3Q 2022 Results

Thursday, 3rd November 2022

Operator: Welcome to the Saudi British Bank third quarter 2022 results webcast and call. With us today we have the CEO and Managing Director, Tony Cripps; Chief Financial Officer, Lama Ghazzaoui; and the Head of Investor Relations, Sirish Patel. At this time all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. To ask a question during the session, you'll need to press star one-one on your telephone and you'll then hear an automated message advising your hand is raised. Please be advised that today's conference is being recorded. I'll now hand you over to Sirish.

Sirish Patel (Head of Investor Relations): Hello and welcome to our results call for the third quarter of 2022. As mentioned by Sarah, we have our CEO and Managing Director, Tony Cripps, and our CFO, Lama Ghazzaoui, with us on the call today. Tony will kick off the call, summarising the key updates for the quarter, followed by Lama, who will provide the usual summary of our financial performance. We aim for the presentation element to be c.15 minutes and then we shall open up the floor for Q&A, which will take place over the phones. Slides are available to download from our website and our webcast. So without further ado, I'll hand you over to Tony to start the presentation.

Tony Cripps (CEO): Okay, thanks a lot Sirish. And welcome to the call everyone. So I'll start off just by making a few opening remarks and then Lama will get into the financial details. Basically, Q3 was a continuation of the plan that we outlined at the beginning of the year. We've exceeded the guidance we gave and the factors behind that are partly due to interest rates but also what's pleasing is our volume growth has also been very pleasing and our top management has been very good.

So as we've been saying since the fourth quarter last year, the assumptions on interest rates we always felt were way too low and we've seen that play out and we also indicated that our sensitivity to those rate rises would be more significant than most other banks in the Kingdom. So that has unfolded. We continue to be a key player in the Kingdom's Vision 2030 programmes. We're a key participant in all the giga projects, the Red Sea Project for one and we're supporting NEOM as the spending accelerates and the CAPEX requirements go up and the plans unfold now, with the green hydrogen plant construction, etc. Our participation in those projects is significant.

In addition, it's pleasing that our retail business, which we have said since last year we're getting into a position where we're going to be growing at market, retail portfolio now stands at SAR21.2 billion and we've seen very good growth in our lending in both retail and corporate. Year to date about 9%. Our first quarter was 5%, which was very strong, followed by second quarter, which was flat and then a strong rebound in the third quarter of 4%. So as we've always said, because the book is 75% corporate, a bit more, our loan growth is non-linear in the corporate book. It ebbs and flows depending on repayments, drawdowns, etc. It's the nature of corporate institutional banking. But overall, we're expecting the loan growth to continue into the fourth quarter and into 2023 as well.

We've shown strong growth in NSCI and our net interest margin, as we call ithas widened to 2.5% and that reflects the sensitivity.

Our cost of risk still remains low and we ended the nine months with an annualised cost of risk below our guidance, which was just 17 basis points. It's not a reflection of the fact we're not growing the book. As I've pointed out, we've had a very benign credit in our corporate business, which of course is 75% of our portfolio. So that explains the nature of the cost of risk being low. Our NPL ratio is at 2.3% ex-POCI and has been trending down.

Our returns are improving. We achieved a 13% ROTE for the third discrete quarter and this has been building through the year. Our ROTE year over year stands at about 11%.

And we continue to enjoy very healthy capital. Our liquidity and funding is very strong and we have an 18% CET 1 ratio, 179% LCR ratio and a 71% NIBs ratio. Our NIBs demand deposit ratio remains at the top end of the market but has come under a little bit of pressure as you'd expect, as consumers quite rightly take advantage of higher rates and move some of it into time deposits.

But overall, our strategy remains firmly on track. We're ahead of previous guidance. There's been really good momentum in growth. Our commitment to spending on digital with the expectations that our revenues would be going up is paying off. The automation of our services, our propositions, both retail business and significantly the middle and the SME proposition, where we've launched the new platform, is really going to set us up for efficient growth in those three portfolios.

So the ingredients are all there. So with that, I will pass you over to Lama, who will give you some detail updates on the financials.

Lama Ghazzaoui (CFO): Thank you, Tony and good afternoon, everybody. We start at slide 3. We generated SAR4.1 billion of net income before Zakat and income tax for the first nine months of the year, which is up 23% year on year, and SAR3.5 billion of net income after tax, which was up 26% on last year.

Comparing the third quarter net income after tax of SAR1.4 billion with the third quarter from last year, we were up 58% and up 29% on the trailing quarter.

On a year-to-date basis, net income before Zakat and income tax was up 23%, which was driven by higher revenue and higher income from associates, partly offset by higher expected credit losses and higher costs.

