



BBK 2ND QUARTER, 2023 CONFERENCE CALL

Video Transcript

Sumaya (SICO):

Good afternoon ladies and gentlemen, this is Sumaya Al Jazeeri from SICO and I would like to welcome you all to the BBK Group second quarter 2023 results conference call.

It is my pleasure to host BBK group's senior management today. We have here with us to present Dr. AbdulRahman Saif Group CE, Mohammed Abdulla Group CFO, Mohamed Al Rayes General Manager – Treasury and Investment, Zain Al Zayani Head of Corporate Communications & Marketing, Hussain Toorani Head of Treasury, Ahmed Abdul Qudoos Head of Group Board Secretariat and Abeer Swar Assistant Head of Group Board Secretariat.

As the management begins, you should be able to see the Bank's presentation on screen and have received the earnings release and detailed financials of on Bahrain Bourse's Website for Q2 2023.

The presentation will be followed by Q&A and management discussion. We will take all your questions; You can either ask your questions verbally or type them separately and we will address them. Now without further delay, I would hand over the call to Dr. AbdulRahman Saif to commence the conference call. Thank you.

Dr. AbdulRahman Saif:

Thank you, Sumaya. Good afternoon ladies and gentlemen and thank you very much for your participation in this quarterly investors meeting. This time we had some delay holding the investors meeting because we thought with the summer vacations and holiday if we held it in July it may impact the participation, so that was a judgement call we took but we will, except for summer, ensure timely arrangement of this conference call on a quarterly basis. As usual we will start with the presentation, my colleagues will lead the presentation, so I will hand over to Mohammed Abdulla Group CFO to start the presentation.

Mohammed Abdulla:

Thank you Bu Khalid. Good afternoon ladies and gentlemen, a quick summary of the corporate highlights for the second quarter of 2023 that can be classified into financial and non-financial.

In terms of the financials, the Bank has financed the Beyon Cable Extension with \$200 million, and was able to close \$250 million of two-year club loan facility. In addition, the Bank is continuing offering facilities for ESG initiatives by offering facilities for ESG compliance, loans and of course we have adapted energy saving solutions across the BBK premises.

In terms of the non-financial highlights, the Bank continues investing in enhancing customer journeys and service quality where it has introduced corporate business account digital on-boarding, meaning corporate clients can open business accounts digitally. We are launching customer appreciation initiatives in rewarding our customers. Also, we have maintained our ISO certification for bank business continuity plan. These are the major corporate highlights for the second quarter.

I will hand over to my colleague Zain for the corporate social responsibility.

Zain Alzayani:

Good afternoon everyone, just a quick update on BBK's efforts and supporting the community. We have several initiatives that we are rolling out or have rolled out with women empowerment, we are going to be launching our second batch of the women on-board training and development program. We also introduced BBK Grow a few weeks back, which is a six-month program designed to help youth and empower them with career skills; we also have a program that we will be introducing soon with INJAZ for coding skills for youth, and we have launched the DigiPro, the digital academy for employee training and development.

In terms of Youth and community, we've supported the Ministry of Youth Summer Initiative, Youth City and we also have the National Road Safety Program partnership with the Ministry of Interior. In terms of sports, we are also supporting the equestrian turf race, which is something we do on a regular basis, as well as the Bahrain's Victoria cycling team. Thank you.

Dr. AbdulRahman Saif:

Thank you Zain. Bu Fawaz on key governors and investors relation development.

Ahmed Abdulqdoos:

I will cover few developments in this area. The major thing that happened during the quarter was that high-level controls of the Central Bank of Bahrain was fully revised to be aligned with current governance initiatives and the implementation is effective from 1st of October 2023. However, the Board decided early adoption of all governance related issues. The HC Module covers other areas such as compliance, Audit, Human Resources and remuneration, etc. The Bank's governance philosophy is not only to comply with the regulatory requirements but also to adopt the best international practices in this regard. We had some initiatives that now are reflected in the HC module and the Bank has been implementing it for a long time.

As far as compliance is concerned, the Bank has done a gap assessment against the revised module and the level of compliance was very high,. The Board considers compliance with various regulatory requirements as one of the Bank's priorities, the governance manual was reviewed by the Board encompassing most related policies. The policies are in line with the revised module and the international practices.

