3Q23 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

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Mazen Al-sudairi
Head of Research, Al-Rajhi Capital

Good afternoon everyone, this is Mazen Al-sudairi from Al-Rajhi Capital. Al-Rajhi Capital is proud to host Al-Rajhi Bank Q3 2023 Earnings Call, welcome all to the call. And now I will handover to Rayan, Head of Investor Relations to introduce the management team.

Rayan Alshuaibi
Director Investor Relations, Al-Rajhi Bank

Thank you, Mazan. Good day everyone and thank you for joining the call. With us on the call today are our MD and CEO, Waleed Al-Mogbel, CFO, Abdulrahman Al-Fadda, and Chief Digital Officer, Abdullah Al-Furaiji. As always, our CEO will start with the results highlights, then our CFO will cover the financial performance in more detail, then we'll open the floor for your questions. Now, I'll hand over to Waleed. Waleed, back to you.

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

Thank you, Rayan. Good day everyone and thank you for attending our earnings call for the third quarter of 2023. As always, I will start by taking you through our performance highlights for the last quarter, then I will cover a final brief on the progress made on our Bank of the Future strategy 2023, then I will give the floor to our CFO, Abdulrahman, to cover the financial performance in more detail.

Now, to take a closer look at our results highlights for the first nine months of 2023. If we move to slide three, starting with our balance sheet, in the first nine months of 2023 the bank delivered a growth of 5.2 year-to-date and 8.3 year-on-year in total assets, driven by the financing and investment portfolios. The investment portfolio continued its strong momentum, recording a growth of 26% year-to-date and 26% also year-on-year, which will help to diversify our yield income and support the bank's liquidity position.

However, the bank during this year continues its smart growth approach across all business to achieve its strategic growth, which resulted in the financing portfolio recording a growth of 4% year-to-date and 6% year-on-year, reaching now to 591 billion. The growth in the financial portfolio was mainly coming from the non-retail book, which grew up 25% year-on-year, supported by 24% growth in our corporate book and 20% growth in the SME book. In retail, the growth was mainly coming from mortgage. It recorded almost 7% year-on-year and represents around 38% of our total book and now also represents 53% of our retail book.

On the liability side, total liabilities stand at almost 700 billion, an increase of 7% year-on-year and 6% year-to-date, which will bring the LDR to 81%, which is well below the regulatory minimum. Moving to the profitability, net income showed a slight drop of 2.3% for the period. The drop was mainly driven by the net yield income which was lower by 5%, driven by higher cost of funding. However, the non-yield income continued having a slight growth, showing almost 1% year-on-year. This resulted in total operating income decreasing by almost 4% in the first nine months of this year and now it is standing at 20.5 billion.

If we look at the credit quality, the bank continued to maintain best-in-class asset quality, with cost of risk standing now at 25 bps, NPL at 60 bps and that also with a healthy NPL coverage of 240%. Operating efficiency continued to be an area of focus for the management, which helped us to maintain a market-leading cost to income ratio at just below

27%. Lastly, the bank continued to maintain strong financial position with a healthy total capital ratio of almost 21%, well above the regulatory minimum.

If we move to slide number four, which demonstrates the accomplishments made so far on our present strategy. As we are in the last chapter now of our Bank of the Future strategy that started in 2021, we have achieved our strategic KPIs well ahead of time and will continue toward a great result until end of this year, an accomplishment that we are proud to witness and would never have been possible without the hard work of our people and the confidence of our shareholders. We will continue building on the success made on our Bank of the Future strategy. However, it is worth highlighting that we are finalizing now our new strategy for the next three years till 2026. We will share of the details of the strategy once it is approved by the board, by the end of this year. With that, now I will hand over to Abdulrahman, our 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. As-salamu alaikum wa rahmatullahi wa barakatuh. Good day ladies and gentlemen. It is my pleasure to welcome you again on our Q3 earnings call. On the financial slide, our total assets stand at around 800 billion, an 8% increase year-on-year and almost 2% increase on a sequential basis. To analyze the 5% year-to-date movement, as you can see on the bottom left-hand side of the chart, you see that as continuous of the management initiatives to improve the average earning assets. We've reduced our interbank portfolio, while we increased our investment book to improve the average earning assets. The net increase is only SAR 9.0 billion.

