IR Call Transcript (Edited Version)
QNB Group Q1 2021 Results

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PRESENTATION

Operator

Good day and welcome to Qatar National Bank first quarter 2021 results conference call. This call is for investors and analysts only. And media should please disconnect now. This conference is being recorded.

At this time, I would like to turn the conference over to Rahul Bajaj. Please go ahead.

Rahul Bajaj *Citigroup Inc., Research Division - VP*

Thank you. Good morning, good afternoon, good evening, everyone on the call. This is Rahul Bajaj from Citi Research. We welcome you all to Qatar National Bank's first quarter 2021 results conference call being jointly hosted by Citigroup and QNB financial services.

On the call, we have the QNB management team with us to give us a view on first quarter performance and take investor and analyst questions. On the call, we have Mr Ramzi Mari Group Chief Financial Officer. We also have Ms Noor Mohamed Al Naimi, General Manager of Treasury, and Mr Mark Abrahams, Assistant General Manager of Trading and Treasury. At this moment, I will hand over the call to Mark to take it forward. Over to you, Mark.

Mark Abrahams Qatar National Bank (Q.P.S.C.) – Assistant General Manager, Trading - Treasury

Thank you very much indeed Rahul for hosting the call and welcome everyone. Before we begin, I would just like to highlight and repeat the fact this call is only for investors and analysts and any media should disconnect now, please.

I will begin by giving an update on Qatar in light of COVID-19 followed by a brief overview of macroeconomic environments in CASA. Then I will cover QNB's financial results for the quarter ended 31st of March 2021. And then finally open up the floor to Q&A.

Qatar has taken all necessary precautionary measures to protect the society, its population and economy from COVID-19. Whilst the impact of the COVID 19 pandemic provides uncertainty, Qatar's economy has weathered the storm and activity is rebounding as business resumes. Moreover, Qatar's COVID vaccination program is progressing fast as more than 30% of the population has now had at least one dose of the vaccine. Qatar's non-energy private sector economy continued to expand strongly over the second half 2020 and the first quarter of 2021 as coronavirus related restrictions were lifted, according to the Qatar's financial centers purchasing managers index. The top line PMI has been comfortably above the expansionary threshold of nine months and has been accelerating in recent months, clearly signaling sustained improvement in business conditions in the non-energy private sector segment of the economy.

Moving forward, private sector growth will be boosted by the continued structural reforms, including ownership liberalization, the promotion of foreign direct investments, labor reforms, and several initiatives to support SMEs as well as self-sufficiency in strategic sectors. Tailwinds for investment in increasing hydrocarbon production will drive economic growth going forward. Six new LNG liquefaction trains, a plan to increase Qatar's LNG production by 64% to 126 million tons per annum. Qatar is going to go from 77 million tons per year to 110 million tons by 2025, and then up to 126 million tons by 2027.

Positive spillovers from increased hydrocarbon production are combined with diversification efforts and structural reforms to boost activity and spending in the manufacturing and services sectors.

I will now move on to QNB's quarterly financial results for the three-month period ended 31st of March 2021. The financial results were as follows. Net profit was QR 3.3 billion or USD 0.91 billion. Considering the global economic conditions, QNB group following its conservative approach towards building adequate reserves gained potential loan losses has opted to increase its loans loss provisions compared to last year, which will assist in protecting the group from any adverse experiences in the portfolio. This has impacted the reported profitability. In addition, QNB group has continued on its operational rationalization exercise which has resulted in significantly reducing the cost to income ratio from 25.6% last year to currently 23.4%. Operating income maintains at QR 6.7 billion or USD 1.8 billion clearly demonstrating QNB group's success in maintaining growth across the range of revenue sources even in these challenging conditions. Total assets remain over QR 1 trillion at QR 1.042 trillion or USD 286.4 billion up by 8% from March, 2020. This was driven by growth of 2% in loans and advances to reach QR 720.6 billion or USD 198 billion.

QNB group remained successful in attracting deposits, which resulted in an increase in customer funding by 6% from March, 2020 to reach QR 749.6 billion or USD 205.9 billion. This has also improved the group's loan to deposit ratio to 96%. The group was also able to attract high quality wholesale funding. The group issued a $1 billion five-year bond in January. This deal attracted strong interest from around the world from key global investors, reflecting our investors' confidence in QNB group's financial strength and its position as the largest financial institution in the Middle East and Africa region. And also clearly demonstrates our standing as a high-quality regular issuer, and confirmation of our successful strategy becoming a leading bank in MEASEA. Despite several challenges and headwinds from the global pandemic, QNB group was able to maintain the ratio of non-performing loans to gross loans at 2.2%, 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 these conditions.

