

# **SAB 2Q2023 Results**

Thursday, 3rd August 2023

## Introduction

Sirish Patel

*Head of Investor Relations, SAB*

**Operator:** Welcome to the Saudi Awwal Bank Second Quarter 2023 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 speaker's 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:** Thank you. Hello and welcome to the Results Call for the second quarter and first half of 2023 for Saudi Awwal Bank. As mentioned by the phone operator, we have our CEO and Managing Director, Tony Cripps and our CFO Lama Ghazzaoui with us on the call today.

As usual Tony will kick off the call summarising the key updates for the quarter followed by Lama who will provide a summary of our financial performance. We aim for the presentation element to be roughly 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.

## Overall Performance

Tony Cripps

*Managing Director & CEO, SAB*

**Tony Cripps:** Thanks Sirish and good morning, good afternoon, good evening and thank you very much for joining the call. I'll just start with a few comments on overall performance, and then hand over to Lama for the financials.

Our first half revenues were pleasing SAR6.3 billion up 48% on 2022, and our profits before tax of SAR4 billion, up 61% on last year. Costs are in line with plan, and what is pleasing I think mostly in the first half is that loan growth has been very consistent both in Q1 and Q2. 8% year to date and our portfolio is over SAR200 billion for the first time in our history and being the leading trade bank in the kingdom with an off-balance sheet commitment exceeding SAR100 billion.

So our strategy is on track. The digital transformation continues at pace, and examples such as our mortgage proposition, our international affluent global view, global transfer, connecting SAB's retail business to the HSBC network globally is unique in the Kingdom, and our MSME application which we launched has really driven real financial progress in our SME strategy and results.

We also published our first ESG report during the quarter detailing our commitments for the short and the long term.

So the list of achievements I'm personally pleased with, the progress we've made not just in the first half, but over the last two years since we launched the strategy, and more recently our senior management group got together to refresh the strategy, and we hope to be announcing that in the second half, guiding new financial targets and a three to five-year horizon as I said, which we hope to update in the third or fourth quarter.

So back to the 2023 performance so far, our planning assumptions at the start of the year of Fed funds around five to five and a quarter hasn't really changed. We had an increase in rates, whether or not there's another increase is up to the market, but we are where we are.

Our growth plans are intact and we don't feel that there are headwinds for that growth plan in 2023. The economy has slowed a bit. The global outlook is a little bit unclear, but we're confident in our own growth in the second half.

SIBOR levels are around 6%, and have had an effect on our cost of funds during the quarter as you've seen, and we've elected to support key strategic customers on the deposit side and paid up for some deposits with certain relationships.

These actions have resulted in this quarter in a lower NIBs ratio up until the 30th of June where we closed at 61%, which is still industry leading. It is a lumpy position on NIBs for us because we are 75% a corporate bank, and so we see very large inflows and outflows associated with some of the giga projects.

At the end of June, we are where we are, and that NIBs ratio in the corporate space did jump a lot in early July, but it could again be drawn down later in the month. So it is a bit up and down, but we're quite confident that we have the levers in the second half to manage with a low loan deposit ratio. We don't have to chase high yielding deposits necessarily, but we do so on the basis of our strategic long-term plans. But the effect has been material on the cost of funds in the quarter, but that does not necessarily create a trend; I just want to highlight that.

And NIM sensitivity, which is a key question for all of you. We highlighted that we were taking steps this year with a view that rates would be peaking this year at some point, but we wanted to reduce our NIM sensitivity for when rates possibly started falling in 2024. And our sensitivity has dropped materially in the quarter, and is neutral at the moment.

And this is by design although, perhaps it's happened a little earlier than perhaps we previously guided. It's not a science and we manage this day to day. But with that, overall, I am pleased. I know that NIM is a hot topic and we'll do our best to assure you that we are managing this, and the second half guidance hasn't changed at this point in time, but we will update, of course, as the market materialises and with that, the Fed funds rate peaking or not is something that we are watching very closely.

So the strategy is on track. Financial performance is very solid. And Lama, I'll now hand over to you and you can give the guidance on our financial results. Thank you very much.

