, broadly in keeping with last year.

Moving to our final chart.

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

The Return on Average Equity for the opening quarter of this year was 14.5%. This compares to 13.2% in Q1 18, and to 12.0% for the full year 2018.

The Return on Average Assets was 1.59%, the comparable returns being 1.44% in Q1 18 and 1.38% for the full year 2018.

The total Capital Adequacy Ratio in respect of the opening quarter of this year was 16.9%. This compares to 17.2% at year-end December 2018, noting that retained earnings are not factored into the computation of interim period ratios.

The T1 capital ratio at the quarter-end was 14.9%, whilst our CET 1 ratio was 13.5%.

As regards asset quality ratios, the NPL ratio for the quarter was 1.51%, with coverage at 206.8%. Although slightly tighter than December 2018, the ratios nonetheless remain at very comfortable levels

That brings an end to my presentation.

However, before I hand back to Amir I would like to summarize by saying that we consider the year to have got off to a satisfactory start. Solid and sustained growth continued throughout the Group, albeit in conditions characterized by aggressive competition for business in all markets. That said, it is reassuring to see the ongoing benefits of our diversified earnings base work to support the fuller Group.

The Group continued its strategy of investing in its people and in emerging technologies in order to best protect the bank and its performance into the future.

We are hopeful that the momentum witnessed thus far this year will continue as the year unfolds, notwithstanding challenges and uncertainties from many quarters, not just locally but in markets further afield.

Thank you very much for your time.

And now back to Amir.

Amir Hanna:

Thank you Jim, thank you all for listening.

We will pause for a minute waiting for questions. If you have any questions just type it in and we will get back to answer your questions as they are received.

We’ve got a couple of questions for now to start. Just a reminder, keep writing in your questions for us to answer them as they come in.

The first question is on exchange income. The exchange income increased to KD 10 million from KD 7.1 million a year back, what drove it and is this sustainable?

Jim.

Jim Murphy:

An element of the increase was due to business activity. There were some good movements in foreign exchange related business activities, but the substantive part of the increase was due to exchange movements in respect of the Tier 1 issuance that we did in 2015.

As we issued in dollars, we revalue our position at the end of each quarter. The rates moved in our favor this quarter vis a vis the movement in the earlier quarter. A substantive part of the increase that we see here was due therefore to this technicality if you like, the residual being to activity levels in the business.

Amir Hanna:

The following questions, what is the guidance for net interest margin and guidance for cost to income ratio for 2019?

Jim Murphy:

Taking the net interest margin first. We have seen that the net interest margin has plateaued. As we got to the end of the rising interest rate cycle at the end of last year, we saw the plateauing of the net interest margin.

Broadly speaking the margin in quarter one this year was in line with the preceding quarter, as if you would have seen. Now in terms of going forward for the rest of the year, I think it is fair to say that net interest margin will be pressured. We would be happy to see the margin remain at the level that it is currently at, but we are conscious of pressures that will be at play on that margin.

We don't currently expect any rate increases in the year ahead, which had provided a tailwind over recent periods. What we do expect is good business growth, but markets are competitive and pricing is very keen. In terms of guidance for the remainder of the year, we would expect to see the margin slightly pressured and maybe on a slight downward trend. But we certainly will work to stay where we were at in the opening quarter. I suppose flat might be the way to regard the margin for the remaining quarters of this year, but acknowledging some pressures.

Amir Hanna:

You have mentioned positive outlook on government spending in Kuwait. How much loan growth do you expect to see in 2019 given these projects?

Isam Al-Sager:

It really depends as I mentioned earlier on how the government will implement the mega projects. The more projects that are awarded, the more growth we will see in our loan portfolio. So growth is mainly tied to government spending on these projects.

On the other side, we witnessed a pickup in our loan portfolio in the first quarter of this year from the private sector also.

All in all, I would say that growth is still dependent on projects awarding, and we are positive there will be more projects awarded before the end of year.

Jim Murphy:

If I may just add, it will certainly be helpful if there are project related opportunities ahead. A significant part of that we saw in the opening quarter, we grew the loan book by 3.5% in the 3-month period, a sizable part of that was not related to government spending but due to momentum elsewhere in the business. There are good lending opportunities in the private sector that we see in our home market. There are also good lending opportunities at other overseas locations, we see that at the GCC offices in particular.

So although we don't expect to see a repeat of the order of magnitude of growth that we saw in the opening quarter, the pipelines are very solid. If there is a pickup in government spending that will certainly give another boost to what we already see as a buoyant nine months ahead.

We are hopeful and optimistic that we will see good business written in the nine months ahead.

A question on the screen here about provisions.

Provisions had been decreasing in the fourth quarter last year and the first quarter this year. Should we expect the trend to continue or should we expect the same level of provisioning going forward?

That's a good question.

We are very happy to see the downward trend. The cost of risk is certainly a lot lower than we experienced say in the early part of last year. I think at one point the cost of risk was at 1.2 to 1.25%, whereas now we are operating in the high seventies to 0.8%.

We would be happy to see the cost of risk remain roughly where it is at the moment. Compared to earlier periods it is a very acceptable level, and arguably is approaching what might be considered a more normalized cost of risk.

I would be doubtful at this stage that we would see a reduction on what we have recorded in quarter one, given the context.

That said, it is a cost of risk that we are more comfortable with. If we move through the remainder of the year with a cost of risk of the order of magnitude that we have seen then I think that that would be quite acceptable. We would be disappointed if it were to increase from current levels.

Amir Hanna:

At this point we don't have any further questions. I would like to conclude the call.

Thank you everyone for being with us today and looking forward for the coming quarters.

I will just hand the call back to the operator for closing statement

Operator:

Ladies and gentlemen this concludes today's conference call.

Thank you for your participation. You may now disconnect.