

KIPCO's Q3 2018 earnings conference call

November 15, 2018

Nick Paton: Thank you very much. We would like to extend our welcome to everyone who is on the line. We are here for the KIPCO third quarter conference call. It's my great pleasure to have on the line Mr. Pinak Maitra (Group CFO), Mr. Declan Sawey (Group Treasurer), Mr. Anuj Rohtagi (Director, Group Financial Control) and Mr. Moustapha Chami (Director, Finance and Accounts department).

We will be coming back in a few moments to talk about details of asking questions. But for now, we will hand over to KIPCO for the call. Thanks very much.

Pinak Maitra: Thank you, Nick. Good afternoon everyone and thank you for joining us. We will go through pages of the presentation, which is available on our website.

Before we start, I would like to draw your attention to page 2 of the presentation which reads out a brief disclaimer. Some of the statements that we will be making today, and information presented in the presentation are forward looking. Such statements are based on KIPCO's current expectations, predictions and estimates. They are not guarantees of future performance, or achievements of results.

The format of the call will be the same as in previous quarters. We will begin with an update on consolidated group results followed by performance of our major lines of business. This will be followed by a Q&A session.

I will hand over to Mr. Moustapha to go over page 4.

Moustapha Chami: Thank you, Mr. Pinak. Page 4 highlights KIPCO Group's financial performance for first nine months of the year 2018.

It can be noted that the Group has generated revenue of US\$1.9bn for the nine months period ending 30th September 2018, and this indicates a robust YoY growth of 10.3% over 9M 2017. This was mainly driven by higher interest income from our banking segment which had a growth of 14.0%. Also, this is the result of consolidation of our investment in education sector in 9M'18 which resulted US\$65mn revenue which was not consolidated in the same period of 2017. That was offset by lower investment income in 9M'18 that shows US\$58mn in 9M'18 vs US\$174mn in 9M'17.

The net profit in 9M'18 was however slightly lower at US\$67mn which is a decline of 8.7% mainly due to lower investment income compared to 2017 that

was driven by one-off investment gains recognized in 9M'17. This translates into a EPS of 9.4 fils per share or 3.1 cents per share vs 10.7 fils per share in 9M'17.

If you look at quarter to quarter movement in Q3'18, the net profit was 30% higher vs Q2'18 and a 2% increase over the same period of last year. Overall our performance in terms of profit from continuing operations for the nine months exceeds our last year performance while reported net profit broadly falls in line with our 2018 expectations as previously communicated in our Shafafiyah guidance.

Please note that during Q3, we have chosen to classify our investment in the pay-tv business as a non-current asset held for sale as per accounting standard IFRS 5. This is based on the fact that we are going through a process whereby we are exploring various strategic options in relation to this asset. The details of this reclassification are available in note 17 of the financial statements.

Now, I will hand it back to Mr. Pinak to go over Burgan Bank performance.

Pinak Maitra:

Thank you Moustapha. Page 5 outlines the details of Burgan Bank's performance. Starting with an important update. Burgan Bank Group went ahead with its planned rights issue in Sep'18 and successfully completed the subscription in Oct'18, raising equity capital of KD62.5mn or USD206.4mn. This amount translates into 120 bps positive impact over 10.8% CET 1 ratio or 16.5% capital adequacy ratio reported for 30th September 2018.

We would like to remind you that Burgan Bank holds its own investor call. For this quarter, the bank held its investor call on 1st November. The call's transcript and presentation are available on Burgan Bank's website which contains detailed information about operations. I will touch upon a few key highlights of the operations.

Continuing with its solid performance during the previous quarters of 2018, Burgan Bank Group reported strong 9M 2018 results with net profit of KD71 million, or US\$234mn which is 32% higher than 9M 2017. During the third quarter itself, the bank registered KD20.5 million, or US\$68million profit, registering a 36.3% growth compared to third quarter 2017. Improvement in 9M 2018 is mainly a result of higher net interest income by 10% owing to higher net interest margins which expanded by around 30bps in 9M 2018 vs the same period last year and an increase in non-interest income by 27.5% owing to higher foreign exchange gains from subsidiaries and higher dividend from group associates. Positive impact of the Group's regional diversification is quite visible as operating income continued to grow both in Kuwait (representing ~57% of Burgan's revenue) as well as in our regional operations. Operating efficiency improved further as visible from the cost to income ratio for the group which improved to 39.2% in 9M'18 vs 43.3% in 9M'17.