**Lama Ghazzaoui:** Thank you, Tony. We start at slide three.

On a year-to-date basis, we generated SAR4 billion of net income before the zakat and income tax which was up 61% or SAR1.5 billion on the first half of 2022. This was driven by higher revenue both increased NSCI and higher non funds income. And these factors were partly offset by higher impairment and higher operating expenses although these are in line with plan and translate into solid cost of risk and cost efficiency ratios. These key movements can be seen in the bottom left chart, again a pleasing first half.

Cost efficiency stood at 32% as a result of the strong revenue performance and absolute cost expenditure is in line with the plan. Cost of risk of 37 basis points for the half was within our expected range, and asset quality remains strong, and there are no indicators of additional stress in the portfolio.

On a quarterly basis, we generated SAR2.0 billion of net income before zakat and income tax. In the second quarter, this was up 53% on the second quarter of 2022, and mainly driven by higher revenue and notably higher net special commission income from both the shift in rates and also higher average volumes.

Compared to the first quarter of 2023, net income before zakat and income tax was down 2%, and this was from lower non-funds income which in part reflects the seasonality of the second quarter and the higher trading and the total gains in the first quarter. Impairments were also considerably lower in the second quarter as we benefited from higher writebacks and recoveries.

Net special commission income was stable quarter on quarter as volume growth broadly offset the contraction in NIM, which despite an increase in yield saw a greater increase in cost of funds. The higher cost of funds has resulted in a contraction of NIM of 9 basis points in the second quarter, and during the quarter our spot NIBs ratio fell to 61% and the average NIBs balances fell to 62%.

From the central bank data published earlier this week for June, banking sector NIBs ratio fell to 54% so we remain well above the sector. Much of the banking sector has experienced a drop in NIBs as customers look for higher return on their deposits and given where SIBOR levels are currently.

Where appropriate and as Tony mentioned and dependent on relationships, we have catered for some requests, which have driven up our overall cost of funds and our NIBs balances can be lumpy like our corporate lending balances, but we're very focused on building up these balances in the second half of the year.

Our net income after zakat and income tax was SAR1.6 billion for the second quarter. During the quarter, we took a provision of zakat and tax that actually relates to 2019 and 2020, which was approximately SAR100 million. Excluding this our net income post zakat and income tax would be closer to SAR1.7 billion which would be more in line with the first quarter performance. Excluding this provision, our first half underlying growth was 15.2%, and we remain very pleased with the build-up of the returns since the launch of the strategy.

Moving on to balance sheet, loans were up 4% in the quarter and 8% year to date driven by strong performance across both businesses, corporate and retail. And the June Central Bank data suggest that we've grown significantly faster than the market, and we expect to build on this position for the second half. Our customer deposits were up 4.%, and our NIBs ratio as mentioned fell to 61%.

Lastly, of course, on capital, our CET1 closed at 16.5 as growth in loans accelerated.

On to slide four, the left-hand chart shows the usual quarterly revenue built by segment. Corporate and institutional business revenues remain at a solid SAR1.7 billion for the quarter, but came down 1% Q-on-Q reflecting the increased cost of funds mentioned earlier.

Our wealth and personal banking business revenues continued to build as the business continues to show strong momentum in growing its asset book. Our treasury revenues remained robust at SAR477 million for the quarter. This was in line with the second quarter of 2022, but showed a fall compared with the trailing quarter of Q1 because Q1 benefited from higher than usual gains from our investment portfolio.

The bank also grew its investment portfolio to SAR94 billion, which is a key part of the strategy to manage interest rate risk when rates start to fall, which we expect to occur anytime during 2024. This strategy will enable us to cushion the bank for excessive fall in NSCI compared with previous periods when rates have fallen.

The top right-hand chart shows our NSCI build, where the second quarter was stable at SAR2.5 billion. Our gross yields improved in the quarter to 4.9%, but this was more than offset by a steeper increase in cost of funds, which led to a fall in NIM to 3%. This can be seen in the bottom right-hand chart, and as is often the case, cost of funds do tend to rise faster than on the asset side. Our year-to-date NIM remained at around 3.1%.

On to expenses, costs increased 18% year on year, and were down 1% Q-on-Q. The year-on-year movement largely reflects the continuation of our investment phase. Mostly people-related, but also including digital investment spend whilst also absorbing 100% of our subsidiary SAB Invest, formerly known as the Alawwal Invest.

Cost efficiency for the half was 31.9% which is significantly better than the 37.8% for the full year of 2022.

