Banque Saudi Fransi Q4-2023 Earnings Call
Wednesday, 14th February, 2024

Speaker 1:

Thank you for joining the Bank of Saudi Fransi Q4-2023 Earnings Call. I will now pass you over to your host, Waleed Mohsin from Goldman Sachs.

Waleed Mohsin:

Thank you much. Good day everyone. Thanks very much for joining Bank Saudi Fransi's fourth quarter, '23 earnings call hosted by Goldman Sachs. Today's call is being recorded and is intended for analysts and investors only, and any media personnel should disconnect at this time.

It is my absolute pleasure to welcome Bank Saudi Fransi's Management on the call, Mr. Bader Alsalloom, Chief Executive Officer, Mr. Ramzy Darwish, Chief Strategy and Finance Officer, Mrs. Zuhair Mardam, Chief Treasury and Investments Officer, and Ms. Yasminah Abbas, Head of Investor Relations. So without any further delays, I will pass over the call to Yasminah Abbas, Head of Investor Relations.

Yasminah Abbas:

Welcome ladies and gentlemen to BSFs earnings call for the fourth quarter, 2023. I would like to thank you, Waleed and Goldman Sachs team, for hosting this call. Our CEO, Bader Alsalloom will go over the earnings summary and give a strategy and an ESG update, and then he will be followed by our CFO, Ramzy Darwish for a more detailed walkthrough of the financial performance. With that, I'll hand over to you, Bader.

Bader Alsalloom:

Thank you Yasminah, and thank you everyone and a good day to everyone on the call. Thank you for spending the next hour with us as we go through the fourth quarter of 2023 earnings call. I'm delighted to provide an overview of the results of this exciting year for BSF. Not only have we delivered a strong financial performance, but we have also made excellent progress in the execution of our strategic plans.

On the financial highlights let me start by summarizing our financial performance for the year. Net income in 2023 increased by almost 20% to 4.223 billion riyal, while the return on equity has grown to 10.6%. This became possible due to the healthy lending activity alongside proactive asset and liability management that resulted in higher margins year-on-year. Loans and advances grew by 13% over the year with commercial loans remaining the main driver for growth.

In consumer lending, we also registered solid growth despite higher rates, particularly in auto and personal finance. Investments grew by 9% year-on-year as we continue to lock in higher rates for longer

maturities on the back of the elevated interest rate environments. We managed to balance our expanding assets with a strong inflow of deposits that grew by 9% in 2023, driven by interest bearing deposits at the expense of demand and savings accounts. This was anticipated given the higher rate environment and further moderated our NIB percentage to total deposits to below 50%. However, we expect this ratio to become more stable during 2024 as benchmark rates have stabilized and start declining later this year.

On the asset quality side, our NPL ratio improved substantially thanks to write-off of legacy exposures and coverage ratios improving. Underlining asset quality remains stable with a moderate improvement of cost of risk despite the coverage enhancements made during the year.

Our capital position continues to be robust with a tier one ratio of 18.9%. This gives us confidence in our ability to expand our balance sheet and pay attractive dividends. As you may have seen already earlier this month, we announced a recommended second half dividend of one riyal per share, bringing the total annual dividend to 1.953 riyals per share. This equates to a payout ratio of 55% for the earnings per the year.

I'll now proceed with our strategic updates. Now almost a year ago we refocus and simplified our existing strategy to 10 vital initiatives, which you can see on the slide and which cover our core business segments as well as rebranding and technology infrastructure upgrade as key enablers. Let me give you a quick update on these initiatives on the next slide. Overall, we're seeing a positive momentum in strategy execution with overall progress now at 62% compared to 56% last quarter. Starting with wholesale banking, we made strong progress with 76% completion compared to 65% last quarter. Here we activated the Global Transaction Solutions operating model, which will help us improve cashflow and reduce risk, and expand our FI and government lending.

In personal banking, we gave momentum mainly working on an affluent strategy implementation and digital solutions. We have also kickstarted the wholesale partnership with personal banking boosting cross sale and relationship coverage. The overall completion reached 40% compared to 33% last quarter. In private banking, we have made excellent progress and have reached 84% as we close key investment offerings with our investment arm Saudi Fransi Capital, broadened the product suite and enhanced our VIP experience events.

At JB, formerly known as Saudi Fransi Leasing, we also saw positive momentum with 83% completion. We made significant progress in repositioning of the JB, digitalizing the personal finance products and overall digital IT capabilities. We also introduced JB's new digital personal loan offering and improved the brand recognition through a successful marketing campaign. Finally, last but not least, on Saudi Fransi Capital, more modest 42% progress has been reported given the complex nature of the business. In 2023, we finalized SFCs wealth management strategy with collaboration initiatives to be rolled out over 2024 and 2025. We also launched many of the transformational initiatives and established a broader market presence with bespoke real estate advisory.

