Transcript

Banque Saudi Fransi Q123 Earnings call

Monday, 15 May 2023

Shabbir Malik From the management we have today Mr Bader Alsalloom, the Chief Executive Officer. We also have with us Mr Ramzy Darwish, who is the Chief Financial Officer, Zuhair Mardam, the Chief Treasury and Investments Office, and Sander Aardoom, the Deputy Chief Financial Officer. I'll now hand it over to the speakers to start the call. Please, go ahead.

Bader Alsalloom Thank you very much. Good day to everyone. This is Bader Alsalloom and I'll be starting today's earnings call presentation with, as usual, a quick overview of the financial performance for BSF for the first quarter, and in today's earnings call we also want to cover what we've been doing on the strategy side and the progress and developments when it comes to our strategic initiatives. Now, to start with, from a financial performance perspective, strong quarter for BSF in the first quarter. Loans & Advances grew by 8%, driven by 8% commercial growth and 6% on the consumer lending growth, that was led with deposit growth of 11% year-on-year, mainly on the back of interest bearing deposits. And Investments grew by 4% year-on-year to SAR 44.8 billion.

On the income statement side, 24% top line growth year-on-year, mainly on the back of 36% of NII growth with the high interest rates and our healthy NIM of 3.65%, which is a 79 basis point growth year-on-year. Net income grew by 23% as the growth was partially offset by the increase of operating expenses, mainly given that this is a transformational year and our investments mainly are in IT infrastructure, and increased impairments. On the asset quality side, a modest rise in NPL ratio and cost of risks and moderated NPL coverage ratio, mainly from isolated pockets in our commercial book. From a capital and liquidity perspective, capital funding and liquidity remain strong and comfortably within regulatory limits. We did see a decline when it comes to NIBD percentage to 57%, mainly on the back of the shift to interest-bearing deposits and a rising interest rate environment.

Now, next in today's session we also want to take you through the Alfursan initiatives that are being done on the strategy side. Just to give you a quick overview and a background on the evolution of our strategy, back in 2019 BSF released its five-year LEAP strategy which took the bank up to 2024, and it was basically a comprehensive strategy to reimagine and modernise the bank and comprised of 163 strategic initiatives. Later in 2022, with the COVID-19 pandemic and the sudden rate declines in 2021, the bank decided to refresh the strategy and also extend it by another year to 2025, and that was called our strategy refresh. That was a refresh that included 102 initiatives and the main shift in this strategy was shifting from market share to profitability, given that the earlier 2019 five-year LEAP was based on market share, in 2021 our strategy refresh was a shift to profitability rather than market share.

2022, of course, after the rising rate environment, the increase in levels of inflation, the micro and macroeconomic developments and the management changes within BSF, we embarked back in December 2022 on a new strategy refocus which basically used the existing strategy refresh, that was refreshed back in 2021. That takes us up to 2025. However, for the remaining three years we have a specific focus and a simplified strategy to two turnkey initiative areas or turnkey focus areas by refocusing and simplifying our existing strategy, of course, on an evolving external environment. Now, this is the evolution of our strategy. As I mentioned, next slide please, our strategy actually revolves around ten key focus areas in addition to two priorities for 2023 and 2024 which is upgrading our technology infrastructure and also the upcoming rebranding. Our ten initiatives or focus areas revolve around five business areas or five business pillars, being wholesale banking, private banking, personal banking and our two leasing and investment banking arms being Saudi Fransi Leasing and Saudi Fransi Capital.

Next slide. Now, our strategy is driven by our aspirations for market position rather than market share, profitability and customer experience. Those are our three strategic goals. As I mentioned, we have identified five strategic pillars or business pillars that the strategy refocuses or we focus on going forward until 2025. That is wholesale banking by solidifying our market position. Our ambitions are, by 2025, to become one of the top three wholesale banks from an ROE perspective. Personal banking to continue leveraging segmentation and synergies with a primary focus on affluent banking and, by 2025, to become one of the top two when it comes to affluent banking by market share.

Private banking, which we're known to be a strong player in the market. It is to become the number one private bank by market share by 2025. Saudi Fransi Leasing, through the expansion of new market segments, mainly the mass segment, with the retail banking to become one of the top two when it comes to finance and leasing companies by market share. Last but not least, Saudi Fransi Capital, our investment banking arm, that is to continue building on our synergies with mainly our corporate banking and our private banking to become one of the top three investment banks by net income. Of course, these strategic pillars and business pillars are all based and reliant on strategy enablers being risk, technology, customer experience, our digital ambitions, our Treasury and, last but not least, organisational effectiveness and people.

