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Issued and paid up capital KD 262,500,000
Commercial Registration Number 24067
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ص.ب: ٥٣٨٩، الصفاة ١٢١٧٠
دولة الكويت
هاتف: ٢٢٩٨ ٨٠٠٠ ٩٦٥+
فاكس: ٢٢٩٨ ٨٤١٩ ٩٦٥+
رأس المال المصرح به ....٤٠ د.ك
رأس المال المصدر والمدفوع ......٢٦٢،٥٠ د.ك
سجل تجاري رقم ٢٤٠٦٧

بنك برقان
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Date: 23/11/2020
Ref: 636/2020

الكويت في:2020/11/23
إشارتنا : 2020/636

M/s Boursa Kuwait

السادة / شركة بورصة الكويت المحترمين،،،

Dear Sirs

تحية طيبة وبعد،،

Sub: Transcript of Burgan Bank K.P.S.C. Analyst Conference for the 3rd Quarter 2020

الموضوع: محضر مؤتمر المحللين لبنك برقان ش.م.ك.ع. للربع الثالث من عام 2020

Reference is made to the above subject and in compliance with the provisions of clause (4) of article (8-4-2) of Boursa Rule Book; attached is the transcript of the Analyst conference that was held via phone at 02:00 pm, Wednesday, corresponding to 18/11/2020.

بالإشارة إلى الموضوع أعلاه، والتزاماً بأحكام البند (4) من المادة (2-4-8) من كتاب قواعد البورصة، مرفق لكم طيه محضر مؤتمر المحللين والذي تم عقده عبر الهاتف في تمام الساعة 02:00 ظهرا من يوم الأربعاء، الموافق 2020/11/18.

Best regards,

وتفضلوا بقبول فائق الاحترام،،،

خالد فهد الزومان
Khalid Fahad Al-Zouman
رئيس المدراء الماليين للمجموعة
Group Chief Financial Officer

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BURGAN BANK

Q3 '20 Earnings Conference call Transcript

Wednesday, 18th November 2020

Q3' 20 Burgan Bank Earnings Call

Monday, 23rd November 2020

Transcript of Burgan Bank Earnings Conference call

on Wednesday, 18th November, 2020 at 14:00 Kuwait time (UTC+03:00)

Burgan Bank Participants:

Mr. Raed Al Haqhaq	Deputy Group Chief Executive Officer & CEO- Kuwait
Mr. Khalid Al Zouman	Group Chief Financial Officer
Mr. Naveen Kumar Rajanala	Group Head of Strategy & Capital Management

Operator:

Good day and welcome to the Burgan Bank Q3 2020 Results Conference Call. This conference is being recorded at this time. I would like to turn the conference over to Elena Sanchez. Please go ahead.

Elena Sanchez (Moderator):

Thank you. Good afternoon, everyone. This is Elena Sanchez and on behalf of EFG Hermes, I would like to welcome you all to Burgan Bank's Q3 2020 Results Conference Call. It is a pleasure to have with us the following speakers from Burgan Bank: Mr Raed Al Haqhaq, (Deputy Group Chief Executive Officer and Chief Executive Officer – Kuwait), Mr Khalid Al Zouman, (Group Chief Financial Officer) and Mr Naveen Kumar Rajanala, (Group Head of Strategy and Capital Management). The call will begin with a presentation from Burgan Bank on the key highlights of Q3 2020 and then we can open the floor for Q & A. Mr Raed, please go ahead.

Raed Al Haqhaq:

Thank you, Elena. Good afternoon everybody, welcome to Burgan Bank Group Earnings Conference Call. I will start with slide number three. This slide covers the revenue, which as you see has increased from KD 47 million to KD 57 million, the net income from KD 6 million to KD 10 million (from the second quarter to the third quarter). As far as efficiency is concerned, we have managed to control costs by reducing operating costs from KD 23 million to KD 22 million and as a result, there is a healthy reduction in the cost to income ratio from 49% to 39% (of almost 10%).

As far as capital ratios are concerned, our CET1 continues to be healthy at 10.7%, above minimum required. Our overall CAR is at 16%, well above the minimum required. Liquidity wise, our NSFR is at 110.4%, above the 80% requirement, and the LCR is at 134%, above the 80% minimum requirement.

