Burgan Bank

FY 2019

Earnings Conference Call Transcript

Wednesday, 11th March 2020

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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 Ranjala	Group Head of Strategy and Capital Management

Chairperson:

Ms. Elena Sanchez	EFG Hermes

Operator:

Ladies and gentlemen, good day and welcome to Burgan Bank Full Year 2019 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, madam.

Elena Sanchez:

Thank you. Good morning, everyone. Good morning and good afternoon, everyone. This is Elena Sanchez from EFG Hermes and I would like to welcome you all to Burgan Bank's full year 2019 results conference call. It is a pleasure to have with us in the call today, 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 the management on the Key Highlights of 2019 and then we can open the floor for questions and answers. At this time, I would like to hand over the call to Mr. Raed Al-Haqhaq. Thank you.

Raed Al-Haqhaq:

Thank you, Elena. Good afternoon, everybody. Thank you for joining us for the financial overview. I'll start with slide number three, which is basically the same slide that we've been highlighting for the last three quarters. As you know, we have chosen to close our subsidiaries' financials one month before the end of every quarter. So, we are reporting 11 months results for subsidiaries and the full 12 months for Kuwait. So, from 2020 onwards, we would be reporting 12 months for both subsidiaries and Kuwait.

The following slide (slide 4) is for the key achievements in 2019. I will start with the Net Income where we have reported KD 84.7 million a growth of 3% in comparison with 2018 even though for the subsidiaries, we are reporting 11 months' results instead of 12 months. Return on Equity is in double digits at 10%, recommended cash dividends of 12 fils per share. As for Assets\ Quality in Kuwait, our NPL ratio stands at 1.6% , the same level as 2018. You can see also a drop in NPL Ratio at the Group level from 2.7% to 2.5%. The cost of credit dropped significantly from 1.1% to 0.5% in Kuwait and also at the Group Level, it dropped from 1.4% to 1.1%.

In terms of our assets / loans, as highlighted in the beginning of last year that we will target our growth in Kuwait, our target was 7% to 8%, which we have achieved in Kuwait. We also have highlighted that the international business will be reduced and we will focus on our core business in Kuwait and as a result, there is a reduction of 12% in the subsidiaries' loans. Deposits in Kuwait had grown by 19% in comparison to a 10% drop in2018. For the subsidiaries, you can see a drop of 4% in deposit volumes compared to 11% drop in 2018. We have prepared a separate slide for the sale of Bank of Baghdad which will focus on the execution of the deal, the impact of the deal and where we are now.

The following slide (slide 5), we will cover the Revenue and Margins on one chart and the Operating Profit and Cost-to-Income on the other chart. I will start with the Revenue trend. You can see Kuwait's Revenue grew by 7%, moving from KD 165 million to KD 176 million. International business Revenue reduced from KD 104 million to KD 92 million, mostly due to the 11-month reporting and the reduction in size. Margin has been impacted slightly by the change of the interest rates. In Kuwait, there is a movement from 2.3% to 2.1% and the overall margins moved from 2.9% to 2.7%.Operating profits of KD 110 million in 2018 grew by 16% and we have achieved KD 128 million for 2019. Subsidiaries' Operating Profit, reduced from KD 62 million to KD 53 million due to the one-month lag in reporting and the proactive reduction in asset size.

Cost-to-Income Ratio of Kuwait continues to be low and there is a ~500 bps absolute drop from 32.3% to 27.6%. Also, at the Group level, the Cost-to-Income Ratio, reduced from 42.1% to 41.2%.

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

Khalid Al-Zouman:

Okay, slide number 6 talks about our Cost of Credit, and you can see, we are at 1.1% in 2019 at Group Level compared to 1.4% last year and 0.5% in Kuwait in 2019 as compared to 1.1% in 2018. The reason for the drop is that in the last year (2018). we have taken extra general provisions for one of the subsidiaries and in Kuwait. We also have some specific provisions which we have been taking during these periods. So the overall provisions between 2018 and 2019, we have reduced our specific, which means that there is improvement in our loan portfolio. Through the general provision, we have taken less in 2019 whereas in 2018 we took KD 15 million. This year we took only KD 4 million, so that makes the drop in our cost of the credit.

In terms of our Net Income, this reflects growing revenues, especially in Kuwait, plus controlling our expenses. That has been reflected in our Net Income. However, on the top of that, in 2019 we have also taken additional general provision to make sure if there is anything coming in 2020, we have a strong base whereby we can absorb these losses if it happens.