Now, again, digging deeper into our strategy refocus, our strategic initiatives are mainly built on core business strengths and opportunities and taking advantage of those opportunities going forward. When it comes to wholesale banking we want to build on the strength of a strong corporate relationship team, our strong project and structured finance team and our strong cross-value proposition and to take advantage of the opportunities with objectives to strengthen our position when it comes to becoming the premier wholesale banks and boost the income.

Our focus with initiatives when it comes to this specific area which we have introduced is we want to focus on global transaction solutions, mainly being cash management and trade finance by GTS revamp, and we also want to expand our FIG and multinational corporate coverage. So, those are the two focus areas when it comes to wholesale banking. When it comes to personal banking, continuing to work of our strengths of having a strong and solid position and deep knowledge of affluent banking as we are positioned as an affluent bank. The focus of initiatives when it comes to personal banking is to scale up our affluent banking and to provide superior daily banking for our non-affluent banking by strengthening our channels.

Private banking, again working off of our strength with our leading market position and the specific focus areas within the strategy focus will be to expand our product suite and more of an experience-centric reward model. Saudi Fransi Leasing, again we want to work of our strength of having the regulatory advantage in a non-bank personal finance market and our legacy as a strong player when it comes to the auto finance area by expanding within the market segmentations. Here, the focus initiatives will be digital channel acceleration, product diversification and brand repositioning, which we're planning to roll out towards the end of this year, early next year.

Last but not least, Saudi Fransi Capital being a strong player within the investment banking world with its technical talent and proved excellence and trust. Specific focus initiatives will be to synergise with wealth management, mainly on private banking and our affluence personal banking to develop new areas of expertise, as an example real estate advisory and attractive investment solutions for both our private banking and our personal banking, mostly affluent banking. In the near future we will be sharing more information as we progress in the strategy refocus exercise with specific KPIs when it comes to the businesses. So that, in a nutshell, is what we have been doing when it comes to

strategy and, without further ado, I'll pass it on to my colleague Ramzy Darwish, our CFO, to go through the financial performance.

Ramzy Darwish Thank you, Bader, and a warm welcome to everyone taking the time to join us today for the Q1 2023 earnings presentation. As the CEO mentioned, strategy was really one of the most important elements worked on in the first quarter and I'm sure the focus, in terms of doubling down on our strengths, will continue to bear fruit, as we saw in the first quarter. Today, I'll be walking everyone through the financial results. A really strong quarter overall, driven by interest rates and overall lending growth.

Starting off on the balance sheet on slide nine, the bank grew total assets and lending by 8% year-over-year and on a sequential basis total asset growth and lending were both up 4%. You will note in the later slides that the growth was mainly from our commercial business, given the bank's corporate DNA. Investments increased by 1% for the quarter as maturities, new investments at higher yields and better mark to market contributed as the bank continues to maintain and manage overall liquidity ratios.

Speaking of liquidity, the HQLA book remains more than sufficient to maintain adequate liquidity levels as evidenced by the regulatory ratios highlighted in this update. To fund this balance sheet growth, liabilities grew 10% year-on-year, driven by 11% deposit growth and debt securities issues last year. On a sequential basis, liabilities grew 4%, driven by 6% deposit growth, almost exclusively interest-bearing deposits. Some of the deposit base is transitory and the bank will continue to optimise funding costs that ensure a healthy balance sheet and earnings growth.

Total equity for the quarter increased by 3%, driven by internally-generated capital via earnings and a slight improvement in mark to market on debt securities. For greater context, the debt securities were marketed at SAR 775 million lower whereas cash flow hedges were marked lower by SAR 1.1 billion. Again, important to highlight that this component of equity will gradually be recycled to the income statement as time passes and until maturity, where it will be more than compensated for by higher interest rate margins.

On the next few slides we will unpack some of these major balance sheet items. On slide ten, you will note a healthy 8% year-on-year growth for loans and advances or 4% for the quarter. This was driven by both the commercial and consumer segments, with a greater tilt towards commercial lending, which grew by SAR 5.0 billion for the quarter, with the contracting and manufacturing sectors representing the bulk of this increase. Consumer lending also grew 2% for the quarter, with mortgage growth of 2%, personal financing growth of 4%, and 7% growth in credit cards on the back of a successful campaign with the Alfursan brand.

In terms of composition, there were no significant deviations, with commerce and manufacturing continuing to represent the largest proportion of the commercial book and mortgages representing roughly half of the consumer lending book. Overall, competition remains strong but our focus on our core relationships remains and has been instrumental in allowing for the balancing of portfolio growth at adequate margins. The pipeline for commercial lending still presents attractive prospects for growth, especially given the healthy liquidity and capital position we'll talk about later.

