3Q22 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

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Mazen Alsudairi
Head of Research, Al-Rajhi Capital

Good day all, this is Mazen Alsudairi from Al-Rajhi Capital. Al-Rajhi Capital is proud to host Al Rajhi Bank Q3 2022 earnings call. Welcome all to the call. I will now hand over to Rayan, Head of Investor Relations, to introduce the management team.

Rayan Alshuaibi
Director Investor Relations, Al-Rajhi Bank

Thank you, Mazen. Good day, everyone and thank you for joining the call. Attending from our side, our CEO, Waleed Almogbel. CFO, Abdulrahman Alfadda, and GM Corporate, Hossam Albasrawi. As always, the CEO will start with the performance highlight and strategy update, followed by the CFO to cover the financial performance in more detail. Then we will open the floor for your questions. I would like to remind you that third quarter financials and today’s presentation are uploaded on our website and the investor relations mobile application. Thank you again for joining the call. Waleed, over to you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, Rayan. Welcome, everyone, and thank you for attending our earnings call for the third quarter of 2022. As always, we will go through our performance highlights and then an overview of our strategic performance. Now let us take a closer look at our third quarter performance, if we flip to the first slide.

For the first nine months of 2022, the bank continued to deliver strong performance across all business lines, supported by our strategic initiatives and improved economic activities. Starting with the balance sheet, we were able to deliver 19% growth year-to-date and 27% year-on-year. If we look on the asset side, the growth was mainly driven by financing portfolio, growing at 23% year-to-date and 32% year-on-year. The financing portfolio now reaching almost 557 billion. Mortgage recorded a growth of 40% year-on-year and now represents around 38% of our total book and 50% of our retail book. In addition, non-retail book grew by 65% year-on-year, supported by 65% growth in our corporate book and 60% growth in our SME book.

If we look to the liability side, total liabilities stand at 654 billion, an increase of almost 18% year-to-date and 26% year-on-year. LDR of around 88%, and it is still below the regulatory minimum. We also delivered a solid net income growth of 19% year-on-year, to reach 12.7 billion, driven by both net yield income, which increased by 10% and non-yield income with a growth of 23%. Our total operating income has increased by 13% year-on-year, standing at 21.3 billion. We continue to maintain best-in-class assets quality, supported by a positive economic outlook and good recovery. We maintain a healthy cost of risk, standing at 43 bps compared to 60 bps for the year 2021. In addition, the outstanding portfolio quality resulted in low NPL, standing at 55 bps, compared to 65 bps last year with a healthy coverage ratio above 270%. Also, several management initiatives supported the delivery of further cost efficiency, resulting in a market-leading cost-to-income ratio of 25.6%, an improvement by more than 1.6 percentage points year-on-year. Lastly, the bank maintains a strong financial position with a healthy capital ratio of 19.6%, well ahead of the regulatory minimum.

If we move to the next slide, allow me to give you an update on the progress of our strategy execution. To shed some light on the pillars of our strategy, we will start with the first pillar, building on the core. We continue to focus on retail as a core banking business for us. We have seen a financing growth of 70% in our retail book since we introduced our Bank of the Future strategy end of 2020. Also, our corporate portfolio has witnessed an outstanding growth of more than 100% since 2020, a result of our continuous effort to expand our corporate portfolio and reposition ourselves. Corporate book now represents around 19% of our total financing book. SME is an integral part of our strategy to position ourselves as bank of choice for SME. The SME book has more than doubled since 2020, with a growth of 136%, representing 18% of our non-retail book, compared to 15% in 2020. Demand deposits also continue to be one of our priorities, with a growth of 14% since the strategy inception. In addition, we continue to improve our revenue mix with our non-yield income as a percentage of our total operating income, standing at 22%, compared to 18% in 2020.

If we look to the second pillar, outperforming our competition, the bank continue to focus on delivering the best customer experience in the market across all business segments, helping us to maintain NPS leadership at 75%, compared to 66% in the fourth quarter of 2020. With regard to our loyalty programme, we have done a very good progress during the year, with the total registered customers increased by around 500,000 customers during the third quarter to reach 5.5 million, up from 2.4 million in 2020.

