SABB Q2 Results Webcast

David Dew: Welcome, everyone, to our inaugural quarterly results call. We are pleased to welcome our investors, potential investors and analysts. I am David Dew, the managing director of SABB. I am joined today by Mathew Pearce, our chief financial officer. We will update you. I will update you on SABB as it looks today, post our merger with Alawwal Bank and provide you with an update on the merger. Mathew will take you through the key highlights of our financial results for the first half of 2019. We will aim to take about 15 to 20 minutes following which we will have up to 45 minutes of Q&A.

So, let's begin. The first two slides are a snapshot of who we are today. There was nothing new in these slides and I will simply make two points. The first point, we are a significant financial institution doing business in a key emerging market that is an important member of the G20. Saudi Arabia is opening up to the global economy at a pace and extent greater than ever before and we are well positioned to support these efforts. Indeed, as most of you will know, Saudi Arabia will host the G20 meetings next year. The second point is we have a unique partnership with a leading global institution, and that of course is HSBC. As such we would argue that we are the leading international bank in the Kingdom and that that is a very strong position to hold in the present environment.

The next few slides relate to the merger. We are proud of the small piece of history we have made in legally combining two significant banks with strong histories and successful track records in serving our customers, developing our people, investing in the Kingdom and supporting the broader economy. The message I want to give you is that we have got off to a strong start with the merger and we are very much on track with all our initial expectations. We have done a very significant amount of work and we are well supported by a large and dedicated team of experienced executives and highly capable consultants. In other words, we are not learning on the job, but placing strong emphasis on prior integration experience and the reasons of that is quite simple.

This is by far the biggest project that either bank has ever undertaken and the stakes are too high to take any unnecessary risks. We also know that the real integration work has only just begun, albeit the detailed planning has been underway for some time. We're also very mindful that we have undertaken this merger in order to create value and that value will be the ultimate measure of success. But I will come back to that in a couple of slides. So, in terms of governance, we have appointed the new board and the new management team. Another piece of history, we are delighted and indeed privileged to have the first female chair of a listed company in the Kingdom and we are, I believe, the only listed company to have two female directors.

We had our first full meeting of the new board last month and I can assure you that I personally am truly excited of the prospects of working with the new board to deliver on the very significant opportunities that we see. We also have appointed a strong management team from both banks and you can see the names in the deck. This is the team that will deliver a successful integration culminating in full systems integration and customer day one in 18 to 24 months’ time. I do want to spend a couple of minutes on slide eight because this is the heart of the value discussion I mentioned earlier. Our previous guidance on synergies and integration costs is on the left of the slide and we are now in a position to improve that guidance as detailed on the right.

So, if we look at the slide, the previous guidance in terms of cost synergies was 10 to 15% of the combined base and we have now increased that to 15 to 20% of the combined cost base. We did not previously provide any guidance on revenue synergies, but we are now guiding that we expect revenue synergies of two to three percent of the combined revenue base. And then finally, in terms of integration costs the previous guidance was one and a half to two times annual run-rate cost synergies. And we have narrowed that somewhat to 1.5 to 1.8 times annual run-rate cost synergies while noting of course that we have expected the cost synergies to increase.

The bottom two slides give you a sense of timetable if you like. So, on the bottom left is the profile of synergies showing that we expect synergies to fully kick in in year 2022 and will obviously build up progressively between now and 2022. So, in a sense, synergies, as you would expect, back-ended whereas the opposite is true for the integration costs, which will be very much concentrated this year and 2020. So, we will start to see the full benefits flow through in 2021 and then expect to hit pretty much everything in year 2022. I will now hand over to Mathew to take you through the first half financial results.

Mathew Pearce: Thank you David. I shall start from slide 12. For the first 6 months of 2019, SABB generated a solid underlying operating performance, but the bottom line was depressed by significant one-off credit losses. Revenue growth was largely driven by Net Special Commission Income. Our cost efficiency remained within historic range excluding merger-related expenses.

Excluding the growth from the acquisition of the Alawwal bank portfolio, loans remained fairly flat throughout 2019. We see this as a positive sign given the previous 3 years of deleveraging. We saw modest growth in new and rollover loans which offset headwinds from scheduled loan maturities.

CET1 was in line with previous guidance, diluted by the accounting for the merger, and we are comfortable with our Capital position. Our announcement of an interim dividend, which is similar in absolute amount to last year, is a signal of our confidence in our capital generating capacity and reflects our view of the one-off nature of the credit losses experienced in the second quarter.