On slide 11 we highlight the main funding element and that's the deposit basis, which grew 6% in the quarter and were primarily from interest-bearing deposits, which grew 17% as corporate deposit growth of 32% offset a smaller 5% decline in retail deposits. Non-interest-bearing deposits were relatively flat, down less than SAR 0.5 billion, versus last

year or SAR 0.9 billion year-to-date. It should be noted again that, as is usual, there were transitory deposits during the quarter and the bank will continue to optimise the funding base for greater efficiency and to manage costs. Overall, given the flat non-interest-bearing deposit volumes and increase in interest-bearing deposits in the quarter, the percentage of NIBDs to total deposits now stands at 57% versus 61% at '22 year end.

On slide 12 we provide the broad strokes for what was again a really strong quarter in terms of performance, with a record operating income before impairments of SAR 1.6 billion, 32% higher than last year. Along the same lines, net income at SAR 1.076 billion provided for a 23% growth over last year and 19% growth compared to the fourth quarter. This positive momentum is one we aim to continue to replicate over the longer term. I'll go over a few of the main highlights here and dive into the details over the next few slides. The main contributors include net interest income up 36% year-on-year and 8% over the previous quarter, accentuated by NIM expansion of 79% basis points from last year and 35 basis points for the quarter. Non-interest income did include some variability, with 3% lower numbers compared to Q1 last year and 15% lower from fourth quarter, mainly due to lower brokerage income as well as lower trading income from previous year one-offs.

Operating expenses were 18% higher year-on-year due to employee-related and G&A expenses, in addition to one-off reversals in the first quarter of 2022 but also important to note that opex was lower 2% sequentially from the last quarter. Similarly, impairments were at SAR 406 million, 68% higher than Q1 2022, driven by continued coverage for pockets of stage migration in the commercial book. Nevertheless, impairments were 15% lower on a sequential basis. In terms of operational efficiency, the cost-to-income ratio did improve and we showed strong momentum there thanks to loan growth and better interest margins leading to higher earnings. The ratio, standing at 30.7%, shows an improvement of 1.5% and 2.5% compared last quarter and last year respectively. Finally, on profitability, both the return on average. Equity and return on average assets improved, with the return in average equity now in double-digits and the return on average assets improving by more than 20 basis points when compared to Q1 or Q4 of 2022.

On slide 13 we talk about the main driver in operating income and that's the net interest income which witnessed a growth of 36% year-on-year as earning asset growth of 7% year-on-year and NIM expansion both played positively. In absolute amounts, net interest income was at SAR 1.9 billion from SAR 1.4 and 1.7 billion in Q1 and Q4 of 2022 respectively. Average interest-earning assets growing by SAR 13 billion outpaced the SAR 8.9 billion in average interest-earning liabilities and, taken together with the increase in SIBOR rates and more of the repricing kicking in, NIM for the quarter was at 3.65%. On the bottom right-hand chart, the NIM waterfall shows that the positive impact on the bank's NIM of improved yields on loans of 279 basis points year-on-year more than compensated for the negative impact of increased cost of funding of customary deposits and cash flow hedges.

On slide 14 we bring about a focus on one of the largest performance drivers given the bank's overall structure and interest rate standing and that is the positive positioning for a rising rate environment. The bank's interest rate sensitivity analysis is included on the annual disclosures in our financial statements and continues to conclude on a ten basis point positive sensitivity for every 100 basis points rise in rates on the assumption of a stable balance sheet structure, with the reverse also being true. The bank's interest rate sensitivity reflects the net loan position and you can see this in the top chart. The net loan position in variable rate assets driven by a balance sheet skew towards floating corporate loans. With a relatively high proportion of fixed rate liabilities or non-interesting bearing deposits, effectively SAR 115 billion of net interest rate-sensitive assets will be repricing with 34% in less than one year, 48% within one to five years, and 17% over five years.

In order to mitigate the interest rate volatility in net interest income and earnings, and also to manage the regulatory interest rate risk in the banking book which takes into account all on and off balance sheet assets and liabilities, whether it is held to maturity or not, banks in the Kingdom typically lend or invest in long-term fixed assets or, in the case of BSF, also utilise cash flow hedges to mitigate interest rate risk exposures and resulting earning volatility. The size of the cash flow hedge portfolio is driven by the development of the bank's balance sheet structure, for example the lending of fixed rate retail loans, the bank's interest rate risk appetite, and structural market trends. For greater context and background, we have highlighted in the bottom right chart the cash flow hedge percentage of interest rate sensitivity, which is calculated by dividing the cash flow hedge portfolio by the total interest rate sensitivity gap.

