P.O. Box 5389, Al Safat 12170
State of Kuwait
Telephone: +965 2298 8000
Fax: +965 2298 8419
Authorized Capital KD 400,000,000
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Commercial Registration Number 24067
www.burgan.com

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بنك برقان
BURGAN BANK
K.P.S.C. | ش.م.ك.ع

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الكويت في: 2023/02/20
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M/s Boursa Kuwait

السادة / شركة بورصة الكويت المحترمين،،،

Dear Sirs

تحية طيبة وبعد،،

Sub: Burgan Bank K.P.S.C. Analyst Conference transcript for the Financial year 2022

الموضوع: محضر مؤتمر المحللين لبنك برقان ش.م.ك.ع. للسنة المالية 2022

Reference is made to the above subject and in compliance with the provisions of clause (4) of article (8-4-2) of Boursa Rule Book; attached is the transcript of the Analyst conference that was held via phone at 02:00 pm, Tuesday, corresponding to 14/02/2023.

بالإشارة إلى الموضوع أعلاه، والتزاماً بأحكام البند (4) من المادة (8-4-2) من كتاب قواعد البورصة، مرفق لكم طيه محضر مؤتمر المحللين والذي تم عقده عبر الهاتف في تمام الساعة 02:00 من بعد ظهر يوم الثلاثاء، الموافق 2023/02/14.

Best regards,

وتفضلوا بقبول فائق الاحترام،،،

خالد فهد الزومان
Khaled Fahad Al-Zouman
رئيس المدراء الماليين للمجموعة
Group Chief Financial Officer

بنك برقان
Burgan Bank

BB/005-08/2022

FY'22
Earnings Conference call Transcript
Tuesday, 14th Febraury 2023

FY' 22 Burgan Bank Earnings Call

Tuesday,14th February 2023

Transcript of Burgan Bank Earnings conference call on Tuesday, 14th Febraury 2023 at 14:00 Kuwait time (UTC+03:00)

<u>Burgan Bank Participants:</u>

Mr. Khalid Al Zouman	**Group Chief Financial Officer**
Mr. Naveen Kumar Rajanala	**Group Head of Strategy, Capital Management and Investor Relations**
Mr. Hamad Al Bader	**Manager – Group Strategy, Capital Management and Investor Relations**

Operator (Elena Sanchez):

Good afternoon everyone and welcome to the Burgan Bank Group FY 2022 Earnings Call. Thank you very much for taking your time to attend this conference call. Today's conference is being recorded. With that I would like to hand over to Mr. Hamad Al Bader from Burgan Bank, to kick off the call.

Hamad Al Bader:

Thank you, Elena. Good afternoon everyone and welcome to the Burgan Bank Group FY'22 earnings call. Thank you very much for taking the time to attend this call. Joining this call from Burgan is Mr. Khalid Al Zouman, Group Chief Financial Officer and Mr. Naveen Rajanala, Group Head of Strategy, Capital Management and Investor Relations and Myself.

I would like to highlight that slides 4,5 and 6 are highlighting Burgan Bank Group's key details including, key overview of the bank & its strategy.

With that, let me cover Slide 8 which highlights key business updates:

- As we noticed over last few quarters our Retail transformation in Kuwait has been underway over the last 18 months & these efforts are providing results:
    - In 2022 the client acquisition numbers are up given strong sales focus & successful product enhancements.
    - The Key impacts:
        - Revenues: 25% year-on-year.
        - Loan Growth: 22% year-on-year.
        - And the deposit balances also have grown.
- Another key progress has been a strong turnaround in BBT's performance:
    - Our strategy of lower loan growth, tighter underwriting and focused efforts on recoveries has started yielding results.
    - Key impacts of BBT standalone:
        - Operating performance:

- ✓ Revenues +71% year-on-year; Net Income +472% year-on-year; ROE (FY'22) 54%.
- ✓ Asset Quality: CoC 0.2% (FY'21: -4.0%); NPL Ratio 4.2% (FY'21: 6.7%).