Moving on to the key financial highlights. On a reported basis, NIM was temporarily diluted by the timing of the merger late in the 2nd quarter, and will normalize over time. The underlying margin on a proforma basis is set out on the next slide. Return on Equity was diluted by the merger following an increase in shareholders' equity by SAR23bn as consideration for the acquired business. Returns will be enhanced in the future as a full year of post-acquisition profits are booked and as the benefits of the merger are fully realized. Many of you will be more familiar with the Return on Tangible Equity metric commonly used globally. This would certainly appear to be a more accurate reflection of performance going forward for SABB.

Cost efficiency ratio increased as a result of merger-related transaction and integration costs, excluding which the ratio was around our historic level of 30% on a reported.

The CET1 ratio declined including a dilution in the order of 200bps from the accounting for the merger.

On a reported basis, operating income increased by 9%. Excluding the incorporation of the post-acquisition revenues from the acquired Alawwal bank portfolio for the last 2 weeks of June, underlying Operating income was up 5%. This was driven by growth in NSCI as a result of a series of benchmark interest hikes in 2018 which led to repricing benefits in our corporate loan portfolio and commercial surplus deployment. Non-funds income was lower including a decrease in fee income across all product lines, notably trade finance and credit cards. We remain though a market leader in both these products and the decline was largely driven by the macro environment.

Operating expenses grew 26%. Excluding the incorporation of the post-acquisition expenses to support the acquired Alawwal bank business and the merger-related transaction and integration costs, underlying costs grew by around 8%. This included some one off items in both the current and prior year. Otherwise recurring cost items remained well controlled.

Provisions for expected credit losses in the first half of 2019 were SAR1.7bn. This included provisions for credit losses for certain troubled originated corporate loan accounts, and provisions for credit losses on the acquired performing loan portfolio. Both of these are explained in more detail later on.

The proforma income statement was broadly similar in trend and drivers, so I won't dwell further. The rest of the presentation though will focus on the proforma basis.

Moving on, I will now focus a little on NSCI as it represents almost 80% of total revenue. You can see here that NSCI increased by 4% quarter on quarter, and it was 6% higher Half on Half, despite a decline in interest earning assets. This was due to the benchmark rate hikes. You can see this on the right hand side. The growth in the yield on the portfolio outstripped an increase in cost of funding. We continued to do well generating NIBs / CASA through winning operating account mandates from customers, whilst reducing expensive deposits.

You will notice that the data points flattened off in the first and second quarter of 2019. We see this as the peak of our margin and see pressure going forward as benchmark rates are entering a cut cycle. Also we should be mindful that in a challenging economic environment, the appetite for quality credit assets will put pressure on the margin of the Bank. Whilst we have not seen significant client spread compression to date, a skew in the mix towards higher quality assets may be a headwind. Typically, a 25bps change in benchmark rates leads to a change in our margin of up to 10bps on an annualized basis.

Moving on to Costs, as you can see from the right hand side, through 2018 and into early 2019, our cost efficiency ratio remained around our historic level of 30%. Looking then to the left hand side, the merger has led to an increase in our ratio as a result of two points: (1) The combination with a bank with a higher ratio naturally has a dilutive impact. (2) The merger-related transaction and integration costs also increase the ratio. We would expect that once the synergies are fully realized and the integration costs discontinue, we will revert back towards our historic range. However, we should be mindful of two sources of potential future cost inflation: (1) The continued imperative to invest in digital, and (2) The need to retain and invest in talent. Over time though these should lead to competitive top line returns.

To the next slide, in 2019, following the previously mentioned increase in provisions, the NPL ratio now stands at 4.6% including the acquired credit impaired portfolio. The coverage ratio was 124%. Previous cycles have seen NPL ratios up to 5% so it feels like we are near a normal peak. It is good to remind everyone that we and the sector are well capitalized. We see the significant charges in the second quarter as largely one-off.

As you know, the acquisition accounting requires us to adjust the acquired portfolio from Alawwal Bank to fair value, incorporating lifetime expected credit losses across both the performing and non-performing portfolios. The portfolio included a number of troubled accounts that are common to both banks. Under the strict letter of the accounting rules, SABB should continue to account for its pre-existing, originated, portfolio using an amortised cost less impairment approach under IFRS9, and not to consider it through the lens of fair value. However, in reviewing the implied credit risk adjustments on the acquired portfolio for common troubled accounts in what is now one bank and one portfolio, SABB chose to revisit the levels of its IFRS 9 provisions for those common names. Whilst this may be viewed as a conservative approach, I think by now you are all used to that from SABB.

