SABB 1H20 Results Webcast and call transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Second Quarter SABB Financial Results Presentation for 2020.

At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question and answer session. To ask a question during the session, you will need to press star 1 on your telephone and wait for your name to be announced. I must advise you that this conference is being recorded today.

And now, I would like to hand the conference over to your speaker today, David Dew, Managing Director; and Mathew Pearce, Chief Financial Officer. Please go ahead.

David Dew: Thank you, moderator. A very good day to all of you and welcome to our results call for the second quarter of 2020. My name is David Dew and I am the Managing Director of SABB. As usual, I am joined by our CFO, Mathew Pearce and together, we will take you through our second quarter results.

We anticipate that the formal presentation will take up to 20 minutes and then we will be happy to answer your questions. Because of COVID-19, we are using this virtual format for the second time and I hope that it enables you to get the value you are looking for from the call.

So, if I may go to the first slide in our webcast and the key messages. The first message is that in a difficult period, we have had some real successes. We have demonstrated quite remarkable operational resilience in the face of the global pandemic. We have fully achieved our core objectives of maintaining all services to our customers, keeping our customers and staff safe, and supporting our customers wherever we can. This is no small achievement.

We also completed the first anniversary of our merger. We remain on track to deliver full integration in the first half of next year and we remain on track to deliver the benefits of that merger. Those benefits will increasingly flow through from next year on.

We have maintained focus on business as usual and continue to invest in digital solutions. The importance of this has been made even more clear as a result of COVID-19. Our underlying performance is resilient. Mathew will take you through the numbers in detail, but we see clear reasons for optimism. I am sure this will be a key topic in the Q&A session.

I'd like to make one comment on the goodwill impairment charge. It is a one-time non-cash accounting charge. It has no impact on the bank's capital, liquidity or funding. It has no impact on our ability to lend to and support our customers. It is very much business as usual from our perspective.

Mathew and the finance team did a great job in completing the merger accounting within the 12-month permitted period. This is now done and behind us.

As a sign of our underlying strength, we completed a very successful SAR 5 billion Tier 2 Sukuk issuance in July which further enhanced what was already a very strong capital position. Our levels of capital and liquidity are very high. This is a strong foundation on which we can build.

On the next slide are some examples of what we have done in response to COVID-19. We are proud of the way we have come together to support each other and to support our customers. There are no real changes on the next three slides in the webcast. We continue to operate a well-diversified business albeit with obvious concentration in the corporate sector for our loan book. And the partnership with HSBC remains a core component of who we are and our positioning as the leading international bank in Saudi Arabia.

On the capital and liquidity slide, you can actually see the strong numbers I referenced earlier. The capital chart on the left hand corner is particularly interesting. We were at exceptionally high capital levels in the quarter before the merger but we have already replenished half the drop in capital ratios that we saw on legal day one despite the significant levels of provisions we have taken and despite calling the SAR1.5 billion Tier 2 Sukuk in the last quarter.

This is a strong set of core financial metrics which is where I hand over to Mathew to cover the numbers in detail. Mathew, over to you.

Mathew Pearce: Thank you David. I shall start from slide 10.

Year-to-date, SABB generated a net loss before zakat and income taxes of SAR 6.2 billion. This included a goodwill impairment charge of SAR 7.4 billion which I will discuss in detail on the next slide. Excluding the goodwill impairment charge, Net income before zakat and tax was SAR 1.2 billion for the first 6 months of 2020 on a reported basis, an increase of 17% or SAR 177 million compared with the first half of 2019. The more meaningful explanation is on a proforma basis which I shall use in the rest of the presentation.

Before I explain the underlying proforma results for the first half, I will spend some time on goodwill impairment. As you will be aware, Goodwill arises as the premium between the value of consideration given to Alawwal shareholders and the fair value of net assets received. However, Goodwill was in our view inflated by an interpretation of the accounting with which we do not agree yet have been obliged to follow.

A key driver of the Goodwill is the value we ascribed to the shares we issued as our consideration to the Alawwal shareholders. The accounting standard drives you to use the quoted market price at that time, which was SAR41.70 precisely, and under normal circumstances that may make sense.

In our case though, we do not view our circumstance as normal. Quite the contrary, we view our circumstance as unique. Our share price at the date of merger was temporarily inflated by the inclusion of the country, and SABB, into the MSCI EM Index. This is a common phenomenon to index inclusion and this can be witnessed in other markets where there has been an index inclusion event. However, to our knowledge, we are the only public merger to have been executed in the middle of a country's inclusion.

We therefore believe strongly that using the share price of SABB at the exact date of the merger did not represent the fair value to acquire the Alawwal net assets. In support of this, we must be conscious of the fact

that the vast majority of those new shareholders to SABB could not exit their stakes at that precise and temporarily inflated price due to the turnover of our stock and large shareholders restricted from selling.
We feel strongly therefore that the share price at merger date cannot be considered a true fair value of the consideration, and whilst we believe that the accounting standard does allow the application of judgement to abnormal circumstances such as ours, our auditors did not share this view, and after a long debate, we were obliged to follow the auditor's interpretation. We do not believe this represents the economics of the deal. We do not believe this is in the best interests of our shareholders or the market.

This resulted in our Goodwill being inflated by c. SAR 5.5 billion. The implication is that this makes passing any goodwill impairment test more difficult. At the year end, we passed the test despite this headwind. What has changed is obviously the emergence of COVID-19.