The percentage was at a peak of close to 70% in the past but, with expectations for higher rates, a significant reduction had taken place over the past few years reaching a low of 20% in the third quarter of last year. Now, as rates have stabilised and potentially peaked, the intention, similar to that of banks investing in long-term fixed instruments such as bonds, is to reduce potential future volatility in earnings by increasing the received fixed hedges. It is important to note that the cash flow hedge book has a relatively low average duration of between 2.0-2.5 years and, as they mature, mark to market reserves improve and replacement hedges provide for an improvement in the gross yields. On slide 15 we zoom in on non-interest income which witnessed a 3% year-on-year decline or a 15% reduction on a sequential basis. Non-interest income was slightly lower by 3% as exchange income growth of 24% was offset by trading income down by 53%, which had witnessed several one-off transactions in the first quarter of last year. Net fee and commission income increased 1% year-on-year as trade finance, cards and other fee increases offset lower brokerage and asset management fee income.

On slide 16, the final element of the net operating income is on expense, which had a growth of 18% year-on-year due to employee-related costs but also excess accrual reversals in the first quarter of 2022. For reference, excluding these reversals, growth would have been more in the range of 11% year-over-year. Outside of the staff-related expenses, other cost growth was relatively muted. We continue to exercise discipline in the budgeting and procurement process to identify efficiency opportunities and to improve the bank's overall cost-to-income ratio. And although the operating expenses as a percentage of average interest-earning assets increased to 1.33%, we did have an improvement on Q4 by two basis points and the enhanced income has allowed for an improvement in the cost-to-income ratio to 30.7%. Also important to note again on a sequential basis we did witness a 2% decline in the expenses without sacrificing on performance.

On slide 17 we highlight the credit trends which, similar to operating expenses, were higher on a year-over-year basis but sequentially lower. The net impairment of SAR 406 million was 68% higher year-over-year but lower by 15% sequentially, as highlighted in top charts. This was mainly driven by continued coverage on the isolated pockets of migration that were highlighted last year with a small offset, to some extent, by reversals in off-balance sheet commercial impairments where the guarantees had been called. The non-performing loans ratio was at 2.59%, slightly higher by five basis points, driven by 4% loan growth and 6% rise in NPLs. The resulting cost of risk was therefore 116 basis points year-to-date but important to highlight that this figure does not account for the impairment reversal of off-balance sheet impairments. If included, the cost of risk would be around 97 basis points.

In terms of the NPL coverage ratio, this increased three percentage points to 122.9, with the bulk being on Stage 3 NPL coverage, which was up by 6.7 percentage points. Stage 2 and Stage 3 coverage remained relatively stable with a slight decrease. The trend in the credit metrics was significantly impacted by the one corporate legacy exposure that

migrated to Stage 3 in the third quarter of last year and continues to be enhanced from a coverage standpoint. Otherwise, underlying credit quality continues to remain solid. We expect that when taking into account loan growth, fresh NPLs, recoveries and write-offs, that the coverage ratio should continue to improve throughout the year.

On slide 18 we discuss liquidity and capital where, to a great extent, there has not been any significant movement and it remains solid. This is evidenced by the LCR increasing 4% to 200% and the NSFR decreasing 3% to 199%. Similarly, the SAMA loan-to-deposit ratio sits at 80.9, providing ample liquidity for lending growth. On liquidity, we continue to explore opportunities to diversify funding to ensure stability for both the short and long terms while also, when the situation is warranted, extending the maturity profile opportunistically. Total capital increased on the back of earnings and internal capital generation. RWAs increased 1% year-on-year but are 2% lower this year on the back of the implementation of Basel III reforms. As a result, the capital adequacy ratio is at 20.7% and the Tier 1 ratio at 19.7%. Our capital position continues to provide ample room for asset growth while noting that, based on the ICAAP projections, we will continue to have adequate capital for the foreseeable future.

Lastly, on slide 19 we provide a quick snapshot on where we stand against the guidance. For loan growth, it's slightly above target with 3.6% growth in the quarter and we continue to target high single-digit growth for the year across both the commercial and retail segments. NIM at 3.65% is currently above guidance but we expect stabilisation between the second and third quarters of this year and on a full-year basis to be within guidance. For cost of risk for the quarters, we started off high as expected and again important to highlight the off-balance sheet impairment reversal for context which is excluded here. Nevertheless, with all the expectations for loan growth, NPLs, recoveries, we continue to view the high end of the cost of risk as achievable on a full-year basis.

