

## 2Q23 FINANCIAL RESULTS

### EARNINGS CALL TRANSCRIPT

August 1, 2023

### **Mazen Al-sudairi**

***Head of Research, Al-Rajhi Capital***

Good afternoon everyone, this is Mazen Al-sudairi from Al-Rajhi Capital. Al-Rajhi Capital is proud to host Al-Rajhi Bank Q2 2023 Earnings Call, welcome all to the call. And now I will handover to Rayan, Head of Investor Relations to introduce the management team.

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### **Rayan Alshuaibi**

***Director Investor Relations, Al-Rajhi Bank***

Thank you Mazen, good day everyone and thank you for joining the call. With us on the call today MD and CEO, Waleed Al-mogbel, CFO, Abdulrahman Al-fadda, and GM Corporate, Hossam Al-baswari. As always Waleed will start with a performance highlight and strategy update, then followed by Abdulrahman to cover the financial performance in more details. Thank you again for joining the call and Waleed over to you.

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### **Waleed Almogbel**

***Managing Director and Chief Executive Officer, Al-Rajhi Bank***

Thank you Rayan, good day everyone and thank you for attending our earnings call for the second quarter of 2023. As always, I will go through our performance highlight for the quarter, then I will cover in brief the progress made on our Bank of the Future strategy. After that I will give the floor to our CFO to cover the financial performance in more details.

If we take a closer look at our results highlights for the first half of 2023 in slide three. Starting with the balance sheet, in the first half of 2023 the bank delivered growth of 3% year to date and 11% year on year in total assets driven by financing and investment portfolios. The investment portfolio continued at a strong momentum, recording a growth of 19% year to date and 26% year on year which helps to diversify our yield income and supports the bank's liquidity position.

However, the bank during this year also continued its selective approach across all business to achieve its strategy goals, which resulted in financing portfolio recording a growth of 2% year to date and 11% year on year, reaching to almost now 579 billion. The growth in the financing portfolio was mainly coming from the non-retail book which grew by 37% year on year, supported by 40% growth in our corporate book and 25% growth in SME book. In retail, the growth was mainly coming from mortgage recording 14% year on year and now mortgage is around 39% of our total book and 53% of our retail book. On the liability side, total liability currently stands at 681 billion, an increase of 9% year on year and 3% year to date, which will bring the loan to deposit ratio to 82%, which is well below the regulatory minimum.

Moving to the profitability, net income showed a slight drop of 1% for the current period. The drop was mainly driven by net yield income which was lower by 5%, driven by higher cost of funding. However, the non-yield income continued to positively trend, growing at 3% year on year. This results in total operating income decreasing by 3.5% in the first half of 2023, standing at 13.6 billion.

If we look at the credit quality, the bank continues to maintain best in class asset quality, with cost of risk standing at 25 bps, NPL standing at 61 bps, and a healthy NPL coverage ratio of 225%. In terms of operating efficiency, it has continued to be an area of focus for the management, which helps us to maintain a market-leading cost to income ratio

of 26.7%. Lastly, the bank continued to maintain a strong financial position, with a healthy total capital ratio of 21.7%, well above the regulatory minimum.

If we move to slide four where you will see the progress made so far on the execution of our Bank of the Future strategy. We started our Bank of the Future strategy back in 2021 and we are proud of the hard work of our people, which helps us to achieve our strategic KPIs well ahead of time. We will continue to build on the success made in our Bank of the Future strategy; however, it is worth to mention that we are currently in the process of developing our new strategy for the next three years until 2026. We will update you about the details of the strategy once it is approved by the board by the end of this year.

The execution of the strategy is on the right track and most of the 2023 strategy KPIs have been achieved and the remaining is in the process of the achievement by the end of this year. With that now I will hand over to Abdulrahman, our CFO, to give you a detailed update of our financial performance and thank you so much.

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

Good day ladies and gentlemen, it is my pleasure to welcome you again on our Q2 earnings call. Our total balance sheet stands at 785 billion, 11% year on year increase and almost 1% on a sequential basis. To analyse the 3% year to date movement, as you can see on the bottom left hand side of the chart, we have seen our interbank book have gone lower by 15 billion and our investment book by 19 billion higher. This is part of the management initiative to improve our average earning assets. Our financing book has increased by almost 1.9% and we'll cover it in the following slides.

In terms of the funding we continue to diversify the funding profile in order to manage our cost of funds efficiently, where you can see the bottom right hand side of the slide, our interbank book has increased by 11 billion, our customer deposits by almost 6 billion. And it worth to highlight in April, in the second quarter, we've tapped in for the first time the international debt capital market to raise a five year senior unsecured sustainable sukuk, part the management actions to improve the funding profile and improve the cost of fund efficiently.

