IR Call Transcript (Edited Version)
QNB Group Q1 2023 Results

CORPORATE PARTICIPANTS

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Ashwath PT *Goldman Sachs*

Rahul Bajaj *Citigroup*

Chiradeep Ghosh *Securities and Investment Company*

Janany Vamadeva *Arqaam Capital*

Naresh Bilandani *JP Morgan and Chase*

PRESENTATION

Operator

Hello, everyone, and welcome to the QNB Q1 Earnings Call. My name is Nadia, and I'll be coordinating the call today.

I will now hand over to your host, Janany Vamadeva from Arqaam Capital to begin. Janany, please go ahead.

Janany Vamadeva *Arqaam Capital*

Thank you, Nadia. Good morning and good afternoon, everyone, and thank you for joining us today. This is Janany Vamadeva and on behalf of Arqaam Capital I am pleased to welcome you to Qatar National Bank Q1 2023 earnings conference call.

I have with me here today from QNB management Mr Ramzi Mari, the Chief Financial Officer; Mrs Noor Mohamed Al-Naimi, Group Treasury and Financial Institutions; and Mr Mark Abrahams, Group Treasury. Without further ado, I'll now turn the call over to Mr Mark Abrahams. Mark, over to you.

Mark Abrahams *Qatar National Bank (Q.P.S.C.) – Executive Vice President – Group Treasury*

Thank you very much, Janany and Arqaam Capital, for hosting our call today. Before we begin, it is customary to remind everyone that this earnings call is for investors and analysts only and any media personnel should disconnect now, please. I will begin by giving an overview on the macroeconomic environment in Qatar. Then I will cover QNB's financial results for the three months ended 31 March 2023 and, finally, open the floor to questions and answers.

The global environment continues to be affected by the negative consequences of excessive post-pandemic policy stimulus and geopolitical tensions. Higher inflation and monetary tightening resulted in a marked slowdown of global growth and financial instability in some advanced economies. Geopolitical woes in Eastern Europe have added further uncertainty and volatility to this outlook. Supply chain constraints and geopolitical concerns have supported elevated energy prices and robust fiscal and external revenues in Qatar, which added further momentum to the strong domestic macroeconomic backdrop.

As a result, the economic recovery is in full force locally, while the banking sector remains resilient and healthy, presenting significant growth, ample liquidity, adequate levels of capitalisation, and higher set quality and robust profitability. The successful preparation and organisation of the 2022 FIFA World Cup Qatar, the largest sports event on earth and the largest event ever hosted in the region also led to stellar economic growth. The momentum associated with the event contributed to an 8% year on year GDP growth for Qatar in Q4 2022, the strongest performance in more than a decade.

Importantly, Qatar’s non-energy sector was particularly buoyant, with close to 10% growth during the same period. The event has further resulted in the highest GBP growth rate for 2022 in the region, principally driven by non-oil and gas sectors. The 2022 FIFA World Cup Qatar further consolidated the country’s position as a regional and international hub for business, investments, commerce, tourism and culture. This accelerated the execution of the Qatar National Vision 2030 and assisted in the transition towards a knowledge-based economy.

In the medium to long term tailwinds from investments and increasing hydrocarbon production will drive economic growth, with six new LNG trains planned under the flagship Northfield Expansion Project, one of the largest capital expenditure projects in the region and industrial engineering projects in the world. This investment is expected to increase Qatar’s LNG production by 64% to 126 million tons per annum, contributing to almost a third of global LNG demand. The project will include an equivalent expansion of Qatar’s refining, downstream and pet chem capacity.

Positive spillovers from these projects will combine with diversification efforts and structural reforms to boost economic activity and spending in the broader manufacturing and services sectors. Qatar is therefore laying the foundation for continued GDP growth over the medium and long term through investment, diversification and stronger private sector engagement. I will now move on to QNB’s financial results for the three months ended 31 March 2023.

I will now move on to QNB's financial results for the 3 months ended 31st of March 2023. Key financial results were as follows:

Net profit was QAR 3.9 billion or USD 1.1 billion, a robust growth of 7% compared to last year. Solid revenue growth resulted in an increase in operating income to QAR 9.3 billion or USD 2.6 billion, up 20%, demonstrating QNB Group's success in maintaining growth across the range of revenue sources despite market volatility.