Cost to income at 30.7% is in line with expectations and we continue to remain within guidance. For return on equity at 10.9%, this is an area where we've had great traction, improving 210 basis points year-on-year and we expect to reach guidance on a full-year basis. Lastly, in the CET1 ratio at 17%, it is expected to remain within the 17-18% range as capital generation through earnings is supplemented with partial reversal in mark to market. With that, we can bring a close to the session and we open up the Q&A.

Shabbir Malik Thank you. Thank you very much, Ramzy, for the presentation and also Mr Bader for the introduction on strategy. To the participants, if you would like to ask a question, you can either raise your hand or you can also type your question in the Q&A box. We will wait for the questions to log in. Our first question comes from Waleed Mohsin. Waleed, your line has been unmuted. Can you hear me?

Waleed Mohsin Presentation to the BSF management team. Three quick questions, please, from my side. First of all, on credit quality, if you can talk a little bit more about which sectors drove the increase in cost of risk and the increase in Stage 3 provisioning, please? Secondly, on your NIM guidance, I wanted to understand your underlying assumptions regarding interest rates and the trajectory of the NIM during the rest of the year. I say this because your guidance of 3.3-3.5% for the full year implies that for the remainder of the year your NIM will fall to an average of between 320-345 basis points. So, I wanted to understand where and when do you expect the NIM to peak and when do you expect such a sharp drop that NIM will fall within your conservative guidance range? And my third and final question, thank you for taking us through the strategic goals and pillars, amongst the targets you've stated under the strategic pillars, which one of them would you consider to be the most ambitious? Thank you.

Ramzy Darwish Thank you, Waleed. Maybe we'll split these up. I'll begin with the first question and maybe we'll have our Treasurer on the second and the CEO, we'll give him the chance on the strategy question. Might I just have to repeat that question again, though. For the legacy accounts, which were classified as NPL last year, it's related really to one group and it's split evenly across services. It's a holding company assigned to this sector and manufacturing. The operating companies would have fallen under this category and this was the main account that we had last year, that we are continuing to enhance the coverage on throughout this year. On the second question relating to the NIM?

Zuhair Mardam Sure. With regards to the NIM guidance trajectory throughout 2023, our NIM guidance is based on what the market is forecasting today. The market is forecasting three cuts to the end of the year. Now, we believe with the migration of current accounts into time deposits, that could have a further impact on cost of funding. So, we decided to remain conservative for now and guide the market in line with the cutting rate environment or, let's say, the anticipated cuts end of the year and not to take a view outside the market pricing. Moreover, we expect to onboard long-term or medium-term funding that could potentially further impact on cost of funding. As for now, we remain within those guidelines.

Bader Alsalloom Regarding the third question of strategy and which one would be the most ambitious of our strategy business pillars, all of them are ambitious, however the most ambitious would be the personal banking and our focus on affluent banking, given that we are known to be and our core business is corporate and private banking. Further, those are two areas that we are well positioned in, however when it comes to personal banking, given that we're not a large retail player and now our ambition is to become one of the top two when it comes to affluent banking. That is the most ambitious out of the five.

Waleed Mohsin Thank you, much. This is very helpful. Thank you.

Shabbir Malik Thank you. Our next question is from Edmond. Edmond, please go ahead.

Edmond Audible?

Shabbir Malik Yes. We can hear you.

Edmond Excellent. I just want to understand the sensitivity, ten basis points for 100 basis point rise in interest rate or fall in interest rate, how much of this is a reflection also of the hedging programme you have in place? I'm trying to understand, next year or we have by the end of the year a cut in interest rate. What will the impact on your margin sensitivity for a 25 basis point cut in interest rate, including the hedges? Also, I'm surprised to not see the hedges increasing now since most of the banks they are showing some increase in the fixed rate investment portfolio, which we haven't seen for Saudi Fransi. So, I would expect your hedging portfolio will be growing over time, not declining, at least from the last quarter until now.

The second question will be on the stage migration from Stage 1 to Stage 2. Is there any clarity what is the reason for that? And the last question is it's still unclear if SAMA has injected liquidity or replaced liquidity through the institution into the banking sector but it's still puzzling me the cost of funding for some of the bank is higher than the medium of the industry, and some of the bank below the medium of the industry and being growing 10% sequentially on deposit, time deposit. So, I just want to understand from you what's your view on the time deposit that came into the industry.

It seems to be very cheap, cost-efficient, and it seems to be also cheap for you to grow in the time deposits where your cost of funding has been constrained into the quarters. How will this play out for the rest of the year? And what is the impact of the cash flow hedges on your asset yield going forward? We have 50 basis points in 1Q? What is the expectation for the rest of the year? Thank you.