Our financing book has increased by almost 4% year-to-date and if you can move on to the funding side, the management continues to diversify the funding profile in order to manage our cost of funds efficiently. As you can see on the bottom right-hand side of the chart, our interbank portfolio has increased by 29 billion year-to-date. In Q3, we also tapped in USD 1.4 billion of a green syndicated loan at an attractive spread to be able to diversity our funding sources. Our customer deposits were almost flat. On the Sukuk, if you recall in April, earlier this year we've tapped in the international debt capital market, where we raised USD 1.0 billion of green syndicated senior unsecured Sukuk.

Zooming into the main driver of the balance sheet movement, as you can see on the top left-hand side of the chart, our financing book stands at 591 billion, a 6% year-on-year and almost 2% increase on a sequential basis. The retail book represents almost 72% of the financing as of Q3. To analyze further the 4% financing portfolio year-to-date growth, we have seen financing portfolio growth driven by the mortgage and corporate, while the ex-mortgages of the retail book continue in the degrowth mode. On the mortgage, we have increased our book by almost 3% on a year-to-date basis, flat on a sequential basis. It's worth to highlight, in Q3 we securitised 6.0 billion of our mortgage book, which will bring the total mortgage origination since the beginning of the year to almost SAR 11 billion, which will drive the net absolute growth in the mortgage book since the beginning of the year to almost SAR 18 billion.

Ex-mortgages of the retail book have shown a 5% contraction, which is in line with the previous communication, where we've been saying that the new originations are lower than the monthly repayments, giving the management initiative to focus on value rather than volume. Corporate and SME have shown 20% and 16% growth year-to-date respectively. Mortgage book stands at 229 billion as of Q3, which represents almost 53% of the retail book and 38% of the overall financing book. Our total customer deposits stand at SAR 566 billion, almost I would say flat year-to-date. It's worth to highlight that CASA as a percentage of the overall customer deposits have reached 66.7%, a 50 basis point improvement compared to Q2. To analyze the movement in the customer deposit, as you can see on the bottom right-hand side of the chart, we continue to focus on growing our CASA, which gives us an opportunity to shed off some the term deposits in order to improve further our cost of funds and optimize it accordingly.

If we move to the profitability section, our net income for Q3 stands at almost 4.15 as of Q3, 5% lower year-on-year and almost flat on a sequential basis. A sequential trend is highlighted on the bottom left-hand side of the chart, where we have seen the NII has increased by almost 4%, while the non-yield income has contracted by almost 10%. Expenses were higher by almost 1% and impairments were 5.3% higher on a sequential basis. Our net income for the period stands at 12.5 billion, almost 2% lower year-on-year. And the breakdowns, as you can see on the bottom right-hand side of the chart, our NII went lower by 5%, while non-yield income almost flat, expenses almost 1% higher, while impairments were 53% lower compared to the same period last year.

To further zoom in, into the net income drivers, I will start with operating income. Our operating income for Q3 stands at almost 6.9 billion, 5% lower year-on-year and almost 1% higher on a sequential basis. The operating income for the period stands at 20.5 billion as of the first nine months, where you can see the drivers on the top right-hand side of the chart. NIIs were lower by 5%, which is a function of the NIM contraction year-on-year. Fees were lower by almost 6%. This is due to the fact that there are certain fees as a part of the origination on the financing book. We stopped taking those fees from 1st July onward. Nevertheless, if you remove that factor, the fee incomes are growing in line with our expectation. Exchange income was higher 7% year-on-year. This is basically to focus into improving our cross-sell vis-à-vis on the retail or on the corporate segment. Other income has increased by almost 47% year-on-year, which is basically the mark-to-market on our fair value through P&L book for the year.