QNB's cost-to-income ratio remained strong at 21.7%, which is considered to be one of the best ratios among large financial institutions in the Middle East and Africa region. Total assets are at QAR 1.178 trillion or USD 324 billion, up by 6% from the same period last year. Loans and advances reached QAR 810 million or USD 222 billion. QNB Group remained successful in attracting deposits, which resulted in an increase in customer funding by 5% from March 2022 to reach QAR 828 billion or USD 227 billion. The group's loan-to-deposit ratio reached 97.9%.

QNB Group's ratio of nonperforming loans to gross loans stood at 2.9%, a level considered to be one of the lowest among financial institutions in the Middle East and Africa region, reflecting the high quality of the group's loan book and the effective management of credit risk. In addition, the coverage ratio on Stage 3 loans was further increased to 104%. Total equity increased to QAR 103 billion, up by 5% from March 2022. The bank's capital adequacy ratio at 19.3% is comfortably higher than both QCB and Basel III requirements.

Before we begin the Q&A, though we welcome all questions in the interest of time, we would appreciate if the questions are please limited to 3 per participant. For any further and detailed discussion on our results, you may directly reach out to our Investor Relations team. We will now turn to Q&A. Thank you very much.

Operator

(Operator Instructions) Our first question today comes from Ashwath PT of Goldman Sachs.

QUESTIONS AND ANSWERS

Q - Ashwath PT *Goldman Sachs*

I have 3 questions. The first is how has 1Q '23 print change your guidance for the remainder of the year? Second being, how do you see loan growth pipeline in Qatar? And the third on margins for your domestic business, especially because of the higher competition for resident deposits.

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

'23 guidelines. On the balance sheet, it is the same, as we mentioned before, 4% to 6%. On the profit and loss, it's marginally higher than what we gave in December. It is now 7% to 9%. Loan growth. First quarter private sector loan growth was -- domestically was 2%.

Government, as we mentioned before, they will continue to pay part of their loans. They paid around [QAR 10 billion] and that's why public sector loans dropped by 2%, and that's why we ended up with a flat number.

In December, we still believe that the overall growth in the group will be in loans between 4% to 6%. Margins. On margins, if we talk about local stand-alone, we always need to take into consideration overseas branches because these are 1 unit. You cannot separate them. And what the impact, if you look at them separately, what the impact the number there is the fund transfer pricing, which is something internal that we utilize to encourage overseas branches to generate funding at a lower rate. So this needs to be ignored because it's something internal.

If we take a quarter-on-quarter movement in interest income for head office operations and overseas branches, we realized that we grew by QAR 548 million, which is a big number. So our margins were closed, if not higher, marginally by 1 basis point. If we take overall margin for the group, we can see from December that there were a drop of around 3 basis points. The bulk of that drop came from Finansbank. The reason for the drop in Finansbank interest was different one. The earthquake was a reason, the decrease in income from CPI Securities was the most important factor. So less inflation impacts overall interest income.

And the last one, which is in fixation of IAS 29. It's a matter of how you apply the standard. But this will be adjusted once we reach end of the year, of course, all dependent on what the inflation number will be. So this is roughly where we see interest income in terms of analysis for the first quarter. We still believe that net interest income by end of the year will grow between 5% to 7% on last year.

In terms of margin, we should go back to around 255 basis points. We said last year that we have enjoyed 13 basis increase on margin, different factors. One reason why the increase was the inflation in Turkey. However, this year, the impact will be the other way around, but still we will be able to manage overall impact. And we don't see a drop of more than 5 basis points of where we have been in December. The most important thing is that absolute number of interest, we're still going to see growth in net interest income. And as I mentioned 5% to 7%.

Q - Rahul Bajaj *Citigroup*

I have 2 quick questions actually. One is a clarification from the previous comment which was made. So 7% to 9% P&L growth. So just wanted to clarify, is this before the hyperinflation charge or after the hyperinflation charge?

A - Ramzi Talat A. Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

After.