Ramzy Darwish Thank you, Edmond. It is a lot to manage there, so we'll have to break it down point by point, if you don't mind repeating some of the questions. I think we'll start with the first one on the NIM. Our Treasurer is going to respond there but I think the response for the ten basis points, this is all inclusive, so everything would be included there in terms of on-balance sheet and off-balance sheet and this is what's reported in the annual financial statements. I think also in terms of the addition of fixed rate assets, as you had mentioned, you discussed other banks maybe increasing here. So, when I discussed the drop from the previous years, from close to 70% to 20% that was the low in the third quarter of last year and it has since increased to 23.2% as of the first quarter. Again, I think this is a built-in assumption, that we want to reduce the interest rate risk. There is an amount that is going to, on a consistent basis, be utilised to ensure that interest rate risk is managed. Then, on top of that there's an opportunistic layer that we would be adding for positioning and other purposes. In terms of the staging question, Zuhair, do you want to take this one?

Zuhair Mardam Yes. Zuhair Mardam speaking here. That's a good question and it really comes out in the financial statements but the Stage 1 to 2 movements there, they are really due to applying the various staging rules we have to the overall portfolios. This is not due to any new credit concerns whatsoever. Asset movements have always been there and we've seen that on a regular basis in other quarters as well, these large movements which are made up of many smaller amounts into Stage 2 and often also back again to Stage 1.

Ramzy Darwish And, Edmond, if you don't mind, if you could repeat the third question on the time deposits.

Shabbir Malik Edmond, you're on mute.

Edmond Thanks. The last question is when I look at your cost of funding it hasn't increased as I would have expected with the decline in the CASA, so either the CASA impacts or the increase in the time deposit, it's yet to be reflected in your cost of funding or it is a similar story we have seen with some banks where they are growing 10% sequentially on the deposit while the cost of funding has been constrained? So, the question is for you and for the market, if you are able to comment on the trend on a broader basis is if SAMA has been placing deposits into the system in terms of a cheap deposit, what is the tenor of this deposit and is this sticky on the balance sheet?

Zuhair Mardam Just on the cost of funding interest expense not rising as much as peers, I think we continue to try to optimise the use of our day-to-day funding. As for SAMA, we cannot comment exactly on what have they injected or not. What we have seen globally from the regulator and others is regular day-to-day activities whereby some of the government-related entities are placing funds into the banking sector but apart from that there is nothing in terms of support.

Ramzy Darwish And I would add to that. I think in terms of pricing, if that's the question, I think it is competitive pricing across the banks. I've not seen anything averse to that.

Shabbir Malik Thank you. Our next question is from Olga Veselova. Please, go ahead.

Olga Veselova This is Olga Veselova, from Bank of America. Can I please come back to the question about interest rate hedges? What is the best way for us to model your impact of cash flow hedges on NII? We have our own assumptions of interest rate policy rates for the next, so what's the best way to model that? Also, I'm looking at your slide 14. You disclose the percentage of cash flow hedge swaps, which used to be 70% at peak and now 23%. Sorry for my naïve question but what's the best way to use this ratio, this 23%? How shall we read that? This is my first question. The second question is about your cost of risk. You mentioned that there was an impact of off-balance sheet impairment reversal. Could you please repeat for us if the cost of risk guidance excludes this reversal and if it does then what would be, including reversal, the real cost of risk guidance? Thank you.

Ramzy Darwish I'll start with first question, Olga. Thank you for that. For me, I try to think of it in the simplest form instead of using a cash flow hedge the other alternative is to borrow short-term or invest or lend longer-term fixed rate, so that's either through a bond or through a mortgage. If I were to try and translate this in terms of balance sheet, you could theoretically take the cash flow hedge portfolio and convert it to on-balance sheet in terms of deposits and in terms of investments. I think this is the simplest way to provide that colour. Then, when you're looking at the analysis, I think that top right-hand chart on page 14 really is the best way to look at it in terms of modelling the impact now and also going forward given the tenor bucket breakdown that is provided there. For the second question?

Zuhair Mardam The cost of risk formula excludes the reversal on the on-balance and investments there, as the CFO explained before. So, the cost of risk was 116 basis points for Q1. If you exclude that minus 71 or actually include it in the ratio, then you would end up with 97 basis points for the quarter, but our guidance is linked to the proper definition of the cost of risk which excludes the reversal. So, the 116 basis points is part of our full year guidance and, as the CFO said, based on the expected recoveries, etc., we still hope to end up in the higher end of the cost of risk guidance.

Shabbir Malik Thank you. We'll now move to the next question. Nauman, your line is open. Please, go ahead.