Moving to the third pillar, transform technology. Strengthening and improving our technology and digital infrastructure is a key to our success in capturing business opportunities and market leadership. Now digital to manual ratio stands at 92/8, compared to 83/17 in 2020. Additionally, online account opening reached 94% of the total retail accounts opening during the period. We have also seen an improvement in our end-to-end digital financing, which has reached now 27% of our personal finance. Relying on technology to improve our operation excellence, we increased the number of bots to reach almost 500, compared to 312 in 2020. As a result, our average transaction per month also witnessed a significant increase to reach now almost 700 million transactions, compared to 300 million transactions by end of 2020, in every month.

Addressing a new client's need is a key pillar of our strategy. Launching Emkan, our microfinance company, is one of the main item under this pillar, to enhance the product offering for the group. The financing portfolio of Emkan has more than doubled since 2020 and now standing at 6.6 billion. We continue also to improve our payment solution, helping us to further capture point of sale market share, which has reached now above 34% as of August 2022, compared to 28.4% in December 2020. Lastly, number of active customers continue to improve, supported by our best-in-class digital capability, reaching to almost 13 million customers, compared to 9.6 million customers in 2020, a more than 30% increase.

Now, if you allow me to hand over to Abdulrahman, our CFO, to give you more detailed update of our financial performance. Thank you so much.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

Thank you, Waleed. Good day, ladies and gentlemen. It is my pleasure to welcome you again in our Q3 earnings call. I will go over the financial performance slides very quickly so that we can have further time during the Q&A session.

Our total assets stand at SAR 741 billion, a 27% year-on-year increase and almost 4% on a sequential basis. To analyse the 19% year-to-date movement of our total assets, as you can see on the bottom left-hand side of the slide, our interbank placement has been reduced by 11 billion. This is part of the management action to further improve the average return on our average earning assets. Our investment book had increased by almost 21% and our financing book had increased by almost 23% year-to-date. Our funding profile has been well diversified over the year, where we have raised close to around SAR 117 billion, close to around 19% year-to-date growth. Where you can see that interbank borrowing, we have raised close to around SAR 54 billion, which include close to around SAR 4.4 billion worth of US dollar ESG syndicated loan that we have announced in Q3. Our customer deposits have increased by almost SAR 44 billion and our total shareholders' equity, including the Sukuk Tier 1 issuance that happened in January, we have raised a total of around SAR 18.8 billion.

Zooming in further into the drivers of the balance sheet movement, our total financing book stands at SAR 557 billion, which has recorded 32% year-on-year increase and almost 7% on a sequential basis. The retail book represents almost 76% of the overall financing, while non-retail is almost 24%. To analyse the 23% financing portfolio growth year-to-date, we have seen a broad-based growth across all business lines. As you can see on the top right-hand side of the slide, our mortgage book has increased by 26% year-to-date, ex-mortgage of the retail book by 8%, which will drive the total retail growth of around 16%. We had outstanding growth into the corporate as well as SME, by 52% and 47% respectively, which will bring the total non-retail book growth of almost 51% year-to-date growth. Mortgage book stands at SAR 214 billion, which represents almost 50% of the retail book and 37.9% of our financing book. Our customer deposits stand at SAR 556 billion, 16% year-on-year growth and almost flat on a sequential basis. CASA, as a percentage of the overall customer deposits have reached almost 70%. To further analyse the 9% year-to-date growth in customer deposits, as you can see on the bottom right-hand side of the slide, our demand has increased by almost 4 billion. Time deposits have increased by almost 35.5 billion year-to-date.

If you move to the profitability section, our net income for the quarter is at 4.3 billion, 15% year-on-year growth and almost 2% on a sequential basis. The sequential growth driver is highlighted on the bottom left-hand side of the slide, whereby the NII had increased by SAR 120 million, non-yields have dropped by close to around SAR 62 million, Opex have increased by SAR 41 million, while impairments have been reduced by almost SAR 90 million on a sequential basis. To analyse also the period income, our total net income for the period is around SAR 12.7 billion, which is almost 19% growth year-on-year. The main driver, as you can see on the bottom right-hand side of the slide, the yield income has showed around 10.4% increase, non-yield income by 23.3% increase, our Opex had increased by almost 6.1% and the net charges have been reduces by almost 6% year-on-year.