Q - Rahul Bajaj *Citigroup*

After, okay. So linked question to this is the much higher level of hyperinflation charge, which was booked in the first quarter. Is it fair to assume a similar like QAR 700 million to QAR 750 million of hyperinflation charge would be applied for the remaining quarters for this year? Because that seemed to be like almost 70%, 75% higher than quarterly run rate of 2022.

A - Ramzi Talat A. Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

Impossible to guess how much the hyperinflation impact on profitability will be because it's highly dependent on what inflation is going to be and how we are going to manage the net monetary position of the entity. So, there are different factors that impact the number. We will try our best to minimise it but at the end, the most important factor is the inflation, which is something no one can guarantee.

Operator

The next question goes to Naresh Bilandani of JPMorgan.

Q - Naresh Bilandani *JP Morgan and Chase*

Thank you Mr. Ramzi. I appreciate it. One -- pardon me, I joined a few minutes late, just while you were mentioning the impact on the interest income. And I just wanted to have one clarification there, please.

Could you please explain once again with regards to how the impact of transfer pricing is affecting overall in the NII line? Because -- and clearly, I think this has probably something due to the fact that although the pressure is coming from Turkey, it is being reflected more in the Qatari segment. Also, would it be fair to assume that some of the impact of the NII? And pardon me if I missed this comment, had to come from the shift in the loans moving from Stage 2 to Stage 3 in the previous quarter. So there's a loss of NII coming from that portfolio. That's one.

And second is, if you could please throw some thoughts on when -- or to what extent should we expect a turn in the credit volumes inside Qatar because the more recent readings in the more recent quarter shows that I think the trend has kind of remained more abound at this stage. So any views there would be extremely helpful.

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

Now if you try to analyze the breakdown of interest income through our note on segmental, the analysis in materially be impacted by the transfer of pricing that we adopt in head offer, and how we manage and how we price that funding that comes from overseas branches. It is something internal. It's a tool that we use in treasury and financial control in order to encourage our overseas operation to generate funding number one.

Number two, the diversify; and number three, to reduce cost of funds. If they are able to do that, we compensate them by a better fund transfer pricing, which impact their profitability. It's something internal. The net impact on the group is 0, okay? How we manage this? Please note that we have one pool of funding that's set in treasury. Every single Riyal generated by overseas operation is rooted to head office and every loan given by overseas operation is borrowed from treasury. This funding to treasury, and borrowing of strategy, there is a price mechanism that is built and that price mechanism is changed every quarter and every year based on the parameter of the market and based on what we want from overseas operations from a funding perspective.

And that's why I understand where you're coming from when you say what impacted though we have profitability standalone from a segmental node. The most important factor here is fund transfer prices. Now in financial control, when we analyze interest, we analyze head office and overseas branches as one unit because to us, this is all branches are included as 1 unit with that offer. If you look at this, the number of the interest income for that unit, it grew by QAR 550 million in the first quarter.

And the overseas -- the overall negative impact that happened is coming from Turkey, as I just mentioned. So this is where -- about Stage 3 to Stage 2, zero impact because the bulk of loans that were moving to Stage 3 last year, they have interest spending on them. So there were no material impact on net interest income for the half stand-alone. Now credit volume, again, I mentioned that in the first quarter, we were flat because public sector continued to decrease OD accounts whereas private sector moved at around 2%. We still believe that year-end overall growth in loans will be between the 4% and 6%.

Q - Naresh Bilandani *JP Morgan and Chase*

Understood. So just one follow-up here. If I take a look at the interest expense line. Naturally, this has increased quite significantly, given the rates environment. Would it be fair to assume that the trend that we are seeing in the blended funding cost is -- has an impact from the fact that some of the deposits, probably there was a timing impact and they left towards the tail end of the quarter. So the funding cost overall is looking quite high.

That's one follow-up. And the second follow-up is mentioned in your previous comment, where with regards to Stage 3, I understand as they were moved into Stage 3 towards the end of the last year, interest gets suspended. But what I'm trying to see is naturally because the interest on them was recognized last year, but it is not being recognized this year, which also has an impact on how the gross interest income is moving. Is that -- is that a fair way to understand?

