Q1 ’20 and H1’20

Earnings Conference call Transcript

Tuesday, 18th August 2020

H1' 20 Burgan Bank Earnings Call

Monday, 24th August 2020

Transcript of Burgan Bank Earnings conference call that took place on Tuesday, 18th August, 2020 at 14:00 Kuwait time (UTC+03:00)

Burgan Bank Participants:

Mr. Raed Al Haqhaq	**Deputy Group Chief Executive Officer & CEO- Kuwait**
Mr. Khalid Al Zouman	**Group Chief Financial Officer**
Mr. Naveen Kumar Rajanala	**Group Head of Strategy & Capital Management**

Operator:

Good day and welcome to the Burgan Bank first half of 2020 earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Elena Sanchez. Please go ahead.

Elena Sanchez:

Thank you. Good morning and good afternoon, everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to Burgan Bank’s H1 2020 results conference call. It's a pleasure to have with us in the call today the following speakers from Burgan Bank, Mr. Raed Al Haqhaq, Deputy Group Chief Executive Officer and Chief Executive Officer-Kuwait, Mr. Khalid Al Zouman, Group Chief Financial Officer, and Mr. Naveen Kumar Rajanala, Group Head of Strategy and Capital Management. The call will begin with a presentation from management on the key highlights of the first half of 2020. And then we can open the floor for Q&A. At this time, I would like to hand over the call to Mr. Raed. Thank you.

Raed Al-Haqhaq:

Thank you, Elena. Thank you everybody for joining us. Hopefully everybody's staying safe and in good health. I will start with the first slide - slide number 4 in the power point, which is basically what we have done to deal with the current situation. Our response to COVID-19 has been swift and immediate. We have swiftly responded by supporting our customers, community and employees in those difficult times. I will start with our customers. We have postponed the retail loans for six months, and as far as corporate and private banking, relationship managers are in direct contact and supplying our clients with all of the information and any activity that they require remotely. Our call center has been operating smoothly, 24/7 remotely and even during the full curfew.

As far as our employees, we have formulated COVID-19 response team to monitor on a regular basis the safety standard across all of the bank. We have also introduced seamless remote access through all the functionalities from relationship manager, operation, credit admin, and so on. We have not stopped there, we have also continued our training remotely to keep our staff up to date with all their training requirements. Last, but not least, we have kept supporting our community through significant contribution to COVID-19 related relief measures, introducing and maintaining our high safety measures for our employee and staff. Branches and ATMs have always been kept safe and we have also provided all with sanitizers, masks and gloves.

I can move to slide number five, please. Starting with February, you can see that our customer registration increased from 10,000 to 24,000. But most importantly, the activities online have increased from 171,000 to 939,000. This is thanks to our investment in technology throughout the last two years by upgrading the operating systems, strengthening the middleware, enhancements on the Omni channel platform, introducing the Tijariti app and other products to facilitate the remote access of our clients.

On slide number seven, as we have mentioned, the Bank of Baghdad sale did not go through due to the current macroeconomic (situation), the buyer reconsidered the transaction, which we totally understand. And as far as the financial impact, we had already booked a loss of KD 8.7 million in the fourth quarter last year, and there is no further P&L impact currently. The only change that happened was to the NPL ratio, where you can see an increase of 70 basis points. Mr. Khalid will be covering slide number nine onwards

Khalid Al-Zouman:

If we turn to slide number nine, which talks about our revenues and margins and we're trying to show here to our investors and readers of the financials, that our revenues were stable during the previous quarters, maybe we have some exceptional revenues like recoveries and income in Q4'19. However, it has been stable for the first quarter, except when CBK started to lower the CBK discount rate. And everybody knows that at the end of Q1' 20, Central bank decreased the CBK discount rate by 125 basis points. This has been affecting our margins and because of this our margins went down. But at the same time in Q2'20, we started to see some lower activities. Remember that we went into a full lockdown, and this has been lowering trade and economic activities.

