BBK 3RD 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 BBK Group's third quarter 2023 results conference call.

It is my pleasure to host BBK Group's senior management today. We have Dr. AbdulRahman Saif Group CE, Mohammed Abdullah Group CFO, Ahmed AbdulQudoos Head of Group Secretariat, Mohammed AlRayes General Manager of Treasury and Investment, Hussain Toorani Head of Treasury, and Zain Al Zayani Head of Corporate Communication and Marketing. As the management begins, you should be able to see the company's presentation on screen and have received the earnings release and detailed financials on Bahrain Bourse.

The presentation will be followed by a Q&A session and the management will be taking all your questions. You can either ask your questions verbally or type them separately and we will address them. Now, without further delay, I will hand the call over to Dr. AbdulRahman Saif to commence. Thank you very much.

Dr. AbdulRahman Saif:

Welcome to the quarterly Investors Conference. As we promised last time, we are arranging it close to the announcement of the results. We are very proud of the performance throughout the year, and this applies to the third quarter. The Bank has achieved outstanding results despite the challenging operating environment globally and regionally.

We will have the presentation that will cover financials, as well as other parts, such as our corporate strategy development, corporate governance, and ESG initiatives. Following that, there will be a session for questions and answers.

Mohammed Abdulla:

On the corporate highlights and as part of the Bank's digital strategy roadmap, the Bank continues to invest in innovative platforms for different customer segments and different journeys. Recently and during the third quarter, we have launched BBK Business Platform, which services corporate clients and SMEs. In addition, the Bank was able to launch the investment solution on digital platforms. Moreover, we have strengthened our different platforms to enhance the customer experience, including trade finance and other platforms. Thank you.

Zain Al Zayani:

In terms of the Bank's corporate social responsibility initiatives, the Bank continues to support different sectors across Bahrain. When it comes to women empowerment, we have already started with the Women on Board Program, the second batch in the next week or so. When it comes to training and education, we recently launched the BBK Grow program, which is a six-month program designed to help enhance the skill set of young Bahraini graduates, and they have already joined the workforce after finishing their training. Our BBK scholarship students are also along their second year of study.

When it comes to youth, we continue our support to the different societies within Bahrain, like the Child Wish Society, the Future Society for Youth, and Childcare Home. When it comes to the community, we launched Nasmaakom, the first application of its kind in Bahrain. It connects hearing and speech impaired customers with our customer support centers. We also continued our support with the Bahrain Paralympic Committee. Then finally, the bank supported the nationwide call for Gaza, and we donated 100,000 Dinars to the cause. That is all from my side. Thank you.

Ahmed A.Qudoos:

I will add a couple of points on corporate governance. In BBK, corporate governance is one of the Bank's main pillars and it is very important to the Board and all the interested parties, including the shareholders and other stakeholders.

The main development in corporate governance was the revision of the Central Bank's Rulebook, High-Level Controls module, which encompasses all the corporate governance practices and that took place last quarter. However, the Bank continued to ensure compliance and implementation of the same in Q3. For the audience who missed the last conference call, the conference discussed the group's performance and some of the initiatives in the fields of renewable energy, environment, and sustainability, which are also another very important pillar for the Bank. The Bank would like to also re-emphasize on holding these conferences and re- ensure the group's commitment to transparency with all stakeholders. Thank you.

Mohammed Abdulla:

The Third quarter of 2023 was a record third quarter for the Bank. The Bank has achieved a net income of BD 20 million versus BD 14 million for the same period of last year, a growth of 39% year-on-year, mainly driven by the growth in the net interest income of 27% year on year, due to the continuous balance sheet optimization. Other income reduced by 32%, mainly because of the performance from some of our associates, while operating expense has gone up by 7% in account of investing in our strategic initiatives. Net provisions have reduced compared to the third quarter of last year by almost 56%.

Moving to the year-to-date performance for the period ending 30th September, again, this is a record high 9-month period performance for the bank. 45% growth on the net interest income touching BD 100 million dinar as net interest income compared to BD 70 million dinars for the same period of last year. Other income, BD 15 million compared to BD 29 million in the same period of last year. As for the operating expenses, we have witnessed a growth of 7% year-on-year, and the total provision for the year to date, was around 50% higher compared to last year.

Year-to-date performance is 27% higher as the Bank reported at BD 57 million net profit for the 9-month period ending 30 September 2023. As for the financial position of the bank, the balance sheet reported a total asset of almost BD 4 billion as of end of the third quarter of 2023.

Net loans and advances are almost in line with the same period of last year, while the customer deposits have grown by 5% to stand at BD 2.2 billion, and the shareholders' equities are almost in line with the same period of last year.