In addition, the coverage ratio on stage three loans is standing at 110%. Total QR 93.5 billion up by 5% from March, 2020. The bank's capital adequacy ratio is standing at 19% comfortably higher than both QCB and Basel three requirements. Group is very well capitalized and comfortably exceed other regulatory liquidity and leverage ratios.

With that, I will now close, and we will turn to questions and answers. Thank you.

QUESTIONS AND ANSWERS

Operator

Thank you. If you would like to ask a question, please press star one on your telephone keypad. Please ensure the mute function on your phone is switched off to allow your signal to reach our equipment. If you find your question has been answered, you may remove yourself from the queue by pressing star two. Please restrict yourself to two questions. Again, please press star one. We will now take the first question from Walid Mohsin from Goldman Sachs.

Q- Waleed Malik Mohsin *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

A couple of questions from my side. First, if you could comment on the funding situation in Turkey particularly the access to the swap market and the impact it's having on margins and asset quality. Secondly, if you could talk about the trends that you're seeing on asset and credit quality, particularly in Egypt and Turkey, especially in the stage two bucket. Thank you.

A- Rahul Bajaj *Citigroup Inc., Research Division - VP*

Mark, if you can comment on liquidity situation in Turkey?

A - Mark Abrahams Qatar National Bank (Q.P.S.C.) – Assistant General Manager, Trading - Treasury

Certainly. Obviously with the with the surprise announcement recently of the change in the governor, there was quite a significant spike up in the offshore FX forward rates and also the CDs levels as well in Turkey. From a QNB finance bank perspective, we've always been very, very prudent from very conservative liquidity measures anyway. And from the bank's perspective, there was never at any point any requirement for a single dollar or Turkish Lira funding from the group here in Doha. And since that time, we've been in daily contact with our colleagues in Turkey. And as I'm sure you've seen, there's been a significant reduction in the volatility of the offshore market, as I think there's a sense of stability of return to this market. So there was no undue panic at that time. There was a natural spike up I think on that unexpected news. But in terms of the funding of QNB finance banks specifically, and I think the border economy, things have definitely stabilized and calmed down, and that's reflected very much in the London FZ swap market and the current reduction back down in the CDs market.

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

On asset quality in Turkey, Egypt. If we start with Egypt. Now stage two loans in Egypt from around 8 to 9.5, because we see some accounts that need to be shifted from stage one to stage two. But in terms of NPL ratio in Egypt, still stable around the 2.4, 2.5. We don't see until today in Egypt major pressure in terms of NPL. However, we wanted to increase the stage two. And I think reaching 10% at this stage, and the way the economy is going is a good idea from a conservative point of view. But if we look at the overall number in Egypt, their coverage ratio maintained around 111. Stage two coverage increased to 14.2% from 13.7%. And the cost of risk is still stable around 110. So the number doesn't show any momentum of weakness in the book, but we still believe that we need to be conservative in Egypt. And that was reflected in the stage two loan.

If we shift to finance banks, the stage two loans does not materially increase. It's still stable along the 9%. The coverage ratio again stable, close to a hundred percent. NPL ratio marginally grew from 4.5 to 4.6, nothing material. The stage two coverage also increased to 11.7 from 11.3. And the cost of risk in reality dropped to 145 from 175. So whether it was Turkey and Egypt, we can summarize by saying we still enjoy a very strong coverage ratio. We are not seeing strong momentum of weakness in the book. However, QNB has taken a very conservative approach in building their provisions. We want to maintain a strong coverage ratio, and we want to continue to grow coverage in stage two and stage three.

Q- Waleed Malik Mohsin *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. Thank you. Just the last follow-up. Any of these events, I mean, how is this changing your growth strategy in Turkey and Egypt? And what I mean by that is obviously the unexpected turn of events in Turkey which has pushed up the cost of funding, normalizes a little bit with the nomination in the swap pocket, but still pushing it up. And number two, I mean, rates remain relatively elevated in Egypt, which has meant that capital expenditure seems to been pushed out by six months or so. So how has it changed your kind of growth outlook for Turkey in Egypt these two factors?

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

Growth in Egypt this year in terms of balance sheet, we don't see it as strong as what we have seen in previous year. That's why we are still anticipating for 2021 for the growth to be 10-12% only. Loans not to grow by more than 7-8%. Deposits will continue to be between 10-12%. For Turkey, in terms of balance sheet, we agree that there is vagueness in how interest rates is going to go forward, and we fully appreciate the impact of the changes that took place. Still, we believe that Turkey will continue to grow in terms of balance sheet between the 15-17%, which is higher than what we anticipate in Egypt this year. Overall, the growth in both countries will be lower than what we have seen in previous year. So we are taking a very careful approach and growing the business whether it was in Egypt or Turkey this year until we see the overall economical implication.

