Burgan Bank

Q3 2018

Earnings Conference Call Transcript
1st November 2018

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Burgan Bank Participants:

Mr. Raed Al Haqhaq – Group Acting Chief Executive Officer

Chairperson:

Ms. Elena Sanchez – EFG Hermes

Operator: Good day ladies and gentlemen and welcome to the Burgan Bank Q3 2018 Earnings Conference Call. Today's conference is being recorded. At this time I'd like to turn the conference over to Elena Sanchez. Please go ahead, ma'am.

Elena Sanchez: Thank you good afternoon. This is Elena Sanchez from EFG Hermes and I would like to welcome you all to the Burgan Bank Q3'18 Results Conference Call. It is a pleasure to have with us in the call today Mr Raed Al Haqhaq, Group Acting Chief Executive Officer of Burgan Bank. The format of the call will be the same as in previous quarters. Mr Raed will present on the key highlights of the results and then he will be receiving questions from the audience. I would like to hand over the call now to Mr Raed. Please go ahead. Thank you.

Raed Al Haqhaq: Thank you, Elena, for the introduction. Good afternoon. We are running now the 31st time that we have done this which is the quarterly result overview. Before I start I would like to highlight that all the statements and information presented on behalf of Burgan Bank during the call shall be subject to the disclaimer on – actually on the page number 18 to Burgan Bank Quarterly Investment, presentation material for the third quarter of 2018.

I will start by highlighting, which I'm sure that all of you are very familiar with, which is the macro environment that we're operating under. The global economic growth, as you have seen, and the decline in liquidity, also the Fed rate hikes and the frequency that it's happened, which has affected all of the major currencies. As far as the Kuwaiti Dinar – as you know, the discount rate has not been moving at the same rate as the Fed or the Libor rate. As far as the oil prices continue to be over the estimated price in the beginning of the year, which is healthy for the oil-producing countries and creating surplus for their annual budgets.

I will highlight the status and the economic numbers of Kuwait. We continue to have a very high rating of double-A with a stable outlook. The GDP is one of the highest and the public debt to the normalized GDP is also at 18.5%[(1)] which is one of the lowest. The fiscal oil prices we are – in our fiscal budget we have estimated at $48.1. As you know, currently it is at the $70 level. When it comes to the sovereign wealth and the percentage of GDP Kuwait enjoyed the highest percentage which is at 492%.

(1) Correct statement is 18.8% rather than 18.5%.

The Group financial we are using the same format. As you can see on the left it is the third quarter result and we are using Kuwait KD, the Kuwaiti currency and US dollar for easy reference. I will start with the income statement. We have recorded a 6% increase in our net interest income. However the non-interest income has shown an increase of 60%. This is basically due to dividends received from one of the investments that we have and of course the normal trade finance instruments and FX which is highlighted in the following slide when we go to it. The total revenue has increased by 19%. Operating expenditure is under control with a slight increase(1) of 2% and the operating profit has moved from KD 30 million to KD 42 million or $100 million to $137 million at a growth of 38%. The loan provisioning has increased by 89%, mostly from our foreign subsidiaries which will be highlighted in the coming slide. The precautionary also has been maintained at the same level of 2017, KD 5 million. The net income after the costs and before the costs is also highlighted. Before the costs of AT1 is 36%. After the costs is 44%.

We have also shown some main indicators on the balance sheet, which is the total customer loans. It has been decreased by 7%. This is mostly due to the currency devaluation of the Turkish Lira with some agreed settlements in Kuwait. The total equity has seen a slight increase of 2%. Now, let's go to the KPIs where the net interest margin is healthy at 2.9% with an increase of 30bps. Cost to income ratio also has moved in the right direction, reaching 38.5% and return on the tangible equities at 11.6% in comparison to 8.4% last year. The NPL ratio also has moved in the right direction from 4.2% to 2.9% and our CAR before the capital increase, this is what we have closed the third quarter with, is 16.5%. I'm also highlighting the impact of the recent successful capital increase.

