Transcript

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Banque Saudi Fransi Q323 Earnings call — Tuesday, 31 October 2023

Shabbir Malik Good day, ladies and gentlemen. Welcome to Banque Saudi Fransi's third quarter results call in collaboration with EFG Hermes. My name is Shabbir Malik. This call is being recorded. Joining us today is the senior management of Banque Saudi Fransi. We will start the presentation with an opening remark from management, and then we will proceed to a Q&A session. I will now hand the call over to Yasminah Abbas, the Head of Investor Relations. Yasminah, over to you.

Yasminah Abbas Welcome, ladies and gentlemen, to BSF's earning call for the third quarter of 23. Thank you, Shabbir. Thank you, EFG Hermes team, for hosting this call. Our CEO, Bader Alsalloom, will go over the earnings summary and strategy update, and then followed by our CFO, Ramzy Darwish, who will go through a more detailed walkthrough on the financial performance. Before I hand over to our CEO, I just would like to encourage everyone to download our IR app. The QR code is available on the last page of the earnings deck. This will give you access to all the earnings presentations, as well as keep you updated on all our news. Over to you, Bader.

Bader Alsalloom Thank you, Yasminah. Welcome, everyone, and thank you for attending the BSF third quarter earnings call. I'm pleased to report a strong set of results for the first nine months of 2023. The impressive performance was underpinned by a favourable economic backdrop and focused execution of our strategic and operational agenda. Let me begin by summarising our financial performance for the period. Starting with the balance sheet, loans and advances grew by 10% year-on-year, driven by balanced and high-quality lending growth of 1w1% in commercial and 7% in consumer. In addition, investments grew by 7% year-on-year as we continue to fortify our high-quality liquid assets and lock in higher rates for longer maturities.

On the liabilities side, deposits expanded 5% year-on-year, mostly in interest-bearing deposits, given high-rate environment. We also raised additional longer-duration debt securities and utilised additional short-term interbank and SAMA facilities to fund our asset growth. On the P&L side, the rising benchmark rates translated to solid NIM expansion, which together with the robust balance sheet growth resulted in 24% topline and 27% bottom-line growth.

On the asset quality side, the NPL and coverage ratios both improved, but cost of risk increased to 0.98%, mainly from coverage enhancements on isolated pockets in our commercial book. [Unclear] has, however, trended down for the last two consecutive quarters, and this will continue to normalise into the fourth quarter. Our capital position remains very strong with a Tier 1 ratio of 18.7%. On the liquidity side, our NIBD percentage of total deposits moderated to 55.9% from the expected shift of interest-bearing deposits in the rising interest rate environment. Our overall liquidity remained comfortable. However, LCR is at 171% and SAMA LDR at 84%.

Moving on to our strategy, slide 4. As you recall, back in the first quarter of this year, we refocused and simplified our existing strategy to ten vital initiatives, which you can see on the slide. For wholesale banking, of course, it was to expand our financial institutions in government function, and also our new multinational corporate coverage, and also to revamp our global transaction solutions. For personal banking, we are focused on scaling up in affluent and providing superior daily banking for our non-affluent. For private banking, expanding our product suite and experience-centric rewards are key initiatives. At Saudi Fransi Leasing, our new brand, JB, we plan to scale up financing and leasing. And last but not least, Saudi Fransi Capital, we aim to leverage opportunities in capital markets.

Finally, the two key priorities for the first half of 2024 are to complete our technology infrastructure upgrade and rebranding. Let me give you a quick update on these initiatives on the next slide. Overall, we are seeing positive momentum in our strategy execution, with overall progress now at 56% compared to 51% last quarter. Starting with wholesale banking, we've made strong progress with 65% completion compared with 51% completion last quarter. Here, we enhanced the operating model for our global transactional banking, finalised the scope of our new digital cash management solutions, and established the new multinational corporate unit.

Progress on personal banking was more modest, with completion now at 33% versus 31% last quarter, a reflection of the greater complexity of these initiatives. During the third quarter, we kick-started the affluent strategy implementation and launched version 2 of our Omnichannel staff pilot. We also initiated the partnership model between wholesale banking and personal banking, which is set to create more synergies and improved cross-sell. In private banking, progress is now at 78%, which is a solid improvement from 68% last quarter, as we closed key investment offerings with Saudi Fransi Capital and secured several significant transactions under a special private banking programme. We also introduced a new off-plan product to our private banking clients and successful executed several VIP experience events.

At Saudi Fransi Leading, now we branded to JB, we made significant progress in digitalising personal finance products and overall digital IT capabilities, with a percentage now at 81% versus 73% in the previous quarter. We also repositioned the business to JB, which I'll expand on shortly. Finally, on Saudi Fransi Capital, more modest 37% progress at been reported, given the complex nature of the business. This progress includes the finalisation and commencement of our wealth management collaboration strategy during the quarter.