Now moving on to the key enabler initiatives. Looking first at our technology infrastructure upgrade. On ICP, our Integrated Corporate Portal, which will serve our corporate clients, we are nearing completion of the phase one backend build having received regulatory approval and with final testing in progress. For the phase two front end, we finalized business requirements and remain on track for a phased rollout of ICP after the second half of this year. For Omnichannel, our retail offering and private banking offering, we onboarded staff for our pilot and are working hard on ongoing future developments and testing with marketing activities in hand readying for a launch for the first half of 2024.

Last but not least, on our core banking system, we completed user acceptance testing for the second phase plan for our go live this quarter. That after development activities for the third phase will continue into 2024. And finally, on rebranding, we have finalized the brand for the key digital channels, our cards as well as branches, and we are go live ready for the first half of 2024.

And last but not least, let me address the ESG or sustainability developments at BSF. ESG principles are increasingly embedded in all of our processes that we do at BSF. For ourselves, we have identified five key areas that are essential for building long-term relationships with our stakeholders. These pillars are exemplifying the highest ethical and governed standards, accelerating sustainable economic growth, creating a thriving workplace, serving our clients, and protecting our communities. On the right side of the slide, we showcase some of our key accomplishments that we are proud of. Here I would like to highlight the reduction of carbon emissions aligning with the global decarbonization goals and vision 2030, the establishment of the ESG governance structure with the board oversight and BSFs ESG policy adopted in March, 2023.

In conclusion, I am pleased with the progress we are making on our strategic goals, including profitability, market positioning, and customer experience. All of these will certainly contribute to long-term sustainable shareholder value growth. With that, I'll pass it on to our CFO, Ramzy Darwish who will go through the financial performance in more detail. Over to you, Ramzy.

Ramzy Darwish:

Thank you, Bader. Good afternoon to everyone on the call and thank you for joining us. Apologies in advance, but just getting over flu so my voice is not fully back to normal, but to kick it off, overall on a full year basis, we reported a record financial performance in 2023 with bottom line growth driven primarily by interest rate increases and lending growth. Nevertheless, we did have quarterly income decline on a sequential basis as net interest margin was impacted by migration and the shift of transitory deposits in the liability mix, as well as from one-offs in trading income and operating expenses, which we will expand upon shortly.

We'll cover the details over the coming slides starting off with our balance sheet on slide nine. As highlighted in the table or in the charts on the right, the bank grew total assets by 9% year-on-year. This mainly was coming from 13% lending growth, predominantly coming from the commercial book. Investments increased by 9% year-on-year as the bank continues to invest to maintain and manage overall liquidity ratios and manage interest rate risk.

Liabilities grew 10% year-on-year. This was driven by interest bearing deposit growth, debt securities, as well as interbank funding, while non-interest bearing deposits declined. The majority of this change within the liability constituents had occurred in the fourth quarter. Total equity increased by 6% year-on-year, driven by internally generated capital via earnings. This was partially offset by dividends and positive other reserve movements.

On the next slide, we highlight the core balance sheet items starting with loans and advances where we had a healthy 13% year-on-year growth for loans and advances. For the quarter this growth was at 3%. This was driven by both the commercial and consumer segments with a greater tilt towards commercial lending, which grew by 14% during full year 2023 or 3% in the fourth quarter, and this was driven mainly in the commerce, services, utilities, financial and manufacturing sectors.

The pipeline for commercial lending still presents attractive prospects for growth, especially when given the macro environment position the Kingdom is in and the healthy liquidity and capital position of the

bank. Consumer lending grew 10% year-on-year with a 3% pickup in the fourth quarter with personal financing, credit cards and auto loans in particular, showing solid growth momentum during the year.

On the next slide, we go through deposits where we had the deposit base growing 9% year-on-year or 4% for the quarter. This was from interest bearing deposits, which grew 49% year-on-year or 24% for the quarter with mostly the corporate segment contributing to this increase. Non-interest bearing deposits were down 16% year-on-year with the bulk of the decline coming in the fourth quarter, which was 13% quarter on quarter. Corporate, in particular, had a 20% decline in non-interest bearing deposits for the year, but was flat for the quarter, whereas retail had a 13% decline for the year, and this decline mainly was in the fourth quarter and mostly through transitory private banking deposits that had accumulated throughout the year. We had originally expected these to remain well into 2024. As a result, interest-bearing deposits increased, and this was mainly again from the corporate segment and in particular for the quarter from both corporate and retail.

