2Q22 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

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Mazen Alsudairi
Head of Research, Al-Rajhi Capital

Good afternoon everyone who has joined in the call. This is Mazen Alsudairi, Head of Research at Al Rajhi Capital. We are glad to host Q2 2022 earnings call for Al Rajhi Bank. We have with us the management of Al Rajhi Bank, led by the CEO, Mr. Almogbel, and the CFO, Mr. Alfadda, and Treasury GM, Mr. Alajaji. Without further delay, I will pass on the microphone to Al-Rajhi Bank.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, Mazen. Welcome, everyone, and thank you for attending our earnings call for the second quarter of 2022. We will go, as always, through our second quarter highlights, then I will give you an overview of our strategic performance regarding Bank of the Future strategy. Now, let us go and take a closer look on the first slide.

Starting with the balance sheet, we delivered almost 14% growth year-to-date and 30% year-on-year. The growth came from all lines of business, 32% from retail, almost 40% from non-retail and 30% from the investment book year-on-year. Looking further to the net financing, we delivered a growth of almost 15% year-to-date and 33% year-on-year, resulting in financing portfolio to reach now up to SAR 520 billion. That is supported by mortgage, with a growth of 45% year-on-year. Now, the mortgage represents around 38% of our total book and 49% of our retail book. On the liability side, the total liabilities stands at SAR 628 billion, an increase of almost 13% year-to-date and almost 30% year-on-year. That gave us an improved LDR of around 84%, which allows for additional room to grow the financing portfolio.

On the net income side, we delivered a solid net income, Alhamdulillah, with a growth of almost 21% to reach SAR 8.4 billion. That is driven by both net yield income, which increased by 11% year-on-year and non-yield income growth of 30% year-on-year, driven by the payment and cross-sell activities between the business segments. Our total operating income has increased by almost 15% year-on-year, standing now at SAR 14.1 billion.

Going to the third element. We continue to maintain best-in-class asset quality. Cost of risk is healthy, standing at 47 bps, supported by a positive economic outlook and good recovery, compared to 60 bps for the year of 2021. Additionally, we continue to maintain a low NPL, standing at 57 bps compared to 65 bps last year, with a healthy and stable coverage ratio of close to 300%.

Lastly, the management also continued their usual exercise to deliver on cost efficiency, which led to improve our cost-to-income ratio by more than 2.1 percentage points. That resulted in cost-to-income ratio of 25.4%, compared to 27.5% in the same period of last year.

One last point we would like to clarify. Please, note that there will be no dividend distributed for the first half of 2022. This came in line with the management approach of weighing between dividend distribution and preserving capital to support the asset growth, given the available opportunities we are seeing in the market currently.

If we move to the next slide. Since our strategy inception, we are on track executing the Bank of the Future strategy. If you recall, we have four pillars. First is building on the core. We continue to focus on retail as a core banking business. We have seen a financing growth of 64% in our retail book since we introduced our Bank of the Future strategy by the end of year 2020.

Additionally, our corporate portfolio has witnessed a solid growth also of more than 60% since 2020, which is a result of our continuous efforts to expand our corporate portfolio and reposition ourselves. The corporate book now represents around 17% of our financing book.

SME is an integral part of our strategy, positioning ourselves as a bank of choice for SME. We have seen a strong growth in our SME book, which has doubled since 2020, with a growth of almost 120%. Now, SME represents 20% of our non-retail book compared to 15% in 2020, although we have seen a massive growth in our large customer in corporate book.

Demand deposits continue to be one of our priorities, with a growth of 17% since the kick-off of our Bank of the Future Strategy. Our demand deposit grew by 3.7% in the first half of the year, while the market growth is 2.3%. One of the items that we focus on in the first pillar as a part of our strategy is our non-yield income as a percentage of our total operating income. It continues to increase, reaching now 23% compared to 18% in 2020.

Moving to the second pillar, outperforming our competition. We continue to focus on delivering the best customer experience in the market and improving NPS, which has now reached 74%, compared to 66% in 2020. For the banking assets market share, and as per the initial figures from the Central Bank, our market share reached around 20.1% compared to 16.9% by end of 2020. With regard to the loyalty programme, we have done good progress during the year with total registered customers now reaching more than 5.0 million customers, up from 2.4 million in 2020.