On the NIM side, our year-to-date NIM stands at 2.98%. Q2 NIM was almost 2.95%, while Q3 NIM stands at 3%. Basically, the NIM expansion of five basis points is a function of the asset yield expansion by almost 25 basis points, while the cost of funds was only by 20 basis points. This is in line with the management communication previously, our forecast that we have almost reached the bottom in our NIM and we've seen a reversal of the NIM sequential contraction which started back in Q1 2020, where the average sequential drop in the NIM over the last 14 quarters was 16 basis points. So, that is a positive trend which is in line with our forecast for the remaining of the year. On the bottom right-hand side of the chart, you can see that the NIM on a year-to-year basis has contracted by 68 basis points. All business lines have shown an asset yield expansion, nevertheless the cost of funds was negating that improvement, giving an increase on the term deposits, as well as an increase in the SAIBOR compared to the same period last year.

To move and analyze the second driver of the net income on the expense side, our opex for Q3 almost 1.9 billion, 1% lower year-on-year and almost 1% higher on a sequential basis. Opex for the period stands at 5.5, almost 1% higher year-on-year and, as you can see, the management initiatives to optimize the cost, although our staff and depreciation has increased to support the increase in the total assets, as well as an increase in the number of transactions, the management initiatives to optimize our G&A have paid off and reduce that delta of an increase in total opex, which will bring the overall cost to income ratio to be 26.9% as of the nine months.

On the asset quality, net impairment charge almost 380 million, 23% lower year-on-year and almost 5% higher on a sequential basis. Our cost of risk stands at 25 basis points lower compared to the same period last year of 43 basis points. As you can see on the bottom both charts, which is in line with the category as well as the segment movement, this is a function of updating our ECL model that has taken place over the course of the year, which is in line with the commentary that the management have provided over the last three quarters.

Our NPL balance stands at around 3.6 billion, flat year-on-year and almost flat on a sequential basis. On the NPL formation, as you can see on the top right-hand side of the chart, our write offs stand at around 2.3 billion, compared to 3.4 billion at the same period last year, while the NPL formation is at 2.3 billion compared to 3.5 billion at the same period last year. That brings our NPL ratio to 60 basis points, where we have seen an improvement on the retail NPL that dropped on a sequential basis by almost seven basis points, also the corporate side by almost 26 basis points to be at 1.2%. Our NPL coverage stands healthy at almost 240% as of Q3. Our ECL stock stands at 8.6 billion as of Q3, while the movement, as you can see, which is in line with the previous commentary, you can see it by segment over the retail and non-retail book.

Our gross financing stands at almost 600 billion. It's worth to highlight that our Stage 1 exposure is almost 96.7%, which is very healthy compared to the industry benchmark. Our stage coverage, we've seen our Stage 1 at 49 basis points, one basis point lower compared to Q2. Stage 2 coverage stands at 12.6% compared to almost 13% in Q2, while Stage 3 is at a healthy level at 62.7% compared to 63% in Q2. Liquidity position remained healthy and within our regulatory requirement. Although our headline LDR stands at 104%, nevertheless our regulatory LDR stands at 81%. LCR and NSFR at a very comfortable level and above the minimum regulatory requirements.

On the capital side our total RWA stand at 519, almost 8% year-on-year and almost 4% growth year-to-date. The growth in the total RWA is a function of the credit RWA, which has increased by almost 4.2% year-to-date. Our RWA density stands at 64.8% as of Q3. On the capital ratio, our CET1 ratio stands at 16.5% and our Tier 1 capital stands at 19.6%. You can see that there is a small dip in Q3, which is a function of the dividend that has been distributed, which we have announced back in Q2. On the bottom right-hand side of the chart, you can see that we had a 63 basis point drop in our Tier 1 capital. This is a function of given that the RWA and the dividend contributed to a 227 basis point drop in our capital adequacy. Nevertheless, that has been offset by 238 basis points of internal capital generation. Return matrices are stable and still within the industry-leading return matrices, where our RORWA, ROE and ROA remain stable at almost 3.3%, 19.5% and 2.1% respectively.