Overall, given the increase in interest-bearing deposits and the decline in non-interest bearing deposit volumes, the percentage of NIBDs to total deposits now stands at 47.1% versus 61.1% at 2022 year-end. We do expect this ratio to start stabilizing in 2024, as mentioned by the CEO, as benchmark rates stabilize and potential decline later in the year.

On the next slide, we go through the P&L and on a full year basis we had net income grow 18% year-on-year, driven by strong 22% net interest income growth, which benefited from lending growth as well as higher margins on higher benchmark rates. This was partially offset by higher operating and risk costs. As a result, both return on equity and return on assets improved year-on-year to 10.6 and 1.73% respectively. On a quarterly basis however, net income declined 34% relative to the third quarter as the positive NIM trajectory reversed due to the change in funding mix. This was further exacerbated by one-offs in the trading income lines as well as the operating expense lines.

Let's now, on the next slide, unpack the individual components of P&L starting with net interest income. The main driver for operating income

Speaker 2:

... income growth highlighted previously was NII at 22% growth year-on-year. This was driven by average interest earning asset growth of 12.4 billion or 6% year-on-year, outpacing the average interest earning liability growth of 5.2 billion.

Moreover, alongside the NIM expansion, these both played positively on a full year basis. Higher interest rates improved lending yields more than offset correspondingly higher funding costs and the cashflow hedge impact, leading to a 46 basis points NIM increase for the full year to reach 3.53%. As already mentioned on a quarterly basis, the NIM declined 43 basis points to 3.22%, resulting in a full year NIM of 3.53%.

For the quarter specifically, this is the result of funding costs having increased due to the higher average portion of interest bearing deposits in the funding base during the quarter. This also has an impact on the rate sensitivity, which we delve into on the next slide.

As you'll see, the bank remains positively positioned for rising rates, although substantially less so than prior years, which as you know, reflects our net long position in variable rate assets driven by a balance sheet skewed towards floating corporate loans. We've added a few new data points in the middle of the chart here to provide more color.

In this respect, around 157 billion of assets are repricing during 2024 relative to 115 billion of liabilities. It should be noted that this reflects only the on-balance sheet repricing and does not include off-balance sheet transactions or hedges. Given this, and based on our latest calculations, when looking at on and off balance sheet items, our rate sensitivity is now around plus or minus three basis points for every 100 basis points change in benchmark rates. This has declined from plus or minus 10 basis points at the end of 2022.

This decline mirrors our active management of interest rate risk. And in particular our fixed rate assets relative to our fixed rate liabilities as shown in the middle chart on the bottom of the slide. Here, you can see that following the lower of benchmark rates during COVID in 2020, we actively reduced fixed rate asset component and have increased it more recently in the subsequent pricing rate environment.

Again, we manage this position tactically, both in on-balance sheet positions such as more recently in increasing fixed rate, longer maturity, investment positions, and off-balance sheet through our cashflow hedge portfolio. The size of the cashflow hedge portfolio is driven by the development of the bank's balance sheet structure and our expectation for interest rates. As such, the cashflow hedge position has increased since the second half of 2023.

On the next slide, we go through non-interest income where we did witness a 6% year-on-year decline or 19% on a sequential basis. The main drivers of this movement were first 43% decline in trading income due to lower activity in the treasury markets advisory business, as well as a one-off 55 million trading loss in the fourth quarter arising from credit valuation adjustments within the derivative portfolio.

Second, we had lower investment income by 19 million, mainly on fair value through other comprehensive income investments, predominantly in the third quarter. Third, moderately lower exchange income by 4% or 19 million riyals. All of these were partly offset by a 2% higher fee and commission income where trade finance and other fee income improved, while brokerage income declined in line with the market.

On the next slide, in operating expenses for the year, we had witnessed an increase of 14% year-on-year, mainly due to employee related costs, but also in excess accrual reversal in the first quarter of 2022 and some non-recurring costs incurred in the fourth quarter of over 70 million riyals. Some of these were operational one-offs with the remaining being more transformation related expenses including marketing and investment in JB and the multifamily office launch. As a result, on a quarterly basis, expenses rose 14% quarter on quarter and the bank's overall cost to income ratio now stands at 32.4%, which is still a 69 basis points improvement year-on-year.

On the next slide, when we talk about credit quality for the trends during 2023, these were impacted by the migration of a legacy exposure to NPLs last year. This resulted in a spike in the provision charge in the fourth quarter of 202 and continued elevated impairments and cost of risk during the first quarters of 2023 as we enhanced coverage on this exposure to 100%.

Then you'll recall from the last quarter call that the holding company for this name was written off. And finally in the fourth quarter of '23, the operating companies for this name were similarly written off. This takes the total write-offs during the year to around four billion riyals. Aside from this name, underlying credit quality remains robust across both the corporate and retail portfolios, both holding up well despite higher rate environment. The net result of these factors was an overall 13% year-on-year decline in the impairment charge compared to the fourth quarter of 2022, a resulting improvement in the cost of risk to 96 basis points and a lower NPL ratio to 1.06% from these write-offs.