The next slide (slide 7) talks about our NPLs and our NPL ratio has reduced from 2.7% to 2.5%. There are two things which affected our ratio. First, the sale of BOB. has reduced our NPL ratio and we disclosed this in the market at the time when we signed the contract. With the provisions we took in 2018, and the general provision we have taken in 2019 has improved our coverage ratio significantly. With that, I will hand over to my colleague, Mr. Naveen.

Naveen Kumar Rajanala:

Thank you, Mr. Khalid. If you'll go to slide 8, so as we've been telling over the last few quarters, we've been pursuing the cautious growth strategy which is led by a focus on opportunistic growth in Kuwait. As you can see the Kuwait balance sheet grew by 8% while we've been carefully managing the growth in the international operations. This reduction in the size of the loan book and the international operations is primarily due to two factors. One is the devaluation in the Turkish Lira and the proactive strategy to k not grow the book and reduce the underlying risk in the book.

At Group level, our loan book continues to be well diversified with no specific concentrations. The biggest chunk of the loan book is in the personal segment. We also grew our balance sheet on the liability side with Kuwait growing the deposit base by 19%. The Kuwait market continues to be extremely liquid and access to customer deposit remains pretty strong. We have been diversifying our funding sources by issuing bonds both in the local and international market as well as doing syndicated loans. But having said that, we continue to have strong access to customer deposits.

If we move on to the next slide (slide nine) our capital ratios continue to be strong. The core equity tier 1 (CET1 ratio) is well above the minimum at 11.5%. And from a total capital adequacy ratio (CAR) point of view, we are close to 17%. These ratios have been strong and have been maintained at these levels post the rights issue at the end of 2018. As I said earlier, liquidity in in Kuwait specifically has been fairly strong, which is reflected in our regulatory liquidity metrics. Both the Net Stable Funding Ratio and the Liquidity Coverage Ratio remain well above the minimums and underscore our strong access to liquidity both in the domestic and international markets.

If you move on to slide number 10, it gives a quick snapshot of the Group's performance at an entity level. If I were to start with Kuwait, Kuwait is the flag bearer of the group and that's where the large proportion of the assets and the business is generated. Kuwait's proportion of the Group's business continued to increase over the last 18 months. And we expect that to continue in a similar trend. Kuwait's assets are almost 75% of the Group's assets and generate almost 80% of the Group’s Net Income. Kuwait loan base grew by 8%, as we said earlier. And the net interest margin fell slightly by 20 basis points. It's still holding up and we expect that to be stable in spite of the increase in the cost of funds in the local market, which as a trend had picked up at the beginning of 2019, but we've seen that kind of normalizing towards the end of 2019 and we expect that trend to continue in 2020. Cost to income ratio, is a good story and reflects our focus on containing operating expenses and controlling that while growing our top line. Cost of credit, again, a similar story, while the NPL ratio is being maintained well below 2%.

Turkey’s proportion of Group's business continues to decline and that's a reflection of our Group strategy. Loan book in Turkey reduced by 12% which is a reflection of both the TRY depreciation as well as the proactive reduction of the loan book. Turkey continues to generate good NIMs for the group, and its cost of credit also given the headwinds in the market is a fairly good performance. NPL ratio has gone up at the end of last year, but again, this is the tail effect of the August 2018 events, which if you compare it to the market as a fairly respectable number at 5.8%. Algeria continues to be a good business for us as reflected in its cost to income ratio and net interest margin at 7%, and cost to income ratio of ~36%. The risk metrics of the franchise also is fairly solid, with NPL ratio of 2.2% and cost to credit of less than 2%.

Tunisia is a small franchise for the Group. It's less than 2% of the Group's assets, but it's a healthy franchise which generates good returns for the Group.

With that, I'll hand it back to Mr. Khalid.

Khalid Al-Zouman:

Thank you very much. This slide (Slide 11) has been included to give more information for the investors and also the shareholders. We did the disclosure in the market, but that was sort of a regulatory requirement, but we didn't say why we did this transaction. I myself going back years when we took over this BOB. I thought BOB, it's like / should be the one of the jewels among our subsidiaries, especially after what had been the change in 2003 and 2004 in Iraq. However, the market has been very difficult, it's a difficult environment to do business. A lot of things have not progressed as planned. during this period, we had to change CEOs. It's difficult to find skilled people who can work there and move things forward. That's not an issue. The issue is the environment itself. So, there was a decision that if we moved this bank outside Burgan Bank so we can focus on Kuwait and build up a good franchise in Kuwait and revenues Whereas the KIPCO group can capitalize on it. So, Bank of Baghdad has not gone far away from the KIPCO Group. In our disclosure, we said that in this transaction we're going to have a loss of around KD 8million to 9 million because of the difference between the carrying amount and the valuation. However, the buyer opted to buy at a price over the valuation and this amount will be recorded as a profit hopefully in Q1 when the transaction is completed of an amount of KD 4 million. So that's the story of BOB. And finally, I'll turn it back to Mr. Raed.