Asset quality remained stable as you can note that the NPA ratio remained within the range at 2.4%. At the same time, we continue to have very prudent provisioning levels where around 90% of our provisions are in the general category. Please note that all of this is before implementation of IFRS 9. Coverage ratio continues to be strong at 245% (including provisions and collateral).

We have also shown a few key balance sheet indicators here. Loan exposure is slightly down by 5.7% vs Dec'17 reported numbers, largely owing to currency devaluation of Turkish Lira and loan maturities in Kuwait in normal course. Kuwait and Turkey operations represent majority of our loan exposure, i.e. 66% in Kuwait and 23% in Turkey. With respect to deposits, as we have highlighted in our earlier presentations, the drop-in deposit base in 9M is a result of the bank completing its term funding initiatives such as 350 million dollars three-year club deal in first quarter of 2018.

On the next page we have details on page 6, performance of regional operations of Burgan Bank. If we look at loan book movement, major contributions are from our subsidiaries in Algeria and Turkey. Turkey had circa 30% growth in local currency. However, significant currency devaluation of Turkish Lira in the third quarter meant lower loan book in US Dollar reporting compared to 2017 base. For reference, the Turkish lira depreciated by 37% over Dec'17 base. Overall, regional loan book remains around \$5bn mark which is ~35% of total Burgan Bank loan book. In terms of deposits we can see that similar development happened as that of the loan book.

All our franchises are operationally moving in the right direction, with growth in net profit except for Bank of Baghdad. Decline in profit in Bank of Baghdad was a result of lower operating income (down 46% vs 9M'17) due to lower loan volumes. The performance was also impacted by one-off write-down of US\$7mn in Q1'18. Overall growth in net profit, particularly in Turkey is driven by improvement in net interest margin and in Algeria due to non-interest income. The non-interest income growth in Algeria is on account of higher foreign exchange gains due to recent update of regulations in the country, whereby a 0.25% transfer fee on LC LG was replaced by 1% FX margin. The cost to income ratio is trending in the right direction for all subsidiaries except Iraq operations due to reasons explained previously.

Now, I will pass it on to Declan to cover Gulf Insurance Group, United Gulf Holding and United Real Estate Company.

Declan Sawey:

Thank you Pinak. Slide 7 shows Gulf Insurance Group. You can see on the top left chart that the gross premium written for the first 9 months 2018 is at \$834mm, compared to \$813mm for the same period last year. It would appear to be a very small year-on-year growth, but there are a couple of points that are worth mentioning. Firstly the 2018 numbers for GPW do not include Takaful policyholders premiums which were included in the 2017 numbers. So, on a like for like basis, this would have added another 8% to the growth number. Also,

our Turkish business grew at a healthy rate in local currency terms, but as Pinak mentioned earlier, we have seen the Turkish Lira decline by 37% in 2018. This depreciation has had approximately 4% impact in terms of growth. So, on an operational basis the business is growing well around the mid-teens.

You can see on top left chart, the sudden increase in premiums in 2017 was due mainly to the contract with the Ministry of Health for medical coverage of Kuwait retirees known as “Afiya”. This contract was initially for 12 months and was subsequently extended for a further 12 months. The Ministry of Health has announced that it is going to re-tender this contract for a 2 year period. In the meantime, GIG will continue to operate on the same terms. We expect that the existing contract will be renewed until the re-tendering is completed, which is mid 2019 at the earliest. Customer satisfaction feedback that we have received from the retirees has been very positive and the company is optimistic that the contract will be renewed.

On the top right chart, net investment income for the first 9 months of 2018 is down to \$16mm from \$22 million the previous year. This reflects the decline in the regional equity markets. On the bottom left chart, you will see that the combined ratio has reverted to the long-term average of 94%. In 2017 combined ratio of 100% was due to a one-off provision adjustment in one of our subsidiaries. So, the picture for Gulf Insurance Group is one of good growth without any compromise on our underwriting standards. Our net profit for the first 9 months is up 35% on the previous year to \$35mm and return on equity to has also improved to 17.4%. The quality of these earnings has improved as well, being driven by better underwriting results rather than investment gains.