At the macro level, the IMF have revised the GDP forecast for Saudi to be 0.8%, driven by the oil GDP contraction, while the non-oil GDP is showing very positive for Q2. It stands at 6.1% growth on a year-to-year basis. In addition, the IMF also revised the GDP forecast for Saudi for 2024 to be 4%. Consumer spending is still healthy, where we have seen an increase in the overall consumer spending by 7.8% up to August year-to-date. On the interest rate side, on our base case forecast, there will be another additional rate hike in November which already I think is factored into the market. Nevertheless, our base case forecast for the remaining period is higher for longer.

Putting that into perspective, we kept our financing book guidance unchanged. It is worth to highlight that as usual, given the seasonality factor, we are seeing some of the repayment pressure into Q4. Nevertheless, the pipeline is still healthy and we continue expecting the growth. Nevertheless, it will be within our guidance for this year. As far as the NIM, in Q2, if you recall, based on the market outlook and given the recent Fed hawkish commentary we have updated our forecast for the rates for this year. It is worth to highlight on the NIM, as I mentioned Q3 this year represents an inflection point for the NIM expansion on a sequential basis. Nevertheless, we're expecting the trend to continue forward whereby the asset yield expansion will outpace the cost of funds expansion, which bring 2024 as an inflection point on a year-to-year basis for the NIM expansion. The other guidance, we kept it unchanged. Waleed, back to you.

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

Thank you, Abdulrahman, for the financial performance overview. Now we will open the floor for Q&A session. Operator, back to you.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the Q&A session. If you would like to ask a question and have joined via Webex, then please use the raise hand icon to ask an audio question. To submit a written question, please us the Q&A chatbox. Alternatively, if you have joined us on the telephone, then please press star followed by one on your telephone keypad. Our first question comes from Naresh Bilandani, from J.P. Morgan. Naresh, please go ahead.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Hi. Thank you very much. It's Naresh Bilandani, from J.P. Morgan. A few questions from my side, please. One is you talked about the securitisation of the mortgage portfolio of around SAR 6.0 billion in Q3. Just wanted to reconfirm, is this a sale of mortgages or a securitisation where you converted this to RMBS or this was a sale to SRC similar to what you did in the first quarter? It would be great if you can please share some economics of the transaction. You also mention on slide nine that you have stopped regarding some fees on banking services. Is this related to this sale? I just wanted to reconfirm that. That's the first one.

My second question is on asset quality. Given the fixed rate nature of the loan book that you have, which supports your asset quality despite the volatility in the rates, is it fair to assume that the cost of risk for the franchise will continue to say in control just around the current levels going into the next year too? That's the second question. The third is given the fact that loan growth remains muted and you are generating capital and the capital position is quite healthy, would it be fair to assume that you have a better affordability of a higher dividend payout over the next one or two years to enhance your medium-ROE?

And since we have Abdullah on the line, just some questions on the digital side which I think is a good opportunity to ask him. Any thoughts you can share on the progress of the Urpay wallet in terms of the number of merchants or clients onboarded and if you can also throw some thoughts on if there is any rate of return on investment that you're targeting from Neoleap, and also if you have made any progress on commencing the third-party payments processing via the Neoleap platform. Thank you. Sorry, it's a bunch of questions, I realize that, so if you want me to repeat any, please let me know.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

That's fine, Naresh. On the first question related to the mortgage securitisation, it is in line with what we have done in Q1, which is a pure sale to SRC. Now, in terms of the economics, let me repeat what we have said in Q1. As long as the delta between the new origination rate minus the securitised book plus the fee income associated with the servicing fees is a net positive it is net income accretive over time. That's on the first question. And the second part of your first question, no, that is not related to the fee income drop into the third quarter.