On slide six for credit quality, our cost of risk for the quarter was 28 bps and 37 bps for the half, and cost of risk fell in the second quarter as we expected from the increase in recoveries during the quarter.

Following the strong growth in loans, our NPL ratio fell to 1.9% excluding POCI which is closer to recent Saudi banking sector averages, and also a significant improvement on the ratio directly after merger. Our asset quality remains strong, and there are no indicators of

additional stress in the portfolio. And our coverage ratio now stands at 151% with a portfolio well-provided for, and we continuously monitor and assess for any signs of increased pressure of risk.

On to customer lending on slide seven, our gross loans have grown another 4% this quarter taking us to over 8% year to date. Growth accelerated in our corporate and institutional business, and our retail business also continues its strong momentum since we launched this strategy.

Our corporate originations grew to SAR20.6 billion in the second quarter driving a net growth of SAR6.8 billion, which translates to 5% growth in the quarter faster than the sector based on the June Central Bank data, and this has come across a number of sectors and also from the Vision 2030 Giga-project activity.

Retail growth of SAR1 billion translates to 2% quarter on quarter growth, and 11% year on year. The overall retail portfolio now stands at SAR49 billion with a mortgage portfolio, which has been the key driver of the retail performance now stands at SAR24 billion.

Although total market mortgage originations fell in the quarter, our market share of originations remain strong at 8.5% demonstrating our continued build-up of market share. The fall in total market originations appear to be impacted by both seasonality and the change in the mortgage subsidy programme, but we continue to take a share in originations that exceed our stock market share.

Our cards business continues also to do well, and we remain the number one with respect to card spend and the overall business remains highly profitable.

On to slide eight, our deposit base remains strong closing the period with SAR223 billion of customer deposits and a regulatory LDR of 74%.

Our spot NIBs ratio did fall during the quarter as mentioned although the drop was less pronounced if using average NIBs balances for the quarter, which was 62% for Q2 versus 63% for Q1. Our NIBs, which we still have an edge for as compared to the market and we have the liquidity to support our customer borrowing aspiration.

Moving on to returns and capital on slide nine, first half ROTE was 14.7%, but excluding the zakat and tax provisions relating to prior years, underlying RoTE remained above 15, at 15.2. The top left-hand chart shows the progress we've made over the last few years on this metric, and the investments we're making also are accretive and with the roadmap as such, we believe we can materially build on these levels of returns.

Our capital ratios are now on Basel III reforms basis, and we closed the quarter with a CET1 ratio of 16.5% and a total capital ratio of 18.6%. And we announced earlier this week that our interim dividend for the first half of 2023 were SAR 0.88, which is broadly a 55% payout ratio.

We regularly of course explore options to support our capital base, and to cater for the longer-term growth plans of the bank, and of course we'll update the market as and when appropriate.

Finally, a few words of conclusion before we move to Q&A. Of course, our plan remains on track. We continue to demonstrate delivery of strong financials from asset quality metrics to revenue generation to loan growth, and yes, we've experienced a faster transition to time deposits, which has resulted in a NIM contraction in Q2, but we're confident we can build some of this back, and therefore stabilise NIM for the second half. This provides a perfect segway to our guidance for 2023.

We're making a number of changes to the guidance. Loan growth performance has been strong, and our pipeline remains strong and recent post-June performance also has been strong, therefore, we are updating our guidance to 12-13%, and we hope to be at the upper end of this range.

We are maintaining the NIM guidance of at least 3.1% for the full year, and we expect further yield upside and building back the NIBs as we said in the second half. Of course, clearly downside risk does exist if the rate environment continues to add some pressure to acquiring and sustaining NIBs balances, which is affecting the entire sector not just SAB.

We've updated our cost efficiency guidance to 32-33% for the full year. No changes to cost of risk guidance as we are not witnessing any notable incremental stress on the portfolio. And finally given the changes I just mentioned our RoTE guidance narrows, and we have upgraded this to be at the mid-teens level.

That concludes the presentation element. Thank you very much for listening. Operator, we can start the Q&A.

## Q&A

**Operator:** Thank you. If you wish to ask a question, please press star one, one on your telephone and wait for your name to be announced. To withdraw your question press star one, one again. Please stand by while I prepare your first question. First question comes from Waleed Mohsin at Goldman Sachs. Waleed your line is open. Please go ahead.