Zooming in further into the main driver of the balance sheet movement, our total financing book as at Q2 stands at 579 billion, 11% increase year on year and almost flat on a sequential basis. It's worth to highlight that our retail book as a percentage of the overall financing stands at 74% compared to 76% at the year end. To analyse the 2% financing portfolio growth year to date, as you can see on the top right hand side of the chart, our mortgage book has increased by almost 3%, taking into consideration that in Q1 we have securitized almost 5 billion of the mortgage book. Nevertheless, ex-mortgage of the retail have contracted by almost 4%. If you recall in our Q1 we have mentioned that taking into consideration the higher interest rate environment as well as the expensive funding profile we have raised our personal finance pricing whereby that impact the customer DBR as well as the ticket amount, which led to the new origination are lower than the monthly average repayment, which naturally explains the contraction that we've seen where that trend is expected to continue for the remaining of the year. Corporate we had a decent growth of almost 9% year to date coupled with an SME growth of almost 7% which will bring the non-retail book growth of almost 8% year to date. Mortgage books stand at 229 billion, represents 52.7% of the retail and almost 39% of the overall financing book.

Our total customer deposits stand at SAR 571 billion as of Q2, whereby our CASA represent almost 66.2% as of Q2 compared to 64% as of the year end. It's worth to highlight that as you can see on the bottom right hand side of the chart we had a decent growth in our CASA, by almost 4.7% year to date. And given that also the market have on the

CASA based on the SAMA data that came out last night market overall had a contraction of 0.2%, nevertheless those accounts are mainly non-retail which is usually volatile and expect a further migration to the time deposit over the medium term. The growth into the CASA have led us to further shed off almost 9 billion of time deposits.

If we move to the profitability section, our net income were close to 4.1 billion for Q2, 3% lower year on year and almost flat on a sequential basis. The sequential trend is highlighted at the bottom left hand chart of the slide where you can see that our NII have increased by 1.3%, our non-yield income went lower by almost 1.3%, while our expenses have increased by 2.2%, coupled with almost flat sequential growth on our impairment charge.

Our net income for the period stands at SAR 8.3 billion, almost 1% lower compared to the same period last year. And the driver, as you can see on the bottom right hand side of the chart, our NII went lower by 5%, our non-yield income increased by almost 3%, expenses were higher by almost 1%, while our impairment charge were lower by almost 38%.

To zoom further into the net income driver I'll start with the operating income. Our operating income for Q2 stands at 6.8 billion, almost 4% lower year on year and 1% higher on a sequential basis. The operating income for the period, as you can see on the top right hand side of the charts, stands at 13.6 billion, 3.5% lower year on year, and the driver as you can see were as follows. NII went lower by 5%, fees were up by 1%, exchange income 8% and other income went higher by almost 6%.

On the NIM side our Q2 NIM stands at 2.95%, compared to 3% in Q1, which will bring the year to date NIM to be around 2.98%. There are a couple of parts over here I would like to highlight. If you recall the NIM contraction started from first quarter 2020 and on average the NIM contraction on a sequential basis were almost 17 basis points over the last 13 quarters. This time around this is the lowest NIM contraction that we've seen since the beginning of 2020, which is positive from our side and in line of our communication during our Q1 earnings call. Nevertheless, over the second half of the year, we have seen a further increase into SAIBOR, given that the current three month SAIBOR stands at 6% and we're expecting it to be flat at the current level for the remaining of the year.

The NIM contraction on a year to year basis, as you can see on the bottom right hand side of the chart, were close to around 78 basis points. All business lines have shown the NIM expansion, nevertheless the costs of funds were negating by almost 173 basis points.

To move and analyse the second driver of the net income, our OpEx for Q2 stands at 1.84, which is almost 1% higher on a year to year basis and almost 2% on a sequential basis. Our OpEx for the first half stands at 3.6, almost 1% higher year on year and the driver, as you can see on the top right hand side of the chart, were mainly coming from the staff costs coupled with the depreciation, taking into consideration the 11% increase into the balance sheet growth year on year coupled with a high transaction amount by 27%. And finally, executing our strategical investment to execute our Bank of the Future strategy. However, if you see that our G&A we made part of the management initiative to further improve as a part of our activities to be able to manage our cost to income there has been a decent drop of almost 15% compared to the same period last year. Operating income were lower by 3.5%, while OpEx were increased by 1.4%, that delivered to a higher cost to income ratio to almost 26.7%. Despite that, we're still having one of the most efficient cost to income ratios into the market.

Onto the asset quality, our net charge for Q2 were almost 360 flat on a sequential basis, almost 38% lower on a year to year basis. Our costs of risk were 25 basis points for Q2, which is if you recall over the last three quarters our costs of risk were almost flat at 25 basis points. The movement on the 38% year on year, as you can see on the bottom left hand side of the chart, are mainly coming from 310 million release from our gross charges, take into consideration that we have updated our ECL model for our corporate book. Coupled with a better recovery by almost 130 million that we've

seen on a year to year basis. From a segmental basis, in line with what I mentioned earlier, we topped up our retail book, while the non-retail book we had a release of almost SAR 1.3 billion.

