Burgan Bank

FY 2018
Earnings Conference Call Transcript
28th February 2019

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Burgan Bank Participants:

Mr. Raed Al Haqhaq – Chief Executive Officer Kuwait and Acting Group Chief Executive Officer

Chairperson:

Ms. Elena Sanchez – EFG Hermes

Operator: Good day and welcome to the Burgan Bank Full Year '18 Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Elena Sanchez. Please go ahead.

Elena Sanchez: Thank you. Good afternoon and good morning everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to Burgan Bank's Full Year 2018 Results Conference Call. It is a pleasure to have with us in the call today Mr. Raed Al Haqhaq, Chief Executive Officer of Kuwait, and Acting Group CEO of Burgan Bank. The call will begin with a presentation from Mr. Raed and then after that, we can open the floor for Q&A.

At this time, I would like to hand over the call now to Mr. Raed. Thank you.

Raed Al Haqhaq: Hi, Elena. Hi, everybody. Good afternoon. As always, we are covering now the full year result of 2018. Before I start, I would just like to highlight the legal disclaimer on the last page of the presentation. Also, for easy reference, we have done KD and dollars. Of course, I'll be covering the KD portion of it and in the Q&A, if there is any question, I can shift to dollars.

I will start with the first slide, which is highlighting our earnings. You can see that our revenue has increased by 11% from KD 239 million to KD 265 million. Net income also grew by 27% from KD 65 million to KD 82 million, almost KD 83 million. And the earnings per share by 28% from 24 fils to 31 fils.

As far as the return on equity or our dividend per share, it stands now at 10.7, moving from 8.3, a 2.3% growth. And the dividend per share, an increase of 71%, reaching 12 fils. Of course, here I need to highlight that we also have 5% dividend share and it is subject to our general assembly approval.

Net interest margin grew by 50 basis points, reaching 2.9 and the cost of income ratio dropped from almost 46 or 45.6 to be exact, to 42.1 CET1 increased by 1% moving from 10.9 to 11.9 and this is due to the capital increase that we have done throughout the year.

The following slide, I will go a bit deeper on the revenue. I will start with the net interest margin. We have been successful in increasing it, moving from 2.4 to 2.9. And you can see it is a 30-basis point increase from 2.6 to 2.9 between 2017 and 2018. As far as the component of our revenue, as you know, we have the net interest income standing at KD 184 million and non-interest income at KD 81 million, moving from KD 69 million last year.

Operating profit, again, we can go to the cost of income ratio and you can see a healthy movement from 48.5 down to 42.1. And our operating profit moving from KD 121 million to KD 154 million.

Net income and earnings per share. Earnings per share moved from 24 fils to 31 fils. And the net income moved from 65 to 83, highlighting a growth of 28% on earnings per share and 27% on the actual net income. Return on equity also is a reflection of that, moving from 8.3 to 10.7. And the dividend per share from 7 fils to 12 fils, again, including highlighting the approval of the general assembly and the factors share distribution.

Our (NPL) ratio as a group from 4.1 to 2.7 and this year, also, 2.7. Kuwait operation dropped from 3.1, to 1.8, to 1.6 in 2018. And on the right hand side, you can see the coverage ratio, which is one of the most important ratio in measuring (NPLs) and their coverage. In Kuwait, it moved from 170% to 339%. As a group, we removed from 120% coverage to 168%. Also, I would like to highlight the size going down from KD 196 million, to KD 133 million, to KD 128 million.

You can see our total assets remain at the same level at KD 7.3 billion. Kuwait representing the majority at KD 4.3 billion [1] and our international subsidiary representing 33% from the total or around KD 3 billion. The sectorial distribution continued to be healthy. We have a focus on reducing our real estate exposure. You can see it going down from 22% to 19%.

Liquidity and all of the main indicators. You can see our (LDR) stand around 89%. And our customer deposits dropped from 4.2 to 3.8. This is a reflection of both a capital increase and our KD 100 million bond. Liquidity metrics if we continue to operate out of the required coverage, where our LCR is at 129, and as you know, it is 100 as per the requirement. And our net stable funding is 100 requirement and we're operating at 117.