The overall NPL coverage ratio as well as stage three coverage improved as provisions on this legacy name were enhanced during the course of the year, albeit with a moderate drop-off in the fourth quarter. In terms of stage two coverage, this declined in the fourth quarter from migration of a highly provisioned balance to stage three. While stage one coverage was enhanced through a management overlay to align more closely with peers pending finalization of the ECL model.

Recalibration on the next slide, for liquidity and capital, liquidity and capital remain solid and continue to provide the ample room to sustain our growth momentum. The LCR now stands at 196% and indeed a net stable funding ratio at 117%, while the headline loan to deposit ratio increased to 104%, our regulatory LDR remains at a comfortable 84% level relative to the 90% maximum.

With respect to capital, total capital increased 2% year-on-year as net income generation was partly offset by dividend payments and movements and cashflow hedge and FVOCI reserves. Together with 4% RWA growth from lending expansion total CAR declined modestly to 19.5% and tier one CAR was stable at 18.9%.

Finally on the guidance, looking back at 2023, we are pleased with the solid financial performance for the full year, which was largely in line with our expectations save for some one-off items in operating expenditure and trading income in the fourth quarter. For 2024, we expect the lending growth momentum from last year to sustain at similar growth levels, again weighed more towards corporate.

For the net interest margin, we exited 2023 with a quarterly margin of 322 basis points against which we are guiding to 3.1 to 3.3% for the full year. This outlook is driven by an expectation of more stability in benchmark rates, albeit with modest rate cuts materializing later in the year together with more stable non-interest bearing deposit balances and lower overall interest rate sensitivity.

As our cost of risk in 2023 was impacted by a legacy exposure that had migrated to NPL in 2022 and was written off during the second half of 2023. In the absence of this factor and against the backdrop of a relatively benign risk environment, we do expect cost of risk to normalize to around 60 to 70 basis points in 2024. We expect to continue to deliver positive draws, taking our cost to income ratio below 32%. And with all these factors combined, we are expected to improve our return on equity between 11 to 13% while maintaining a core equity tier one ratio in the 17 to 18% range. With that, we conclude our part of the presentation and we can move on to Q&A.

Operator:

Welcome to the Q&A portion of the call. If you would like to ask a question, please use the raised hand feature on your screen. Alternatively, you can use the Q&A box to write a written question. Our first question comes from Chiro Gosh. If you could unmute your microphone and ask your question.

Chiro Gosh:

Thanks for the call. Just fairly clear, I mean given a pretty good understanding of their results. Two quick things which I want to get a sense of that the deposit growth was fairly strong, so how should we look at it going ahead? And why exactly are you accumulating? Secondly is the opex side. Is it fair to assume that the 74 would be the more sustainable number of operating expense going forward on a quarterly basis?

Speaker 2:

Okay. Thank you very much for your question. With regards to the deposits, as our balance sheet continues to grow driven by our commercial activities, we continue to gather deposits, namely through

time deposits given the higher rate environment and the continuous migration we have been seeing from current accounts to time deposits. And this is a natural function of the growth of the balance sheet.

And for the second question, in terms of operating expense. We highlighted during the presentation that there were some one-offs in the fourth quarter. Some of these again, are more operational in nature and some are more transformation in nature. Marketing and investment in the launch or rebrand of Saudi Fransi leasing to JB as one example and the launch of the multifamily office would not be expected to continue going forward.

In terms of guidance, I think that's why we provided the cost to income at 32% percent or below 32% because we do intend to maintain positive jaws in that front. And when you break that out in terms of what it means on operating expenditures, it should be more in line with what we've seen throughout the first three quarters this year.

Chiro Gosh:

And just on a quick one, so the whole write-off thing is behind us. Is it fair to assume?

Speaker 2:

Yes, we would say it's fair to say.

Chiro Gosh:

Okay. That's it from my side. Thank you very much.

Operator:

Our next question comes from Rahul Bajaj, if you could open your microphone and ask your question.

Rahul Bajaj:

Hi, thanks for taking my question. Very useful presentation. I have three questions basically, the first one is on margins. You mentioned that 100 basis points of rate move basically impacts your margins by three basis points, if I understood that correctly. And this is before all the hedges and before the impact of the hedges. Now given such kind of immaterial impact on your balance sheet, on your income statement coming from interest rate moves, does it really make sense to build further hedges now?