The second question on the asset quality, I think you have to take into consideration the following factors. A 72% of the financing book is retail, which is granular in nature. That's number one. Second, we haven't compromised in terms of the credit quality of the borrowing customers. Still, the majority are government-related employees and salaried assigned. Third factor, it is a fixed rate and I think we don't expect the retail NPL to be materially moving higher from our historical average of 35-45 basis points.

The third question on the growth. Year-to-date growth on our financing book is almost 4% versus when we started communicating our strategy the CAGR growth was almost 26%. The last three years we have taken a call to preserve capital where we have seen an opportunity to further expand ROE and we leveraged that by reducing the payout ratio to be in the range of 24-29%. Given that the growth outlook is lower than the last three-year average, we basically returned closer to our historical average of a dividend payout ratio of 60-70%. The first half the payout ratio was almost 55%, so we're not far away and we'll continue to evaluate the opportunity between preserving capital versus distributing a dividend to maximize the shareholder value.

As far as the fourth question related to Urpay, in terms of the customers, overall our active customers, and I think we've seen very good progress, our active customers are almost 3.5 million of customers on the wallet. We're making quite a lot of progress in improving the wallet from a peer-to-peer to more of a lifestyle. Maybe, Abdullah, you want to elaborate further what we are doing on to increasing the customer touchpoints with our wallet.

Abdullah Al-Furaiji
Chief Digital Officer, Al-Rajhi Bank

A

We are progressing the transactions through Urpay with more than 200 features in our Urpay app. We are the first wallet to introduce and promote the family wallet in the Kingdom and also we are the first wallet to introduce the lifecycle concept instead of financial app. And also, we will continue enhancing our offering to be more agile, more insights and actions rather than execution.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Thank you. And there was a question on Neoleap too. What's the rate of return on investment, if you've started thinking on some targets from Neoleap and if you have started commencing third-party processing on the Neoleap platform? And I just had a follow-up, Abdulrahman, on the fee income. On slide nine, when you're showing the drop in fee income from banking services compared to nine months '22 last year, you mentioned that you stopped regarding some fees from 1st July. Can you please just throw some light on that please.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On Neoleap, it's our second fintech company that we've launched as a part of our Bank of the Future strategy. Basically, it's to help us to maintain our payment leadership. What I can guarantee you is all the investments that we are making are recording a very good return on investment. Unfortunately, that is not disclosed, nevertheless I think it is moving in line of our strategic objective. We outsource the acquiring as well as the card processing to Neoleap, with an objective for them to be able to improve the scale, efficiency, for them to be able to expand outside Al Rajhi Bank. This is something as a phase one. As and when we believe that there is a good maturity, that is something that we will further look into. As far as the fee income, there has been a regulatory change in the retail origination whereby there are certain fees that we are supposed to record it as a part of the fee income. That has been stopped since 1st July onward.

Naresh Balandani
Head of MENA Equity Research, JP Morgan

Q

Where are they being recorded now or are they not being collected at all?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

In line with the regulatory changes, they're not collected at all.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Three questions, please, from my side. First, on net interest margins. If I look at your latest guidance and take the lower end of the range which is 55 bps lower versus last year, this implies roughly eight basis points of net interest margin expansion for the fourth quarter. Abdulrahman, if I were to understand correctly, you mentioned that NIMs have clearly dropped. Would it be fair to say that, all else equals, you can start seeing something to that tune, like five to ten basis points of net interest margin expansion if nothing else changes. I just wanted to confirm if I'm understanding the new net interest margin guidance correctly. That's the first question.