For the third pillar, transform technology, we continue to strengthen our technology and digital infrastructure as we are continuously improving all of our channels. Digital-to-manual ratio currently stands at 91/9 compared to 83/17 in 2020. Online account opening reached 95% of the total retail account openings in the second quarter of this year. In addition, we have also seen an improvement in our end-to-end digital financing, which has reached now 26% of our personal finance. For the operation excellence, we have currently more than 408 bots as compared to 312 bots in 2020. Our average transaction per month has increased to reach now 612 million transactions compared to 295 million transactions by end of 2020.

Last pillar of our new strategy is to focus on clients' needs. We continue to grow Emkan financing portfolio, which has reached now SAR 5.6 billion with a growth of 73% compared to the end of 2020. Also, we continue to improve our payment solutions. Our point of sale terminal market share has reached 33.7% versus 28.4% in December 2020. Number of active customers also continued to improve, supported by our best-in-class digital capabilities, reaching now to 12.6 million customers compared to 9.6 million in 2020, a 31% increase. Now, if you allow me, I will hand over to Abdulrahman, our CFO, to give you a more detailed update of our financial performance, and thank you so much.

Abdulrahman Alfadda

Chief Financial Officer, Al-Rajhi Bank

Good day, ladies and gentlemen. It is my pleasure to welcome you again to our Q2 earnings call. I will go over the financial performance slides very quickly so that we can further time during the Q&A session later on.

If we can move on to slide number six. Our total assets stand at SAR 710 billion, a 30% year-on-year increase and almost 8% on a sequential basis. To analyse the 14% year-to-date movement of our total assets, as you can see on the bottom left-hand chart we had a 14.4% increase in our investment portfolio and almost 14.8% on the financing portfolio.

Our funding profile has been well diversified over the year, where we have raised almost SAR 86 billion, as you can see on the bottom right-hand side of the chart, increase of our interbank borrowing by SAR 25 billion and almost SAR 41 billion on our customer deposits.

Zooming in further into the drivers of the balance sheet movement, our total net financing was at SAR 520 billion, a 33% increase year-on-year and almost 7% on a sequential basis. It is worth to highlight that our retail book represents almost 79% of the overall financing while non-retail is almost 21%.

To analyse further, the 14.8% movement in our financing portfolio, as you can see in the top right-hand side of the chart, we have seen a broad-based growth in all business lines. Mortgage 18% growth year-to-date, ex-mortgage of the retail book 7%, corporate 22% and finally SME around 38%.

Our total customer deposits stand at SAR 553 billion, a 24% year-on-year increase. It is worth to highlight that our CASA as a percentage of the overall deposits, is almost 71.8%. To further analyse the year-to-date movement of 8% in our customer deposits, as you can see in the bottom right-hand side of the chart, our demand deposits have increased by 3.7% year-to-date and if you recall, in Q1 we had a drop, which we have discussed. The drop in 1Q happened right at the end of the quarter and we managed to grow that. Sequential growth was almost 7.2% versus a market growth of only 90 basis points. Time deposits have increased by almost 19.5%. This is to support the overall growth in our total assets.

If we move to the profitability side, our Q2 net income is close to around SAR 4.3 billion, an 18% year-on-year increase and almost 3% on a sequential basis. To analyse the sequential growth, as you can see on the bottom left-hand side of the chart, our NII has increased by 4.2%. It is worth to highlight that our gross yield was higher by 10% on a sequential basis due to our activities to reprice the retail assets plus the impact of the SAIBOR movement into the corporate and treasury book, whereby our average yield assets has improved by 11 basis points on a sequential basis. However, that was partially negated by higher cost of funding.

Our non-yield income was almost 2% lower, expenses 2.9% higher, which will bring the pre-provision profit to be 2.7% higher on a sequential basis. Impairments were almost flat. Our net income for the period is around SAR 8.4 billion, which is almost 21% year-on-year, driven by the following. NII has increased by almost 11%, non-yield income by almost 30%, Opex higher by 6%, which drives the pre-provision profit to be 18% year-on-year increase. Impairments were flat.