**Waleed Mohsin (Goldman Sachs):** Yes. Good afternoon. Thank you much for the presentation. I have four questions please. Firstly, on net interest margin, a number of moving parts so apologies for the follow-up here. But if I were to understand correctly your guidance, you are saying that it seemingly first quarter was the peak in terms of net interest margin and from here on in the second half, net interest margin should be flattish relative to second quarter levels with both as you said upside, downside scenarios depending on how rates and cost of funding turns out, but your base case remains that NIMs will be flat in second half versus second quarter. So if you could confirm that that would be great. That's the first question.

Secondly, Tony, in your opening remarks, you talked about net neutrality to rates. So if I just wanted to confirm if I heard that correctly how much has the sensitivity to rates come down? If you could confirm that, that would be great.

Third, I mean, it's pleasing to see the upgrade to loan growth guidance given your first half performance and the bank being on some of the large ticket transactions in Saudi Arabia. Would you still see further upside to where your loan growth guidance stands? And is it just cost of funding in the market, which prompted you to keep this guidance at 12-13% versus an upgrade to perhaps a mid-teens level?

And fourth and final question, you touched upon some of the changes in the capital side. Risk weight density has gone up materially to 85% this quarter. If you could please unpack that, that would be very helpful. Thank you.

**Tony Cripps:** Okay, thanks. I'll take the first three questions. Maybe Lama, you could come in on the fourth.

We as I said, we have – we saw some NIM contraction obviously in the second quarter, and some of that was selective. And so, we think that it's entirely possible that we can pull some levers in the second half of the year, which could see some of that reverse, and therefore leave our NIM guidance overall for the year where we started at 3.1.

I think that the environment has clearly slowed from a global perspective. There's been a downgrade in the IMF and World Bank's forecasts of the Saudi economy, and the global economy is soft. So we at this point wouldn't upgrade our corporate loan growth or our overall loan growth either to above the guidance that Lama previously mentioned, which is above where we were previously, which is encouraging. But I wouldn't want to go further than that.

I think there are risks on the horizon that we need to be, I guess, conservative around in terms of giving guidance. And Lama, on the capital question, if you could answer that one?

**Lama Ghazzaoui:** Yes. It's mainly because of the adoption of the Basel III reforms impact. But really, Q-on-Q, it was not material. It was from 84 to 85. It's really the Q4 to Q2, it's the Basel III reforms impact relief.

**Waleed Mohsin:** Got it. Thank you much. And just the question on the neutrality of the book to rate –

**Lama Ghazzaoui:** Yes, neutrality to rate, yes, sorry your second question. I mean, as we calculate it regularly, we know that we've taken all these measures to protect for the future rate cuts. And we know that it is not the 4 to 6 basis points that it used to be. We are now more neutral to rate sensitivity.

It now stands at three basis points, but we could call that more neutral than any sensitivity.

**Waleed Mohsin:** You would say 3 bps for every 25 bps?

**Lama Ghazzaoui:** For now, yes.

**Waleed Mohsin:** Got it. So that means as you move –

**Lama Ghazzaoui:** Sorry, Waleed on an annual basis, of course. Yes.

**Waleed Mohsin:** Yes, of course. But to understand that correctly, so that means that going forward, as we move closer to rate cuts, this can reduce further, which means that your downside to rate cuts would be even minimal or would be even less than 3 bps.

**Lama Ghazzaoui:** Yes, fair to say.



**Tony Cripps:** Yes, that's correct. We haven't yet put in place any hedging, which we have the capacity to do in respect of derivatives. And we continue to build the investment book, as Lama mentioned to SAR94 billion, which again puts us in a better position should rates start to decline later in the year or in 2024. That's correct.

**Waleed Mohsin:** Got it. And my final follow-up, Tony, you mentioned risks. You're referring to a mixture of global and domestic risks. And if yes, on the domestic side, are you more concerned with the funding environment or are you thinking here repayments?

**Tony Cripps:** No, I just think that with the guidance that we've seen recently from the IMF and the global economic outlook has, I guess, become a bit more cautious. There's credit tightening in the US. There is a less rapid recovery in China than previously assumed.

And therefore, Saudi's own growth has been downgraded by most economists. And therefore, we just have to be mindful of that, and not overestimate the growth capacity in the system around that. The oil price, of course, is hugely important and at the moment is remaining in the range that we've assumed, and therefore, the economy is still solid. But we just wouldn't want to overestimate the pace of expansion that didn't represent, I guess, a more conservative outlook.