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

No, no Naresh, we still -- we have some loans at Stage 2, which is with interest suspended. The loan that moved to Stage 3 from the beginning of the year their interest was suspended last year. So there were no impact on '22 in terms of interest suspend or removed. We have many loans in Stage 2 with interest suspend. Again, this is on a conservative approach of QNB and how we manage our book. It's not only Stage 3 account has interest suspended some Stage 2 account have interest suspended.

On the overall implication on interest expense stand alone, to be honest it would be impossible for me to be able to give you a question on the phone, on the overall impact on -- or the breakdown impact of interest expense during the first quarter. If you draw the question to the team, I'm sure they will be able to give you a full analysis on the details on this.

Operator

Our next question go to Chiro Ghosh of SICO.

Q - Chiradeep Ghosh *Securities and Investment Company*

This is Chiro Ghosh from SICO Bahrain, 2 very quick questions. The first one is I saw that the trading and other income were a little higher. If you can tell us how much of this was sustainable or rather one-off that will give us some guidance? And second of one is, how are you looking at the Egyptian business as a whole after the current development?

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

Trading income grew -- we've seen this happening in fourth quarter last year and in the first quarter of this year, the bulk of this income is coming from international operations, mostly Turkey. Again, the nature of this business is opportunistic. It highly depends on the market rate. And if you see the opportunity, you will liquidate part of the book that you have. Is this -- can this continue? It will, but not at the level that you have seen in the fourth quarter and the first quarter of this year.

But again, the most important factor is the market condition. The second (technical difficulty) on other income, it is a one-off income. It's mainly caused by the valuation of our insurance arm in Turkey, which is Cigna. We used to own 50 -- plus/minus 50%. Now we own 100% of the entity. Because of that acquisition based on a financial account standard, we need to do valuation. And based on that valuation, we generated the profitability. This is the one-off income.

Now Egypt, again, in regardless of the devaluation, our investment in Egypt is long term, and we don't look at it as 1 year or 2 years. Egypt is still an important market. It's the second largest home market for -- the third largest home market for the group. We still enjoy a close to 20% return on equity from the entity. We're seeing very strong number. If we look at the guideline for Egypt this year, we're talking about a growth of close to between 14% to 16% on assets, loans and deposits and close to 25% to 27% growth in profitability. So the entity continues to grow. It continues to be very profitable with a good return on the equity.

Q - Chiradeep Ghosh *Securities and Investment Company*

Just one quick one on the previous question he asked that are you actually seeing project owners coming in and lending book within Qatar? I did not get the answer for the previous question.

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

You're talking about project financing?

Q - Chiradeep Ghosh *Securities and Investment Company*

No, I'm just saying overall, the project rollout has again started in Qatar. I mean, do we expect to see loan growth picking up in second half of the year? The private sector or anything?

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

You're talking about production or you talk about the project investment in the project in terms of the work -- you talked about the North Field project?

Q - Chiradeep Ghosh *Securities and Investment Company*

Yes, yes, exactly.

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

This started 2 years ago. But in terms of actual projection, as far as I know, it's I think, '24, '25. The actual production will start in terms of financing for this project, it's already started. But as we always mentioned, QNB participation in these loans is usually limited because the pricing of these loans is extremely low. So to us, if you want to maintain 250 basis points margin, the participation in this project will - for QNB will not be that big.

Q - Chiradeep Ghosh *Securities and Investment Company*

No, sir, I wanted to get a sense of overall -- how will the lending book come in, I mean, the private sector lending book. So it was more related to that.

A - Ramzi Mari *Qatar National Bank (Q.P.S.C.) - Group CFO*

In terms of private sector, as we mentioned, the 2% growth in 1 quarter is a very good number. We think this momentum will continue. And a big chunk of the growth that we are going to see in the overall Qatar operation will come from the private sector this year.

Operator

(Operator Instructions) Thank you, it appears we have no further questions. I will now hand back to the team for any closing comments.

Mark Abrahams *Qatar National Bank (Q.P.S.C.) – Executive Vice President – Group Treasury*

Thank you very much for your time and attendance today. We appreciate your focus on QNB. Wish you a good day, and we'll speak again in 3 months' time. Thank you very much. Bye now.

Operator
Thank you. This now concludes today's call. Thank you so much for joining. You may now disconnect your lines.