4Q22 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

February 2, 2023

Mazen Alsudairi
Head of Research, Al-Rajhi Capital

Good afternoon, everyone. This is Mazen Alsudairi from Al-Rajhi Capital. Al-Rajhi Capital is proud to host Al-Rajhi Bank Q4 2022 earnings call. Welcome, all, to the call. Now, I will hand over to Rayan, Head of Investor Relations, to introduce the management team.

Rayan Alshuaibi
Director Investor Relations, Al-Rajhi Bank

Thank you, Mazen. Good day, everyone, and thank you for joining the call. With us, on the call today, our MD and CEO, Waleed Almogbel, CFO, Abdulrahman Alfadda, and GM of Retail, Majed Alrajhi. Our CEO will start with the financial highlights and strategy update, followed by our CFO, to give you more detail about our financial performance. I would like to remind everybody that today's presentation is available on our website. Thank you again for joining the call, and Waleed, over to you.

Waleed Almogbel
Managing Director and Chief Executive Officer, Al-Rajhi Bank

Thank you, Rayan, welcome, everyone, and thank you for attending our earnings call for the fourth quarter of 2022. We will go, as always through our performance highlights, followed by an overview of our strategic performance. Now let's take a closer look at our fourth quarter performance. If we move to the first slide, for the year of 2022, the Bank continued to deliver a strong performance across all business lines, supported by our strategic initiatives and improved economic activities. Starting with the balance sheet, hamdulillah, we were able to deliver 22% growth for the year. On the asset side, the growth was mainly driven by financing portfolio, which is growing at 26% year-on-year. Now our financing portfolios have reached SAR 568 billion.

Mortgage recorded a growth of 30% year-on-year, and now the mortgage portfolio represents around 38% of our total book and 51% of our retail book. Non-retail book also has witnessed good growth by 59% year-on-year, supported by 57% growth on our corporate book, and 61% growth on SME. On the liability side, currently, the total liabilities stand at 662 billion, an increase of almost 19% year-on-year. Loan to deposit ratio stands at 86%, which is still below the regulatory minimum. We also delivered a solid net income growth of 16% year-on-year to reach SAR 17.2 billion, driven by both yield income, which increased by 9%, and also, non-yield income with a growth of 20%. As a result, our total operating income has increased 11%, standing at SAR 28.6 billion.

Also, we continue to maintain best in class asset quality, supported by a positive economic outlook and good recovery. We maintained a healthy cost of risk of 39 bps, compared to 60 bps for the year of 2021. The outstanding portfolio quality resulted in low NPL, standing at 54 bps, compared to 65 bps last year, with a healthy coverage ratio of 260%. Also, several management initiatives supported the delivery of further cost efficiency, resulting in a market leading cost to income ratio standing at now 26%, which is an improvement of more than 85 bps year-on-year. Lastly, the Bank also maintains a strong financial position, with a healthy capital ratio of 21.4%, well ahead of the regulatory minimum.

If we move now to slide number four, which will mainly cover the performance and execution of our 2023 strategy. As you might know, this year is the last year of our strategy. We continue to focus on retail as a core banking business. We have seen a financing growth of 72% in our retail book, since we introduced our Bank of the Future strategy. Also, our book portfolio has witnessed an outstanding growth of more than 100%, a result of our continuous effort to expand our corporate portfolio and reposition ourselves. The corporates book, represent now 20% of our total financing book. Also, if you remember, SME is part of our strategy, and we try to position ourselves as a bank of choice for SME. The SME book now has more than doubled, since starting our strategy, with a growth of almost 160% and currently, it's representing 18% of our non-retail book, compared to 15% when we started our strategy. Although the market has seen a shift in the deposit mix, hamdulillah, the Bank was able to grow demand deposits by 6%, since strategy inception. This will continue to be one of our priorities, as one of the items that help us to reduce our cost of funding. In addition, we continue to improve our revenue mix with our non-yield income as a percentage of our total operating income, and now standing at 22%, compared to 18% in 2020.

Outperforming our competition, which is our second pillar, the Bank continued to focus on delivering the best customer experience in the market across all business segments, helping us to maintain NPS leadership at 75%, compared to 66% in 2020. With regard to our loyalty programme, we have made good progress during the year, with total registered customers increase by around 700,000. And now it's reaching 6.2 million customers, registered in our loyalty program, compared to 2.4 million in 2020.

