ASX/POMSoX announcement

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KINA SECURITIES 2017 FULL YEAR RESULTS MEET EXPECTATIONS IN LINE WITH MID-YEAR GUIDANCE

Financial highlights Full Year 2017

- Statutory net profit PGK23m
- Underlying net profit of PGK30m
- Final dividend of PGK 10.0 toea/AUD4.0 cents per share. (Full year dividend to PGK15.00 toea/AUD6.0 cents per share)
- Net interest margin 7.6% within mid-year guidance
- Restored USD Correspondent banking arrangement with revenue flows of K 7.1m
- T1 and T2 capital ratio 28%, compared with regulatory minimum of 12%
- Maintained sound loan credit quality with arrears at 4.75% and total write-offs stood at PGK2.0m.

Kina Securities Limited (KSL) has reported a statutory profit of PGK23.0m and an underlying profit of PGK30.0m for the full year ended 31 December 2017, in line with mid-year analyst expectations and Kina's market update.

The financial result compares with statutory and underlying profit of PGK41m in the previous corresponding 12 month period.

The 2017 result was impacted by lower foreign exchange income in the first half year due to the lack of a USD Correspondent Bank partner and a one-off lease termination payment expense of PGK7.0m.

The 2H 2017 profit improvement to PGK20m reflected the restoration of the USD correspondent banking relationship. However, overall, the results continued to be impacted by the subdued business conditions in PNG arising from a foreign currency shortage. Despite these challenges, Kina continued to strengthen its Banking and Wealth Management franchises during 2017 to achieve the following operational highlights including:

- Growing loan market share from 4.8% in December 2016 to 5.8% at the end of December 2017. The total market is PGK12.6billion.
- Achieving 21% growth in loans of PGK125m for the full year compared with December 2016.
- Delivering a 16.8% increase in Business lending and a strong growth in Personal lending of 33.6%. Total loans now recorded at PGK746m before an allowance for losses of PGK13.3m for the Group.
- Launching a new Vision City branch in Port Moresby and increasing the number of transactional accounts by 26%.
- Progressing the fund administration agreement with Nasfund delivering a revenue of PGK3.5m in the second half of 2017.

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- Upgrading the core banking system and delivered new mobile banking applications for both corporate and retail customers.

Commentary

Kina Chairman Isikeli Taureka said the full year result reflected a solid underlying performance given the challenging PNG economy and circumstances faced by the Group with the loss of its USD correspondent banking partner.

“Kina has responded appropriately and effectively to meet those challenges. 2017 was a year in which we invested in our Banking and Wealth Management businesses, transitioned to new senior management, reinforced our technology innovation and developed new products and services. We plan to build on these solid foundations in the coming years.

“Our performance against our strategic priorities including ongoing delivery of profitable, quality lending growth; continued growth in the low-cost deposit base to reduce our cost of funds; and maintaining a strong prudential and conservative capital adequacy position were pleasing highlights of the result.

“This progress has put us in a good position to take advantage of market opportunities as they arise in 2018.”

Kina Chief Executive Officer and Managing Director Greg Pawson said despite the challenges faced in 2017, the business remained in good shape.

“In our Banking business, we have restored our USD correspondent banking relationship during the year. In addition, we have upgraded the core banking system and delivered new mobile banking applications for both corporate and retail customers. Our Wealth business also delivered the new Fund Administration contract with Nasfund which has commenced delivering revenues and customer benefits.”

Mr Pawson said Kina would continue to focus on building a track record based on a consistent and focused strategy and disciplined execution.

He said Kina has sharpened its strategic priorities for 2018 and beyond. “As the only integrated financial services company in PNG, our strategy is based on differentiation, value for money, and targeted market segments,” Mr Pawson said.

“Our vision is to become the best, dynamic, progressive and accessible financial services company in PNG. Aligned with this vision is our purpose to ensure our customers and communities are empowered to have financial independence and security. This aspiration is underpinned by technology and innovation,” he said.

Kina Bank

Kina Bank recorded net interest income of PGK72.4m for the full year, up 11% from the previous corresponding period. This was achieved by driving loan book growth while ensuring careful management of cost of funds and yield on interest earning assets.

Interest income from investments grew by 17% or PGK2.8m. Interest income on loans grew by 32% or PGK19.3m.

In 2017, bank fees and commissions income grew by 11%, reflecting growth in lending and retail customer segments. This assisted in cushioning the impact of the drop in foreign exchange income.

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Total non-interest income for the Bank was lower by PGK12.5m. As advised to the market in May 2017, the impact in H1 2017 is PGK10.7m in respect of loss of FX revenues. The acquisition of a new USD correspondent banking partner in July 2017 has enabled a restoration of FX revenues to PGK7.1m for the year. However, this is still lower than the prior year by PGK13.5 m.

Kina Wealth Management

The Wealth Management division delivered growth in the funds management, stockbroking and trustee businesses. Funds Under Management grew to PGK6.9b (10%) during 2017. This resulted in an increase in funds management revenue to PGK10.2m for 2017.

Kina's Funds Administration's agreement to provide services to PNG's largest superannuation fund Nasfund was progressed during the year. This agreement contributed PGK3.5m to revenue in 2017. The Funds Administration Service achieved revenues of PGK12.5m in 2017. Kina now provides Fund Administration services to 90% of the market. The Funds Under Administration have grown by over 60% to PGK11.0b.

Asset Quality

Overall asset quality was well managed during the year. The impairment expense was PGK3.3m in 2017, up marginally from PGK2.8m in 2016. Loan impairment expense as a proportion of Gross Loans and Advances (GLA) remained low at 0.4%. The write-offs during the year stood at PGK2.0m.

The Coverage ratio stood at 105% as at 31 December 2017 and is marginally lower than the levels at December 2016.

Operating Expenses

Operating expenses from ordinary activities for full year 2017, excluding the one-off lease termination payment expense, grew by 21% compared to 2016 reflecting the investment in new systems and infrastructure in supporting growth in core banking business and the funds administration business. Staffing costs grew to 53% of total cost up from 51%. Business operating costs including IT spend remain at 25% of total cost.

The Cost to Income ratio, excluding the one off lease termination expense, was 61%, up from 48% in 2016. The increase in the Cost to Income ratio was largely due to a drop in foreign exchange income. If the FX income had been at the level of the previous year, the ratio would potentially have been similar to that achieved 2016. Kina's key objective for 2018 is to manage the Cost to Income ratio down.

Capital

The capital of the business remains strong, with regulatory capital (T1+T2) at 28% of risk weighted assets (RWA), compared with a regulatory required minimum of 12%.

External environment

The PNG Budget announced in November 2017 estimated real GDP growth for 2017 will be around 2%. For 2018, the market expects a flat to downward GDP growth profile, despite the Government's expansionary fiscal policy. Domestic consumption remains weak and ongoing difficulty in accessing foreign currency continues to hamper business's ability to generate growth. The recent increase in commodity prices may provide relief over the medium term.

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PNG is still experiencing the impacts of the drop in global commodity prices as detailed in a recent World Bank report. The report reaffirmed that there is a positive outlook for agriculture commodities, due to improved weather and growing conditions. The report also highlighted that resources sector would be the main driver for overall GDP growth in 2018.

Outlook

Despite these challenges, Kina remains positive about its opportunities, given the growth in its Bank and Wealth Management franchises. Kina is well-placed to achieve growth given its ability to leverage its unique position in PNG as a diversified financial services company and the new opportunities available through technology innovation in the digital world. These important factors, in addition to Kina's highly engaged workforce, provide confidence about Kina's ability to perform solidly over the longer term.

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