Transcript

Banque Saudi Fransi Q1-24 Earnings Call Sunday, May 5, 2024

Shabbir Malik Good afternoon and good evening, everyone. I hope everyone is doing well. My name is Shabbir Malik and on behalf of EFG Hermes I welcome you to BSF's first quarter results call. The management will do a presentation and then we'll open the floor for questions and answers. I will now hand it over to Yasminah Abbas, the Head of Investor Relations. Yasminah, over to you.

Yasmina Abbas Thank you. Good afternoon and welcome to BSF Q1 2024 earnings call. I would like to thank you, Shabbir and team, for hosting this call. Speaking first is BSF's CEO, Bader Alsalloom, and he will go over the earnings summary for the quarter as well as an overview of the strategy execution and share with us a couple of exciting updates. He then is followed by the CFO, Ramzy Darwish, for a more detailed walk-through of the financial performance. And with that, I'll hand over to Bader.

Bader Alsalloom Thank you, Yasmina. Good afternoon and greetings to all for joining us on this call. We appreciate your time, as we discuss our Q1 2024 performance over the next hour. I'm pleased to share this quarter's results with you, which reflect the return back to normal, following the one-off impacts last quarter. Our results are also in line with our expectations and guidance. We're especially excited by two strategic milestones which we have achieved year-to-date. The completion of phase two of our new core banking system, which happened in the first quarter. And most recently, albeit not in the first quarter, but important to highlight the launch of our new brand.

We'll delve into them shortly, but first, let me take you through highlights of our financial performance. Our net income for the first quarter of 2024 saw a notable increase of 7% to SAR 1.15 billion, with the return on equity reaching 11.1%. This growth was primarily driven by a decrease in our cost of risk, while operating income grew 1% from non-funded income growth. Growth in our loan book was also strong, up by 13% year-on-year, supported by both commercial and consumer sectors. Customer deposits increased by 4% year-on-year, reaching SAR 174.8 billion, driven by increased interest bearing deposits, although non-interest bearing deposits increased on a sequential basis.

Regarding asset quality, we saw significantly improvements with our NPL ratio decreasing to 0.94%, reflecting write-offs in our commercial book and the NPL coverage increased to 155%. Our capital position remains robust, with 18.4% Tier 1 ratio. Additionally, our liquidity metrics are comfortably within regulatory limits, further strengthening our financial resilience. Next, let's move on to our strategic update.

Overall, our strategy execution continues to show rapid enhancement, with an overall progress rate now at 66% compared to 62% last quarter. In wholesale banking we have taken significant steps, achieving a completion rate of 78%. We have expanded onboarding and lending to government entities, established a tracker for multi-national corporate referrals, launched three supply chain financing products and activated government agreements.

Moving to personal banking, progress stands at 46% compared to 40% last quarter. Notable achievements include the pilot launch of LOMBARD lending to our upper affluent segment and Leads Management Dashboard. We've also piloted Elite Plus, our new upper affluent segment, and further progressed the partnership with wholesale banking, enhancing cross-sell opportunities and customer relationships. Private banking has seen impressive progress, reaching 86% completion rate. This includes, among others, finalising a proposal for the advisory development programme. Additionally, we hosted several VIP experience events to enhance client engagement.

Moving on to the next slide, JB, previously Saudi Fransi, leasing has also made significant achievements with an 86% completion rate. We've introduced JB's new digital personal loan offering and achieved encouraging growth in this product. We've also defined a new credit card proposition and further refined JB's strategy and focus areas for this year and beyond.

Lastly, at VSF Capital progress stands at 43%. Key highlights include identifying their WealthTech Partner, redesigning the onboarding and KYC process, automating internal reporting and starting the repositioning of the real estate advisory unit. We're also optimistic about the pipeline in real estate funds.

Now let's talk about key enablers on our next slide. Looking at our technology infrastructure upgrade, first starting with ICP, our new integrated corporate portal. Phase one back-end testing is in progress and it's scheduled for roll-out during this year. For phase two functional specifications are signed off and technical specifications are in progress. with Omnichannel, our new retail and private banking platform, we concluded several rounds of testing and piloting in 2023 and early 2023 and are expected to go to market in mid-May.