Liquid asset ratio, sorry, stands at 29%. The following slide had I think our capital movement and all of the components, which I will focus on the last here, which is 2018. You can see our (CAR) currently stands at 17.4 and our (CET1) at 11.9. Both of them above the minimum requirement of 14% and 10.5%.

The following slide is detailing the component of all of the activities, regional activities. The first one, I will take them item-by-item in order to have a better comparison. If you look at our loans, Kuwait operation represents 67%; Turkey, 23%; Algeria, 10%; Iraq, 1%; and Tunis is 0.2%. Revenue, 59% is coming from our Kuwait activity, 19% from Turkey, 16% from Algeria, 4% and 2% both from Iraq and Tunis.

Net income 46%[2] is coming from our activities in Kuwait, 11% from Turkey, another 11% from Algeria. A drop of 0.5% due to losses and Iraq and Tunis healthy at 3% given its size.

The growth in loan, and as we have highlighted, we are still operating at KD 7.3 billion, however we had healthy growth in Kuwait of 2%, maintaining very high efficiency. And Turkey, you will see that there's a drop of 18% but as you know, there is a deval on the currency that escalated this drop. Algeria, 6% to growth. Iraq, intentionally we are dropping loan portfolio where it stands now at 22% below 2017. And the loan growth in Tunis is 6%.

The main indicator on the right hand side, I will just highlight them fast. Kuwait net interest margin is 2.3%. And then 3.7% for Turkey, 6.9%, Algeria, 1.4%, Iraq, and 2.5% for Tunis. Cost of income ratio is 32.3%, the most efficient franchise we have, Kuwait. Turkey is moving in the right direction. They are now at 42.8%. Algeria, 58.7%, also a drop, and due to the non-activity in Iraq, we are having a cost of income ratio of almost 101%. And Tunis healthy at 35.8%. Our (CAR) stands at 17.4 Kuwait, 17.9, Turkey, 14.5, Algeria, 66 in Iraq, and 16.8, all of them above the required regulatory ratios.

(1) Correct statement is Kuwait represent 67% of group loans rather than KD 4.3 billion.
(2) Correct statement is Kuwait represent 76% of group net income rather than 46%.

Let me just summarize and then we can go to the Q&A. It's been a good year where we have recorded a growth of 27%, return on equity of 10.7%, an increase of 2.3%. And also, the dividend at 12 fils, an increase of 71%.

We will continue to be prudent when it comes to risk, monitoring all of the region that we operate under and focusing on efficiency and increased earnings per share and bottom line offering.

I will take any questions that you have please.

Operator: And if you'd like to ask a question on today's call, that is star 1 on your telephone keypad. And we'll go first to (Vikram Vith) with NBK Capital.

Vikram Vith: Yes, thank you for the wonderful presentation. I had a question on Turkey. Given what's happened in Turkey in terms of the currency devaluation and also, potentially asset quality worsening in 2018, also margins could potentially go down in 2019. Given the balance sheet structure in Turkey, plus with the slowdown in real GDP growth, most of the analysts are forecasting a slowdown in credit growth for 2019 compared to where it was 2018. So given these three factors, how do you see Turkey for yourself in this year? Thank you.

Raed Al Haqhaq: Thank you, (Vikram), for your question. I will take them one by one. As you know, our franchise in Turkey continues to be profitable. We continue to remain fully hedged as far as the investment from an effectiveness point of view. You are absolutely right; the (NPL) have increased in all of the operating banks there, including us. We continue to build reserve and I'm sure that you have seen the financials.

As far as the loan growth, we have already mentioned this from the second quarter last year that we're not expecting to increase our size there. We will continue helping and supporting our client, of course. But we don’t have a strategy on increasing market share.

As far as their entire profit indicator is positive, you can see that their cost of income ratio is positive, spread is positive. The movement is (NPL) is marginal as far as their size in comparison to the total group. Let me just highlight some figures that their net interest income is 11% of total net income and their loan size is 23% of the total loan size.

Vikram Vith: And given all these factors, where do you see - in a sense, what kind of earnings growth should we expect in Turkey for 2019?

Raed Al Haqhaq: Again, (Vikram), we will continue with the same approach that we have taken midyear last year, even before the deval. Turkey will have the same size if not a bit smaller, however, we are maintaining our present debt, helping our client using our franchise, whether it is Kuwait or Algeria, support their trade finance, their project finance. And of course, liquidity is also available here whenever they require it.