To move on, our operating income for the second quarter was SAR 7.1 billion, a 13% year-on-year increase and almost 2.7% on a sequential basis. The operating income for the period is at SAR 14.1 billion, and you can see the drivers at the top right-hand side of the chart. NII went higher by 11%. It is worth to highlight that despite that, our average earning assets increased by 31% year-on-year. NII went up by 11% due to the NIM contraction.

Fees have increased by 25%. As explained by Waleed earlier, this is due mainly on the payment revenue as well as improving our cross-sell activities. It is worth to highlight on the payment revenue, it was driven by the following factors. A, higher consumer spending by 8%. B, acceleration of further positive migration to the cashless payment method whereby ATM transactions went lower by 10%, point of sale higher by 47% and e-commerce by 80% and finally increasing our market share from the point of sale terminals from 30.3% to almost 33.7%.

Our exchange income has delivered 52% due to further improvement by our Treasury colleagues where they have improved our cross-sell activity with the rest of the business line in the organisation. Our NIM stands at 3.76%, where we have seen almost 68 basis point contraction year-on-year. And, as you can see on the bottom right-hand side of the chart, the driver of the NIM contraction. 61 basis points on the retail book, which is mainly impacted by the back book pricing, given the competition that we saw in 2021.

Corporate and Treasury have delivered 11 and 10 basis points, respectively, due to the improvement of SAIBOR. Cost of funds have impacted our NIM by 35 basis points due to the following factors; A, the SAIBOR has increased from 80 basis points for the first half in 2021 compared to 2.05% in the first half this year. B, the increase on our time deposits to be able to support the growth. Finally, the management have delivered a seven basis point improvement in our average earning assets.

To move and analyse the second driver of our net income growth, our Opex for Q2 was almost SAR 1.8 billion, 5% year-on-year growth and almost 3% on a sequential basis. Opex for the period stands at SAR 3.6 billion, almost 6% year-on-year growth, driven by all main contributors of our Opex line items to support 30% growth in our balance sheet.

Additionally, the higher transactions by 42% year-on-year and finally our strategic investment made to execute and deliver our Bank of the Future Strategy. The management have delivered 208 basis point cost-to-income improvement due to 670 basis point positive jaws. Our operating income has increased by 12.8% while our Opex has increased by only 6.1%.

To move on, our impairment for Q2 was SAR 580 million, flat year-on-year and on a sequential basis. Cost of risk has further improved to 47 basis points compared to 64 basis points in the same period last year. Our impairment for the first half is around SAR 1.1 billion, flat on a year-to-year. Although our recovery was lower by SAR 200 million, nevertheless our gross charges were lower by SAR 200 million accordingly. Subsequently, we top up our non-retail book due to the portfolio growth, while we release on the retail portfolio, given that we have updated our ECL model in line with IFRS requirement whereby 98% of our exposure is stage 1.

Our NPL flat at SAR 3.0 billion and our NPL ratio at 57 basis points, 10 basis points lower compared to the same period last year due to the further improvement on our corporate NPLs, which we have delivered a 58 basis point improvement. Our NPL ratio at 293%, which is at a comfortable level and above the industry benchmark.

Our ECL stock stands at around SAR 9.0 billion, as I mentioned earlier, we topped up our non-retail book. It is worth to highlight, if you can see on the bottom left-hand side of the chart, our stage 1 exposure is almost 97.3% of the exposure compared to 97% in the same period year, an almost 30 basis point improvement due to improvement of the quality of the booking. Our stage 1 coverage, at 71 basis points, stage 2 almost 22% and finally stage 3 at almost 71% is within a comfortable range and above the industry benchmark.

Liquidity position remained healthy and within the regulatory requirement. Although our headline LDR is at 94%, nevertheless our actual LDR is at 83.8% in Q2. LCR and NSFR at a comfortable level and above the regulatory requirements.

