

KFH Malaysia getting back on its feet

BY ADELIN PAUL RAJ

Kuwait Finance House Malaysia Bhd's (KFHM) 11-odd years in Malaysia has been bumpy, to say the least. It has been in and out of losses over the years, plagued mainly by its legacy financing portfolio, and despite several turnaround efforts, the road to sustained profitability has so far been elusive for the country's first foreign Islamic lender.

But that is about to change, says its CEO David Power.

In his first face-to-face interview since taking the helm last September, he tells *The Edge* that the outlook for KFHM is finally looking brighter now that some fundamental changes have been made at the company.

For one, he says there is now stronger leadership — six new senior executives were appointed as part of a management shake-up two months ago, and for the first time, several in key positions are from the parent company Kuwait Finance House KSC (KFH) itself, reflecting KFHM's commitment to turn around and grow its wholly-owned Malaysian subsidiary.

For another, KFHM has rebuilt its entire risk management framework, enabling it to monitor its financing portfolio closely to avoid making the same mistakes of the past. Industry observers say a lack of strong leadership in its early days and lax risk management practices were what brought on its problems with bad loans.

"When I took over, there were 18 vacancies in the top structure. This bank had been running on acting positions for quite some time, so obviously, one of the key things for me to do was to resource the top structure, to make sure that we had the right people on board, and at the same time, look at where the paying points are in this organisation, where the problems are and then look at how to fix those problems with short-, medium- and long-term views," he says.

According to Power, 2017 will be the year for KFHM's resurgence in the banking market.

Power is confident that with its ongoing one-year business tactical plan for 2017, KFHM will be able to return to profit this year, after bleeding red ink in the last two years. And, from as early as next year, it may start looking at mergers and acquisitions (M&A) to ramp up its growth in Malaysia.

He and his team are also busy finalising a longer-term, three-year road map for the group that will kick off next year.

"I've been here just over eight months now and a lot has happened since then. I firmly believe we've now got the right team in place running the bank. Most of the new key executives are global bankers in their own right, with significant relevant experience. Now, it's just a matter of using this experience in driving new business," Power says.

Resurgence

While the plan to turn around the bank sustainably is still very much a work in progress, Power is heartened by the fact that improvements are taking place much faster than anticipated.

The group has started paying more attention to retail banking in a bid to ease its strong reliance on corporate banking for earnings. The group's other key business is in treasury and capital markets.

"The retail [banking business] has turned the corner, corporate [banking] is in the process of turning the corner, treasury is fine — there are no issues there. And then, at the end of the day, there's the back-end processing, which we've built up to help make [our propositions to stakeholders] 'simpler, better, faster' — that's a key strategy for us now. So, it's all coming together right now and it's a really positive story from where I sit," he says.

But KFHM's FY2016 financial results, released about two weeks ago, still reflect a loss.

The group's net loss narrowed to RM28.28



MOND SHAEZIN FARVA/THE EDGE

Power: I firmly believe we've now got the right team in place running the bank

A snapshot of KFHM's performance

	2016	2015	2014	2013	2012	2011
Total assets (RM mil)	10,795.5	10,668.0	10,471.6	9,490.9	9,096.7	8,970.8
Total liabilities (RM mil)	1,148.5	9,000.6	8,765.5	7,881.3	7,977.1	7,463.3
Operating revenue (RM mil)	490.6	493.6	456.1	464	494.4	499.8
Profit before tax and zakat (mil)	28.3	-37.2	135.6	148.6	90.4	-644.4
Net profit (RM mil)	-28.3	-37.2	92.8	97.7	60.5	-471.6
Gross NPF ratio (%)	6.9	7.4	7.4	10.6	15.6	23.2

million compared with RM37.18 million in the previous year. The narrower loss was because its impairment allowance on financing, advances and receivables, while still substantial at RM78.4 million, was lower than the previous year's RM99.74 million.

Operating revenue grew marginally to RM490.62 million from RM483.64 million. Its gross non-performing financing (NPF) ratio improved to 6.9% from 7.4%, but was still a strong deviation from the Islamic banking industry average of 1.3% last year.

Gross financing contracted 7.4% to RM6.86 billion, while total assets nudged up slightly to RM10.79 billion from RM10.67 billion. It remained in a strong capital position, with its Common Equity Tier-1 ratio at 20.27%.

"We could have reflected a profit in 2016, but my view was that it was a good opportunity for me, as the new man on the block, to come in and look at the areas that we may face some problems. And so, we took some precautionary provisions to cover that ... to ensure that we now have a stable balance sheet and a stable earnings base, going forward," he explains.

He adds that "98% of the current provisions are from our legacy portfolio that has been in our books for many years now — almost all of it is pre-2013. There was no specific sector that prevailed, it was a fairly generic mix of shipping, property, and oil and gas."

