Gulf Bank of Kuwait (K.S.C.C.)

Earnings Conference Call Edited Script

Year-end 2022

6 February 2023

Corporate Participants:

Mr. Tony Daher – CEO

Mr. David Challinor – CFO

Ms. Dalal AlDousari – Head of Investor Relations

Host:

Ms. Elena Sanchez – EFG Hermes

Elena: Good morning and good afternoon, everyone. This is Elena Sanchez, on behalf of EFG Hermes; I would like to welcome you all to the Gulf Bank year end 2022 earnings conference call. It is a great pleasure to have with us on the call Mr. Tony Daher, Gulf Bank CEO, Mr. David Challinor, Gulf Bank CFO and Ms. Dalal AlDousari, Head of Investor Relations at Gulf Bank.

I will now turn the call over to Dalal.

Dalal: Thank you, Elena. Good afternoon and welcome to Gulf Bank's year-end 2022 earnings call. We will start our call today with key highlights and updates on the operating environment of Gulf Bank during the year 2022 presented by our Chief Executive Officer, Mr. Tony Daher followed by a detailed presentation of our financial results by the Chief Financial Officer, Mr. David Challinor.

All amounts in the presentation are in millions of Kuwaiti Dinars and have been rounded to simplify the charts. During our presentation, we will try not to repeat the currency when discussing specific amounts unless that amount is in another currency other than Kuwaiti Dinars.

After the presentation, we will open the floor for Q and A received through the webcast platform. Feel free to type in your questions at any time during the call. The presentation will be available at our corporate website and will be disclosed to Boursa Kuwait.

Please note that we can only comment on inquiries and information that are publicly disclosed. I would also like to draw your attention to the disclosure on **page 10** of the presentation, with respect to forward looking statements and confidential information. Please feel free to reach out to our investor relations team if you have any questions.

Now, I would like to handover the call to Mr. Tony Daher. Tony?

Tony: Thank you, Dalal. Good morning and good afternoon, everyone. Our results of 2022 demonstrate good progress with Gulf Bank delivering strong financial performance, with our core businesses sustaining good growth momentum. We also made tremendous progress on our strategy and digital transformation initiatives, in line with our long-term plan to deliver sustainable value to all our stakeholders.

In 2022, the Bank realized the benefits of the Kuwait-focused strategy and is proactively meeting the changing needs of our customers. The Kuwait economy continued to recover in 2022, and demonstrated resilience and positive signals, despite challenging global markets and political situation. These challenges included high inflation, tighter monetary policy, and the war in Ukraine, amongst others. However, the local economic stability is supported by relatively good oil prices, recovery in key economic sectors, and ongoing structural reforms.

In 2022, and in line with Gulf Bank's focus on customer experience and friendly services, Corporate Banking commenced its digital transformation initiatives across all banking channels, and so far, the Bank has managed to migrate most clients onto the new online platform.

In Consumer Banking, the segment embarked on many initiatives to provide customers with best-in-class and secure banking services. During the year, the Bank launched an Omni-Channel Digital Transformation initiative which aims to move from a siloed approach to an Omni-Channel approach in order to unify customer experience across all touchpoints. This initiative will also support the Bank in meeting Central Bank of Kuwait's Cyber Security Framework and future customer needs. Furthermore, we continued to introduce tailored and rewarding products to our customers, and as a testament, the Bank was recognized by receiving two awards; the first is the "Most Rewarding Prepaid Card" for our Mastercard MOUJ Cashback Prepaid Card. The second award is for the "Best launch experience in the Middle East and North Africa" for the launch of the integrated and innovative "Click to Pay" service.

Also in 2022, we conducted several initiatives to provide our employees and community with new skillsets and opportunities specifically in the field of IT, data science and cyber solutions, with the aim to help future generations achieve local development goals, and to contribute to our community.

Looking forward, with robust fundamentals and strategic focus, the Bank is very well placed to deliver market-leading shareholder returns.