If we move to slide number 10, what we're trying to say here that during this period we are trying to control our expenses, if you look at the previous quarter and going forward we are trying to control and monitor our expenses. And because the revenues went down due to faster repricing of our loan book, our cost income ratio has increased. In terms of slide number 11, here it talks about our cost of credit. Same thing, again, if you look at the previous period where we had a very decent cost of credit. However, in Q4'19 the jump is because our bank has taken certain provisions on the group level, because we wanted to strengthen our provisioning coverage at the group level. Plus, we rebuilt certain provisions as we had previously written off a debt using some provision from the CBK pool. Now that we recovered those debts, we were rebuilding those provisions. So, in a nutshell, in Q1'20 we saw some drop and in Q2'20, although in BBT, we had some nonperforming loans coming into our books, but in Kuwait and Algeria, we have very minimal charges. So, although we have been affected by BBT, because of the good performance of loan book in Kuwait and Algeria, we kept the same level of our provisioning charges. Plus, in Q2'20, we have taken some precautionary provisions.

Going to the last slide between our cost of credit, revenues and operating expenses, you will see our net income has been a reflection of the three items we discussed in the previous slides. And if you see the drop in Q2 '20, why it has been very low because of the precautionary provision I just mentioned in the previous slide. And if you look at the right side of the slide, if you compare last year-half year with this year-half year, last year-half year we have some exceptional income, like we have some dividend and some recoveries, that's what made the difference. Plus, as I mentioned, the CBK discount rate has also affected our revenues, which affected our net income. Last year, we have a higher CBK discount rate. The reduction started with 25 basis points in November'19 and then in Q1'20, another 125 basis points. So, this has affected our revenues.

The last slide I am going to talk about, which is slide number 13, is actually our NPL coverage and NPL ratio. We just want to highlight to all the readers of our financials, that if you look at the previous quarter and now, you would see that the only change is coming is in Q2, which is mainly from Turkey. Otherwise, as Mr. Raed just mentioned, we were in a situation to sell BOB but now the deal has been canceled so we are adding BoB's NPLs to the calculation of our non-performing loan ratio. However, if you look at the coverage ratio, our coverage has dropped mainly from BBT, because in Turkey they have a lower coverage. So, with their loans becoming NPLs and their lower coverage, it has affected our NPL coverage ratio. But still we think 185%, is a reasonable number. Yes, it is lower than the previous period, but we hope that these loans, as we go on, either we recover or we are going to build a provision to improve our ratios. And thank you. With that slide, I turn over to Mr. Naveen, our colleague.

Naveen Rajanala:

Thank you, Mr. Khalid. Now that we have covered the profit and loss update and our income statement, moving to the balance sheet, so we continue to grow in Kuwait and as we've been seeing over the last few quarters, Kuwait remains the growth engine of the group. Our loan book in Kuwait grew by about 5% and the group level we are stable with the international portfolio stabilizing over the last couple of quarters. The loan book continues to be well diversified without any concentration in any particular sector.

Moving on to slide 15, as a group, we continue to be extremely liquid. Our access to deposits continues to be strong. In Kuwait, we've added about KD 100 million in deposits, but at the same time we've not gone out and raised a lot of liquidity because at the same time the required cash reserve ratio was reduced in Kuwait by the regulator. So, we did not want too much carry costs in our balance sheet. But as I said, the access to liquidity continues to be strong and it's reflected by the CASA balances, which has grown in excess of 35%. We were historically at around 30-32%, and it's much stronger now at 38%, which also reflects the increased activity of our clients where a lot of the cash is being left in the account and lesser expenditure by clients and hence reflected in the improved CASA balances.

Moving on to the capital. Critical point here is at the end of March- beginning of April, the regulator announced a series of measures to bolster the economy. and help the banking sector, like a lot of the other regulators have done across the world. One of the things they announced on the capital side was the temporary suspension of the capital conservation buffer which in Kuwait is 2.5%. So as a result, across the system the minimum capital requirement fell by 250 basis points. But we continue to maintain capital at healthy levels close to or above the 10.5%in terms of in CET 1, and at the Total Capital level we are well above the original requirement. We are managing our RWA's, as we've done in the past, optimizing at every level, but without sacrificing customer loan business. We continue to be open to a customer loan business as is reflected in the loan growth in Kuwait over the last couple of quarters.