- Coming to the final item:
  - All the regulatory approvals are in place.
  - Sale consideration is USD 125mn.
  - All transaction terms are agreed and we expect to complete Iraq Stock Exchange requirements over the next few weeks.
  - The key impacts of BOB's sale are as follows:
    - CET1 Ratio improves by 70bps+
    - Protection of NPL Ratio by around 60bps.

With that I will hand over to Mr. Khalid Al Zouman.

Khalid Al Zouman:

Thank you, Hamad. Moving on to slide 9, with some performance highlights. Let me start with FY'22:

- Burgan's margins have improved by +30bps year-on-year to 2.4%. The CBK rate hikes helped & supported along with improved margins in Turkey.
- Credit Costs improved significantly to 60bps for FY'22, down 130bps year-on-year, international operations performance was very good on credit costs front, especially Turkey.
- FY'22 Net Income increased by 15% to reach KD 52.1mn & Q4'22 Net income grew significantly year-on-year to reach KD 11mn.
- The recommended cash Dividend for the year is 8 Fils per share.

Moving to slide 11, which captures all key P&L items:

- The Group's Revenues has been stable at KD 232mn for FY'22. The revenue has been driven by the Net Interest Income growth of 15% year-on-year, this growth has been offset by fall in investment income, mostly security gains.
- The Net Interest Income growth was a result of 30bps improvement in Net Interest Margins; in Kuwait margins improved by 10 bps.
- The Group's Operating Profit for FY'22 is at KD 125mn; fell due to expense growth in Kuwait & Turkey.

- The Group's Net Income grew with a CAGR of 24% to reach KD 52mn for FY'22.
- The Cost to Income Ratio increased to 46.1% for the Group and 44.6% for Kuwait, due to lower investment income and a slight increase in operating expenses.
- With our ongoing prudent risk practices across the Group, Cost of Credit has been significantly reduced to 60bps for the Group and 50bps for Kuwait. This is largely attributable to the improved performance of Turkey.

Moving on to slide 12, we have added this slide to give a true sense of the bottom-line generated by the bank.

- The normalized income generated by the bank is KD 77mn which is pre- IAS 29 impact.
- The IAS 29 impact on P&L has brought down the reported Net Income to KD 52mn

Moving to slide 13, which reflects the Group's stable Asset Quality metrics:

- The Group's NPLs for FY'22 stood at KD 88mn, decreasing by 34% over the past two years, driven by a fall in BBT's NPLs and increased recoveries.
- The Group and Kuwait's NPL ratios are at 1.9% and 1.4% respectively for FY'22.
- Significant reduction of the Group's Provision charges by 43% over past two years down to KD 25mn for FY'22.
- Our Coverage ratio for the Group and Kuwait continues to be healthy. The Provisions coverage ratio is 279.2% for Kuwait and 205.7% for Group.
- Collateral benefits are on top of the provisions & are not included in these ratios.

I will now hand over now to Mr. Naveen who will cover the rest of the presentation.

Naveen Rajanala:

Thank you, Mr. Khalid. Good afternoon everyone.

Moving on to slide 14, which shows details of Assets over the last 3 years and loans by stages over the last 3 years:

- Firstly, the Group's total Assets are stable at KD 7.2bn
- The Group's loans for the year are at KD 4.2bn.

- No major movement in the sector concentration as it remains similar to the previous quarters.
- The loans by stages graph shows a healthy trend over the past two years where stage 1 loans improved to 83.1% and stage 2 loans fell to 14.8%.
- Further if we drill down 2022 numbers, the stage 2 loans share of Kuwait business is 14.1%.
- The staging criteria applied is as per CBK IFRS 9 rules and is applied to Kuwait and International operations numbers.