**Waleed Mohsin:** Got it. Thank you much, Tony. Thank you, Lama.

**Tony Cripps:** Thanks, Waleed.

**Operator:** Please stand by for your next question. Your next question comes from Rahul Bajaj at Citi. Rahul, your line is open. Please go ahead.

**Rahul Bajaj (Citi):** Hi. Thank you, Tony, Lama, Sirish, Rahul Bajaj from Citi. Three quick questions from my side. The first one kind of follows up on the previous commentary around downgrades to the macro outlook. I'm just trying to understand what these downgrades to the macro outlook means for your ECL models and provisioning going ahead. I mean, have you already incorporated these changes into a ECL model or you plan to do it? And what, if any, impact do you expect, maybe in 2023 or 2024, from these macro downgrades? So that's my first question.

The second one is on NIBs-balances. Quite a sharp decline, as we discussed earlier, in 2Q. If I understood correctly from Tony's initial commentary that these NIBs-balances are now back in the bank, with the bank, in the early part of 3Q. Just wanted to understand, at these kind of high levels of SIBOR, what levers do banks like SAB really have to grow the NIBs-balances? I mean, it's ultimately, I think, the customer's game rather than banks having much levers at this stage. If you could throw some light there, that would be useful.

And finally, just a quick clarification, the one-off in Zakat and Tax was a SAR100 million number, if I heard correctly. So that gets the 2Q levels to SAR329 million, which still looks high from a quarterly run rate basis. So just wanted to understand why was it higher, even if I adjust for this SAR100 million of previous year payment? Thank you.

**Tony Cripps:** Thanks. On the first question, our ECL modelling that we took in Q4 last year, as we highlighted previously at the end of Q1, we took some overlays. They were conservative and they were proven to be conservative, based on the higher interest rate scenarios that we put in.

We are continually upgrading and testing those models, and we haven't yet determined whether further provision should be taken. We're working very closely with SAMA as well in their own assumptions, and we'll continue to do so. But at this stage, no, we aren't.

We're up to date, but we're not at this point taking further provisioning. So, Lama, on the third question?

**Lama Ghazzaoui:** Yes, Rahul, if you're comparing last year's Zakat with this year's Zakat, excluding the SAR100 million, the Zakat is a factor of the profit. So with higher profits, the Zakat in absolute terms definitely will be higher, but the percentage of Zakat is now almost at the floor, which is the 10% plus.

**Tony Cripps:** And on the NIBs, we said that in the second quarter, we strategically selected to take some very large deposits from strategic clients, where we paid, but it was about relationship. And because of our low loan to deposit ratio, if we choose to, in the second half, not to chase some of those deposits, we don't have to, in terms of loan to deposit ratio.

We will, of course, continue to manage strategic relationships, and where there is longer term business associated with those relationships, including capital markets business that is executed by HSBC, where we own 49% then we will do so, even if that means our NIBs ratio is a bit lower temporarily.

And on the retail side, we, of course, can select or not to pay up for time deposits, which again, we can pull those levers. So we do have the ability to manage this in the second half.

**Rahul Bajaj:** Understood. Just one quick follow-up question and this is a separate question, on dividends. So now that you've upgraded your kind of lending growth guidance, I'm just trying to understand how should I think about dividend payout ratio for the full year. With faster growth, does it mean that maybe the payout ratios in the last couple of years would not repeat, and you'll probably go for something below 50%, or meaningfully below 50%, or you think that's the range, 50% plus or minus, that you'll probably try to maintain for the full year?

**Lama Ghazzaoui:** Tony, I'll take this. For now, we're maintaining this 50-55% because we – our policy is to grow the dividend payout in absolute terms, in line with the growth in the profits, of course, or in the returns, of course, taking into consideration, all future growth and capital requirement. But this is the level that we plan around in the short and the medium term.

**Rahul Bajaj:** Understood. Thanks, Lama. Thanks, Tony.

**Operator:** Please stand by for your next question. Your next question comes from Gabor Kemeny at Autonomous Research. Gabor, your line is open. Please go ahead.