Slide number four: This is where I would like to highlight the revenues and margins. I'll focus on the second and third quarter on your right-hand side. You can see that our total revenue increased by 21% from KD 47 million to KD 57 million. In terms of the components of the revenue, our non-interest income increased from KD 15 million to KD 23 million and net interest income increased from KD 32 million to KD 34 million. Net Interest Margin increase of 10 basis point is mostly due to the reduction in the cost of funds. The increase in the non-interest income is mainly due to increase in the trade finance activity, which is mostly LC's and LG's.

The following few slides will be covered by Mr Khalid.

Khalid Al Zouman:

Okay, thank you, Mr Raed. On slide five, we present our operating expenses evolution. We have seen during the past quarter how we tried to reduce our expenses As Mr Raed mentioned earlier, and as we mentioned in the last investor call, at the end of Q1 that there were initiatives within the bank to reduce our costs. We have seen this reflected in Q2 and Q3. Overall, I expect our operating costs to be lower by 8% to 10% from 2019 levels. A detailed exercise was done to reduce the budget expense numbers, and hence overall, we think there will be a reduction compared to 2019 levels.

Slide six, it shows the evolution of our cost of credit. Actually, you'll see that it's high, and it is because of CBK precautionary provisions. The Central Bank thinks that the second wave is still to come in terms of the pandemic and it might impact in the next quarters. So, as you know, during our last call, we said that Central Bank asked us to book KD 10 million and this quarter they asked us for KD 7 million (as provisions). You will see the change in the provisions also, Burgan Bank, even without Central Bank request, within the KD 15 million of provisions you see in Q3, we have billed an overall provision, just as a precaution for ourselves in discussion with the management.

But overall, I think that normalised cost of credit is about 1.2%.

If we go to slide number seven, which shows the net income, it is actually the reflection of our higher credit costs and our cost optimisation process. Also because of the CBK discount rate cut which was effected in Q1, our revenues have been affected drastically. That's why compared to Q2, in Q3 when the lockdown finished, things are coming back to normal a little bit, but not much. Hence, we think we are rebounding with our bottom line.

In slide number eight, it talks about our asset quality, provisions and coverage ratio. In Q2, the main change is that BBT has incurred some NPL's which impacted our Q2 NPL ratio and our Coverage ratio. However, if you look at Kuwait, it has still maintained a good quality loan book so far. Between Q2 and Q3, the main change has been because of the FX devaluation on the Turkish Lira. When we convert the NPL's, especially of Turkey, there is a reduction in KD terms and that's one of the main reasons our NPL ratio and our coverage ratio has improved.

So, we believe that we still have a good coverage ratio above 200%. Kuwait has shown that they have maintained a good asset quality in our books.

And from here, I will pass to Mr Naveen, he will take you through slide number nine onwards.

Naveen Kumar Rajanala:

Thank you, Mr Khalid. So now let's look at how the balance sheet has progressed in Q3. So, the key message here is the Kuwait balance sheet continued to grow, relative to the end of 2019. In the last three quarters in 2020, the Kuwait balance sheet has grown by KD 250 million, and the international balance sheet has shrunk. The reduction is more a proactive strategy to make sure that the growth is contained specially in Turkey as we've been saying over the past few quarters. There's also a little bit of impact of the Turkish lira devaluation to reduce the international loan book. But the loan book continues to be well diversified. We do not have any particular sector which is hurting our loan book specifically.

So that's on the loan side, if we can move on to the next slide, which is talking about the deposits. Even on the deposit side, in the Kuwait balance sheet, you can see that there's a substantial increase in access to customer deposits over the last nine months. The deposits have grown in excess of KD 350 million.

Access to liquidity continues to be fairly strong. It was always strong in Kuwait and it continues to be strong in Kuwait and that access to liquidity remains fairly strong across the group as well. Our CASA balances usually trend around 30% plus, so we're at 32%, and all in all, from a deposit point of view it's a good story even in the light of the current crisis.

If you move to slide number 11, to give you a picture of capital levels. As mentioned in the previous investor call, in Kuwait, the regulator has allowed a reduction in the required capital ratios on an interim basis. The expectation or the initial communication was till the end of the year. So, we're not sure if that's going to be extended. Since March the requirement for the minimum capital and CET1 has fallen by 2.5%, which is due to the removal of capital conservation buffer. We've taken a conscious decision to maintain our capital levels above the original minimum.