Comparing the third quarter to the same period from last year, net income before Zakat and income tax was up 58% and this was driven by higher revenue, partly offset by increased costs and higher expected credit losses. We would explain the main drivers in the next few slides but as Tony said, our NIM has reached 2.5%, SAIBOR is now over 5.5% and the change in SAIBOR over the last six months has contributed to the increase in NSCI and revenue during the third quarter. This is of course driven by our largely floating rate book, which reprices every three to six months, and therefore we still expect further NIM expansion to come.

ECLs has dropped again and leave the year-to-date cost of risk at 17 basis points, which remains below the bottom end of our expected through-the-cycle range. However, we remain vigilant to the current economic backdrop and given the pace of the rates rises, we are closely monitoring our customers to understand whether any ECL overlay is required. Therefore, we would still maintain a cost of risk outlook for 2022 at the lower end of the 30 to 60 basis points range despite the year-to-date position.

Costs were up by 8% year-to-date, which reflects the investment phase we are currently in and is in line with the guidance and comments we've made in our last call. Cost-to-income ratio continues to improve with a third quarter ratio of 36.6%.

Our return on tangible equity for the nine months was 11% and for the third quarter discrete was 13%. We're very pleased with the build-up in returns and continue to do more.

From a balance sheet perspective, we have now booked 9% year-to-date growth with 4% growth in the quarter. Towards the end of the quarter, as per our pipeline and planning process, we saw a strong increase in originations and especially in the corporate business and supported by continual growth in retail. But this again goes to show the lumpiness particularly in our corporate business, a feature that actually will continue.

Customer deposits are up SAR16 billion or 9% but we've seen a SAR5 billion fall during the quarter and our NIBs ratio is now 71%, which reflects the current rate environment that Tony mentioned. Our capital of course remains strong and healthy with a closing CET 1 ratio of 18%.

The strong performance in revenue has continued into the third quarter with revenue reaching SAR2.6 billion for the quarter. The last time we were at this level of generating revenue was actually just before Covid hit the globe and the rates went down. We generated SAR2 billion of net special commission income in the quarter and with expected direction to continue as rates have pushed even further ahead. NIM increased to 2.5% in the third quarter with cost of funds also increasing to 90 basis points.

We are experiencing margin compression and seeing pressure on both the yield and the liability side as rates have risen at a rate few were expecting. Therefore, we are currently recalibrating how current performance translates into our theoretical NIM sensitivity. Broadly at the start of the year we that this was 10 basis points for every 25 basis points movement in benchmark rates but this has now shifted more towards 8 basis points. Given the pace of the changes, it is fair to assume further downward pressure on this. However, despite the increased competition and the resulting margin compression, we're confident that we'll see further NIM expansion in the short term and have actually seen this into the fourth quarter.

Non-funds income fell marginally in the third quarter, mainly driven by fee income, which was impacted by a one-off catch-up of interchange expenses from a prior year. So excluding this, fee income was broadly unchanged and on a year-to-date basis non-funds income was up by SAR300 million or 18%, so the overall position is pleasing.

Expenses for the nine months increased 8% year on year and the third quarter expenses were up marginally on the second quarter and as in line with expectations and the plan. As we said in the last call, we still expect a small step-up in the expenses in the second half as we wrap up investments and from some inflationary pressures.

And then into the next year we do see a more fundamental step-up in costs, both due to digital investments made that have gone live or will go live during 2022 and also from continued investment in our people, systems and processes. In addition, having transferred these three businesses from HSBC Saudi Arabia, we now fully consolidate their costs into our income statement and in addition there are a number of other areas across our investment plan that will also kick in.

So cost efficiency improved to 40.1% for the first nine months and 37% for the third quarter. It's worth mentioning that this is the first quarterly cost-income ratio below the 40% since the legal merger and we still improve further improvements despite the increase in our expected cost base.

Moving on into credit quality and impairment. The cost of risk dropped during the quarter to 8 basis points and represented a SAR38 million net charge. This can be broken down into a charge of SAR120 million offset by recoveries and write-offs of around SAR60 million together with some improvement in off-balance sheet exposures.

As mentioned earlier, we still feel our full year cost of risk will be at the lower end of the 30 to 60 basis points range and at the lower end of the banking sector.

Non-performing loan ratio of 4.4% or 2.3% if you exclude POCI balances remains stable this quarter and has throughout the year. And as a reminder, the POCI balances were the acquired balances which we wrote down to their net recoverable value during the merger accounting. Our coverage ratio of non-performing loans excluding POCI reduced to 134% and this was mainly due to a small handful of corporate customers moving through to stage 3.