As far as the investor relations development is concerned, an increased number of investor queries and interactions were received during the last quarter and were attended by the Investor Relations team. We continue to encourage these interactions and holding such meetings for the best interest of the investors.

Thank you.

Dr. AbdulRahman Saif:

Thank you Bu Fawaz. So next we move to financial highlights of the end of June 2023.

Mohammed Abdulla:

Thank you Bu Khalid for the second quarter of 2023 year-to-date, June, the bank has achieved BD 37 million net profit compared to BD 31 million achieved till end of June 2022, representing a growth of 21% year-on-year, mainly driven by net interest income of BD 67 million, representing a growth of 56% year-on-year due to dynamic balance sheet management by the bank. On the other hand, other income has recorded BD 10 million versus BD 21 million last year, representing a reduction of 52% on account of the performance of associates. Operating expense has grown by 7% being investment in our resources and strategic initiatives. The net provisioning year to date is BD 6 million compared to BD 2 million last year, mainly on ECL and precautionary provisions.

Moving to the performance of the second quarter, in particular, we have reported BD 17 million as net profit versus BD 16 million in the second quarter of last year, a growth of 9% driven by net interest income of BD 33 million compared to BD 22 million, a growth of 49%. Other income reported as BD 3 million for the quarter versus BD 9 million in second quarter of last year representing a reduction of 71% as we mentioned for the first half, this is driven by the associates performance.

Operating expense, a 10% growth for the second quarter, BD 17 million versus BD 15 million for the second quarter of 2022. The provisioning was BD 2 million for the second quarter versus BD 1 million for the same period of 2022. Moving to the financial position, total assets, loans and advances and customer deposits remains flat compared to end of 2022.

Moving to the key main indicators. The return on average equity stands at 12.3 for the first half of 2023 compared to December 2022 level of 11.7%. Return on average assets at 1.8% compared to 1.7% for December 2022. While earning per share is at 41 fils compared to 39 fils, cost-to-income ratio improved to 43% compared to 47% in 2022. Specific provision coverage at 68% versus 72% mainly because of writing-off some accounts that the coverage has dropped.

ECL remains at 2.3% and the gross NPL slightly moved above 2022 to 4%. Capital adequacy at a very comfortable level of 27.1%, while NSFR and LCR at a very comfortable level above the CBB minimum requirements at 136% and 275%.

Thank you.

Dr. AbdulRahman Saif:

Thank you, Bu Abdulla. I believe we will open the floor for questions and answers please.

Reem from SICO:

Hi, good afternoon. This Reem Al Bari SICO, I just have one question regarding your 2Q results. It's about fee income. So, fee income in 2Q 2023 was at BD1.5 million versus BD4.8 million year on year.

Can you please tell us what has impacted fee income this quarter? Was it because of a one-off gain last year? Because of the Bank's loan books have not increased?

Mohammed Abdulla:

The fee income impacted mainly on our initiative and support of the customers at this difficult time. So, we believe that the impact is on temporary basis and it will pick up again in the coming quarters after that.

Dr. AbdulRahman Saif:

I think the main challenge here, this is for Reem and in general for other participants, as we coming from COVID and the consequences and as the 27-month long deferral has come to an end, there are still some market segments that are lagging behind and that are in the process of recovery.

So really the challenge is the kind of support we can offer to our clients, be it retail, SME or corporate, and how do we position ourselves in terms of fees pricing in terms of their facilities.

What has added to the market challenges is the sharp rise in interest rate, and that has really added to the challenges our customers are facing. So this is where banks come into play to really look at all possible means to support our clients.

And we are offering valuable support through pricing including fees, etc. We are hoping that with this support, we can help our clients especially SME's and Corporates to recover and then you know, we resume the normal operations.

Reem, do you have any other comments or questions?

Reem from SICO:

I just had one more question. It's about retail lending. It's continued to decline consistently from the second quarter onwards. It went from BD 694 million and 2Q to 682, then 660 in the year end. Is this due to the Bank's inability to compete on the retail lending end? Impact of lower overall demand in this environment or a shift of focus towards corporate lending?