Moving on the slide number 6. Here, I just wanted to elaborate on two key strategic milestones which were realised during the third quarter. First, a moment ago, I mentioned the successful rebranding of Saudi Fransi leasing to JB, which is a repositioning of this business to diversify its offering to target distinct new market segments in the personal financing space. This strategic realignment was underpinned by a robust marketing campaign during the quarter, and we are excited by the potential in this business. Second, we opened our Sur Multifamily Office during the third quarter, which caters to the needs of our ultra-high net worth and high net work clientele, helping them to institutionalise, protect, and grow their wealth through access to diverse opportunities and a specialist team of advisors.

Moving next to slide number 7. Looking first at our technology infrastructure upgrade on ICP, our new Integrated Corporate Portal, the build of the phase I backend is in progress, while business requirements for phase II frontend have been finalised. We remain on track for a phased rollout after the second half of next year. For omnichannel, we have been working hard with ongoing future development testing and marketing activities, readying for a launch in the first quarter of 2024. Finally, with our core banking system, we finalised testing activities for the second phase with friends and family, and pilot implementation is expected to be completed by year-end. Thereafter, development activities for the third phase will continue into 2024.

Next, on the rebranding, we have finalised the brand and go-to market strategy, and we are getting geared for a go-live in the first half of 2024. In conclusion, I am pleased with the progress we are making on our strategic priorities, and I am excited by the strategic opportunities and value this will unlock going forward. With that, I'll pass it on to our CFO, Ramzy Darwish, to go through the financial performance in more detail. Over to you, Ramzy.

Ramzy Darwish Thank you, Bader. Good afternoon and a warm welcome to everyone taking the time to join us today for the Q3 2023 earnings presentation. On the strategy side, as the CEO highlighted, we have two major strategic initiative launches with JB and Sur, along with good traction on many others, which should help drive longer-term prospectives. On the financial side, overall, we reported a strong third quarter, continuing the momentum from the first half, with bottom-line growth driven primarily by interest rate increases and lending growth. We will go through the rest of the financial details over the coming slides, starting off with our balance sheet on slide 9.

The bank grew total assets by 8% year-to-date. This was mainly from 10% lending growth, and this coming predominantly from the commercial book. The asset growth constituents are highlighted in the top-right chart, whereby the loan growth is the dominant factor for the year. Investments increased by 4% year-to-date as the bank continues to invest and maintain overall liquidity ratios and interest rate risk. Investments did decrease 6% quarter-on-quarter, as expected and highlighted in our previous call, given expected maturities.

On the liability side, we had growth of 9% year-to-date. This was driven by debt securities, interbank, and client deposit growth, and mainly from IBDs, or interest-bearing deposits, and this is highlighted in the bottom-right chart on the slide. Total equity increased by 1% year-to-date. This was driven by internally generated capital via the earnings, partially offset by dividends and movements in cashflow hedge and revaluation reserves. On the next few slides, we will unpack some of the major balance sheet items.

On slide 10, in the top-left chart, you will note a healthy 10% year-to-date growth for loans and advances, or 3% for the quarter. This was driven by both the commercial and consumer segments with a great tilt towards commercial lending, which grew by 3.8 billion, or 3% for the quarter, or 11% during the nine-month period. And this was mainly in the commerce, services, financial, and manufacturing sectors, as highlighted in the middle-top chart. In terms of composition, commerce and services continue to represent the largest proportion of the commercial book, totalling 42% of the book compared to 37% in the previous quarter, as the bank continues to focus on more value segments.

The pipeline for commercial lending still presents attractive prospects for growth, especially given the healthy liquidity and capital position of the bank. On the consumer lending side, we had 7% growth year-to-date, with a really solid pickup in the third quarter of 4% sequentially, with personal financing and auto loans both showing solid growth momentum. As a result, the composition of the non-mortgage book out of consumer loans increased to over 51% from just under 50% previously.

On slide 11, we have highlighted the main funding element, and this is the deposit base, which grew 6% year-to-date, or 3% Q-on-Q, and was primarily from interest-bearing deposits, where we had a growth of 20% year-to-date, or 12% on a sequential basis, as corporate interest-bearing deposits growth was offset by decline in retail, mainly from the private banking segment. Non-interest-bearing deposits were down 3%, both on a year-to-date and a sequential basis quarterly, due to a 19% decline in corporate, which was partly offset by 9% growth in the retail segment. Overall, given the increase in interest-bearing deposits and the modest decline in non-interest-bearing deposit volumes, the percentage of NIBDs to deposits now stands at 55.9% versus 61.1% at 2022 year-end.

On slide 12, we provide the broad strokes for what was another strong quarter in terms of performance, with another record in terms of net operating income before impairments. This was at 1.7 billion riyal for quarter, 23% higher than

Q3 last year, and up 6% on a sequential basis. Along the same lines, net income grew 27% year-on-year, and 6% on a sequential basis, from strong net interest income growth, which benefited both from lending and higher margins due to higher benchmark rates. This was partly offset by higher operating and risk costs. The varying contributions are highlighted in the bottom-right chart on the slide.