Moving to the third pillar, transform technology. Strengthening and improving our technology and digital infrastructure is a key to our success in capturing business opportunity and market leadership, especially in digital. Now, digital to manual ratios stand at 92/8, compared to 83/17. Additionally, online accounts opening reached 94% of the total retail account. Also, we have seen an improvement in our end-to-end digital financing, which has now reached 35% of our personal finance. Relying on technology to improve our operational excellence, the number of bots currently stands at almost 500, compared to 300 bots in 2020. As a result, our average transaction per month has witnessed a significant increase, and now it's reaching almost 700 million transactions, compared to 300 million transaction by the end of 2020, which is an increase of more than 135%.

Addressing the new client needs is a key pillar of our strategy. Launching Emkan, our microfinance company, is the main item under this pillar, to enhance the product offering for the group. The financing portfolio of Emkan has more than doubled, since 2020, standing at 7.7 billion. Also, we continue to improve our payment solutions, helping us to further capture point of sale market share, and launching neoleap our payment digital company for B2B and B2C. It was one of the key pillars in this strategy. Now our point of sale market share has reached 37.5%, compared to 28.4% in December 2020. Lastly, the number of active customers continue to improve, supported by our best in class digital capability. If you look at the group level, we now have almost 18 million active customers, compared to ten million at the end of 2020. If you allow me now, I will hand over to Albulrahman, our Group CFO, to give you a detailed update of our financial performance. And thank you so much.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

Thank you, Waleed. Good day, ladies and gentlemen. It is my pleasure to welcome you again to our Q4 earnings call. I will go over the financial performance very quickly, so that you can have more time during the Q&A session later on. We will start with our balance sheet. Our total assets stand at SAR 752 billion, a 22% year-on-year increase, and almost 3% on a sequential basis. To analyse the 22% year-to-date movement, as you can see on the bottom left hand side of the slide, investments have grown by close to around 21%, and financing by 26%, which we will cover in further detail in the following slides. Overall, on the funding side, our funding profile has been well diversified over the year, where we have raised around SAR 139 billion. 22% year-to-date growth and the details, as you can see on the bottom right hand side of the chart, interbank borrowing has increased by close to SAR 53 billion, out of which, 4.4 billion of dollar ESG syndicated loans, that was tapped in the second half of last year.

Our customer deposits have increased by almost 10.3% year-on-year and finally, our total equity has increased by 49%, out of which, if you recall, we have tapped into the debt capital market, and we raised SAR 16.5 billion of Tier 1 Sukuk. Our financing book stands at SAR 568 billion, a 26% year-on-year increase and almost 2% on sequential growth. The retail book, 76% of the overall financing, while the non-retail book is almost 24%.

To analyse further the 26% year-on-year growth on our financing portfolio growth, we have seen a broad based growth on all business lines. Mortgage has increased by 30%. Ex-mortgage of the retail book by 7%, which will bring the overall total retail book growth of 18%. Corporate and SME have grown by 57% and 61% respectively, which will bring the total non-retail book to almost 58% year-to-date growth. Mortgage stands at SAR 222 billion, out of which, it represents 51% of the retail book and close to 38.5% of the overall financing. To move on to customer deposits. It stands at SAR 560 billion, 10% year-on-year growth, and almost 1.6% growth on a sequential basis. CASA, as a percentage of the overall customer deposits, stands at 64.2% as of Q4. To analyse the 10% year-to-date movement in our total customer deposit, as you can see on the bottom right hand side of the chart, we have seen a dip by almost 6% into the CASA, which attributed mainly into Q4, where we've seen the demand balances went lower from the government and large accounts, which is, historically, volatile and sensitive to the rate environment. Nevertheless, on the retail side, we have not seen that major movement. Time deposits have increased by 55% year-on-year to support the overall asset growth.

If we move to the profitability section, our net income for Q4 was standing at 4.4 billion, 10% on a year-to-year basis, and almost 1% on a sequential basis. To analyse the sequential movement, as you can see on the bottom left hand side of the slide, our NII went lower by 2%. This is due to higher cost of funds in Q4, compared to Q3. Nevertheless, that has been compensated by better non-yield income by almost 11%. Our OpEx has increased by 7.5% on a sequential basis in Q4, while impairments were lower by 28%. To analyse the 16.3% net income growth, year-on-year, our net income stands as SAR 17.1 billion as of 2022, and the driver, as you can see on the bottom right hand side of the slide. NII has increased by close to 9%. Total non-yield income has increased by 20%, while OpEx has increased by 7.6%, offseted by a lower impairment by close to around 15%.