I just wanted to understand what's your hedging strategy going forward? Because if you add on these hedges, probably the NIM [inaudible 00:28:17] would be even lower compared to three basis points. Any thoughts there would be useful. My second question is around the interest bearing deposit, the time deposit growth that we've seen in the fourth quarter. Is the full impact of cost of fund increase already felt in fourth quarter, or you think there's part of the impact which will be felt in the first quarter of 2024 as well? If these funds were taken towards the end of the quarter, potentially there would be an impact of higher cost of fund coming through in the first quarter as well. Any thoughts there would be useful.

And my final question would be on costs. You mentioned there was the 74 million in one off in the fourth quarter cost related to transformation and other things. Just wanted to understand this less than 32% guidance that you provided for 2024, does that include further transformation related expenses? I'm thinking like rebranding, which could be a major transformation expense. Is that all-inclusive less

than 32%? Or further transformation related expenses would be over and above the 32% guidance? Those are my three questions. Thank you.

Speaker 2:

Thank you very much. Probably I'll start off with the first question with regards to the interest rate position. On the hedging to be specific, it's a function of how much fixed assets we would like to have on our books.

Speaker 3:

Now given the fact that interest rates were significantly higher throughout 2023, we have increased our proportion of fixed rate interest rate exposure, vis-a-vis our interest rate risk management framework, and our appetite towards where we are in the cycle.

We have reduced our interest rate gap significantly, as shown on page 14, having fixed rate assets towards fixed rate liabilities at 94%. This includes, not only hedges, but fixed rate investments and retail assets which are fixed in nature. As we have communicated in the past, we will continue hedging based on where we see the interest rate cycle and closing the interest rate gaps, and depending on the structure of the balance sheet and the growth of the balance sheet with regards to current accounts and other fixed rate liabilities.

Speaker 4:

And so I'll just add to that again, it is highly dependent also on the balance sheet structure and the liability mix, and what transpires in terms of fixed versus floating constituents throughout the year. So that cashflow hedge portfolio really is dynamic in nature in terms of what we're trying to limit a risk on.

On the second question, in terms of the interest-bearing deposits growth and the non- interest-bearing decline, I think the full impact was witnessed in the fourth quarter. When we look at initial results so far, it is promising for the first quarter thus far, and building in expectations for growth on both of these line items, we do expect, again, in terms of our NIM guidance that we stay relatively flat from where we are now. We do have a wider range on that front just to take into account potential changes or migration shifts that we've witnessed, given the higher rate environment. And on the third question for costs... Sorry, if you can just repeat the question?

Speaker 6:

Yeah, so my question on cost was, given that you had transformation-related, one-off costs in 2023, could there be transformation-related similar one-off costs, for example rebranding related costs or anything, which could go over and above the less than 32% CIR guidance that you're providing?

Speaker 4:

Yes, very clear. So on the transformational investments, a few of them may continue going forward, as we continue to invest in the technology transformation. The ones related to our subsidiaries for

example, we would not expect to continue, but it is really budgeted for in our expectations, and included in the 32% cost-to-incomes.

Speaker 6:

Perfect. All clear. Just one quick follow up on the hedges, if I may? Sorry. Which is, I mean, as I understand most of these hedges are coming at negative carry currently. Does that also impact your NIMs, as you build those hedges, bill rates come down?

Speaker 4:

Yes. Every new additional cash flow hedge would immediately start as a negative carry, but again, it's highly dependent on what we're trying to achieve in terms of managing the interest rate risk for the bank. And at plus minus three basis points now we have reached a level where we are fairly comfortable with that risk. Again, it depends on the balance sheet structure. If we do have changes in terms of additional fixed rate liabilities, we would be trying to, again limit the interest rate risk that this could create.

Speaker 6:

Understood. Thank you. Thank you. Very clear.

Speaker 5:

The next question comes from Shabbir Malik, if you could unmute your microphone and ask your question there.

Shabbir Malik:

Hi, thank you very much. Can you hear me?

Speaker 3:

Yes, we can hear you,

Shabbir Malik:

Yes. Thank you very much for the presentation. I have a question regarding, I may have missed your opening commentary on this one, but just want to understand, you explained that you saw a exit of your non-interest bearing deposits in the fourth quarter from the high net worth segment. I just wanted to understand, is that basically a customer switching from CASA to time deposits, is the customer, have they exited or the deposits exited the bank? And is there any way for you to kind of rebuild that CASA base going into 2024?

Secondly, if you can quantify, again the one-off in operating expenses, that would be pretty useful. And thirdly, in the non-interest income section, you explained that there was a one-off related to, I believe it was... Sorry, just going through my notes again, the credit valuation adjustment. Can you please explain what that means? Thank you.