Next on core banking system and rebranding efforts. I'll cover these in more detail on the following slides. Now when it comes to CBS, our core banking system, this is a significantly project, replacing 30 fragmented systems and consolidating them into one unified system. Over the past few years we have worked on deploying various releases of CBS, each more complex than the earlier one. Our first release was issued in December 2020, followed by subsequent releases.

Major progress was made in 2023, then we saw the completion of phase two testing for user acceptance, rolled out a family and friends technical pilot programme and completed design user training and change management activities. The hard work of 2023 enabled CBS release to go live in February 2024. This marked the pivotal milestone, as we introduced critical functionalities, such as corporate and retail accounts, Islamic and conventional recurring deposits, and a comprehensive overhaul of our branch channel.

Looking ahead, we expect the roll-out of Release 3 during 2025, which will further enhance our capabilities. Our CBS project journey is testimony to the dedication and hard work of our team and I'm very happy and proud that the majority of the journey has already been completed successfully.

Moving on to the next slide. CBS is not just a technical upgrade, it's a strategic initiative that underpins our digital transformation that will help us realise our ambitions. CBS enables us to enhance our product offering and services, predict client needs and streamline our operations using the latest innovations and advanced analysis. The benefits of CBS are many. From an enhanced customer experience with full digitalisation and 24/7 self-service capabilities to improve the efficiency and reduce IT workload, CBS is revolutionising how we serve our customers and manage our operations.

CBS also serves as a key enabler for our strategy ambition to position ourselves as a leader in customer experience. Already we've realised significant benefit from CBS implementation, including future proofing our tech landscape and improving efficiency. Just one of many examples, we witnessed and impressive 80% increase in straight through processing rates for SARIE transactions. This is one of many examples. CBS has also streamlined our credit cards and personal loan processes, making them one to two times faster and more efficient than before.

Now let's switch to another important achievement, our new branding which came to life recently, a few days ago. Again, albeit that this is a more recent development, but lots of work was actually done in Q1 and worth mentioning here. As part of our strategic evolution, Bank Saudi Fransi has undergone a rebranding, emerging as BSF. The new brand was officially launched on 2 May for BSF employees and senior management. We have also completed rebranding physical and digital assets, including over 70 branches, 300 ATMs, six offices and several e-channels and applications.

With our heritage, BSF inherited equitable values, trust and sophistication in our DNA. Our acronym, BSF, symbolises the next generation of banking, making a pivotal shift in our industry positioning. Our brand strategy is founded on shared beliefs, an active purpose and a compelling value proposition. But why the change to the rebranding of BSF? It's not just about refreshing our imagine, it's about strategic enablement for future growth. We aim for leadership and profitability within focused market segments and our new brand gives us a competitive advantage in achieving this goal.

We've responded to external changes by adapting to shifts in the economic landscape and the evolution of the banking sector. Increasing customer expectations and technical advancements have also influenced our decision to rebrand, ensuring we remain relevant and competitive in a rapidly changing environment. Overall, our new brand embodies our commitment to innovation, customers and sustainability. It's a symbol of our readiness to embrace change and drive a positive impact in the banking industry and beyond.

Finally, I'd like to touch upon our ESG developments and some achievements in that area. ESG is part of BSF's DNA. It's deeply rooted in our bank's strategy and processes. Allow me to remind you of our five key pillars. First, exemplifying the highest ethical and governance standards. Second, accelerating sustainable economic growth. Third, creating a thriving workplace. Fourth, serving our clients. And last but not least, protecting our communities.

Moving on to the next slide, I'd like to highlight the progress BSF has made in boosting our ESG ratings. In 2023 our ESG risk rating score from Sustainalytics stood at 28.4. In the first quarter of 2024 we've significantly improved, achieving a score of 20.9, surpassing all Saudi banks as of March 2024. Additionally, I'm pleased to announce that BSF has attained the highest score in the SMP global ESG rating among Saudi banks for 2023. This achievement underscores our dedication to sustainable and responsible practices. We acknowledge that sustainability is a journey and this success motivates us to enhance our ESG practices further.

In conclusion BSF is now well positioned to achieve its three core strategic goals. To become a top player in our target segments, focus on profitability and returns. And last but not least, deliver outstanding customer experience. These goals will drive our progress towards becoming one of the top three Saudi banks in our chosen market segments by 2025 and with aspirations to lead in private banking.

Now I'll hand it over to our CFO, Ramzy Darwish, who will delve into the financial performance. Ramzy, the floor is yours.