As mentioned in the last call, we continue to monitor portfolio for signs of or indications in increased pressure or risk, and however we are well provided for and always remain vigilant to the changing macro-economic landscape.

On to customer lending. Our gross loans have grown 9% year-to-date, 11% year-on-year and as a reminder, grew 9% during 2021 also. Our year-to-date growth of just under SAR15 billion is roughly split 60/40 between corporate and retail businesses.

During the third quarter, our gross loan balances grew SAR7 billion or 4% and the chart in the centre of the slide shown in front of you. As you can see, corporate activity was strong, retail growth continued in a sustained fashion and the incorporation of the SAR1.3 billion of balances from the margin lending business that has transferred into Alawwal Invest also contributed. The growth in the quarter was in line with our expectations and as mentioned earlier, once again demonstrates the lumpiness in our book.

The corporate activity remains across a broad spectrum of sectors and includes working capital facilities, project-related financing and others.

In retail, quarterly growth of just under SAR1 billion was mainly driven by mortgages and personal lending. Our mortgage portfolio is now SAR21.2 billion and our share of originations is now just below 5%, another pleasing result given the investments made in this business at the back end of last year and the start of this year. Personal lending balances also grew ahead of the market, as did our cards business. So again, a pleasing quarter in our retail business.

Funding and liquidity remain competitive strengths for SABB. Our high-quality customer base provides the bank with a rich source of funding; and despite a drop in our NIBs ratio, we are comfortable that we can maintain a core level of NIBs given our corporate business, which provides roughly 60% of our NIBs. However, as mentioned earlier and a number of times, the liability side will come under pressure due to the rise in rates and the pace at which the rates have risen.

Moving on to returns and capital on slide 9 and as we've already mentioned, our returns have continued to build with our year-to-date annualised return on tangible equity of 11% and a quarter-to-date annualised ROTE of 13%, and we expect further expansion of this.

Our CET 1 ratio decreased during the quarter, closing at 18%. The key moving pieces in this quarter were roughly 60 basis points from net income, 50 basis points from payment of the interim dividend of SAR1.2 billion, roughly 10 basis points from growth in RWAs and finally a broad 30 basis points reduction from a fall in the fair value of debt instruments that are valued through OCI as a result of increasing rates, but still generating a healthy yield.

And, of course, capital remains a fundamental strength and we're ready to deploy it for the opportunities that lie ahead.

Finally, a few words of conclusion before we can start the Q&A. We continued the delivery of improving financials, strong revenue and profit growth. We controlled the cost base while continuing to invest, leading to sustained improvements in returns. Our loan origination continues at pace with 9% year-to-date, in line with our plans. The corporate nature of our book of course continued to translate to a lumpy profile but the pipeline is still positive. The macro environment, which continues to shift, still has the ingredients for a prosperous banking sector and the wider economy. The strategy is on track and our investment journey continues, with our progress but as we've always said, we aim to take market share and therefore more to be done. And finally, we have the core ingredients of capital, liquidity, funding to support the maximum growth agenda.

That's all. Thank you. Operator, we can start the Q&A.

Operator: Thank you. As a reminder, to ask a question, you'll need to press star one-one on your telephone and wait for your name to be announced. Please stand by while we compile the Q&A queue. Thank you. We'll take our first question. This is from the line of Rahul Bajaj from Citi. Please go ahead.

Rahul Bajaj (Citi): Hi, thanks for the call. Rahul Bajaj from Citi. Three quick questions from my side actually. So the first one is on margins. If I kind of fast-forward into 2023, when we've formally reached the peak of the rate increases and then rates are stable at higher rates, so to say, and if you're already seeing the yield revisions, on the yield side, on the asset side, all the revisions have happened, is it fair to think that your margin could actually compress into 2023? Because all the asset-side revisions would have been done while your liabilities side will continue to slowly move away from CASA, I would say, I mean the CASA, customers are trying to shift to timed deposits and often higher cost of funding. So is it fair to think that if rates become stable starting next year that might actually lead to some compression in margins as we move ahead? So that's my first question.

The second one is on costs. You mention that 2023 you should expect some sizeable increase in cost. If you could kindly provide some kind of outline around what kind of size of increase are we thinking about and where will these investments go. Is it kind of high single digit kind of growth rate or a double-digit growth rate? What would be an ideal kind of cost increase you're thinking about for next year? That would be useful.

And my final question is on your capital markets business. I notice an interesting kind of change in your segmental reporting this quarter, because you had kind of kindly separated out the capital markets in your segmental reporting. I just want to understand why has that changed? I mean do you have any kind of special plans or kind of how you want to develop that capital markets business and you think that it might become more meaningful as go ahead, and so it's worth showing separately? I mean, how should I read this change in disclosure? Those are my three questions. Thank you.