I'll go over a few of the main highlights here, and dive into the details over the next few slides. The main contributors included net interest income, which was up 28% year-on-year and 5% over the previous quarter. This was accentuated by NIM expansion of 65 basis points. Non-interest income was up 3% year-on-year. It was driven by higher fees and commission income, as well as trading income. And on a sequential basis, non-interest income improved by 7%. Operating expenses were 13% higher year-on-year due to employee-related and G&A expenses, in addition to one-off reversals in Q1 of 2022. Impairments at 1.18 billion riyal were 34% higher year-on-year, but 20% lower on a sequential basis.

On operational efficiency in terms of cost to income, we had very strong momentum there, and this continued thanks to loan growth and better interest margins leading to higher earnings. The ratio standing at 30.5% is a 2.9% improvement compared to the nine-month period from last year. And finally, on profitability, as a result of all these items, both the return on equity and the return on assets improved year-on-year to above 12.5% and 2% levels respectively. Now, we'll take a deeper dive into the individual components of P&L in more detail.

On slide 13, we unpack the main driver in operating income growth, that's the net interest income, as mentioned, grew 28% year-on-year, as earning asset growth of 6% year-on-year and NIM expansion both played positively. Average interest-earning assets growing by 11.5 billion outpaced the 4.4 billion in average interest-earning liabilities. And higher interest rates improved lending yields, which more than offset correspondingly higher funding costs and the cashflow hedge impact, leading to a 65 basis points NIM increase to reach 363 basis points for the nine-month period in 2023. On a quarterly basis, as shown in the bottom-left chart, net interest margin expanded 9 basis points quarter- on-quarter to 366 basis points, which is now at or near peak levels, with the majority of floating rate assets having repriced to higher rates.

On slide 14, we bring about a focus on one of the larger performance drivers, given the bank's overall structure and interest rate standing, and that is the positive gearing to rates. To reemphasise, our rate sensitivity was around + or – 10 basis points for every 100 basis points change in rates. This reflects the net loan position in variable rate assets, driven primarily by the balance sheet skew towards floating corporate loans. The size of the cashflow hedge portfolio is driven by the development of the bank's balance sheet structure and our expectations for interest rates. As such, the cashflow hedge position has increased since the second half of 2022 to now cover 30% of our interest rate sensitivity gap.

Nevertheless, it is important to reiterate the cashflow hedge book has a relatively low average duration of between two to two and a half years, and as they mature, the market-to-market reserves improve, and replacement hedges provide for an improvement in the gross yields. Now, as rates have stabilised, the intention is to manage potential future volatility in earnings by increasing the received fixed hedges.

On slide 15, we zoom in on non-interest income, which witnessed a 3% year-on-year increase, or 7% growth on a sequential basis. The main drivers of the year-on-year growth were 4% higher fee and commission income from higher trade finance and other fee income, which was offset by a lower brokerage and asset management income. Additionally, we had 19% growth in trading income due to increased activity in the treasury markets business. These were partly offset by lower one-off investment incomes, mainly on FVOCI investments.

The final element of the net operating income on slide 16 is on operating expenses, which have increased 13% year-on-year. Again, this was due to employee-related costs, but also excess approval reversals in the first quarter of last year. And for reference, excluding these reversals, growth would have been more in the range of 10% year-on-year. And as highlighted previously in the calls in Q1 and Q2, this would trend lower over the course of the year when we had been at 18% growth year-on-year in the first quarter, trending lower to 15% in the first half, and now down to 13% for the nine-month period. We continue to exercise discipline in the budgeting and procurement process to identify efficiency opportunities and to improve the banks overall cost-to-income ratio, which now stands at 30.5%.

On slide 17, we highlight the credit trends, where the year-to-date impairment charge increased 34% year-on-year, due to the enhanced coverage on isolated legacy exposures, which migrated to NPL last year. As a result, the cost of risk grows 14 basis points year-on-year to 98 basis points but has declined sequentially during the last two quarters from the 116 basis points we had during the first quarter. The NPL ratio improved to 1.97% during the quarter, with the sequential trend impacted by write-offs. The NPL coverage improved both year-on-year and Q-on-Q to 139.5%, mainly from additional Stage 2 and 3 coverage. We expect that when considering loan growth, fresh NPLs, recoveries, and write-offs, the improvement witnessed in these credit metrics over the last two quarters will continue into the fourth quarter.

On slide 18, we discuss liquidity and capital, which both remain solid, and continue to provide ample room to sustain our growth momentum. The liquidity coverage ratio now stands at 171%, and the net stable funding ratio at 116%, while the headline loan-to-deposit ratio increased to 105%. Our regulatory loan-to-deposit ratio remains at a comfortable 84% relative to the 90% maximum. With respect to capital, total capital declined 1% year-to-date, as net income generation was more than offset by dividend payments and movements in cashflow hedges and FVOCI reserves. Together with the 2% risk-weighted asset growth from lending, the CAR declined modestly to 18.2%, and the Tier 1 now stands at 18.7%.

Lastly, on slide 19, we provide a quick snapshot on where we stand against the guidance. In terms of loan growth being above target, and although we would still caveat the potential for prepayments and settlements, especially given the seasonality in the fourth quarter, we are revising the financing growth for the full year to low double digits. Similarly, on the net interest margin, currently above guidance at 363 basis points, a revise in the guidance to 3.5 to 3.6% with potential to be slightly above the range. Positive risk at 98 basis points for the year, and 79 basis points for the third quarter, provides some visibility on the full year, and as such, we retain the guidance as is.