Moving to the key financial performance Metrics, the return on average equity reached to 12.7% as of end of third quarter of 2023, while the return on average asset was at 1.9, annualized earning per share stands at 43 fils, and cost to income ratio slightly lower than 44%. The coverage ratio for specific is around 72%, while the ECL (stage 1 & 2) coverage ratio is maintained at 2.3%. As for the gross NPL ratio, we are at 4.1%, and the capital adequacy was at a very comfortable level of 27%. Other liquidity parameters are all at comfortable levels above the Central Bank minimum requirement. Thank you.

Sumaya (SICO):

Thank you very much to BBK Management. I would like to open the floor for Q&A. Just a reminder if you have any questions – Do type them or you may raise your hand, and we will address them.

Sumaya (SICO):

The first question is from Ahmed Al Doseri, it reads; can you please tell us the reason behind the loan book contraction in the 3rd quarter especially in the corporate segment?

Dr. AbdulRahman Saif:

I believe our loan book has been very stable over the last couple of years. We have grown aggressively in some areas and in some markets. We, on purpose, took a decision to reduce our exposure in certain sectors and in certain markets. We have done this as part of our balance sheet optimization, considering several factors. Number one is the funding and cost of funding fundamentals that have changed drastically over the last two years or so. Number two is to preserve our asset quality. Number three is to defend our margins. We have done that successfully, and this is highly responsible for the significant increase in margin and for the reduction in our provisions and increase in our net interest income.

Sumaya (SICO):

The next question is about fee income, the fee income recovered in the 3rd quarter of 2023, which is a positive; can you give us more color on this because the loan book has declined so what is giving the higher fee income?

Mohammed Abdulla:

The fee income is returning to its normal levels during the first quarter and previous years. What we have seen a dip in the second quarter, mainly because of our support to certain clients to waive certain fees, and now we are gradually back to the normal trend.

Sumaya (SICO):

The next question, well, it's a comment. Let me congratulate BBK's board, management team, and staff on its ability to ensure a strong nine months of the year, as well as a strong quarter. Further, I would like to extend our gratitude to His Majesty the King Hamad bin Issa Al Khalifah, His Royal Highnesses, and other officials, dignitaries for providing a platform for enabling this performance. I have a few points to clarify.

The first one goes during the nine months of 2023, interest rates and net interest income, a large proportion of the increase in net income was due to higher net interest income as well as Q3 2023 and better efficiency in terms of lower cost to income ratio. Some part of this is due to higher interest rates. Borrowers' financials with higher rates has the ability of borrowers to maintain their profitability and/or free cash flow or net income growth has been impacted. If so, what is the risk of any lower profitability of the followers that could get reflected in increased potential risk of provisioning? Can you give a sense of the broader environment in Bahrain and more specifically with BBK?

Dr. AbdulRahman Saif:

I think there are several issues here, and I will take them together. What happened during COVID, as we all know, was a major interruption or disruption to all markets and businesses. The interest rate has dropped to near zero. There were a lot of restrictions on mobility around the globe. The recovery was not fully shared by all markets and sectors, so some recovered faster while others took a time lag.

Unfortunately, with the recovery, we had a new challenge, which was a sudden and swift rise in interest rates, multiple rounds of high increases in interest rates. That has added to the complication really faced by the corporates in different sectors. Bahrain has introduced a support package, including loan deferral, the last was June 2022. We had around 27 months of loan deferral, complete or optional. You have all these challenges with short-term reversal of cycles.

It is challenging to always predict the timing and magnitude of interest rate, but during that time, it was even more complicated. However, we have spent time to really discuss our balance sheet, our interest rate exposure, our asset quality, and so on. Starting the third quarter of 2020, we have taken a number of measures to protect the bank and to put our balance sheet on a better, sustainable path.

Thank God, the outlook or the economic fundamentals came in line with our reading and with the outlook that we adopted. That has helped us enhance our asset quality. Our NPL dropped to 4% from as high as 8%. Our net interest margin suffered during 2020, the first half of the year, but then started to recover. It has proved to be sustainable now for the last two years. Our business has continued to grow.

In the midst of great uncertainty, we became very selective in our business in terms of markets and in terms of sectors, and that is a natural course of action to take. Our priority was the asset quality, control over provisions, and in the meanwhile, improve our fundamentals. That's what we achieved really. In summary, interest rate rise is part of it, but I think this was helped by the total balance sheet exposure to interest rate rather than being very timely and selective. We don't have a trading portfolio on interest rates, so we have risk limits to subscribe to. As my colleague Mohammed mentioned, we had to support our clients. This is the time when our clients need us the most.

We have taken into account reduction of fees, reduction of prices to really help and show our strong support to our clients in these difficult times. I hope I have answered all the issues raised.

Reem AlBeri (SICO):

Hi, my name is Reem Al Beri from SICO. I have a question about net provisioning. I have noticed it was lower in Q3 2023- mainly just higher recoveries. Were these recoveries from retail or corporate?