We move to slide 8 on United Gulf Holding Company

As you can see on the top left, revenue for the first 9 months of 2018 was \$131million, which represents growth of 17% compared to same period last year. This is due to improved performance of its underlying investments, which are stakes in Burgan Bank, KAMCO and FimBank, as well as the consolidation of Global Investment House. KAMCO acquired 71% of Global on 1st September. Global is an asset management and brokerage business with operations in Kuwait and other countries in the GCC.

You can see on the top right chart, fee and commission income of \$41million, which is \$16million increase over the same period last year. This growth is mainly because of higher advisory and management fees earned by United Gulf Holding Company and KAMCO.

On bottom left chart you can see, net profit at \$12million is 50% higher than 9M17 reflecting the improved performance by the underlying entities such as Burgan Bank (where net profit increased by 11%), FIMBank (which has increase in net profit by 27%) as well as substantial increase in United Gulf Holding fee. The provisions of USD8 million largely includes specific provisions on the loan portfolio for FIMBank.

On bottom right chart, you can see Assets Under Management have increased to \$12.1bn mainly due to Global acquisition. Going forward, the yield on this enlarged portfolio will be higher as large percentage of Global portfolio is invested in client equity portfolios which typically generate higher fees.

UGB's total consolidated capital adequacy ratio stood at 13.6% as of 30 September 2018 against the minimum capital adequacy requirement threshold of 12.5%.

If you move to Slide 9 to United Real Estate Company.

The top left chart shows \$226 million revenue for the first 9 months which is a growth of 8%. This was due to growth in contracting and service revenues, hotel revenues and positive income from associates, which was a loss in the previous period of last year. The growth in contracting and services segment relates to United Facilities Management or UFM. Operating profit, shown on the top right chart, showed a similar trend.

On the bottom left chart, you will see \$11mm year to date net loss. This is due to several factors. Firstly, utility charges in Jordan and Oman where our malls are located, are up significantly. In Jordan, they are up 40%. There is also a delay in certain anchor tenants i.e. the hypermarkets opening in these malls, which had a detrimental impact on footfall. Some contracts with other tenants were conditional on these anchor tenants being open. Settlements have been reached with these tenants and have resulted in provisions being booked. Finally, rising interest rates in Lebanon and Jordan have increased the cost in these operations. The company has succeeded in renegotiating some of its loans on more favorable terms. It has also issued a long-term bond earlier this year in which 40% of the allocation was to fixed rate investors which should reduce the impact of rising interest rates on profit margins going forward.

The return on equity for the first 9 months is shown as -2.4%, reflecting increased costs as I mentioned earlier. The prospect is for higher revenue from our malls as they become fully operational.

I will now hand over to Anuj to discuss remaining pages.

Anuj Rohtagi:

Thank You Declan. We are on page 10. As we have pointed in our earlier calls, the pay-tv business in MENA has been undergoing structural changes and a combination of several external factors has impacted dynamics of business operations. OSN continues to face temporary headwinds and though micro-economics are improving, we face subdued demand in our core markets owing to piracy (particularly BeoutQ platform), geo-political reasons and new fiscal reforms by government which has partly resulted in sizeable expat population base exiting from some of our core markets, overall shrinking our target market. However, we continue to believe in the potential of the business driven by the available larger market opportunity to grow in this vertical, both in DTH and in

OTT. OSN is well recognized brand, as you know, in the market with best in class platform and highly attractive content offering. At the same time, given the challenges business has been facing, we believe it is only prudent to assess all our strategic options for this investment with a view to maximize value for our shareholders. This process is currently going on.

In the meanwhile, shareholders and OSN management together continue to target to harvest opportunities in market through streamlining efforts within the company. A careful review of various revenue opportunities and cost rationalization initiatives are currently ongoing. For example, the company has recently come up with a new pricing proposition. It is called 'El Farq'. It was initially piloted in Saudi Arabia which had effectively passed on the benefit of selling through online sales channels to eventual customer in terms of price reduction. The initial response has been positive, and management has plans to roll out similar offers in other markets. Customer experience has only gotten better with these initiatives. We have been able to maintain our customer base despite the intensity of issues I mentioned earlier. At the same time, various cost rationalization efforts are being reviewed covering content cost as well as operating expenses. Management has undertaken an in-depth review of what content works for customers and what does not. As a result of the review, a high double-digit or low triple digit range of savings in content cost is expected in 2019 that will help us build a trajectory of business in next 5 years. There is a vast network of telecom operators in the region and OSN has an exciting pipeline to leverage its partnership network to grow in new markets. OSN is also undergoing changes on the digital business front which will validate its technological superiority in the MENA region in coming quarters. In terms of WAVO, product development is in progress at a fast pace and there is a clearer line of sight for a soft launch in Q1 2019.