Q- Waleed Malik Mohsin *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

Got it. Thank you so much Ramzi. That's very helpful. Thank you Mark.

Operator

Our next question is from Chiro Ghosh from SICO.

Q - Chiradeep Ghosh *Securities & Investment Company BSC, Research Division - VP of Research*

Hello. Thanks for hosting the call. This is Chiro Ghosh. So I have two questions. The first one is related to this gas expansion and the hydrocarbon production that has been planned in Qatar. So can you please tell me in which year do you expect the borrowing demand to come from? So would it be in 2022, 2023 or later? That's one.

And secondly, with such a spike in interest rates in Turkey, aren't you expecting NPL ratios to go up? So, if we can throw some light on that.

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

Let's start with the first question about borrowing for gas for the north field. This is a QP decision. I don't think we can comment exactly when they are going to start borrowing for this project. We know the cost, we know that there will be some borrowing, but when or what is the structure we are going to use, I cannot comment.

Q - Chiradeep Ghosh *Securities & Investment Company BSC, Research Division - VP of Research*

But most likely not in 2021, right?

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

No, it could be, this is a very larger project. Borrowing will not be one year or two year, borrowing will extend until the maturity of the project, which is 2025. So there could be a part of that borrowing happening in 2021.

In terms of impact of higher rates on NPL ratio in Turkey. Definitely having a rate at this level will have implication on some of the accounts. And this is why we are watching very carefully the inflow of NPL. Now we were helped especially during last year and early this year in terms of some banks, especially public banks, were aggressive in lending. So some of that lending to the private sector were used to repay some of the loans in the private sector. And that's why we have seen many of the loans which had deferred installment for the last year being repaid as a result, which helped in managing the NPL ratio. Going forward, we need to be very careful and we are monitoring the NPL inflow very carefully.

Q - Chiradeep Ghosh *Securities & Investment Company BSC, Research Division - VP of Research*

That's all from my side. Thank you.

Operator

Again, as a reminder to ask a question, please press star one. And as a reminder, please limit yourself to two questions. We will now take the next question from Edmond Christou from Bloomberg Intelligence Research. Please go ahead.

Q- Edmond Christou Bloomberg Intelligence – Analyst

Hi. Thanks for the call. Do you still expect cost of risk to be between 65 to 75 basis points? The upper end in first quarter. Just want to see if anything has changed with rising interest rate Turkey.

Also, can you give me some color on the domestic book Qatar in terms of staging? I believe most of the staging that happened in first quarter was related to the international market, if you could kind of give some flavor on the corporate in Qatar.

The second question is on the margin. We talk about four to five basis point decline in margin this year. Does it look optimistic to you with rising interest rates in Turkey? And where do you see domestic margin given the yield curve right now? Thank you.

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

Okay. Several questions. I'll try to remember to answer all of them. Cost of risk as of March is 74 basis points. Expectation for the year as I mentioned in January to continue to be between 70 and 75. I don't see us reaching 80 basis points that we have seen last year. So first quarter this year would drop between the 5 to maximum 10 basis point.

Margin, we have a drop of one basis point during the first quarter. However, if we look at margin for Egypt and margin for Turkey, especially Turkey, there was a major drop in margins, especially in Turkey. And this is something that we discussed in December when we said that there will be major hit to net interest income in Turkey because of the increase or the rapid increase in interest. It will take around three to six months period for Turkey to be able to absorb the implication and move forward. And we go back to seeing net interest income at normal level. Unfortunately, what's happened in the first quarter in Turkey, again, made things more complex because no one can expect what the central bank is going to do in terms of managing ventures. Will it be a gradual drop? Would it be a sharp drop? So, with that vagueness, it's extremely difficult for us whether it was here at the group level or in Turkey to estimate what will happen in net interest income. And that's why we need to wait and what will happen.

Even in Egypt, there was a drop in net interest income, but it was a marginal drop because of assessments suspending interest for some accounts. But what would be the impact, overall impact on the group? I think we are going to see another four to five basis point drop on interest margin. So I will not be surprised if we ended up the year around the 245 basis points, which still is a very strong NIM for a bank at our size.

Q- Edmond Christou Bloomberg Intelligence – Analyst

Okay. Thank you. And just follow up on the asset management, the reduction in the asset management. Is this the reason for this in term of deposit and loan and how should I think about in terms of fee generation going forward?