Moving on to slide 15, the key messages are as follows:

- Top left chart shows decline in customer deposits. But this is due to optimization of funding strategy costs especially in rising rates environment. We are proactively replacing and reducing expensive deposits with other liquidity sources.
- We continue to focus on maintaining and growing CASA balances; the CASA balances are about 36% of total deposits, which continues to trend upwards.
- Looking at the regulatory ratios; LDR, NSFR and LCR, no surprises here. We continue to be well above required levels.

Moving to slide 16, the key takeaways are:

- The Group's CET 1 Ratio fell marginally to 10.8%, but this is a temporary blip. Once Bob is sold the CET 1 ratio should go up to 11.3% to 11.5% levels.
- The regulatory minimum capital requirements will be back to pre-Covid levels from Q1'23.

Moving on to slide 17, which provides an aerial view of the key metrics of our international operations:

- Some key common points:
  - Overall metrics across the international operations are very positive.
  - The NIMs continue to be high across all these markets.
  - These international operations constitute about 24% of the Group's assets.
  - The contribution of the international operations to the Group's results has been strong in FY'22.

- Turkey:
  - 2022 has been a remarkable year for BBT, on a standalone basis.

  - As you can see all metrics trending positively, Asset quality improvement continues with NPL ratio fall & CoC reductions.
- Algeria
  - Algeria continues to be a profitable franchise with high margins and low credit costs.
- Tunisia
  - It's a small & profitable franchise.
  - Delivering a stable performance in 2022.

Moving on to slide 18, to give a quick update on Q4'22 numbers:

- Revenue growth of 17% over the past 2 years; largely due to strong international performance.
- Net Income grew to reach KD 11mn.
- NIMs for the Group and Kuwait both increase to reach 2.8% and 2.0% respectively in Q4'22, reflecting more or less the full impact of rate hikes that started in Q2'22.

I will now hand over to Mr. Khalid who will conclude the presentation.

Khalid Al Zouman:

Thank you, Mr. Naveen.

To Summarize:

- We have made significant progress in key strategic initiatives in the year, as we have covered in certain slides.
- We expect margins to be stable and Credit costs to also normalize, we don't see any surprises at this stage.
- Lastly, macro headwinds and risks still remain:
  - likelihood of global recession could impact credit costs.
  - We have been hearing about recessionary fears and of this happens, they will impact credit costs across the banking system.
  - Turkey will remain volatile, especially in the run-up to the elections in May.

Lastly, I want to say that Burgan's prayers and thoughts are with the families and individuals who have been impacted by the recent tragic earthquake in south Turkey and Syria.

With that, I conclude the presentation and will now hand it back to Ms. Elena.

Elena Sanchez:

Thank you very much for the presentation. We will now move to the Q&A. If you have a question, you have two options. Either you can write it in the Q&A designated area, or you can click on the Raise Hand icon and I will unmute your microphone. We already received a few questions here in the Q&A chat, so I will start reading some of them. One of them is do you have a target retail loans contribution to total loans, driven by your new retail strategy?

Khalid Al Zouman:

As mentioned earlier there was growth in 2022, and we expect this to continue in 2023. With the current CBK discount rate level, this provides an opportunity because, the retail loans in Kuwait are fixed at five years, so we expect there will be a slowdown and, by 2024, maybe CBK's discount rate will be going down, that means we have a healthy loan book with good margins locked for five years. So yes, we're going to continue this year in growing our retail loans.

Elena Sanchez:

Thank you, Mr. Khalid. I will move on to the next question. Please let us know if you intend to call the AT1 bond at the first call date in July 2023.

Naveen Rajanala:

The first call date is 2024, not 2023, so we are still a good 15 to 18 months away from that event. Obviously, this has not been discussed but we will look at and discuss and our action will be reflected based on market practice. Unfortunately, it's too early to get into the discussion of how much will be called and what price it will be called, etc. But again, I think the recent impact is that all banks are calling back and we will take the call and expect to not deviate from market practice.

Elena Sanchez:

Thank you, Naveen. Next question. Can you provide some guidance on NIMs and cost of risk for 2023? How should we be thinking about loan growth in 2023 as well? And also, sorry, it's a lot of questions in one question, any guidance on the net monetary loss from Turkey for 2023, given the current situation?