Tony Cripps: Maybe I'll take the first one Lama and you can take numbers two and three, if that's okay. On the first one, as Lama said, in the early part of the adjustment to rates we'd expected 10 basis points for every 25 increase in rates, and that was reasonably accurate. And I think logically as rates reach a peak, then that sensitivity might be adjusted down a bit, which is why Lama said a range perhaps of 8 to 10. As you pointed out, the reprice on the assets side will happen at the same time as some customers will be looking clearly for yield on the deposit side of the balance sheet and yields are likely to trend a bit lower, as we've seen this year from a higher level.

So yeah I think that's a reasonable assumption. I would say that the benefit that we've seen on the rate increases have only been quite recent, because we really have only had six months where rates have gone up, even though they've gone up sharply. And the benefit for us in guidance is over a full 12 months. So the next six months and longer particularly with additional rate increases and guidance by the Fed that there would be more rate rises, it isn't yet the plateau of that benefit for us. But what you've mentioned is logical.

Lama over to you on questions two and three.

Lama Ghazzaoui: Yes, thanks Tony and thank you Rahul. On your second question, on the increase in cost, this is coming from a change in the cost base basically because we have now expanded our capital arm when we took over the three businesses from HSBC Saudi Arabia, and this meant that we are now consolidating more of the expenses that used to go under the income from associates line. So it was below the line, now it is all consolidated within the cost line.

Plus of course some investment that is still being done into our people and our systems, that will start having tangible impact into the depreciation line for example as well as investments in ESG and of course continued investments into Alawwal Invest our 100%-owned capital arm, to further expand on our wealth management, which actually leads me to answer your third question on why we have separated capital market vertical. It's exactly because this is now a more significant subsidiary, now having consolidated these businesses into it and therefore it requires a separate vertical for more transparency and disclosure it requires a separate vertical into the operating segments disclosure. And this will actually – the strategy behind that is to enable us to expand on our wealth proposition and serving our affluent customer base.

Rahul Bajaj: Understood.

Naresh Bilandani (JP Morgan): Thank you. Hey, Tony, Lama, Sirish, it's Naresh Bilandani from JP Morgan. Three questions please. Lama, if you could please very briefly once again explain why the NIM sensitivity would be going down from 10 basis points to 8 basis points. Is it largely led by the funding cost, which then would be straightforward, but if you please can elaborate once again just for the lack of any confusion, that would be very helpful. That's one.

Second is, could you please explain what is driving the pace of growth in the exchange income? We've seen an improvement therein in each quarter. So any insight that you can share there, that would be very helpful. Concurrently also I think the fee income has been somewhat weak. So if you can please explain that trend?

And my third and final question is, you know, you mentioned on the call your statement, you said that you may look to add an ECL overlay in a rising rate environment. Is there then a chance that in Q4 we could see a bump up in impairment charges as you may decide to take an overlay and something that has kind of been a trend that we see in the previous year also? If you can please just clarify that, that would be super helpful for modelling. Thank you.

Lama Ghazzaoui: Thanks Naresh. So on the NIM sensitivity going down to around 8%, yes of course, I mean some pressure on not just the cost of funding with the rising interest rate and from the demand that we're seeing from our customer base on moving into TDs, which actually starts taking a quicker pace than the repricing of the loan portfolio. And on the other hand, of course, there's also margin compression that we've also started experiencing. So to be more on the, maybe, prudent side and to factor the faster repricing of liabilities, we are now guiding more towards the 8 basis points until, you know, we can observe additional maybe data points from the behaviour of the recent changes in the interest rate.

But again, I keep reminding, our book is largely floating. Our loan book is largely floating and therefore it reprices quicker than some of the other peers and therefore more sensitive. And the competition will remain and as time passes you would expect that there would be more opportunities for customers to renegotiate their margin. So it's on both sides, on the liabilities as well as the loan side.

On your question for the exchange, it's actually more consumption, it's largely BAU. These are the normal trends that we actually intend to remain at and to plan for. So there were no one-offs basically. And maybe a word on the fee income. Maybe some few items were one-offs in the fee line; but as I said, excluding that, we would remain broadly unchanged in the fee income line. But we keep, you know, continuously revising our mapping, our costs associated with transactions and we enhance our presentation.