Our total RWA at SAR 471 billion, almost 27% year-on-year increase, mainly driven by almost 29% growth in our credit risk RWA. It is worth to highlight that our RWA density is at 66.4%. Our Tier 1 ratio at 17.9% in Q2 and as you can see on the bottom right-hand side of the chart we have delivered a 140 basis point improvement in our Tier 1 ratio, mainly driven by the improvement in to the Sukuk, which we have issued in January. Nevertheless, it's worth to highlight that although RWA contributed to 190 basis drop in our capital ratio it has been offset by 190 basis points of internal capital generation.

Finally, the bank delivery of a both record quarter and period have further improved our return matrices accordingly. Our RORWA stable at a 3.74%. Our earnings per share for Q2 is SAR 1.05 while for the period at SAR 2.08. Our ROE at 23.4%, which is considerably one of the highest ROEs in the Saudi banking system. And, finally, our ROA at 2.55%.

Despite, the IMF have revised downwards the global GDP growth; however, they maintain the Saudi GDP growth for 2022 and they have further upgraded the 2023 guidance accordingly. Saudi GDP for Q2 flash report came out recently. 11.8%

expansion, mainly driven by 23% oil GDP growth and a 5.4% non-oil GDP growth. The macro outlook is supportive for the credit growth over the medium-term.

Subsequently, we have also updated our rate forecast for the remaining of the year, whereby we are expecting four additional rate hikes by the Fed until the year-end. That is in addition to the nine rate hikes that have been delivered so far. Finally, I would like also to highlight that SRC at the end of June have revised their rates higher by 60 basis points and the current mortgage origination ranges are between 5.25% to almost 6.1%.

Finally, we have kept our guidance unchanged for 2022 and I would like maybe to spend a few minutes to discuss our rationale. On the financing portfolio guidance, although we have delivered 14.8% for the first half, however we are expecting July and August, given that it is the summer holiday in the Kingdom, to be a slow month. In addition, we are expecting a further corporate repayment in the second half of the year.

On our NIM, although there was a 45 basis point contraction against 55-65 basis point contraction guidance, however we are seeing the following factors. We take it positively, the SRC hiking the rate by 110 basis points cumulative since the beginning of the year. That is one. Secondly, the positive impact of the SAIBOR movement on our Corporate and Treasury book. Thirdly, we repriced our retail assets that are also contributing positively onto the NIM. Nevertheless, that is negated by higher cost of fund, whereby we update our average SAIBOR from 2.5% to almost 2.8% for full 2022. Thank you very much. Waleed, back to you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, Abdulrahman, for the financial performance review. The good progress made in our Bank of the Future strategy helped us to achieve such a strong result. We will continue driving excellence to go beyond the unthinkable in creating a financial ecosystem that provides our valuable customers with innovative and smart financial solutions. Now, if you will allow me to open the floor for the Q&A session. Operator, back to you.

QUESTION AND ANSWER SECTION

Operator: Thank you.

If you would like to ask a question, please use the Raise Hand button found on our WebEx toolbar. Alternatively, you can submit a written question using the Q&A chatbox. If you have joined via the telephone, please press * followed by 1, and when preparing to ask your question please ensure that your lines are unmuted locally. Our first question comes from Nida Iqbal, from Morgan Stanley. Please, go ahead.

Nida Iqbal
Equity Analyst, Morgan Stanley **Q**

Thank you for the call. I have a few questions. My first question is on the growth in corporate, which has been very impressive at Al Rajhi. Can you talk about your strategy there, what sort of corporates you are targeting and how you see the retail versus corporate mix evolving, and also how big of an opportunity is SME?

My second question is on the cost-to-income ratios that have declined to 25% as of the first half. These are best-in-class ratios already, so what further cost efficiencies, if any, can be put through and what do you see as a sustainable cost-to-income ratio for Al Rajhi. Then, finally, you mentioned no dividend as you continue to focus on growth. Can we please get some thoughts on how you are thinking about dividend for 2022? Thank you.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

A

Thank you so much for your question. I will answer the first question and I will leave the second two questions to Abdulrahman. We are a retail bank and we are known in the market as a retail bank. However, that does not stop us from not growing in the corporate and to have a corporate portfolio in our balance sheet. The most important thing is that we will grow in corporate with the quality and the right names in the corporates. We are not aiming to be a corporate bank and most of our portfolio will remain as a retail bank.