As you can see, the total capital levels are trending above 16%, which is where we typically operate and at a CET1 level it's around 10.7%, above the original minimum of 10.5%. However, the regulations do not allow the inclusion of interim profits in the capital. So typically, we see at the end of the year that these ratios go up while these ratios typically fall during the year as the balance sheet grows.

Just covering the liquidity side of things as well. As I said, right at the beginning, when we were covering deposit, liquidity and access to liquidity across the group continues to be strong. Even though the minimum Liquidity Coverage Ratio and Net Stable Funding Ratio requirements have been dropped for the sector to 80%, we continue to be well above 100% and in Q3 even stronger at 134% for Liquidity Coverage Ratio and 110% for the Net Stable Funding Ratio.

With that, I'll hand it back to Mr Raed to cover the last two slides.

Raed Al Haqhaq:

Thank you, Naveen. Look at slide number 13, this is the breakdown of the Kuwait and the international operation. You can see, Kuwait continued to be the largest franchise with total loans of 74% and net income contribution of 84% (of the total). Revenue increased from KD22 million to KD 32.5 million (Q2'20 to Q3'20), expenditure also increased slightly from KD 8.9 million to KD 10.8 million. In terms of provisioning, there is a reduction here from KD 12 million to KD 7.5 million. Like Mr Khalid said, this is due to the KD 7 million precautionary provisions that we have taken. As far as net income, it's moved from KD 0.8 million to KD 13.9 million.

In terms of major KPIs in Kuwait, the net interest margin increased from 1.4% to 1.6% (Q2'20 to Q3'20), Cost to income ratio, a reduction from 40.6% to 33.1%, and costs of credit decreased from 1.4% to 0.9%. Please keep in mind that the cost of credit was majorly affected by the KD 7 million precautionary provisioning that we have taken. NPL ratio is healthy at 1.6% against 1.7% on the second quarter.

As far as the international operations are concerned, the total contribution is 26% from total loans and net income contribution of 16%. Revenues increased from KD 24.1 million to KD 26.9 million, and a reduction in expenditure from KD 12.1 million to KD 10.7 million. Provisions increased from KD 6.8 million to KD 10.9 million due to the current circumstances. The net income is stable at KD 2.7 million against KD 2.6 million for the last quarter.

The international operations KPIs are net interest margin 4.2% against 4.5%, cost to income ratio 39.8% against 50.2%, a good reduction from the second quarter to the third quarter. And the cost of credit on the third quarter is 3.7% against 2.2%. The NPL ratio, is a reduction from 13.1% to 12.4%.

The final slide is the summary. As you know, all of the institutions including us have been affected by the pandemic. However, we are seeing recovery evidenced by our results from the second to the third quarter. Kuwait continues to be our core focus and this is where most of the growth is targeted. We, as always, continue to help our clients during this difficult time and support them and all of their financial needs.

I believe we can start with the questions if you don't mind.

Moderator:

Sure. Thank you. Operator, if you can please indicate how to place a question. Thank you.

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 telephone 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. Once again, please press star one to ask a question. We will take the first question from Aybek Islamov from HSBC.

Aybek Islamov:

Yes. Thank you for the presentation. So, I had a couple of questions with regards to your performance. The first one, could you comment on your ability to reduce the cost of funding further? And also, on a similar note, I've seen a decent drop in repo rates as a reaction to lower discount rate in Kuwait and possibly some other factors like Turkish lira movement. Do you think you are at the bottom on your asset quality or do you think they can go lower? So that, that's my first part.

And secondly, how do you think about the cost of risk asset quality in Kuwait? You know, to what extent do you think the Central Bank will now manage the specific cost of risk or precautionary cost of risk? So that's asset quality.

And thirdly what do you think of the growth outlook in general in Kuwait? Where do you see the public sector spending? How is the parliament approving projects? What's the approval execution like? You know, is it helping you in terms of the loan growth pipeline or not? And that's all. Thank you.

