Dukhan Bank – Q4-23 Earnings Call Transcripts

Date: February 6, 2024
Time: 13:30 Doha

Executives from Dukhan Bank:

1. Osama Abu Baker - Group Chief Financial Officer
2. Riaz Khan – Head of Reporting & Budgeting and Investor Relations Officer

QNBFS Chairperson:

1- Shahan Keushgerian, Sr. Research Analyst

Operator:	Hello and welcome to the Dukhan Bank Conference Call. I would like to advise all participants that this call is being recorded. Thank you. I'd now like to welcome Mr. Shahan Keushgerian to begin the conference. Shahan, over to you.
Shahan Keushgerian [QNBFS]:	Thank you. Hello, everyone. I want to welcome you to Dukhan Bank's Fourth Quarter and Fiscal Year 2023 Financial Results Conference Call. So, on this call from management, we have Osama Abu Baker, the Bank's Group CFO, and Riaz Khan, Head of Reporting & Budgeting, and IR officer. So as usual, we will conduct this call with first management, reviewing the company's results followed by a Q&A session. I will turn the call over now to Osama. Please go ahead.
Osama Abu Baker [Dukhan Bank]:	Thank you, Shahan, and good afternoon, everyone. As usual, we will begin by briefly discussing the broader economic context before delving into our key accomplishments for the financial year 2023. Later on, Riaz will provide you with updates on the financial performance of the Group, followed by a question-and-answer session. Let's start by addressing the global economic landscape where geopolitical tensions impacted economic landscapes with implications on trade and investment flows, inflation rates fluctuated with some countries experiencing moderate inflationary pressures. Financial markets exhibited volatility in responding to economic data, geopolitical events, and Central Banks' actions. Now, shifting our focus to the domestic markets, after experiencing a somewhat sluggish first half of the year, we notice a resurgence in the momentum in the later part of the year, all sectors of the economy exhibited growth. Notably, we have witnessed a remarkable surge in visitors as Qatar welcomed over 4 million visitors during 2023, exceeding all historic annual visitor numbers and setting a new visitor record. This was certainly positively reflected in the local consumption and tourism sectors.

	Furthermore, tailwinds from planned CAPEX investments under the flagship Northfield Expansion project coupled with related downstream projects, is also providing a boost to the overall economic growth. Additionally, during the recent governmental procurement forum, Qatar plans to launch $19 billion worth of projects by 2024 to be carried out by the Public Works Authority and Qatar General Electricity and Water Corporation. All of these investments will combine with ongoing diversification efforts and structural reforms by the State, are expected to further stimulate economic activity and spending across various services and manufacturing sectors while ensuring alignment with Qatar's 2030 vision with particular emphasis on healthcare, education, travel, and tourism. Now, talking about Dukhan Bank's strategic approach. It revolves around the core values that define our business, placing a significant focus on digitalization and sustainability. While upholding these values, we have successfully retained our market share and remained dedicated to continuous digital innovation. Despite substantial changes in policy rates, we have sustained robust profitability, reduced our cost of risk, and achieved high recovery rates. In parallel, sustainability is deeply integrated into our strategy, underscoring our commitment to environmental responsibility. Now, let's turn our attention to the Group's financial performance for the financial year ended December 2023. I am pleased to report that we have achieved notable success. Our total income has grown by QR 1.6 billion reaching QR 6.1 billion. Our bottom-line profitability for the year 2023 increased by 4% from last year and reached the highest-ever net profit of QR 1.3 billion. Our liquidity remains robust, and the capital adequacy ratio was comfortably higher than the minimum requirements and currently stands at 17.2%. Over the past year, within the capital market space, we have reached noteworthy milestones with our successful listing on the Qatar Exchange standing as a strong testament of the trust and confidence of our shareholders. Dukhan Bank is now part of all major indices, including the MSCI Emerging Markets Index, FTSE mid-cap index, and all the QSE indices. This is a historic achievement for us, especially considering our listing on the Qatar Stock Exchange early last February. By ending here, I will let Riaz share more details on our performance for the year 2023, followed by the Q&A session.
Riaz Khan [Dukhan Bank]:	Thank you, Osama, and welcome everyone. As mentioned in our previous call, the year 2023 was indeed a challenging year, particularly for the banking sector. However, the bank was able to successfully navigate these challenges and reported a record net income of QR 1.3 billion. Currently, our total assets stand at QR 114 billion, predominantly composed of financing assets at QR 77.6 billion, constituting 68% of our total assets. The