For the SME, we believe there is an opportunity to serve the SME customer since, especially the micro and small business, they have the same nature like retail customers, and we believe we have the ability to serve them. Abdulrahman.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On the cost-to-income ratio, although we are having one of the lowest cost-to-income ratios in the Kingdom, nevertheless the way that we operate as management is to deliver at least anywhere between 300-400 basis point positive jaws between operating income growth and operating expense. We are not shying away from spending as long as it is giving us an opportunity to grow and to scale our business accordingly, nevertheless while optimising our cost base accordingly. That is on the second item.

On the dividend, as Waleed mentioned, and the management recommended not to distribute the dividend for the first half, as far as the second half, it is still too early. Usually, we the announcement on the dividend either in January-February next year and we will take into consideration the growth outlook in the second half as well as the medium-term. Then, we will assess accordingly and we will announce, taking into consideration the capital, the growth, liquidity and all other factors accordingly.

Nida Iqbal
Equity Analyst, Morgan Stanley

Q

Thank you very much. That is very clear.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

I just wanted to get your thoughts on liquidity in the banking system and how you seeing liquidity maybe if you can comment on the liquidity that was quoted in the press to the extent that you can. But more specifically for yourself, there was a very impressive, roughly 400 basis point improvement in your regulatory LDR, whereas when I look at your deposit growth, that was 9% versus around 7% for loan growth. So, there's a 400 basis point drop in your regulatory

LDR but 200 which the loan deposit potentially would imply. And you have delivered this despite increasing your CASA ratio. So, I just wanted to understand, are you changing tenors? What are you doing? And how was this LDR achievement beyond the headline LDR. That would be very helpful. And if the liquidity injection, if any, from the regulator, from the government helped in that case.

Second, on asset yields. You were able to deliver positive asset yield improvement during the quarter and you mentioned that you were able to improve your retail yields as well. So, I was just wondering if this is a function of mortgage caps. Is there anything else happening on the retail side which you can talk about?

And, finally, linked to this, while the mortgage caps have gone up, and as you mentioned 60 bps now, there was 50 bps in April, 10 bps in December. This is a cumulative around 120 basis in the fourth quarter but SAIBOR has gone up more than that and time deposit costs have gone up more than that. So, when you look at the spread on mortgages, has it actually narrowed and is this 50 bps actually helping or is it just maintaining and old gap? Thank you.

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

Thank you, Waleed. This is Abdulrahman Alajaji. On the liquidity front, the overall liquidity in the market has improved, especially toward the end of the quarter and that is evidenced by looking at the average reverse repo in the banking system. We have seen a low of SAR 6.0 billion and now, as we stand, we are at SAR 107 or SAR 106 billion. Also, key indicators have improved. So, if you look at the LDR in the system that has improved from 82.2 in May to 79.7 in June. One point also worth mentioning and highlighting, if you look at the SAIBOR/LIBOR spread or the differential, it had also improved where we have seen a high of almost 150 basis points in April and now we are at a level of 18 or 19 basis points. So, this is on the first question.

The second question, two main points here. If you look at the asset growth Q-on-Q or the loan growth Q-on-Q, it stood at 7.3%. On the deposit side, it has grown by 8.9%, so this is one point. The second point, some of the deposits that we are attracting are longer dated in maturity or in tenor and that has more weighting on the LDR calculation. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Waleed, on the third question related to the point that you have mentioned on our gross yield, indeed, we managed to increase our average earning asset yield in Q2 by almost 11 basis points compared to Q1. This is due to the function of multiple things. A, is the SAIBOR movement has impact on the corporate, as well on the treasury book. But more importantly, as well, is on the ex-mortgage of the retail book and this is a function of long-term rates, liquidity, as well as SAIBOR, and to a smaller extent is also the mortgage. Nevertheless, if you recall the first changes that happened in the mortgage cap was somewhere on 14th April which will take some time to see that impact.