Now turning to Page 2, I would like to summarize our financial results with six key messages:

First, our net profit grew by 47% for the year 2022, to reach KD 61.8 million in comparison to KD 42.1 million reported in 2021.

Second, our earnings per share is up 46% to 19 fils and the Board of Directors is recommending a distribution of cash dividend of 10 fils per share, representing a 51% cash payout, in addition to 5% bonus shares, for shareholders' approval at the Annual General Meeting to be held in March 2023.

Third, our gross customer loans reached KD 5.2 billion, an increase of KD 319 million or 7% compared to the end of 2021. This growth was supported by both our Corporate and Consumer segments although at a faster pace for Consumer segment.

Fourth, the portfolio continued to be resilient as our non-performing loan ratio (NPL) for the year end 2022 stood at 1.1%, together with a strong NPL coverage ratio of 504% including total provisions and collaterals.

Fifth, the relaxed capital regulatory minimums that were introduced in 2020 were partially restored from first of January 2022. With that, at the end of the year, our Tier 1 ratio had a buffer of 371 basis points, and our capital adequacy ratio had a buffer of 389 basis points. These buffers have allowed the Bank to grow its businesses in line with its strategy.

And sixth, the Bank remains an 'A' rated bank by major credit rating agencies. Our current position stands as follows:

- Moody's Investors Service maintained the Long-Term Deposits Rating of "A3" with a "Stable" outlook.
- Capital Intelligence affirmed the Bank's Long-Term Foreign Currency Rating of "A+" with a "Stable" outlook.
- Fitch Ratings has upgraded the Viability Rating of the Bank from 'bb+' to 'bbb- 'during the year and affirmed the Bank's Long-Term Issuer Default Rating at "A" with a "Stable" outlook.

So, our performance during the year has further strengthened the Bank's fundamentals and will help the Bank continue to grow in a sustainable way into the future.

With that, I'll turn it over to our CFO, David Challinor, who will cover the financials of the year 2022 in more depth, thank you. David, over to you.

David: Thanks Tony.

David: **Turning to page 3,** we can see the movement of net profit from 42.1 to 61.8. The increase of 19.7 was mainly driven by the decline of 17.6 in total provisions. The Cost of Risk for the full year was only 49 basis points compared to 95 last year, which shows the overall improvement in the quality of our loan book. We also saw higher net-interest income of 9.9 supported by strong loan growth and the impact of the rate hikes. Also, higher non-interest income of 1.1. Operating expenses increased by 8, which almost entirely related to staff costs, an area where we've been investing heavily during the year.

You can also see our Return on Equity improved by 2.5% and we are now generating similar levels to the pre-covid period. It's also worth noting that Q4 2022 represented the 6th consecutive quarter of profit expansion which is evidence of strong earnings momentum.

Turning to page 4, we have a detailed breakdown of our income statement.

On line 1, interest income was up 58.5 or 31% in 2022 compared to the same period of last year. This was due to 7% growth of the Bank's loan book coupled with 7 CBK discount rate hikes totaling 200 basis points.

On line 2, our interest expense increased by 48.6 or 91%. The cost of funds is rising faster than the increases in asset yields but despite this we were still able to generate an expansion in net interest income, which grew 7% in 2022 versus last year, and 4% from Q3 to Q4 of 2022.

On line 6, operating income increased by 11.0 or 6%. This was predominately due to the increase in net-interest income of 7% and non-interest income of 3%.

On line 7, operating expenses have increased by 8.0 or 10% year-on-year, mainly driven by increased investment in our staff. The cost to income ratio reached 47.6% for year-end 2022, which we believe will normalize once we realize cost efficiencies upon the completion of the Bank's digital transformation journey.

On line 9, you can see our credit costs declined by 19.0, from 43.9 in 2021 to 24.9 in 2022. The cost of risk was 49 basis points in 2022, almost half of it versus 2021. This was due to an improvement in the operating environment in Kuwait, strong recoveries, and the overall high quality of our loan book.