Cost to income at 30.5% is in line with expectations, and we continue to remain within guidance. On return on equity at 11.5%, it’s an area where we’ve had great traction, and we expect to remain within guidance on a full-year basis. Lastly, the CET ratio at 16.4% is expected to improve to within the lower 17 to 18% range, as capital generation through earnings is supplemented with partial reversal in market-to-market. With that, we can move on to Q&A.

Shabbir Malik Thank you very much for the presentation. We'll now move to the Q&A session. As a reminder to the audience, if you'd like to ask a question, you can either raise your hand, or you can also type your question in the Q&A box. We move to our first question from Waleed Mohsin. Waleed, give me a second, please. Yes, your line is now open. Please go ahead.

Waleed Mohsin Yes, thank you, Shabbir. And thank you much for the presentation to the BSF management team. Three questions, please, from my side. First, I wanted to ask around the headline loan-to-deposit ratio, 105%, we acknowledged that the regulatory LDR sits at 84, so comfortably below the 90% regulatory maximum. However, just wanted to get your thoughts on how much do you intend to flex this ratio? Because, technically speaking, you can move closer to 90 on the regulatory LDR, which will help your headline LDR even higher, and avoid competition of deposits. So, just want to get your thinking around that. How are you going to manage the headline and the regulatory LDR ratio? That's question one.

Secondly, despite the upgrade in your net interest margin guidance, your range still implies some NIM compression for the fourth quarter. Just wanted to get your thoughts there. Is this how we should think about, or shall we read more into your comment, Ramzy, which was that there could be some upside and you might end up with a net interest margin which is above the guidance range?

Third and final question, on loan growth. I recall at the end of the second quarter, you were cautious, and you talked about repayments, and you've highlighted this again. But at least there have been some trends which have convinced you to upgrade guidance. So, wanted to get a sense of what has changed. Is the corporate lending pipeline materialising faster than expected? Are you seeing that in terms of committed but undrawn facilities? So, any colour on the pipeline and what convinced you to upgrade the guidance, other than obviously the outcome for nine month, would be extremely helpful. Thank you.

Zuhair Mardam Yes, hi, Waleed. This is Zuhair. So, with regards to your question on the loan-to-deposits ratio, our simple LDR is intentionally maintained to optimise our funding costs. So, looking ahead, then, to 2024, we anticipate the deposit growth will grow as needed to support our projected expansion with carefully managing costs. It's important to recognise that a deposit in the banking sector will likely come from the client deposits as opposed to current accounts, given projected higher rates environment. Consequently, we do not foresee any improvement in the CASA ratio. As you mentioned, the LDR across the sector is above 100%.

As for the bank, we have also raised within the past year a DCM twice, so we've raised 700 million in late 2022, as well as a $900 million sukuk in 2023, whereby they do have a comfortable weighting towards a liability denominator base. That will obviously improve our regulatory ratio. So, it's a matter of whether it's needed or not, and we manage it through optimising our costs.

Ramzy Darwish Ramzy here. Thank you, Waleed, for the questions. On the net interest margin question, I think, again, there's lots of variables at play when we look at the net interest margin. Part of it is going to be the non-interest-bearing deposits percentage of total deposits, where I think at a sector level, we still see pressure on that front. So, we want it to be more conservative. And when we look at rates overall in terms of the movement, it has been volatile, I think, at the long end. But with the pause in the federal reserve rates and the feed-through that that has on the rates locally, we don't expect much more repricing to take place. So, we view it more as a stabilisation than a pure contraction, and that's why we've highlighted that there could be upside to this level, as well.

And then, lastly, in terms of the loan growth, I think when we look at the historical period, namely last year, the third and fourth quarter, it was fairly flat in terms of long growth. I think there were expectations that there could be potentially the same type of outcome, but when you look at the loan growth that we had in the third quarter across the board with both a commercial side, but also on the retail side in terms of personal loans and auto loans, we've had good traction on that front. So, that gave us a bit more confidence in upgrading this to the low double-digit side. But we would still, I think, caveat that there is potential for prepayments and settlements throughout the year, but mainly in terms of seasonality, we typically see this in the fourth quarter.

Waleed Mohsin Got it. That's very helpful. Thank you much. Just one follow-up on the first question regarding the LDR, shall we expect similar kind of levels, gradual increases? Did I get that correct, gradual increases in LDR or broadly stable levels?

Zuhair Mardam Yes, I would say that you expect similar levels going forward.

Waleed Mohsin Got it. Thank you much, Zuhair and Ramzy. Thank you.

Shabbir Malik We now move to the next question. This is from Nidhi Gopal. Nidhi, your line is open. Please go ahead.

Nidhi Gopal Thank you for your attention. Just to add two questions. For the [inaudible] structure, I'd like to mention…

Shabbir Malik Sorry, Nidhi. Try again.

Nidhi Gopal Can you hear me?

