Company: **EFG Hermes Securities Brokerage**

Conference Title: **Burgan Bank Q3 19 Earnings Call**

Moderator: **Fuyumi Archer**

Date: **Monday, 28 October 2019**

Conference Time: **15:00 (UTC+03:00)**

Operator: Good day and welcome to the Burgan Bank Q3 2019 Earnings call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Naveen Kumar. Please go ahead.

Naveen Kumar Rajanala: Thank you very much. Again, good afternoon ladies and gentlemen, welcome to Burgan Bank's Q3 Earnings call. I am Naveen Kumar Rajanala and I look after Strategy and Capital Management for Burgan Bank. With us, we have Mr. Raed Al-Haqhaq, who is the Chief Executive Officer for Kuwait. So, without further ado, let's jump into the presentation and then I'll hand it over to Mr. Raed after slide number three.

So if I could ask you to start with slide number three, I just want to highlight as highlighted before in the first quarter and second quarter that this year, we are presenting our financials with one-month delay or lag in the subsidiaries' financials. So that continues for the whole year and for the nine-month period as well. The nine-month period would have eight months of subsidiaries' results from January till August of 2019.

Q3 2019 would have June till August numbers for the subsidiaries. So with that, we will move to slide four and I'll hand it over to Mr. Raed.

Raed Al-Haqhaq: Thank you, Naveen. Good afternoon everybody. I'll start with slide number four, which is highlighting the performance highlights. As we have mentioned towards the year end last year, we're targeting growth in Kuwait and a reduction in size in subsidiaries. We can see that Kuwait grew by 7.7%

against a reduction of 4.8% for the same period last year. As a group, the overall growth this year is 1.5% against a reduction of 6.6% last year. On the deposits, its the same story, Kuwait deposits grew by almost 9%-10%, a movement from 2.6% negative to a positive 6.2%. Overall, as a group, the deposits grew by 3.3% this year against a reduction of 3.4% last year.

As far as the net interest margin, Kuwait margin is 2.1% this year against 2.3% last year and the slight reduction is due to increase in cost of funds. At a group level, the margins are almost at the same level at 2.8% this year against 2.9% last year.

Cost of credit reduction of 0.8% from 1.1% to 0.3% in Kuwait, and a reduction also of 0.6% from 1.4% to 0.8% for the Group.

For Return on equity, we have reported 10.4% this year against 12.6% last year. I need to highlight here that the impact of the capital increase last year impacted the return on equity this year. Naveen!

Naveen Kumar Rajanala: Yeah, moving on to the next slide, slide number five. So the key messages here are: One is the normalised top line for Kuwait grew by 6% versus the same period last year and international revenues would be impacted by the one-month lag as highlighted previously. But on a normalised basis, the group revenue has shown a slight growth if we were to account for the one-month lag and the normalisation.

Margins are holding up at a group level. We are at 2.8% in spite of the slight drop in the Kuwait business.

Moving on to the operating profit and efficiency, the key thing here is operating profit at Kuwait level grew by 11%. Our operating expenses both at group level and Kuwait level are lower, so the slight uptick in the cost income ratio is more due to the lower one-off revenues in 2019. There's a slight increase in cost to income ratio due to the devaluation impact of Turkish lira on BBT revenue. So if we can move onto the next slide!

Mr. Raed Al-Haqhaq: Slide number six on the cost of credit., You can see reduction in Kuwait of 80 bps from 1.1% to0.3%. As far as the group level is concerned, we're almost at the same level as 2017 at 0.8%, a good reduction from 1.4% last year.

In KD terms, Kuwait actual cost of credit is at KD 6 million, subsidiaries' cost of credit is KD 16 million, with a total of KD 26 million. In comparison, cost of credit was KD 15 million last year in Kuwait, KD 21 million for subsidiaries with a total of KD 45 million. Hence a reduction of 43%.