Ramzy Darwish Thank you, Bader, and good afternoon everyone. Thank you for joining us today. Overall, we are pleased to report that our financial performance in the first quarter is back to normal, free from the one-offs that we discussed in Q4 of last year. Our net income for the quarter increased due to the normalisation of cost of risk. The decline in margin year-on-year was counterbalanced by continued asset growth sustained in the first quarter this year, as well. Additionally, asset quality metrics are also showing improvement. We'll delve into the details as we progress through the presentation, starting with an overview of the balance sheet on slide 14.

Total assets increased by 6% during the first quarter, primarily fuelled by growth in lending and investments. The investment book itself increased by 9% year-to-date from high-quality liquid assets to manage interest rate risk, while also capturing higher yields. You'll note on the right-hand top part of the slide a chart that indicates the constituents of this change, and the majority coming from the loans and advances with SAR 6 billion growth, or 3%, contributing the majority of the growth.

On the bottom right-hand part of the slide the liabilities overall indicated a 7% growth, with deposits growing 2% mainly from non-interest bearing deposits and increased wholesale funding, both short term through the interbank and FI market, and also from the long-term senior debt with debt securities and term loans.

On the next slide we highlight loans and advances, which grew 3% year-to-date or 13% year-on-year. This is coming from both commercial, which grew 3%, as well as consumer growth of 5%. The commercial activity highlighted in the bottom left part of the slide reflects healthy corporate activity, as commerce, contracting and services showed growth. On the bottom right-hand part of the slide with consumer loans we indicate faster than market growth with particular strength in auto loans at 14%, personal finance at 6% and mortgages at 3% growth. It should also be noted that a significant portion of this growth in auto loans and personal financing, more specifically, comes from JB, where early success of the rebrand and strategy is gaining momentum.

On the next slide, in terms of deposits we had shown 2% year-to-date growth in deposits, primarily coming from the corporate segment. We had non-interest bearing deposit growth of 3% for the quarter, again mainly coming from the corporate segment. Interest bearing deposits had a growth of 1%, as we continue to try and optimise costs and efficiency. As a result, on the bottom left-hand part of the slide, this dynamic resulted in stabilisation and slight improvement in the share of non-interest bearing deposits to total deposits, which now stand at 47.6%.

On the next slide we discuss net income, which grew 7% year-on-year from lower impairment charges and increased 39% relative to the fourth quarter of last year. The bottom table and chart provide colour on where the main drivers were, as net interest income was stable, but a significant normalisation and impairment more than offset the increase in operating expenses. Additionally, you will note normalisation to the trend on non-interest income and operating expenses from the one-offs highlighted in the previous quarter.

Now let’s dive deeper into the composition of the P&L, starting with net interest income on page 18. Net interest income was broadly stable, as highlighted in the top-right part of the slide, where expansion on interest earning assets was offset by rising interest expense from hedging and cost of funds. The bottom two charges indicate this in a different light, with 9% quarter-on-quarter growth and interest income offset by 16% growth in interest expense.

As a result, on slide 19 we highlight the net interest margin which trended lower compared to last year, mainly on the back of rising cost of funds, as shown in the top charts. Nevertheless, this has broadly stabilised with net interest margins at 319 basis points versus 322 basis points last quarter. There's also shown a different light on the bottom left chart, where the customer deposit cost more than offset increasing trends on the asset side. It's also worth noting that interest rate hedging had a relatively minor impact on margin, with a 13 basis points impact year-on-year and 1 basis point on a sequential basis.

Now let’s delve into NIM sensitivity. As mentioned last quarter, the bank sensitivity significantly declined during 2023 and now, all else equal, is quite limited and is assessed at plus-minus 3 basis points for every 100 basis points’ change in benchmark rates. It should be noted that this is calculated based on balance sheet and off-balance sheet items, and we provide more colour on both of these on the right-hand side of the charts. Where although cash flow hedges remain at the same notional amount, when added to the on-balance sheet sensitivity again provides a view on more limited net interest margin sensitivity.

On the next slide we highlights non-interest income where we had a 5% year-on-year growth and 28% growth compared to last quarter, given one-offs discussed in the trading line in Q4. On the top right chart you will note the main driver coming from trading income, reflecting more BAU volatility and market opportunities. The bottom right chart also shows the improvement driven by brokerage asset management and increased trade finance income, with cards fees lower, mainly due to the Alfursan campaign, which provided the boost in the first quarter of last year.