Whilst SABB already maintained a reasonable level of provisioning against these accounts prior to the merger date, the additional provisions represented a top up of provisions across a few accounts. Whereas the adjustments to the acquired Alawwal bank portfolio result in an increase to goodwill on the balance sheet, the adjustments to SABB's pre-existing facilities are charged directly to the income statement. The exposures were primarily in the contracting and related sectors.

The provisions in the second quarter also included a charge against the acquired performing loan portfolio. IFRS9 accounting standard requires us to take additional provisions post merger on this portfolio, despite having taken fair value adjustments for lifetime expected credit losses on the merger date just 2 weeks earlier. We see this as a potential double count.

On slide 17, we've included some key points on the acquisition accounting which applies the Purchase Price Allocation method. Key to which is the need to recognize the acquired assets and liabilities at fair value on the date of the merger. This has resulted in some adjustments compared to the previously reported book value by Alawwal bank. These adjustments are reflected in goodwill. You will already have inferred from our Q2 public disclosures that the fair value adjustments are some SAR5-6bn. This is consistent with our expectations in our deal model, and with our previous guidance where we flagged a capital dilution in the order of 200bps which equates to this size of impact. As can be seen from our Q2 disclosures, the majority of the adjustments relate to the loan portfolio, which is the typical area of impact in banking M&A.

The accounting at Q2 is provisional and we have 12 months within which to finalize. However, we have endeavored to capture as much of the impact now with available information, despite the short timeframe.

On Capital, CET1 was impacted by the dilution from the accounting related to the merger, in the order of 200bps, as previously advised. Whilst we have likely dropped to the lower quartile in the sector, it is a well capitalized sector. The difference between quartiles is not in our view significant enough to warrant concern, and we are confident of our future capital generating capacity.

Finally then before I hand back to David for closing remarks, a few brief points on loans and deposits. Loans grew by SAR49bn as a result of incorporating the Alawwal bank portfolio into SABB. Excluding that, the loan book remained fairly flat this year. Deposits likewise saw growth through the merger, by SAR60bn, excluding which deposits grew. We are pleased with our mix of low cost funding overall however we do expect more benefit through achievement of the synergies from the merger. I'll now hand back to David.

David Dew: Thank you, Mathew. So, to sum up briefly, we have legally completed the merger and appointed a new board and a new executive management team. The integration is well underway, supported by a dedicated project management office and we have increased our expectation of the benefits from the merger. Mathew has described our first half financial performance, which is solid from an operating perspective, but has of course been impacted by one off credit losses. Our balance sheet and capital remain strong. And our interim dividend is, we believe, an important signal of confidence in how we view the future. Our customer advances, excluding those from the acquired book, were broadly unchanged but we are starting to see modest growth momentum in loans.

And the final point, our greater scale and a more efficient operating platform together with our ongoing partnership with HSBC, we believe, will reinforce our unique positioning as the leading international financial institution in the Kingdom. That completes the formal presentation. I will now hand back to the moderator and begin the Q&A. Moderator, please.

Moderator: Good day, everyone. Should you have any questions, kindly type them into the question box on the bottom left side of your webcast page and they will be answered by David and Mathew. We'll hold off briefly just to collect some questions. Our first question is from Edmond Christou from Bloomberg Intelligence. Thanks David and Mathew for organizing the call. Please, can I get some clarity on PPA? The contractual cash was not expected to be collected. Is this amount provisioned for, and how does it impact CET1? What is behind the impact of the merger of 200 basis points on CET1 in your presentation? And then he has a second question, the analyzed cost of risks seems very high in Q2. And around four percent versus one percent in Q1, you are taking an additional provision and against the troubled exposures. Has there been any write-offs for loans or restructuring?

Mathew Pearce: Sure. Thank you. I'll take those two points and David can provide us comments on top of that. On the second one, just very quickly, no, there aren't any write-offs to bear in mind of any significance. To the first one on PPA, and obviously there were a few components there asked, maybe then I'll just try and briefly explain this. So, you have to recognize the acquired portfolio at fair value and compare it to consideration paid. I mentioned the five to six billion of fair value adjustments that you can imply from the disclosures. Effectively, that downward negative adjustment on certain asset categories such as loans is then transferred to goodwill. Goodwill is thereby deducted from regulatory capital, and so essentially that impact of the negative adjustment of six billion is a direct charge to capital and that is what results in the 200-basis points dilution.