Moving to the next slide, just kind of building on the deposits story, Kuwait as a market remains extremely liquid. Burgan as a bank is also extremely liquid. Along with the relief on capital side, the Basel III liquidity ratios- such as NSFR ratio and the Liquidity coverage ratio were lowered, but we continue to maintain a very healthy NSFR at more than 105% in Q1'20 and almost 105% in Q2'20 with the liquidity coverage ratio also at healthy levels in excess of 130% in Q1'20 and 110% in Q2'20. With that, I will hand over to Mr. Raed to run through the last few slides.

Raed Al-Haqhaq:

Thank you, Naveen. And again, we will move to slide number 18. This is where you can see that the loan distribution and the net income with some measures. Kuwait continues to be the largest loan portfolio we have in the group at 73% from the total, with net income contribution of 77%. Revenue went down from KD 80 million last year for the same period to KD 57 million; expenditure also went down from KD 26 million to KD 20 million, and this is thanks to the cost control measures we have taken. As far as provisioning, it went up from KD 4 million to KD 17 million. This is mostly due to the KD 10 million precautionary provision that we have taken, which has a direct effect on the net income moving from KD 47 million to KD 19 million.

So, the major KPIs - net interest margin went down from 2.2% to 1.7% This is mostly due to the CBK discount rate cut. Cost to income ratio has been impacted on the revenue side, from 32.7%

last year for the same period to 35.5%. Cost of credit also has been impacted from 0.3% last year for the same period to 1% now. NPL ratio 1.5% versus 1.7% currently, a slight increase.

As far as the international operations, the loan portfolio is 27% of the total, net income is 23% of the total. Revenue, almost at the same level, KD 56 million versus KD 54 million. Expenditure also almost the same, KD 24 million last year against KD 25 million now. Provisioning went up from KD 13 million to KD 18 million and net income went down from KD 13 million last year to KD 6 million for the same period. Some KPIs on the international activity - net interest margin went down from 4.6% to 4.4%, Cost to income ratio went up from 43.6% to 46.3% and cost of credit went up from 1.8% to 3%. NPL ratio, as Mr. Khalid mentioned, went up from 5.3% to 13.1%.

In summary, the first half of 2020 results reflect the impact of COVID-19 on us and we continue to be prudent on the risk and our risk appetite. Also, we are controlling our costs and we remain liquid, well capitalized to weather this current global crisis. Elena think we can start taking questions if you don't mind.

Elena Sanchez:

Sure. Thank you for the presentation. Operator, if you can remind the participants how to place a question in the queue. Thank you.

Operator:

Thank you, ma'am. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you're using a speaker phone, please make sure your mute function is turned off to allow your signal to read your equipment. Again, press star one to ask a question. We'll pause for just a moment to allow everyone an opportunity to signal for questions. And we take our first question from Alex Ayoub from Waha Capital, please go ahead.

Alex Ayoub:

Hi. Thank you very much for the presentation and congrats for the results, especially during these very tough times. I have a few questions. First one, just want to see if you can give us some guidance on where do you see the NPL going both internationally and in Kuwait for 2020. And could you also explain a bit more what really happened there in Turkey or in the international side? Why the NPLs almost tripled? Then the next question is more about the restrictions from CBK. We understand that you have restrictions to pay dividends in 2020. Do you think they could also be restrictions on paying the coupon on the perpetuals and is that your intention or not? Thank you very much.

Khalid Al Zouman:

In terms of the direction of the NPLs, we expect in Kuwait there is not much significant movement. As our CEO -Kuwait was explaining, we were in close contact with our customers in the last four months since the crisis started. We have been updating all our analysis and looking at their(customer) needs, so we don't expect too much impact in Kuwait. I think the expectation is in Turkey in 2020, I think is the peak, but let me explain something here, the increased NPLs coming from Turkey at the group level is because at the group level, we follow our strong CBK regulations. As per local guidelines in Turkey, some of the loans which became NPLs in Q2'20 at Group level are regular in Burgan Bank Turkey. So, it's because CBK have been strict with their provisioning rules, and that's why you will see some loans will become NPL in our books, but regular in Burgan Bank Turkey under their regulations.