Vikram Vith: Okay. So you're saying the growth in Turkish earnings will be similar to what you see in Kuwait, right?

Raed Al Haqhaq: Absolutely yes..

Vikram Vith: Okay. All right. Just one more question on Kuwait. The Kuwaiti growing at around 3% to 4% now.

Raed Al Haqhaq: Absolutely.

Vikram Vith: Most likely -- I'm not sure about 2019 -- most likely to grow at the same pace, 3% to 4%.

Raed Al Haqhaq: You're right.

Vikram Vith: Do you see any scope for getting market share here or would you grow somewhat in line with that?

Raed Al Haqhaq: No, we are targeting to grow above the market. Of course, as you know, everybody is anticipating the large product and we always have been a corporate bank. This is where all of the majority of the portfolio add in our income. If this happens, then we will, of course, increase our growth. If it's the same as 2018, then we'll be at the same level, which is 3% to 4%.

Vikram Vith: Three to four-percent. Okay. Just one last question. In terms of the cost income ratio, do you see any room to optimize cost income ratio either in Kuwait or in Turkey?

Raed Al Haqhaq: Let me just go a bit deeper on the cost to income ratio. Kuwait is one of the efficient ratios, even within the Kuwaiti sector, 32.3%. We have done large investment and we will continue to do large investment in IT. We have changed our operating system. We are developing our omni-channel, and so on.

Turkey, even with all of the circumstances, their cost to income ratio has been evolving and now, at 42.8%. The remaining small franchise, Iraq and even Tunis, they are not representing much from the total cost to income ratio. We are always targeting to the lower 30s. Now, overall, we are at almost 34%, 35%. But with all of these investments in our IT and platform, most likely, we will maintain it at this level.

Vikram Vith: Okay. So you think the cost income ratio will be maintained at about 34%, 35% for this year, right, given the '19 investments?

Raed Al Haqhaq: Yes, absolutely.

Vikram Vith: Okay. All right, that's all from me. Thank you for all your answers.

Operator: We'll go next to (Vishan Bagwen) with Abu Dhabi Capital Group.

Vishan Bagwen: Hello. Yes, thank you for this opportunity. I had a question on the loan growth for various sectors. Can you please give us some understanding or your expectations of how do you see the loan growth in various segments, especially the personal loan status has basically improved significantly from 27% to 30% for you versus real estate, which has seen a contraction. So what kind of trends are you seeing for 2019?

Raed Al Haqhaq: Absolutely. I will go to Slide 6, which you have highlighted. Our real estate exposure, we will continue to maintain at this level or even lower. However, just let me highlight that the personal under our own classification, it's not purely retail. I think it has also private banking and corporate. This is just the segment that we are operating under.

You can see the growth in this segment, there was multiple angles. So it was retail, or private, or even corporate. So even though it is 30%, within this 30, there are sub-segments. And as far as the distribution, we feel that this is the right distribution. Just let me highlight. When it comes to oil and gas and construction, mostly in Kuwait, as the larger projects come, whether it is on the main contractor, or the sub-contractor, you will see a gradual increase into these two sectors, which is mostly oil and gas and construction.

Vishan Bagwen: Okay. So with the rise in private loans of the portfolio, do you see a case of whether your margins could further improve from 2018 levels?

Raed Al Haqhaq: Private banking, usually margin is not as healthy or as large as corporate or retail. There, we are focusing on multiple channel of income distribution, as you know. So private banking spread in comparison to the other business unit, they are the lowest. So it will not affect the overall spread. As a matter of fact, you will see spreads affected mostly in corporate, medium to small, and retail of course.

Vishan Bagwen: Okay. That's good. And lastly, on the (NPL) ratio reduction, which we have seen in 2018, so what has driven this improvement and how do you see this going forward in 2019?

Raed Al Haqhaq: Sure. Let me just highlight on the (NPL) ratio, which we have a slide on. It's on Page 5. The group (NPL) ratio stand at the same level at 2017. However, rightfully mentioned by you, we have gone down from 1.8 to 1.6 in Kuwait. This is due to extra provisions that we have taken and you can see also on the right hand side that our coverage ratio also went up.