Shabbir Malik But there seems to be an echo. Okay, we'll try the next question. Chiro, please go ahead, your line is open. Chiro Ghosh, your line is open. Please, if you would like to ask a question, go ahead. Okay, we'll move to the next question. Rahul, your line is open. Please go ahead. Rahul, please make sure your line is unmuted.

Rahul Bajaj Yes, hi, can you hear me?

Shabbir Malik Yes, please go ahead.

Rahul Bajaj Yes, so, thanks for taking my question. This is Rahul Bajaj from Sidhi. I have three quick questions, actually. The first one is a follow-up on the margin question which was asked earlier. So, I understand, as you alluded, that most part of the repricing is already done. So, how should we now think about the hedges that you are building? So, are these hedges coming with a negative NIM impact, or are they neutral as we go into the fourth quarter? I'm just trying to understand, will fourth quarter margins be negatively impacted due to the cost of funding increases and the impact of these hedges on your margins? So, that's the first question.

The second question pertains to staff cost. We see a sizeable jump in the quarterly run rate for staff cost in 3Q versus the previous quarters. Just wanted to understand if there is any one-off element there, and if the third quarter staff costs is a new run rate we should be thinking about.

And my final question is around this comment you made earlier around funding sources, and you mentioned short-term interbank lending, short-term interbank funding, and long-term debt available options for the bank. If you could please provide us some colour around the range of pricing, where the average with this funding is available. So, for example, a timed deposit versus a short-term interbank versus a long-term debt for the bank. Or are they pretty similar in terms of pricing? Any colour there would help us think through how cost of funding could behave as we head into 2024. Thank you. Those are my three questions.

Zuhair Mardam Okay, so, with regards to the hedging activities we have, any replacement of current outstanding, so as the cashflow hedge contract matures, replacements would be in a favourable rates environment. So, those will have a positive impact on net interest margins. However, any addition contracts that they enter into are NIM detractors, which will impact obviously the NIM, given the inversion of the yield curve in the current environment. However, if you look at our net interest margin in this current environment, we have seen quite a significant movement, which places us in an extreme exposure towards high interest rates. So, we continue assessing our fixed rate exposure, and acknowledge the fact that it is a detractor. However, we should not ignore the current rates environment as a significantly high one. Our hedging of our loan book is used as a risk management tool, since we have a relatively small fixed-rate loan book when compared to our peers, due to the large proportion of assets into our corporate lending.

So, also, I'd like to add one more aspect to this, is that we have done a switch exercise in government securities to extend our interest rate risk duration, which will also contribute towards probably a reduction in some of our hedging activities. However, we continue assessing hedging our loan book at a certain phase, given the current environment based on our interest rate gaps.

So, on the third question, I'll take the third question, with regards to short-term funding vis-à-vis medium-term funding. Obviously, medium-term funding comes at a cost, which is the cost of funding of the bank. Now, given the fact that we do have migration from current accounts to timed deposits, that will have an impact on our cost of funding, and it has been evident. However, as we continue growing our asset book, medium-term liability is required in order to manage our asset liability mismatches, and this will put some pressure on cost of funding. However, as we speak, we have a relatively contain cost of funding when compared to our peers, and I think we do have some room to grow in that respect. Short-term funding is relatively cheap, and they are done on a collateralised basis using the repo or the interbank activity, and these are tools that maintain our day-to-day shortage of liquidity in case we're short on day-to-say.

Ramzy Darwish And then, just on your last question, Rahul, on the staff costs, there's a few elements that are going to be at play here. There's obviously going to be accruals for management bonus that would have to kick in. So, as the bank is performing better, there's a set formula that is accrued on a monthly basis, and this will show up in the quarterly staff cost. There are also variables in terms of cost increases, but this would be offset to a certain extent by resignations and shifts within the organisation. But I would say, so long as the performance is going to be at this level or stronger, this would be the new run rate.

Shabbir Malik Thank you. We'll try Chiro one more time.

Chiro Ghosh Hi, can you hear me?

Shabbir Malik Yes, we can now. Please go ahead.

Chiro Ghosh Perfect. This is Chiro Ghosh from SICO Bahrain. A couple of questions from my side. Does the retail loan growth in this quarter appear to be quite strong? So, I just want to get a sense of what would be your strategy going forward, and what kind of margin are you making on this retail business? Because you're still not a major player in the retail business. Are you cutting costs to gain some market share? If you can throw some light on that. Secondly, it's about the write-off. The write-off was quite strong. So, what would be the write-off strategy going forward, and which are the sectors which contributed to this write-off? And third one was, very quickly, I know you've answered it a bit, the cost-to-income ratio has been quite well. How sustainable is it going forward?

Ramzy Darwish I'll just maybe start with the second one on the write-off. So, the question is just in terms of the size, is this abnormal? I think all the banks will look at the NPL portfolio, and there is a designation that is set by IFRS, but also, each bank will have their own policy. And whenever the recovery is deemed so longer possible or the timing is out of question, then the bank would look at taking through a write-off. It does go through the necessary approvals in terms of governance within the bank with the board or board-delegated committees, and this is something I think we have seen other banks do also in the past. So, from our perspective, we want to make sure that we are in line with the rest of the market, and nothing really abnormal that we've seen of this on the write-offs.