On the next slide, in terms of operating expenses we had an increase of 9% year-on-year, mainly on the back of employee related costs, reflecting increased head count and the correlated pay to profitability. As a result, at the bottom left part of the slide the charts show cost to income rising slightly to 33.2%. However, we maintain a positive outlook on this with the strategic investments expected to reap benefits in operational efficiency, as well as frontline benefits, such as customer experience, time to market and others.

Additionally, cost to average interest earning assets declined to 1.28% due to faster growth of earning assets. Sequentially you will note a 9% drop in expenses, again attributed to one-offs and non-recurring transformation related expenses that had occurred in the fourth quarter last year, which we had discussed.

On the next slide when we dive into the cost of risk, the quality of the portfolio remains healthy with cost of risk normalising to 60 basis points from higher levels last year. The impairment charge highlighted in the bottom charts show a significant 32% reduction from last year and 33% reduction from the last quarter, reflecting normalisation absent the legacy account that was dealt with over the last two years.

The quality is further reflected on page 24 in the non-performing loan ratio and the coverage ratios. With NPLs coming down below 1% and coverage ratios improving to 155%. This is due to many factors, including growth and lending, conservative provisioning and write-offs over the past 12 months. You'll note stage-wide coverage improved on Stage 3 loans specifically, whereas coverage for Stage 1 and Stage 2 loans remain broadly the same.

On slide 25 we highlight the liquidity position, which continues to remain robust and comfortably meeting regulatory requirements. The bank continues to opportunistically tap the capital markets to diversify and extend the liability profile. We executed a $700 million public sukuk in the first quarter, in addition to a $250 million term loan facility, reflecting the solid appetite available for the bank. The bottom two charts reflect the still robust position with LCR at 166% and the net stable funding ratio at 116%. Lastly on capital, we experienced a slight reduction driven by RWA growth, but still reflecting more than adequate capital ratios. With the CET1 ratio at 16.2%, the Tier 1 ratio at 18.4% and overall total CAR at 19%.

To conclude, a solid start to the year, which brings us to the guidance, where on loans and advances we experienced 3.4% growth year-to-date and the guidance, having been at low double digits, remains unchanged. We continue to view that the robust activity in the corporate segment will drive the majority of this loan growth for the year. On net interest margin at 319 basis points remains in line with the guidance between 310 and 330 basis points. This is again subject to a change in deposit mix, but also the growth in margins overall. On cost of risk at 60 basis points remains within guidance at the lower end of 60 to 70 basis points, and we continue to believe that the bank will be able to achieve these levels or even better. On cost to income, the ratio at 33.2% versus 32%, again expectations for limited cost growth with enhanced income growth expected to drive this below 32% by the close of the year.

On return on equity at 11.1%, again within guidance of 11 to 13%, and we expect to continue to remain within these levels. Finally, on the core equity Tier 1 ratio 16.2% slightly below the 17 to 18% guidance. We will continue to monitor and manage this throughout the course of the year, but expectations as of now remain unchanged for the full year. With that, we bring a close to the financial highlights section and we will pass it on to the operator for Q&A.

Shabbir Malik Thank you very much, Ramzy, for the presentation. Also, Bader, thank you very much for your comments. We now open the floor for Q&A. If you would like to ask a question, please raise your hand or you can also post your question in the Q&A box. We have a couple of hands raised. I'll start off with Nida Iqbal. Your line should be open, please go ahead.

Nida Iqbal Thank you very much for the presentation. I have two questions. Firstly on the cost of funding and the funding dynamics this quarter. I saw that term deposit shares were down quarter on quarter. Do you think we’re at the peak in terms of term deposit share and where do you see cost of funding evolving from here?

My second question is on the asset growth and the loan growth this quarter. I think the consumer [inaudible 00:25:02] I just wanted to get some colour in terms of expectation for the next few quarters.

[Inaudible 00:25:13 - 00:25:31] do you expect consumer loan growth to remain strong, the way we've seen [inaudible 00:25:34] quarters [inaudible 00:25:35]. Thank you.

Shabbir Malik I wasn’t able to get the second one, but maybe you can start with the first one and then maybe she can try again. The first one was around cost of funds.