**Gabor Kemeny (Autonomous Research):** Thanks. A few follow-up questions from me, please, on the point you just mentioned. The first one would be, if you could elaborate a bit on what levers do you see on, I think you mentioned that you could pull on the NIM side over the second half to improve your NIM. I think you mentioned retail time deposits, but if you could elaborate a little bit further on that, please.

The second one, I mean, on these relationships that you paid up on deposits. What was the rationale here? Was it like you are expecting more corporate lending business? And if yes, have we seen that already in Q2 or is this something you expect over at the second half?

And the related question to corporate loan growth, I understand you talk about the global issues, slowdown, etc. But what do you see in your books, actually? If, for example, I look at your credit commitments, I mean commitments to extend credit, there's actually quite a nice jump in the second quarter. I wondered what was the scope for this to translate into actual loan over the second half. Thank you.

**Tony Cripps:** On the levers we have time deposits in retail, we can be selective. On the strategic relationships, yes, you're right. In relation to the Giga-projects, for instance, we expect more drawdowns associated with those projects. They're on track. They were healthy, and we're very confident around them. So where we have strategic relationships there in the short term associated with deposits, we expect ancillary business, lending growth, and capital markets business to come from those strategic relationships as well.

So, yes, they're longer term in nature, I guess. But we selectively choose those relationships in the projects that we want to be associated with.

**Gabor Kemeny:** Got it. That's helpful.

**Operator:** Your next question comes from the line of Naresh Bilandani from JPMorgan Chase Bank. Please go ahead. Your line is open.

**Naresh Bilandani (JPMorgan Chase Bank):** Thank you. Hi, Tony, Lama, Sirish. It's Naresh Bilandani from JPMorgan. Thank you very much for the presentation. Three questions, please.

One probably a repeat of what I also like presented to you in the first quarter call is just keen to understand, to what extent is the fee income in the quarter, in this quarter, more driven by volume? So I'm just keen to understand if the rate of origination on the credit side slows, is there a risk in the second half, as I think the first half fee income performance looks quite impressive. I'm trying to get a handle on whether this is a new normal for the fees. Also, if you can share some insights on what drove the fee income in this quarter that would be extremely helpful. That's the first one.

My second one is, I took a look at your segmental disclosures, and there's been some movements. If you can please throw some insights on that would be helpful. It shows a SAR17 billion drop in the CIB liabilities over the quarter, and then there's a SAR20 billion pickup in the treasury liabilities. So can you please just explain what this movement was led by? And that's the second question.

And my third and final question is on the loan growth. Now, this has continued to be strong for your franchise and also for the peers. So more just an industry question that despite higher rates, we've continued to see some strength. So can you please share your views? Are we – what we're seeing, is this still somewhat of a lagging view?

And if we don't see, hypothetically, if we don't see a cut in the rates next year, do you reckon the pace of corporate growth could be at a risk in some shape and form? I know you did allude to the macro risk, but also I'm cognisant of the Vision 2030 targets for the corporate.

So if you can please share some thoughts on how long can this pace of growth on the credit side continue, despite elevated rates that would be extremely helpful. Thanks a lot.

**Tony Cripps:** Thanks. On the first question on fees, 50%, as we've previously guided, 50% of our fees come from our trade business, where we're number one in the Kingdom. And we've seen very strong growth again.

And despite a somewhat slightly slower outlook in the second half, perhaps, we think that the trade volumes will still be very strong given the vision and the opening up of the Kingdom. So we're still positive on fee income in the second half. On the liability side, Lama, do you want to take that one?

**Lama Ghazzaoui:** Yes. Hi, Naresh.

**Lama Ghazzaoui:** We've seen some boundary changes between the businesses, with some relationships between corporate and treasury, but largely the corporate drop in NIBs, which affected the corporate business and some increases in due to banks in the treasury segment. So this is the reason for the increase on one side and the decrease on the other side.

**Naresh Bilandani:** Okay. And on the question on the loan growth, please?

**Tony Cripps:** On the third question, yes, I think, when we got together recently and looked at the strategy for the second half and beyond with our economists and our strategists, the oil price is still obviously critical to the Saudi economy and to much of the infrastructure spending that is driving growth.

And while the oil price stays healthy, the government's deficit position or surplus position and the ability to commit and underpin those projects remains. So at this point, despite slower GDP growth, while the oil price remains around the government's assumptions of \$80 a barrel or thereabouts, we remain confident in corporate loan growth into the second half and into 2024.