Speaker 4:

Sure. Thank you for the questions. Starting off maybe with the first one on the net interest bearing deposit decline. This was from, again, the high net worth segment, not single client, but several clients. We had seen this growth throughout the year, and you can see that in the retail segment growth for non-interest bearing deposits from the beginning of the year. We had understood that they are transitory nature. Again, I think expectations were that they were going to be with the bank for a longer period, into next year, but in terms of where did they go, it's really a mix of items.

Certain would have gone to time deposits is one example. Others to investments, and others to other banks. That would be sort of the breakdown from that perspective. I think when we look at the initiatives that have been put in place and the focus on private bank, given the strength of BSF in private banking, we have seen growth in this front, and we do expect with the investments that we've made over the past year and the focus on experience type centric rewards, that it is making a difference in terms of the buildup for other high net worth new to bank clients.

So I would say we expect some growth on that front, definitely for 2024. On the second question, in terms of the one-off costs, in terms of break out, what I do have is in terms of operational one-offs, it's roughly 30 million. And for growth in investments for subsidiaries and other transformation investments, it's about 40 million.

On the third item, with regards to the credit value adjustment, it's basically the restructuring of outstanding derivatives transactions with large negative mark to market in 2023. Which basically we had to provision some CVA charges on the back of that, and this is a one time off, as usually CVA charges are done at time zero when NPVs are zero. However, in this instance, the MTM were quite negative in terms of micro-market.

Shabbir Malik:

So this is related to movement and market interest rates, or is it related to the underlying creditors in the counterparty?

Speaker 4:

So CVA is a counterpart provision that we do for non-collateralized counterparts on derivatives transactions. So essentially, related to the credit change.

Shabbir Malik:

Credit change? Okay. Maybe, I guess going back to the point about deposits, so do you think there are other concentrated deposits which could potentially be at risk of either converting to time or shifting to maybe another bank? Is that something that you would be worried about going into 2024, especially with rates where they are and potentially coming down?

Speaker 3:

Sure, I'll take this one. The answer to your question is no, we do not have any concentrated clients or deposits within this specific segment. We do not expand. We continue, of course, to expand and diversify our client base within private banking. So the short answer is no. We do not have any concentration within private banking, nor do we expect a repeat of what we were impacted in Q4, for 2024.

Shabbir Malik:

Great. Thank you very much.

Speaker 5:

The next question comes from Naresh Bilandani, if you could unmute your microphone and ask your question there.

Naresh Bilandani:

Hi, thank you very much. It's Naresh Bilandani from JP Morgan, can you hear me?

Speaker 3:

Yes, we can hear you. Go ahead.

Naresh Bilandani:

Great, thank you very much. Just three questions please. One is coming back to the net interest margin. Now, this is a pretty, quite a material decline that you are expecting over the years. So I'm just trying to understand how much of this NIM decline is being led by pressure from increase in the time deposits, and the negative carry on the hedges? It would be very helpful if you can please throw some light on, how do you see, especially the mix of deposits changing over the course of this year? And how much further growth would you expect between demand versus cost versus time deposits?

I mean, I'm just thinking in hindsight, do you think it still makes sense for you to add to the hedge book currently, since the carry continues to remain negative, and it could very well remain so for the next four to six quarters at least? So any thoughts on that would be very helpful. So that's the first one. Second is in the presentation you do mention that every 100 BPS of a change in rates affects your NII by 67 million. If I got that right? I think you have that on slide number 13, where you say that roughly about 100 BPS change could potentially lead to 67 million delta in the NII.

But I'm looking at the note 34 in your financial statements that you've just put out, which says that every 100 BPS decline could actually lead to 627 million decline in the NII. I'm looking at note 34 on page 105 of your financial statements. So I think there is a bit of a disconnect between the two items that you mentioned, because the sensitivity as shown in the financial statements looks to be a lot more severe than what you are guiding in the presentation.

So if you can please just clarify that, that would be very helpful? And third is a question on the cost of risk. Now we started the last year, we also started with the cost of risk, which was Prima facie, a lot more benign, as you have started this year with. But over the course of the year, we did see some risks coming to the upside, and definitely we saw some further pressures come through. I'm just keen to get some comfort from you with regards to the concentration risk and asset quality, if you feel, where would you see such risks come through, if they do at all over the course of this year, in the impairment charges? Thank you.

Speaker 3:

Thank you, Naresh. Thank you for the questions. Maybe to start with the first one, in terms of the NIM decline, I presume this is talking about the guidance, the full year versus guidance? I do want to highlight-

Naresh Bilandani:

Yes it is, yeah.

Speaker 3:

Again, the fourth quarter at 322 basis points. So from our perspective, we will really be viewing it almost as a flat to next year. We do have obviously 10 basis points on either side of that that we've built in. It has come, mainly as a result of the CASA ratio, so the shift in the balance between non-interest-bearing deposits and interest-bearing deposits. Only because of the significant difference between those two in terms of the cost, or the yield on those.