Chiro Ghosh These are mostly legacy loans, right?

Ramzy Darwish Correct. So, they would be fully provided for, and this one specifically is the holding company for the NIM that was shifted to NPLs last year.

Bader Alsalloom And regarding the retail loan growth and strategy, more specifically when it comes to pricing, we haven't changed the strategy when it comes to pricing, nor are we really focusing on market share. However, the only shift that we have made when it comes to that strategy is more focus when it comes to our affluent segment, especially with the recent rollout of our segmentation programme.

Ramzy Darwish And on the last question in terms of the cost-to-income ratio in terms of the sustainability, I think we've had tremendous growth, really, in terms of the earnings profile. The cost side has grown, as well, but not to the same extent, so we've had a positive jaws. And I think, looking forward to next year, with the risk costs hopefully looking in a better position, we would view this as something that is sustainable, and hopefully also something that we can improve going forward.

Chiro Ghosh So, is there still a massive line-up of digital spending, or you are comfortable at this stage?

Ramzy Darwish No, in terms of spending, a lot has already been invested in terms of the technology transformation. A lot of these would start to come. Some have already come online this year, and some of them will be towards the end of next year.

Chiro Ghosh Okay, that's all from my side. Thank you very much.

Shabbir Malik Thank you. We'll move to the next question from Mohammad Al Rasheed. Mohammad, your line is open. Please go ahead.

Mohammad Al Rasheed I have three questions. The first one is regarding your investment books. So, I have noticed that many of the banks have grown their fixed-rate investment or government sukuk portfolio massively over the last five quarters, but that wasn't the case for your bank. So, can you help me understand what's the reason behind this? So, based on my understanding, it's actually from [unclear] requirements. I expect it must be better to buy government sukuk rather than lend to corporate and then do the cashflow hedge. So, I just wanted to understand your view on this.

My second question is regarding is regarding your stage allowance ratio. So, you have relatively higher Stage 2 and Stage 3 allowance compared to the market, but your Stage 1 allowance ratio is almost half the market level. So, if you can shed some light on that, that would be very helpful.

My final question is regarding your credit risk RAW intensity. I notice that it has been going down over the last five quarters as percentage for interest-bearing assets, while in other corporate peers we have seen the opposite trend, especially after the implementation of Basel IV. So, if you can please help me understand what's the reason behind that, that would be also very helpful. Thank you.

Zuhair Mardam Okay, thank you for your question. So, I'll start off with the first question before I pass it on to Ramzy. With regard to our investment book, we have grown 4% since Q4 of last year. And the reason behind not adding or being too aggressive on the investment book is, we tend to keep our liquidity for franchise growth as opposed to entering into investments, based on our board risk appetite. And our investment book remains concentrated towards HQLAs, as it provides comfortable liquidity ratios when needed, or access to liquidity when needed. Nevertheless, our cashflow hedge do provide us a similar exposure to fixed-rate interest rates, given the fact that you can actually flip between fixed and floating assets using off-balance sheet instruments. And BSF is quite unique in that, as we can swiftly change towards fixed rate and flow-through using interest rate swaps.

So, I think the way to look at it is, you can add our cashflow hedges towards our investment book. It can give you some sort of a flavour on what kind of fixed-rate exposure we could have. Just to highlight that a portion of our investment book remains on flow-through basis, as well, and then these are fixed as we see fit within our interest rate gaps and interest rate risk of the banking book framework.

Ramzy Darwish Thank you, Mohammad, for the questions. I'll take the second one in terms of the staging. As far as I understood, the Stage 1 coverage compared to peers, this is really driven by the model that each bank would be using in terms of probability default, and also the macroeconomic environment. We are currently, in this quarter, reviewing the model, as every bank is doing on an annual basis. And we're going through this now, so there is potential that we do see additional coverage on the Stage 1 side. In terms of Stage 2 and 3, these are really again determined by the risk theme in terms of what is the adequate coverage for the specific loans. When we look at the overall, we also take into account the improvement that we've had on that front almost to 140% in Q3.

On the last question in terms of the credit risk intensity, Basel IV did come into implantation this year. It did lead to initial improvement for BSF, but across the banks in Saudi, as far as we understand. And that's because of a change in the inclusion of shares as collateral for the RWA. So, it depends really on how the bank is increasing their loan book, and the propensity in terms of what is collateralised by shares versus uncollateralised. So, I really can't, I think, comment on the other banks, but this is the picture that we have at BSF.

Mohammad Al Rasheed Okay, that was very clear. Just a follow-up regarding the first question. So, from a capital efficiency perspective, isn't it better to buy fixed-rate government sukuk than to increase your fixed-rate exposure than doing cashflow hedge? I just want to confirm this understanding.