Khalid Al Zouman:

Going back to the NIMs, we expect it will be stable for 2023. In terms of loan growth, Burgan is always a conservative bank in terms of loan growth because we have to look at our CET1 ratio, so we always want to have a cushion with our CET1 ratio. In terms of IAS 29 impact, it will still be there in 2023, but when we built up the scenarios with our economist, our view is that it should not be at the same level as 2022, but i think it's too early to comment.

Elena Sanchez:

Thank you, Mr. Khalid. A question on capital. What is your minimum internal level for CET1 and CAR compared to the regulatory requirement?

Naveen Rajanala:

As we have said in the past, I think we typically aim for about 100 basis points of buffer over CET1 ratio. The CET1 ratio minimum is expected to go back up to 10.5% for Burgan. We expect to, or we aim to, have around 100 basis points over that. But obviously during the year, as I've explained in the past, as there is growth in RWAs, this ratio keeps falling, but at the end of the year, once the profits or retained earnings are added back, we tend to be around the 11.5% mark. We've done that very successfully over the last six to seven years, and we continue to aim to do that. At a total capital level, the minimum will jump to 14%, we typically aim to have about 200-250 basis points of buffer at the total capital level.

Elena Sanchez:

What is a normalized cost of risk for the bank?

Khalid Al Zouman:

In the past, around 1%. However, the conservative approach which has been done in 2021 has been reflected in our performance for 2022. So historically, it is 1%, but lately we have been noticing a drop down on our cost of credit.

Elena Sanchez:

Okay. What is the current percentage of CASA accounts of total deposits? And what is the percentage of USD-denominated deposits and loans at the group level?

Naveen Rajanala

CASA is 36%, at group level, of total deposits. I don't have the exact figure of dollar-deposit percentage, but effectively it's driven by the fact that what is our balance sheet, our asset requirement on the other side. Most of our dollar deposits are either funded by syndicated loans, or some of the international operations that we have, they have access to dollar deposits. But it's again a conscious choice to use the syndicated route because the costs are a lot more effective than borrowing it directly from customers.

Elena Sanchez:

Thank you, Naveen. A few questions on credit quality and cost-to-income ratio. What is driving the increase in the cost-to-income ratio from Kuwaiti operations on a year-on-year basis?

Khalid Al Zouman:

We have been investing in our retail banking and that's why we increased our sales force. We have been investing in our digital banking also and that's what has been driving our operating costs and staff costs.

Elena Sanchez:

Thank you, Mr. Khalid. What is driving the increase in absolute NPLs in Kuwait in 2022?

Khalid Al Zouman:

It was a one-off, and just one customer, and we took the decision earlier in 2022 that we classify it as NPL and at year-end we wrote it off.

Elena Sanchez:

Okay, thanks. Apart from the sale of BOB, what are the other strategies to boost capital buffers?

Naveen Rajanala:

I think once the BOB sales settles down, as I said, that will be plus 70bps. We are looking at other potential solutions, like in the past we have done some RWA-optimization and we'll continue to look at those and make sure that our capital levels are at the levels we mentioned earlier, to ensure that enough buffer above the CBK minimum continues to be there for the foreseeable future, factoring in our growth plans.

Elena Sanchez:

Do you have a target for the KIPCO entities lending exposure reduction from 24% in 2021?

Khalid Al Zouman:

Yes, there is a plan for reduction.

Elena Sanchez:

What is the percentage of dinar-denominated corporate loans at the end of 2022?

Naveen Rajanala:

Most of our corporate book is Kuwaiti dinar-denominated. If I were to give a split of corporate in terms of KD-FC, it would be close to 85%-15% in favour of KD. Retail book is completely KD, and we also have a private banking book which is also 90%, 95% Kuwaiti dinar-denominated. The key difference, as Mr. Khalid pointed out, retail is fixed whereas the other two portfolios are CBK discount rate-linked, and they reprice pretty much the very next day if there is a hike or drop.