**Naresh Bilandani:** Okay. That's an encouraging view because I would have assumed that elevated rates at some point starts feeding into management mindsets for your corporate clients. And we could see some risk going into 2024, assuming rates don't come off materially. But you're saying that this healthy pace of growth is likely to continue through into 2024 also. I'm sorry, I'm not trying to put words in your mouth, Tony, but I'm just trying to get some view from you.

**Tony Cripps:** Yes, I'll reiterate that the oil price is obviously very critical for the economy, given the government's support of the large projects. And those large projects support the supply chain into the middle markets. So while the oil price remains healthy, it underpins, even though GDP growth might be slower at 2%, the non-oil GDP growth is much healthier through the diversification of the economy. So therefore, we remain pretty optimistic.

And if, as the yield curve is implying, rates do start to fall in 2024 in the US, then Saudi rates will start to come down as well. And that will be helpful.

**Naresh Bilandani:** All right. Thank you, Tony. Thanks, Lama.

**Tony Cripps:** Thank you.

**Operator:** Thank you. Please stand by for your next question. Your next question comes from Shabbir Malik at EFG Hermes. Shabbir, your line is open. Please go ahead.

**Shabbir Malik (EFG Hermes):** Hi, thank you very much. I have a question around your non-funded income. Maybe you've touched on it earlier in the call. Sorry, I missed that part. But what was the reason for the dip in non-interest income this quarter? Is this more of a sustainable level for non-funded income for the rest of the year, in your opinion?

And my second question is in your NIB ratio, which has come down quite sharply this quarter. In terms of the 60% CASA or NIB ratio that you have right now, what proportion of that do you think is more granular in nature and is less likely to slip out as fast as the more corporate oriented or the chunky CASA deposits? If you can give some colour on that, that would be pretty useful because historically, I think at a high interest rate environment, the CASA ratios for SAB, and generally for the banking sector, have been much lower. So what is the risk that this ratio is going to stick around the 60% level and not go down to, let's say, 50% or maybe below that?

**Lama Ghazzaoui:** On NFI, just remind me, are you asking on the Q1 levels of NFI or the first half NFI?

**Shabbir Malik:** Q2 versus Q1, there was a bit of a dip in Q2 non-funded income so.

**Lama Ghazzaoui:** Yes, it's because Q1 non-funded income included higher than normal gains made from disposals of certain investments and some related hedges unwinding, which had an impact in Q1 of around roughly SAR100 million in revenue. And this feature, of course, did not repeat in Q2. We were not expecting it anyway, but this is one of the major elements of the difference of NFI in Q2 versus Q1.

And of course, another reason for the fee income specifically, which fell 5% Q-on-Q, it is due to seasonality. It's just part of the revenue that we talk about. But on non-funded income, largely, it was investment-related and unwinding of hedges.

**Shabbir Malik:** Thanks for the additional colour. On NIBs?

**Tony Cripps:** Yes, on NIBs, we are mindful of customer behaviour, which is logical. And so there is, as you point out, logically, from a historical point of view, potential downside risk, which we're watching very closely.

And it's hard to predict exactly, but at this point, we're sticking to understanding there are levers we can pull, given our low loan-to-deposit ratio, where we're not chasing, unless for strategic reasons, like in Q2 with some of the larger – our very, very large institutional customers whom we can afford not to chase some of that deposit growth. But for the industry overall, you're quite right, the trend is lower and it's logical. How quickly that continues is uncertain at this point.

**Shabbir Malik:** Great, thank you very much.

**Operator:** Thank you. There are no further questions in the queue. We have one just come through, so that's Nauman, apologies, just stand by for a second. Next question is from Nauman Khan at SNB Capital. Nauman, your line is open. Please go ahead.

**Nauman Khan (SNB Capital):** Thank you for this opportunity, just wanted to have some colour on your investment book as well. Over the last few quarters, you have aggressively increased your book as well, but this trend seems to be changing in Q2 as well. So is there

any change in the strategy there, one, and if you can throw a little more light on what's the duration and profile of your investment book that would be very helpful. Thank you.

**Tony Cripps:** Yes, we took a view in Q4 last year when longer rates in the US were peaking, and the yield curve started to invert. We at that point decided, having previously been expecting higher rates, with the peaking in rates at the longer end of the curve, we substantially increased our investments.