Secondly, if you could please kindly comment on the funding strategy from here on. I know you're pretty comfortable from a regulatory LDR perspective but what can we expect more in terms of mortgage securitisation and your issuance plans, if any? And third and final question is on digital. You've delivered 58% growth in digital subscribers, more than 15 million digital customers. If, Abdullah, you could kindly comment on some KPIs that you track or are you targeting in terms of market share, cross-sell or profitability of these digital customers please. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Waleed, on the NIM, and I think year-to-date NIM stands at almost 298 basis points, you need also to appreciate there are a lot of moving parts and I think one of the most volatile is the CASA migration. If you recall, in the SAMA monthly publication, CASA as a percentage of the overall customer deposits has reached 53.5%, which is one of the lowest levels in more than a decade, so this is volatile. Nevertheless, we still see, despite some kind of an assumption on CASA migration, we see still opportunity on the asset yield expansion driven by the ex-mortgages of the retail book. That book has been repriced nicely since the beginning of the year, which helps us to further improve our asset yield and we'll continue to look at that. So, overall, I think there are a lot of moving parts. Nevertheless, from a management perspective, what I can assure you is that the way we look into the NIM over the coming period is that the asset yield expansion will outpace the cost of fund increase. That's on NIM.

As far as the funding, now I think from a management perspective there has been quite a lot that we have done since 2020. We've basically tapped into the local AT1 market, where we've raised 16.5 billion. We've tapped in twice into dollar syndicated loans, both are ESG compliant, as well as in April, we tapped into 1.0 billion of a senior unsecured five-year issuance as a part of a 4.0 billion EMTN programme. We've securitised a cumulative of 11 billion of our mortgage book since the beginning of the year. From the management's perspective, we will continue to do what we have done since the beginning of 2022 in order to further optimize our cost of funds, diversify the funding sources and to support the growth over the medium term in the most efficient way that will help us to further improve the shareholder value.

Abdullah Al-Furaiji
Chief Digital Officer, Al-Rajhi Bank

A

From a digital perspective our strategy is to expand our digital capabilities and to have a customer-centric approach, also to enhance our journey over time as we move from inside to be an action app with real-time communication, also to expand our offering within Al Rajhi group. Let me share with you some facts and numbers. In the past 12 months we introduced more than 100 app releases to the market. Also, we have more than 280 million logins on a monthly basis as an average. And also our customer base, our customers onboarded through digital doubled in the last 12 months. Also, we introduced more than 380-plus products and services enhancements in the retail app, with also more than 185 products and services in our E-corp app.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Got it. Thank you very much. That's very helpful. Abdulrahman, just one question on fees. Then, given the change in regulation around the fees, the third quarter is the right base for future growth? This is the base that you grow off or are there still any one-offs that need to be offset?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I will repeat what I've mentioned earlier. If you remove that one-off, that practically changes the factor and I think the fee income is moving in line with our forecast. However, management have launched lots of initiatives, which is part of the '26 strategy, to further improve the fee income contribution to the bottom line and you have seen it in some of non-yield income. We've seen a growth into the exchange income. We've seen a growth into the trade, cash management, bank insurance. Lot's of the fee income contribution, we are expecting management to focus to further improve the fee income contribution to the bottom line.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Got it. Thank you very much. Thank you.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

Thank you very much. A question regarding the funds released from securitisation. These funds can only be used for new mortgage origination or these funds are at the discretion of the bank to be deployed anywhere profitably? That's my first question. Second, in terms of funding, have you explored savings as a product for funding? Historically, it has been very current account dependent but is savings a potential opportunity that you can grow in? Thirdly has there been, as far as you can tell us, any intervention from the central bank in terms of injecting liquidity into the system or have there been any new conversations regarding ensuring that adequate funding is available to the system to ensure that a lot of these megaprojects are executed? So, those three questions please. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Shabbir, in terms of the funding that came from the securitisation, there is no restriction. It is up to the bank management to be able to deploy that funding into the most efficient source of improving further our asset yield. This is part of the management's initiative to further improve the asset yield which, if you recall my earlier comments on the NIM, whatever we've done that has helped us to further improve the asset yield expansion, given that, as mentioned earlier, the delta between the new origination rate minus the securitised rate plus the servicing fees, is a net positive. That is part of the initiative to improve the return on the average earning assets. As far as the liquidity is concern, I think usually SAMA has been monitoring all the developments into the liquidity market and into the funding. They have been active several times in the past, whether by changes on the LDR or injecting liquidity. From our perspective, funding is available, there is no issue with the liquidity. Nevertheless, it has a cost. As far as the saving, I will leave it to the MD and CEO to comment.

