BBK 1ST QUARTER, 2023 CONFERENCE CALL

Transcript

Dr. AbdulRahman Saif: Good afternoon ladies and gentlemen, welcome to this quarterly investor meeting. The focus is on quarter one financials of Bank of Bahrain and Kuwait.

I am joined by a group of executives from the bank. Mohammed Abdulla is the Group CFO. Mohammed Al Rayes is Head of Treasury and Investment. Hussain Toorani is Head of Treasury. Ahmed Abdul Qudoos is Group Head of Board Secretariat. Zain Al Zayani is Head of Marketing and Public Communication and Abeer Swar is the Assistant Head of Group Secretariat. As usual, we share with the participants some brief about certain activities, awards, our corporate social responsibility initiatives that were undertaken during the quarter and then we have more focus on the quarter one financials. My colleagues will be presenting this and then we allow sufficient time for interaction with our investors through Q and A. So based on this agenda we will start the presentation.

Mohammed Abdulla: Thank you, Dr. AbdulRahman. On the corporate highlights, in summary, there were four areas that we had initiatives during the first quarter of 2023 mainly on the customer journeys, cybersecurity, ESG and at the end, investment in our people. In customer journeys, the bank has launched Samsung Wallet and the Virtual Metaverse, whereas in term of the digital defense we have signed an end-to-end cybersecurity solution with Beyon Cyber. On ESG we have taken certain initiatives financing Alba solar farm project and offering solar panel prepackaged loans for customers.

And of course, we have adopted energy-saving solutions within the Bank's premises. And the last initiative was investing in our people, where in term of development we have introduced DigiPro - a Digital Academy for continuous development of our staff.

These are the major four initiatives in term of the corporate highlights for the first quarter of 2023.

Zain Al Zayani: Good morning everyone. I'll take you quickly through our corporate social responsibility initiatives that we've supported this past quarter. And as you know, BBK supports the community in different sectors. And I'll talk a bit about women empowerment, where we are going to be seeing the first Women on Board program participants’ graduate tomorrow at a ceremony. So that's been a successful program.

When it comes to training and education, we've seen the successful completion of the first semester of our 50 BBK scholarship students, and they're on track in their program. We've seen our BBK Digital Literacy Program graduates also complete their program requirements. In terms of youth and community, we are developing a new training program within Injaz, and we've also supported the Ministry of Interior with their National Road Safety Program. And when it comes to sports, we're continuing the support for the BBK Junior Tennis Championship, as well as supporting His Majesty the King's Cup for Endurance Ride Championship and the Bahrain Turf race.

Thank you.

Ahmed AbdulQudoos: Thank you Zain and thank you Dr. AbdulRahman. I would like to start with some of the initiatives in corporate governance and Investors developments. Some of the developments happened earlier this year in the first quarter.

Of course, as you kindly know, that the commercial Company law as well as the Central Bank Rulebook and our Articles of Association encourages us to review the composition of the Board from time to time to ensure that it is large enough to take appropriate decisions and efficient enough to cater for the business of the Bank; so what the Bank has decided, supported by a decision by the major shareholders, is to reduce the size of the Board from twelve members to ten members and this has happened during this first quarter and we have taken the Extraordinary General Meetings approval in this regard.

The second issue, the Articles of Association for the Bank was fully reviewed and amended to be in line with current legal and regulatory requirements and the amendments over the years were combined into a single document for ease of reference.

This project has taken a lot of time from legal aspects, because we want to have a single document for the shareholders which they can refer to and updated to cater for new regulatory and legal requirements.

One more issue, a new Board was formed, after the AGM, the appointment by major shareholders and other members elected amongst independent directors and conclusion of the new term of 2023-2026 election on 28 March 2023; and the Board committees accordingly were recomposed with new members and in line with regulatory requirements, as you are kindly aware, there is a revised HC module of the Central Bank that has given more emphasis to corporate governance and to the role of the Board.

And we have recomposed our committees to be according to the new requirements as well as the international best practice.

We had some of the KPIs concerning governance issues and the ESG framework surpassed this year, I can highlight two of them which are specifically a Board of Directors issue, first the number of independent directors increased from 14.467% to 50% that is half of the Board are now independent directors and the regulatory requirements is 33.3%, which is one third of the Board, so we have achieved that and of course we always emphasize on the independence of judgment for any Board member, whether independent or non-independent, so this is something that we abide by and we try to improve all the time.