Zuhair Mardam Entering into a cashflow hedge does not expose you to capital consumption, since it is off balance sheet. The only thing that would impact is the volatility in margin, which is minimum when looking at a certain cycle. However, entering into a government debt has a zero risk-weighted asset, and entering into it within a hedge, assuming there is no shift in fixed-rate exposure, also it would have close to zero exposure. Owning a government debt would basically imply you to go and fund it, whether through overnight repo from SAMA, or in the open-market operation, which has also quite a costly rate. While cashflow hedge does not require any funding.

Mohammad Al Rasheed Yes, that's also just… Sorry if I didn't get that one very clear. So, basically my question, instead of lending, for example, a corporate 10 billion, and then do a cashflow hedge, here the corporates, that equates 100%, while the government bond would be significantly lower. So, instead of loaning 10 billion for corporate, then doing the cashflow hedge, why not just buy directly the government sukuk or the fixed rate bonds? Assuming I want similar absolute constant amount of fixed rate exposure. That's basically my question.

Ramzy Darwish Maybe I'll just chime in here. I think when we look at interest rate risk exposure, there's many ways in terms of hedging that. Part of it would be investing in long-term fixed assets. Part of it would be cashflow hedges. But also, you could include the lending to the retail side in terms of fixed assets. Notably, I think we've seen a big increase across the system on the mortgage side. From our perspective, if we wanted to do the same, we would be increasing the leverage of the bank, so we would be buying government securities fixed rate, but we would have to fund it with a timed deposit, and this would, I think, from our perspective, put additional risk in terms of the ratios, and in terms of managing the liquidity on a day-to-day basis. It's true that they are repo-able with the central bank, but it would increase the leverage of RWA, and this is an area where we've decided we want to be as efficient as possible.

Mohammad Al Rasheed Okay, very clear. [Unclear]. Thank you.

Shabbir Malik Thank you. We'll move to the next question. [Unclear], your line is open. Yes, go ahead, please.

Unidentified Speaker Hi, can you hear me now?

Shabbir Malik Yes.

Unidentified Speaker So, thank you for this presentation and taking my questions. My first question is on the liquidity situation in the market. How do you see the liquidity situation in the third quarter versus the second quarter? Did it improve or did it worsen? And what is your reading about the overall ability to get deposits and cost pressure for getting, let's say, a billion of deposits? Is this improving, is this worsening, and how do you read the market now? So, that is one.

My second question is regarding your subsidiary that you just rebranded JB. Just if you could throw some colour on the target market for that subsidiary. Is it both individuals and corporates, or is it targeted towards individuals, towards personal lending? So, just some colour on that would be very helpful. Also, is it on the traditional model of physical [unclear], or is it more digitally focused? Those things, some ideas on that would be really helpful. Thanks.

Zuhair Mardam Okay, I'll maybe take the first question with regards to liquidity in the sector. So, we have seen the local day-to-day liquidity quite volatile in terms of repo activity with the central bank. However, you can see that the [unclear] spreads have remained quite stable, which provide you some sort of a feel that the liquidity condition has been relatively contained, and SAMA had ensured some sort of orderly market conditions. So, despite some volatility on day-to-day liquidity, we can see that the LCR NSFR across the banking sector quite comfortable, and that provides you a feel driven by the high-quality liquid assets that bank do hold, which provides you direct access to the central bank on overnight basis.

Now, the challenges going forward with the ample credit growth ambitions that the Kingdom has, I think it will be quite challenging in terms of deposit growth, and that will come at the cost. However, I think raising deposits in the banking sector is a function of paying, and we expect that this will continue, costs will continue increasing.

Bader Alsalloom And regarding our leasing business, our recently rebranded leasing business, JB, the target market here is mass individual market. Historically, we will, of course, continue to grow the auto leasing business, mainly through individuals, with some pockets of corporate clients, mostly for fleet financing. However, we recently rolled out personal loans for mass individuals for smaller tickets. And we are planning to actually roll out for consumer products, such as credit cards and others, hopefully by the first half of 2024.

Ramzy Darwish And just to answer your question in terms of the model, it is a digital-focused model.

Speaker Thanks, guys. That's really good.

Shabbir Malik We will now move to the next question. This is from Olga Veselova. Olga, your line is open. Please go ahead.

Olga Veselova This is Olga Veselova from Bank of America. Three questions from my side, please. One is on capital. You have a very solid CET1 ratio versus the regulated limit. And I am wondering, what's your capital management strategy? What is behind this willingness to maintain a relatively high cushion? So, what is your comfortable cushion? What's your view on managing this cushion? My first question. My second question is on interest rates. So, what is your current level of interest rates on term deposits and on savings accounts, if you charge any interest on savings accounts? That's the second question.

And my third question is, sorry to come back again to this interest rate hedges, but just for me to understand better. So, if we were to assume flat benchmark rates from here, flat, no changes, and some pace of customer migration similar to what you had last quarter, do you see ability to maintain flat margin with the help of hedges? Or now ways, no deliverable, because the cost of funding keeps going up? These are all my questions. Thank you.