To further zoom into the net income driver, I will start with operating income. Our operating income for the quarter was 7.2 billion, 10% year-on-year and almost 1% on a sequential basis. Operating income for the period is 21.3 billion, almost 13% increase year-on-year. And the drivers, as you can see on the top right-hand side of the slide, our NII has increased by 10%. Although our average earning assets have increased by 30% year-on-year, but the NII went higher by only 10% due to the NIM contraction. Our fees have increased by almost 22% year-on-year, this is mainly driven by the payment revenues, where we have seen a further acceleration of the positive migration to the cashless payments coupled with increase in consumer spending and the increase in the market share under acquiring business. In addition, we have seen also the fee income which is correlated to the corporate growth, for example trade and cash management, we have seen a decent growth year-on-year. Exchange income increased by 52% year-on-year and other income was 7% lower. This is due to the lower dividend income, given that we have been rebalancing our equity portfolio in the second quarter.

Our NIM stands at 3.66%, which has showed an almost 55 basis point contraction, compared to average 2021, and almost 66 basis points compared to the same period last year. The driver of the NIM contraction is, as you can see on the bottom right-hand side of the slide, our retail book has contributed 47 basis points. Although the trend has been positive recently, where we are managing to reprice our assets. Corporate and treasury have showed around 11 and 13 basis points NIM improvement, given the SAIBOR impact. However, our cost of fund has impacted by 49 basis points on our NIM. This is for two main reasons. A, the increase on the SAIBOR. SAIBOR average for last year was 81 basis points, compared to almost 241 basis points for the first nine months. The second reason is the increase in the wholesale funding to support the overall financing portfolio growth. Finally, the management have delivered 6 basis points improvement, due to the initiative to improve the average earning assets. Finally, it is worth to highlight that as we have seen, given that our initiative to reprice our assets, if you recall in the second quarter, we managed to expand our gross yield by 13 basis points. In the third quarter, we managed to further improve the gross yield by 15 basis points, and we continue to expect that trend to further accelerate over the coming period.

To move on and analyse the second driver of the net income growth, our Opex for the quarter was almost 1.9 billion, 6.1% year-on-year growth and almost 2% on a sequential basis. Opex for the period is almost 5.5 billion, almost 6.1% growth compared to the same period last year. This is in line with the growth on the overall balance sheet of 27% year-on-year and also higher transaction value, compared to the same period last year. In addition, the bank has made strategic investments to execute and deliver the Bank of the Future strategy KPIs. Having said that, we have delivered 165 basis point cost-to-income improvement. This is due to the 690 basis point positive jaws, whereby operating income has increased by 13%, while Opex has increased by only 6.1%. Our cost-to-income stands at 25.6% for the period.

On the asset quality, our net charges for the quarter was 490, almost 17.5% year-on-year lower and almost 16% lower on a sequential basis, with cost of risk to be almost 43 basis points, compared to 62 basis points in the same period last year. Our net charges for the period was close to around 1.6 billion, which is an almost 6% year-on-year drop. This is mainly coming from the lower gross charge. If you recall, in Q2 we were saying in line of the IFRS 9 requirements, we have been updating our ECL model, taking into consideration the positive macro outlook for Saudi. To show the segment movement, as you can see on the bottom right-hand side of the slide, the release is coming from the retail book, given that 98% of that exposure is stage 1, while we top up the non-retail book, taking into consideration the 52% growth in non-retail financing book year-to-date.

Our NPL stands at 3.1 billion, 4% year-on-year higher and 3% on a sequential basis. To show the formation of NPL, although we have written off 3.4 billion since the beginning of the year, the net flow is around SAR 3.5 billion. Our NPL ratio stands at 55 basis points, which is almost 12 basis points lower compared to the same period last year. Mainly driven by the improvement on the non-retail book, whereby we have seen a 79 basis point improvement in our non-retail book, which stands at almost 110 basis points, while the retail NPL is flat year-on-year. Our NPL coverage is 272%, although we have seen it lower compared to the previous quarter, nevertheless, it is still higher compared to the average competition, where in Q2 the NPL coverage stood at around 113%.

Our ECL stock stands at around 8.5 billion as of Q3 and, as you can see in the movement on the top right-hand side of the slide, this is in line with updating our ECL model and portfolio growth onto the non-retail book. Our gross financing book stands at 566 billion, out of which stage 1 exposure is at 97.5%, compared to 97% last year, i.e., 50 basis points improvement to show the quality of the new origination that we are booking over the year. Stage 1 coverage is at 65 basis points, stage 2 at almost 20%, stage 3 at 66%, healthy and well ahead, compared to the competition.

Liquidity position remains healthy and within the regulatory requirements. Although our headline LDR at 100%, but our regulatory LDR stands at 88.4%, which is in line with our internal optimised level that we have been monitoring on a day-to-day basis. LCR and NSFR at a comfortable level and above the regulatory requirement.