Finally, on the delta, let me try to clarify. Since the beginning of the year, if you look, the mortgage rates have increased by 110 basis points on average. When I do the calculation of the SAIBOR on an average basis, the second half of last year was almost 80 basis points, the first half this year is almost 2.05%. So, the net increase is almost 125 basis points. I know at some point in time it might have went higher but on an average basis 125 basis points.

However, the way that we look at is we look at the mortgage rates, which, as I mentioned, the current range is 5.25%-6.10%, although it is 20 years in tenor, average duration is almost ten years. We monitor it against the 10-year Saudi Riyal rate, which is almost at 3.7%.

I agree with you, on the short-term the delta between the gross, and the cost-of-fund has been narrowing over time and from our perspective, mortgage is considered to be one of the best products for us, given that there is still a demand.

Secondly, it is capital efficient, 50% RWA. And, finally, the cost of risk is very low in the mortgage book. So, if you look at it from all that perspective, mortgage is one of the best ROE expansions for the bank.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

Thank you very much. A couple of questions from my side. One, I noticed that your FX income was quite strong this quarter. Maybe if you can touch on that. Second, in terms of deposit growth, impressive growth in demand deposits. If you can maybe talk about the source of these deposits. Would you say that this is more transitional in nature or they are more sticky?

I have a question on your NIM, as well. I think what has been interesting over the last month is that the SAIBOR/LIBOR spread has tightened quite a lot, by about 100 basis points. Wouldn't that be beneficial for your cost of funds and I'm talking relative to you NIM guidance because one reason why your NIM has come under pressure is because of increasing cost of fund but given that the spread has tightened, there should be some benefit that comes to the bank. So, I would like to hear your thoughts on that.

And on last question, maybe more of a long-term question. In terms of scalability, do you think that in order to continue increasing customer base, your loan book and deposit volumes, would you see a parallel increase in costs or you have built enough capacity that cost growth is going to be in and around the current rate of 6% over the medium to long-term?

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

Thank you, Shabbir. From an FX point of view and this is something that we have started towards the second half of last year is to expand and to promote our cross-sell opportunities, whether it is on the retail front or whether on the corporate front. This is something that we have done.

We have started to promote our digital platform and we have started to reduce our margin, so dependency on volume rather than one single transaction.

We have introduced new channels, new products, etc., and this is something that if you look in last year's results you will see our P&L on the low side.

However, this year, this is something that we are getting back going forward. We will continue with our strategy. We are the number one FX provider in the Kingdom from a volume point of view, our market share stands between 30% and 32%. Thank you, Shabbir.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Shabbir, on the second question related to the CASA growth, and I think this is part of the DNA of Al Rajhi Bank is to focus on to continue every day in growing CASA. What we have seen in Q1 was only a short-term. I think you have been covering us for quite some time and you know that from a historical perspective the bank has been delivering a strong CASA growth year after year. So, from our perspective, historically we have been only focusing on growing CASA from the retail perspective and I would like also to highlight, while we continue our corporate book on the asset side, our corporate team also focusing into improving the 360 relationship and one of them is to grow the CASA from the corporate clients, whether be it the regular corporate clients or semi-government or government accounts. This is something that Al Rajhi Bank will continue to do in the upcoming future.

The third item related to the NIM, yes, we take positively that the SAIBOR/LIBOR differential became lower but nevertheless that should impact our cost of fund. However, if you recall the slide before our guidance, and if you recall, we have updated our forecast for the Fed rate hike. Previously, in the Q1 earnings call, if you recall, we were forecasting ten rate hikes by the Fed. Now, we have upgraded Fed hikes cumulative for full year to almost 13 hikes. Our average SAIBOR for full 2022 forecast in Q1 was 2.5% and we have increased it to almost 2.8%.

Now, finally, on the scalability. I think if you dialled in before the call you will have been able to see the video or the promo that we have put in place. This is the strategy that we have been taking over the last few years to be the leader in the digital side, transform our technology to be able to scale up.