To further analyse the net income driver, I'll start with operating income. Our operating income for Q4 was close to SAR 7.3 billion, 6% year-on-year growth, and almost 1% on a sequential basis. The total operating income for full year is SAR 28.6 billion, as you can see on the top right hand side of the slide, net yield income was 9%. Although our average earning asset increased by 29% year-on-year, the NII only went higher by 9%, due to the NIM contraction. Fees have improved by almost 18%. This is attributed to the payment revenue, and improved fees from remittance, wholesale fees, such as trade, cash management, FI, and also, financing related fees, coupled with lower brokerage fees, due to an almost 33% drop in the overall average daily volume in 2022, compared to last year. FX has shown a very good improvement year-on-year, almost 48%. This is due to a pick-up in remittance market share, as well as a better cross sell coordination among the Group. Our NIM stand as the 3.55% for 2022, a 66 basis points contraction, compared to the same period last year. However, if you see, in the bottom left hand side of the slide, the grey line is representing our gross yield. If you recall, we've mentioned that Q2 was an inflection point of our gross yield expansion, which the trend, as you can see with the grey line, has been improving. In Q2, we increased our gross yield by 13 basis points, followed by 15 basis points in Q3, and 50 basis points in Q4, which will bring the overall expansion into the gross yield for 2022 to almost 9 basis points. It’s worth highlighting that the exit rate for our gross yield is close to 5%. Nevertheless, that has been negated by higher cost of funds, given the SAIBOR has increased, year-on-year, by almost 233 basis points, coupled with high dependencies on the time deposits. Our cost of funds stand, at the end of the year, at 97 basis points, 75 basis points year-on-year increase, and the exit rate for the cost of funds is close to around 1.72%. Now, although the average NIM for 2022 is 3.55%, the exit rate for Q4 is around 3.26%. Hence, we are expecting a drop, in Q1, onto the NIM. Nevertheless, in Q2 and this year onwards, we'll see a further expansion into the NIM on a sequential basis, taking into consideration the repricing of our gross assets, as well as optimising our cost of funds going forward. On the right hand side of the chart, you can see that the 66 basis point contraction was attributed to 75 basis point increase in the cost of funds. However, from a business line, you see that although the retail book showed a contraction of 29 basis points, from a yield perspective, that has been negated by both corporate and treasury by a combined 32 basis points.

If we move on to analyse the second driver of the net income growth, our OpEx for Q4 was at SAR 2 billion, an 11.7% year-on-year increase and almost 7.5% on a sequential basis. The increase in our OpEx for Q4 was related to few one-off items as part of the G&A item, to position ourselves for the future. Our full year OpEx stands at SAR 7.5 billion, a 7.6% year-on-year increase, and you can see that all line items have shown an increase year-on-year. This is to support the overall 22% growth in our balance sheet, as well as the higher transaction volumes, which went higher by 36 basis points. And finally, the strategical on investment made to execute and deliver the Bank of the Future strategy. We have delivered 86 basis points cost to income improvements, due to the positive growth of 350 basis points between the operating income growth and operating expense growth. Our cost to income stands at 26.1%.

On the asset quality, our net charge for Q4 was almost 40% year-on-year lower, and almost 28% on a sequential basis, which brings the cost of risk to 39 basis points, compared to 60 basis points at the same period last year. Our net charge for the period is almost SAR 2 billion, which is almost 15% lower year-on-year. And as you can see on the bottom left hand side of the chart, we had a lower gross charge in 2022. This is due to updating our ECL model in line of the IFRS 9 requirement, taking into consideration the positive macro outlook of the Saudi economy. On the right hand side of the chart, you can see that the majority of the release on the lower net impairment were coming from the retail book. This is a factor that 98% of the retail exposure is stage one. NPL stands at around almost SAR 3.1 billion, a 2.5% year-on-year increase, and almost 1.1% lower on a sequential basis. The increase was mainly on retail, while we have a better improvement into core non-retail NPL. On a formation basis, although the write-off has been almost SAR 4.5 billion, that is negated by a new inflows of around SAR 4.5 billion. The NPL ratio stands at 54 basis points, compared to 65 basis points at the same period last year. Although the retail NPL is higher by four basis points year-on-year, and probably six basis points on a sequential basis. However, that’s negated by further improvements into the corporate book, which shows the quality of the new origination. Our NPL coverage stands at 260%, lower compared to the same period last year. Although that went lower, nevertheless, it is higher than the average competition, as per Q3 data.