investment portfolio follows closely, reaching almost QR 20 billion and contributing 17% to the total assets.

Our balance sheet is predominantly funded by customer deposits representing about 78% of our total liabilities, and totaling QR 78 billion. This is followed by market funding which contributed 20% and amounted to QR 19.6 billion, while maintaining a regulatory ratio of loans-to-deposit of less than 100%, which currently stands at 98.1% distinguishes us among Qatari banks.

Notably, our reliance on non-resident deposits has decreased to less than 2%, as we continue to cultivate strategic and generational domestic relationships.

In our commitment to safeguarding profit margins and managing our cost of funds, the net profit margin has been maintained at around 2%, similar to the previous year's closing position despite facing a significantly high cost of funds.

We now anticipate the conclusion of the rising cost of funds cycle which was linked to FED rate hikes and QCB benchmark rate increases as inflation shows signs of cooling off. This would reduce pressure on our cost of funds and lead to positive margin evolution.

Examining the breakdown of the Group's total income, two primary contributors stand out:

- First, financing and investment income, which rose by QR 1.7 billion, or 42%, compared to the previous year, reaching QR 5.6 billion, and contributing 92% to the Group's total income.
- Second, the highest contribution comes from net fee and commission income, which was up by 22% compared to last year, amounting to QR 256 million.

Turning our attention to impairments. The net impairment charge after taking the impact of recoveries for the current year totaled QR 333 million, marking a notable reduction from QR 660 million in 2022.

The gross impairment charge excluding recoveries was QR 488 million, demonstrating a decrease from last year's QR 734 million. This reduction is primarily attributed to banks' long-standing conservative approach to provisioning, along with the strong recoveries and collections relating to written-off financing. Also, significant Stage 3 recoveries of QR 155 million were observed in 2023, a marked improvement from QR 75 million reported in the previous year.

The staging of financing activities aligns well with the industry standards with Stage 1 at 80%, Stage 2 at 15%, and Stage 3 NPLs at 5.4%, with decent coverage of 4.2% against Stage 2 accounts, and 69.9% against the Stage 3 accounts. Here is an important point to note that, if we consider an eligible collateral benefit, the Stage 3 coverage ratio reaches approximately 95% against the NPLs.

	Our financing book remained well diversified, encompassing all sectors including Government at 22%, Real estate at 29%, Commercial at 9%, Consumer at 7%, Contracting at 5%, Industrial and Manufacturing at 1%, and Services & other sectors about 27% of the total loan book. The Group's capital adequacy ratio at the end of 2023 stands at 17.2% when exceeding the regulatory requirement of approximately 14.3%. This positions us to grow confidently in the future. Looking forward to 2024, we project a sustained growth trajectory, anticipating mid-single-digit expansion in our balance sheet that aligns with the overall GDP growth targets for the country. These drivers of the growth will predominantly be wholesale banking and private banking segments with our growth strategy emphasizing quality over quantity. Regarding bottom-line profitability, we foresee our comparable mid-single-digit growth mirroring the expansion anticipated in the overall balance sheet. While we anticipate no significant deterioration in the asset quality, our approach to provisioning remains conservative. We will continue to build adequate buffers to safeguard against unforeseen adversities. In summary, our focus for the upcoming year will be on delivering another successful year while prioritizing NIM protection, robust liquidity, and maintaining our current market share while fostering the growth of our balance sheet. Now, we will open the floor for the Q&A. Thank you very much.
Operator:	Thank you. If you would like to ask questions, simply press the star followed by the number one on your telephone keypad. That is star one, if you wish to ask a question. Our first question comes from the line of Mark Krombas from TFI. Please go ahead.
Mark Krombas [TFI]:	Thank you, gentlemen, for making the call. I have two questions. One is the source of the impressive fee income growth and whether you feel this is a one-off or whether it's sustainable in the upcoming year. And the second question is, if we see rate drops in the second half as the sort of markets are pricing in in the U.S.? What impact do you think that would have on your NIMs for the year 2024?
Osama Abu Baker [Dukhan Bank]:	Can you repeat the second part of your question, please?
Mark Krombas [TFI]:	Yes. If rates drop, like it's expected. If interest rates fall like, I think the yield curve is pricing in around one 1.5% reduction in the second half of 2024, how does that impact your net interest margins, just overall lower rates? That's my second question.