Mr. Raed Al Haqhaq:

Thank you, Mr. Khalid. In Summary, Burgan has managed to achieve a double digit return for its shareholders. We continue to have a strong risk management framework evidenced by the improvement in asset quality and the lower credit costs, including a higher credit coverage. We have focused from the beginning of 2019 and we will continue to focus on our digital offering and digital strategy. We have already launched the upgrade of our new application and we will continue develop our enhancement and the alternative channel offering. We can go to the questions and answers if you don't mind.

Elena Sanchez:

Hi, this is Elena. Thank you for all the comments and for the presentation. While we wait for questions to come on line, just a couple of questions from me. First of all, on the cost of risk for Kuwait it was 50 bps last year. It is the lowest it had been for a long time. And you mentioned it was a combination of lower specific and general provisional cost. How should we think about the cost of risk for 2020? Do you think that the central bank may be willing to lower the requirement for general provisions in 2020? The CBK cut the discount rate last week by 25 bps. Also, you didn't capture the full impact of the rate cut on the margins and also at the beginning of February, they cut it by 50 bps. So how should we look at that pressure or letting use of 25 bps and the room for banks to cut the deposit rates with the new rates. Thank you.

Khalid Al Zouman:

I find that your question has two legs or two sides, first is the cost of credit expectation in 2020 and the impact of CBK discount rate. Full cost of credit in Kuwait, we expect that there is not much of a change, a drastic change. However, the recent Corona thing and the prices of oil, yes, the management is sitting now and reviewing what would happen if things continue for a while. So, I have to be very honest with you, that whatever has happened of late, we need to look how this impacts us. Cost of credit, when we did our budget, we reviewed our portfolio. In Kuwait, we expect there is no change at all. That's one thing, now the recent incident, I think as I see we are sitting with the management to see what the consequences of the events of drop of prices of oil and the Corona issue.

Second, you talked about CBK discount. When we did the budget, we have our Treasurer, we have our in-house economist and we already expected that there might be a discount rate cut to happen in Kuwait already built in the budget. The difference is we thought the cut iss going to be in the middle of the year while it happened in March. However, when we calculated last week what the impact, it is not significant actually to our bottom line. I hope that answered your query.

Elena Sanchez:

Yes. That's very helpful. Thank you. Operator, we can now open the floor for Q&A.

Operator:

Certainly. Ladies and gentlemen, if you would like to ask a question over the phone, please press star one on your telephone key pad. Please make sure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Once again, please press star one to ask a question. We'll just pause for a moment to assemble the queue. We will now take our first question from Rakesh Tripathi from Franklin Templeton Investments. Please go ahead. Your line is open.

Rakesh Tripathi:

Yes. Hi. Thank you very much for the call. I had a couple of questions sort of related. My question was primarily on your capital levels and your loan expectations for 2020. What would be your loan expectations for the loan growth expectations for the group in 2020? And do you see any impact on your capital levels? Your CET1 is close to the minimum. So, if you do expect a significant growth over the next year or the next couple of years, would you be looking to also boost the CET1 levels?

Speaker/ Naveen Rajanala:

Let me start with the growth question. So we expect the growth this year to be around the 5% mark at a group level, and a bulk of the growth is going to come from Kuwait. And as Mr. Khalid just pointed out, obviously it has to be taken into context with how this Corona situation unfolds over the next quarter or so. Is this a temporary blip or is this going to be prolonged? That's a question we don't know at this stage, that's the million-dollar question. And the other issue is the oil price drop and how permanent that is and/or is that a temporary blip? But having said that, under a normal scenario, we budgeted for a growth of about 5% for the group, mostly led by Kuwait. We do not expect our Turkish franchise to grow this year. It'll be flattish of minimal growth of 1% to kind of maintain customer relationships where we do not see that moving the dial.

Our Algerian franchise might grow at about 3% to 4% at the most. Again, we are carefully monitoring the situation in Algeria from a political environment point of view. So, in a nutshell, that's where we see in terms of growth. Now in terms of your question on capital, we ended the year at 11.5%, which is a good 1% above the minimum requirement. We typically operate around the 11% to 11.5% and definitely aim to close the year as close to 11.5% as possible. So we do not see any imminent need for capital injection to boost these CET1 capital levels.