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

Growth in loans in the group was only 2%, which is a rarity for QNB to show this low level of growth in loans. The main reason for that is that mid-March a couple of large loans matured and they were repaid. But [inaudible] month is around QR 11 billion. And this impacted the overall growth in loans in the group, especially in Qatar. However, looking at the pipeline for loans within QNB, especially in the property market, we are seeing very strong pipeline. I still confirm the guidelines we gave on growth and loans at the beginning of the year. We still expect 5-7% growth in loans. So the momentum for growth in loans, especially in second quarter and going forward, we'll continue to be much better than what we have seen in the first quarter.

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Q- Edmond Christou Bloomberg Intelligence – Analyst

Thank you very much.

Operator
We will now take the next question from Aybek Islamov from HSBC.

Q- Aybek Islamov *HSBC, Research Division - Analyst*

Yes. Thank you. This is Aybek from HSBC. Just a couple of questions really. I mean, I'm looking at the first quarter net income. It looks like a pretty good start to this year. When you think about the guidance of net income growth you gave earlier, which I believe it was between 4% and 6% increase in net income, how do you feel about your guidance after you reported first quarter results? That's my first question.

Second question is, in your financial statements, you have unrealized translation losses in foreign currency, obviously, given this depreciation in Turkish lira and also some unrealized losses through other comprehensive income on debt securities. How do you think it will evolve? And is there a chance you may recycle some of it in your income statement?

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

Debt security will not impact P&L. Going back to the main question on overall growth and [inaudible] income, I still believe that growth in net interest income for the year will continue to be between the 4% and 5%. I totally agree with you that we have been able to manage the net interest income and interest margin very well during the first quarter, even with the drop in Turkey and Egypt. But I think a growth of 5% overall for the year will be a very strong growth in terms of net interest income for the group.

[Inaudible], is there anything else I missed in your question?

Q- Aybek Islamov *HSBC, Research Division - Analyst*

Yes. I also wanted to ask you about net income guidance. You gave at the start of the year I think it was between 4-6% for net income growth, EPS or net income. How you feel about this guidance now that you've reported first quarter results?

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

No, I think I'm very confident that this can go up to 5-7%. And we are very optimistic that we'll be on the high side of the guidelines.

Q- Aybek Islamov ***HSBC, Research Division - Analyst***

Okay, thank you.

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

Just to continue on this. Definitely first quarter gave us very good sign that this should be a better year than what we originally anticipated. And this is clearly reflected in how we manage our cost to income ratio with material input to 23.4 from 24.3. This is much better than what we anticipated. The group is managing the post very carefully. Growth in net interest income is better than what we originally anticipated because we were very worried about the hits that will come from Turkey. The hit took place, but the group were able to manage the cost of funding much better than originally anticipated. And that's why positively reflected on the new guidelines. At the same time, we are not seeing major pressure on NPL. The conservative approach we have taken in the last two years are paying off now, and that's why we are anticipating that cost of risk will drop from the 80 basis points that we have seen last year. This can summarize how we are looking for the year 2021.

Operator

We will now take the next question from Naresh Balandani from JP Morgan.

Q - Naresh N. Bilandani ***JPMorgan Chase & Co, Research Division - Research Analyst***

Thank you. Hi, it's Naresh Balandani from JP Morgan. Thanks for your time. Mr Ramzi, just two questions please. One is, if I take a look at the presentation, you've kindly highlighted that the mix of US dollar denominated loans has increased to 61% compared to 55% at the end of the last year. If you can please throw some color on what drove this change in the mix, and if this could have any impact on your net interest margin, given the rise in the US bond yields. That's one.

The second is my question on the Qatari segment. If I take a look at the segment of the financials, I see that the fact that your investments growth has been slow – overall lending growth has been flat, but assets have grown quite sharply. And now I assume this is probably sitting in excess liquidity because of the loan maturities that you saw in the first quarter. Do you believe that this could potentially offer a positive surprise in the domestic segment loan growth in the later part of the year, given that we've seen a very solid start in the public sector loan book as we are seeing at the system level?

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

Thank you. Absolutely. I will tackle your second question first. The mix in the balance sheet of course materially changed in the first quarter because the liquidity in the group was materially better. I've been in the bank now for more than 21 years. I don't recall when our loan to deposit ratio was at 96.1%. But I need to tell you, as a CFO, I'm not very fond of 96.1. I think a normal ratio for a bank at our size should be between the 98% and 99%. Why? Because I need to have the best trade-off between a strong liquidity and a strong profitability. 96.1 definitely impact net interest income for the growth. This liquidity was reflected on the growth that we have seen on cash and due from banks, which grew by 24% from March last year and 12% from December. So major increase in cash and due from bank which has a major small margin which does not exceed 25 to 50 basis points in terms of margin.