Naveen Kumar Rajanala:

Thank you. So, if I just summarise all the points that you asked for, so one starting with funding costs, then NPL and the outlook for that cost of risk and more from a precautionary point of view, and then lastly growth outlook in Kuwait. Maybe I'll pick up the first one, net interest margin and funding costs implication on that and the NPL, then I'll ask if my colleagues want to kind of look at precautionary and the growth outlook for Kuwait.

So, in terms of funding costs, what we've seen as a trend, as Mr Khalid had pointed out the Central Bank discount rate has clearly impacted the yield, but typically in our business, the yield reduction happens pretty much overnight, whereas the funding costs take some time to catch up. Now we've seen some impact of the catch up in Q3 where the margins improved by 10 basis points. We probably have room for another 5-10 basis points if the trend continues. But then again, there is pressure on the yields as well. So, I think the margins and outlook, as things stand today, is potential upside of 10 basis points at the most by the end of the year and then stabilise till the interest rate outlook and the interest rate environment changes.

So that's only the margins and funding costs. Again, I don't know if I've addressed your question or if you have anything on that particular point.

Aybek Islamov:

I think, yeah, you've covered that. Thank you.

Naveen Kumar Rajanala:

On the NPL's, yes, we have obviously reduced the NPL ratio between Q2 and Q3. And as Mr Khalid pointed out, one of the factors is the devaluation and also Turkey has taken some measures to reduce it further in Q3. Our outlook is that this is potentially the bottom, and I say bottom in the sense of you know, the NPL peaking. We hope that this then naturally and gradually comes down. There are many factors at play obviously, difficult to kind of estimate that, but our drive is to make sure that this goes down and potentially closer to the 4% level or slightly south of it. But again, it depends a lot on the way things shape up in the next 45 days or so.

On the precautionary, I'll ask my colleagues to give a bit of a direction in terms of where precautionary would go going forward.

Khalid Al Zouman:

Mr Raed, do you want to comment on the precautionary?

Raed Al Haqhaq:

You go ahead. I'll take the last one, please.

Khalid Al-Zouman:

Okay. I think the Central Bank's view on this pandemic is that it has a three-year impact. The Central Bank thinks even if the banks manage their books this year, maybe things will impact in 2021. There was a discussion between the banks and the Central Bank – do you remember the issue about banks do not take profits or pay dividends? Do remember there was a confusion a few months ago about this which came in the newspaper?

So, I presume for the time being the Central Bank will continue also in Q4. I think they will come back to the banks and ask for precautionary provision. Whether this will continue, all depends. I'll leave that last question to Mr Raed as our DGCEO to talk about the government spending and going forward in terms of the expectations in the Kuwaiti market and growth for next year. There is no question, we have a long discussion with our economists and considering all the variables- We have new leadership, and we expect that things will improve. That's our feeling as citizens, and we expect that there will be some growth in the economy.

So, I leave it to Mr Raed to conclude the last question.

Raed Al Haqhaq:

Thank you, Mr Khalid, you are absolutely right. Even in the middle of the pandemic which is April-May and during the full curfew, government payments did not stop. Matter of fact, they have escalated. So, all of the contractors, the ones that we are financing have been receiving payments faster even than normal years. As far as the government spending, there is no slowdown in any existing project. All of them are operating at the same rhythm, mostly in the oil sector, medical and operating sector of the economy.

On top of that, the deposits have been extremely healthy and you can see it due to the fast reduction in our cost of funds. As you know, Central Bank discount rates decreased where we are repricing our loan portfolio overnight, but we still are running a liquidity ladder where the deposit will be repriced on maturity. This is where you can see that our cost of fund, like Mr Khalid and Mr Naveen said, is dropping fast. We are now almost at the level before the Central Bank of Kuwait reduction.

So, the economy is healthy, the target to grow for us in Kuwait is 6% to 7% as we have highlighted. And we have achieved so far almost 80% of that growth. As far as the Kuwait economy, the expected growth is around 4% to 5%.

I hope I have answered this question.

Aybek Islamov:

Yes, thank you. Thank you.

Operator:

The next question from Conrad Legaspi of MUFG bank.

Conrad Legaspi:

Hi, good afternoon, everyone. Just a quick question on the NPL. Is there a breakdown of NPL amount and the ratio in each of the foreign markets that Burgan Bank operates in? Like in Turkey, Algeria? We know the domestic portfolio is good (asset) quality, but in the foreign side, just give us sort of a breakdown on how the countries are performing in terms of NPL and the amounts and ratio. Thank you.