Our NPL stands at almost 3.6 billion, which is almost 15.8% higher on a year to year basis. Nevertheless on a sequential basis, the delta we're only 66 million, which is almost flat. From a formation perspective, our write offs for the period were almost 1.6 billion compared to the same period last year of around 2.1 billion, which has showed an improvement in our NPL formation. Putting that into perspective our NPL ratio for Q2 stands at 61 basis points, one basis point higher compared to Q1. Although that our corporate have increased the NPL from 99 to 113 basis points still leading one of the best, or the lowest NPL ratios into the market, if you recall Q1 non-retail book NPL for the competition were close to around 2.8%. That coupled with a better efficiency in our retail NPL, despite the portfolio contraction, our retail NPL stands at 43 basis points. NPL coverage 225% as of Q2, a slight drop compared to Q1 of this year.

Our ECL stocks stand at 8 billion and the movement, as you can see that's a 9% which in line with the comments made earlier. Our gross financing stands at 587, out of which close to 97% are a stage one exposure. Our stage coverage for stage one, 50 basis points compared to 51 basis points in Q1. Stage two 13.1% compared to 16.1% in Q1. And finally, stage three at 60% compared to 63% in Q1. So overall still despite the contraction that we've seen in stage two and stage three coverage we still have one of the best stage coverages into the market.

Our liquidity position remains healthy, although that our headline LDR stands at 101.5% compared to 103.7% in Q1. Nevertheless, the regulatory LDR came at almost 82% compared to 87.8%, take into consideration the revised SAMA definition, which if you recall we do have a SAR 24.8 billion worth of alternative funding that were eligible for the revised weighting that was implemented from 1st June onward. LCR, NSFR healthy and remains at a very comfortable level.

On the capital side our total RWA stands at 503 billion, which is almost 6.9% increased year on year, mainly driven by the increase into the credit risk RWA. It's worth to highlight that our RWA density reached to one of the lowest levels, which has come to around 62.4% compared to 66.4% at the same period last year. Our CET1 ratio stands at 17.2%, our Tier 1 stands at 20.5%, almost 25 basis points improvement compared to the year end of 2022. And to analyse the movement, as you can see on the bottom right hand side of the chart, although that our RWA have impacted 23 basis points on our capital adequacy, nevertheless that has been compensated by 59 basis points of an internal capital generation.

Our return matrices are stable and industry-leading. As you can see that RORWA stands at 3.31%, our ROE stands at 19.6% and finally our ROA at 2.15%.

Now, before we jump into our guidance for the remaining of the year maybe a couple of minutes into the macro outlook and the interest rate outlook. At the macro level the based on the flash report that we published a couple of days ago Saudi economy have printed a 1.1% growth in the GDP in second quarter, mainly driven by the non-oil GDP of 5.5% and a contraction into the oil GDP. IMF have revised the GDP forecast for Saudi to be around 1.9%, for 2024 is to be around 2.8%. Consumer spending is healthy, we've seen almost 9% growth year on year and a 3% on a sequential basis.

On the mortgage side in Q2 we've seen the total mortgage origination were close to around 16.9 billion, 26% drop on a sequential basis and almost 46% on a year to year basis. This is due to the fact that the revision into the subsidy programme that was being implemented in the latter part in February.

As far as the interest rate, the Fed have delivered four rate hikes since the beginning of the year despite the soft CPI print a few weeks ago, our base case forecast is to the Fed to maintain at the current level for the remaining of the year and probably push any rate cut to probably later part in Q1 next year, early part of Q2 next year. Having said that we revised our average SAIBOR forecast for the full year from 5.45% in Q1 to almost 5.85%. Current three month SAIBOR stand at 6% and our expectation for the three months SAIBOR are to maintain and hovering at the 6% for the remaining of the year. We still continue that the gross yield to go to maintain its positive momentum to grow and negating the cost of fund as we've seen in the second quarter.

Putting that into perspective, we kept our financing portfolio guidance unchanged at the mid-single digit. We revised our NIM by 15 basis points further contraction to be in the range between 40 to 50 basis points, taking into consideration the following factors. I have mentioned about the increase of average SAIBOR compared to Q1, that's one. Second, we still see a potential CASA migration, if you recall SAMA published the data yesterday and if you look at the demand deposits as a percentage of the overall customer deposit have dropped to 54.4% compared to 56.4% at the beginning of the year which is considered to be the lowest level since 2011. That is adding a further competitive pressure into the banks to raise CASA and we're expecting a stiff competition into the deposit side. Coupled with a lower mortgage and also further contraction into our personal finance, which led to a further downgrade as the rationale behind the NIM revision. The NIM revision will have an impact on the NII, which will further revise down the cost to income ratio to be below 27.5% and also ROE to be above 19%. We have seen the quality of the portfolio over the last six months and the stage migration and we basically have done our forecast where we are comfortable with revising upward our guidance on the cost of risk to be in the range between 20 to 30 basis points, taking into consideration the last three quarters the cost of risk were almost 25 basis points. On the capital side we haven't changed the guidance.