ECL stocks stand at SAR 8 billion, and the movement, as you can see on the top right hand side of the chart, which is a reflection of the ECL update on the models. Our gross loans stand at SAR 576 billion, out of which, 97.5% is stage 1, which is a 50 basis point improvement, compared to the same period last year, which is reflective of the new quality of the origination. Stage 1 coverage stands at 58 basis points, stage 2, at 17.9%, stage 3, at 64.1%, although there is a drop, both on a sequential and a year-to-year basis, but again, this is well ahead against the competition as of Q3.

The liquidity position remains comfortable, and in line with the regulatory requirements. Although that our headline LDR at almost 100.6%, but our actual LDR is at 85.9%. LCR and NSFR is at comfortable levels and above the regulatory requirements.

Our total RWA is close to around SAR 500 billion, almost a 17% increase, year-on-year, due to the increase into the credit risk RWA. It is worth highlighting that the RWA density stands at 65.3% as of Q4, compared to 68.2% for the same period last year. Total capital is at almost SAR 107 billion, out of which, 94.7% is Tier 1 capital. Our CET1 is at 17%, Tier 1 ratio is at 20.3%, and finally, our total capital is at 21.4%. As you see, on the bottom right hand side of the slide, we have delivered 390 basis points improvement on our Tier 1 capital. This is due to the Sukuk issuance that attributed to that increase. In addition, it is worth highlighting that although RWA contributed to 345 basis point drop in our capital ratio, however, that has been offset by 386 basis points of an internal capital generation.

Finally, the Bank's delivery of a record quarter and the period has further improved our return matrices. Our RORWA stands at 3.71%, earnings per share for Q4 was SAR 1.08, while for the full year, it was close to around SAR 4.25. ROE stands at 22.7%, while ROA is at 2.46%.

Before I go into the 2023 guidance, I will just spend a couple of minutes on our assumptions.

Saudi Arabia has reported the growth for 2022 GDP of 8.7%, which is the fastest moving G20 economy. And I think, despite the recessionary pressures globally, the GDP forecast expected, as per the IMF, for 2023 and 2024 are 2.7% and 3.4%, respectively. We still further have a positive outlook about consumer spending and the credit growth, driven by the 2030 vision initiative. On the interest rate side, the Fed delivered 17 hikes last year, and one further last night. We are expecting the peak into the short-term rate to be in May this year, and it will be stabilised for the remainder of 2023. Nevertheless, we have seen the impact of the higher interest rate environment, it has impacted the credit demand somehow over Q4 and over the beginning of the year. Finally, on strategy execution. As Waleed mentioned, we will continue to further execute our final year of the 2023 strategy.

Having said that, our financing portfolio guidance for 2023 is as follows. It is mid-single digit, and we take into consideration the following factors. There is a positive growth outlook, driven by the 2030 vision initiatives, such as increasing the home ownership, empowering the SME and corporate demand, due to the giga projects. Nevertheless, that will be somehow negated by the higher interest rate impact. Which is impacting the cost of funds and affordability for the retail customers. Thirdly, we have taken the assumption of securitisation into our forecast for 2023 to securitise a portion of our mortgage book. On the NIM, we have guidance for a 15 to 25 basis points contraction. It is worth highlighting, as I mentioned earlier, the exit rate for Q4 is 3.26% versus an average of 3.55% for the full year. Hence, we will have an immediate drop by the start of Q1 by close to around 29 basis points. Nevertheless, as I mentioned earlier, 2023, or specifically, in Q2 2023, it is going to be the inflection point of the NIM sequential growth over time, given that we are repricing our gross yield, and optimising our cost of funds efficiently. Our ROE is above 21%. Cost of risk is in the range between 30 to 40 basis points. Finally, our Tier 1 ratio will be above 20%. Waleed, back to you.