Ramzy Darwish So, thank you, Olga, for the questions. On the first item in terms of the capital and CET1 ratio, obviously we do take this into account in terms of what is the most optimal for the bank. I think we are recognising that there is healthy surplus of capital, but at the same time, we do want to take into account the internal capital adequacy assessment plans that we have with the regulator, and this goes out three years. From our own perspective, we're also looking out to five years, and we want to make sure that there's enough capital to support the growth profile there.

Zuhair Mardam The second question with regards to raising deposits, I would say that today, in the current environment, client deposits are being raised at around the 6% level.

Olga Veselova And savings accounts?

Zuhair Mardam In terms of savings accounts, savings accounts, which also count as a timed deposit, would be slightly lower than the regular benchmark levels. I would say around 1%. It's categorised as… Savings accounts are quite minimal across the bank, so I wouldn't really take it into account.

Olga Veselova Okay.

Ramzy Darwish And on the third question, in terms of net interest margins, assuming things remain flat at this level, I would say previously, in the first two quarters, when the inversion was higher, it was more of a challenge. Now, at that these levels, with the inversion being more limited, it is going to detract from the NIM. But because of the quantum and the size of these hedges compared to the overall balance sheet, it would not have as big an impact as if it was the entire stock. So, we would expect that it would detract, but in terms of the impact and attribution, it should be minimised from that respect.

Olga Veselova Okay, that's clear. Thank you very much.

Shabbir Malik Thank you. We'll now move to the next question. This is from Naresh Bilandani. Just give me a moment, please.

Naresh Bilandani Hello, can you hear me?

Shabbir Malik Yes, please go ahead.

Naresh Bilandani Great. Hi, Bader, Ramzy, Zuhair. Good to speak to you all. It's Naresh from JP Morgan. Thanks for your time, and congrats on a good set of results. Clearly, it is a good delivery. I have three quick questions, please, and some of these may be a bit of a follow-on from what has been previously asked. I know it may be a bit too early, but if we assume no major moves from the Fed, how should we think of the NIM next year, keeping in context the hedging book yield? I know you may be offering a refined guidance in Q4, but if you can shed any early thoughts on how much expansion, if any, you could enjoy, say, if Fed stays on hold, that would be very helpful. That's the first question.

Second is, just following on from the previous question, clearly I think the high level of CET1 is indeed curtailing your ROE versus the peers. Just wanted to hear more on your plans. How do you intend to use this or pay it back? I know, naturally, this would lead to some expectations of how you're thinking on the dividends, which I know is a board decision. But do you feel comfortable in recommending a higher payout to the board versus, say, the previous year, given the current capital level and the profitability you're enjoying? Or do you think the loan demand next year is going to be strong enough that you want to maintain this level of capital? That's the second question.

And the third and final question is, is there any seasonality in the current quarterly delivery? I know you had a pretty solid Q3 last year, too. But then in Q4, I think the profitability slipped on impairments on OPEX slightly. So, do you reckon there's any risk of the same trend occurring this year, too? Thank you.

Ramzy Darwish Hi, Naresh, thank you for the questions. I'll start maybe with the first one in terms of the net interest margin. Again, it's something that we are looking at for the budget for next, but also for various capital and interest rate planning going into next year. I'd say with interest rates being stable, we would expect the net interest margin to also similarly be stable. But when you look at the variables, there are many that are at play. We talked about the non-interest-bearing deposits as a percentage of total deposits as on. But at the same time, the longer out you go, you also need to factor in the maturities on both sides of the balance sheet, and the repricing that would take place. So, even the cashflow hedges, as an example, would start to mature and roll off, would be adding the hedges at higher levels than what they are in terms of stock.

For the CET1, again, I think when we look at capital overall, we do have bilateral discussions and agreements with the regulator. And on this front, I think we are still comfortable with the level, given the expectations for growth. It's not necessarily only for next year, but over the longer term, three to five years.

And then, in terms of the last question on seasonality, I think last year specifically, we did have more muted loan growth, and this fed through overall into the income. Our expectations are that, so long as we can continue growing the balance sheet and focusing on the strategic initiatives in mind to enhance fee income, then there is potential and propensity for additional loan growth.

Naresh Bilandani Great. That's very clear. Then, just following up, given that this has been a very profitable year, and clearly because the capital level is also quite high, I'm just keen to get your view on, do you feel comfortable in recommending to a board somewhat of a higher payout, or should a 2022 payout of 55% still be reasonably good, keeping in line the growth forecast? Any parts that you can share, that would be very helpful.

Ramzy Darwish So, I think we would stick to our 50 to 60% range to the payout. Obviously, this is something that we have to go through when it comes time to deciding that. But at this juncture with the growth potential over the course of the next five years, especially with a lot of the Vision 2030 initiatives and the requirements thereof, we feel comfortable with that position.

Naresh Bilandani Got, all right. Thank you very much.

Shabbir Milak Thank you. I think we've come to the end of the hour mark. I would urge those participants whose questions have not been answered to send their questions to the investor relations team. I now hand it over to management for any concluding remarks before we close the call.

Bader Alsalloom Just thank you everyone for your time today, and we look forward to receiving any additional questions, and of course, the Q4 earnings call. Thank you.

Shabbir Milak Thank you very much. This concludes our call. Have a nice evening, everyone.