Speaker Thanks, Shabbir. Hi, this is [Inaudible 00:25:54]. Regards to our cost of funding, it reflects the strategy positioning for the anticipated growth in credit. We have recently onboarded a relatively more substantial medium-term liability through DCM and loan borrowing compared to our peers. This proactive approach would ensure that our funding mix is optimised for upcoming credit growth opportunities. Obviously this will allow us to capture a significant portion of asset growth going forward. We've also implemented several liability-focused initiatives aimed to optimise costs. As of today, we stood at 47% NIMs, however, we remain focusing on other borrowing, specifically in wholesale funding. And this will continue putting some pressure on cost of funding.

Yasmina Abbas We were able to gather that it's about loan growth. Maybe Nida, you just want to go over the question one more time.

Shabbir Malik Nida, your line is open, please go ahead.

Nida Iqbal Hi, thank you. [Inaudible 00:27:21 - 00:27:39].

Shabbir Malik We'll move to our next question, this is from Rahul. Rahul, your line should be open, please go ahead.

Rahul Hi. Thanks for the presentation and taking my question. I have three question, basically. The first one is on NPL and cost of risk. We've seen some recent decline in absolute level of NPLs for Banque Saudi Fransi over the last several quarters now. Would you say that the majority of the legacy account clean-up that you've been doing now is done or you think there is more to come? Reading on that, how do you see the normalised cost of risk level for the bank has changed through this clean-up? Is 60 basis points the new normal for the bank now, after all the clean-up, or you think it can go lower or higher? That's my first question.

The second one is on the margin [inaudible 00:28:40]. We did see cost of funds go up and a slight pressure of margins sequentially in 1Q. How should we think about margin over the next couple of quarters, as interest rates remain higher for longer and there's no new cut? I'm assuming the hedges will continue to be slightly negative as we head into the next few quarters, but then overall it would be great to understand how you're thinking about margins over the next couple of quarters.

My last and final question is on lending volume, lending growth. We saw pretty recent loan growth coming in the first Q. If you could please help us understand how your timeline looks for 2Q and 3Q, that would be very useful. Thank you.

Ramzy Darwish Thank you, Rahul, for the question. Maybe to begin with the first on the NPL and cost of risk. I think the first part to that question is whether the majority of the legacy positions are done and dusted with. I think the short answer is yes, the majority would be completed. I think when we look at the cost of risk through the cycle for corporate lending in general, we do expect somewhere between 60 to 70 basis points, in line with our guidance. Again through the cycle, in any given year it could range slightly higher or slightly lower than that, depending on recoveries. I think that's an area where we continue to focus on not only this year, but in general, to make sure that for the loans that have defaulted in the past, that there is some level of recovery that we can exercise and gather from that. I would say compared to last year, when we had budgeted for some significant recoveries, this year we had not done the same, so the cost of risk is excluding a lot of these potential positive surprises.

Then on the margin question, just to highlight the impact that we'd seen last quarter, given some of the deposit mix shift, a lot of that still does impact into the first quarter. I would say going forward we would expect more normalisation and stabilisation there. I would not suspect cost of funding to see a significant increase compared to what we saw in Q4, Q1 of this year, without a requisite change on the asset side.

Given where we stand now in terms of interest rate risk positioning, we would view it as being broadly stable and agnostic to where rates move going forward. Subject to the growth of the balance sheet overall, depending on where it's coming from, whether it's interest bearing or non-interest bearing deposits, this does play a role. But I would suspect again, if we continue to maintain the current level of deposit mix, we should not see a significant shift on the overall net interest margin.

Bader Alsalloom I'll take the third question regarding the lending growth for the remainder of the year. Our pipeline continues to expand and is a robust pipeline. A key driver when it comes to the pipeline for the remainder of the year, when it comes to achieving our guidance, when it comes to loan growth includes the converging of our existing business pipeline to actual exposures. We are also leveraging on existing clients when it comes to trade and supply chain financing. We continue to increase our participation on our giga and mega projects and we continue to increase our focus when it comes to multi-national corporates, MSMEs and also Fis, to expand our corporate lending business.

To answer your question, we continue to have a robust pipeline for the remainder of the year and we do expect the loan growth, more specifically when it comes to our corporate book, to continue throughout the year.

Shabbir Malik Thank you. I'll now move to the next question. Naresh, your line is open, please go ahead.