For hedges specifically, for the fourth quarter, actually it was a bit less of an impact compared to the third quarter. Nevertheless, it is still negative. We do understand that. But when we look at the cash flow hedge portfolio, it really is about mitigating the interest rate risk for floating rate corporate bank. And we felt that this is necessary. Given where we stand now, and we'll talk about the sensitivity, we feel, again, we have reached a level where we are definitely more comfortable, especially given the expectations of interest rate cuts coming later in the year. It could last several quarters, as you mentioned. But from our perspective on the risk management side, we feel a lot more comfortable.

On the second question between difference between what we have here and the presentation and what's in the financial statements. On the financial statements in note 34, this is only related to floating rate exposures for on-balance sheet items. So when we would be viewing our interest rate risks, the one that we're presenting here, the plus minus three basis points is really the one that we'll be monitoring for interest

Speaker 7:

... interest rate risk purposes and what we would also be including in the interest rate risk in the banking book reporting for net interest income as an example. For the third question, sorry, Naresh. I'm going to have to ask you two if you can repeat it. There was a concentration risk within that.

Naresh:

Yes. I'm just trying to get some comfort on what are the risks that you're seeing that could emerge to this cost of risk over the course of this year? Because last year you had a concentration in the portfolio which you had to manage and that led to an upward spike in the cost of risk compared to your guidance. Is the book relatively clean enough now? I know that headline NPL ratio does look quite low, but are you sensing, are you being watchful on any certain exposures that you may have to take a fresh look at it once again over the course of this year?

Speaker 8:

I'll take this one if I may. I mean regarding 2024 or more specifically, sorry, 2023 our legacy risk is I could confirm that it has been cleaned. And as we stand today, we feel much more comfortable with our forecast when it comes to cost of risk for 2024. Looking at the health of our loan book, we have cleaned up most, if not all, of our legacy matters in 2023, which is evident from Q3 and Q4 provisioning and write-offs. For 2024, we're now much more comfortable with the forecast for cost of risk between 60 to 70 basis points.

Naresh:

Understood. Thank you very much. Maybe just one very quick follow up. In the financial statements, have you made any disclosure anywhere? What is the average price of your hedges, please, if I may?

Speaker 7:

No. We don't put that in the financial disclosures. We do provide the mark to market, the principle balance, but I do want to get back to you also there. Sorry, I didn't respond to whether it makes sense for us to add hedges. Again, I think given the position we are in right now, I think we do feel, again, comfortable.

We do build into our expectations that we would be adding, but it is I think again, more dynamic, heavily reliant on the interest rate outlook and view, which is already, I think priced into the market is one factor. But the second would be the balance sheet structure going forward and how that transpires according to our expectations or budget.

Speaker 8:

Sorry if I may add just one point on the cost of risk question, the third question. That for 2024, we will continue to have a conservative approach of provisioning, however, at lower levels than 2023.

Naresh:

Okay. Thank you very much both for your answers. I appreciate it.

Moderator:

The next question comes from Olga Veselova, if you could unmute your microphone and ask a question.

Olga Veselova:

Thank you. Thank you for taking my questions. I have three. The first question is again on the deposit mix. And I apologize, I'm coming back to the same question, but that's a very unusual change in just one quarter. I'm trying to understand what exactly has happened. There was an almost 12 billion Saudi outflow of on-call deposits. How many customers were there? What part of funds moved to term deposits? How can we be confident that any similar changes will not be repeated in 2024? That's my first question.

My second question is about your loan growth. Why did you choose to grow lending above sector average in the fourth quarter instead of staying away from loan growth and away from this expansive new funding? It looks like this shift in loan growth appetite came at the price at least in the fourth quarter. And my final question is about LDR, loan-to-deposit ratio. How comfortable are you with LDR being above market average? Do you want to make efforts to trim it down a little bit or you are fine given that a regulatory LDR is below summer limits. Thank you.

Speaker 7:

Thank you, Olga, for the questions. Just on the first question in terms of the deposit mix. Again, we did see in the retail segment in particular on the high net worth individuals, some pick up throughout the year. We did realize at that time that they were transitory in nature. And you'll see it grew about close to 5 billion throughout the year.

Our expectations again were that they would last till middle of next year, but this did not happen for whatever reason. In terms of where it did go, again it is a split amongst the three. Some had left the bank, some went into time deposits and some went into investments with the likes of Saudi Fransi capital, other capital arms. Sorry. In terms of the customer information, it's not something that we would be providing publicly so unfortunately can't share too much on that front.