So, yes, we expect that that some NPLs will come in Q3'20 or Q4'20, but majority will be coming from Turkey, we don't expect them from any other franchise, honestly, at this moment.

Raed Al-Haqhaq:

As far as the dividend, CBK has been very clear, as long as the bank is healthy at year end and there is no drop in any major ratio, then the dividend will be seen and discussed. And as you have seen, whether it is our liquidity ratio or our capital ratio, we continue to maintain above the required ratio. The perpetual payment, it is for sure; we will make the payment for sure, there is no other intention whatsoever.

Khalid Al Zouman:

One thing I just want to clarify when the regulator says about the banks to not pay dividend, they are referring to the BIS regulations, and international regulations. It doesn't mean that the banks will not pay. This decision has been postponed to year end and to see the financial position of each bank. So, there is no restriction as such for dividend.

Alex Ayoub:

Thank you so much. That's very clear. I'll leave the other investors and then come back with other questions later. Thank you.

Raed Al-Haqhaq: Thank you. Alex

Operator:

Thank you. Once again, ladies and gentlemen, if you would like to ask a question, please press star one. We have everybody take our next question from Nadine Mdeihoi from Arqaam Capital. Please go ahead.

Nadine Mdeihoi:

Hi, thank you for the call. I have a couple of questions. What percentage of your corporate book for the group is under deferral? Can we assume the entire retail in Kuwait is under deferral? And can you give us a breakdown of the deferral for Kuwait and Turkey separately? Also given that 60% of the deposits come from time accounts, can we see further improvements in cost of funds in the coming quarters maybe supporting them in H2? Also, are you still left with more repricing in your corporate book? And finally, can we take Q2 cost base as the run rate for the coming quarters? Thank you.

Khalid Al Zouman:

I didn't get all your questions, but I will answer what I understood from you. The first question when you're talking about deferrals, what we did for our retail loans. Okay. this is a good gesture from the banks. In the beginning of the crisis that we want to relax the repayment for our customers. So, the banks met and the group CEO's of all the banks decided, let's postpone the installment for six months. Now to the best of my knowledge, this is only one time. It will not happen again. However, under the IFRS rule, because of this action, there is something called the day one loss, because now the loan has a longer maturity, but the income is the same. So, the effective interest rate is lower. So, we calculated, and actually we disclosed it in the market, If I'm not mistaken, we have a special disclosure on CMA, as the wanted the impact of this postponement. And we, as I think around KD 8.5 to 9 million at that time. So, Have I answered the question? The first one?

Nadine Mdeihoi:

Yes. Can you give just the breakdown for the deferral for Kuwait and Turkey separately? Do you have it?

Khalid Al Zouman:

No, the deferral is only at Kuwait level. This is a decision made for Kuwaiti banks, nothing for Turkey.

Nadine Mdeihoi: Okay, perfect.

Khalid Al Zouman:

So, the second question, please. I think you mentioned?

Nadine Mdeihoi:

Okay. Given that 60% of your deposits come from time accounts, can we see further improvements in cost of funds in the coming quarters may be supporting them? And are you left with more repricing in your corporate book?

Raed Al-Haqhaq:

And what happened as far as the loan portfolio, most of our loan portfolio is corporate, which has re-priced immediately. However, as you know, when it comes to the fixed deposit, there is a lag effect. Our deposits average maturity is six to seven months, so they take a little longer to reprice. And you can see that our margins will go to the 2019 level with a slight reduction, this is what we are hoping. And if you can see our CASA balances, which is the current account, the savings account, we are increasing them, which will help the reduction of the cost of funds.

Nadine Mdeihoi:

Okay. And final question please, can you take the Q2 cost base as the run rates for the coming quarters?

Khalid Al Zouman:

Yeah, because we have done an exercise at the end of Q1, among the management, with the leadership of Mr. Raed and the group CEO, and we decide cutting all of that unnecessary expenses, if you would like to say.