Our total RWA stands at 479 billion, almost 21% year-on-year increase, mainly driven by the growth onto the financing book, whereby the credit risk RWA has increased by 23% year-on-year. It is worth to highlight that our RWA density stands at 64.7%, compared to 67.9% at the same period last year. Our total Tier 1 plus Tier 2 capital stands at 93.8 billion, out of which 94% is Tier 1 capital. Tier 1 capital ratio at 18.4%, while total capital at 19.6%. We have delivered almost 193 basis point improvement in our Tier 1 capital, as you can see on the bottom right-hand side of the slide. It is worth to highlight that although RWA, given the financing portfolio growth has contributed to a 232 basis point drop in our capital adequacy, however, that has been offset by 288 basis points of internal capital generation.

Finally, the bank's delivery of both a record quarter and period has further improved our return matrices. RORWA stands at 3.76%, our earnings per share for the quarter at 1.07, while for the period at 3.16, compared to 2.68. Our ROE is at a healthy level at 23.08% and our ROA at 2.5%.

Before we move on to the guidance, it is worth to highlight a few things. Number one, at the macro outlook. Despite that the IMF have revised the global GDP growth forecast, they still maintain a positive outlook for Saudi for this year and also for next year. We are quite positive about the growth outlook for the Saudi economy, taking into consideration the economic reforms and also taking into consideration the 2030 vision initiatives.

On the interest rate side, we expect that next week the Fed to hike 75 basis points and probably in December by 50 basis points, in addition to 12 rate hikes that have been delivered so far, which will add pressure to the cost of fund. Nevertheless, we continue to reprice our retail assets, taking into consideration the ex-mortgage of the retail book, as well as SRC have revised the mortgage rate in October by 50 basis points. The current mortgage origination are in the range of 6.0% to 6.5%. Finally, the bank will continue to focus on executing the Bank of the Future strategy.

Having said that, we are revising our financing portfolio guidance higher to high-20s. We are keeping the NIM guidance unchanged. We are revising higher, as well, our cost-to-income ratio to be below 26%. We are revising lower our ROE by 50 basis points, taking into consideration the bank's decision to preserve capital and not distribute dividends for the first half, which adds pressure into the denominator. For the cost of risk and the capital, we kept it unchanged. Waleed, back to you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, Abdulrahman, for the financial performance overview. The good progress made in our Bank of the Future strategy helped us to achieve such strong results. We will continue driving excellence to go beyond the unthinkable in creating a financial ecosystem that provides our valuable customers with innovative and smart financial solutions. Now, if you allow me, we will open the floor for Q&A session. Operator, back to you.

QUESTION AND ANSWER SECTION

Operator: Thank you.

If you would like to ask a question and have joined the call via Webex, please press the raise hand icon on your screen. If you have joined us on the phone, please press start followed by one on your telephone keypad now. Alternatively, you can use the Q&A chat box if you have joined the call via Webex. Our first question comes from Waleed Mohsin of Goldman Sachs. Waleed, your line is now open, please go ahead.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Thank you so much. I have three quick questions. First of all, if you can talk a little bit about the corporate growth momentum. You have been able to deliver around 40 billion year-to-date in growth, if I put the SME, FI and your corporate book together. That is significantly higher than competition and pretty much in line with what you have predicted on the mortgage side. Your comments around this in terms of the initiatives, etc., especially on the SME side will be extremely helpful.

Secondly, you have kept your net interest margin guidance unchanged. In the context that now six-month SAIBOR is at 5.8, so another 120, 130 basis points increase with the last quarter. Liquidity seems to be tight and when I look at your regulatory LDR of 88.4%, it seems that you will have to do something around that, and cost of funding pressure should continue well into fourth quarter. Any comments on that, on how you intend to maintain the margin contraction within your guidance, would be very helpful. And within this, if you could also comment on liquidity in the market, that would be useful. My third and final question, you had around 1.3 billion of write-offs during the quarter which, Abdulrahman, you mentioned. If you could please talk a little bit more about it, where are these emanating from and how should we think about them? Thank you much.