In terms of Net income, we have reported KD 67 million this year against KD 71 million last year. The dip highlighting the one-month lag, which has affected our subsidiaries. And you can see a 52% growth in Kuwait Net Income from KD 51 million to KD 67 million. Also worth highlighting that last year we had KD 14million worth of extraordinary income. This year it is only KD 4 million. As far as the return on equity, it fell from 12.6% to 10.4% mostly due to the impact of capital increase last year.

Naveen Kumar Rajanala: So moving on to the asset quality slide seven. There is a marginal increase in NPL levels and NPL ratio at group level despite the headwinds. The slightly higher NPL ratio for Kuwait is predominantly or primarily due to one high net worth individual account, but again this particular exposure is heavily collateralised, and we expect it to be very likely regularised over the next couple of quarters.

Our coverage remains extremely strong at 160% at group level, and at Kuwait level, it's close to 300%. So our asset quality continues to be strong despite the headwinds in some of the markets.

Mr. Raed Al-Haqhaq: On the customer loans, slide number eight, you can see the growth in loans is almost KD 200 million @ 8%, and there is a drop in the subsidiaries' loans of KD 100 million from

KD1.4billion to KD 1.3 billion. On the sectoral exposures, we continue to be diversified with 30% under personal sector as the biggest exposure, which by itself is diversified.

On the customer deposits, there is also a growth in Kuwait from KD 2.5billion to KD 2.6billion, and a slight reduction in the subsidiaries' deposits from KD 1.4 billion to KD 1.3 billion. Also you can see here that we are focusing on the low cost deposits, which represents 30% to 33% of our total deposits as shown in the chart.

Naveen Kumar Rajanala: So moving on to capital and liquidity in slide nine, so we continue to be a capital efficient organisation. Our CET1 is around the 11%. This number does not have the interim profits for the first three quarters. We'll have the retained earnings as a part of the capital and the CET1 ratio by the end of the year. So typically at year end, we expect our CET1 to be about around 11.5%.

Again, from a liquidity point of view both at Kuwait level and at group level, we continue to be very liquid and comfortable On Both short term and long-term liquidity ratios as per Basel 3, we continue to be performing well.

Mr. Raed Al-Haqhaq: Slide number 10, this is basically, where we are highlighting the contribution of all of the operating entities.

You can see Kuwait assets are 71% of the total assets, revenue contribution is 59%, net income contribution is 79%. I just need to highlight here that there is an 8% increase in the loan book, which in KD terms is KD 210 million. The KPIs for Kuwait are 2.1% net interest margin, 32.5% cost income ratio, cost of credit is 0.3% and the NPL ratio is 1.9%.

For BB Turkey, the assets are 15% of total assets. Revenue contribution is 19%, net income contribution is 7%. This is where also you can see a reduction in the loan portfolio of 13% or in KD terms, a KD 125 million reduction. Net interest margin is healthy at 4.5% with cost income ratio of 46.8%. Cost of credit is 1.8% and the NPL ratio is at the same level of 3.5%.

Algeria's assets are 8% of the total assets, 17% revenue contribution, net income contribution of 11%. Then also, here you can see a reduction of 6% representing KD 25 million. The remaining two subsidiaries honestly, they are small, but I will highlight them quickly.

Iraq is 4% of total assets while Tunisia is 2%. Revenue wise, it is 3% for Iraq and 2% for Tunisia. Net income contribution is 0.4% for Iraq and 2% for Tunisia. Let me highlight here that you might see a large percentage increase of 17% of loan growth in Iraq. In actuality, it is KD6 million growth but due to the size of the franchise, percentage shown looks high. The same thing for Tunisia, it's 5% growth represents KD 0.3 million or KD300,000.