Naresh Balandani Thank you very much, it's Naresh Balandani from JP Morgan. Just two questions, please. And please bear with me, these might be a bit broad-based, so any insights would be helpful. First, we've recently seen an improvement in the mix of funding between non-interest bearing and term deposits at the system level, as we can deduce from the summer data. While the results of BSF and probably for the other bank don't show that any of these benefits translated positively on the funding cost, can you please throw some light, if you have seen an structural change in the liquidity dynamics at the system level in the recent months. And if you can expect that some of these benefits of the shifts in the funding that we've seen in the first quarter eventually trickle down as benefits in Q2 for the funding costs? Any [inaudible 00:34:17] from you there would be super helpful. That's the first question.

My second question is that the credit volumes for BSF and all the other peer banks in the system have been quite strong in Q1. Would you please be able to throw some light on the underlying driver for the same? I know you did throw some light in the pervious question whether the momentum could continue at the same pace, but I just want to get some firm clarification from you if the momentum continues at the same robust pace as we go into the second quarter also?

I think more generally, the recent media headlines have been indicating rationalisation of some of the large projects that are ongoing in the country. Do you reckon this affects the medium-term growth plans for the bank too, in any form? Thank you.

Speaker I'll take the first question. With regards to the mix of funding components, we have seen an improvement across the sector. However, some of which of the demand deposits can really come from call accounts, which are remunerated demand deposits. It's not necessarily coming at free money, but could be coming at a cost. In our instance, we did see an improvement in our current account to total deposits. However, we have also seen substantial increase in our wholesale funding, which has contributed to our cost of funding. We expect this to be maintained at current levels, as the CFO had mentioned that our NIM guidelines have not changed.

We've also seen quite some pressure on corporate margins, which had contributed towards that slight slump in our NIM. Going forward, we do not expect any major substantial change in costs.

Bader Alsalloom I'll take the second question regarding loan growth credit volumes and mainly when it comes to the momentum for the remainder of the year. We do see that the momentum is increasing when it comes to credit demand, especially on the corporate side. On the back of what I've just previously mentioned, mainly on these giga and mega projects. When it comes to the publicly announced rationalisation that the government is currently conducting, we at BSF at least, do not expect this to dampen any of our growth plans for the remainder of the year. Given of course the massive investment required for this and banking, or more specifically local banking, will play a smaller role in this. We do not actually expect this to impact it, nor have we seen it actually impact or dampen any of the credit demand, especially on the back of these giga and mega projects. On that, we do expect the momentum to continue throughout the year, even with this rationalisation of projects.

Naresh Balandani Thank you, Bader, that's clear. If I can please have one follow-up question. You mentioned that some of the current accounts at the system level are not free and there's an element of remuneration on those accounts. Would you please be able to clarify that comment because that was not very clear, if I understood that right.

Speaker Demand deposit does consist of several categories, including saving accounts and call accounts. And these are remunerated based on an agreement or bilateral agreement with certain customers. These are not necessarily coming at free money, so those are demand deposits, but could potentially be remunerated. Those can incur costs on banks. They are categorised as demand deposits, however they're actually part of the interest paid liabilities of banks.

Naresh Balandani Maybe I'll just send you an email on this one, for some follow-up questions on this one, but thank you very much for your response, I appreciate it.

Shabbir Malik Thank you. We'll now move to the next question. [Inaudible 00:38:49] your line should be open.

Speaker Thank you for the conference call and all of your answers so far. I have three questions. The first one is your NIM sensitivity you showed one slide where you discuss the margin sensitivity to 100 basis points change in interest rates. But can you also comment on what happens to the margin if rates fall by between 25 to 75 basis points? I know you have a lot of hedges, but do these hedges kick in as early as we have a 25 basis points rate cut or do they actually become effective from the time when cumulative rate cuts are 100 basis points and above? That’s my first question.

Second, can you talk about the liquidity release through potential mortgage securitisation? I think quite a few banks are now considering securitising mortgages with the international investors, rather than with the Saudi Refinancing Company. How important is that liquidity release for securitisation for Banque Saudi Fransi? That’s my second question.

Thirdly, regulatory risk reserve, we know that Central Bank was planning to introduce this regulatory risk reserve ahead of the pandemic, but then the plans were delayed. Where are we now in terms of the introduction of this regulatory risk reserve and can you give us some colour, is there any particular formulaic approach as to how these reserves would be calculated?