So there is a double positive, which is a drop in (NPL) in Kuwait and increase in the overall coverage. This is the same for the group when it comes to the coverage. We have increased from 155% to 168%. And when it comes to the absolute value, you can also witness a drop from KD 196 million, to KD 133 million, to KD 128 actual million. The only impact that we'll have to – which is hopefully a positive impact is the recovery process, which as you know, nobody can predict it as long as we have this large coverage. We are hoping that we can recover it as soon as possible.

Vishan Bagwen: Okay, that is from my side. Thank you.

Elena Sanchez: Hi, Raed, this is Elena, just a couple of questions from me. In terms of provisioning IFRS 9 and provisioning going forward, now that IFRS 9 is – has been almost implemented and the bank has been asked to compare the (ECL) with the current stock of provisions and based on extensive provisions do you think that this could be an indication for lower recovery provisions and lower overall provision costs going forward in – from 2019?

Raed Al Haqhaq: Elena, you are absolutely right and it is part of our financial footnote. We have implemented IFRS 9 with the Kuwait rules. We continue to have surplus between the IFRS 9 and the total provisioning. Going further, IFRS 9 will be the accounting metrics, however, also Central Bank of Kuwait provision will continue to be the same. We will take which one is the lower of the two and then we will go on further – higher of the two, sorry.

Elena Sanchez: Okay. Thanks. I think I have we have a question in the queue. Yes.

Operator: Yes, we'll go next to (Vikram Vith) with NBK Capital.

Vikram Vith: Hi and thank you. I feel I just had two more questions. My first question is given that the Fed has become dovish when it comes to rate – when it comes to interest rates and also the Central Bank of Kuwait is not following the Fed, given these two aspects, how you see your group margins, group with margins in 2019. That's my first question.

Raed Al Haqhaq: Let me just highlight that – yes, hi, can you hear me, please?

Vikram Vith: Yes, I can hear you, yes.

Raed Al Haqhaq: Hello?

Vikram Vith: Yes, yes, I can hear you, yes.

Raed Al Haqhaq: Let me answer the first one, if you don't mind. We'll continue to have the highest interest margin in the country and going further, that we're not anticipating that it will go higher because honestly of concentrating on maintaining the same market share or even adding to it of 3 to 4%. So at 2.9 net interest margins, we would focus on non-interest income and the cost interest ratio, of course.

Vikram Vith: Okay, okay, understood. And you obviously had a great 2018, a very large increase in earnings growth, congratulations for that. How should we expect 2019 in terms of earnings growth?

Raed Al Haqhaq: Honestly, We sent…

Vikram Vith: Sorry.

Raed Al Haqhaq: As you know, we tend not to forecast. We can highlight and it is there in the presentation and of course in the financial. Our growth in net income is coming from Operation. We had extraordinary growth when it comes to revenue and to expenditure; the net between the two is only 2 million KD.

Vikram Vith: Okay, okay. All right. Thank you.

Raed Al Haqhaq: Thank you.

Operator: We'll go next to (Ibek Islamov) with HSBC.

Ibek Islamov: Yes, thank you, yes, the (Ibek Islamov) from HSBC. A couple of questions on Turkey, well firstly, what are your thoughts about the cost of risk in Turkey in 2019? I presume it's going to be quite painful and in that regard, what's your commitment to cut costs in Turkey, right? Because you do appear to have a fairly high cost/income ratio there. I think probably I repeat the question that was asked earlier. That was the first question, yes, we should go ahead and answer it.

Raed Al Haqhaq: Just let me highlight, maybe it's not there in the presentation but our cost to income ratio in Turkey is one point – 170 basis points, going up from 72 basis points. Again, you have to…

Ibek Islamov: Sorry, compared to ratio, right, we are talking about?

Raed Al Haqhaq: Cost of credit.

Raed Al Haqhaq: Cost of credit?

Ibek Islamov: Cost/income ratio, not cost of credit. Okay, you were talking about cost of risk, cost of credit, okay. I follow you, yes.