Waleed Almogbel
Managing Director and Chief Executive Officer, Al-Rajhi Bank

Thank you, Abdulrahman, for the financial performance overview. The good progress made on our Bank of the Future strategy has helped us to achieve such strong results. And now we will 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 and you have joined via WebEx, please press the raise hand icon on your screen. Alternatively, you can submit a written question in the Q&A chat box. If you have joined us on the telephone, please press star, followed by one, on your telephone keypad. We will pause for a moment to allow questions to be registered. Our first question comes from Naresh Bilandani from JP Morgan. Naresh, please go ahead.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Thank you very much. Hi, it's Naresh Bilandani from JPMorgan. Two questions, please. The first one is likely to be unsurprising. It's on the loan growth, and I'm just keen to understand the drivers in a little bit more detail on the loan growth guidance that you have put out. And just what parts of the segments book are you seeing the biggest slowdown, if any? Assuming if we were to take an optimistic view, and if there could be any upside risk, where do you think those could potentially come from? Also, I think since you are the first large bank to report and guide, how do you see this being construed as a read a cross into the trend for the industry as a whole? And towards the final point in your presentation, again, on loan growth, you mentioned that the guidance also includes a portion of securitisation. So, if we adjust for pre-securitisation, would you be able to guide how we should think of the loan growth, just so that we have a like for like assumption on what the model trend could be?

That's first on the loan growth guidance. The second is just on the net interest margin. Thanks for providing the insight into the sequential progression. Now, I'm just going to try to think that to some extent, is the lower loan growth a conscious decision from a NIM perspective. Because last year, you had a very strong growth rate, and the NIM pressure was significantly higher. But I remember in your previous investor discussions, you mentioned that you were inclined to think that the sequential NIM will turn more towards the end of this year. But now it seems like you sound a lot more positive on the NIM turning a lot earlier. So, is that more on an internal conscious decision to reduce the loan growth, so as to push the top line further than expectations? That's the second question. These are the two most important questions that I have. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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Thank you, Naresh. Related to the first question, you need to take into consideration the following three factors in the loan growth forecast for 2023. Number one is the base effect. You have seen our financing book, in 2022, has grown by close to around 25.5%. If you recall, 2021, we grew, also by 43%. In 2020, we grew close to around 26%. So, the compounding factors need to be taken into consideration. So, the base has gone higher, that's number one. The second factor is the impact of the higher interest rates. We have seen the impact of the higher interest rates, both at the corporate and on the retail side. It is impacting the DBR for the customer eligibility, and my colleague, Majed, will be able to shed some light onto the retail side. But on the non-retail, again, higher cost of funds will also impact the demand, and will increase the pressure on repayments. That is on the loan growth. Majed, anything on the retail?

Majed Alrajhi
General Manager Retail Banking, Al-Rajhi Bank

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On the retail, we have seen interest rate goes up significantly that affect the eligibility of customer in terms either in mortgage or other product as well and refinancing time has extended. It used to be 20 months, and now it's gone to around 24. That is one of the impacts of the significant increase in interest rates.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I think we covered, Naresh, the two parts. Regarding the third part, we are at a very comfortable position from a liquidity perspective, you've seen that our loan to deposit ratio at 85.9% LCR, NSFR at a very healthy level. We've also tapped into the debt capital market. But I think, overall, we are very comfortable. And I think, from the historical standard, it is much tighter than whatever it used to be. So, from our perspective, these are the three, I would say, factors that need to be taken into consideration into the loan growth guidance. The second part related to securitisation and without securitisation. Again, unfortunately, we will not be able to disclose that, given that we are forecasting some kinds of securitisation, to be able to relief capital, to further improve the NIM over a longer term. Now, in terms of the second question related to the NIM vis-à-vis the loan growth.