David Dew: The only point I would add to that is yes, if you annualize the cost of risk in the second quarter, then clearly, it's a very high number. But I think we've gone some way to stress why we believe that it is very much a one-off quarter and it would not be appropriate in our view to simply analyze the second quarter. Next question please.

Moderator: The next question is from Neri Tollardo from Morgan Stanley and he's asking of the SAR1.7 billion provisioning in Q2 '19, how much of it was related to Alawwal's book and how much of it to SABB's?

Mathew Pearce: Hi, Neri. Yes, thanks for the question. I think the first thing I would say is that when you take the whole thing together, essentially, we're kind of saying this is one off, and you shouldn't, as David said, try to read into that cost of risk and take it forward in terms of the split. And we're not disclosing the precise split itself, but from the disclosures in the accounts under the business combinations note, you can kind of roughly get to the impact anyway because in the goodwill, the note on business combinations, we actually are required to disclose what would have been the Alawwal Bank profitability had we incorporated it from the beginning of the year.

We've got the whole thing in terms of co-bank together, but you can see that we've reported the two weeks of profit included in our numbers post that period where it reports a loss of SAR 343 million, which is a combination of this number on the Alawwal portfolio, plus a little bit of a regular profitability. So, if you take that number you can push it up a little higher because of normal operating profit in there. You can kind of get to a rough split between the two items.

Moderator: We have two follow up questions from Neri. The first is, is it correct that you first fair valued the book and then took provisions as well? And do you consider that to be double accounting? Does this open the room for reversal? And the second question from Neri is given the high level of provision in Q2, what does this mean for cost of risk going forward? Even absolute terms or relative to SABB's history of cost of risk. And then finally, he's asking on the synergies of what revenue or cost base should we calculate them, full year '18 or half year '19?

Mathew Pearce: Okay. Thank you. So, to the point on the double count, yes, effectively for the acquired portfolio. So, you're looking at sort of stage one and two that Alawwal Bank was reporting pre the merger. We have fair valued that, taken into account lifetime expected credit losses across both what was the stage one and stage two. And then in addition to that, because all of that is being reported under stage one on an acquired basis, we are then required to do a provision on top of that for 12 months ECL for those assets in stage one. I think one of the challenges is that these are two accounting standards that don't play very well together. The fair value that's done on the merger date is under one standard called IFRS-3 for business combinations. And then after that, two weeks later you're required to draw up a balance sheet and run your IFRS-9 model almost regardless of what's been done there.

We are aware of one other instance of this globally in Scotia Bank that has also experienced this having made some acquisitions in a post IFRS-9 environment and also reported such similar credit losses through the P&L. In our mind, this is a potential double count. Certainly, as you've seen from the PPA adjustments, we have a good amount of fair value adjustments and to have an additional amount on top of this is required by the accounting. Certainly, in our expectation, if we've got our fair value adjustments correct, then over time as these loans unwind or repay, we would expect some reversals. Certainly this is a large number of loans and they will have various schedules of maturity, so it'll come out over time, and you shouldn't expect any kind of concentration of release as this comes.

David Dew: In terms of the other two questions, I'll take both of them. So, I think one of the questions was cost of risk going forward, and we would point you to slide 16, which effectively goes back 10 years and gives you the history of cost of risk over that period. We have consistently guided that through the cycle. We expect to operate on a cost of risk in the 30 to 60 basis points range, and that has not fundamentally changed. But what I would add to that is in 2018 we had a lower cost of risk and essentially that was because 2018 was impacted by IFRS-9 cost of risk adjustments through the balance sheet at the beginning of the year. And therefore, in a somewhat similar manner for this year, given that we have taken a very high level of impairment in the second quarter, it would not be unreasonable to assume that perhaps we have, in some sense, maxed out our provisions for this year.