Hossam Al-basrawi
General Manager Corporate Banking, Al-Rajhi Bank

A

Hi, this is Hossam Albasrawi. Regarding the corporate book, what we announced almost two years ago about what is our strategy on corporate, the results of this strategy are starting to bear fruit because in the heart of it, it was focussed around expanding our customer base. In that expansion of our customer base, we were leveraging our strength in retail, digital, and our reach and our size as a bank. Now it is also worth mentioning here, that the focus of this strategy was around the vision 2030 and what comes with that, around support for the SME business and the big project finance that is happening with the government. This growth, we view it as a very healthy growth and we are very excited about it because, not only is it expanding our customer base, but also it is pulling the right liability growth on corporate and, as well, originating new revenue streams in fees and cross-sell activities across the different segments of the bank.

If we look at segmental growth, our growth has been consistent across all segments, large, middle and small. And the cross-sell activities with cash management, trade, FX, investment and advisory business have been also consistent and have shown good growth. We are very excited about what to come next and I just want to highlight that this growth came from two avenues, new transactions and transactions that we approved in the past two years for Capex and project finance, that we started to draw down in the last quarter. We are very excited about the future and further growth around corporate business.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Waleed, regarding the second question related to the NIM, yes, we acknowledge that there is pressure on cost of fund, this already has been factored into our forecast for Q4. From a NIM perspective, there are two parts. Number one, the improvement into the gross yield, and I think I have highlighted in my presentation a cumulative of close to around 28 basis points improvement into the gross yield. Also, we are expecting that to further improve over the coming period. Definitely, the higher cost of fund will have an impact, nevertheless, there are multiple things that we could do in order to further manage our cost of fund. For example, earlier this week we had announced the establishment of a public Tier 1 Sukuk up to SAR 10 billion. That will also have a further improvement into the LDR going forward. So, we do have all the tools and we have been discussing this for quite some time, management have all the tools required to be able to further support the growth going forward. We will do it in the most efficient way that has a positive impact into the shareholder value.

The third question related to the write-off. Yes, the net write-off in Q3 is exactly 1.3 billion, out of which around 750-odd, this is related to the retail, which is in line with the historical trend that we have been seeing. We have seen almost close to around 540 on the corporate side. Basically, what we have seen is a couple of troubled names into the wholesale trade sector, where those guys have been fully provisioned and we have taken a decision to write off in the third quarter. Thank you.

Waleed Mohsin **Q**
Managing Director, Goldman Sachs

Thank you very much, that is very helpful. Just one final confirmation. If you put all of this together, your guidance, the reason for the ROE downgrade is more leverage rather than ROA?

Abdulrahman Alfadda **A**
Chief Financial Officer, Al-Rajhi Bank

Definitely. I think the guidance revision onto the ROE by 50 basis points, as I mentioned earlier, is take into consideration that if you look compared to last year, last year we paid almost 0.875, which is almost 3.5 billion, of a dividend. Where in the first half this year, management have taken a call to preserve the capital, given that we have seen an opportunity to grow and further improve. So, long story short, yes, it is a function of, given that the denominator is growing larger, that is why the ROE guidance has been changed lower.

Waleed Mohsin **Q**
Managing Director, Goldman Sachs

Thank you so much.

Naresh Balandani **Q**
Head of MENA Equity Research, JP Morgan

Thank you very much. It is Naresh Balandani from JP Morgan. Congrats on the results. Three questions from my side, please. One is on the increase in mortgage rates from SRC that we have seen year-to-date. Would you kindly be able to share some thoughts on how much further increase should we expect in these benchmark LTFR rates over the next six to 12 months, or any broad guidance you can provide, even for the near term. That will be extremely helpful, that is one. Second is would you please be able to clarify some thoughts on the liquidity strategy, given the fact that the regulatory LD ratio is not too far from the 90% limit. It would be very helpful if you could guide on what liquidity actions are you planning going into the year-end that could help you continue the healthy growth on the balance sheet, as we have observed year-to-date? My third and final question is on dividends. I am just trying to get some comfort or any indication from you on what your thought process is for dividends for the second half of the year, as we go into the year-end? I appreciate the growth rates have been very strong, you have been deploying capital quite well, but just some rough thoughts that you can provide, that would be super helpful. Thank you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

A

If you allow me to answer the last question, then I would leave the first two with Abdulrahman. If you remember, as we mentioned in the last earning call, that as long as we see an opportunity to grow on the market, we will take it and we will preserve capital to maintain a healthy equity. For the second half of this year, I think it is too early to have at least a visual for that. As you mentioned, we are approaching now the quarter end and a lot of factors is going on in the market, so we will see by the end of the year, what is the result, what is the forecast growth in the market. Then we will recommend to the board the best approach and strategy for the bank. Abdulrahman.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On the first question, Naresh, regarding the recent SRC rate increase, I think this was the third time since the beginning of the year, the total cumulative increase has been almost 160 basis points since the beginning of the year. We understand that the rates are a function mainly onto the long-term rate and taking into consideration the current sovereign spread for the local issuance, I don't think it is correlated to the SAIBOR either, the short term or the longer term. However, we monitor what is the long-term rate, especially we have seen the 10-year treasuries have been going higher over the last few days, and we see 10-year treasuries at 4.04%. This is the benchmark for you to be able to quantify and correlate with the SRC rate compared to whatever the long-term rate is.