Elena Sanchez:

Thank you, Naveen. I can see a lot of questions on NIMs, even if you already indicated your guidance, but I will try to summarise them all together, one of the questions is whether the spike that we saw in the NIM in Q4 2022 is sustainable. Another question is around whether NIMs can be sustained in 2023, despite the assumption of NIM contraction in Turkey. And also, how do you expect higher rates to impact your NIMs? I think it's all incorporated in the guidance you have given, but if you could elaborate a little bit more, I think that would be helpful. Thank you.

Naveen Rajanala:

Again, as Mr. Khalid pointed out, we expected to be at the same level purely because though the market expects a few more rate hikes to happen, as we've seen in the past, the CBK discount rate does not necessarily follow the same path. It's hard to guess the future movements of CBK discount rate. But at the same time, what we've also seen in the past is the KD deposit rates are also going up. So, factoring in everything, we don't see this adding any upward movement on NIMs. We expect the NIMs to be at these levels. There's always room for optimization, but I think our base case is that it'll continue to be the same.

Secondly, in Turkey last year, margin was a very good story, but we're already seeing pressures on those Turkish margins this year, so we might have some drop there. Hence, considering all of this, we expect the margins to be at the same levels as at the end of 2022.

Elena Sanchez:

Thanks, Naveen. And there is a related question to that. What is the impact of new regulation in Turkey that caps lending rates?

Naveen Rajanala:

As I said, we're already seeing that, and that will have some impact on our margins, and we are monitoring. But it's a little too early, as you can appreciate, the regulations there are changing very, very frequently.
So, it's a little difficult to give the outlook, especially when we are in a period where elections are about three months away. So, a lot of regulations and requirements will keep going up and down, it's slightly difficult to give an outlook.

Elena Sanchez:

Does your CET1 ratio guidance of 11.3% to 11.5% include the dividend payment of 8 fils per share for 2022?

Khalid Al Zouman:

Yes, absolutely.

Elena Sanchez:

A question on the capital ratios for the subsidiary in Turkey, and how much buffer you have there over the minimum requirements.

Khalid Al Zouman:

Actually, we are working closely with our colleagues in Turkey in order to have a sufficient buffer for their capital requirements. We have agreed with them on an overall risk-weighted asset boundary and we will always be there to support. But having said that, in the coming period, I don't think they need any capital injections from our side, and they are running their balance sheet in a very optimized way.

Naveen Rajanala:

If I can just add to Mr. Khalid, one of our strategies, as mentioned, is we're maintaining or containing the growth, and in our planning processes also we've ensured that the balance sheet growth is in such a manner where retained earnings is good enough to be a sustainable business. So, we do not foresee capital injections based on our plans.

Obviously, we understand Turkey is a volatile market. If regulations change then, we will inject cash. But as of now, they are very sufficient. In terms of numbers, Basel III, the minimum CET1 ratio requirement is 7%. As of September, they were at 9.7%. And there was a recent regulation change at the beginning of this year, where they moved the exchange rate that they're using for capital calculations and in spite of that change, BBT has enough buffer to continue as per our original plan.

Elena Sanchez:

Okay, thanks for that. A question on cost of risk and return on equity. Is cost of risk in the 60 bps area likely for 2023? And also, what is your target ROE?

Khalid Al Zouman:

Upon the review of our budget, we reached a conclusion that it will be in that range. However, today it's difficult to project. There is no question that there will be an impact of recent tragic event in Turkey, But we have insurance and we have business continuity plans in place, our guys are very proficient and they know their work.

Elena Sanchez:

Are you seeing a shift from CASA to time deposits? And if you are seeing that, will that impact your funding costs?

Khalid Al Zouman:

Our focus was to improve CASA balances in Kuwait, and that's why we invested a lot in retail, because that will bring in the cheaper funds. Even in 2022, we changed our draw account features, so we attracted more customers, and thus the incentivization scheme has been built around how to bring in cheaper funds.