I think, over the last few years, we are in a totally different environment than this year. In 2020, probably, interest rates were quite low. Liquidity was ample into the system, loan to deposit ratio, capital adequacy, etc., were at a much better level, compared to the current environment. We have seen a few opportunities to expand and improve our leverage, to further improve the shareholder value by improving the ROE, and we've taken advantage. Now we're living in a totally different environment, three month SAIBOR stands at almost 5.5%. So, these factors need to be taken into consideration for both the financing portfolio guidance, as well as the NIM sequential growth over the medium term.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Maybe just one follow-up. I know it's not in your expectations for this year, but hypothetically, if we assume, as is being implied in the Bloomberg consensus, that we may have a rate cut this year. I know you are thinking of steady rates this year. Could you like simplistically guide how would your guidance on the net interest margin change, if rates do actually decline, say, by 25 bps, as we are seeing in the Bloomberg numbers right now.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Sure. So, a disclaimer, you guys know my view about the theoretical NIM sensitivity for 25 basis points movement into SAIBOR, I've been discussing that. That is a more theoretical, and I think the industry trends over 2022 are proving that that there is a huge delta between the theoretical versus the actual NIM. But nevertheless, to answer your question, for every 25 basis points lower SAIBOR, the NIM would improve by close to 4 basis points.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Got it. Thank you very much.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

First on loan growth, I want to get your thoughts on the growth rates that you expect on retail versus non-retail. And the reason why I ask that is that even if I look at the numbers for December for mortgage origination, and if I were to analyse that and take out the natural repayments, we're still probably looking at mortgage growth, which will be high single digits, early double digits. And then you've been growing quite aggressively on the corporate side taking market share, so the mid-single digit loan growth guidance looks quite conservative in that context. So, I was wondering that if it's less of a credit demand issue, it's more of a cost of funding issue, whereby the management believes that there isn't enough reasonably priced funding available to pursue loan growth. And if this decision has been taken to also ease pressure on the cost of funding side, because obviously, liquidity, the LDR, not only for Rajhi, is tight, but also tighter for the whole market.

So, your thoughts on this will be much appreciated, especially talking about the different segment growth at play. Secondly, one of your comments you made in terms of there is pressure on repayments, because rates are moving higher. Now, in that context, you've grown your corporate loan book, and historically, we've seen that your cost of risk on the corporate book is higher than your retail book. And then your rates have moved up substantially. A corporate customer, which was paying all in 2% is probably paying 6% on borrowing. So, from that perspective, you seem quite comfortable with your 30 to 40 basis points cost of risk forecast. So, I just wondered if cost of funding is an issue, if repayments are an issue, then cost to risk looks a relatively benign assumption. Then lastly on securitisation and your net interest margin.

If your assumption is that rates stay flat, then are you expecting the SAIBOR LIBOR spread to narrow and help you on the cost of funding side? Because as loan growth across sectors slows down, then that spread narrows, and that helps you? Or is there anything else that you expect to play out? Because, effectively, if you have another quarter of NIM contraction, then you would need a decent amount of NIM expansion for the rest of the year, and it will not come without rate cuts. So, just trying to understand how you think that will play out. And then linked to this, my understanding is that if you securitise the book today, the cost of funding for an SRC is quite high as well. And the back book is priced below 5%. So, I'm just trying to understand why would securitisation not have a negative impact on net interest margin? Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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I'll start, Waleed, on the loan growth where I will start with the corporate, then I will leave the floor for my colleague, Majed, on the retail side. Again, on the corporate side, you mentioned aggressively, and I think Yes, we pick up market share, but it wasn't at the expense of the overall total return from any corporate relationship. So, that's one point that I would like to clarify. And I think for the corporate demand, it will be impacted by the higher cost of funds. If you have a three month SAIBOR stand at 5.5%, and I'm taking a wild guess of 150 basis points above the three months SAIBOR for any corporate loan, it's close to around 7% of a cost of fund.

It's a high margin for most of our corporate customers, unless they have a very huge margin to be able to pass through to the end consumer, which, in this current environment, the inflationary pressure, I think, it's very difficult. So, I think on corporate, yes, we believe that there is a demand. And I think a lot of things our colleagues in the corporate team are focusing on is attracting new to bank customers. And we've seen a much better improvement in the mix of the new to bank customers and the increase in the wallet share of the existing customers. Majed, on the retail outlook for 2023.