On your last question on ECL overlays, again, we do not intend to usually back-end our ECLs into the fourth quarter. This happened unintentionally. Last year Q4 we said it was caused by a very little number of customers and not something that is across the customer base. Now we're guiding towards having to analyse the impact of interest rates on our customer base, which customers are more sensitive or more, you know, it applies to their businesses, and hence if it requires and it is material, we will be taking an overlay. But again, as we can see it now, we're still within the much lower end of our range of ECL, of the 30 to 60. So even with this. So we're giving more guidance into what to expect but we're now still recalibrating the impact on our customer base.

Naresh Bilandani: Got it. Thank you very much Lama.

Waleed Mohsin (Goldman Sachs): Yes, good afternoon, thank you very much for the presentation. Three questions please. Firstly, on asset quality. So you mentioned you had certain sectors you're monitoring closely or you're monitoring overall, but if you could please talk about which sectors in particular seem vulnerable to you or are showing early signs of stress given the increases in rates, that would be very helpful.

Secondly, I want to understand for a corporate-focused bank like yourself, how profitable is the new retail business at this moment that you're writing? And the reason why I say that is, you know, retail is largely fixed rate and given where SAIBOR is, if you had written a retail personal loan a couple of months ago, if it was funded by time deposits, it will be unprofitable by now. So just want to get your thoughts on, you know, what's driving the motivation to continue growing the retail space?

And thirdly, third and final question, on the CASA mix, if you could perhaps break out the CASA between retail, corporate and you know, mass market, affluent. The reason why I ask this is trying to figure out, you know, what part of the CASA book is sensitive to rates and where does the CASA balance end once the rate cycle is done? Thank you.

Lama Ghazzaoui: Thank you Waleed. So on your last point, on the CASA mix, we're now 60/40, with 60 being corporate, and it ranges, you know, between the 55 and the 60. But on splitting it between mass and affluent, maybe in our future calls, we can give more breakdown of which is mass, which is affluent. But again, retail is – is also, you know, largely affluent. We'll give this breakdown maybe in future calls. Noted, thank you.

On your first question, on asset quality, which sectors remain or seem vulnerable? We don't have a specific business that is vulnerable. We are again as a corporate bank, largely skewed towards the large corporates still as a loan book. We don't see that our customers are vulnerable per se but we would want to be taking this into consideration early on. Even if we don't see indications, we would – this is why we call it an overlay, because then we would account for it on a general basis rather than on customer by customer. But we're not yet seeing signs as we speak.

On your second question, how profitable is the new business, I think, on mortgages. So, I, again, we're still trying to grow our mortgage market and our mortgage book and there's definitely substantial growth in the market as part of the Vision 2030. And we, you know, this is a big part of our strategy. But as the rates start to increase slightly, especially with the SRC repricing, we will start getting maybe closer to these rates. But the rate environment remains ever-changing. On an overall book, of course, you know, we don't incur losses and we don't intend to – don't forget, the mortgage book is still 12-13% of our overall book, so it is not as substantial as the rest of the peers.

Tony Cripps: I'd just like to comment there as well, and that point is exactly that. We've got over SAR 200billion of deposits and 70% NIBs, and the mortgage book's 13%, so it's not – definitely not funded by time deposits.

We also take the view that building a fixed-rate proportion of the balance sheet which is relatively low, which has been a benefit for us in the last 12 months, it's now logical with rates getting to 5% or 6% or even a little bit higher. Now is the time to be thinking about proportionally building more of the balance sheet into a fixed-rate component, which we have guided that that's our intention to get the retail business to 30% of the balance sheet. Now is the time to do it and twelve months ago, it wasn't the time to do it, we weren't quite ready so that was unfortunate, but the strategy now is to push retail growth, you know, reasonably aggressively at or above market, and it's the right time to do it because rates will peak next year. Everyone's looking for the global economy to slow further and, in that environment, it's exactly the right strategy to build a fixed-rate component in the book as a higher proportion.

Waleed Mohsin (Goldman Sachs): Got it, thank you. I'll just follow up on this. You know, obviously the mix of the deposit base is quite clear, but from a marginal perspective or from a new loan origination perspective the deposits coming into the system are largely time deposits, which are being priced, apparently, at, you know, SAIBOR plus. And if we look at the increase in the mortgage rates, the SRC cap since December, it's only 150 basis points. But, at the same time, the increase in SAIBOR over that period is more than 400. So, from that perspective, I was wondering if the new marginal business, which has been written on mortgages or retail, if that's profitable?

Tony Cripps: It absolutely is, because we're not, like other banks, paying up the time deposits and we've got a high NIBs ratio, so we're funding the mortgages where each mortgage is written against the cost of fund due to the profit. And, as I said, building a fixed-rate book now will make a lot of sense in 12-13 months' time when rates peak and they have to start falling, I guess. After inflation peaks it'll be, and then you'll see margins on that book, on the fixed-rate book, widening as the funding costs start falling.