Waleed, back to you.

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**Waleed Almogbel**

***Managing Director and Chief Executive Officer, Al-Rajhi Bank***

Thank you, Abdulrahman, for the financial performance overview. Now we will open the floor for Q&A session. Operator, back to you.

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. If you would like to ask a question and have joined us on Webex, please use the raise hand icon found on your Webex tool bar. If you have joined us on the phone, please press star followed by one on your telephone keypad. Our first question comes from Naresh Bilandani, Naresh please unmute locally, state your company name and proceed with your question.

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



Hi, Waleed, Abdulrahman, Rayan, it's Naresh Balandani from JP Morgan, thank you so much for the presentation. I have three questions please. So first, thanks for clarifying, that was my first question actually on what led you to change your NIM guidance. Perhaps the way to present this is if you can please just also throw some light on what further trends could potentially emerge that could lead you to cut your guidance again and see more pressure on the NIM than what is anticipated now? Clearly because we've seen guidance being revised downwards consistently for the past three quarters, so keen to know where exactly, how much further risk should we see on this line from this point on?

My second question is on asset quality. Actually, we are seeing a widening divergence between the stage three loans and NPLs. So can you please explain what is causing this? Is the divergence coming more from retail or the corporate segment? And also I think when I take a look at your segmental breakdown we are seeing write backs continuing to come through in your corporate segment, so can you please explain why this is happening? So that would be super helpful.

Also just while we are on asset quality, and sorry for the bulk of questions there. If you can please also just confirm is there any scenario currently where a retail customer could potentially see a change of rate of interest on the loan during the life of the loan? I think that would be super helpful. So the divergence between stage three and NPLs, whether this is coming from corporate or retail and the write backs in your corporate segment.

And my third and final question is on the personal loans books, that's a non-mortgage retail book which has continued to show a negative trend of 3% also in this quarter. Could you please just clarify on what's the quarterly and the year to date trend on a gross basis? So I'm just keen to see what is the level of new origination that you are seeing compared to the maturities that is bringing the net number negative at this stage. How much further do you think we should expect to continue seeing this decline for? Thank you.

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



Naresh related to the NIM and if you can see that over the last 13 quarters we have been seeing that the net yield has been going lower given that there were on 2020, 2021, the interest rate environments were low and basically there has been a revision into the SRC cap rate back on 1st June 2020. Nevertheless, given that there has been an expansion into the overall balance sheet over the last three years the time deposit balance has increased. So that is basically the major driver coupled with a higher interest rate, current 3 months SAIBOR as I mentioned is 6% where back in those days were 80 basis points. So these are basically the main drivers.

Nevertheless as I mentioned earlier, the positive trend that we have seen is in the second quarter the NIM dropped by only five basis points versus a 17 basis point average since Q1 2020. Now the risk is higher SAIBOR from the 6% handle and any further Fed rate hikes, that is considered to be one risk. Second risk is a further migration from, or a more migration than our anticipation from CASA to time deposits. But again, from this year we believe, as I mentioned earlier, and I think the Rajhi Bank is geared to take the benefit over the longer term from the rates to start going lower. If you look at where the euro dollar futures are pricing probably the first cut that probably later part of Q1 beginning in Q2, if that happened we believe the NIM will further expand from the current level. That's on the NIM drivers to address your first question.

Onto the second question related to the divergence between the stage three and NPL. Not all stage three customers are considered to be an NPL. The reason is inline of the IFRS9 requirement the customer who passed due 90 days which is qualified to be an NPL and if he started paying back then he will be moved out from the NPL to a performing. Nevertheless, there is an IFRS requirement that the customer needs to be in cure period to move from stage three to stage one to almost 12 months and from a stage two to a stage one almost six months. So this is the divergence are related to the cure period between the time that the customer comes back from the NPL in order to move between two stages.

On the writeback, and I think I addressed and a part of the asset quality. The reason for the writeback on the corporate are coming from two main reasons. Number one, a better recovery that we have seen compared to the same period from last year. And if you recall this is one of the management initiatives to be able to improve the cost of risk by improving our recovery. The bank have been making a lot of progress over the last few years to improve their recovery year after year, so that's one rationale. The second one, in Q1 we have updated our ECL model to take into consideration the macro outlook, were mainly are coming onto the corporate model. That led to a release onto our gross charge.