Majed Alrajhi
General Manager Retail Banking, Al-Rajhi Bank

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So, overall, in terms of retail, let's take mortgage, we were expecting to see a slowdown last year end of the quarter, and the beginning of this year, and that is mainly due to the fact of the interest rate impact to customer eligibility. But we are expecting to see continuous growth for 2023, but not to the same level as the previous year. And as well, we are working on several initiatives, in terms of getting out and tapping non-REDF customers for our mortgage book. On our non-mortgage book, we are expecting to see a flattish, on that perspective, and we will continue to hold our position as a market leader on the retail banking.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

The second question, Waleed, is related to the NIM and the securitisation? First of all, you made a statement that our back book on the mortgage is below 5%. A, we don't disclose that information, and the number that you presented is inaccurate. So, that's number one. Secondly, as long as the new origination rates are minus the securitised book, plus any servicing fees, is a net positive, then that is a NIM expansion over the medium term and a longer term. And I think the assumption that we're having is in line with our expectation, and we don't see any risks from that perspective. Finally, related to the SAIBOR LIBOR differential, we have factored in that the current existing SAIBOR LIBOR differential is intact. And I think if you look at the current three month SAIBOR priced at 5.50%, we have factored in a SAIBOR of close to around 5.6%, on average, for the rest of 2023.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Thank you much That's, that's very helpful. Just on the back book point, what I meant was that most of the origination in the last two to three years came at a point when the cap was around 5%, so that was the basis for the assumption that a large part of the back book is at 5%.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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Also, you have to take into consideration, Waleed, that Alrajhi Bank has been the first bank in the Kingdom to capture the mortgage growth opportunity from 2018 onwards. And those rates were much higher than the cap rate that was introduced on 1st July 2020.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

But then selling that book would also be, again, I'm just trying to think why would you like to sell that book, which is priced at such high margins?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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As I mentioned earlier, Waleed, as long as the delta between the new rate of origination minus the securitised book, plus any servicing fees, is a net positive. It is a no brainer for us. It will have a further NIM improvement over the longer term.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Got it. Thanks you very much, as always. Thank you.

Nida Iqbal
Equity Analyst, Morgan Stanley

Q

My questions were actually answered. Thank you very much.

Abdullah Alburaidi
Equity Analyst, Ashmore

Q

My question is regarding the cost of risk, regarding the ECL model. Now the oil prices are lower than the average over the last year, the growth of the loan book is slowing down, so there should be the granular effects of higher cost of risk, not lower. What changed in the ECL model?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Our ECL model, Abdullah, takes into consideration multiple factors. One is the GDP forecast, unemployment rates, consumer spending, and multiple variables that are filtered into our ECL model. Our cost of risk for 2022 was 39 basis points, and the guidance that we have provided for 2023 is 30 to 40 basis points.

Abdullah Alburaidi
Equity Analyst, Ashmore

Q

Yes. But GDP growth and everything else was higher last year, so the cost of risk should be higher.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

But also, you have to take into consideration the compounding factor. Last year was a growth of 8.7%. On top of that, the forecast is around 2.6%, with a further improvement in the unemployment rate and two other variables that need to be taken into consideration. That is one. Secondly, you need to take into consideration the following factor, as well. One, 76% of our financing book is retail. So, the spread is distributed against millions of customers. That's number one. Second is the nature of the retail customer still has not changed. 98% salary assigned, 92% government related employee, and we haven't changed our risk appetite.

Abdullah Alburaidi
Equity Analyst, Ashmore

Q

Okay, thank you. That is clear.

Aybek Islamov
Director Equity Research, HSBC

Q

How big are the off plan mortgages in your overall portfolio? What are the conditions like for off plan mortgages, interest in the off plan mortgages that you see today? And a related question is do you accrue interest on off plan mortgages? That's the question. And secondly, I think we discussed Basel IV introduction in the previous conference call. Can you elaborate further on the potential impact of Basel IV on the capital ratios?

Majed Alrajhi
General Manager Retail Banking, Al-Rajhi Bank

A

For mortgage off plan, it's in line with all product prices. So, there is no differentiator between off plan and other offers.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

And the second part is we accrue interest, usually, the treatment is the two years. And during that two years until it will be fully dispersed. Still, we accrue a profit into that. Now, the last question related to the Basel III reform implementation, which started at the beginning of 2023. We have done a parallel run on the second half of 2022. And the impact for us is a small positive, taking into consideration that in line of the Basel III reform for the mortgage RWA, it is assigned as per the LTV of the book. Last year's mortgage RWA stood at around 50%. But within the metrics that have been provided by the Basel, our LTV, I think, on average, is lower than close to 75%, which will assign a lower RWA, compared to the 50% that has been imposed in Basel III.