So we think it's the right strategy to continue pushing on the mortgage growth and we'll continue to do that into 2023.

Waleed Mohsin: Got it. Thank you very much, thank you.

Shabbir Malik (EFG Hermes): Hi. Thank you very much. My first question is around time deposits. I was wondering what is the typical tenor of these time deposits that people are moving in to? And, right now, rates are still trending upwards, but once, let's say, they start stabilising, let's say some time first quarter of next year, do you expect a faster shift from CASA to time deposits? That's my first question.

My second question is around the growth outlook, let's say over the medium-term, now that SAIBOR is close to 6%. Do you expect any moderation in demand from your customer because the finance costs have gone up so significantly in such a sharp fashion? Do you expect any moderation or do you believe that the macro story is still very compelling and that outweighs, you know, any negative impact on appetite because of higher interest rates?

And, finally, in terms of cost-to-income, do you think you can end this year below 40% cost-to-income ratio? Thank you.

Tony Cripps: Okay. Let me take the macro question first. So, our view is that the Saudi economy will hold up well into next year, despite what, obviously, are higher risks to the global economy. So GDP at 5%+ is still a reasonable assumption for Saudi itself. And so, in that environment, we expect the growth will still be good, but clearly the risks are on the upside in the global economy and therefore we're seeing or having conversations with clients about CAPEX, and while we haven't seen, yet, any behavioural change, it's logical that clients are beginning to get a little concerned. At the moment, we haven't seen it so we're not guiding in any way, but it's logical to think of that risk at a higher level. But Saudi itself, you know, is a bright spot, as you know, and we think that continues into next year, which is why our growth agenda remains as per the plan.

Lama, over to you on the other questions. Thanks.

Lama Ghazzaoui: Thank Tony. On the growth outlook and the moderation in demand, this was your second question I think.

Shabbir Malik: Question was on time deposits, tenor of time deposits and, let's say when rates peak and cost-to-income ratio, correct.

Lama Ghazzaoui: Sure. Our time deposits currently are still of a short-term nature, so, you know, one to three months, but we're now listening to, you know, customers say that they are thinking of – you know, now with SAIBOR close to 6%, as you said, we're seeing some discussions on longer term, which is also very helpful for the LDR. And, I mean, our aim is to definitely reach over the period of strategy of, you know, below 32% of cost-to-income ratio and we're on the right track. So, below the 40% that's what we aim for.

Shabbir Malik: And just, I guess, to the point about the time deposits, do you expect that once rates, kind of, stabilise in sometime early next year, could that be an incentive for a lot of the customers to switch from CASA to time deposits?

Lama Ghazzaoui: We're already – as I said, we're already in discussions with, you know, several of our large customers or our affluent base, on some demand to shift to TDs, so, you know, it depends on the size, the tenor, you know, the sensitivity to pricing. But, yes, you know, that's why we're now guiding towards this impact.

Shabbir Malik: Great, thank you very much.

Jaber Mogbil (Olayan Group): Oh, sorry, this is Jaber Mogbil from Olayan Group. Hello Lama and hello Tony. My question is regarding the 13% return on tangible equity target by 2025. And, since you already reached that number by this quarter, do you intend to disclose any revision to the target or do you want to keep it at 13%?

Tony Cripps: So we've guided in the past that we intend revising the forecasts for 2023 and medium guidance beyond because the environment's changed significantly from a year ago, and so we will – we'll do that I think, Lama, early next year, is that correct, after the full-year results?

Lama Ghazzaoui: Yes, that's the intention.

Jaber Mogbil: Excellent, thank you so much.

Tony Cripps: Thank you.

Operator: And we'll now take our next question, please stand by. This is from the line of Aaron Armstrong from Ashmore. Please go ahead.

Aaron Armstrong (Ashmore Investment Management): Hi. Thanks for taking the question. Firstly, in terms of the cost-of-fund side, can you talk a little bit more about how you're seeing deposits shift from zero cost CASA into the time deposits? You mentioned, kind of, one to three months where you're seeing them moved to. Can you talk about how your pricing works, so what the kind of incremental cost to you is when a deposit moves across from CASA into something with a duration, say, of one to three months that you mentioned?

And then can you talk a bit more about the reason that corporates have CASA balances with you. Is that because they need it for day-to-day cash management purposes and therefore there could be some stickiness, or is it on a discretionary basis and it's very easy for them to lock up that cash for three months or six months?