Osama Abu Baker [Dukhan Bank]:	Thank you for the two questions. The first question was about the growth, and if there are any one-offs. If you read from our announcement or call for the third quarter, we indicated that we have some one-offs during the third quarter and we requested the investors and the analysts not to rely on one quarter for their projections. In Q4 there were no one-offs. So, if you want to analyze our fee income, it's better to take an average for the full year, quarter-on-quarter. Regarding the second part of the question, usually in this part of the world and typically in Islamic banking, NIMs improve when the interest rates start to decrease, we anticipate an improvement in our NIMs next year, and it will range or will stay in about 10 basis points on average for the full year.
Mark Krombas [TFI]:	Okay. Thank you very much.
Operator:	Thank you. Our next question comes from the line of Salome Skhirtladze from Bloomberg. Please go ahead
Salome Skhirtladze [Bloomberg]:	Hello, thanks for taking my question. I have two questions. The first on cost to income and overall expense level. So, there was around 80% increase versus last year. So, given your digitalization strategies, do you expect the level to remain same, or there's some growth to be expected, this is one part of the question? And another one is on the loan book. Could you give a bit more details about the real estate loan segment and their exposure? Do you have the most exposure to hospitality or commercial real estate? And what is the expected utilization occupancy rates versus 2022 and 2023 years? Thank you.
Riaz Khan [Dukhan Bank]:	Okay. So in terms of the first question on the cost-to-income ratio, currently our cost-to-income ratio is above the 30% mark, and as you highlighted that this has been the target for us to ensure that the cost-to-income ratio continue to be on the lower side below the 30% mark. So that is something which the bank always targets and that is something which we will continue to target in the years ahead. Additionally, there was an unprecedented increase in the cost of funds, which affected the overall net banking income, which could be a one-off factor going forward, as we expect the cost of funds going back to their originals, where we started from. So that will help us on the net banking income. And as far as OPEX is concerned, the target of the bank is to continue to ensure we remain range-bound with the historical trends as well as with the inflation trends. So that answers the first question on the cost-to-income ratio. In terms of real estate exposures, real estate is one of the exposures where we keep a very close eye from Credit Risk management perspective. Its always remained the top priority for the top management, and currently, our exposure contributes almost 29% of our total loan book. In terms of the quality of the assets, as we have mentioned previously, the quality has been A-rated assets in this category of loans and we normally deal with large corporates as well as ultra-high net worth of individuals backed up by appropriate collaterals. So that is something where the management is very confident. One more point I can add here that as part of our conservative approach, we have stopped Commercial Real Estate lending 4 years ago, unless it is a reputable name with solid