The second good news is the percentage of women directors for the group increased to 31.8% of the total population of Board members and we had set an earlier KPI for ourselves which is 25% and have surpassed that. So, we're proud to announce this good news.

Lastly, the new revamped website was launched encompassing a new Investor Relations platform. We tried to give the most emphasis to our existing shareholders and potential shareholders and provide them with all information they would need as well as information about transfer of dividends and how to do that digitally.

All of this is encompassed under the new platform and we always welcome new suggestions and new improvement to that. That's all from my side. I would hand over to Mr. Mohammed Abdulla for the financial highlights.

Mohammed Abdulla: In term of the performance for the first quarter of 2023, as you have seen in our publication, the Bank has reported a net profit of BD20 million, a growth of 33% year on year, mainly driven by the growth of the net interest income of 64% at BD33 million, compared to last year of BD20 million.

The other income at BD7.2 million lower than last year mainly on account of our associate negative adjustment mark to market that we had to reflect in the first quarter of 2023.

In operating costs, we continue investing in our systems, customer journeys and our staff. Thus 6% growth in operating costs is witnessed over the same period of last year, net provisioning of BD4 million versus BD1 million compared to last year. Mainly these were general provision or precautionary provision that we have added to our portfolio.

In term of the balance sheet, the loans advances are flat compared to December 2022; total assets are higher than December by almost 3% at BD3.9 billion, this is almost in line with 2019 balance sheet, taking the bank to pre-pandemic positions, customer deposits at BD2.2 billion with a growth of 4% since December 2022. Shareholders' equity at BD553 million a reduction of 7% mainly on account of mark to market valuation of our investment instruments and the payment of dividends.

A quick look at the key performance indicators: the return average equity stands at slightly lower than 13%. Return on average assets is at 1.97 whereas the earnings per share stored at 44 fils and the cost to income ratio around 40%. In terms of the asset quality, the coverage ratio a specific coverage ratio around 70% while the ECL for stage one and two coverage ratio is 2.31%, almost a similar level of December 2020. Gross NPL slightly increased from 3.41% to 3.95% while the capital adequacy ratio was at 26% and the NSFR and LCR above the minimum requirement at a healthy level of 141% and 311%

That's it in term of the financial performance - thank you.

Q&A Session Introduction: Thank you for joining the conference call of BBK 1st quarter 2023. I would like to thank Dr. AbdulRahman and deputy management for this presentation. We will commence with the Q&A session and as a reminder you can ask your questions verbally or you can type them, we will give you a few moments to do so, thank you.

Mr. Ali Al Tarif There was difficulty entering the meeting. Regarding Corporate Governance the number of Board members are still 9 members, any reason? Also it is good that the Bank now publishes the NPL ratio as suggested in previous meetings. To shed some light on that and the provisions as well as on the net interest margin.

Dr. AbdulRahman Saif: Thank you Mr. Ali. So, on the first point, difficulty in login, we do apologize. I think we have experienced some technical problem and hopefully it's resolved. On the corporate governance, about the missing one director, I believe this is yet to be an appointed director by one of the major shareholders.

On provision and NPL in general, my comment is we are seeing high degree of recovery from COVID and the slowdown that was associated with the impact on the global economies. However, we have gone from this short cycle into another short cycle of steep interest rate, unprecedented for a long-time interest rate hike and this comes at a background of a sharp slowdown. So, interest expense is increasing for our clients and that puts additional pressure on clients.

So, we are mindful of these developments and on the impact and that's why we recognizing the real risk, business risk. As my colleague Group CFO said, we're taking additional general provisions to cover for the operating environment and the associated risk. So, most of these provisions are general and these are precautionary. However, we have seen minor increase in our NPL from 3.41 to 3.95 due to downgrade of accounts and we are paying high attention to managing the stress account and managing our NPL within the 4%. We came down from as high as 8% and we want to do our best to preserve this within the 4%.

Mohammed Abdulla: On the net interest margin, I think in the first quarter marginally improved over December 2022, and on what we have published in our annual report. So, marginally has improved in the first quarter.

Participant question (Reem Al Barri): NII grew profoundly – we saw significant NIM expansion; this was both unexpected and out of the norm.

1. First question – is this sustainable? What is the guidance for the year?
2. Second – what drove this interest income gain, is it investment securities – sovereign bonds? Or wider yield expansion on loans? Because we do see T bills have gone down, investment securities also declined.