From our perspective, the number of the customer base has increased year-over-year. We improved our active digital customers. We have been improving further our services and products on our digital platform, as you saw on the promo before the call. So, all of that will help us on the digital side to improve the customer NPS, loyalty, engagement and finally to manage our costs efficiently. So, the answer is, yes, there could be a further scalability without negatively impacting that much on our cost base going forward.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

Thank you very much.

Mohammed Al-Rasheed
Ashmore Group, Equity Research Analyst

Q

I have a question regarding the recent change in mortgages. The Ministry of Housing has introduced a new option where the beneficiary can get the subsidy in terms of a 100,000 upfront payment. So, my question is the rate offer to the beneficiary who will choose to get this 100,000 upfront payment, would it be the same as the one who choose the interest cost subsidy. Because the way I think about it is that here there is no interest cost subsidy and the credit risk might be higher.

And my second question is regarding your second half funding. I am wondering if you are considering of issuing a further Tier 1 Sukuk to finance your growth expansion. Thank you.

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

Mohammed, related to the first question on the new subsidy programme announced by REDF recently that is optional to the bank to participate. I think from our perspective, as Al Rajhi Bank, for multiple reasons I think we have decided not to be part of that. Our understanding is that the subsidy programme works as follows. There are five to six initiatives or subsidy programme in addition to the interest subsidy. The customer cannot choose two. It has to be only one, be it an interest subsidy or any other subsidies that the REDF announced recently.

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank **A**

Mohammed, with regard to the second question. I just would like to highlight that all options are on the table and if needed and when needed, we will be ready in the most efficient way, in terms of funding cost as well as maximising our shareholder value. It is worth mentioning to everyone that we have officially established our EMTN programme in dollars. So, again, all options are on the table when, and where needed. Thank you.

Chiro Ghosh
VP, Financial Institutions Research, SICO **Q**

My first question is about the net interest margin. In the previous quarterly update at the first half of the year you will see a margin pressure. Maybe in half of the year it will stabilise and in the later part of the year your margins can be revised back. Does that still continue or does that still hold? In our model we might have pass through now a better margin than what you're guiding at this moment. That is my first question.

The second one is I got the impression that the mortgage rate on the consumer side remains fixed, so anything above that SAR 500,000 on which the interest is paid by the consumers, does that also revise up? Does he have pay a higher interest rate on that? That is my second question.

And the third one is a quick one again. I see that new NPL formation, the first half was roughly SAR 2.0 billion while the provision, which you have provided is roughly SAR 1.2 billion. Although you are sufficiently provided, I just wanted to get a set whether this roughly SAR 2.0 billion would be the new norm then perhaps the provision might go up. Just to get a sense of that.

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

On the NIM question, and for the first half our NIM contracted 45 basis points and the guidance is within the range of 55-65 basis points. The only variable that we have changed from the last quarter is updating the SAIBOR forecast for 2022 from 2.5% to 2.8%. Nevertheless, we are quite comfortable that the guidance that we have provided, a 55-65 basis point contraction is still intact. That's number one.

Secondly, regarding your question on the mortgage, on the revised rate. It is always the case. REDF will be only subsidising the customer up to SAR 500,000. Anything above that, irrespective what is the rate, whether that be six, five, four, seven, the customer will bear the cost for that.

Finally, related to your question on the NPL formation that we have in the second half, it is almost about SAR 2.1 billion, and if you do the math you can see that mainly it is coming from, a combination between the retail, which is a normal flow that we have seen. However, on the corporate side we have seen a couple of names that they have moved from stage 2 to stage 3. On the sector basis, one of them is manufacturing, mainly one large account on the manufacturing side and there are probably two small accounts in the wholesale trade. These are one-time events. Nevertheless, I think our risk team are managing the portfolio in the most efficient, alongside with our colleagues on the corporate side.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

If the interest rate cycle keeps going up, the interest expense of the corporate goes up, do you expect to see more corporate defaults?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Well, to be honest, if you look at the first half, although average SAIBOR has moved from 80 basis points to almost 205 basis points, we managed to grow our corporate book by 22%. It varies from customer to customer but overall Al Rajhi Bank, despite the movement in SAIBOR, our corporate team have managed to deliver 22% growth year-to-date.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

That is all from my side. Thank you. Thank you very much.