As highlighted earlier by Moustapha, KIPCO has recognized OSN as held-for-sale in its books of accounts during the quarter. OSN's share of losses will not be recorded in the Profit & Loss from continuing operations in KIPCO's books.

Now I will move on to page 11 where we have other key entities of the Group. United Industries as you know reflects our share of results from the industrial segment which includes Qurain Petrochemical Industries Company (QPIC), SADAFCO and Advanced Technology Company as key assets.

Net profit for the period for UIC increased by 14% to USD17mn largely due to increased share of income from its portfolio investments such as Advanced Technology and Overland Real Estate Company.

Now for Jordan Kuwait Bank. It has also performed well with healthy Net Interest Margin of 3.5%. Net profit for the nine-month period was 26% higher vs the same period last year at \$39mn mainly as a result of provision reversals on credit facilities. They were around USD5.5mn reversal vs USD14.6mn provisions in 2017 same period. In addition, there were higher other income - USD15.3mn vs USD11.9mn in same period last year).

We will now move on to page 12 to go through some of the key points of our funding profile. As you can see from the numbers, we continue to be comfortably placed with respect to our debt maturity which is now close to 5 years. Our cash position remains very strong at close to \$1.1bn which can cover all our debt obligations till 2022.

In November 2018 recently, KIPCO successfully completed issuance of KD100mn equivalent to USD330mn 5-year corporate dinar bond. The issue was 1.35 times oversubscribed, receiving a record number of investors. The bonds are available in fixed and floating rate tranches. The fixed rate bond pays investors a coupon of 5.5% annually, while the floating rate bond pays investors a coupon of 2.25% annually over declared Central Bank of Kuwait discount rate which is 3% currently, so 5.25% currently. There is a cap of 1% over fixed-rate coupon so maximum it can go for floating rate is 6.5% coupon. The bonds were issued at par and will pay coupons semi-annually in arrears. Its proceeds would be utilized to repay USD 233mn EMTN note due in February 2019.

Now, to summarize, all our businesses continue to be fundamentally strong. The diversity of our portfolio has been a key factor in our consistent performance quarter on quarter.

The next few pages in the presentation contain some useful information for reference including a summary balance sheet, income statement and few business overview pages in annexure. I will now hand over to Nick to check if there are any follow up questions.

Operator: We have the first question on line from Sergio Calci from JPMorgan.

Sergio Calci: I can see you are looking to sell your stake in Panther Media Group, I had a few questions relating to this. Which bank do you engage with so at all to advice you on the sale and when do you expect the transaction to close?

What are your plans for the use of proceeds, is it buy back any bonds or to invest in other business?Have you had any discussion with your rating agencies on the impact of the sale on your rating? If you could give a bit of color on this, it would be much appreciated.

Pinak Maitra: Thank you so much Sergio.

To answer the questions. Thebanker is major global powerhouse, we are not here to advertise the banker. But, they reflect the quality like JPMorgan, from where you come from. That's perhaps the best way I want to describe it. And the process has begun, as you are very familiar. There is a preparation phase which we are going through and once the preparation phase is over, in the coming quarters, we are going to talk about, what is the outcome of the preparation phase.

As you would appreciate, in any strategic initiative, there is always a trade-off between being very open which is KIPCO's culture and at the same time, respecting the banker who is running the process with views and the general advice we are receiving from the banker is that during the preparation process, less is more. So at this stage, we are going to be basically asking patience from your side. And we all understand what is a strategic process, that is what we are embarking on, where we look at a number of options and then execute on something that is in best interest from the shareholder's point of view. That's as far as I can go in this. We are quite hopeful that in the coming quarters, we will be giving more quality.

In terms of the rating agencies, given the stage of the process, we will have separate dialogues with them and we will keep them posted.

Sergio Calci: Okay. That's very helpful. If I could just follow up as well with just few more questions at the holding company level. Could you please tell me the cash balance at the holding company level at the end of third quarter?

What were your expectations of the cash inflows for the holding company in 2019 i.e. dividends you get from your portfolio companies? If you are planning to issue any Euro Bonds in 2019, to refinance the 2020s, is there something which you are looking to do or not?