So we're always going to be cautious in terms of forward looking guidance, but if you take it in that historical context and the sort of norms we expect over the economic cycle, adjusted for one off adjustments then that probably will give you a sense as to where we expect cost of risk to go. In terms of the synergies piece, I think you should continue for cost synergies to look at the 2017 cost base. I don't think it makes a whole lot of difference in terms of the ballpark ranges we're talking about, but for revenue synergies, we're comfortable enough if you want to look at the 2018 revenues on a combined basis of the two banks. Either way, you will get to a number in the sort of 200 million to 300 million range for the revenue synergies. So, I don't think it makes a whole lot of difference. And what we're looking to do here is directionally give you the sort of numbers that we're building into our business cases. Can we have the next question, please?

Moderator: Our next questions are from Rahul Bajaj of Citibank. And the first is, could you please give us some guidance for 2019 lending growth, NIMs and credit risk costs, which have been answered. And then the second follow up question from Rahul is on the accounts, how do you plan to deal with the impact of the blended EPS that gets calculated now with difference in tax rates flowing through on a combined basis on your income statement?

David Dew: Okay, so the first part of the question in terms of loans and NIMs, as we said in the presentation, and we will be guiding to modest loan growth, we've certainly seen some evidence of that albeit the legacy SABB book has been broadly flat this year. But that's against a significant maturity profile, and we continue to see modest signs and modest evidence of modest pickup in growth. So, I think our guidance there would to be a low single digit loan growth. In terms of NIMs, as Mathew said before, we do think for this particular cycle that NIMs have plateaued and that we would therefore expect to see modest reductions in the remainder of the year based on the overall outlook and scenario for benchmark rates. But the latest scenario I saw was pricing in another couple of interest rate reductions by the Fed this year. And we've guided that every 25-basis point reduction in benchmark rates causes a change in NIM of up to 10 basis points.

Mathew Pearce: The question around EPS and whether we should have one EPS or two EPS because we have a mixed shareholder base. I certainly understand the question about having two EPSs. I think at this stage, given how late this matter of the change in reporting of the tax came out for the quarter end, the banks were directed to only report one EPS. At this stage, I'd certainly like to work on that going forward to provide investors with better insight into the EPS for a zakat in a corporate income tax base. So, we will look at that going forward and get back to you. But at this stage, we are guided to only publish a single EPS. Next question please.

Moderator: Our next question's from Shabbir Malik of EFG Hermes. And the question is, given that the transaction has created sizable goodwill of about SAR15 billion, do you see the risk of cost of goodwill impairments in the coming year? And then the second thing is the transaction should unlock synergies, but will this be enough to defend a huge goodwill?

Mathew Pearce: At this stage, we are not anticipating any goodwill impairments. The size of the goodwill, there are a couple of components to it, the first of which I mentioned is the size of the fair value adjustments, the five to six billion which I highlighted in my presentation, was consistent with our deal model at the time. So, no surprises for us. In terms of the synergies that have been included in our deal model, we have just increased the guidance to you on that above and beyond what was factored in, so we see that as positive. The absolute goodwill number also moved up because the share price increased over a period of time since the exchange ratio was locked in during that period for the most part up until right at the very end of MSCI inclusion, the premium of the SABB share over Alawwal share remained consistent throughout that period.

And it was just a function of the running up in the share price, so we didn't see that in itself as a risk of goodwill or put together at this point in time. And we're not anticipating that. We are certainly very confident from a business economic goal perspective of the deal that we've done. Nothing has changed in terms of our view of the deal model and the decisions made and the information that we have today. If anything, else, the improvement in the synergies expectations is a positive.

David Dew: I think given the importance of this question, I'd like to simply reinforce and emphasize Mathew's response, which I agree with entirely. Nothing has happened that is not in line with our expectations and our deal model, and therefore, we remain very comfortable not only with the strategic rationale of the merger, but indeed the actual underlying economics of it. Next question please.

Moderator: Our next question is a somewhat related question from Chiro Ghosh of Sico Bank and he's asking if the land and properties from Alawwal were also revalued or still held in book value.

Mathew Pearce: So very simply, yes. Alawwal assets and liabilities were considered and that included property, plant and equipment including the buildings and the land. And they were adjustments in there, so that was covered. Hopefully, that answers your questions. I would just reiterate that technically speaking, it is provisional accounting for the second quarter, albeit at this stage, we feel comfortable that we've done a good enough job to make sure that we've captured the major parts of the impact at this point. Thank you. Next question please, moderator.

Moderator: Next question from Vikram Viswanathan from NBK Capital. What is the sustainable cost of risks for the combined entity?