Lama Ghazzaoui: Yes. So, on your first question, on the cost of fund and how we price it, of course when it's a corporate customer, especially the large corporates, you know, the discussion is different than when it's a retail customer. So it's really on a case-by-case and, you know, the tenor, the size and, of course, the relationship history. Sorry, the line was a little bit not clear on your second question. Could you please repeat it?

Aaron Armstrong: So, perhaps, more on the cost-of-fund side for corporates, so could you give any, kind of, example of what you're charging today for a one month or a three month for either a large or a mid-size corporate customer?

Lama Ghazzaoui: No, that's not usually public information. But, again, as I said, it ranges from a customer to a customer and it depends on the need at that point in time.

Aaron Armstrong: Understood, thank you. And then, perhaps, just on the stickiness of corporate CASA.

Lama Ghazzaoui: You know, our current customer base, especially the corporates, we consider very sticky and it has always been, and these are – yes, these are more day-to-day cash management and, you know, needed balances for running their business, so that's why it is – it's more sticky in nature.

Aaron Armstrong: Thank you. And the increase in cost of funds that we saw in Q3 was around 40 basis points. Is that a surprisingly high number for you or is that a, kind of, quarter-on-quarter increase we can expect to see of that kind of magnitude going forward?

Lama Ghazzaoui: Yeah. Again, you know, we came from a low base; you know, we had been, for quite some time, one of the lowest banks in terms of paying up or in terms of cost of fund. So the step-up is, again, a reflection of the rate and, you know, a reflection of the fact that our liabilities re-price also faster and in a shorter term.

Aaron Armstrong: That's great, thank you. And then, perhaps, just any more, kind of, clarity you can give. I think you mentioned the corporate re-prices in three to six months. In terms of retail and other areas of the book, could you talk about re-pricing there, please? And, also, you mentioned competition a little bit as well, is that something to impact re-pricing ability?

Lama Ghazzaoui: So the retail book is fixed in nature; and, you know, the mortgages usually – you know 15 to 20 years' tenure, so this is all on fixed basis. The personal finance average life is two to three years and then it gets re-priced, but on booking terms retail book is all fixed. But the competition, of course, is also fierce on the retail space, so, you know, this is why for the new bookings, or even for attrition or retention or for attracting new customers, we have to also be, you know, mindful of the competitive environment in the retail space.

Aaron Armstrong: That's great, thank you.

Mohammed al-Rasheed (Ashmore): Hi, good afternoon. Thank you for the call, and congratulations on the results. I have three questions. My first question is regarding your net interest margin going into the fourth quarter. So, if we observe your asset yield here, as you mentioned, most of the re-pricing happens in the three to six month. So for example, in the first quarter your asset yield didn't pick up, but during the second and the third quarter, it picked up very handsomely. However, given that average SAIBOR was almost flat throughout most of the first quarter and it started to spike by the beginning of the fourth quarter, it seems that you might find some competition on your net interest margin going into the fourth quarter. So, I want to know your thoughts on that.

My second question is regarding your POCI book. So I noticed, during the first nine months of this year, you have taken around 237 million provision. What was the reason behind that, and shall we expect more provision taken on POCI?

My third question is regarding the government mega and giga-project financing. So another large corporate player has suggested that there is a slowdown in terms of the drawdown of these projects, and you are saying that the government might reconsider what's the percentage of debts versus equity in financing these projects after the spike in debt, so your thoughts on that would be very appreciated. Thank you.

Lama Ghazzaoui: Thank you, Mohammed. On your first question on the net interest margin, of course, I mean, we've seen, you know, just yesterday see more rate hikes and, you know, a signal of, you know, slower-for-longer headlines and, you know, the movement in SAIBOR has also been significant. So, yes, I mean, you know, we are – you know, we are – we have always been and, you know, still very sensitive to the movement in interest rates. And of course, again, as I've said, our cost of funds reprices much faster and has picked up. So, yes, we do – you know, we have been seeing and witnessing compression in some rollover deals and their margins, and that's why we're now, you know, factoring a – you know, the sensitivity not at 10 bps but more so at the 8bps, so we can factor the impact from both the liabilities and the margin compression side.

On the POCI, we take more provisions on these loans as and when, you know, maybe more – you know, some utilisation of the limit stake rate. Don't forget that some of these POCIs are performing POCIs, so they are still able to draw down on their lines, but we still cover for those loans so we can keep a certain coverage ratio in place, but this is in line with the plans. So, again, this is not a surprise.

The giga-projects – you know, if other peers see there's a slowdown, we actually see that the pipeline is healthy. Our discussion with our customers are still ongoing. These are very large in nature and in scale – that the time, you know, taken between discussions and, you know, ribbon-cutting is quite significant, but we're still very optimistic about the future and our ability to participate in those projects. Tony, you want to add anything?