As far as the second question, some actions on the liquidity. Firstly, let me try to confirm to you that our optimised internal level into our LDR is anywhere between 87% to 88.5%, so we are within our internal optimised level. This is to show an efficiency from our perspective in monitoring the cost of fund. Now in terms of the actions we could do, I think I mentioned earlier, at the beginning of the year we issued 6.5 billion Tier 1 Sukuk. In the third quarter, we have launched the ESG compliant dollar syndicated loan. At the beginning of the week, we announced establishment of a public transaction for a Sukuk issuance up to SAR 10 billion. We also have an opportunity to securitise some of the mortgage book. We have seen some of the competition are doing that. All of those actions are at our hand. Again, let me retreat what I've mentioned earlier, the bank will do the most appropriate action, take into consideration the best value from a cost of fund and from a capital perspective.

Naresh Balandani
Head of MENA Equity Research, JP Morgan Chase

Q

It is very kind of you, thank you very much. Just in very brief, could you explain the last point on the securitisation of the mortgage portfolio, how do the mechanics of this work? You basically pick and choose the mortgages that you want to sell from your portfolio, you bundle them and sell them to SRC, you still remain as the manager of the mortgages. Is my understanding on these lines correct?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I think SRC, since founded in 2017, there has been a lot of improvement to standardise the securitisation. I think it took a bit of time, but I think currently it is become from a documentation, legal infrastructure, pricing, monitoring the exposure after securitising, has become an autopilot. And we'll follow whatever the standardised SRC actions related to the securitisation, Naresh.

Naresh Balandani
Head of MENA Equity Research, JP Morgan Chase

Q

Got it. Thank you very much.

Nida Iqbal
Equity Analyst, Morgan Stanley

Q

Hi, thank you for the call. I have two questions. Firstly, a follow-up on the NIMs. Given the shift towards term deposits more to the financing and higher SAIBOR levels, when do you expect NIM trends to turn positive sequentially? When do you expect the positive impact of the repricing of your loan portfolio to offset the cost of funds? Secondly, on the loan growth outlook, of course this year has been extremely strong. It will be great to get some colour on the outlook for 2023 in terms of loan growth and, in particular, how you expect demand to be impacted, given the higher rates? Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Thank you, Nida. In terms of the NIM trajectory, there are two things we have taken positively. A, we are repricing our retail assets, which is the ex-mortgage of the retail book. We also take into consideration the recent price increase by SRC. Those are our positive factors. If you recall also, Nida, we have been saying that our ex-mortgage of the retail book, although it is fixed rate, legal maturity five-year, but behaviourally, that book is repriced anywhere between 18 to 24 months. Whatever the old vintages that have been originated over the last couple of years, and I think that will take some time, we forecast that by sometime in the second half of 2023, that will see the full benefit on repricing the entire book.

As far as the cost of fund, definitely, that is something that we are managing efficiently. Definitely, we have grown our wholesale funding, but again, from a priority perspective as a bank, growing our CASA is a top priority for us, in the retail, as well as for corporate customers. I think there is a lot of moving parts, but, nevertheless, I hope that answered your question regarding the NIM trajectory.

As far as the loan outlook growth, in our opinion the credit outlook growth is positive for the Saudi economy, given the macro outlook. We are still positive about the mortgage growth over the coming period. Yes, it has slowed down and I think the base has increased. Maybe Hossam will shed some light into the corporate and SME, but bottom line, we still have a very positive outlook into the corporate and SME. Hossam?

Hossam Al-basrawi
General Manager Corporate Banking, Al-Rajhi Bank

A

On the corporate side, like I mentioned before, we're very well geared and focussed around the vision 2030 projects and we have a lot of pipeline projects that have already consumed some of the lines, and there's more lines to be consumed and a lot more projects that are coming up. I think that will create also some good demand for credit.