Raed Al-Haqhaq:

As you can see it on slide number 18, KD 6 million has been adjusted so far in comparison to the same period of last year, we went down from KD 26 million to KD 20 million.

Naveen Rajanala:

Ok just to add one thing, the profit figure of Q2 ('20) was impacted by the KD 10 million precautionary provision required by the regulator so you have to factor that as well., So I don't think you can take KD 6 million as the guidance for profit going forward.

Nadine Mdeihoi:

Okay. Thank you very much.

Operator:

Thank you. We have no further questions at this time. My apologies, Mr. Ayoub has a follow-up question, please. Go ahead.

Alex Ayoub:

Hi. Thank you very much. I just wanted to have a feel about how to look at the revenues for the second half because we see that you took quite a hit because of the lower rates in Q2. What should we expect for the next six months? Should we expect something similar to Q2 or hopefully some normalization? What do you think on that front?

Khalid Al Zouman:

Yeah, I can say from a stable to little improvement, because our deposits will be re-priced as we go along. So, let's see Q2 will be our base and if it doesn't continue, it will improve.

Alex Ayoub:

Fantastic. And then can you give us a feel about capitalization? Where do you expect the capitalization to be in 2020? Do you think you're going to be around the 10.5% level, or you think it can be hit, for example, because of the Turkish Lira? What's your target there on the capitalisation, please?

Raed Al-Haqhaq:

As far as the Turkish Lira impact, as you know, we continue to be hedged, so the impact on our CET1 will be minimal. And as far as the growth, we are still continuing to have an average growth 3% to 4% for the year. So, our CET1 will be within the same ratio as you see if not a bit better.

Alex Ayoub:

And so, when you say, you are hedged on TRL, can you just give us a bit more detail on how you're hedging that. I guess you're hedging the equity portion in Turkey set up, I guess the hedges should be quite expensive now just how you're doing that.

Raed Al-Haqhaq:

4 to 5 years ago, which is basically what you had mentioned, we are hedging our equity exposure in Turkey using forwards and it has been an effective hedge for the last four to five years. We are almost 100% effective.

Alex Ayoub:

Wow. Okay. And I'm sorry, can you maybe, I missed it. What did you mention about the capitalization? You expect it to be around the same levels, correct?

Raed Al-Haqhaq: Yes, yes, absolutely.

Naveen Rajanala:

The only thing is at the end of the year there is retained earnings so the capital levels will be closer to 11%, so it is expected to be slightly higher. In Kuwait, interim profits are not added in CET1 so that comes in at the end of the year.

Alex Ayoub: So sorry, could you repeat that please

Raed Al-Haqhaq:

I will repeat, Mr. Naveen is highlighting that in the fourth quarter, you will see also our retained earnings will be added, which will positively impact our CET1 and the total capital ratios.

Alex Ayoub:

That's fantastic. And sorry, just to come back to the question I asked the first time, so the central bank mentioned, I think someone said the central bank said you should not pay dividends if the capitalization in Q1 is below 10.5%, is that correct or no?

Khalid Al Zouman:

No. In the beginning, I think it was misunderstood in the, because the regulator r said that the BIS international standards state that the banks keep some buffer in their capital before paying any dividend. However, it is premature to say now and this decision will come at year-end and will be subject to AGM approval.

Alex Ayoub:

Okay. Understood. And what about the perpetual? Was anything said about the perpetual? what's the strategy there?

Raed Al-Haqhaq:

No, all of our senior debt and our bond issue, there is no impact on them. We will continue to pay them on time

Alex Ayoub:

Okay. I'm sorry to just ask again on that, but, even if you don't pay the dividend, then you still pay the coupon on the perpetual?

Raed Al-Haqhaq: Absolutely. We will continue to honor our obligation

Naveen Rajanala:

Yes, that's correct. To clarify, the dividend stopper works the other way. So that is, if you do not pay a coupon, then you're not allowed to pay dividends But, for whatever reason if dividend is not paid, that does not stop the payment of coupon. Coupon payment is completely independent decision and which the bank will continue to honor.

