

BLOM Bank Q1 Results Conference Call Transcript**24 May, 2017****Beirut time 15:00**

Anas Aboul-Hosn:

Good afternoon, everyone, and thank you for joining us today. This is Anas Aboul-Hosn from Arqaam Capital. I am pleased to welcome you to BLOM Bank's Q1 2017 earnings conference call. I have with us today Mr. Saad Azhari, the Chairman and General Manager of BLOM Bank. Without further delay, I will now turn the call over to Mr. Saad Azhari. Please go ahead.

Saad Azhari:

Thank you Anas. Before I start, let me perhaps break the good news as we just heard that the Central Bank governor, Mr Riad Salameh's, term was renewed for another six-years. This is something overdue as the market has been anticipating the renewal given the confidence and stability that Mr Salameh projects on the country's economy. With regards to the macroeconomic situation in Lebanon, it has not changed much since our last call. The economic situation is relatively stable but the growth rate is still low. There are some political tensions concerning the new electoral law as there are different proposals without a consensus on a single new law yet. Accordingly, if the politicians do not reach an agreement, the existing electoral law will prevail and elections will be held by September of this year. I think this will bring more stability because people's uncertainty about the elections will ease. So I guess between renewing of the Central Bank governor's mandate and the potential holding of elections in September, there will relatively be more stability. In parallel, we are looking forward for a promising summer season given the better-than-expected hotel bookings which will hopefully translate into a revival of tourism from the Gulf. More specifically, after Eid during the months of July and August.

Since I'm speaking generally about the economic situation, I have to say a few words about Egypt which is our second most important

market. As you know, interest rates were raised by 2% at the beginning of this week. Most probably, this was under pressure from the IMF as I don't think the Egyptian authorities were convinced with the move but they had to comply since they are now under the IMF program. Though, when you look at the monthly data, inflation is on a declining trend. Accordingly, I don't think this measure was needed because this will definitely impact the economic situation in terms of lending growth, since the current rates are at 22%-23% if you look at the interest rate corridor and how much customers are paying. It is becoming challenging for the retail business due to the high interest rates. But, in general, our bank is not affected by the higher rates. Currently, we have a very high level of liquidity with a loan to deposit ratio of 34% and thus we can benefit from the higher interest rates. And even for our outstanding loans, higher rates will be beneficial. But for the overall economic situation, I hope that it will not stay at these high rates. As for the currency, it has relatively stabilized around the 18 Egyptian Pound per USD level with no exchange rate difference between the official and black markets. There is also enough supply of dollars with no backlog. The general expectation is that the currency will fluctuate between 16 and 18.5.

As for our consolidated results in the first quarter, profits increased by \$4M million to \$112M compared to the same period of last year. Our assets grew to 30.1 billion. Return on equity was around 15.4% and we still maintained a very low level of cost to income ratio at around 34.2%. In term of capital, we have a high capital adequacy ratio of around 18.5%. Moreover, the General Assembly decided to redeem our 2011 preferred shares and we will not be issuing any replacements. Also, our Gross NPLs have gone down to around 2.8%. This is due mostly to a big loan that was 100% provisioned and was put off balance sheet. Our coverage ratio – including real guaranties and collective provisions – stands at around 154%.

Other important developments that we have experienced to date include the devaluation of the Egyptian pound that affected the income statement and balance sheet since it had depreciated by 50% over the past year. And Egypt represents almost 10% of the balance sheet. But on a consolidated level, we were able to increase the size of our balance sheet and income statement. The share in profits of

Lebanon increased due to the lower corporate tax rate in Lebanon versus the other countries we operate in. I don't want to go into details at this stage and prefer to open it up for questions and answers.

Operator:

Thank you. Ladies and gentlemen, if you wish to ask a question, please press zero-one on your telephone keypad. Thank you for holding until we have our first question. Our first question is from Anna Shaarawy from FFA Private Bank. Please go ahead.

Anna Shaarawy:

Hello Mr. Azhari. My first question will be on the operating environment in Lebanon. What are your views on the latest budget developments such as the proposed new taxes and their effect on the sector including the effect on capital inflows, funding cost and interest margins? Thank you.

Saad Azhari:

Okay. I have to say that we, as an Association of Banks in Lebanon, have been following closely the subject of taxation in the Parliament. And I must admit that we have been receiving open ears from the Parliamentary Finance and Budget committee. For example, many of the proposed tax hikes have been reconsidered as the committee is now convinced that the budget should not include any tax bills that require a change in tax legislation. From where I see it, there is no major change in taxation that will pass when the budget is approved. Where taxation might resurface is when they discuss the increase in the salaries of the public sector. And there, they also have additional tax proposals which are not currently being discussed. But in general, bills that were once considered in the budget and which had an adverse effect on banks have been shelved.