Aybek Islamov
Director Equity Research, HSBC

Q

Thank you.

Adnan Farouk
Managing Director & Head of Research, Jadwa Investment

Q

The first question was on the one-offs in costs you mentioned in the fourth quarter. If you could highlight what those one-offs in costs were. And what is the outlook for operating costs going forward?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I will start on the OpEx side. I think you've seen us, over the years, we're not shying away from increasing our OpEx, as long as we have an efficiency. So, for example, in 2022, our OpEx has increased by 7.6%, but we delivered an operating income of 11%. As long as we deliver a decent positive jaws, that will have a further efficiency on a cost to income ratio. On our one-offs that I've mentioned in Q4, this is, again, I mentioned it earlier, this is to help us further to position ourselves to further execute our 2023 strategy, and beyond, to further improve our shareholder value. As far as the non-yield income, I think payment is one of the main areas of the growth opportunities that we have delivered over the last few years, especially, as Waleed mentioned earlier, we've been growing our market share into the point of sale terminals, it reached almost 37.5%. Also, we're increasing the market share in the spending, the credit card penetration. That's one. Also, into the corporate side.

Our corporate team is not focusing only on the balance sheet lending. We've seen a further pickup on trade, cash management, FI, and also, better cross-sell activities on the FX. Finally, if you recall, one of the pillars of the strategy is to fulfil more customer requirements. We have launched two FinTech companies. One is Emkan and the other one is a neoleap. Those help us to further improve the revenue contribution not only coming from the bank, but also, to increase the contribution that's coming from those two entities that we've launched over the last couple of years.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

Maybe a follow up? I just want to understand, again, or maybe a clarification, what is your interest rate outlook for the NIM expectations that you've given? A second question. You mentioned that you've increased revenues from the remittance business. Is that mainly due to market share gains? Because I think, overall, remittance volumes in Saudi are down, relative to last year. And my third question is, again, on your growth on the retail side. Some of the data that I've seen suggests that there is growth in private sector jobs. Would that not positively benefit your growth prospects, even if the debt servicing burden has risen for others? Those are my three questions, thank you.

Majed Alrajhi
General Manager Retail Banking, Al-Rajhi Bank

A

I will start with the last comment regarding the private sector. We believe that yes, the economy is shifting into the private sector, and the private sector will be the main contributor for employment for the upcoming years. So, we are focusing on certain segments, which are mainly blue chip, A and B companies, and we know that they are strong, in terms of their financials. And we review each company by itself. So, we do believe that yes, the private sector will be upcoming. And we have grown over the last couple of years in the private sector portfolio, compared to our government. But, still, the government is the main player for our retail portfolio, and we're looking closely at the private sector, at who we can on board within our retail.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Shabir, related to your first question. I would, again, humbly repeat my disclaimer that there are lot of moving parts, related to the theoretical NIM sensitivity. Nevertheless, to address your question, for every 25 basis point decrease in SAIBOR, it will have a positive impact on NIM by close to four basis point. The second question related to the pickup in market share into the remittance. I'm sure that you guys are aware that Al-Rajhi Bank has a leading market share into the remittance business into the Kingdom. Although the volume has not increased materially, compared to the same period last year, the pickup in market share is due to a further improvement into the distribution, the focus, and also, the introduction of the FinTech company, neoleap, they are offering the wallet, as well as the cross border remittance.

Having said that, that all contributed to a 48% increase in the FX. And I think next week, we'll be able to disclose the fee income distribution as a part of footnote number 20 in our detailed financial statement. You will see that our remittance business has increased by 44% as well. So, the pickup in the market share was not compensated of lower margins, nor on the fee, or into the FX.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

Got it. Thank you.

Operator:

That is now the end of the Q&A session. For those of you who have not been able to have your questions answered, please reach out to the investor relations team. Thank you. I will now hand you over to the MD and CEO, Waleed Almogbel, for closing remarks. Please go ahead.

Waleed Almogbel
Managing Director and Chief Executive Officer, Al-Rajhi Bank

Thank you everyone for dialling in and for your interest in us. We are very proud of our results, and we will continue to focus on execution and achieving our strategic goal for this year and beyond. We look forward to meeting you in the next quarter earnings call, inshallah Thank you.