Anuj Rohtagi: Thank you, so the cash balance for 30th September at the holding company was US\$1090mn, so 1 billion and 90 million dollars.

Sergio Calci: Okay.

Anuj Rohtagi: In terms of cashflows, as you know, we have been leaving a lot of cash at our underlying operating entities because of the level of cash we are maintaining. So for 2018, we received around 76million dollars, as cash from various dividends, interests, etc. at the holding company level. We expect it to be something between US\$75-100 million for next year and if required, we can, since we control these entities, we can increase that payout if required. As you know, we are maintaining that much cash, so we do not see any real reason to upstream more cash.

Sergio Calci: And in terms of refinance, any update on that, if you are planning to refinance your 2019?

Pinak Maitra: Right, 2019 is already taken care of by the current bond, the Kuwaiti dinar bond. That will go off in February and then we got in 2020, that we are thinking about. That's the one probably in second half of 2019, we will be, that's been the historical pattern of KIPCO, to see what is there. We will talk to all the bankers who been involved in our history of our Euro bond issues and then we will see what is the most friendly investor desire, based on that we will take an approach. But that is a second half of 2019 matter, to basically deal with

maturities coming due in first half of 2020 maturity. So pro-activeness of refinancing will continue. Of course, as you rightly brought up, if the strategy initiatives result in more cashflows then obviously that may result in us not requiring to do a bond and paying off. So that's a scenario, it's too early now in the process, to talk about them but broadly we are trying to guide you in terms of direction of where we are going.

Sergio Calci: Okay. Perfect. And finally, do you have any expectations for any investment, like kind of exiting investments in your portfolio companies next year or are you planning to keep it in the same?

Pinak Maitra: There are other initiatives in progress which again are broadly, you know, in early stages of basically getting a banker appointed. And again, I have to take you back to the KIPCO strategy. If you think any of our business is not growing at a 15% top line, if their margins are not expanding by 15% and if their return on equity is not directionally trending towards the 15% level and they are not core to the group, we would be looking at those assets to dispose them off. We have identified a few who are doing very well but their long-term potential from our own underwriting criteria, our own portfolio returns expectations are lower, and so there is another asset for which process has begun, which may exit in 2019.

Sergio Calci: Okay. Thanks.

Operator: The next question is from Sebastian Teodoresc from JPMorgan.

Sebastian Teodoresc: Thank you very much for the presentation. I have a few follow up questions as well. In terms of the overall cash position at the holding company level, there has not been much change over the quarter despite the capital injection in Burgan. So, could you offer any color on how you funded that capital injection? My second question is that would you forecast any additional capital cash flow injection needed for OSN? I think you did in the first half of this year. My third question is for us to understand the OSN direction, thought it is still very early, but is there any contingency plan if you do not manage to sell this asset? Thank you.

Anuj Rohtagi: In terms of Burgan Bank's rights issue, that happened after 30th September. So that's why it is not reflected. We subscribed to our share. As we mentioned before we were looking at various options and eventually our share of roughly 60 million dinar which accounted for roughly 25 million dinars that went out in October. With regard to OSN the number we gave you previously is a total funding requirement for the year of around 100 million and our share would be around 60 million has been provided from shareholders in various tranches. So that's the broad number for OSN.

Pinak Maitra: So, taking the last bit of your question. You made a conclusion there. It is probably premature to say what plan B should be. But we recognize the thrust

of your question is what is the likely cash injection requirement. Strategic options involve multiple routes. So, depending on the how routes would play out, we would be able to project cash requirement or cash receipt. So, we acknowledge that there is always in life a plan B. KIPCO has got visibility around the scenario that will happen. The long-range planning and budget process of the group is in progress including OSN. So, towards December 2018, we will have a sharper color of those numbers. So, I think we will be able to give you fuller answer in fourth quarter 2018 or in first quarter 2019 earnings call.

Sebastian Teodoresc: Thank you very much.

Pinak Maitra Thank you Nick. Everybody, I just want to acknowledge we have been experiencing inclement weather. It has been declared a public holiday today, but I want to thank the team for making it and coming to the office to do this call. So, we have been on call of duty to basically show in action that we really take our investors seriously and we are happy to continue to do our best in our obligation and communicate with the investors. So, thank you very much.

Nick Paton: Thank you very much gentlemen