Anna Shaarawy:

Okay. Thank you. And maybe another question about what we've been hearing about the new sanctions from the U.S. Treasury. Do you have any particular concerns for the bank or the sector in general? And if there were banks up for acquisition due to the sanctions would Blom be interested?

Saad Azhari:

As members of the Association of Banks, we travel twice a year to the U.S. where we meet our correspondent banks as well as Washington-based government bodies that are involved in international/banking

affairs. I have to say that the press in Lebanon is exaggerating the matter for various reasons. I can tell you that the U.S. considers the banking sector as a pillar of stability and they want to make sure that whatever decisions they take, the banking sector will not be affected negatively. For the U.S., the two pillars of stability are the Lebanese banking sector and the Lebanese army. The former represents the economy and the latter the security situation. Currently, discussions are underway to introduce modifications to the existing law that are primarily applicable to South America where oversight is still loose. So the concern is not really Lebanese banks but elsewhere given that Lebanese banks are compliant with the existing law. And there is no reason to think that local banks are going to be listed. The whole scenario was rather used for political reasons and constituted rumors in Lebanon. No local banks are being sanctioned and there are no banks for sale for that matter. There is no substance for all those rumors.

Anna Shaarawy:

Okay. Thank you. One last question about the Central Bank's (Banque du Liban) tighter capital requirements in light of the new IFRS 9 implementation in 2018. Do you see BLOM Bank as being well prepared? Thank you.

Saad Azhari:

As I said earlier, our capital adequacy is high and the provisioning that we have taken for IFRS 9 is beyond what is required. And as a result we have redeemed our preferred shares without issuing new ones. Additionally, we are funding the acquisition of HSBC branches by the 17th of June without the need to issue new shares.

Anna Shaarawy:

Okay. Thank you. I'll go back into queue.

Operator:

Ladies and gentlemen, if you wish to ask a question, please press zero-one on your telephone keypad. I will take the next question from Anna Shaarawy from FFA Private Bank. Please, go ahead.

Anna Shaarawy:

Yes. Thank you. I just had two more questions on the operational side. What's your outlook in terms of NIMs? Are you comfortable with the current levels for this year? What about balance sheet growth and cost efficiencies?

Saad Azhari: I think for this year, we are going to see net interest margin at around 2.3% which is about the same level as last year. I'm comfortable that we'll be able to preserve that level. Whereas NIMs in the first quarter were slightly lower than the end of last year, it's going to be better for the second quarter and net interest margins will end up at the same level as last year.

As for the balance sheet growth in the first quarter, especially in Lebanon, assets and deposits grew well. On the other hand, growth in loans was relatively weak and hopefully this will change given the expected tourism revival in summer. As for Egypt, I believe the recent increase in interest rates will have a damper on loan growth in the short term. Relatively, overall lending growth will be flat for this year versus a higher level of growth for assets and deposits.

Anna Shaarawy: Yes, my last question is going to be about Egypt. You were saying earlier that BLOM will benefit from the recent rate hike. Is this because the impact from the repricing of T-bills will outweigh the higher cost of funds that you have to pay on deposits?

Saad Azhari: True, and given our ample liquidity position, we are able to capitalize on the rise in interest rates by making placements in the interbank and T-bills markets. Additionally, we are witnessing improvement due to the higher rates paid by customers on loans. So, overall the increase in the cost of funds has been offset by a larger increase in lending rates. But in general, the increase in interest rates will impact the growth of lending as a whole, in addition to the quality of loans if higher interest rates persist. A yearly increase of 800 bases points in lending rates is considered too high.

Anna Shaarawy: Okay. And one last question about your expansion plans in Egypt. Egypt represents 10% of BLOM's balance sheet. Do you see this number remaining the same for the year or should we expect an increase by the end of this year or perhaps in the short-term?

Saad Azhari: You know our expansion plans are continuous and we are growing our presence in Egypt and expect to have more than 40 branches by the end of the year. Our operations in terms of Egyptian pounds are recording good results. Even in dollar terms, we hope to be able to

match the profits of last year even though the currency has depreciated by 50% over the past year. In general, we are positive about the growth of the business and I believe interest rate levels will start adjusting and dropping in the short term.

Anna Shaarawy: Okay. Thank you.

Operator: Ladies and gentlemen, if you wish to ask a question, please press zero-one on your telephone keypad. Thank you for holding until we have our next question. Our next question is from Caspar Romer from Blakeney Management. Please, go ahead.

Caspar Romer: Hi, Mr Saad. Thank you for doing this call. I've got three questions if I may. The first is if you could just clarify what the impact of an increase in public sector wages would have on you? Is it a macro budgetary impact? Or, would there be any sort of follow through on your cost base? The second is when exactly the preferred shares were retired? Was that at the beginning or the end of the quarter? And then the last would be what the Gross NPL ratio was at the end of 2016 in comparison to the end of the first quarter? Thanks very much.