Mathew Pearce: I think we've answered that question in one of the previous questions when I referred to slide 16. We don't want to give any further guidance than we've already given, that through the cycle we expect cost of risk of 30 to 60 basis points. It's for the analysts and the investors to determine where we are and where you believe we are in terms of the economic cycle, but that when we see certain blips in the cycle, then normally there is an opposite reaction in the following periods. So other than that basic guidance, I don't want to say anything more in terms of cost of risk.

Moderator: Our next question is from Waleed Mohsin of Goldman Sachs. How much of your loan book and funding is linked to US dollars? I.e., LIBOR rather than SAIBOR, while asset yields have moved, lower funding costs have remained the same.

Mathew Pearce: Yes. Thank you. Very simply put, we are a Saudi domestic focused bank, although we have a very strong international connectivity through HSBC, the vast majority of our funding and indeed our borrowing base is in the Kingdom and is in Riyal and that constitutes the major part of our balance sheet. Whilst we do have some dollar lending, particularly in trade, we have very little funding relatively speaking in dollars and we are really linked and exposed, if you like, more to the SAIBOR and other domestic curves than we are to the LIBOR curve, notwithstanding the implicit interrelation between them because of the peg between the dollar and the Riyal.

David Dew: I mean, I would add on that point that the peg is of course, a fundamental part of Saudi's monetary policy. It's a policy that has the country in very, very good stead over a long period of time, and the link between SAIBOR and US dollar LIBOR is of course very, very close. And SAMA historically has moved rates in tandem with the Fed also very, very closely. But Mathew is absolutely right. The vast majority of our book is in domestic currency. Next question please.

Moderator: Next question is a follow up from Shabbir Malik of EFG. What gives you the confidence to increase the synergy target?

David Dew: I think as we continue to do our detailed planning, as we continue to actually do the integration following legal day one, as we are able to access all records, all customer documentation, basically everything. So, we get increased and additional information, and that has guided us together with the progress we've made to date, albeit it is still early days as I said, but that has guided us to believe with a good level of confidence that we can deliver the increased synergies that we've spoken about. Next question please.

Moderator: We have a question here from Edmond Christou. What is your coverage ratio for the group including purchase credit impaired and where do you see NPL ratio going forward?

Mathew Pearce: Okay, thank you, Edmond. If I take you to slide 16, and this is an important point to understand. So, let me first explain around POCI, the purchased and originated credit impaired piece effectively substantially includes the acquired credit impaired portfolio from Alawwal Bank. When we acquired this, we acquired it on a net fair value basis. So, we have now a net loan exposure to those customers adjusted down for the credit risk adjustments and effectively on day one have zero provision because we've recorded it at its new fair value. So, there was no provision against it explicitly, but implicitly that has been taken into account.

So, when you compare on slide 16 the second quarter, you can't compare the SAR6.2bn provisions against the SAR5.0bn of stage three, for lifetime expected credit impaired plus the POCI because it's not like for like effectively on POCI. The provision has been netted against the gross loan, so when we look at coverage ratio, now in a world where you have a more sizable proportion of the book that's under POCI, you must look at provisions against the stage three, the five billion. And that's how we get to the 124%. If you actually break down by stages and you just looked at this SAR5.0bn and you looked at the provision coverage base stage, you would find that at June on a combined basis as we reported, we had a 69%

provision against that, which is consistent with what we reported on a pro forma basis previously. And indeed, what SABB was reporting on a standalone basis before.

But I think it's a very important point that when you look at coverage, because of the way the accounting works, you should definitely not be looking at the denominator in terms of NPL of adding in the stage three plus the POCI because it will be unfairly diluted in that sense. And in terms of the NPL ratio looking forward, we've already guided that our sense is that we are reaching the peak of the current cycle. In terms of NPL ratio, that peak is broadly consistent with previous peaks in terms of previous economic cycle. So, this feels to us like a normal economic cycle, and again, the system remains extremely well capitalized and SABB remains extremely well capitalized to deal with these economic cycles and peaks in NPLs. So, nothing out of line with what we believe we've seen in previous economic cycles.

Moderator: We have a few questions from Vikram of NBK Capital. The first question is, what is the total magnitude of integration expenses? And then he's asking as a follow up, in the first two years, will the integration costs exceed the revenue synergies? And then as a final question, he's wondering if you will be able to hit the run-rate cost of risk in 2020.