Malik Zahir
CIO, SICO

Q

I have two questions for you. The first question relates to your interbank borrowing. Last quarter, you indicated you had to go borrow due to the redemption, funds moving out in your demand deposits. But when I look at this quarter also I see your interbank borrowing has increased by about SAR 35 billion to about SAR 42 billion. The increased interbank lending is about 35% of your loan growth. It is about 8% of your total loans outstanding. For a bank like Al Rajhi, which typically used to fund with demand deposits, I am sure this is a very costly source of funding. So, what is your strategy with regard to your interbank exposure? How do you expect to decrease it and how do you expect to manage it?

The second question relates to there was a Bloomberg article, which mentioned that the central bank intervened to reduce the spread between the SAIBOR and LIBOR, which had ballooned due to liquidity reasons. And they said that they have placed deposits with banks. So, did Al Rajhi benefit from those deposits and, if so, how much was it? Those are the two questions. Thank you.

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

Thank you, Malik. For banks, interbank borrowing is part of our funding profile, whereby also I wanted to highlight earlier that SAMA has also introduced the term repo and extended it to three months. So, this is cover the shortfall from a liquidity point of view. However, we are still managing our funding mix between non-profit and profit-bearing deposits. As of end of June, 72% of our customer deposits are non-profit bearing. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Related to the second question, I do not think we can comment on behalf of the central bank. However, from our experience with one of the most professional central banks in the region, SAMA is the lender of the last resort for the banking system. However, and I think from our perspective, they have a broad spectrum of tools to manage the system liquidity if required and during all times.

I think for a short-term fluctuation SAMA offer banks on repo, as my colleague has just mentioned, and they have extended the open market operation. Beyond that, SAMA might inject liquidity through the placement of deposits in the banking system and I think they historically have done that. If you recall, in 2020, during the pandemic and also during 2016 when rates or the SAIBOR/LIBOR differential went higher.

Malik Zahir
CIO, SICO

Q

Thank you.

Mohammed Al-Hadhrami
Portfolio Manager, HSBC

Q

Ask about the pricing of the loans recently. How do you see the competition in pricing in the second quarter versus the first quarter? Now, what is your outlook about the competition of pricing, whether in the mortgage or corporate going forward? Given that there is an increase in the cap mortgage rate, what do you think about the reaction of the banks in pricing? Would they move quickly to the high end or because of the competition, the pricing will be similar to what you have witnessed in the second quarter?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Thank you, Mohammed. I think from our perspective, as I've mentioned earlier, and since the end of Q1 beginning of quarter two, the bank, taking into consideration the higher SAIBOR, the level of the interest rates, the yield curve has been steepening since the beginning of the year, although that has inverted recently. Nevertheless, I think we have been taking a lot of decisions to reprice our retail assets accordingly, taking into consideration the shape of the yield curve, the level of the interest rate, and the cost of fund and the level of SAIBOR.

We have seen the competition in the second quarter in the retail business has been, to some extent, much more relaxed compared to what we have seen in 2021 and I think it varies from one organisation to another. However, on the corporate side, I would say competition is stiff but nevertheless, it varies from one organisation to another.

Now, as far as going forward, time will tell how the level of interest rate, the changes in the rate hike by the Fed and what SAMA might follow, what is the liquidity situation going forward. So, there are a lot of variables need to be taken into consideration. However, rest assured from an Al Rajhi Bank management perspective, we will do whatever it will take from to grow in the most efficient way to further improve the ROE accordingly and in the most efficient way for the shareholders of the organisation. Thank you.

Operator: We have no time for any further questions. For those who have requested to ask a question, please direct these to the IR team, who will address your questions. I will now hand back to the management team for any closing remarks.

Waleed Almogbel
Chief Executive Officer, Al-Rajhi Bank

Thank you, everyone, for dialling in and for your trust in us. We are very proud of our result and we will continue to focus on execution and achieving our strategic goals for this year and beyond. We look forward to meeting you again in the third quarter earnings call. Thank you.