Rakesh Tripathi:

Okay. That answers my question. You also mentioned that in Turkey you do not expect much growth. Can you briefly talk about where the capital levels for the Turkish unit are as of now with the regulatory minimum?

Naveen Rajanala:

Yeah. Turkey is also on the Basel III. So, if I talk about Turkey standalone, their minimum requirement there is 7% in terms of CET1. Their CET1 is around the 9.5%- 9.8% mark. So we have enough buffers in BBT to absorb any growth, but again given that we manage capital at Group level, and also given the macro environment there, we do not expect growth to come in Turkey. And at the current levels, there is more than enough capital on a standalone basis.

Rakesh Tripathi:

Okay. The 7% that you said is inclusive of any regulatory, like any additional buffers or any liquidity buffers or any other countercyclical buffers, anything of that sort. Is this inclusive of that?

Naveen Rajanala:

Yes. Given the size of the franchise into the relative to the market, it includes all regulatory buffers., sorry, you were going to ask something?

Rakesh Tripathi:

Yeah, yeah. Just one last thing. The 9.5% to 9.8% level, you mentioned it, would this be at the end of the year?

Naveen Rajanala:

Yes.

Rakesh Tripathi:

Okay. Great.

Naveen Rajanala:

So, the total capital level on their own 18%. So 9.5% to 9.8% would be the Tier 1 or CET1 level.

Rakesh Tripathi:

Great. Great. Thank you very much.

Operator:

As a reminder, ladies and gentlemen, please press star one to ask a question. There is currently no question over the phone, sir. As a reminder, you may press star one if you wish to ask a question. We have a question over the phone from Waruna Kumarage from Sico, please go ahead. Your line is open.

Waruna Kumarage:

Hi. I have just one follow-up question regarding loan growth. You mentioned that you expect a 5% growth initially before factoring in the recent developments. Would like to know where you specifically you expect this to come from in terms of sectors, and again as a follow through to that, what is the currently the government infrastructure spending situation? Do you expect - what kind of expectations do you have for 2020?

Raed Al Haqhaq:

As we have mentioned last year, we will target the growth to be in Kuwait. Kuwait expected growth will be around 7% to 8%, mostly in the operating sector, Infrastructure contracting and service sector. We don't want to change our risk appetite when it comes to these sectors. the Government of Kuwait came up with a very encouraging and a large infrastructure plan and service plan. And this is where we have done our technical analysis and this is where we are targeting to grow at.

Waruna Kumarage:

Okay. Because the thing is recently, we have seen the slowdown, although there was like activity was very strong. But as of late wasn't there a slowdown in government projects? And I was wondering whether how will that effect going forward in terms of the country's political situation in that backdrop?

Raed Al Haqhaq:

You are absolutely right. There is a slowdown, but there is still an absolute growth between the two years, and we are estimating that the growth to be close to 7% to 8%. So we have already taken a sensitivity analysis on this growth and we are being extremely conservative when it comes to the absolute enhancements of the underlying loan book. And if you keep in mind that most of our financing will be also through non-cash, such as LC/LG.

Waruna Kumarage:

Okay. Okay. All right. Thank you very much.

Operator:

And we now have a follow up question from Rakesh Tripathi from Franklin Templeton Investments, please go ahead. Your line is open.

Rakesh Tripathi:

Oh yes. Just one last question regarding bank of Baghdad. Can you briefly talk about what was the, how much was the NPL impact of the exclusion of bank of Baghdad in basis points? How much would that have impacted the NPL at the end of the year?

Raed Al Haqhaq:

Sure. Bank of Baghdad impact on NPL is 0.7% from the total group NPL.

Rakesh Tripathi:

Okay. Thank you.

Operator:

As a reminder, you may press star one to ask a question. As there is no further question in the queue, I would like to turn the call back to your host for any additional or closing remarks.

Elena Sanchez:

Thank you very much. Thank you everyone for participating in the call and thank you for Burgan Bank management for taking the time and answering all the questions. If you have any concluding remarks, please go ahead. Thank you.

Raed Al Haqhaq:

Thank you, Elena. Thank you everybody for joining us. Looking forward on the following call after the first quarter results, thank you.

Operator:

Ladies and gentlemen, that will conclude today's conference call. Thank you very much for your participation. You may now disconnect.