Related to the second question also is there any scenario for the customer to be able to change the rate, and I think rates are fixed rates for mortgage is 20 to 25 years, for personal finance it is in line of our normal offering whenever customers are looking to top up he will be topping up at the current rate environment which is higher than the last few year's vintage, which is a positive, which you guys have seen it as a part of the reason why our gross yield has been going higher over a year.

Last part is on the origination. As I mentioned earlier given the higher interest rate environment that will impact the loan amount which we've seen the new originations are lower than the average monthly repayment which led to the portfolio contraction. In Q2 we've seen our personal finance contracted by close to almost 5.8 billion. And again this trend we are expecting it for the remaining of the year.

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

Q

Okay, so we should expect to continue seeing a similar kind of reduction. Would you be able just to numerically just guide on what is the number of new originations versus the maturities? Do you have the number handy with you, would you be able to guide on that?

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

A

The number is in the top of my mind and I remember it very closely, but unfortunately I cannot disclose that.

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

Q

Okay, all right. Thank you very much for your replies, thanks a lot.

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

Q

Thanks so much. So three questions please from my side. Firstly, on credit growth previously you had alluded to a slowdown in retail loan growth for 2023, but if you look at the second quarter we've also started seeing a slowdown in your net corporate origination. So I want to understand if this slowdown is intentional, reflecting the elevated cost of funding situation in the market? And if that's true when shall we expect the bank to increase new origination, especially on the corporate side? So that's the first question.

Secondly on cost of funding, it's increased meaningfully across banks this quarter and the headline loan to deposit is above 100% for the sector. I was wondering how you think about cost of funding from here and what options do you have in terms of funding? Because historically banks have reverted to AT1 instrument issuance, it seems that market, the pricing has gone up globally. And then secondly if it's riyal funding it's coming from the local market so it's not really helping the local liquidity. So I wanted to get your thoughts on how this liquidity situation eases in the local market.

And third and final question on your fee income, which has slowed down sequentially. Now, how much of this slowdown that we're seeing is on account of lower credit originations? So meaning that the fee are linked to credit. And how much is it due to other dynamics at play? So I'm thinking here the resilience of your payment and payment system related fee and other non-credit related fee, so any guidance or any thoughts on that would be very helpful, thank you.

**Waleed Almogbel**  
*Managing Director and Chief Executive Officer, Al-Rajhi Bank*

A

Thank you Waleed for your questions. I will take the first one and Abdulrahman and Hossam also will cover the second questions. If you recall when Abdulrahman talked about the financial highlight, the banking system loan growth recorded more than 5% in the first half, while the bank has achieved 1.9%, excluding the securitisation that we have done in the first quarter, which is the 5 billion. If we included the securitisation back to the balance sheet the growth would be around 3%. This is number one.

Number two, if you remember when we start the year and we have seen the massive increase in the interest rates, we mentioned that our financing growth strategy is to focus more on the quality asset and creating value rather than volume, to improve our profitability and manage the cost of funds.

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

A

As far as corporate is concerned, this is Hossam speaking, our strategy since the past three years was focussing on increasing our customer base and most of our growth came from new to bank clients and now I think we have ranking number three in the market. We have a very decent customer base and there isn't really much to add so the speed of adding new clients is slowing down. Having said that, having a larger customer base and book the attrition ratio of loans are being settled is higher than before and the origination that we've been having is replacing these loans and we still see growth. So now looking forward we have a very decent pipeline of limits that have been approved in the past,

12 months, that are very much related to the giga-project and the large project finance projects and we will start to see this kicking in in the future.

Now, added to that the way that we are growing our book is not only focussed on the asset growth but it also focusses on what kind of ancillary business it brings with it. So today we are very happy to see that especially on the structured finance we are playing advisory roles, we're doing project finance, leading roles, mandating arranger. So in this space I think we are doing very well, it's attracting the right return that we look for.

In addition to that the growth that we are looking at for corporate going forward looks at attracting investment banking opportunities, attracting acquiring business, attracting treasury business and attracting other liabilities also, pulling liabilities for the bank. In addition, on the SME side we continue to elevate good products for the SME sector and that sector and segment is also showing a significant growth and we think that for the remainder of the year we should have decent growth.

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

**A**

Waleed, on the second question related to the cost of funds, it is in an industry trend that we've seen the overall cost of fund increase. There are a couple of things that need to be highlighted. Average SAIBOR in Q2 was close to around 5.80 and the current three month SAIBOR is around 6%. And overall at the industry level, including us, they're expecting the cost of fund to increase further from the current level. Q2 cost of funds for the Al-Rajhi Bank were almost 2.33, but again the message that I have mentioned earlier, that the delta between the expansion into the asset yields versus the increase in the cost of funds have decreased to the level that we've seen the lowest NIM contraction since Q1 of 2020.