Dr. AbdulRahman Saif:

In general, let me say we have an aggressive policy on migration of credit rating. So, we migrate from stage one to two and three aggressively. In fact, compared to the region, we have one of the lowest assets in stage one. This shows our aggressive migration and our conservative approach. Secondly, we have a very conservative stand on booking of provisions and including ECL on stage one and two.

And we have been accumulating very conservative level on all stages including management overlay over the system driven ECR requirement. Now, the reduction in provision is not wholly due to recovery. Our recovery is at normal level. We have been achieving recoveries over the last several quarters. So, the main reduction is first that we have been aggressive in booking provisions during COVID and in the aftermath of COVID and then the improvement in the asset quality. Now that recovery has helped, but it is not a significant recovery.

Sawsan:

Congratulations on a great set of results. A quick question from my side, we have seen a strong growth in deposits in the past quarters, is this seasonal?

Dr. AbdulRahman Saif:

Definitely not seasonal. In managing our deposit, we take into account a number of factors. One is the sustainability of the deposits based on business relationships. Two is the cost of the deposit. Three is our liquidity position. We usually align deposits with our other fundamentals, including our loan portfolio. If you look at our loan to deposit ratio, it has been stable around the low to mid-70s, and this is a comfortable position for us to maintain and sustain.

Now, one thing I should have mentioned is that our committed but unutilized loan portfolio has increased. Going forward, once these are utilized, we should see a better growth in our loan portfolio. With that, it is efficient and justifiable to enhance the growth in our deposit to maintain the loan to deposit ratio within the range that we are comfortable with. That is within the business strategy and not a timely issue.

Sumaya (SICO):

We will go back to the questions typed. There is a question again on the deposit growth. It mentions the 5% growth and total asset growth of 6%. Do you expect growth in deposits and assets to be reflected in increased loans and advances in growth in FY 2024 and beyond? If so, can you kindly give some color on this?

Dr. AbdulRahman Saif:

In general, our growth has been balanced and sustainable over the last number of years. We haven't seen volatility in our fundamentals like our assets, our loan portfolio, or our deposits. One of the achievements is we brought a high stability in our funding. Our balance sheet is mainly in BD and US dollar, and so we fund in both currencies. We brought a vision into funding, especially on US dollar, and we completed a number of repo transactions with different tenors to suit our balance sheet. We have closed our first club transaction with the domestic and Regional Bank on US dollar with competitive pricing.

This year, we have closed another one with the refinancing option, again with domestic and regional banks. The amounts have been significant for us and contribute to the stability of our medium and long-term funding. Really, there is an approach here on managing our funding. Markets are, as you all know, very volatile. We have seen revision of global, regional growth rates downward, unfortunately, and it is likely that we see further revision for downward for the next two years. Really, this is a challenging environment, and we are growing along the macro-economic growth.

For us, as long as we maintain our fundamentals intact and within healthy ranges, if you look at our capital, it is at a healthy level and our liquidity is very sound, and we subscribe to all internal and regulatory with a comfortable buffer. We are deploying our excess liquidity in good yield channels. Our NPL has come down significantly and within a good, but hopefully we continue to reduce the NPL ratio and our coverage, NPL coverage has increased. This is a very balanced fundamental that we look to maintain.

Sumaya (SICO):

Thank you, Bu Khalid. There is a question from Joe, why has the loan book shrunk by 2% while it is growing by 3% at the country level?

Dr. Abdulrahman Saif:

I think I have answered this question, but in brief. Our growth has been aggressive in certain markets and in certain sectors above the economic growth. However, for reasons, we have deliberately reduced our exposure in certain markets and sector. I would say that 2% to 3%, this is the net growth. But if we look at the gross growth, it has been very high in certain markets. I can think of a few examples where BBK has won large ticket transactions. With the Electricity and Water Authority, we won a transaction for BD50 million. For Infrastructure Project, with the Ministry of Tourism, we won a transaction of BD50 million to support certain projects, including the new

Bahrain International Exhibition Center. With Batelco, we have won a major transaction of $200 million. The bidding was among local, regional, and possibly international banks. This shows our ability to win and close major transactions. It is an appetite issue. We may not rely on an aggressive growth rather than a balanced and selective growth.

Sumaya (SICO):

Thank you, Bu Khalid. Following up on the points you have mentioned with the large tickets, if I may ask, have these been utilized or are they commitments?

Dr. AbdulRahman Saif:

The utilization has been continuous and large, but not fully utilized because these are project finance, and the tenor is between 2-3 years. As I mentioned earlier, we still have unutilized limits, and these are approved loans, unutilized. Once utilized, that will add to our loan portfolio.

Sumaya (SICO):

The following question is from Sadiq, given the current market conditions, regionally and globally with regards to geopolitics, which is also associated with higher cost of funds. Is there a change of the bank when it comes to its risk appetite in the region? Is BBK focusing on expanding its loan book in the regions such as GCC, Turkey, India, etc?