Naveen Kumar Rajanala: So just moving onto slide #11, the key change here obviously we're talking about three-month performance, so there is no lag here. The key difference here is quarter three '19 refers to the June to August period, whereas the prior periods we're talking about July to September. Again, from a quarter three '19 performance point of view, it's one of the strongest third quarters we've had. From an expense point of view, one of the lowest expenses. From a normalised revenue point of view, it's also again in line with last year and higher than what it was in 2017. Credit costs continue to be very low compared to the prior periods. And all-in-all, contributing to one of the strongest net income and quarter in terms of earnings and growth from prior periods.

Raed Al Haqhaq: In summary, solid quarter and the cost of credit has been extremely maintained and even reduced. As far as the Q&A we can start now. Colleen, please?

Operator: Certainly. If you'd like to ask a question, please signal by pressing star one on your telephone keypads. If you're using a speakerphone, please make sure your mute function is switched off to allow your signal to reach our equipment. Again, please press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal. We will now take our first question from Waruna Kumarage from SICO. Please go ahead.

Waruna Kumarage: Hi. Thank you very much for the call. I have a couple of questions. First, regarding the Kuwaiti business. You mentioned that the cost of funding in third quarter increased. If I may ask what is the reason behind that? And my second question is on the Turkish subsidiary? What is your outlook in the near-term?

Naveen Kumar Rajanala: So coming to the first part of your question about the rise in Kuwait cost of funds. Now this is a phenomenon that we've started seeing from the end of last year and it's been continuing for the first nine months but what we've seen is in third quarter it started dipping and started normalizing. But again, this is an issue for the entire banking market in Kuwait. The genesis of this is that the two largest liquidity providers in the market have been pulling some liquidity for investments outside Kuwait.

So as a result, given the pressure under net stable funding ratio, banks have had to relook at their cost of funds and revise these funding cost and deposit rates higher. So that's had an impact on most of the banks in Kuwait. But as I said, from quarter three, we are seeing that kind of normalise and we expect that to go down as the year progresses and from next year onwards.

Now in terms of your question on our Turkish franchise, we've adopted a wait and watch approach since quarter one, quarter two last year where obviously the asset book has seen some natural decline due to the Turkish Lira devaluation and at the same time we've been very careful in terms of not growing the franchise. We are maintaining our client relationships in Turkey and where there's a requirement for refinance for the performing loans, we've continued doing that.

But as things stand today, we expect to continue this approach at least for a couple of quarters till we are comfortable with the situation there and the situation pans out as everyone expects with the economy slowly coming back to normalcy. We would then take a decision on the way forward for our Turkish franchise growth.

Waruna Kumarage: Okay. So that means you're cautious in terms of growing the loan book. Is that what you mean?

Naveen Kumar Rajanala: That's correct.

Waruna Kumarage: Okay. And as far as the quality of the book is concerned, do you expect kind of more impairments in the last quarter for next year?

Naveen Kumar Rajanala: We are currently monitoring that potentially it might go up a bit. We are reviewing the situation and it's probably going to be a bit clearer by the end of November or so. But again we expect the economy to normalise, so there would be some lagging effect of the earlier situation, which typically by the time it translates into NPLs, there's a lag effect of couple of quarters. So maybe there is a bit of tail effect left on our NPLs. So we might see some spike in the NPLs but we do not see any dramatic effect on the NPLs.

Waruna Kumarage: Okay. Because I'm referring to this – there were some concerns regarding the regulator requesting banks to impair certain loans on energy and construction sectors. So I wondering what kind of impact will that have on your unit?

Naveen Kumar Rajanala: Well, we've had multiple discussions with the regulator. So though the news was specific to energy and construction, I mean, as a group we had very little –we have very little exposure to the energy sector. We have some exposure to construction sector but I think these are names which the regulator kind of has shared on a client-by-client or a bank-by-bank basis.

So with different banks, they're at different stage of negotiation or agreement with the regulators. So we are still in that process and we expect to be clearer on that number or any impact by the end of November.

Waruna Kumarage: Okay. Okay, thank you so much.

Naveen Kumar Rajanala: Thanks.

Operator: We will now take the next question from Shahad Alawadhi from Wafra. Please go ahead.