Raed Al Haqhaq: Again, let me just highlight what is there in the presentation that Turkey is still one of the subsidiaries but as far as whether in size or in contribution to income, it is not as crucial as Kuwait's in comparison. We will continue to be there in Turkey, it's still profitable. The total profit that we have generated from this franchise is 9 million KD and in revenue term, it's 19%. And as you know, last year, the second and the third and even the fourth quarter, it is not as severe as we stand now.

Ibek Islamov: Okay. I haven't seen the growth in Turkey, but I presume it was very strong in 2018. I mean, maybe it's in the slides and I didn't see it. Could you share the growth in Turkey, in 2018. Can you tell us what it was?

Raed Al Haqhaq: Absolutely. If you don't mind, we can go Slide Number 9 and then of course, any further information we can send it to you. You can go to the distribution. I will take them one by one. Loans, 23%, revenue, 19, income 11 and then let's go to the right hand side, which is the main movers. You can see that our net interest margin grew by 40 basis points. Cost to income ratio, which I was highlighting, too, had dropped by 1.6% - 16% - sorry. And our part stands at 17.9, up by 410 basis points.

Ibek Islamov: All right, so we don't have more information. I mean, do you think your Turkish Lira net income will drop in 2019, because cost of risk will shoot up whereas your operating cost basis is fairly fixed and you can't cut it too quickly?

Raed Al Haqhaq: We continue to with large corporate, we're not into the retail market there. We are dealing with prime client. Evidenced by the (NPL) movement, we are operating within the sector and as you know, in the sector there is the government bank and the private owned bank.

Ibek Islamov: Okay. All right, well, I mean, I probably will get back to you but also, I'm still looking to see your financial, full financial for Turkish business. I don't think it was published yet on the…

Raed Al Haqhaq: We can send it to you and then any further information on this subsidiary, we'll be glad to send it to you, (Ibek).

Ibek Islamov: All right, yes, yes, thank you. So and the next thing I wanted to ask you was what's your views about your balance sheet management in Kuwait? Because one thing we noticed is that the Ministry of Finance stopped issuing bonds, right, and obviously, I mean, there is a problem with whether you reinvested cash, right? A lot of Kuwaiti banks were actually seeking dollars, dollar placements because there are not many alternatives in local KD currency. Right? I mean, Central Bank has been issuing some T bills but I don't think it's an ideal options where your deposit costs keep going up in Kuwait, right? So what's your sense on balance sheet management and can you once again repeat, what's your NIMs expectation in Kuwait, in 2019?

Raed Al Haqhaq: Sure. Let me just – absolutely. First of all, I apologize; I'm not familiar with the initial statement that you made where the Ministry of Finance stopped issuing bonds. Can you just highlight more to me what you mean by it?

Ibek Islamov: Yes, well, the Ministry of Finance issues debt, right, so I understand there was no issuance from September last year or so and the…

Raed Al Haqhaq: Ministry of Finance does issue debt, all of the liquidity. Exactly. This is under Central Bank of…

Ibek Islamov: So I mean, what are your thoughts around balance sheet management in Kuwait? So in a situation where Ministry of Finance does not issue any more debt, where are you placing your cash? Are you putting them in dollars? Are you buying Central Bank T bills? Are you placing cash with the Central Bank? What are you going to do?

Raed Al Haqhaq: Okay. Understood. Understood.

Ibek Islamov: And what is your margin, like outlook, expectation in this regard for 2019?

Raed Al Haqhaq: Absolutely. Then let me go to Slide Number 7, hopefully it will cover most of the questions. You can see that - I will focus into two main rations that we always look at - the first one is the liquidity coverage ratio. You can see we are operating at extremely healthy disposition at 129% where the minimum requirement is 100. So this shows you that when it comes to liquidity and I need you also to look at the liquid asset ratio, which is 29%. This will give you indication of the balance sheet management that we have and how we are able to maintain the 2.9 spread. And then if I can go to the left, which is the (LDR), usually we are operating at an efficient level of 89. So the combination of these is the ratio, shows you that we have liquidity, the interest margin spread has been healthy, above the sectorial average and if you can see, the also movement from the 4.2 to 3.8, this also show you that the contribution of our 100 million KD bond and the capital increase.

Ibek Islamov: Okay, so you reckon that you can keep your margin flat in Kuwait in 2019, is that right?

Raed Al Haqhaq: This is what we have been doing for the last five years, year in, year out.