Tony Cripps: On the giga-projects, we haven't been in discussions about the slow pace of drawdown. For projects like the Red Sea, we expect the drawdowns to be consistent next year. I think NEOM is, by and large, ahead of its previous guidance in terms of the pace at which it's developing. So, no, we haven't seen any guidance that would indicate a slowdown. And the government has made very, very clear that, whether or not the government is in a position to fund on its own, they have a strategy specifically to encourage and make sure the private sector's involved in these projects. It's part of Vision 2030. You know, the guidance under the vision is that the private sector becomes 65% of Saudi's GDP, so I don't think that's changed at all.

Mohammed al-Rasheed: Okay. Very clear. Thank you.

Operator: Thank you. We'll now take our next question. Please stand by. Comes from the line of Edmond Christou from Bloomberg. Please go ahead.

Edmond Christou (Bloomberg Intelligence): Hi. This is Edmond Christou from Bloomberg Intelligence. Apologies if I ask questions that have already been answered; I just joined late. So the question I have is regarding your sensitivity. I believe the sensitivity is only for rate hike; doesn't include any passings-through to your consumers. Since you are the fastest-repricing banks among the Saudis, so I think you will get a better feeling if the consumer is able, or the borrower on the corporate side is able, to pay for higher rates to the financing, so if you can give some comment on colour on how much you are able to pass through into next year? We hear from other bank in the region that it will be very difficult, but I haven't heard these comments from the Saudi yet. The second one, if you can just remind me what is the LDR statutory for the bank. Thank you.

Lama Ghazzaoui: Thanks, Edmond. Actually, our sensitivity includes the pass-through, as well as the impact on the repricing of the liabilities, as well as, you know, some assumptions and – on the – on the impact of the margin compression, so this is a net sensitivity. We are able to pass through, of course, part of the rate increases on the SAIBOR – maybe not all of it, but this is why we simulate such kind of sensitivity. Again, you know, the Saudi market is maybe unique in this, you know, aspect, and, you know, can't be compared, maybe, to the other GCC markets.

Our statutory LDR is in the low 70s currently.

Lama Ghazzaoui: Thank you.

Aaron Armstrong (Ashmore): Hi. Thanks very much for taking the follow-up questions. Just looking at the net interest margin trajectory that we've seen over the last couple of quarters – so previously we had a 30-basis-points quarter-on-quarter improvement in Q2, and this quarter we had a 20-basis-points quarter-on-quarter improvement. However, now that we're beginning to see the pressure come through on the cost of funds, do you think the incremental improvement in net interest margin is going to be more modest because the cost-of-funds pressure is coming through maybe lower than a 5-10 basis points, maybe, quarter-on-quarter? So previously we had kind of 20-30 basis points quarter-on-quarter NIM expansion. However, now we're seeing some more kind of pressure on the cost-of-funds side.

So, whilst the NIM trend remains positive, do we think the quarter-on-quarter improvements in NIM will be smaller going forward?

Lama Ghazzaoui: Yes. That’s why we’re now guiding more towards the 8bps than the 10 bps, because we will start seeing a smaller impact than what we’ve seen so far. And again, we keep revising those, and we will be very transparent and we continue to evaluate the impact, and every time we have a chance we will – we will disclose the sensitivity.

Aaron Armstrong: Thank you. And then, just following up on the prior question – you mentioned your statutory LDR is in the low 70s. And is that a lever that you can use? Can you allow that to increase? Is that something that would be positive for profitability?

Lama Ghazzaoui: Of course. That means we have ample room to actually grow further. We don’t have any pressure on LDR.

Aaron Armstrong: And just kind of from a funding cost perspective, what kind of flexibility that gives you?

Lama Ghazzaoui: So, we are catering for, you know, the demand from our customers to shift from CASA to time deposits, and we will be making sure to retain our customer base and to attract newer customers. We do have ability to grow our deposit base and to pay the right rate to ensure that we retain the customers and attract new customers. But on the LDR, you know, the low LDR shows the room on the loan side, where growth is still our focus in the strategy. And it shows the impact of the large customer base and the denominator, so we get the benefit of both.

Aaron Armstrong: That’s great. Thank you.

Operator: Thank you. And we have no further questions, so I’ll hand back to the speakers. Thank you.

Sirish Patel: Thank you very much for attending our third-quarter call. We’re pleased with our results and cognisant of the fact there’s more to do, but we have lots of optimism for the future. Thank you.

[END OF TRANSCRIPT]