Mohammed Abdulla:

After the CBB loan deferral period, we have witnessed the repayment of the installments that has contributed in terms of reduction. In addition to the high interest rate environment, in which we have seen hesitance from the customers in terms of borrowing or increasing their exposure waiting for the right time.

In general we don't compete on the pricing with banks, we compete on our quality of service and we should see going forward some improvement or pick up in retail portfolio once there is a stabilization in the interest rate environment.

Dr. AbdulRahman Saif: Reem our strategy is to continue growing our market share and retail is a core business for us. So we are not retrenching, on the contrary, we are enhancing our services through our channels, digital channels and digital branches. We are offering new projects and we are competing on not only services but also pricing for the whole spectrum of retail activities, be it personal auto, mortgage, or credit cards. So that is an area that we give high attention to. In addition to the other segments like corporate.

Sausan from SICO: Just a quick question from my side regarding the corporate lending book.

Which sectors is the bank seeing a pick up and lending to regarding the corporate lending?

Which specific sectors are you seeing pick up in lending?

Dr. AbdulRahman Saif: Well, look in general, we have seen a good economic recovery. We look at certain indicators that all reinforce this. We look at, for example, sales data through point of sale, we are the largest point of sale in Bahrain. So in terms of these figures, they confirmed that we have surpassed pre-covid, which is 2019 levels. So there is a good recovery. Now, some sectors have recovered earlier than others. Others are recovering with a timeline. Now in general, retail has recovered very well. Others like hotels, travel have recovered with that timeline and still in that process.

I believe consumers have recovered but sectors like construction, real estate will take time to fully recover. But we are seeing some good signals of the recovery. But this is the nature of certain sectors. Some sectors are pro-cyclical, they go immediately with the cycle and some have a time lag. So I believe Bahrain is no different than the rest of the world. Maybe it's a matter of scale. But as a general trend, I think we are not seeing anything exceptional.

Sumaya (SICO): We have certain questions that have come through prior to the call on the Net Interest Income growth, commenting on it, that was very strong.

Obviously, that was maybe due to the higher interest rates which has pushed them to about 3.5% levels. Is this sustainable? And should interest rates take a downturn? What are the new levels you expecting to close the year out?

Dr. AbdulRahman Saif:

I think the issue is broader than the recent rise in interest rate. To some extent, it's a structural issue and to other extent, it's an interest rate play issue. Now, one of the challenges we faced is the short and sharp cycles, which was not experienced in a long time.

So during COVID, we have seen a sharp reversal of interest rate, it almost touched zero levels or negative. And then this last for around two years only to be reversed with another sharp cycle where interest rate was raised at unprecedented levels even.

So, the issue for us was first structure. We gave it our best thinking in 2020 because the market fundamentals have changed, and we embarked on an analysis of how can we deal with this and how can we prepare for the future.

I want to emphasize we are not traders in interest rates. We only build on our fundamentals to really deal with the cycle. So we started this process in 2020 to prepare for this situation. We have revised our balance sheet to a good extent, both assets and liabilities.

We have developed a new funding strategy at that time, taking into account the availability of funding in both BD and US dollars. These are the main currencies we deal with and the pricing at that time.

So we took a number of actions to optimize our balance sheet and to defend the then declining margin. We have seen agile trend of declining margin grow in 2020. So if you look at our financials in 2020 we managed to really stop the deterioration in the margin and reverse it, and then on a quarterly basis, our net interest margins started to reverse trend to increase even before the aggressive interest rate rise.

So we have prepared ourselves for this situation. I cannot say it's fully interest rate play. It is partially our balance sheet is efficient. Our funding especially wholesale funding is efficient, and so a good part of this, I believe is sustainable. Now, you should look at both sides of this interest income and interest expense.

If you compare our interest expense, even with the sharp rise in the interest rate, you will see the growth in our interest expenses below the market average. And that shows how efficient we are on funding and that has contributed, of course, we have to be competitive.

It's a highly competitive market to attract liabilities and funding these days. And customers are becoming highly sophisticated and their expectation is high. So we are competitive in terms of our pricing to attract deposits and other funding.