Nauman Khan This is Nauman Khan, from SNB Capital. Just a couple of questions. One is on your loan growth guidance of high single-digits. What we have witnessed or seen from across your peers as well, which are focusing on similar markets as you are or customer base as you are and they're targeting more of a mid-single-digit growth this year. So, I just wanted to understand the rationale of you being slightly conservative or what's the view which is different from the others? The other thing I just wanted to ask is that you have been very clear about the cost of risk as well. That means going forward it will be trending downwards, right, and towards the end of the year you may see some reversals coming in on the cost of risk side? Just to get into your bucket of guidance.

Ramzy Darwish Thank you for the question, Nauman. I'll maybe start with the second question in terms of cost of risk. I think that statement is correct, that we had expected and budgeted for a heftier first quarter and over the course of the year, that this would result in line with our guidance figures. In terms of loan growth, I'll maybe provide a comment and allow the CEO to add on to this. But I think when you look at our first quarter growth, 3.6%, given the target of high single-digits, we think it's still in striking distance and we actually have a good head start for the first quarter. There have been quarters in the past where we've seen repayments and slower loan growth, particularly in the past Q4 has been the one that we would always watch out for. So, I think taken all together we still do expect to hit that high single-digit figure. Bader, if you have anything to add?

Bader Alsalloom Your question was regarding comparing our growth with our peers? If you could just repeat that part of the question.

Nauman Khan Thank you. Just to provide some more clarity on what I was asking. The other peers who operating in a similar space, the mid-corporate space, they're guiding towards mid-teen or low-teen growth for this year. Your growth, on the other hand, is slightly on the conservative side as well. I just wanted to have an understanding of where do you think the overall market will go, the colour on that. Do you think that you will see be underperforming or outperforming the market? And do you think there is potential that there may be a surprise on your guidance, there's an upside potential to your guidance?

Bader Alsalloom I think as mentioned by our CFO I think that we are on track when it comes to our guidance of high single-digit. Maybe the reason why it may be not as ambitious as some of our peers in the same space is because we always are conservative and always maintain the diversification of our loan portfolio. Our loan portfolio does enjoy a well-diversified distribution and at the same time we do take asset quality very seriously and we are selective when it comes to our loan growth, hence why our guidance of high single-digit may be a bit lower than some of our peers to maintain the high quality of our loan book.

Ramzy Darwish And at the same time, just to add to that, again the stronger Q1 that we've had, if you just annualise that you could say, yes, it is going to be above but I think we're constantly reviewing guidance on a regular basis and at this point in time I don't think we're ready to make that call in terms of conviction on the full year yet.

Bader Alsalloom Also, one more point, I may add, also when it comes to being selective, when it comes to loan growth and given that we are predominantly more of a corporate bank, we are also selective not just from an asset quality, also from pricing. We are keen to maintain suitable pricing, so we are selective when it comes to pricing and when it comes to asset quality.

Shabbir Malik Thank you, Bader and Ramzy. We'll move on to the next question. Aybek, your line is open. Please, go ahead. Aybek?

Aybek Islamov Let me ask my questions here. Thank you for the conference call. I think the first question is can you remind us why banks in Saudi Arabia don't really do share buybacks? That's the first question. The second one, I see that Alinma Bank announced a quarterly dividend. They're paying a dividend based on first quarter results. Is that something which is becoming a common practice? Is that something that BSF will want to do? I think the third question will be around your technology investments. We know that you invested a lot in upgrading your technology platforms. Should we see some tangible results in terms of better asset growth and, for example, better fee ratios relative to assets? How should we think about the payoff, the tangible payoff from the technology investments that you've done so far?

Bader Alsalloom If I may, I want to start with the third question, the technology question, then I'll pass it on to my colleagues. When it comes to technology and, as I mentioned before, 2023 and most of 2024 is a transformational year, mainly from an IT infrastructure. As we've mentioned before in our calls, we are undergoing a massive and complex upgrade to our core banking system. Actually, it's a shift or an establishment of a new core banking system which were are towards the end of the second third of it and getting into the last and final two releases of that programme. In addition to that, as part of our IT infrastructure upgrade, we're also rolling out a new retail omnichannel

app and online banking for our personal banking clients and our private banking clients, in addition to rolling out the first phase of our new integrated corporate portal.

So, definitely from an investment perspective on the core banking system we will start to see it translate into more cost-efficiency starting hopefully in 2024 and beyond and from previous releases we've already seen some efficiency come out when it comes to turnaround time and rolling out new products, that's when it comes to the core banking system. And when it comes to the integrated corporate portal, it does link to one important strategy focus area and focus initiative, which is of course revamping and upscaling our global transactional banking, being trade finance and cash management and ICP, or integrated corporate portal, will definitely be a major enabler in that, which will hopefully start to increase and expand our fee income starting in 2024 and beyond.