And we did so specifically, as previously guided, to hedge ourselves effectively against rates potentially falling in 2023 at the back end, or certainly we think in 2024 it's likely. And so that strategy is consistent. We increased the book again in Q1 when rates backed up from around 3.4% at the long end of the curve in the US, up to close to 4%.

We opportunistically increased the book again further by a few billion, and the duration of the book is at around six or seven years, I think. And so we have guided that we view this position specifically as a way of reducing our NIM sensitivity, which had previously peaked at around 10, to now around 3, and potentially even a bit lower.

So that when rates start falling, we won't have the same volatility in revenue that we had previously in other cycles where interest rates had fallen sharply, we're in a much better position. So that strategy is consistent, and we are maintaining it going forward.

**Lama Ghazzaoui:** Yes, Nauman, and your question on the duration of the book, the second part of your question on the duration?

**Nauman Khan:** Yes.

**Lama Ghazzaoui:** On average now, it's around five years, and this is what we planned for. Yes.

**Nauman Khan:** Thank you. Thank you very much for that.

**Lama Ghazzaoui:** Sure.

**Operator:** Please stand by for your next question. Your next question comes from Sharat Dua at Amundi. Sharat, your line is open. Please go ahead.

**Sharat Dua (Amundi):** Good afternoon. Thanks for the time. Just a follow-up really to the last question. So is this now a clear long-term strategic change that your bank will be far less exposed to interest rate movements over many years? I mean, I think you said something about six or seven years their position. Is that a fundamental change that you've made and you expect to stick to for this period of time?

And I think you said earlier on that you've maybe brought the sensitivity down to almost neutral earlier than expected. If you can just shed some light on that and just talk a bit about the costs of the hedging. Thank you.

**Tony Cripps:** So the decision to build up the investment book is a cyclical strategy. And if we took a view next year or in 2025 where we felt that interest rates had fallen to a point where we should again increase our sensitivity to the prospects of rates rising, we may well take that position. It's cyclical.

But at the moment, we felt that we've benefited enormously from rates going up, and that was a strategic decision that management took assuming that rates would rise. And now

we're taking a view that rates are peaking. And again, in the future, we may well take a view that rates are again low enough to expose the bank, I guess, to the cyclical upside of higher rates.

So that's just something we analyse every week and every month, and that can change in the future. And it's an assumption on where we think the economy is going and where rates are going.

**Sharat Dua:** Tony, you said it's come in earlier than expected and a bit about the cost side of reducing the sensitivity.

**Tony Cripps:** Yes, I think the NIM sensitivity contraction has been a little bit faster than we thought potentially. Some of it is driven by the cost of funding has gone up a bit faster, and therefore, that's naturally reduced the sensitivity positively to the upside on rates. And also we've increased our investment book further, and that comes at a temporary cost as we invest at the longer end of the curve, which is obviously inverted and so below the current short term interest rate. We haven't yet used derivatives to hedge because again because of the inversion of the curve if we were to hedge at three, four, five years, we'd be in an inverted position and would reduce our NIM sensitivity down further.

So far, we haven't done that. But we chose the investment book as the avenue to do that, and we've done that more aggressively I guess because the outlook has the sensitivity to the outlook slowing further at a global level has perhaps accelerated a bit, and therefore, we were a bit more aggressive in Q1 in increasing the investment book further out the curve, which comes at a cost to NIM, but hedges us against rates falling in the second half and into 2024.

**Sharat Dua:** Okay. So, effectively as we see on the P&L, the volatility has moved down from NIM, but there's increased cost on the NIR side effectively?

**Tony Cripps:** Yes because of the inversion of the curve. If you want to hedge yourself a year out or five years out, you're doing so in an inverted curve, and so it comes at a cost. But we think that's very prudent given the outlook for the global economy and the view on interest rates.

**Sharat Dua:** Okay, thank you.

**Operator:** There are no further questions in the queue.

**Sirish Patel:** Thanks a lot. This would be closing remarks and so thank you for attending the Second Quarter Saudi Alawwal Bank Results Call. Thank you for the questions and we look forward to updating you after our third quarter call later this year. Thank you.

**Operator:** This concludes today's conference call. Thank you for participating. You may now disconnect.

[END OF TRANSCRIPT]