Alex Ayoub: Fantastic. That's very clear. Thank you so much.

Operator:

Thank you. And then we take our next question from Rakesh Tripathi from Franklin Templeton Investments. Please go ahead.

Rakesh Tripathi:

Yes. Hi, thank you for the presentation. I just had one question. You mentioned that Burgan Bank Turkey contributed to the increase in the NPLs in Q2, right? Could you share the NPL ratio for the Turkish unit?

Raed Al-Haqhaq:

Sure, as far as NPL of BBT, Again, I need to elaborate this is what Mr. Khalid has mentioned, the NPL ratio is as per the Kuwait standard. So, their NPL ratio for the year moved from 3.9% to 15.7%.

Rakesh Tripathi:

Oh, that's in H1 you're saying. So, from 3.9% at year end to 15.7% June end basically?

Raed Al-Haqhaq:

Mid-year to mid-year and this is under Kuwait standards not their local standards

Rakesh Tripathi: Right, Right.

Operator: Thank you.

Elena Sanchez: (Elena Sanchez)

Yeah. So just a quick question from me out of the increase in the NPL ratio for the international operations. Was there any impact as well from a consolidating Bank of Baghdad again in Q2 2020?

Naveen Rajanala:

Yeah. So, the impact from the inclusion of BOB, was about 70 basis points and in KD terms that's roughly about KD 36 million.

Elena Sanchez:

Okay. Sure. And out of the provisions in H1, the new provisions that you booked in the first half of 2020; can you disclose how much of those were precautionary and specific?

Naveen Rajanala:

Precautionary, we took KD10 Million in the very recent quarter of Q2'20. The total provision we took was KD 32 million in H1'20 out of which KD 10 million was precautionary and the rest was KD 22 million- mostly specific and a little bit of general.

Elena Sanchez: Absolutely. Thank you.

Operator:

Thank you, ma'am. Mr. Ayoub has a follow up question. Please go ahead.

Alex Ayoub:

Sorry. Thanks. Hey sir, just to follow up on Turkey, can you just tell us a bit about the part from the regulator coming more strict? What has led to this increasing NPL in Turkey? One - just hear some background. What kind of, part of the loan book has deteriorated there please? According to regulatory standards and two what is the strategy in Turkey? I mean, the situation seems to be getting tough. You have a foreign currency loans and Turkish lira are depreciating. What's the strategy we got there. Thanks a lot.

Khalid Al Zouman:

I think in terms of the NPLs of Turkey, for example, now, to classify NPL in Burgan Bank Turkey is after like 180 days. However, in Kuwait after 90 days. So, this difference in the regulation between has affected whether the loan can be classified NPL (in Kuwait), or in their book, could be a regular (loan). In terms of our strategy, we are in continuing talks with Burgan Bank's Turkey management. And we have couple of meetings every month. This is continuous. I was there in the December, then I went there again in January and we talked, we have online talk. And today, we are not anticipating to grow in Turkey. We will keep it flat at this moment.

We have certain guidelines in terms of their credit lending. Already the Deputy Group CEO is in contact with their CEO. And, there is no more foreign currency lending. We are going to focus on local currency lending, for example. We have certain criteria we put down and in general we keep things flat. Definitely, we will support them in case they need capital. Remember this subsidiary is owned 99%, we have no intention to go out from the market. We think this is a political, not economic situation which has affected the economic side. And now we hope we see things changing in 2021 or 2022, for example.

Alex Ayoub: Okay. Got it. Thank you so much. That's very clear. Thank you.

Operator:

Thank you. It's appears that are no further questions at this time. Ms. Sanchez, I'd like to turn the call back to you for any additional or closing remarks.

Elena Sanchez:

Thank you. Yeah. Sorry. I would like to thank the management of Burgan Bank for their time and all the audience for participating in the call. Thank you.

Raed Al-Haqhaq:

Thank you so much

Khalid Al Zouman:

Thank you so much.

Naveen Rajanala:

Thank you so much

Operator:

This concludes today's call. Thank you for your participation. You may now disconnect.