Ramzy Darwish Aybek, I'll maybe comment on the other two points. In terms of the quarterly dividend, I think this is something we've seen from global banks. In Saudi, it is not really very common, as of yet, in the banking sector. I think we do need to take into account the capital adequacy growth expectations and also the regulatory regime that we would have to go through for these items. In terms of efficiency, it may be something that can be considered but at this juncture, in terms of the capital utilisation that we have plans for, we maintain that at the similar level that we are now. On a similar vein, to be honest, on share buybacks, I think the one thing we would want to take into account is the liquidity of the shares. At the same time, I think the global banks have done this route because of the tax advantage that it provides whereas here presumably there would not be the same sort of advantage. I think we would also add on top of that the efficiency cost in terms of transaction cost for the buybacks versus dividends. I hope that answers your question.

Aybek Islamov Yes. Thank you.

Shabbir Malik Thank you. As a reminder, if you would like to ask your question, you can either raise your hand or type it in the Q&A box. Maybe if I can step in here. Just in terms of your strategy, you pointed out that an area for you, an opportunity for you is increasing coverage of the financial institutions growth and product-wise global transaction services, GTS, has been highlighted as key areas. Maybe if you can give more details in terms of the opportunity? What is your positioning there currently and how big of an opportunity do you think this is potentially for Banque Saudi Fransi? Secondly, in terms of project financing, what is BSF's positioning in project financing relative to the other banks in the Kingdom? Thank you.

Bader Alsalloom When it comes to the strategy and more specifically, as you mentioned, when it comes to wholesale banking, which is our core business here in BSF, when it comes to the two focus initiatives or the two focus areas in our strategy refocus, those are two areas that we believe have the greatest opportunity given that they are not at par with the remaining wholesale banking that we have. When it comes to wholesale banking we do have a strong position when it comes to corporate coverage and we do have a strong position, as you know, when it comes to project finance. However, the two areas that we believe would have the greatest opportunity is global transaction solutions and those are two areas that we are focusing on and revamping definitely. Definitely, ICP or integrated corporate portal or digital channels will be a major enabler there and that's why we are focusing on IT infrastructure upgrades for this year which will play a large role and complement our strong corporate coverage from a fee income perspective.

When it comes to the other focus area within wholesale banking, which is FIG and MNC, FIG, financial institutions & government, has historically been an area that was not a focus area for BSF, hence why we saw that this was an area that would definitely help us when it comes to generating deposits and also potential fee income from the FIG, financial institutions & government. MNC is a new area that we're venturing in, as in BSF, and we do see the opportunity when it comes to multinational corporates on the back of the Vision 2030 initiatives and the giga-projects, with many multinational companies actually coming in on many of these projects. So, this is an area that we have not been visible in historically, however we do see on the back of the Vision 2030 initiatives a great opportunity to focus on. I hope I answered your question on those two.

Sorry, the second question being the project finance. Project finance, BSF is known to be a strong player when it comes to project and structured finance area. We continue to be in that very important space for us and, again, when it comes to the Vision 2030 initiatives we see that the biggest growth area within the overall Vision 2030 initiatives and giga-projects will be in the project and finance space. So, that is an area of strength for us and we will continue to be a strong player. We do see ourselves as one of the top three players and part of our strategy is to hopefully become the number one player when it comes to project and structured finance. We do have the advantage of our project and structured finance being within the bank itself where, when we look at our competitors in this specific area, it actually sits outside the bank within the investment bank. For us, it sits within the bank for better access to our balance sheet, which we see as a competitive advantage in this space.

Shabbir Malik Thank you. A question related to that strategy and the cost strength at we've seen. Is there any strategy implementation-related costs that we're seeing in maybe first quarter 2023 that can potentially normalise once that strategy is implemented?

Ramzy Darwish I think this is something we've been investing in for some time on the IT side and although again we had this reversal in 2022 that caused the appearance of a spike, excluding that we were at 11% year-on-year. I think for the full year we would still expect to be below 10%, somewhere in the range of 7-8% would be where we would look to target.

Shabbir Malik Thank you very much, Ramzy and Bader. I think we've run out of all the questions and there are no questions in the chat box as well. So, I then hand it back to you for any concluding remarks.

Bader Alsalloom Thank you very much. Thank you very much, everyone, for your valuable time today.

Shabbir Malik Thanks a lot. Have a nice day, everyone.

Bader Alsalloom Thank you very much.

Shabbir Malik Bye.