According to Power, 2017 will still be a challenging year but the group should be able to return to profit as the bulk of the provisions has already been made.

"Yes, there'll probably continue to be provi-

sions — in banking there is always the risk of further provisions as we are in the business of managing risk but obviously, the view would be to start bringing the provisioning numbers down quite significantly over the next couple of years, as well as the NPF ratios, and then start building up a solid foundation of new businesses, moving forward," he says.

Power declines to reveal its key targets over the next few years, saying only that the group plans to double its assets and liabilities over the next four years. It also wants to take its NPF ratio down to a more normal "1% to 2%" over the next few years.

Building retail

He says the focus this year is to build its balance sheet and stabilise its structure to compete in the market. It is also placing greater focus on building its retail banking business as part of a portfolio rebalancing.

"We haven't been that focused on retail banking. So, we've brought in a retail flavour this year, which is something new to the organisation. There's been a significant reliance on corporate revenue streams and when things start to go bad, as they had done [in the past], it really impacts our revenue. So, one of the things we've done is bring in a really strong retail banking team," he says.

Interestingly, Power, a South African who has over three decades of banking experience, was formerly the group chief retail and private banking officer at KFH in Kuwait. The role also saw him overseeing the retail and private banking franchise in Malaysia, Turkey and Bahrain.

"You'll see, as the year goes, there's a number of new things that we've got coming through — new products and services, new ways of dealing with our customers. We're trying desperately to think 'simpler, better, faster' ... it has to be a cornerstone of what we do. And part of that as well is the customer interaction. For too long, most banks — we're not the only ones — don't take accountability for customer complaints, or customer engagement.

"Now, no matter who you are in the organisation here, if a customer engages with you, you see that engagement through to the end. You don't just pass it on or hand it to somebody else to get it sorted out. So, that's been quite a cultural change," he says.

"If we're going to become credible, if we're going to become effective in the market here, we have to change the way we do business. So, [the change] is around our customer engagement, our process, how we engage our staff as well, and our leadership. I think that's fundamental in the values we have as a bank."

The moves to fix the retail franchise are starting to show results.

"The retail franchise, to a large degree, is now stable and starting to grow. Every month, we're seeing incremental growth in financing, we're starting to see better spreads on our margins, and we're starting to see new customers opening accounts with us. So, from my perspective, retail is now starting to turn the corner in terms of the business."

With that, the group is now looking to improve the corporate banking side.

"Corporate banking has been through a tough time and I think everyone out there knows that. We've maybe made some bad mistakes in terms of some decisions we have taken. Our risk strategy has not necessarily been as robust as it should have been. So, a key focus of mine in the last three months has been to rebuild that whole risk strategy.

"We recently appointed a new CRO [chief risk officer], who has assisted us in building a new risk function and framework ... the key role is to ensure that we place the right assets onto the book and at the same time, effectively manage the existing assets of the bank. We now have a new head of market risk, a head of retail credit risk, a head of corporate credit risk, as well as a new chief of risk architecture. So, we've now built a really robust credit team,

'This time, the turnaround will be sustainable'

When Kuwait Finance House Malaysia Bhd (KFHM) first started operations in August 2005, there were high expectations that, being part of a global banking group, it would lead the way in Islamic banking innovation and help take the local industry to a new level.

But, like the other two Middle East banks that opened here later — Al Rajhi Banking & Investment Corp. (M) Bhd and Asian Finance Bank (M) Bhd — it made little headway.

KFHM ran into turbulence from FY2009 to FY2011, incurring losses after having to make massive provisions for bad financing, causing much scandal in the industry. This was shortly after the global economic downturn, but critics say its problems were also because of weak leadership, lack of corporate governance and lax risk management practices in the earlier years.

It turned in its worst performance in FY2011, with net loss of RM471.6 million and gross non-performing financing ratio at 23.2%.

Bank Negara Malaysia came down hard on it, and the group managed to return to the black in FY2012 after a change in leadership and concerted efforts were made to clean up its books. But it

did not stay profitable for long. — In FY2015 and FY2016, it posted losses again because of high provisions, mainly for the legacy portfolio.

"Without going into too much detail, I think there were two reasons we had these issues," says David Power, the group's fifth and current CEO, on KFHM's persistent battle with asset quality issues.

"One of them was that we name-financed — that is, lending to companies with sizeable assets, but not necessarily the cash flows to pay us — and the other was that we didn't have a robust enough risk infrastructure. That has since changed.

"We were involved in oil and gas financing, to a degree, but we were more extensively involved in property, but on the property development side... so things like the Pavilion and Sunway developments. All that [ended up] working out fine, but we needed to spread our concentration instead of focusing on just one sector... and that's what we're doing now."