Dr. AbdulRahman Saif: Thank you very much Reem, I hope I got your questions well. So, the first one about the sustainability of our performance now and the second is about what is driving the interest income or the net interest income. Actually, these are interrelated.

First, this is the outcome of our detailed work that we have been doing since 2020 and 2021; that we took a deep dive into our balance sheet given the change in fundamentals, complete change in fundamentals business fundamentals in 2020 and the following few years. So, our objective was to enhance our efficiency by restructuring our balance sheet on both side of the balance sheet - assets and liabilities.

We have done so on the asset side, we have identified certain assets and certain markets for either reduction or exit depending on market fundamentals, depending on yield. And then we looked at the liability side with the objective to enhance our efficiency and to reduce our liquidity needs and the cost of funding.

And we have done that, we have actually formed a task force for this particular and we have done that successfully, and if you look at our result, starting from fourth quarter 2020 until now, there has been continuous development in this preservation of our net interest margin and in fact an increase in our net interest margin.

Now we see with the sharp increase in interest rates globally and domestically to a good extent, and this is relative, we manage to contain our interest expense and this is one of the driving. So really when you ask about the drivers, the drivers are multiple but they emanate from our balance sheet optimization exercise and on our sound management of interest rate. So, it is unusual to have those short cycles of interest rate and it puts pressure on banks and non-banks, because of the difficulty to really restructure balance sheet within a short period of time.

But we are continuously monitoring the market, we are taking fundamentals, market fundamentals and then we try to manage our balance sheet efficiently. So yes, we are looking for sustainability of this performance. Now, finally, I would say in spite of our heavy investment in IT infrastructure and digital channels, we are also managing our operating cost efficiently. So, all these together is leading to a more agile bank with higher efficiency. So, I hope I answered both questions, thank you.

Fatema Al Shakar

1. Loan book – loans declined by 2.0% and this is due to a 2% decline in both retail and corporate. Within the corporate can we assume that large loans have matured and not been refinanced? Within the retail – is BBK losing market share to other banks?

2-What explains the decline in fee income? Is it due to lower lending volumes?

Dr. AbdulRahman Saif:

Thank you, Fatema. So, retail is one of the main areas we identified for growth. And over the past number of years, we managed to grow our market share and to grow our loan portfolio on retail. So that is a strong area for us that we would always look to preserve. Even during the Pandemic, we managed to grow our loan portfolio on the retail.

Now, as you would know, starting from July 2022, the 27 month long deferral came to an end and then customers had to start repayment, except those that would still ask for some kind of rescheduling or restructuring. But the top predominantly majority of our customers started repaying, so what was accumulating during the Pandemic started, part of that is due to the repayment that started in July 2022.

However, we will continue to promote this segment for us through our digital innovative channels, through our marketing, through our structures, through our pricing, all the means to maintain our market share and grow it. That is with regard to the retail loan portfolio.

It's a slightly a different story on the corporate loan book. The corporate loan book, we have exposure in Bahrain, the rest of the GCC and the wider Middle East. So that is our loan book. As you know, we have branches in India, we have physical presence in Kuwait, we have rep offices in Turkey and UAE. Our loan book is a kind of more regional than purely domestic.

So, as I said in our exercise for balance sheet optimization and management of risks, including market risk, we have really restructured our corporate loan book. Certain markets; we thought these are maybe relatively high risk.

So, we have taken certain decision to manage our exposure. There are certain exposures, legacy exposures. We thought these yields are not in line with the new market fundamentals, so we took the decision again. That is the situation with the corporate loan book.

In general, we have grown our corporate loan book in Bahrain and certain markets outside Bahrain, we have reduced, so you may not notice a growth in the aggregate loan portfolio, but in Bahrain, we have grown our loan portfolio. Now in Bahrain, we were aggressive on really capitalizing on certain opportunities. You must have noticed we were in the news closing high ticket transaction to certain government, semi-government authorities. As for infrastructure projects, for development projects, we have been aggressive to really do funding for these projects and to enhance our activities and business in Bahrain. So that is really the story on the corporate loan book.

There are a number of factors, you know, in general affecting fee income there. Number one, there has been certain, you know, regulations, regulatory change with regard to charging fees and commissions, so we are again abiding by the regulatory direction on this and that is continuing. The main development that we had to really adhere to is the stress we are seeing on merchants and on customers especially due to the interest expense. In these circumstances, we as a bank, we have to show our support to our clients. This is the time they need us the most so we are attending positively to our clients when it comes to interest rate, when it comes to fee and charges to show our support. So really it is this whether it is retail, corporate or our acquiring business. We are the largest acquirer, our subsidiary CrediMax. So, we had to really show certain balance and certain consideration for our clients. And that is the main reason for the impact on the fee business.