Ibek Islamov: Flat NIM in Kuwait. Okay. Understood. And so next question on dividends, so very good increase in dividend per share, at 12 fils, for 2018. So I presume that probably means that you're going to keep that 12 fils for 2019-2020, right? So that's - I see no drop.

Raed Al Haqhaq: Again, we cannot predict what will happen, what's said is that if we continue delivering the same level of performance, the dividends will be pro rata to this achievement. As you can see, this year we have achieved 82 million(1), we are giving 12 fils as you have mentioned, including a 5% dividend share.

Ibek Islamov: Okay, sounds good. Sounds good, thank you, yes, that's all for me.

Raed Al Haqhaq: Thank you so much, appreciate it.

Operator: For the next, (Dejena Ramdava) with (Arqaam Capital).

Dejena Ramdava: Thank you for the call. This is (Dejena Ramdava) from (Arqaam Capital). I just have one question on realistic exposure. You just mentioned you're sort of either going to maintain the same share or probably reduce real estate loans. Just trying to understand like the asset quality in the strategy of seen in real estate segment in Kuwait, and also if you could give some more color on the segments that you're currently operating in, that would be helpful.

Raed Al Haqhaq: Thank you for the question. I will go to the Slide Number 6 and I will elaborate more on it. As you have mentioned, we had intentionally dropped our real estate exposure from the 22% to 19. Let me highlight the reason for that drop. Basically, most of the real estate activity that we are financing are construction projects that also link to the value of the real estate. The real estate value in Kuwait has dropped but also the illiquidity also has been dropping. Also from risk weighted assets, efficiency consumption, as you know, real estate consume 150% where normal loan consume 100 or even less. So this is, again, toward efficiency and toward the watching the market, making sure that we're not moving after the market move, we are in line and hopefully even before that the market adjustment happen, we are adjusting.

As far as the sector, I will go – the larger exposure we have. Personal, as I've highlighted before, it is under three sub segments so this 30% has sub segments in it, whether it is retail, private banking and corporate. The one next to it is the real estate, which I have highlighted. Then we go into oil and gas, this is where we are forecasting that most of the larger projects in Kuwait will be under this sector and the construction, due to the government project as they have already announced, whether it is micro tunneling or actual construction.

(1) Correct statement is KD 82.6 million group net income rather than KD 82 million.

Dejena Ramdava: Thank you for that. Just to follow up on that, so I understand that real estate is usually the highest yielding asset in Kuwait, so if you're going to reduce the exposure to real estate, so are you going to see any pressure on your margins for 2019 or you're comfortable with your current margin levels?

Raed Al Haqhaq: The reduction in real estate, as you know, loans tend to have repayment schedule so our portfolio usually drop substantial year upon year, especially when it comes to real estate where the average project life is three to five years, with the exception of large ones going up to seven. So there's a systematic drop in this ratio year on year. What we are targeting is not enhancing and just maintaining the normal repayment. When it comes to spread, whether it is real estate or personal, they tend to have the same average spread.

Dejena Ramdava: Okay, thank you very much.

Raed Al Haqhaq: Thank you.

Operator: With the next, (Karil Musabi) with ENBD Asset Management.

Karil Musabi: Hi, this is from Emirates NBD. I had a quick question regarding the perpetual instruments which become callable towards the end of September and we were wondering if any thought has gone through in terms of either calling those or refinancing those as you approach the first call dates? Thanks.

Raed Al Haqhaq: Let me just highlight. We have successfully closed the 100 million KD toward the end of the year and we had the capital increase. As you have mentioned that we have also the, I believe, a perpetual which is – next maturity is coming September. Right now, we are studying all of our financing instruments, our liquidity, and the spread that we're paying and we will finalize it, hopefully by maximum, June, July, whether we are approaching the market or we will continue with it.

Karil Musabi: Okay. Thank you.

Raed Al Haqhaq: Thank you.

Operator: And at this time, there are no further questions.

Raed Al Haqhaq: Thank you, Elena and thank you, everybody for being there. Please, if you have any further question, call us, send us an email and we'll be glad to answer you and speak to you hopefully within the next few months when the first quarter is over.

Operator: This does conclude today's conference. Thank you for your participation.