Khalid Al Zouman:

I can take this question. Oh, go ahead Naveen

Naveen Kumar Rajanala:

No, please go-ahead sir. Yeah. Okay, I will go ahead and Khalid, you can add in if I miss out anything. So, if I understood your question, you wanted a breakdown of the NPL ratio for the international operation. Let me start with Turkey, NPL as of the end of third quarter was 15.3%. But let me just add the caveat here that this NPL number is based on CBK guidelines in CBK calculations. So, under BRSA, the number is different, from a like for like comparison this is not comparable to a typical Turkish bank, which operates under BRSA regulations. So, that's Turkey.

In Algeria the portfolio quality remains strong. It's NPL ratio is 1.4%. Tunisia is a small operation but nevertheless, the NPL ratio is 0.3% and Bank of Baghdad, continued its NPL ratio at what it used to be. The reported number used to be in late seventies, now it's gone up marginally to about 86%. But just to add a little bit of context to Bank of Baghdad numbers, the loan book there has not been growing for the last many years, which is a proactive piece of strategic action that at group level we're doing so that the credit risk within the organisation is contained. They're more focused on non-interest income revenue generating activities, like FX and cash management. So that's from me, Mr Khalid, unless you want to add something

Khalid Al Zouman:

Absolutely, the numbers are as you explained.

Conrad Legaspi: Thank you.

Operator:

As a reminder to ask a question, please press star one. We will now take our next question from Janany Vamadeva from Arqaam Capital.

Janany Vamadeva:

Thank you, Naveen and team for the presentation, I have a couple of follow up questions actually. Probably I missed it at the start with the presentation. Could you give some colour on the payment behaviour of your corporate book, because now the deferral programme has ended like in September/ October, and I think a big chunk of your corporate book was on the deferrals. So, have they all started to pay? And if you could talk a bit about the payment behaviour and implications on cost of risk arising from that.

And the second question is around NIM. There was a 12.5 BPs rate cut recently, does it have any impact at all on the NIM outlook? Like, what does it really impact in terms of the asset side, liability side, and what is the implication for Burgan's NIM outlook?

And my last one is around cash coverage. Is there any chance you could give us the cash coverage? Because in the presentation it includes collateral as well on a quarterly basis. Any chance you could give us the cash coverage, if possible, that would be helpful. That's all for me, Naveen.

Raed Al Haqhaq:

Thank you so much. I'll take the first one. And then Mr Khalid and Mr Naveen, they can follow on the other questions. As far as corporate banking, as you know that our loan book is majority corporate. After the deferral, as of now over 95%, have covered their dues and we are expecting before the end of this month, that all of them will do so. This is supported (by the fact) that our financing is mostly contract specific. As long as the government, who is the main contractor of these clients, with little bit of the private sector, that they are paying them on time, matter of fact, some of our clients have chosen not to take the postponement. So, by end of this month I would say all of them will cover (their dues). As of now, almost 95% already covered.

Naveen you can go and Mr Khalid on the second one.

Naveen Kumar Rajanala:

So, let me just cover the cash coverage at group level is 132% or 131.9%, excluding collateral. I couldn't follow your second question. If you could repeat the 12.5 basis points cut?

Janany Vamadeva:

Yes. There was a rate cut by the Central Bank, the repo rate, 12.5 BPs about a few weeks ago. Does it have any impact at all on like either side of your balance sheet?

Khalid Al Zouman:

Can I answer some of this, if you don't mind, Naveen? I think this move is good from Central Bank. They are easing the cost on the KD. It's good for us. It will ease the cost of funds on the KD. It has impact, not significant, but it has an impact on easing on the cost on the KD itself.

Janany Vamadeva:

Right. Thank you. That's helpful. Thank you.

Operator: We will now take our next question from Waruna Kumarage from SICO Bank. Please. Go ahead.

Waruna Kumarage:

I have a couple of questions. Can you hear me?

Raed Al Haqhaq:

Yes, please. Go ahead.

Waruna Kumarage:

Yeah, So the first question is on the expenses side. I want to know whether you have received any compensation similar to the one your peers got from the government on Capex cost in the third quarter?