The following slide is highlighting the year-to-date or the nine-month results. We continue to show the same pattern where the net interest income growth is at double-digits of 10%. Non-interest income annualized – not annualized sorry. Up to the nine-months is 27%. Revenue is up by 15% and the net profit also has shown the same profitable. I will not go over on each and every ratio. I believe that we have – the presentation has been circulated. So I will be highlighting the main indicators. Of course, just in case I miss something please we have the Q&A and I can elaborate more on any item or any indicator that you'd like to.

The balance sheet also has seen a drop from the nine-month. This is mostly again due to the Turkish Lira and our Burgan Bank Turkish subsidiary and the unexpected settlement of two large corporates. However, the equity is also positive and the non(2)-interest income continued to be at a healthy level with a cost income ratio of 39.2% and a return on equity(3) of 13.4%. NPL is also at the same level of 2.9% on the following slide and the CAR is 16.5%.

(1) Correct statement is decrease rather than increase.
(2) Correct statement is net rather than non.
(3) Correct statement is return on tangible equity rather than return on equity.

The following slide has a little bit more in depth information of the indicators. You can see that our spread moved from 2.3 to 2.9%. This is due to the CBK[(1)] increase and also due to the repricing of our loan, whether it is in Kuwait or the operating subsidiaries. Net interest margin[(2)] you can see it growing from $390 to $460. Also the non-interest income from $170 to $225 with a growth of 11%[(3)]. Operating profit also has seen a growth of 19%, moving from $292 to $416. Also the efficiency or the cost to income ratio has been controlled at 39.2%. Cost of – cost of credit we have tried to separate the Kuwait activity and the international activity. Where you can see in 2016, 2017, 2018 of course we are comparing nine months just to be with the same benchmark. $83 Kuwait now it is $81, international operation $19, currently $68. And the return on equity[(4)] has moved from 9.3% to 10.2% and currently we're at 13.4%.

This slide is highlighting the asset mix and the movement between the three years for the same period. You can see we are at the same percentage, which is by design at 60% loans and then the remaining classification or the category under the financial, which is other assets, T-bills & bonds and due to banks. I would like to highlight the pie chart on the right-hand side, which is demonstrating the sectorial exposures. 31% is the highest exposure we have. However this is into multiple layers. This has retail, private banking and equity participation. The remaining sectors are within our risk appetite, with the highest being real estate at 19%. NPL ratio also shows that we started 2019 third quarter[(5)] at 3.1% and currently we are at 1.5%. I am referring to Kuwait and the overall from 4.1% to 2.9%. The increase you can see, it is from last year nine-months result of 2.7% to 2.9%. This is due to also our international operation and some of the provisioning has been already adjusted against that. This is where the NPL coverage demonstrates the healthy cover of 371% for Kuwait and as a Group 170%.

Slide number 11 highlights the funding mix and also, we are continuing to have the same healthy mix, evidenced by the customer[(6)] deposits of 62%. Demand, saving and other at the remaining percentage of 38%. Capitalization, this is before the capital increase and I have a specific slide just addressing the capital at the third quarter reported under current after the capital increase.

(1) Referring to CBK Discount Rate.
(2) Correct statement is income rather than margin.
(3) Referring to Revenue CAGR growth of 11%.
(4) Correct statement is return on tangible equity rather than return on equity.
(5) Correct statement is FY 2016 rather than 2019 third quarter.
(6) Referring to Customer Time Deposits.

We have added this slide just to show you the operating environment. Each entity with its own currency highlighting their performance and their achievements. The highest loan exposure that we have of course is in Kuwait at 66%. Kuwait represents 60% revenue. This is where we have a drop of 5% in our loans and this is to the early unexpected settlement of two wholesale clients. Revenue went up by 19% and our CAR is at 16.5%. Burgan Bank Turkey represents 23% of our loans. Revenue at 20%, the loan growth is at 39% with a healthy revenue growth of 64%. Also with a CAR of 16.4%. Algeria, 10% of loans, 14% of revenue, 22% increase on loans and +27% on the revenue with a CAR of 14.1%. Iraq is the smallest subsidiary we have with only 1% of our total loans, revenue at 3%. Systematically we are reducing the loan exposure there and, of course, it is reflected with the revenue drop. Tunisia the loan growth(1) is 0.2%, revenue 2% and the CAR at 18.5%(2).