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

A

Hi, Shabbir. For the saving products, we have been active since the beginning of the year to launch some savings products for the retail segment. Now, we are proud to have three different products. One of them is a unique product in the market and we see a good customer base and contribution to our liabilities from these products.

Rahul Bajaj
MENA Equity Research Director, Citi

Q

Hi. Thank you for taking my question. This is Rahul Bajaj, from Citi. I have two quick questions, actually. The first one is on tax. Has there been any discussion by the regulator or GAZT around a 15% minimum tax in Saudi for multinational companies, what has already been put in place for UAE multinational companies? Is there any talk of that and, if there is, how will Zakat be treated in that kind of tax calculation? The second one is on CASA. We've seen migration, as you mentioned earlier, at a system level time deposits moving into CASA and CASA share going down. Where do you think there is a bottom at the system level? Do you think this gradual migration will continue for the foreseeable future or do you to think that there is a minimum level of CASA, a minimum share of CASA in the system which will still sustain even at these high interest rate levels? Any thoughts there will be really appreciated. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On the first question, Rahul, related to the tax and Zakat, I cannot comment about what could be the treatments for the multi-international companies that are coming into Saudi. Nevertheless, I can comment about it from a Saudi banking perspective and specifically for Al Rajhi bank. There has been a Royal Decree back in 2018 as part of the settlement, and I think all the banking systems have done that settlement of the Zakat pre-2018. Post-2018 onward, and I think the Zakat calculation came from ZATCA as part of the Royal Decree that came, which is pretty simple. You look at your Zakat pool and you apply the minimum on your net income of 10%. That is your minimum and the maximum is 20%. I'm not aware of any changes that are coming to the Zakat applicable for the local companies. As far as an international company, I cannot comment on that perspective.

Related to the CASA migration, there are two things that I know. Number one, on the CASA as a percentage of the customer deposit my view, given the current liquidity tightness and also the current interest rate environment, I believe at a system level it will go lower. Now, to what level I have no idea and I think that is something that is yet to be seen. Nevertheless, from us, as Al Rajhi Bank, we continue to focus on growing CASA to be able to improve our cost of funds efficiently. And as you can see from one of the previous slides, our CASA has grown almost 4% year-to-date and our market share into the CASA has improved.

Rahul Bajaj
MENA Equity Research Director, Citi

Q

Thanks, Abdulrahman. My first question on tax was actually on this kind of global rollout of minimum 15% tax for companies and UAE is also implementing 15% tax for all the large companies which are based out of UAE. So, my question was is there any talk of any kind of higher tax rates of Zakat rate which is being talked in Saudi as well?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

It is still under study. I cannot comment on behalf of ZATCA or the Ministry of Finance but then I think we are reviewing that, whether that will be implemented, what could be the impact, etc. Work in progress.

Nida Iqbal
Equity Analyst, Morgan Stanley

Q

I apologize about earlier. I just had two questions, firstly on the loan growth side of things. Of course, consumer loans have been slow this year, given the high interest rate environment. How should we think about loan growth looking forward assuming rates remain elevated? Should we expect consumer loans to remain subdued as we look forward into

2024? And secondly, I just wanted to ask a follow-up on the funding side of things. I see that you are very focused on diversification of funding, with interbank funding increasing a fair bit. Would you be able to give some colour on how the cost of this funding compares with cost of customer deposits right now? Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Nida, in terms of the consumer loan growth, again let me remind you about our earlier comments regarding the management focus for 2023 and beyond. We've said that at the beginning of the year, in light of the current environment it is wise from our perspective to focus into the value rather than volume by focusing on growing a profitable market share. We've been increasing our pricing into the personal finance to make sure that it is adjusted for the cost of funding and the cost of risk. That is one side. We have seen that portfolio contracted and have been openly saying we are expecting that portfolio on a degrowth mode since the beginning of the year. We continue to expect that degrowth to continue, nevertheless what we have seen, is a very encouraging factor in Q3 that the origination is picking up. I think it's about that customers started embracing the new norm of higher rates, which we've seen coming back. That is one.
Secondly, I would like to remind you one of the key KPIs of the government is to reduce the unemployment rate. Given that close to 63% of the population are below the age of 30, there are new retail customers that are coming into the workforce every year. That will help us also to further improve our retail origination over the medium term. I think at the end it's just about pricing, which the management focus is value rather than volume.