Naveen Rajanala:

Yes, completely, I think with any retail transformation, obviously it takes time. I think we've had a successful start; the last 18 months were good. In a rising rate environment, there's always a risk of shift of funds from CASA to deposit, but the team has defended it well, primarily because there's been more focus on increasing client acquisition.

Secondly, we've done product enhancements, as Mr. Khalid mentioned. Draw account is a big CASA driver for most banks in Kuwait, and we've defended and increased the balance very successfully on the back of that. We've also relaunched salary account, which again should bring in CASA balances. But again, it's not going to be overnight, it is something that will build over time. So yes, definitely these are there.

On top of this, we've invested in our cash management solution, and we are seeing already a lot of sign-ups from our corporate customers on the platform. We are seeing increased transactions on those cash management platforms, and we expect that, over time, the CASA contribution from these customers also will build. But again, we'll have to be a little patient with that build-up. Over the next two, three years, you will see the dial moving.

Khalid Al Zouman:

Yes, and I don't know whether we mentioned this in earlier calls or not, but Burgan Bank Turkey have launched their digital banking platform, and they had a very successful launch and they have been collecting good customer accounts and funds through their digital banking. And that's why their team is helping our team in Kuwait, so we can be on a fast track to launch our own digital features.

Elena Sanchez:

Thank you. Can you discuss your progress on ESG?

Naveen Rajanala:

Firstly, from a reporting point of view, we've fixed the ESG reporting infrastructure. We've taken many efforts, over the last 12 to 18 months.. One is because of a lot of the fixeson the reporting, it starts reflecting on all the good things the bank is doing on the ESG front.

If we look at our MSCI ESG rating, the score used to be about 2.7 to 2.8 levels. Now, that's jumped up 30% plus, to 3.7 levels. We expect a rating upgrade on the back of that, but again there's been a little bit of a delay from MSCI's point of view to publish the new rating. But it is imminent. So that reflects all the progress that we've made, especially on the social part.

Now, on the environment part, our colleagues in GSA have started a few initiatives, be it the LED fixing here, we've added a few charging stations for electric vehicles, etc., but these are initial baby steps. I think the game-changer, and we've started some work on it, is to look at the whole risk management from an ESG point of view. That takes time, obviously, but then we also need to have opportunities in this market to give ESG-friendly exposures.

But having said that, our exec management is fully committed to the ESG agenda and we want to continue this journey both in terms of improving our reporting and rating, and also starting to contribute meaningfully to ESG projects as and when they are available.

Elena Sanchez:

Last two questions. One of them is if you could disclose or comment on the share of Kuwaiti dinar profit to total group profit, even a range would be fine. And lastly, if interest rates continue to be high for an extended period of time, in which loan segments do you see higher risk?

Naveen Rajanala:

Kuwait as a percentage of the group is 80%, but again, within Kuwait, as Mr. Khalid pointed out, most of it is Kuwait dinar. I would say about 80%, 85% would be KD, and the rest would be foreign currency.

Was there another question on customer segments?

Elena Sanchez:

Yes, sorry. The last question is if interest rates continue to be high for an extended period of time, in which sectors do you see higher risk of credit quality deterioration?

Khalid Al Zouman:

Interest rate increase might have some impact on some real estate customers. However, usually, as a bank, when we lend to a customer, we lend based on cash flows. We have good coverage, collateral, nothing less than 150%, so every six months we are reviewing our portfolio in terms of portfolio risk management, and yes, we are in the business of lending, always there is a possibility of some non-performing loans eventually.

Elena Sanchez:

Okay. Thanks for that. I cannot see any further questions, so at this point we can conclude the call. I would like to thank Mr. Khalid, Naveen and Hamad for their time and for the presentation. And also, I would like to thank everyone for attending the call today.

Khalid Al Zouman:

I would like to thank you and thank all the attendees for their time.

Naveen Rajanala:

Thank you.

Hamad Al Bader:

Thank you.