Now what options do we have, we have executed a lot of I would say actions over the last few years. We've tapped into the local debt capital market, we've tapped into the international debt capital market, we've tapped into the syndicated loan. We've also securitised a portion of our mortgage book. All the tools are available in our hand in order to be able to manage the cost of funds and delivering the shareholder value.

The last question related to the fee income. The reason because the drop in the fee income on a sequential basis attributed to the following two factors. One, in Q2 I think the number of business days are lower than Q1 which is impacting the transactional activities which led to a sequential drop. Secondly is you're right, there is also a portion that is related to the retail financing, which attributed also to the drop into the fee income on a sequential basis.

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

**Q**

Got it, thank you all, that's very helpful. Just one follow up please on the options on the funding side. So for the securitization a sale of mortgage portfolio is something also on the table as things stand? And looking at your guidance and the commentary it's fair to say that NIMs have troughed as of second quarter, you will expect how things stand at this moment you wouldn't expect any further sequential NIM contraction?

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

**A**

Based on the information that we have and based on what is our outlook and I think I've mentioned earlier related to the risk, and I think we're comfortable with the guidance as we speak now. As far as the securitization, again it is an option always on the table. As long as the delta between the new origination minus the securitized book plus any associated fees that is coming from the securitized book is a net positive that is a NIM accretive overall the longer term.

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

**Q**

Got it, thank you so much, very helpful, thank you.

**Olga Veselova**  
*Equity Analyst Director, BofA*

**Q**

Thank you for hosting this call, this is Olga Veselova from Bank of America, I have several questions. My first question is about unsecured retail lending again. We were wondering about potential to grow more actively in this segment and my question is how sensitive your volumes are to your DBR limits, in case if your borrowers were maxed out on DBRs? Any insights on that topic would be much appreciated. So this is my first question.

My second question is about sensitivity of mortgages to falling rates. When and if interest rates go down how easy is it for an existing mortgage borrower to refinance? Have you ever made behavioural analysis how wide a gap between new production and existing yields should be for a borrower to ask Rajhi for refinancing. And clearly I'm asking this about non-subsidised mortgages only.

And my third question is about coverage. Your coverage remains solid versus many not just local but EMEA peers, but it has been going down in the past two quarters. Where do you see fair level? And I know you don't like giving guidance on limits, or minimum levels, but where would be a comfortable level for the next several quarters? Thank you.

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

**A**

Thank you Olga for the questions. In terms of the first question, we've mentioned that a few times, the sensitivity for the interest rate to the loan amount is very clear. For 100 basis points increase into the personal finance, the loan amount will go lower by around 4%. And I think you've seen SAIBOR have increased from almost 1% to almost 6% over the last few years and I think that that has a serious impact into the overall sensitivity for the borrower to be able to borrow and that has reduced the eligibility amount and reduced the loan amount, which is a factor of the reason why we've seen the contraction in the personal finance portfolio. As far as the mortgage repricing...

**Olga Veselova**  
*Equity Analyst Director, BofA*

Q

Excuse me, before we move on does it work on an additive side in a similar way? So minus 100 bps would be similar to 4%?

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

A

Yes, minus 100 basis points yes will have increased the loan amount by almost 4%. In terms of the mortgage repricing, it's no secret REDF allowed back in the beginning of 2021 for the mortgage customer to be able to reprice. Nevertheless I've mentioned it a few times, this is only on a selective portfolio, for example off plan is not eligible for the refinance, self-construction, undispersed portion of the self-construction is not be able to refinance. And to be honest, and I think we've seen the cases are very limited. And I think unless banks are being able to reprice mortgages much below the current SRC rate there is no value for the customer to be able to reprice.

Now, as far as and when interest rates or the mortgage pricing will go lower over the medium term I think that is something that we have to analyse. Over the last few years the trend was a mortgage rates to go higher, we haven't seen any scenario so far for the mortgage rate to come lower from the current level of 6.5% to 6.75%. But I can assure you that we have all the tools to be able to protect and make sure that we grow and maintain our leading market share into the mortgage.

Finally, on the coverage, you're absolutely right and I think we don't provide neither NPL coverage or a stage coverage. But what I can assure you is you've mentioned the point, Al-Rajhi Bank still maintain the leading position either from the NPL coverage or from a stage coverage. We always implement a prudent risk management, we monitor our stage migration, we monitor the quality of the origination. It's worth to highlight that as I mentioned earlier 97% of our gross financing is stage one, versus almost a market average is close to around 92%, if I recall back in the Q4.

**Olga Veselova**  
*Equity Analyst Director, BofA*

Q

Thank you so much. If I may actually I have one more question, I forgot to ask it. It's a relatively technical question but it's interesting to understand. When you securitize your mortgage book can you explain to us how your finance works? So what level of fee do you receive and do you fully remove your credit risk from the balance sheet?