For the loan growth, you're right, we did grow in the fourth quarter, but I think at all times we're always trying to make sure that it is accretive to the shareholders. And it is ROE positive. We are still generating positive NIM. I think when you look at deposit growth, the difference between NIBD and IBDs, true, there's a far larger difference, but we do still focus on the franchise business, which is lending and the ancillary business that comes as a result of that.

I think we still are going to continue on this path of growing the lending book. It does come at the cost from what we've seen more recently with predominantly coming from interest bearing deposits, but at the end of the day it is still net interest margin positive.

On the last item with regards to LDR, as we communicated previously, we continued to try to run the balance sheet on an optimum basis on core loans over deposit we stood at 104%, which is within our targets that is between 100 to 105%. On the regulatory guideline, we stood at 84%. And the regulatory guideline stands at 100%. And the high core loan-to-deposit is driven by the fact that we have tapped the market several times in the past 18 months, whether through loan borrowings or DCM market, which obviously improves the liability base and actually contributes to a better regulatory ratio when it comes to the regulatory summer loan-to-deposits. Hence, we continue to see a simple hike. As we are a bit different than other banks we have cut to market three times in the past 18 months and including some loan borrowings as well.

Olga Veselova:

Thank you. On the deposits, sir, thank you for disclosing what you can disclose. Can I ask what was the maturity of this new term deposits, which came in the fourth quarter? Or what's the usual maturity of such term deposits? Are they three, six months, nine months?

Speaker 7:

Actually, it's a mix of all of the above as they say. They're basically between three months to one year. And this has been reflected in the LCR as we have seen an improvement in the LCR as they go beyond the database.

Olga Veselova:

Thank you.

Moderator:

Our next question comes from Abdulaziz A., if you could unmute your microphone and ask your question.

Abdulaziz A.:

Hi. This is [inaudible 00:53:51]. I just have two questions, sorry if I missed this. I got disconnected just due to technical issues. My first question is in asset yield. If I look at fourth quarter asset yield has declined. Can you just explain what was the driver behind that? Is it due to hedging? And then you explained a shift to deposits and deposited extremely well on. But can you just explain why this can't get any repeat in the next quarters? Can you give us your insights? Thank you.

Speaker 7:

Sure, thank you. Maybe just to confirm, Abdulaziz A., thank you for the question. You had mentioned the asset yield. I think on the asset side we haven't had any change really in terms of the growth yields. The biggest impact has mainly come from the cost, which has been on the liability side. Maybe if you can point me to where you're getting this info, we can try to tackle that point. On the second question, if you could just, apologies, repeat for me please.

Abdulaziz A.:

Basically on the asset yields, I can see loans grew 3% Q on Q, whether there's any coupled with the investment growth, but still interest income was flat, so it implies a lower asset yield. And then on the second question, just and know why shifted? What happened in the fourth quarter shift deposits, why and shouldn't that repeat in the next quarters?

Speaker 7:

Sure. Okay. On the first question, maybe just to point out on page 13, the net interest margin charts, the middle chart at the bottom, we do highlight here the cost, the interest yield, and the net interest margin. I understand, again, looking at the growth and the interest income that is generating that you may see maybe a decline, but when we look at the net interest margin here, it's on the average balance.

We haven't really witnessed decline on the asset side. I think presumably very much connected again to SAIBOR rates, given the floating rate nature and the repricing there. And we haven't seen a significant change on that front. For the deposit mix on why we don't expect the shift similarly happening going forward. I think again, for 2023, we had seen this buildup and it was multiple accounts. We don't have such a concentration existing right now, so the portfolio is diversified enough that we would not expect this in a normal case.

Abdulaziz A.:

Super [inaudible 00:56:53]. Thank you for taking my questions and thank you.

Speaker 7:

Thank you.

Moderator:

Next question comes from Shabbir Malik, if you could unmute your microphone and ask your question.

Shabbir Malik:

Hi. I think, sorry, I guess I pressed the button by mistake. I am fine. Maybe since I got the opportunity again, I think you mentioned that the regulatory LDR is 100%. I just want to double check that. I would've thought it was 90%. If you can please clarify that.

Speaker 7:

The regulatory LDR is based on a weighted liability base, weighted based on duration. And that guideline stands at 90%. And this is not the core. It basically includes all other borrowings based on a certain weighting on each maturity. The denominator is heavily weight skewed towards the weight, the balance you have. And that's standard. 90% is regulated. We stood at 84%.

Shabbir Malik:

84. Yeah. Perfect. Perfect. Sounds... That's good. Thank you.

Moderator:

There are no further raised hands. I'll now pass back to management.

Speaker 8:

Okay. Thank you very much for your valuable time, everyone. And we look forward to having our next call for the first quarter of 2024. Thank you.

Speaker 7:

Thank you.