Ramzy Darwish Thank you for the questions. Maybe I'll begin with the NIM sensitivity. I think the question was specific on the interest rate hedges that we put on. Typically, this would follow whatever the market standard is and typically in Saudi it would be against the three or six-month CIBOR, so it would not kick in immediately. As soon as there is a cut it would kick in, in line with the either three or six month, depending on when the reset date is there. These would typically also be trying to match as best as possible the loan repricing, as well.

It would, in terms of impact, be the same whether it's 25 basis points or 100 basis points and how much it feeds through. If there's 25 basis points, it would automatically go through, it's not a [inaudible 00:41:44] type level where you have to reach 100 basis points for it to start changing the rate that's received.

On the second question in terms of securitisation, in general when we look at this there's two obvious benefits from a liquidity and capital perspective. Given our position, especially on the mortgage side, it's still relatively low compared to other banks. Albeit growing positively so far this quarter, it's not an immediate concern from our perspective, given a very healthy liquidity and capital position, to look at that. We may entertain the idea subject to the profitability on the back of it, whether we can generate a higher ROE, but at the current stance there's no immediate need to look at this.

Then finally on the question on the regulatory risk reserve, you're right, there was some discussion on this in the past with the regulator. I don't think we're in a position to indicate where this is right now. It's been discussed amongst the banks in draft form and the implementation date and when and how it's executed, we don't have colour that we can share.

Shabbir Malik Thank you, Ramzy. I'll now move to the next question. Olga, your line should be open now.

Olga My first question is on your ROE target for this year, 11, 13%. If we look beyond this year, which instruments do you see to unlock extra profitability? I hear that you [inaudible 00:43:38] on digitalisation on your products, maybe can we translate these initiatives into financials, how this can play out for you in the next several years? This is my first question.

My second question is again about liquidity. We notice this pick up of deposits from [inaudible 00:43:58] deposits in March for the banking sector, this is judged by summer numbers. Can you make any comments on this, have you seen anything unusual in the banking sector in March? And why did this not impact you as a bank?

Third, can we maybe compare the cost of wholesale funding with the cost of demand deposits now for Banque Saudi Fransi? Thank you.

Ramzy Darwish Thank you for the questions. I'll begin with the first one, just on return on equity. I think there's many items that we're trying to target to work on ROE improvement overall. Part of it is the cost side, and this includes cost optimisation and efficiency, but also when we look at the cost of risk overall, this has been an area where we've tried as much as possible to clean up over the last few years, so that it's no longer a weight on the bank going forward.

From the revenue side of the equation, we're really trying to target non-interest income and all the constituents that feed into that from fees across the entire business segment. Asset management and brokerage with the investment banking arm, looking at fees overall in terms of cross-sell with the different areas between wholesale banking, treasury and the products that are provided there, to enhance the ROE on existing business as much as possible.

I think the funded side of the business is fairly clear in terms of the ROA allocation and unless margins change substantially, it's really not going to make a significant difference. Lastly, I would say the cost of funding overall, we've seen it already in the non-interest bearing deposits, it plays quite a big impact and role in ROE, not only on a client basis, but all the way through to the bank level.

Speaker On the liquidity front, yes, we have seen some increase on demand deposits, again back to the previous question, we've also seen significant increase in time deposits across the banking sector, and this obviously continues to put some pressure on costs.

For BSF, again we have increased our wholesale funding. Our wholesale funding is typically where our bonds are trading within the market in terms of costs. Just to maybe shed light, we have printed $700 million in Q1 at US Treasuries plus 105 basis points. We've also printed a view private placements. A private placement in the seven year, which comes at around the 155 against SOFR. These are typically a cost of medium-term liability being raised on the books.

Another component on margins again is the compression in credit spreads, as we continue seeing competition when it comes to our lending activity.

Olga Fantastic, thank you. Can I check on the last one, when you receive wholesale funding in dollars, do you lend out in dollars or do you make cross-currency swap? And if you make a cross-currency swap, what's the cost of swap for you now?

Speaker Generating dollars is part of diversifying our sources of funding. We are Saudi riyal funded mainly, in terms of liability on the dollar front in terms of deployment, it's quite limited on the lending side. We're quite active on the cross-currency or the FX swap market, converting dollars into Saudi riyal, and we do utilise those Saudi riyal generated from FX activity into lending our corporate customer. At the moment the costs are exactly similar to spreads between the SIBOR and the SOFR curve. There's no arbitrage, so generating Saudi riyal using FX market is quite efficient and we generate similar economics.