With KFHM not giving it the desired returns, its shareholder — the world's second largest Islamic bank by assets, Kuwait Finance House KSC (KFH) — in 2015 looked for buyers for the Malaysian asset. However, in late 2015, it changed its mind following a change in leadership and global strategy. It started

looking to build its global operations as a bank, and Malaysia was a key piece of that strategy.

As at last year, of its global operations that include Turkey, Bahrain and Jordan, KFHM and the Saudi Arabia operations were the only ones making losses.

Power says he expects KFHM to turn around this year and believes that this time, it will be sustainable, given the fundamental changes that have taken place and the plans for the group. He hopes to start paying the shareholder dividends from next year.

There may be some scepticism in the market about the group returning to sustainable profitability, given the number of times it has faltered in the past.

To that, Power says, "I can only echo the words of the KFHM group CEO [Mazin Al-Nahedh] on his recent visit here — we've poured in significant amounts of money to make sure that this bank becomes a significant contributor, and we've sent our best people from Kuwait here. So, we are stronger in our commitment to Malaysia than we've ever been."

Can Power pull it off? Only time will tell, but he has certainly set the wheels in motion.

whereas in the past we didn't have these key positions," Power says.

Unlike before, the group's corporate banking team now works closely with the credit risk team.

"Now, credit risk and corporate and, to some degree, the shariah team, go out and visit customers as a unit. We find that our customers are absolutely loving this because they get advice on all three aspects at once... and there's no other bank that does this. I think there're some really good opportunities for us in doing this," he says.

On the corporate side, the group has narrowed its financing focus to a few key sectors, namely property, education, infrastructure and healthcare. Power says, unlike before, the group no longer targets big-name companies with sizeable assets.

"I think for too long, we had been a name-financier here, where we financed companies against their assets, and as a result, we got caught [in a bad situation]. Now, we are no longer an asset financier; we finance based on customers' cash flow. Their business needs to show us that it has the ability to pay us through their cash flow," he says, adding that this is one of the key changes recently implemented in the risk profile of the bank.

"We're going for the second-tier and mid-sector (companies) in the business banking arena. In any case, if you start playing at the top level, your margins are so fine, you're probably doing it at breakeven or a loss, and we can't afford to do that."

On retail banking, he says the group will be actively pursuing the personal financing business, and will continue to play in

the areas of its parent company's strength, namely mortgages and car financing. Personal financing accounted for a tenth of its gross RM6.86 billion portfolio last year.

"A strong competence of KFH is mortgage lending, car financing. We have innovative car finance products globally, but that isn't available locally yet, so there're opportunities for us to really expand. We're talking to large car dealerships at the moment to partner them," he says.

Digital niche

KFHM is investing heavily on a digital strategy to carry it into the future. It is developing its digital banking transformation that will focus on three main areas — internet banking, mobile banking and its website.

"Look, we're in a unique situation — we're

a small bank and we have the ability to disrupt the market because we can be far more agile. We don't have the Maybank scale, but we have the ability to disrupt the Maybank scale in terms of the strategies and the services we provide. So, you don't need to be a rocket scientist to understand we're focusing heavily on the digital [sector] at the moment," Power says.

From a capital expenditure perspective, the group has set aside RM38 million this year on advancing core initiatives, which will include a core banking upgrade.

"Phase 1, which is in motion, is about re-engineering our entire electronic and mobile banking platform. Phase 2, which will kick off fairly soon, is to build a very robust digital platform," he says.

It expects to have an edge over rivals by partnering a financial technology (fintech) firm.

"At present, fintechs are looking for Islamic partners, and they don't have any in Malaysia yet. If you look at the fintech guys from Singapore and India, they're looking to partner with a pure Islamic business. We have already identified who we want to play with. Initially, [the partnership] will relate to retail banking and then we'll expand as we go," he says, declining to reveal more.

Part of the three-year road map that Power and his team are working on is to explore inorganic growth opportunities.

"We have to see a doubling of the balance sheet over the next four years. So, we have to grow, and part of that is the whole digital road map that we're embarking on. We have to drive down our cost-to-income ratio to the upper 40% or lower 50% level in the next three years (from about 72% last year), and digital plays a key role here," he says.

Having branches remains important for the group and it plans to open three or four more over the next three years, to add to the 14 it has now.

"If we want to see KFHM getting some sort of scale, we can't do it organically. We have to look at some form of acquisition. But my key focus right now is to get the bank stable, profitable and to a situation where the back-end is strong enough to handle any form of acquisition," he says.

So, is the worst over for KFHM? "I sincerely hope it is. I think we can't take anymore shocks to the system." ■