Dr. AbdulRahman Saif:

We all know how challenging the business environment is. It is unfortunate that the geopolitical issues in Europe and the region is adding further complications and further challenges on the businesses, not only banking, but all businesses and markets. As I mentioned, we have drawn a risk map or risk appetite map for us during COVID and the aftermath of COVID, and that has helped us to achieve all the performance. It is continuous monitoring for us.

We don't have high exposures in some of the high risk or highly volatile markets, so we will continue to be selective in our approach. Our main or core markets are Bahrain and the rest of the GCC. India is a natural market for us because we have been there over 30 years and we have presence on the ground and we understand the market. Turkey, we have a representative office, and since we started our business, we have been selective, highly selective.. We do not have exposure in the domestic currency, so we will continue our selective position in Turkey. So far, we have been highly successful there, and in markets where we do not have a presence.

Sumaya (SICO):

Thank you. The following question is from Riyad. Share of profit and loss from associates turned from profit of BD3.2 million last year to losses of BD5.8 million this year. If we excluded BCFC's impact, which other associates are contributing to the remaining loss?

Dr. AbdulRahman Saif:

This is a valid question and a valid observation. So, our results are highly driven by our fundamentals. Where we have control, we have overachieved. This is a comfortable position. Now, the bank has invested over the years in subsidiaries and associates and a few of these associates still suffer from the economic situation and we had to take part of this suffering.

So, it is highly concentrated. The highest is, as rightly mentioned, BCFC and minimal on the others. But I want to emphasize that the overperformance of the Bank as a whole comes from the core business and from all the businesses that we have direct control and management. We hope that the impact on these associates is temporary, due to market driven conditions. Once this is managed and reversed, I think this would be a great support to the performance of the bank.

Sumaya (SICO):

There is a question on the CBB's mandate for banks to increase their allocation towards SMEs to 5% by the end of this year and 10% by the end of 2024. To what extent is BBK in compliance with this?

Dr. AbdulRahman Saif:

I want to take this question on its totality first. First, we have always had a significant portfolio in the SME segment, and it is likely that we have always been the biggest or near biggest bank in terms of SME. Our appetite on SME has been there. What have we done in the last two years is really to enhance our SME business. We have restructured our SME department, and we have increased the resources there. We have reviewed, revised our policy, SME credit policy and the requirement, and we have invested in a digital platform. Now we can onboard SMEs in a matter of second, and our platform is end-to-end, digital end-to-end.

This really started several years back to really strengthen our position to enhance our response or turnaround time to our SME business. We have been successful in doing this. It shows our commitment to the SME. Going forward, of course, we are part of this, and we must show our strong support for a national initiative. We are engaged, whether directly with the CBB or at Bahrain Association of Banks (BAB) level, to align ourselves with the CBB and the national requirements.

We must all support this initiative. To my knowledge, this initiative will worked over a number of years, to give banks the room to adapt. We will go with this initiative and support it.

Sumaya (SICO):

Thank you, Bu Khaled. There is a question on capital raising, any refinancing, either organic or inorganic, in terms of refinancing? Any update on the potential for refinancing the bond maturing in FY '24?

Dr. AbdulRahman Saif:

We have our senior bond of $500 million maturing in July 2024. We are one of the rare issuers in Bahrain, especially at the bank level. As I said, we have diversified and staggered our dollar funding. We have started internally the process of the refinancing. We have good experience on this. In my lifetime with the bank, we have done, I think, three or four issuances. The whole team has the experience.

We will start the process with updating our program, updating our documentation, appointing the managers and the legal and the auditors. We know the process very well. It is, as I said, a highly volatile market, especially when it comes to US dollar funding. But we have options. We also have identified an option that will help us to really select the best and most efficient for us.

It is not only the financing, so it is the amount, and it is the cost. If the market is conducive, we would look towards early second quarter of next year too. That is our target. But this must be flexible to really look for opportunities for market stability. We have been in contact with our investors. I must objectively state that BBK's story is very sound.

We keep our communication with the investors. We provide updated financials to them. We are comfortable of the BBK story, but international issuance has other considerations. We hope to see better stability in the market, better visibility, and we are confident that we can refinance this.

Sumaya (SICO):

Thank you, Bu Khaled. With that, I would just like to thank everyone for the participation, reiterating our apologies for the technical difficulties faced in the beginning. I would just hand it over to Dr. AbdulRahman Saif for a very short closing remark. Thank you very much.

Dr. AbdulRahman Saif:

Thank you very much. It is always exciting to meet directly, to have interactive meetings with our investors. We are happy about the active participation and the number and sophistication of the questions. We are always pleased to share our thoughts and responses openly. Thank you very much.