Turning to page 5, we can see the balance sheet.

Over the year, our total assets increased by 296 or 5% to reach 6.9 billion. This was largely driven by a 292 or 6% increase in Net Loans, reflecting a pick-up in economic activity in comparison to last year.

Loans and Advances to customers grew by a 319 or 7% year on year, supported by both our Corporate and Consumer segments although at a faster pace from the Consumer sector as we recorded exceptional growth of 14% year on year.

On line item 17, Customer Deposits declined by 1% year on year to reach 4.2 billion. We saw our CASA ratio decline to 35.2% due to higher rates leading to some transition to term deposits.

On line item 18, we have increased our medium term borrowing by 130% year on year which improves our overall duration.

Moving on to asset quality, our non-performing loan ratio, shown on line 25, was 1.1% at the end of 2022, down from 1.2% at the end of September 2022. Our coverage ratio on line 26, remains exceptionally strong reaching 504%.

Now, turning to Page 6 you can see in the chart on the left that as of 31 December 2022, the Bank has 124 of excess provisions, representing 39% of total provisions.

Looking at the pie charts on the top right of the page, you can see that our stage 1 loans have increased to 93.8%, Stage 2 has declined to 5.1%, and Stage 3 slightly increased to 1.2%.

The chart on the bottom right side of the page shows the evolution of Stage 2 and stage 3 percentages historically. We can see that both our Stage 2 and stage 3 remain very low and stable.

Turning to page 7, on the top left, our Tier 1 ratio was 14.2%, which is above our 2022 regulatory minimum of 10.5%.

On the bottom left, our Capital Adequacy Ratio of 16.4% was above our 2022 regulatory minimum of 12.5%.

Our risk weighted assets, shown on the top right, grew by 8%, mainly driven by the strong year-on-year growth in our loan book.

On the bottom right, our leverage ratio as of 31 December 2022 was 9.7%, which was slightly higher than 9.5% for the same period of last year, and well above the 3% regulatory minimum.

Turning to page 8, we can see our key liquidity ratios. the chart on the left side shows or Liquidity Coverage Ratio, which was 246%, and on the right side, you can see the Net Stable Funding Ratio was 108%. It's worth noting that both ratios are still well above their respective 2022 minimums of 90% and pre-covid minimums of 100%.

Now I will turn it back over to Dalal for the Q and A session.

Dalal: Thank you David. We are now ready for Q and A. If you wish to ask a question, please submit your question into the designated questions text area. We will pause for few minutes to receive most of your questions.

(Pause)

Ok, we will go through the questions.

Dalal (Q1): **We have another question on margins. Why NIM's didn't correspond significantly with interest rate hikes? And what are the trends going forward? David?**

David (A1): The NIM expanded in Q4 by 10 basis points. This followed an expansion in Q3 of 13 basis points. In the first half the NIM remained flat. So, now we're really starting to see the benefit flow through of the rate rises. There's been 7 CBK rate rises in total during 2022. The first 6 were all 25bp and the last one in December was 50bp. However, we've seen a lot of pressure on the cost of deposits following the first 6 rates rises but less so with the rise in December. We also saw recently, on 26 January, another 50bp rise in the CBK discount rate where there was limited corresponding pressure on the cost of deposits. So, we think that the last 100bp of rate rises will work more effectively to support and increase the margin in 2023 which will in turn work to improve the growth in operating profits. We also have significant CASA balances, representing 35% of our total deposit book, and this is acting as a hedge against the cost of fund pressures.

Dalal (Q2): **I can see few questions related to the loan book growth. Although the loan book grew year on year, however it contracted in Q4. David, can you comment on this?**

David (A2): Thanks, Dalal. I think with loan growth its useful to look at our retail and corporate businesses separately.