Olga Perfect. Thank you so much.

Shabbir Malik Thank you. We have a couple of questions in the text box. This one is from Eranjen. What sort of asset yields are you generating from auto loans? Does it improve the average line book?

Ramzy Darwish For that one, without giving specifics on exact yields, I think it's important to differentiate between floating rate and fixed rate loans. Fixed rate typically is going to be these personal finance loans, including auto. Auto loan yields would be in the range of 5-plus percent and in terms of net interest margin would be somewhere around 200 to 250 basis points. So, it does improve, but when you aggregate it in the context of the entire bank's gross yield and net interest margins, it would have a negative impact on margin, but a positive impact on net income.

Shabbir Malik Another question from Ebrahim. What's the impact of launching the identity with the new logo on the profits of BSF in the future?

Bader Alsalloom The question was on the future potential benefits?

Shabbir Malik Yes. I guess maybe you can also touch on the cost, if you can disclose the cost of this marketing spend, the cost of the launching of the new BSF logo.

Bader Alsalloom On the cost of the relaunching, it's worth mentioning that this is two years in the making, so investment or cost was actually spread out throughout the last two years or so. There will be a cost impact for this year, but I can say that most of it was actually impacted 23 and 22 number financials. When it comes to the benefit, of course, the impact of this and the benefit of this, as I mentioned, we are investing in our brand, we are repositioning ourselves in specific market segments. We see that this investment in our brand is more of a long-term investment.

Shabbir Malik Thank you. Maybe one question from my side. If I look at the SIBOR in first question versus the fourth quarter, they're pretty similar. Has there been any changes in loan spreads this quarter versus the previous one? Because in the results of some of the other banks, I've seen a decrease in asset yield quarter-on-quarter. Any thoughts on loan spreads, have they tightened, has the competition increased, which led to this tightness of spreads?

Bader Alsalloom When it comes to the rate environment, it has prompted BSF to take more of a selective and cautious stand in lending, which has entailed preference to more lucrative deals and more financially sound corporate customers. This stance has been at the cost of offering reduced spreads due to stiff competition and taking into consideration, of course, the credit profile of these clients.

Shabbir Malik Maybe one more question. In terms of comprehensive income, it's a bit lower compared to your overall net profit. Anything worth highlighting on that front?

Ramzy Darwish The part of this that would be most impacted in the first quarter is rising interest rates and the resulting mark-to-market that it would have on anything that is fair value. That would include the investments that are for the comprehensive income and also the hedges that are in place. But these would not hit income at any one point in time, unless sold, it would be going through the P&L over time until the maturity of either the investment or the interest rate hedge and would get to zero by the end of its life.

Shabbir Malik The investment book, which is classified as OCI, is there any hedging in place for market changes in interest rates or maybe changes in credit spreads? Maybe there have been increase in credit spreads in the first quarter.

Ramzy Darwish We do have some of our AFS book are hedged against interest rates and this is part of our interest rate risk management. However, when you look at credit spreads, we actually have seen some tightening in credit spreads in global markets in Q1. I would say this is more attributed towards a higher interest rate environment at end of March, and this is basically reflecting that.

Shabbir Malik Thanks very much. We have one more question. We read about foreign banks increasing their presence in the kingdom. Would you like to comment on any material impact on competition from them, particularly in project financing? Which sector do you reckon would they focus on? Any colour on that would be useful, very helpful. Thank you.

Ramzy Darwish Maybe I can begin with that one. We're welcome to have additional counterparts to be dealing with, but also, when they do enter any new market, typically it has been at the higher quality, high end part of the segment, which may have to start lower spreads. At that level, the market maybe were not as keen on getting too involved, so I don't see it as necessarily direct competition with BSF specifically. At the same time, if it doesn't reduce additional liquidity into the system, we are all for it. I think that's it from our side.

Shabbir Malik Thank you, Ramzy. We don't have any further questions in the chat box or I don't see any further hands raised, as well. Would you like to make any concluding remarks before we close the call? Yasmina, any concluding remarks or should I end the call now?

Bader Alsalloom No, thank you very much. Just like to thank everyone again for your time today and we look forward to the next earning call. Thank you very much.

Shabbir Malik Thanks a lot everyone. Thanks for logging in, have a nice day. Bye for now.