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

A

The securitization works as follows, when securitised we fully removed it from our financing book. We stop the accrual and if there is any NPV of the discounting the cashflow between the originated mortgage versus what has been agreed that will be considered as a part of the fee income.

**Olga Veselova**  
*Equity Analyst Director, BofA*

Q

Oh fee income, okay, thank you.

**Aybek Islamov**  
*Director Equity Research, HSBC*

Q

Thank you for the conference call. So a couple of questions please. The first one is about your corporate loan growth in the first half, to what extent it's driven by lending to the public sector and what are the implications to the asset yields? How much are you generating on your public sector loans? The reason I'm asking you is because in 2022 you've been quite active with the lending to public sector institutions. So that's my first question.

I think secondly I'll just circle back on the previous questions on your provisioning stances so far in the first half. So yes, there was first quarter where you revised your ECL assumptions in the corporate book and you had a big reversal or provision writeback on that bit. Now it's the opposite, right, so it looks like you have a reversal of provision charges in the retail portfolio but you're taking a bigger balancing charge in the corporate. So I think the question around this area is about what are your expectations for further ECL revisions? Obviously we are at the point where Saudi Arabia had oil production cuts, oil GDP is not doing that well, non-oil economy better. Is there a chance that you'll be revising your ECL assumptions lower when you're looking at where we are today in terms of macro, what's the chance you're going to be revising your ECL assumptions lower let's say two quarters from now?

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

A

Yes, it's Hossam speaking. Now, for the corporate book we continue to grow across all segments from the giga-projects, the government transformation projects, everything under the vision of 2030. We are one of the largest lenders in this space and we are also playing a big role being a syndication of disciplines, leaders and advisors. And even on the middle and the small segment we continue to grow by innovating and creating more convenient products for our customers. So the growth is across all segments, we expect it to continue across all segments and we play a major role across all of them. So we're very happy with how the portfolio balance is structured and it's very clear in terms of what track we want to play and how we want to play in it. In terms of asset and yield I think it's, we are in line with where the market is.

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

A

Aybek, related to the second question on the ECL model, in line of our internal policy and the best practice we are updating our ECL model twice a year, whether it's a retail or a corporate, taking into consideration the macro outlook. Overall, the macro outlook over the last few quarters has been very positive despite the IMF revision recently taking into consideration the recent production cut. But most importantly, if you read, and I think the devil's in the detail. If you look in the Q2 data the most interesting part is the non-oil GDP growth of almost 5.5%. And I think this is one of the key drivers of the whole 2030 vision is to increase the non-oil GDP and to reduce dependencies on oil. So theoretically

yes, there could be a possibility, nevertheless, and I think from our perspective we are quite comfortable that the guidance that we've provided are in line of expectations for the remaining of the year.

And historically we have done that. If you recall 2020 when Saudi Arabia has been taking, I would say the twin shock between the pandemic as well as the lower oil prices we updated our ECL model. That has also had a negatively impacted our ECL model and our gross charge accordingly.

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**Aybek Islamov**

*Director Equity Research, HSBC*

Q

What kind of spread are you charging maybe, yes maybe can you give us a ballpark number what kind of spread you are receiving on your loans for the public sector projects?

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**Abdulrahman Alfadda**

*Chief Financial Officer, Al-Rajhi Bank*

A

That is not disclosed, that is dependent on every deal has its own dynamics, every deal has its own pricing, every deal has its own structure.

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**Hossam Al-basrawi**

*General Manager Corporate Banking, Al-Rajhi Bank*

A

Dependent also on the risk profile and tenor.

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**Abdulrahman Alfadda**

*Chief Financial Officer, Al-Rajhi Bank*

A

So I cannot generalise Aybek on that.

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**Aybek Islamov**

*Director Equity Research, HSBC*

Q

Okay. Yes, that's fine, thank you.

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**Shabbir Malik**

*EFG-Hermes, Banks Analyst*

Q

Thank you very much. I have a question regarding your FX income, which has been pretty strong the first half relative to first half last year. If you can touch on that that will be pretty useful. Secondly, you've stated there'll be an interim dividend for first half and it seems like you're on trend to paying a higher dividend this year versus last year, my question is given the relatively tight liquidity situation what was the thought process behind giving out a dividend rather than retaining that capital to maybe have more zero cost funding available to the bank. And thirdly, the comment that you made about some regulatory changes in terms of liquidity, if you can please talk about that one more time I

don't think I got the update point. So if you can talk about that regulatory change that will be really useful as well. Thank you.