But through this balance sheet of optimization, we manage to really secure good, efficient funding. We have planned our funding into different schemes. And so you look at our liquidity, it's a very sound liquid position and competitive. So I hope I summarize the situation and in a good way.

Sumaya (SICO):

Thank you. We have one question from Riyadh. Good afternoon, everybody. I congratulate you on the excellent performance during this period.

My question is, has the Bank recovered any interest on defaulted loans during the period? If so, how much has the Bank recovered? And how did you treat from an accounting perspective? Was it booked as interest income for the period or used to reduce the provision for loans and losses?

Dr. AbdulRahman Saif:

First, I will reiterate what my colleague Mohammed said the main performance is coming from the core business, which is our loans and investment banking. This is our core business and this has more than compensated for the deterioration and other segments like the associate. So that is the main have we recovered?

Yes, we have recovered and this is ongoing. The recovery is ongoing. Is it significant? It's not significant what we have recovered.

So our performance was not held to a significant level by a one off recovery. The recovery we did is at the natural level we do every year. It was not abnormal.

Sumaya (SICO):

We have one question regarding the cost to income ratio which has increased in the second quarter to 45% from 39% in 1st quarter of 2023, mainly due to higher overhead expenses. Shall we expect this increase and the overhead expenses to continue? And are we looking at a range of 40% to 45% for the year?

Dr. Abdulrahman Saif:

I think you should look at the trend rather than the quarter on quarter. Our trend shows a downward and, and a cost-to-income ratio on a downward trend.

After 2020, we came from a high level as high as 50% or possibly a bit higher into the 2nd quarter of around 43%. Now, during this period, we have invested heavily in our channels. Enhancing our IT infrastructure, enhancing our delivery channels and digital offering.

As we present it to you, we are leading on retail, digital, we are leading on corporate recently. We have launched a fully digital end-to-end digital corporate onboarding channel, which is the first in Bahrain. So we continue to invest in technology, and as my colleague said, most of the rise in expenses is because of this and because we have to be digitally capable, we have to invest in our resources. We have established a full staff, digital training and awareness program.

We started that this year and we will build on this for the next two years also. So this is where most of the expenses are. Our target is to really continue our reduction on cost-to-income towards the low 40% level. So as a trend, we are moving now in the right direction and we will hopefully build on this.

Sumaya (SICO):

There was a question on the income from associates as the group CFO has mentioned earlier in the presentation that the other income decline was mainly attributed to lower income from associates and subsidiaries.

So is BBK revaluing its stake in certain associates namely BCFC or are you making provisions against this?

Dr. AbdulRahman Saif:

We, BBK has a lot of investments and it is the policy that we value these on an annual basis in good time and in bad times. So it's not like we are looking at re-evaluating because of the negative results. We present an annual assessment to our board. So that's ongoing.

Now in a such a difficult environment, in a high interest rate environment, certain businesses and certain investment will suffer. We are seeing asset classes around the globe suffering because of the high interest rate because it's a different valuation.

Now, for certain investments, we do adjustments through the equity method. So we take adjustment and for others, we have an approved sophisticated provision model that we test and validate on an annual basis. And then we go by the model.

Now, further on top of the model, we are building general provision on top of the model as mentioned earlier by Mohammad. Now we have been building discretionary general provisions over the last three years because of the nature of the market.

So in summary, yes, we are assessing all our subsidiaries and associates as investments on an ongoing basis. We have to adjust according to their performance on an ongoing basis. This is an accounting standard.

Sumaya (SICO):

There was one question also regarding investments on M&A. The bank has constantly in the previous conference calls spoken about this that you're looking into. Could 2024 witness this materializing? Could this be more of a local or a regional opportunity is that we're looking now?

Dr. AbdulRahman Saif:

Hopefully we are serious about this. We are considering specific opportunities. This is under the management of the Board, the shareholders.

And we are excited about M&A and the growth of the BBK Group. So hopefully something can materialize in the short run.

Sumaya (SICO):

Would it be more of a local or a regional opportunities that you are looking at?

Dr. AbdulRahman Saif:

Look BBK has announced this publicly and it was reiterated in the last AGM in March that the scope of this is domestic and regional. The scope of this is financial and non-financial. So it is as a strategy, it is announced and we are looking within this strategy.