Raed Al Haqhaq: Yes, we did.

Waruna Kumarage:

Is it like significant, I mean in the overall context or is it not very significant?

Raed Al Haqhaq:

Mr Khalid, can you elaborate on that please?

Khalid Al Zouman:

Not that significant, not significant to us.

Waruna Kumarage:

Okay. And the other thing is when I look, I mean, based on segmental information, it shows that the Kuwaiti segment, expenses actually increased quarter over quarter. So, can you tell what's driving these expense increase?

Raed Al Haqhaq:

Sure. As we have mentioned at the beginning of the year, we are revamping our IT system. We have started by changing our core banking, and then we have added the middleware. Currently we are updating all the remote channels, which is the touch point, whether it is the app or the website, and we have done now four upgrades and we still have three more to go. So, all the expenditure, the one that you see is mostly towards our investments in technology, including cybersecurity, of course.

Waruna Kumarage:

Okay. Thank you. That's very clear. And lastly, on the non-funded income. Now, you have done a very impressive performance in the third quarter. What I want to know is where are the areas that you have done especially well, especially in the case of Forex income. I mean, it's very healthy this quarter. So, can you elaborate a bit on the sustainability of this line going forward? What do you think about the outlook of the Forex income as well as the investment income?

Raed Al Haqhaq:

Absolutely. As I have mentioned, the trading activities started in corporate, which is the main source of the non-interest income for us, the LC and the LG. If you can see that it is almost at the same level as 2019.The enhancement has been due to the lag effects, honestly, during the partial curfew or the full curfew. A lot of the LC and LG which had not been submitted earlier, have been submitted now. The effect is a reflection of that.

Waruna Kumarage:

Okay, but lastly, we can expect if the economic activity normalises, this will be sustainable. Right?

Raed Al Haqhaq:

Absolutely. We are ranging between KD 20 million to KD 25 million when it comes to the non-interest income and we are now at KD 23 million.

Waruna Kumarage:

Okay. Thank you. Thank you, gentlemen.

Operator:

We will now take the next question from Rakesh Tripathi from Franklin Templeton investments.

Rakesh Tripathi:

Thank you very much. I just had one question about your capitalisation levels. Have you such plans now or in the near future to boost your capital adequacy sufficiently?

Raed Al Haqhaq:

I'm sorry, honestly, the sound at my end it's not clear. I don't know if it's the same thing with Mr Khalid and Mr Naveen. I could not, I couldn't hear it.

Khalid Al Zouman: I could not hear anything.

Naveen Kumar Rajanala:

Okay. Can I just repeat what you said and let me know if that's correct? So, you're saying that your question is on the capital levels and given that it's a little tight on capital, is there any plans to increase capital? Is that the correct question?

Rakesh Tripathi: That's my question. Okay.

Naveen Kumar Rajanala:

All right. I can answer that. So, as I said during the year typically, especially in Kuwait, where interim profits are not a part of your capital and RWA is increased due to asset growth, the capital ratios decline a bit and then they pick up at the end of the year. Having said that, specifically in Kuwait, we have the dispensation from the regulator where the regulator has dropped the capital requirements by 250 basis points. We typically as a bank you know, we like to maintain total capital around 200 basis points over the minimum total CAR. So, so for minimum CAR usually is 14%, so we operate around the 16% level. At a CET1 level, we typically have operated around 11.2% to 11.5%, which is about 100 basis points over minimum. So, and we've managed to keep those levels, even during these difficult times and we expect the ratio to recover beyond 11% by the end of the year. And thereon what we'll try is to maintain it around the 11%, plus/minus a little bit.

So, at the moment, there is no imminent capital increase plan. We do not see a need for it at this point in time.

Rakesh Tripathi: Yes, that answers it. Thank you very much.

Operator:

There are no further questions in the queue, I will hand the call back over to your hosts for any closing remarks.

Moderator:

Mr Raed, would you like to make any final remarks?

Raed Al Haqhaq:

Thank you everybody for joining us and really appreciate all of your questions. If you have any further questions, please do not hesitate to contact us by email or give us a call. We are always available. And I hope everybody's safe. Thank you so much.

Moderator: Thank you.

Operator: Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen, you may now disconnect.