**Waleed Almogbel**  
*Managing Director and Chief Executive Officer, Al-Rajhi Bank*

A

Thank you so much Shabbir for your question, I will take the question related to the dividend and the rest of the team will answer the remaining questions. Just to highlight that the board approved SAR 1.15 dividend per share for the first half of this year. And that is translated to 55% payout ratio. If we go back to the previous years between 2020 and 2022 the dividend ratio was between 24% and 29%. We believe this is a good dividend payout ratio considering that 25% of our net profit will go to that statutory reserve and the remaining we should look at it for the mid-term growth in the assets.

**Shabbir Malik**  
*EFG-Hermes, Banks Analyst*

Q

So shall we assume this is a more of a sustainable level going forward? 50%, 55% payout for the bank?

**Waleed Almogbel**  
*Managing Director and Chief Executive Officer, Al-Rajhi Bank*

A

I cannot assure you on that

**Shabbir Malik**  
*EFG-Hermes, Banks Analyst*

Q

All right, thank you.

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

A

And we'll always as we mentioned earlier, and I think a several times Waleed have mentioned, that we'll weigh in between dividend distribution and preserving capital in order to support the growth. Last few years, as Waleed mentioned, payout ratio was 23% to 29% taking into consideration that there were a super year of growth, given that our growth for this year were, I would say 1.9%, and I think we've recommended to the board and the board approved it is to increase the dividend payout ratio. And we will take that decision and review it on a regular basis. As far as the FX, maybe Hossam you want to cover that?

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

A

Yes, I think in line with what we had mentioned before that the way we are growing the corporate book and what kind of ancillary business it brings with it and how we're focussed on our coverage model being strong and looking at

solution provided to our customers, it's starting to translate on different avenues of income for the bank in FX, and treasury like I mentioned before is one of them and this is an outcome of what we mentioned. So all the trade business that the corporate growth is attracting is also attracting a lot of FX and the focus on the coverage is also attracting a lot of FX. So I hope that answers that question.

**Shabbir Malik**

*EFG-Hermes, Banks Analyst*

Q

So it is more corporate driven than retail driven, the FX income growth?

**Abdulrahman Alfadda**

*Chief Financial Officer, Al-Rajhi Bank*

A

If you look at the remittance, overall it's been flat year on year compared to the same period last year. So I think and still we delivered an 8% growth in our FX income growth coupled with almost 17% growth in our outstanding trade business. I think that is a sentiment of my colleague, Hossam what he mentioned earlier, it's a focus into the overall cross-sell and attracting value rather than volume.

On the regulatory side and I think your last question Shabbir, there has been a change on the calculation of the loan to deposit ratio that was being implemented from 1st June onward. Where the regulator allowed the, I would say the alternative funding, the sukuk to be treated like a customer deposit, i.e. weighted. And given that we do have a close to around 24.8 billion between the Tier 1 local issuance plus the syndicated loan, plus the senior unsecured sukuk that has been issued in April, that has helped to explain the reason why the LDR dropped to almost 82%.

**Shabbir Malik**

*EFG-Hermes, Banks Analyst*

Q

So can you please remind me what was the weightage assigned to it before and what is it now?

**Abdulrahman Alfadda**

*Chief Financial Officer, Al-Rajhi Bank*

A

It was treated as a current account, i.e. without any weight. Now it will attract the same weightage based on the contractual maturity of that funding.

**Shabbir Malik**

*EFG-Hermes, Banks Analyst*

Q

Thanks for that. If I may just one more follow up on the fee income side. So you've mentioned a lot about retail ex-mortgages contracting, is there any initiatives in place to maybe attract more fee-based business from the retail side? So maybe you're not able to grow in terms of volumes, loan volumes, but maybe there is an opportunity on the retail fee side, is that something that you can maybe talk about?



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

**A**

To be honest Shabbir if you look at the numbers our personal finance book have contracted year on year by almost 5%. And what happened to our fee income? It had a growth. And I think we are doing quite a lot in improving the fee income, this is part of the management initiative. And our fee income is not only dependent onto the retail financing, we do have quite a lot and the focus from our colleague on the corporate and the acquiring business our colleagues in the retail on the issuing side and cash management, trade, the derivatives from treasury. The whole cross-sell initiative that has been led by Waleed since the beginning of 2022 have led to a further improvement in the fee income, despite that we have seen a drop into the unsecured lending origination.

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**Shabbir Malik**  
*EFG-Hermes, Banks Analyst*

**Q**

Very clear, thank you very much.

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**Operator:**

Unfortunately, due to time limitations we'll conclude the Q&A session there. If you did have any further questions please send them through to the investor relations team. I'll now hand back to the MD and CEO for any closing remarks.

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**Waleed Almogbel**  
*Managing Director and Chief Executive Officer, Al-Rajhi Bank*

Thank you everyone for dialling in and for your trust in us. We look forward to meeting you again in next quarter earnings call. Thank you.