Q: Could you please comment on cash balances in the statement of financial position and the liquidity overall?

Dr. AbdulRahman Saif: You see cash only once, which is at the end of the quarter. But where we look at our balance sheet, we look at our balance sheet on a more sustainable manner. Certain cash, they are short term and they don't count in our strategy and business plan because we know these are short term. Where we manage, we manage the more stable side of the business. If we look at the more stable side of the business, we are highly liquid, we are comfortable in meeting all regulatory requirements. My colleague Mohammed has given you a glimpse of two regulatory ratios which is the LCR and the NSFR and we are comfortably higher than the regulatory requirement. So that is the stable side of the business we manage.

Now, at times we have a sound risk framework that we comply with at times of volatility, at times of uncertainty, at times of escalating market risk, I think we need to be vigilant; we need to be careful in managing our business at times creating additional liquidity buffer, this is enhancing the fundamentals of the bank. Now we have shown that we can deliver that good liquidity buffer and we can enhance our efficiency and increase our margin. So that is our strategy. There are short term tactical business side and there are the more stable longer term and we are delivering both.

Overall, you look at our fundamentals, they are very strong fundamentals. We are extremely satisfied. We have good profitability and good return, rising return. We have good liquidity position; we have good capitalization position that we invested in especially at times of volatility and global market asset classes impact. You need that cushion on the capital and we are managing the asset quality. So that is the fundamentals that we want to deliver and preserve.

Q: With a high CAR can we expect an increase in cash dividends this year?

Dr. AbdulRahman Saif: As I said, we would like to be efficient so that excess capital gives us further room for growth, to capitalize on any opportunities really and to sustain any unforeseen market deterioration globally. So that buffer is good enough for us in these market circumstances. Now when it comes to dividend; number one, we are governed by a policy, we have a dividend policy that is approved and governed by our Board, and that policy sets certain parameters, certain criteria for dividend approval and allocation. So really any dividend will be governed by that will be also taken into consideration market conditions and will take into consideration any regulatory directions or consideration.

I think the main message we as a bank have built an undisputed track record for 20 years or more than 20 years of continuous profitability and continuous dividend to our investors and customers.

So that is our track record and that is what we want to preserve. Even at the height of COVID we delivered, without compromising the soundness of the Bank, without compromising our main fundamentals. So that is on the CAR and the dividend.

Q. Could you please comment on the decline in share of results from associated companies and joint ventures?

Mohammed Abdullah: This is mainly to do with market-to-market valuation of certain assets under associated companies and have been reflected in the first quarter negatively.

Q. What is the percentage of your credit card loans to the total retail loans?

Dr. AbdulRahman Saif: On credit card, we are a major player in the credit card. In Bahrain we are the biggest. So, I can confirm that in terms of the credit card business we have fully recovered from COVID We are above pre COVID. And this shows our ability to sustain our business and really to deal with market fundamentals.

So that is an integral business for us and BBK group and that business is highly rewarding for us.

Q. Where is the bank's balance sheet positioned in the event of a turnaround and a decline in interest rates – should it happen end of year?

Dr. AbdulRahman Saif: This is a speculative question, but a highly relevant question and this is a highly challenging question. Interest rates globally are well integrated in all economies. Interest rate plays a major role in any economy and of course banks and nonbanks. This is a highly volatile market and as I said earlier, during at least our lifetime we haven't seen such really sharp volatility of interest rate within a very short cycle; usually cycle reversal takes longer time and so it gives economies, banks, non-banks time to adjust to it. But unfortunately, this was not the case this time, it required action by everybody to cope with this.

We have seen global failures of banks and maybe non-banks. An interest rate is part of the reasons and maybe a major part of the reasons. So, we have, as management have to be really be careful in positioning our balance sheet, in managing our interest rate risk and interest rate exposure. We have a sound risk parameter when it comes to liquidity and when it comes to interest rate exposure. We are not traders on interest rate, we don't trade on interest rate and we don't have trading limits.