Mathew Pearce: Okay. In terms of the integration expenses, Vikram, I am going to guide you back to slide eight where we think we've put out enough guidance there. The cost synergies are a baseline of 2017 combined. That's public information to work that out. And the integration costs, we've guided as a multiple thereon, so that should get you to the range on the guidance where we are currently expecting to land. In terms of the first couple of years, and will the revenue benefit exceed, I believe it was the cost of integration for those periods of time. I mean, we've set out here kind of an idea of how these things move out over time and you can see the cost and things like that. So, I think when you plug these things in, you'll get an idea of it. I mean, certainly, as a high-level indication, the revenue synergy part will come out a bit later in the three-year piece of realization and the cost bit will sort of land somewhat in the middle to the end. So, I don't have a current expectation that the revenue synergies are front loaded and therefore would exceed the cost of integration in the early years. And, moderator, there was one third part to that question, I think.

Moderator: Yes, he was asking if you believe that it will be able to reach its run-rate cost of risk by 2020.

Mathew Pearce: Well, again, I think we guided to the extent we're going to in terms of cost of risk and where we expect that to be going forward. So, really, we've got nothing to add in terms of the cost of risk.

Moderator: Our next question is from Shabbir Malik of EFG Hermes. How does the technical service agreements work with HSBC? Is there an annual fee or a variable fee? And would the change in global HSBC leadership affect that strategy?

Mathew Pearce: Firstly, I think it's extremely unlikely that the change in HSBC global leadership will impact our strategy at all and indeed HSBC has publicly stated that fundamentally its strategy remains unchanged. But in terms of HSBC strategy towards Saudi Arabia or anywhere else for that matter, that is a question that should be directed to HSBC. And sorry, what was the second aspect of the question?

Moderator: It's asking them what is the nature of the arrangement with HSBC? Are there annual expenses paid - are there annual charges, fees for HSBC or variable charges?

David Dew: So, this document is not a matter of public record, but what I will say is that we've had a technical services agreement with HSBC in place literally since day one of SABB's existence. So, it has been in place for 40 years. It has served SABB very, very well. It has been extended through to 2027 as part of this merger, which again is a strong indication of HSBC's commitment to SABB as a major shareholder. And essentially, it's on a pay for services rendered basis. So, I don't want to go into any further detail, but essentially, we pay for the services and support that we receive from HSBC. Next question, please.

Moderator: We have a question from Mahmood Akbar of Raidah Investment and he's asking if SABB will follow HSBC's transparency standards and publish the financials of Alawwal for Q2 '19 so that we're able to assess for ourselves the financials of Alawwal during the acquisition period. And then his second question is, could management explain why the fair value gains of the loan should then lead to provision on the full cycle of the loan as mandated by IFRS on stage two loans?

David Dew: Maybe I'll do the first one very briefly. No, we will not be publishing the final financial statements for Alawwal. That is not something we will be doing.

Mathew Pearce: I think on this fair value gains aspect, I believe this is referring back to this matter we talked about taking additional provisions against the acquired performing loan portfolio. What I was referring to was that, to the extent that we are essentially over provided having taken a fair value adjustment on merger date through goodwill and also having taken IFRS provisions against that same book two weeks later, should the receivables that we actually receive in that portfolio be more in line with the fair value that we did on the merger date. Then actually that additional provision would not be necessary and over a period of time, when those loans matured, that provision would naturally drop away and would flow back to the P&L. I hope I've understood your question correctly. If not, please do drop a clarification follow up and I'll answer it. Thank you.

Moderator: The next question is from Farid Aliani of NCB Capital and he's asking what are the drivers of revenue synergies?

Mathew Pearce: The drivers of revenue synergies are essentially funding and improved cross-sell. So, when we look at the cross-sell ratios in the two banks, we think we can do a better job in terms of cross-sell, and we're very confident that we can generate some funding synergies. Next question please.

Moderator: Next question is from Chiro Ghosh of Sico Bank and he's asking strategically, what is the path ahead for SABB?

David Dew: That's a good question. It is very much a subject for the new board to deliberate and ultimately the new board will set the strategy for the new bank. I will say at this point the term of the current board expires at the end of this year, so the boards of Saudi banks are put in place for three years and then those terms are renewed. So, a new board will be appointed in January '20 after approval by the shareholders. The new board will have a very, very fundamental interest in strategy, but in the meantime, I think it would be reasonable to assume that there are no significant changes. So, if you look at the corporate focus actually of both banks, it was very similar in terms of business mix in terms of business model. And so, putting the two together is unlikely to result in any change in the corporate strategy. And we could probably say the same about the retail strategy.