Nida Iqbal
Equity Analyst, Morgan Stanley

Q

Thank you very much.

Mohammed Al-Rasheed
Ashmore Group, Equity Research Analyst

Q

I have two questions, mostly they are a follow-up. My first question is regarding your funding situation. We have seen a huge increase in a quarter-on-quarter basis in the interbank funding, by around 30 billion. My question is, how sustainable would be the sourced funding going forward, especially with the recent tightening on the market? We saw the split between SIBOR and LIBOR spike again, today it was around 140 basis points, so should we expect that this will be replaced by stable term deposits going forward? And point you mention regarding Tier 1 Sukuk, that it goes into LDR, what about the weight and could this be weighted as demand deposits or could it be weighted as five-year term deposits? That would be very helpful.

My second point, a follow-up regarding the mortgage and SRC rate. If we see the 25-year government Sukuk for Saudi Government, it has increased year-to-date by around 280 basis points, while the accumulative revision by SRC is around 160 basis points. I know mortgage, if we take into account the risk weight and the low cost of risk, it is still accretive in terms of return, but relative to the government Sukuk, which has a zero risk weight and even lower cost of risk, it is becoming less and less attractive. What is your thoughts on that? Was this the reason why your mortgage origination during the third quarter was the lowest since 2020, or slowdown was driven by low market growth? Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Mohammad, I think related to the wholesale funding, the sustainability of that, we always, as part of the growth that we have delivered into the corporate strategy, I think, Hossam, also the focus is to further improve the liability side from the corporate?

Hossam Al-basrawi
General Manager Corporate Banking, Al-Rajhi Bank

A

Yes. Part of our growth, expanding our customer base, we are less concentrated than before and we have built our model around a very strong coverage model, as well as good development on the products, especially on the cash management side. With every asset that we are granting on the corporate side, it is pulling a lot of liabilities, and these are well-diversified liabilities and very much sticky with these clients. So, we're very comfortable that the corporate liabilities as well are going to grow at a good rate.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

In addition, I discussed earlier, about the other alternative funding tools that we had mentioned, Sukuk issuance, securitisation, tapping into the debt capital market, whether locally or internationally. And also our decision, you've seen our announcement in the third quarter regarding a dollar-syndicated loan, ESG compliant. These are to our objectives to be able to diversify our funding source and to support us for the growth opportunities over the medium term.

As far as the weightage, yes, it is LDR eligible, and we will follow the SAMA weightage accordingly, in terms of the Sukuk. The last question related to the mortgage, yes, I acknowledge that the delta between the gross yield of the mortgage rate versus the current cost of fund has been narrowed over the last few years, but you have to take into consideration the fact that once you do a mortgage with a customer, at least you'll have your customer with you for 20 to 25 years. You'll be able to cross-sell a lot of the bank products, whether it be unsecured lending, personal finance, auto, cards. Those also contributed to some growth onto the fee income for us. We don't look at it as a per se product, we look at the total, but nevertheless, mortgage in our opinion, given the risk weight and given the cost of risk for the mortgage and the associated axillary business that comes with the mortgage, it's still a very profitable product for us.

Finally, your question about the slowdown, and I think you have seen the numbers from SAMA, the origination. In the month of July, the origination had dropped to almost 7.2, while it recovered in August to almost 12.7. We are still maintaining and growing our market share. Also, you need to take into consideration that the base for the mortgage overall book has increased. Total mortgage book, as per SAMA data as of Q2, is close to around 500 billion. Q3 data has not been published and we are expecting the result to be published next week. Thank you.

Mohammed Al-Rasheed
Ashmore Group, Equity Research Analyst

Q

Just a follow-up, regarding Q3, I am talking about the absolute amount; it was 10 billion, which was the lowest since 2020.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Yes, but we have not seen, Mohammad, a drop in our mortgage market share. If we see a drop in our market share, that is something else. I think the bank has continued to further increase our market share accordingly.