On the right-hand side we have chosen some KPIs that we feel are reflective of the performance of each entity. Net interest margin went up in Kuwait by 20bps. Cost to income ratio also has been controlled and the cost of credit went slightly up from 0.8% to 1.2%. And the net profit margin from 45% to 50%. Turkey KPIs, also the non(3)-interest margin is healthy at 3.8%. The cost to income ratio is getting healthier, down from 60.8% to 39.9%(4). This is due to the profitability and the efficiency of the organization. The cost to income ratio(5) has been increased by 50bps from 0.9% to 1.4%, reflective of the other slide when we have established the growth of the NPL between local and international. Algeria also, cost to income ratio has been dropping. The net interest margin also, the cost of credit. Iraq is a very small subsidiary. Honestly, you can see the level of contribution and the effectiveness of the entity under the very challenging operating environment. Tunisia continued to be healthy with net interest margin of 2.5% against 1.3% in 2017 and cost to income ratio also has been positively adjusted from 38.4% to 34.7%. And the cost of credit has been controlled at 3.7% with a net profit margin of 47%.

As you know, we have finalized our capital increase within the third week of October. The impact is highlighted in this chart. We have managed to have the full subscription date, same structure of the shareholders and the CET1 has been positively impacted. At the end of the quarter we were at 10.8%, currently we are 12%. Tier 1 13.5%, currently 14.6% and our overall CAR is 17.7% against 16.5% with an RWA of $18 billion.

In summary, as you have seen that our revenue grew by 16%. Net income 33%, return on tangible equity by 320bps or 13.4% and our NPL below 3% at 2.9% was a very high coverage of 170%. Our CET1 currently is at 12% and the overall CAR at 17.7%. Thank you and we are ready for any questions regarding the third quarter results.

(1) Correct statement is contribution rather than growth.
(2) Correct statement is 18.7% rather than 18.5%.
(3) Correct statement is net rather than non.
(4) Correct statement is 39.5% rather than 39.9%.
(5) Correct statement is cost of credit rather than cost to income ratio.

Operator: Thank you, sir. Ladies and gentlemen, if you would like to ask a question at this time please signal by pressing star one on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question today. We'll pause for just a moment to allow everyone an opportunity to signal for questions. Thank you.

As a reminder, to ask a question today that's star one on your telephone keypad. Thank you. Okay, we'll now take our first question from Rahul Shah from Exotix. Please go ahead. Your line is open.

Rahul Shah: Thank you very much for the presentation. I had a question on your Kuwaiti operations and in particular the cost of risk and the very high NPL coverage ratio. Is there any light at the end of the tunnel in terms of being able to reduce that cost of risk given your very high coverage ratio and the fact that your NPLs are actually dropping?

Raed Al Haqhaq: Actually as far as the coverage ratio this is an indication of the current NPL that we have and they are secured, as you know. As far as the NPL ratio we are enjoying a very low NPL ratio of 1.5%.

Rahul Shah: Yes, so – so my question is really that – my question is that your cost of risk you're saying is 1.2% which is quite a high level in an environment where you're NPLs are falling and your coverage ratio is already very high. Can you just comment on that anomaly?

Raed Al Haqhaq: Can you please highlight to me where you can see the cost of risk as 1.2%?

Rahul Shah: It's on slide 12, top-right.

Raed Al Haqhaq: Yes, exactly. This is of course including the normal provisioning for the lending portfolio. As you know, we are providing 1% for cash and 0.5% for non-cash. So all of it's not for the NPL ratio per se. And of course we have the general provisioning so it is not the – 1.2% as the normal healthy growth of the portfolio and the provisioning that we are having at the general level. Let me highlight more. We are having now close to 152 million precautionary provisioning and this 5 million is part of them and this is where the 1.2 million(1) is coming from. So it's not against a client or against a lending portfolio.