Shahad Alawadhi: Yes. I have a question regards to cash. Can you clarify reasons for decline in cash, although deposits have increased?

Raed Al Haqhaq: I'm sorry, please, if you can highlight which item either on the balance sheet or income statement of the footnotes.

Shahad Alawadhi: Yes, cash.

Raed Al Haqhaq: The overall deposit has increased – sorry?

Shahad Alawadhi: Yes, reasons for the cash has decreased, yes.

Naveen Kumar Rajanala: Sorry, related to Q2 end or –

Shahad Alawadhi: Yes.

Naveen Kumar Rajanala: Yes, is that cash movement relative to Q2 or relative to end of year?

Shahad Alawadhi: Yes. Q3 – Q2, sorry, yeah.

Naveen Kumar Rajanala: Q2. Again, that – again, cash balance maintenance is something that we look at it from a requirement point of view. That's one-off but again the maintenance of cash is something that we look at from an optimisation of capital and any funding requirement that we might need at the end of the quarter. So that's just a temporary thing. I mean, again maintenance of cash balance is something that we look at it from a liquidity maintenance and also ratio compliance point of view.

So that increase in Q2 was one-off. It's not something that we aim to maintain at certain level of cash balance at the end of quarter.

Raed Al Haqhaq: And just let me highlight the Q4 last year, as you know we had the capital increase. So it is a timing issue.

Operator: We'll now take the next question from Aybek Islamov from HSBC. Please go ahead.

Aybek Islamov: Yes, good afternoon everyone. Thank you for the conference call. I wanted to ask you about the cost of risk. So one of your slides shows that the cost risk in Kuwait is really low at the moment. I think it's 30 basis points, yeah, if I remember correctly from the 5.

Naveen Kumar Rajanala: Yeah.

Aybek Islamov: So what's your sense for the cost of risk in Kuwait going forward? That's my first question. And secondly, I'm curious to know how you feel or what you expect on loan growth in Kuwait for your banks specifically? So every bank in Kuwait shows kind of different gross dynamics and it's on domestic market. What about Burgan Bank? What was your sense for the loan growth over the next 12 months?

Raed Al Haqhaq: As I have mentioned in the beginning, in the investor call towards the year end we have highlight that our target in Kuwait is a growth of 7% to 8% which we have achieved and this will continue to be our target even for next year. As far as the cost of credit, Kuwait has been the lowest cost of credit subsidiary or sorry franchise we have, where currently it is 0.3%. Usually it is at 0.5% to 0.6%, on an average.

Operator: Once again, as a reminder, please press star one to ask a question. We'll now take the next question from Janany Vamadeva from Arqaam. Please go ahead.

Janany Vamadeva: Thank you for the call. I just had a quick question around margins. Say if the Central Bank follows the Fed rate cut, what sort of an impact are you expecting on your margin outlook?

Raed Al Haqhaq: As far as Kuwait, as you know, the Central Bank has maintained the same – Central Bank of Kuwait discount rate. And market has been impacted mostly due to the cost of fund but the actual yields is almost the same.

Naveen Kumar Rajanala: And unlike the others, GCC counterparts – I mean, there's no immediate reaction on the CBK discount rate when the Fed rate is dropped. So we've seen that both on the increase and on the decrease – on the last few increases and decreases, the Central Bank has not followed. But as Mr. Raed pointed out, our spreads were slightly lower. Our NIMs were slightly lower due to cost of fund rise which we expect to kind of normalise and start reducing so we expect to maintain stable net interest margins for the next few quarters at least.

Operator: As a final reminder, please press star one to ask a question. As there are no further questions signalled, I'll now turn the call back to your host for any additional or closing remarks.

Raed Al Haqhaq: Thank you everybody for joining us. Just in case you had any further questions, please you can send us an e-mail and we will reply to you immediately. Thank you, Colleen.

Operator: Thank you. That will conclude today's call. Thank you for your participation. You may now disconnect.