Sumaya (SICO):

There was one question on that you have mentioned regarding the POS and recovery. The economic recovery witnessed in the retail sector, what percentage of POS fees is out of the total fee income of BBK?

Dr. AbdulRahman Saif:

I know it's difficult to draw the borders here. There are different segments or channels where our fees are generated. It is corporate. It is retail, it is through digital channels. As we increase our digital sales, we generate fees, certain fees.

It is Bahrain against our international branches and it is our credit card. So these are the main sources of our fees. Now, what we are saying collectively given the circumstances and taking into account a long term relationship with our clients.

We felt that we need to really look into ways and means to support our clients in this difficult time. They need us more in difficult times than in good times and this is where we show our appreciation of the relationship.

So really, we have taken a decision to forgo certain fees on a temporary basis until we see recovery in our clients on the credit card.

As we all know, during COVID, A cap was imposed on the merchant commission of 0.8%. The cap was lifted in early 2022. However, I don't think it would have been wise to take it immediately from 0.8% to high level given the market conditions at that time. So we thought we would consider gradual increase in, in our fees as we stand today.

The average is below our historic average, but for reasons we have to support our clients. So this is it, as my colleague, Mohamed said, we believe this is a temporary support and relief measures and hopefully with the full market recovery, we will see a normalization in our feed income.

Sumaya (SICO):

We have two more questions. One is regarding your interim dividends and your future dividend policy.

Shall this be a new norm for the bank to witness more interim dividends given the high capital adequacy ratio of the Bank?

Dr. AbdulRahman Saif:

First, we always had a dividend policy in BBK. We are proud that we have mature policies and we revise our policies on an ongoing basis, so we maintain very clear dividend policy under the management of our Board.

In 2019, pre-COVID, the Board decided to introduce as the first bank in Bahrain to introduce an interim dividend. During COVID, we had this discussion. Should we continue given the high volatility, uncertainty and risk or not?

We did not abandon this policy. But we thought and in discussion with the regulator, there were justifications to maybe post given the high volatility and uncertainty. Now we manage to post good profitability in 2020, 2021 and 2022, in spite of the market conditions, we came to a strong conviction that our performance is stable and it is now time to go back to our policy of interim.

So it's not the first time. So now we are assuming the same a tradition if you like or practice that we started in 2019, we are happy that it is sending a strong signal to the market about BBK, about profitability, about liquidity, about capital adequacy. And we should continue on this practice, I think at this time injecting BD 17 million and the liquidity in the market is positive, it should help the market. It should help Bahrain, it should enhance the confidence.

Sumaya (SICO): The final question that was sent to us was regarding the guidance for the next year, second half and next year, where are you targeting your ROE levels to be? And furthermore, the cost of risk in terms of your provisioning?

Dr. AbdulRahman Saif: We are very optimistic and hopefully, hopefully, you know, let me qualify my earlier statement. We are cautiously optimistic. We are fully aware of the market risk, be it on the business side, geopolitical turbulence and commodity pricing, volatility and capital markets.

Then I would call it fragile outlook on interest rate because based on economic releases, we see the swaps changing quickly. So, in spite of these challenges, we are cautiously optimistic to really maintain the strong performance and to build on it.

We are proud that we look at the performance in Bahrain and in the GCC and we stand among the top in achieving 21% and in the bottom line. So we are excited and committed to really maintaining this performance and building on.

Sumaya (SICO): I think that wraps it up for the questions. It doesn't seem we have any further questions. So with that, I'd like to thank everyone for the participation in this conference call of BBK Group discussing the financial results for the second 2nd quarter of 2023. And I will hand it over to you finally for any closing remarks.

Dr. AbdulRahman Saif: I think we take high interest in this meeting. We get more excited as we have more questions. Thank you for all the questions. These are really good questions.

And these are the relevant questions. It is a good opportunity to share with our investors and the participants during this short meeting some of our strategies, some of our thinking, some of our aspirations. So really, we hope this continues in this very active manner and hopefully we look forward for the next meeting with a strong another strong performance. Thank you very much.