(1) Correct statement is % rather than million.

Rahul Shah: And – and do you think perhaps in relation to IFRS 9 being implemented that some of these precautionary provisions could become available for other uses?

Raed Al Haqhaq: We have started our parallel run. As you know, from the beginning of the year we continue to supply IFRS 9 calculations with normal calculations. Until now we have not finalized or heard from the regulator the final decision, but we continue to provide them and we are very much within the IFRS 9 requirement.

Rahul Shah: Thank you.

Raed Al Haqhaq: Thank you.

Operator: Thank you. There are no further questions. And again as a reminder, it's star one to ask a question today. We will now take our next question from Rakesh Tripathi from Franklin Templeton Investment. Please go ahead. Your line is open,

Rakesh Tripathi: Yes, hi, thank you very much for the presentation. I had a few questions regarding the Turkey operations. So given the kind of depreciation that we've seen in the Turkish currency, you mentioned that it partly contributed to the decline in the net loans. Can you talk about how much of the decline can be directly attributed to the Turkey operations? How much of the NPL increase is attributable to it and how do you see the outlook and the capital levels of the subsidiary?

Raed Al Haqhaq: Sure, thank you for your questions, sir. Let me just highlight that our Turkish operation as far as the holding or the Group level we continue to be hedged as far as the equity. If I can please highlight page number 12. You can see that under normal operations local currency in Turkey the loan growth is 23%. And when we consolidate and take it to KD this is where the drop is happening. . The loan growth year-to-date – sorry, I stand to be corrected 39%. And then when you convert it – as you know, the Turkish lira has devalued almost by 35% to 40% which will impact the loan portfolio. For the actual calculation we can send it to you or if there is – okay. The total net decline is 17.8%. This is in the BBT Turkey operation on the loans. This is due to currency.

Rakesh Tripathi: Okay, 17.8% is the impact you said – the percentage decline due to the Turkey consolidation translation effect, right?

Raed Al Haqhaq: Yes, sir. Yes.

Rakesh Tripathi: Okay and can you talk about the NPLs as well? I mean, with the challenging environment that's there in Turkey how do you see the NPLs of this entity performing and how do you see the outlook?

Raed Al Haqhaq: Absolutely. If we can go to the slide that we have highlighted the NPL, which is the slide number ten, you can see that the international activity has moved up from 5.1% to 6.9%. I'm sorry, that you didn't have this indicator but we will supply it also. This is representing an increase in the NPL in both Algeria and in Turkey. Currently Turkey stands at 3.5% NPL which is the lowest or one of the lowest in the sector. If the situation continues most likely the NPL ratio will go up but we need to focus on the coverage of the NPL ratio and the repricing capability of the healthy portfolio. Turkey even with the current circumstances continued to be a profitable entity that is contributing 20% of our revenue.

Rakesh Tripathi: Great. Finally just one last thing. On the capital levels of the Turkish subsidiary can you talk a bit about where its capital ratios are and whether you see any need for a possible capital injection or you feel it's doing fine?

Raed Al Haqhaq: As you know that we have increased our capital in Turkey twice. The first one was on the fourth quarter last year. The second one was on the first quarter. Currently we are enjoying a CET1 of 8% and the minimum of 7%. We don't see any future need to increase the capital due to the fact that we are extremely cautious. We are watching the market and our growth is linked to the healthiness of the portfolio, of course. And our overall CAR there, as you know, is 16%(1).

Rakesh Tripathi: Okay. Okay, Raed. Thank you very much. That answers my questions.

Operator: Thank you. There are no further questions in the queue. I'll turn the call back to the speakers for any additional or closing remarks.

Raed Al Haqhaq: Thank you so much for taking the time and since it is the 31st investor call we look forward of course for the year-end call. Just in case I have missed anything, if you would like to have any further answers to your questions, more information on any of the slides, please feel free to get in touch with that – with us and we'll be sure that we will supply it as soon as possible. Thank you.

Operator: Thank you. This concludes today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

(1) Correct statement is 16.4% rather than 16%.