But we have to manage our balance sheet efficiently and soundly in order to really contain any unforeseen interest rate outlook or interest rate actions. So for we are well positioned on this cycle, however, we have to be forward looking and we are monitoring the interest rate cycle and the fundamentals that could lead to any further interest rate action, be it higher or lower.

And we stand ready to really deal with this and to really contain as much as possible the impact of interest rate on our balance sheet and on our fundamentals. This is a highly challenging task to do really but that is part of our business challenge to undertake.

Ali Al Tarif We have seen that on the CBB's report on customer complaints, BBK and CrediMax have the highest number of complaints among financial institutions.

Dr. AbdulRahman Saif: Thank you Ali, for as usual well crafted, well relevant questions now on the complaints and to be fully transparent, what you see from the CBB is only part of the complaints. This is not the full story. Complaints relate to our customer service and customer centricity drive and we have to take this with utmost care and seriousness. We have created a fully dedicated Customer Experience Department back in 2020 or 2021, and we have entrusted this to look at all communication with our clients, all source, all complaints and all customer requests.

Be it retail, corporate, SME, Wealth Management including whether these complaints are direct or through the social media. Direct through CBB, direct to our call center or direct to our BBK lines. So, the first step is to consolidate all these to have good and reliable feedback from the market. So we are capturing all these customers' inquiries or complaints or what have you. Additionally, we thought we should not be purely defensive to just wait for the customer, so we started doing regular surveys to our clients and we do by segment to really see find out our customer satisfaction, if there are any suggestions, if there are any further services, we need to do to really preempt the complaints, which is the best way to do it. So, we have been doing all these surveys since then. This self-defined us, even resolution times, to really close any complaint or request within this time. And we have established a committee, chaired by the Group Chief Executive to look at all these complaints, resolution times, and the reasons for the complaints. So, this is all the efforts and we are raising a quarterly report on all of this to our board so that shows how serious we are taking this exercise.

So, this is an elaborate answer based on in general, you have asked about the reasons for the complaints, the main reasons. We have seen as we are transforming ourselves into high-tech, modernizing, our IT infrastructure investing into digital channels, updating, to be able to develop new channels, we need to upgrade the whole IT infrastructure starting from core and middleware.

During this process, it's usual to experience certain interruptions, certain breakdowns. So, part of the complaints were related, essentially, to our systems. And hopefully we have managed to resolve most of this lately.

We have upgraded our core and with that, we have upgraded a lot of the other infrastructure and the middleware.

So, in general this is the kind of when it comes to our customer engagement and customer experience.

Ali Al Tarif The shares of the Bank were acquired by Al Salam Bank from the previous owner, what are the Bank plans regarding M&A. Also shed some lights on sustainable finance framework please.

Dr. AbdulRahman Saif: On M&A as the Bank has announced, it has a serious intention to really consider opportunities within this M&A. I think we elaborated during the AGM. So the Bank is taking this forward now to seriously explore opportunities and hopefully that would lead to certain outcome. This is a strategic direction for the Bank and the Bank is dedicating resources and attention to really the M&A

On sustainable development or framework, I think we have now the first major step was to develop an ESG framework and that was done in 2020. The second was to translate this into a full action by defining the main pillars, by defining the details within each pillar, the KPIs and which was done in 2021 and then defining targets for each KPI or for each indicator that is done, and we have published last year our first fully dedicated sustainability report.

Now, within those four pillars we have identified certain targets, certain KPIs for the environment, starting with BBK. So that applies to our premises that applies to our consumption that applies to reaching high level of efficiency in our own business when it comes to consumption of energy, water and paper.

Also, we have identified targets in dealing with suppliers, we want even our suppliers to be ESG conscious and within that we have come up with certain products, retail and corporate on sustainable finance and we have done certain transactions. But I have to say these are the early days. It's important to give it a start and to explore this. And so going forward that will continue, and we would explore areas of enhancement to this.

Basically, we have developed a structure with not a purely commercial terms on this, in terms of the structure, in terms of tenors, in terms of interest rate incentive to really show our contribution to this site. So that is in brief, what we are doing on ESG and sustainable finance development.

In fact, the main thank is due to our investors, to the participant with very rich interaction and questions. We value this, so we will continue with the quarterly investors meeting. Hopefully the second quarter is ahead of us and we are looking for a sustainability of our performance and I think as my colleague Ahmed said, we started investing into our investors platform and any suggestion that would help us to enhance the communication with our clients, with our investors, we will do so.

So, thanks to SICO for hosting this event and for all the participants.