	plans. Due to this we are one of the fewer banks who have room in its regulatory Real Estate ratio. So that is something a comfort for the investors that the management is very conservative when dealing with real estate and the sensitivity around it. And that's how we are confident from this asset quality perspective that the loan book has not shown any adversities. I hope I answered both of your questions.
Salome Skhirtladze [Bloomberg]:	Yes, thank you. Thank you very much.
Operator:	Thank you. Our next question comes from the line of Andy Brudenell from Ashmore. Please go ahead.
Andy Brudenell [Ashmore]:	Hi there. Yes. Thank you for taking my question. I just have a couple of things. You mentioned that there is a plan for mid-single-digit income growth in line with the balance sheet and this is despite the fact that the NIM is improving. And I think you said the reason for that is you want to continue to build as you put it prudent provisioning. I see that the coverage ratio did go up, but it's still pretty low. Can you give us a sense of what's the target, where you're aiming to get to before we would actually begin to see growth in the balance sheet and then begin to generate earnings growth? Thank you. That's question one.
Osama Abu Baker [Dukhan Bank]:	Yes. The coverage ratio for the Stage 3 account has improved from last year, but it's worth mentioning that the disclosed number doesn't account for any collaterals we have. If we include those collaterals, our coverage will exceed the 95% ratio level. We aim to reach a 100% coverage ratio for the Stage 3 accounts. As you know, the collaterals are subject to valuation exercise each and every year. So, if the collateral value declines, we need to cover for that. But as I mentioned, our target is to reach 100% after, or post-factoring in the value of the collateral.
Andy Brudenell [Ashmore]:	Okay. All right. Thank you. And then I couldn't quite hear everything on the last question, but I think that the reply was at 29% of the book is in real estate, is mostly related to large corporates and high net-worth individuals and there's no quality asset quality issues here. Could you maybe talk about where you are seeing the NPLs risen a couple of percentage points in the last few years, it rose again last year, where are you seeing these NPLs appearing, please?
Operator:	Would you like Mr. Brudenell to repeat the question?
Riaz Khan [Dukhan Bank]:	Yes, it's better because we got disconnected and now, we are connected back. So, the last question we answered was from Ashmore, Andrew.
Andy Brudenell [Ashmore]:	Hi. It’s still me. My second question was a comment on real estate exposure that we were not seeing any asset quality issues here and it was large corporates and high net-worth individuals. And although it's a large part of the book, the indication was that is not an area of concern. So, with the NPL ratio rising almost two percentage points in the last few years and rising last year, where are you seeing these NPLs being formed? What areas of the book are seeing the increase in nonperforming loans, please?
Osama Abu Baker [Dukhan Bank]:	Well, as you will notice from the financial, the increase this year was really minimal compared to the previous years. We had some issues in the past, legacy issues that we have dealt with, and it was classified. All the accounts were moved to Stage 3.

	Right now, we don't anticipate any major or material deterioration in the credit quality. Definitely, we cannot guarantee that nobody will go into trouble in the future, or somebody will go into difficulties, but we keep monitoring the situation closely. And as we speak now, we don't anticipate any deterioration. In the past, most of the deteriorations were in the legacy portfolio mainly in the real estate sector and that's why four or five years ago we limited our dealings to government GREs and well-known developers. I hope this answers your question.
Andy Brudenell [Ashmore]:	Yes. Okay. Thank you. Sorry, just one more. Can I just follow up on the other person's question on NIM? I mean the cost of funds moved dramatically in 2023 and we understand kind of why that is. But if there is to be a reasonably sizable reduction in rates, as outlined by that caller, and the NIM is only going to improve 10 basis points, is this a timing thing or are there some other issues going on? Like if we move to 2025 and we see another kind of cuts or just sort of bedding down of those cuts later this year will then kind of catch up, or are there other things going on?
Osama Abu Baker [Dukhan Bank]:	Yes, it all depends on the expectations of the rate cuts. As you know, the market is split when it comes to how many rate cuts, and when the rate cuts will start. We appreciate everybody's views, but we are a conservative bank and conservative management. So, we have assumed the rate cuts to be applied in the fourth quarter of 2024 and we didn't anticipate, or we didn't account for more than 25 basis points as a rate cut. We understand the market is factoring more than those and earlier than that. But to be on the safe side, that was our forecast. So, it's just a matter of a conservative approach, how we protect the NIMs, ten basis points is the minimum actually just to be on the safe side.
Andy Brudenell [Ashmore]:	Okay. Right. Sorry. It's just that the caller I think said if we assume 125 basis points cut this year, what would be the increase and you said 10 basis points, but actually you're only assuming 25 basis points cuts this year. Okay. That makes a lot more sense.
Osama Abu Baker [Dukhan Bank]:	Yes, we are assuming only.
Andy Brudenell [Ashmore]:	Okay Thanks.
Operator:	Thank you. Our next question comes from the line of Ankit Mittel from HSBC. Please go ahead.
Ankit Mittel [HSBC]:	Yes, thank you for the opportunity. I wanted to ask about capital ratios. So, we learned that Basel III reform is going to be implemented in Qatar from Q1 of this year. Can you tell us what are the areas where the presently reform is likely to put pressure on CET1 ratios? Specifically, I think there are material changes to the net open currency position and exposure to commercial real estate. So, if you can share any sensitivities that would be really helpful.
Osama Abu Baker [Dukhan Bank]:	Yes, you are absolutely right. The reform is under review now by the QCB and the banking sector. Unfortunately, those numbers or the impacts are not yet public. We have done our homework, and we are in discussion now with the Central Bank, but unfortunately, I can't give you a comment how it will impact or how much the impact will be because still the regulations from the Central Bank are not final and the implementation is not yet clear. It is in phases and one goal, but what I can assure you is that we have a very comfortable situation when it comes to capital adequacy. It will not affect whatever the changes. And how and when it will be applied, it will not