Saad Azhari: Thank you. Well there is no direct impact with regards to an increase in public sector wages since private sector salaries have been adjusting continuously. Perhaps a more relevant issue affecting the banking sector would be taxation since there are discussions of raising corporate, dividend, interest, and real estate taxes. These measures are being considered as part of financing any increase in public sector wages. Having said that, the government came under attack from the public who called for fighting corruption and enhancing revenue collection instead of raising taxes. The latter is temporarily on hold but will resurface once public sector wage increases are approved.

With regards to preferred shares, we are redeeming them and payment will be made this June given the approval process set forth by the Lebanese Central Bank. However, for capital adequacy calculations and related financial reporting, we have already discounted them from our financials as of Q1.

In terms of Gross NPLs, our end of year 2016 figure stood at 4.2% and dropped by around 1.4% to 2.8%. This was mainly due to writing off a \$100 million real estate loan that was fully provisioned. It was classified as nonperforming on the back of archeological findings that froze construction activities. In retrospect, the government has recently agreed to swap the piece of land – valued at \$300 million – which will constitute an opportunity to restart developing the project again.

Caspar Romer:

Great. Thank you.

Operator:

Our next question is from Maya Boukheir, from Schroders. Please, go ahead.

Maya Boukheir:

Thank you for hosting the call. I came in a bit late to the call and I'm not sure if you have already covered this point. But can I please hear your views on the outlook for deposit growth this year in Lebanon? And do you have any concerns over renewing the fixed deposits received last year as a result of the Central Bank's financial engineering?

Saad Azhari:

Okay. In term of deposits growth, we have seen a relatively healthy growth even though our cost of deposits is considered to be the lowest in the sector. But we have seen a relatively strong first quarter increase of around \$442 million. At the sector level in Lebanon, deposits have grown by an acceptable 1.2% in the first quarter. And I expect for the full year to see a reasonable growth of deposits probably at 6%. As for the fixed deposits that you raised, we have to differentiate between the Central Bank's swap operation that was open to all banks and the reengineering effects of the swap that involved a handful of banks. The first scenario included discounting TBs in Lebanese Pounds against dollars. The second involved attracting extra liquidity or hot money by offering additional interest incentives. BLOM was not involved in the latter case.

Maya Boukheir:

Do we have an estimate of how big this portion is?

Saad Azhari:

I mean there is one large bank that was very active in this type of transactions and it was reported in the press. You may want to research the news.

Maya Boukheir:

Thank you.

Operator:

Our next question is from Sahil Kumar from Moodys Analytical. Please go ahead.

Sahil Kumar:

Hi. Thank you for the call and the presentation. I have two questions. One, what is your current loan to deposit ratio in Egypt? Two, what is your long-term plan in Egypt for the next three to five years and its effect on the size of the consolidated balance sheet? Thank you.

Saad Azhari :

Our loan to deposit ratio in Egypt is currently around 34% which is close to the average of the banking sector. We had a good growth of loans over deposits. But going forward, it is difficult to predict how this ratio will develop given the rise in interest rates that would affect the growth of lending.

As for Egypt's contribution to the balance sheet, it went down from 10% to around 5.4% after the devaluation of the currency. In terms of profits, it represents around 10%. But as highlighted earlier and in the wake of the current fluctuations and volatility, it will be difficult to predict how Egypt's contribution to the overall balance sheet will develop over the coming years. I believe the exchange rate has bottomed and the potential for growth in Egypt is well founded. Accordingly, I expect our Egyptian operations to make up for 10% of the overall balance sheet in the coming three to four years.

Sahil Kumar:

Okay. Thank you.

Operator:

Ladies and gentlemen, if you wish to ask a question, please press zero-one on your telephone keypad. Thank you for holding until we have our next question.

Anas Aboul-Hosn : *Yes. This is Anas. I'd like to please ask a question. Basically, it's regarding the \$173 million that were provisioned against IFRS 9 in FY'18. Are they under Tier I or Tier II capital?*

Saad Azhari : *Actually the \$173 million were allocated for future IFRS9 requirements and don't fall under Tier I or II. Rather, it is the \$110 million deferred liabilities that are under Tier II, and 70% of which could be transferred to Tier I by the end of the year.*

Anas Aboul-Hosn: *Excellent. Thank you very much.*

Operator: *Ladies and gentlemen, if you wish to ask a question, please press zero-one on your telephone keypad. Thank you for holding. We have no further questions.*

Saad Azhari: *Well, thank you very much. And thank you Arqaam and all participants.*

Operator: *This concludes today conference call. Thank you all for your participation. You may now disconnect.*