As with many, many other banks, we're obviously looking to invest wisely in technology and digital solutions to serve our customers. A lot of that activity does take place in the retail sector but equally some of the digital initiatives in trade, in cash management, in foreign exchange etc. are also important to our customer base. So, I think, the answer is in the immediate future, we are unlikely to see any changes in strategy of any significance, but quite rightly the new board will debate, discuss and ultimately approve the strategy for our bank going forward. Next question please.

Moderator: We have a few questions around the cost of risk, which have mostly been answered. The final question from Nicolas Charreyon from Fitch Ratings, and he's asking, Mathew, do you expect more deterioration in asset quality? If you expect any transfers from stage two to stage three loans in the second half of 2019, could you please quantify how much?

Mathew Pearce: I think I'll pick up on a few points that David made previously. So, in terms of things transferring from one stage to another, if you're just looking at the kind of NPL ratio, overall number at 4.6% and we were suggesting that we were near the peak of that. So, it's not to say, don't please read it that it’s 4.6% and it doesn't go any higher at all, but we're seeing near the peak. That's one thing I would say, but I think David has highlighted in terms of outlook and we talked about modest loan growth. There are still some challenges in the economy, so we should be aware of that too. I think that's quite important. We're not giving any specific target or guidance on what would be the NPL ratio itself.

And I think finally, I would say that with regards to IFRS-9, I think we're all learning about IFRS-9 and how the portfolio moves in an IFRS-9 world. But certainly, if you look at our portfolio today, and we clearly have an acquired portfolio, from an accounting perspective, from Alawwal Bank which has had, I'm sure everyone agrees, a pretty decent amount of fair value adjustments made against it, and SABB on certain common troubled names has taken additional provisions against that. Notwithstanding, there might be some movement around the ratio itself. I think it feels like certainly a lot has already been factored into the portfolio at this point.

David Dew: I would agree with Mathew's comment and I would also add the comment we made previously that we tend to be at the conservative end of the risk spectrum. So, although there continues to be some stress in the marketplace, particularly around the contracting names, and that stress is unlikely to be eliminated overnight, we are also seeing some positives. We're seeing some growth potential and we do anticipate, based partly on the provisioning, we've made improved recoveries in the future. So if you put all of that into the mix and then look at the guidance we've already given around normal economic cycles, I think you can definitely get a sense that we do think we're, at least as far as SABB is concerned, we are coming towards the end of this particular cycle. Next question, please.

Moderator: We have a follow up from Mahmood Akbar of Raidah Investment, how significant is the natural attrition among the staff following the merger? And then the final question is from Ibrahim Massoud of Event Income Capital. How long will it take for you to realize your funding cost synergies?

David Dew: Okay. So, in terms of natural attrition, what I will say is it is absolutely in line with historical norms and historical experience, and in line with our business case. And if you like, the deal model, and obviously in terms of natural attrition that is one of the obvious areas of the cost synergy. So, there's nothing there that's causing us any particular concern whatsoever. In terms of funding synergies, I think I'll hand that one over to Mathew.

Mathew Pearce: Yes, thank you, David. I think the starting point should still be to stick to our guidance that we're looking to fully realize everything over three years. And I think that's a good starting point in terms of specific actions and getting synergies in the interim as you go along. We've already started to see some of the actions being taken to yield some of the benefits and that has started to happen, but in terms of the exact phasing of that over time, we will need a bit more time I think to put those actions in place. And I would still guide towards in terms of building the model to just look at fully realizing those within the three years. I think, given time, if we would have one more question please, moderator.

Moderator: At this time, there are no further questions on the line. If you have a question, as a reminder, please type them into the Q&A box, then they will be answered. David, we have nothing else at this time. I would like to hand back the call to you to wrap up.

David Dew: All right. Well, thank you, moderator, and I'd like to thank everybody on the line for attending our results call for the first half of 2019. We hope that you share our enthusiasm for the prospects of our new bank and the exciting journey ahead. We look forward to engaging further with our investors and analysts at our next quarterly call and during any of the number of equity conferences we shall be attending in the future. So many thanks for joining and goodbye.

[END OF TRANSCRIPT]