In our retail business, we saw continued growth in Q4 and a full year growth number of 14%, which is the highest we've seen in at least the last 5 years. Comparing this to the market, according to the CBK data, the market grew 9%, so we've gained market share in 2022, so this is particularly pleasing given the fact that retail is core to our strategy, and we've invested heavily in this business.

On the corporate side, we had a de-growth in Q4 of around KD130m which reflected a combination of scheduled repayments, settlements, and some new bookings.

We're very focused on margin and clearly the margins in retail are much higher – CBK plus 3% versus Corporate at around 1% and sometimes below. In corporate we've raised the return hurdles which has led to a more selective approach in booking new deals. So, we will likely see the asset allocation of the balance sheet between retail and corporate continue to shift more towards retail. This will support margin expansion; it will also allow us to realize the return on investment we've made in retail. We've already seen this asset allocation shift play out in 2022 as retail has gone from 39% of our loan book in 2021 to 42% in 2022. And 3 years ago, it was 35%.

We want to use the balance sheet as efficiently as possible, and I think also given where funding costs are at right now, and particularly the marginal cost of deposits, it makes sense for us to grow faster in retail than in corporate.

Dalal: Thank you David

Dalal (Q3): **We have a question on the cost of risk and asset quality. Are you seeing any pressure on provisions due to rate hikes and how sustainable are the current levels of Cost of Risk? David?**

David (A3): Credit costs continue to be very low and well below where I think the normalized level is, which I've said previously is around 1%. We booked around KD9m in Q4 which is a similar level to Q3. For the full year, credit costs are almost half of where they were last year which is obviously a great outcome. In terms of cost of risk, that translates to 50bp for the full year versus 95bp last year.

The quality of the book continues to be exceptionally high. We continue to have very low NPL's at 1.1%, which have been very stable, and our stage 2 percentage at 5.1% continues to be very low and stable too. And the total provision coverage is over 500% including collaterals. I think we are very well placed to deal with any rate rise stresses. I think in 2023, at least in the first half, we should expect a continuation of the current trend, with no negative surprises. Overall, the asset quality of the bank continues to be very strong, and all the metrics and indicators are very positive.

Dalal: Thanks David. We will pause for few minutes to receive more questions.

(Pause)

Dalal (Q4): **I can see we have questions on operating expenses, what are the reasons for the increase in OPEX? David?**

David (A4): Thanks, Dalal. Total operating expenses are up 10% year on year with almost all the increase coming from the staff costs line. I've said before we've been investing in our staff and in particular Gulf Bank was the first bank in Kuwait to enact gender equality in employment benefits which is something we're very proud of.

We've clearly seen exceptional growth in our retail business and this growth does come with a variable cost element in the form of investment in the sales force. We also awarded pay rises across the bank broadly in line with inflation. We did see a tick up in staff costs in Q4 from the levels in both Q3 and Q2, but this was due to some year-end one offs. My expectation is that staff costs will come down in Q1 2023 and be more in line to the levels we saw in Q2 and Q3. We're still investing in our digital transformation program, which is going well, and we would be looking to realize meaningful cost efficiencies post completion, which we expect will be towards the end of this year.

Dalal: Thank you David

Dalal (Q5): We received some questions on the proposed Business Collaboration with ABK. What is the latest update on the transaction? David?

David (A5): The most recent disclosures Gulf Bank made in relation to the potential collaboration between Gulf Bank and Ahli Bank of Kuwait was on November 23, 2022. The disclosure stated that Gulf Bank obtained the approval of the Central Bank of Kuwait regarding the engagement of McKinsey & Company as the Bank's consultant to carry out the feasibility study.

We will disclose any future material information in this regard as and when it becomes available.

Dalal: I believe we answered the majority of the questions. And with that, we would like to conclude our call for today.

If you have any questions, you may visit our investor relations page at our website or reach us at our dedicated investor relations email. Thank you all very much for your participation today.