And that's why I said I'm optimistic because I know that the pipeline for loan is materially stronger. This will be reflected on a much stronger growth in loans second, third, fourth quarter. And that's why you are going to move growth in net interest come from 2%, which we have seen in first quarter to around 5-7% by year end, which will overall a net interest income for the growth.

Now, in terms of mix of loans in terms of currency, I mentioned that we have two loans maturing in March, both amounting to around 11 billion. Both of these loans were Qatari riyal loans. At the same time, some of the loans that we gave during the first quarter were dollar based because they were given to some companies that enjoy a cashflow and dollar. And that was the reason why the mix changed. Going forward, I think we will go back to where we started the year in terms of the overall mix.

Q - Naresh N. Bilandani ***JPMorgan Chase & Co, Research Division - Research Analyst***

Thank you. That's very clear.

Operator

As a reminder to ask a question, please press star one. We now take the next question from [Inaudible] from Bank of America. Please go ahead.

Q – Speaker, Bank of America

Hi there, gentlemen. And thank you for the call. I wanted to maybe delve a bit deeper into where in particular you felt the cost optimization that's most effective and where you take the most encouragement in cost control, and what the outlook is for your cost base going forward given activity levels are picking up. Again, are you going to start to see a resurgence in cost pressures, or do you think there are further cost optimization projects that you can undertake to continue the favorable trend in cost to income ratio through to the end of the year?

My next question is with regards to the M&A market. Obviously, a lot of fallout last year. Valuations in the banking market have become a lot more attractive. How are you thinking about M&A at the moment? Is this still in the agenda? Are you closer to doing something? Are you less inclined to do something given the risks have also changed commensurately? But just love to get your thoughts on your views with regards to QNB and M&A. Thank you.

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

M&A is always on the table. However, we are extremely careful at this stage because we know that the amount of risk that all banks are facing. So doing a proper due diligence at this stage might not give you the perfect result. And that's why, even though it's always there in the back of our mind, but definitely it’s not a priority at this stage. And that’s why, am I looking at anything today? No. The focus now on the group, increasing the efficiency of the group and managing the risks that still we are seeing especially in international operations. This is probably the number one at this stage.

In terms of cost control. One thing that we have benefited from COVID-19 is the utilization of digital channels. Definitely we materially benefited from what we have invested in the last five years in digital channel in shifting many of our customers to these channels instead of going to branches. That's why there was material drop in number of branches in Turkey. We closed around 50 branches. There were also material drop in the number of staff in Turkey. We limited the growth in number of branches in Egypt because now again we want to focus more on digital channels in Egypt. And there will be new initiatives that we will announce in either very soon that will show to what extent we are giving this important mission in the Egyptian market. In Qatar, again, different initiative have been taken in terms of the number of manpower, focusing our investment on digital channels, reducing number of branches, all these added up to where we see cost income ratio. These initiatives in a continuous process and shifting more and more customers to our digital platform will increase. And we have seen that the acceptance of the customers to these platforms is much stronger today than it was 12 months ago, which is helping us and encouraging us to invest more in these channels in order to generate more business through these channels that will allow us to go back and rethink our cost again with the idea to reduce it further.

Q – Speaker, Bank of America

Understood. Very clear. Just on your lack of appetite for M&A. One of the areas maybe you can address is your strategy with regards to the Saudi market and what you're thinking there, obviously, given the opportunities that could potentially be emerging for you and the huge demand for capital in that market. How has QNB looking at the Saudi market and could that potentially be something that you would look to do M&A and if the opportunity arose in the future?

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

Doing M&A in the Saudi market with the limitation on foreign ownership will be extremely difficult. However, the Saudi market is extremely important for QNB. We already have a license for the branch. The branch is there. Staff is there. We are now moving very quickly in order to start operation in Saudi Arabia again. We are very optimistic about the Saudi market, and we believe it will be one of the most important markets that we are going to have going forward after, of course, Qatar, Egypt, and Turkey. However, doing an acquisition in Saudi Arabia, I don't see that happening because as far as I remember, the maximum ownership you can have is 40%. So, as we always said, if QNB is going to be interested in anywhere in any market in the world, we would only interested if we can get 50% and above to allow us to consolidate. And this option is not available in Saudi Arabia.

Q – Speaker, Bank of America

Understood. Thank you.

Operator

As there are no further questions, I will hand the call back over to your host for any additional closing remarks.

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

I want to thank everyone on the phone call. Ramadan Kareem to all. And hopefully we will see you in the conference call in second quarter. Enjoy the rest of the day.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation. Ladies and Gentlemen you may now disconnect.