Mohammed Al-Rasheed
Ashmore Group, Equity Research Analyst

Q

Just a follow-up, are you considering or have you considered securitising some of the mortgages and instead buying government Sukuk with 25 years, zero risk weight and a similar rate?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Again, I will reiterate my answer to the previous question that has been raised by the previous colleagues. It is one of our options, from the management perspective, we will do the most efficient option that will further maximise the shareholder value.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

The first question is your NPL coverage has always been extraordinary. Now that the bank is also growing in the corporate side and the SME side, we would like to get a sense of what will be your NPL coverage, how do you see your long-term cost of risk, considering your loan loss reserve is not that deep because of the write offs you do? That is my first question. Second one is I know you cannot give me an exact number, but from the Tier 1 Sukuk issuance, what would be the tentative interest rate range that you will be looking at? I just wanted to get a sense of overall impact it will have on the asset side. These are my two questions.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Chiro, let me clarify one thing. Internally, NPL coverage is not the main priority. What is our main priority is to maintain a healthy stage coverage. We do have an internal risk appetite to monitor our stage coverage, then NPL coverage is going to be a function of the gross charge as well as the NPL formation and the write-off. From our perspective, although that NPL coverage has reduced, but still if you look at Q2, our NPL coverage was 293%, market average was 113%. Nevertheless, even the growth that we have delivered into the non-retail book, as you have seen on the previous slide, we top up our gross charge to factor in the growth that we have seen into the non-retail book. As far as the Sukuk rate, again the announcement that we have made earlier in the week, is the establishment of the programme. I think our Treasury team are taking into consideration the market levels, market opportunities and as and when we do have the right, from a timing perspective, our Treasury team will be announcing the planned issuance in due course.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

That is it from my side. Thank you very much.

Rahul Bajaj
Director – MENA Equity Research, Citi

Q

Thanks for taking my question. Rahul from Citi. Two quick questions from my side. The first one is on the normalised level of provisioning. It has been running at below normalised level of provisioning in the last few quarters, maybe in the last few years. As interest rates remain elevated through next year, what would you expect a normalised level of provisioning should be? Should we be pencilling in significantly higher provisioning for these levels or do you think the bank can continue to run at current levels? That would be my first question. My second question is on open banking. If my understanding is correct, the open banking regulations kicked in earlier this year. Just wanted to understand if you had seen any traction or increase in competition for specific products, where newer Fintechs or new players might have entered and they might be making some mark in a specific product and proving some challenge there? Any thoughts around open banking and what you are seeing in the market, that would be useful. Thank you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

A

Thank you for your questions. If you allow me to answer the last question and I'll give Abdulrahman to answer the first one. For the open banking, as you know the Central Bank just issued a guideline for open banking and the bank is ahead in terms of digital, is leading the market for digital and rated number one in Apple Store and also in NPS. We believe we are ready for open banking, based on the last guideline issued by the Central Bank. Abdulrahman?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Rahul, related to the cost of risk, I think you have seen our cost of risk for the first nine months was at 43 basis points, compared to 62 basis points the same period last year. Our cost of risk guidance for this year is in the range between 40 to 50 basis points. The current macro outlook for Saudi is positive and I think that is inline of the IFRS 9 requirement, we need to update our ECL models. We take into consideration the GDP growth, we take into consideration other multiple variables. The current macro outlook for Saudi economy, I have mentioned an IMF at 7.6%, and I think we have also seen a statement by the Ministry of Finance today, reiterating 8% growth for this year. Also, if you recall a few weeks ago, Ministry of Finance have issued the pre-budget statement where they have highlighted the GDP growth forecast up to 2025. The macro outlook for Saudi economy is very positive. Specifically on a rising interest rate environment, the bank is regulated by SAMA. There is a certain regulation related to the debt burden ratio that we have been following. I think that is applicable to everybody, so we do not see any material risk. In addition, Al Rajhi Bank, given the nature of our borrowing customer, given that 90% plus are public-related employees and even 90% plus, as well, salaries assigned. Taking this into consideration, yes, we have seen an improvement to the retail book. In addition, the bank is being conservative, as I said, there is an opportunity also to release something on the corporate side, given the macro outlook, but given the portfolio growth, as we deliver 52% year-to-date growth, leveraging from our position as conservative, we have not taken that decision. And we'll continue to be conservative and apply prudent risk management accordingly.

Rahul Bajaj
Director – MENA Equity Research, Citi

Q

Understood. Thank you.

Operator:

Unfortunately, we have run out of time for any further questions. However, for those who have additional questions, please do not hesitate to contact the investor relations team, and they will be more than happy to address your questions. I will now like to hand the call back over to the CEO for any closing remarks.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, everyone, for dialling in and for your trust in us. We are very proud of our result and we will continue to focus on our execution and achieving our strategic goals for this year and beyond. We look forward to meeting you again and the fourth and year-end earning call. Thank you.