	prevent the bank from growing and it will not affect the bank's ability to pay dividends. I hope this answers your question.
Operator:	Thank you. We have a follow-up question from Saloma Skhirglagze from Bloomberg. Please do ahead.
Salome Skhirtladze [Bloomberg]:	Thank you. I have a quick follow-up question on the regulatory measures. In terms of the stable funding, where do you stand, and what level of net stable funding ratio, if you could comment on this? Thank you.
Riaz Khan [Dukhan Bank]:	We are very close to the regulatory requirements. It depends on the maturity profiles, and how they evolve. So, at the end of December, we were exactly matching to the regulatory requirement.
Salome Skhirtladze [Bloomberg]:	Thank you.
Operator:	As a reminder, if you'd like to ask a question, please press star followed by the one on your telephone. We have a question from Shabbir Kagalwala from Al Rayan Investment. Please go ahead.
Shabbir Kagalwala [Al Rayan Investment]:	Gentlemen, this is Shabbir Kagalwala from Al Rayan Investment. Thank you for the opportunity. I have a question on your investment book. What we have seen is that the investment group book year-over-year has declined and the short-term interbank has gone up significantly. So we would like to know what sort of strategy you have on the investment security side, and what's the current yield on the book?
Osama Abu Baker [Dukhan Bank]:	Yes, the decline was mainly due to some maturities during the year. And as you know, the market was dry last year and there were very limited issuances in the Islamic Sharia compliance state. So that's why you see a slight decline. Our strategy is definitely to build the book based on the internal rating criteria and to maintain a healthy financial position. As you know, without the investment book, we cannot maintain healthy ratios. Our yield is disclosed in the asset-liability sensitivity ratio. I believe it is at the 4.2% level, it is disclosed in the notes of the financial statements. And of course, our strategy is to continue investing in government-related A-rated securities, increase the portfolio in terms of HQLA, and balance the duration as we go. Thank you.
Shabbir Kagalwala: [Al Rayan]:	Thank you.
Operator:	There are no further questions at this time. I'll now have the call back to Mr. Shahan Keushgerian.
Shahan Keushgerian [QNBFS]:	Thank you. So, if there are no more questions, we can wrap this up. And thank you, Osama, thank you, Riaz, for giving us an update on the financial results. And we'll pick this up again next quarter.
Osama Abu Baker [Dukhan Bank]:	Thank you. And thank you everybody for making the time to attend the call today and inshallah we will be in touch soon in April. Thank you very much.
Operator:	Thank you. This concludes today's conference call. You may now disconnect.