As far as the second question related to the interbank, given that if you look at our regulatory LDR, we are still at a healthy level at 81% as of Q3, compared to a 90% cap as per the regulation. Taking into consideration that gap, I think it will give the management the flexibility to be able to diversify the funding sources, which we've been doing since the beginning of 2020, to be able to optimize the cost of funding. Nevertheless, the funding that we've basically raised through the interbank to some extent is lower than the customer deposits, which have helped us to further manage the cost of funds expansion.

Olga Veselova
Equity Analyst Director, BofA

Q

Thank you for hosting this call and thank you for taking my questions. I have several remaining questions. One is about this cancelled origination fees from July. I understand this was a consumer protection measure. Which other consumer protection measures to do you hear from the regulator, if any? This is my first question. My second question is about savings products. You mentioned that there are several new savings products which you launched year-to-date. Can you compare for us the interest rate on savings products versus term deposits, how different interest rates are? And also does this mean that the blended cost of CASA is no longer zero, if SA is not costing zero? And my third question is really a bigger picture question on fees. When I look at Al Rajhi's fees, the average asset ratio, it looks very solid versus Saudi banks' average or MENA banks' average but it is still low by EMEA standards despite the bank's focus on retail and SME segments. Have you made any analysis where this difference is coming from? Are there maybe any services which are free in Saudi Arabia and they're not free in other markets? Any thoughts on that would be very appreciated. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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One the fees side, we are not aware of any further regulation that is coming on the pipeline. Nevertheless, we are part of the ecosystem, so I cannot comment on that perspective, up to our knowledge. In terms of the second question related to the savings products, yes, as Waleed mentioned, I think we've seen the customer behavior change towards moving to the saving mainly from some of the highly sophisticated clients, so we have to offer those saving products. Nevertheless, the savings product rates are much, much lower than whatever the current term deposit is. The current three-month SAIBOR stands at 6.30, which our saving is much, much lower than that rate. Nevertheless, the demand of the growth into the savings I think is a focus area for us, given that to protect our customer base and money to be leaving outside the organization but is a very small portion of our overall CASA, which you have seen at 365 billion as of Q3.

Finally, related to the fees. I think on the fees there is a different way to look at. One way is to look at fees as a percentage of the operating income. another way is to look to the fees as a percentage of the total assets. One other way is to look at the fees as a percentage of the operating expense. In my opinion, the best way for me and for Waleed to monitor the fee is to look at how much it's funding my opex? As of the first nine months, fees as a percentage of opex were close to around 86% in Al Rajhi. Q2 average benchmark in Saudi were close to 63%, And I think I can debate about which one. Is it looking at it as a percentage of assets or opex? From our perspective, the best measurement for us is fees as a percentage of the opex.

Olga Veselova
Equity Analyst Director, BofA

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That's great. Thank you. On the second question, may I ask, maybe roughly, what is the interest rate on savings account? Is it 0.5%, 1%? How low is it?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

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It's much, much lower than 6%.

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

Thank you everyone for dialling in and for your trust in us. Just before we close, I would like to thank Rayan Alshuaibi for the great work heading the IR for Al Rajhi for the last two years and wishing him the best of luck in his new journey. And I would like to take this opportunity to introduce Safwan Al-sulaimani. He will be heading the IR. Good luck Safwan and good luck Rayan. We look forward to meeting you on the next quarter earnings call, inshallah, next year. Thank you.