Despite our strong disagreement with the accounting interpretation, ultimately we have reported a sizable impairment charge. Please do take particular notice that this was really driven by the valuation issue using a share price reference point that was temporarily inflated during unique circumstances.
It is an accounting charge, non-cash. It does not affect anything we are doing or our prospects for the future. And to reiterate, it has no effect on the Bank's capital, liquidity or funding, nor our ability to support our customers or our people; and we have the same level of confidence now that we did prior to impairment. We will have more time in Q&A to clarify further as needed but for now I will move on.

Now delving into the underlying results. Excluding goodwill and other one-off items that can distort period-on-period comparisons, underlying profits of SAR 1.3 billion were 22% lower than 1H19 on a like-for-like basis mainly from lower revenue in funding and non-funding income. Funding income I shall describe in more detail on the next slide. For non-funds income, the increasing challenging economic environment led to a decrease, particularly in loan origination and trade finance fees, together with lower net fees from credit cards as a result of increased competitive pressures.

Underlying costs were lower in 1H20 and our quarterly costs continued their downward trajectory, reflecting the achievement of ongoing cost synergies.
Expected credit losses were lower in the first half of 2020, and 2Q20 included a charge of SAR1.3 billion.

Return on tangible equity was just under 6%, roughly the same as prior year.
Our capital position remained very strong. Our CET1 ratio increased in the quarter to 18.1%. Our balance sheet is in great shape.

Moving on to slide 13. Net special commission income, which represents around 80% of revenue, was SAR 1.8 billion for the quarter, and included SAR 89 million of PV unwind. Excluding the unwind, Net special commission income was 19% lower than the same period last year and 5% lower than 1Q20.
The decrease compared with 2019 reflected cuts in benchmark interest rates together with competitive pressures on spreads, and lower average lending. These factors were partly offset by continued reduction of more expensive time deposits, in line with our ongoing synergy realization programme, which has improved our cost of funding position significantly. Since 1Q this year we returned to our position as having the 2nd lowest cost of funding in the sector. The 2Q20 decrease compared to 1Q20 reflected part of the repricing impact from the March benchmark rates cuts.

On to slide 14. On an underlying basis, 1H20 operating expenses fell by 5% compared with the first half of 2019. On an underlying basis, and excluding the unwind of the fair value adjustment in revenue, the cost efficiency ratio was 37%.

Slide 15 shows the cost performance for the second quarter compared with the trailing quarter. On an underlying basis, costs in the quarter fell 5% in line with our synergy realization programme.

Slide 16 presents the longer-term trend on our underlying costs by quarter for the combined bank. On costs we are in good shape by historical standards and trending well, plus we have more upside still to exact value.

Onto impairment analysis on slide 17. Following an additional booking of SAR1.3 billion of expected credit losses in 2nd quarter, our 1H20 cost of risk ended at 194bps. The 2nd quarter included charges roughly split equally across 3 main themes: provisions against common names of new POCI accounts, an increase in retail customer delinquency due to slower collections activity under lockdown that has now been regulated in the 3rd quarter, and additional charges against certain corporate accounts. Our NPL ratio stood at 5.8% and our coverage ratio of non-performing loans excluding POCI, at 132%.

Slide 18 sets out the trend analysis on the balance sheet. Balances were up 1% compared with the end of 2019, however after two consecutive quarters of growth, gross loans marginally fell in the second quarter largely in the retail portfolio compared with broadly unchanged balances in the corporate book. In the 2nd quarter, in response to the situation, we conducted responsible risk management during a heightened time of uncertainty which to some extent still persists, where we reigned in appetite particularly in the corporate space. This curtailed our otherwise positive momentum in loan growth from the preceding two quarters. Whilst there are signs of optimism compared to where we were in 2Q, I think it is fair to say that none of us are out of the woods yet and a degree of caution still is only sensible. Funding is in great shape. We continue to build out and sustain a quality funding base where all business units contribute significantly. We finished the quarter with over 70% demand deposit ratio and the 2nd lowest cost of funding in the market.

Let me now touch upon the conclusion of our merger accounting. We had 12 months to finalise this accounting. 2nd quarter is the end of that period. As you are aware we had recorded SAR6bn of book adjustments up to 1Q this year. In finalizing the adjustments in the last quarter, we have increased the adjustment by a further SAR3bn. The additional amounts represent a mixture of updated valuations to previously identified troubled accounts as well as some newly identified accounts. All still approached through a conservative lens in valuation terms.
The final exercise created SAR1.9 billion of intangible assets which mainly represents the future benefit of core deposits, and we recognised goodwill totaling SAR16.2 billion prior to the impairment.
We expect that the performing element of the acquired portfolio will deliver a PV unwind of SAR 2.3 billion over the life of the loans with approximately 50 per cent of this being unwound by the end of 2022. The intangible asset will be amortised using a straight line basis.

Finally, on capital, a reminder of our strength. We finished the quarter with a CET1 ratio of 18.1 percent. Total Capital ratio was 18.7%, to which we added an additional 200bps in July when we issued our SAR5 billion Tier 2 Sukuk.
On a year to date basis, CET1 improved 1.1ppt driven by our net profits together with a fall in RWAs partly offset by the payment of 2019 final dividend. Compared with the end of the first quarter, CET1 improved 0.9ppt also reflecting a fall in RWAs, together with an increase in other reserves from narrowing credit spreads and reduced volatility in equity and debt securities recognised at fair value through Other Comprehensive Income. The increase in Other reserves was in part a rebound of the reduction that we saw in the first quarter from widening spreads and increased volatility. The increase in CET1 during the second quarter was partly offset by the payment of the 2019 dividend.

David, I'll now hand back to you for closing remarks.

David Dew: Thank you, Mathew. I'm very conscious that there's a lot to absorb there so, I will take the closing remarks as read and turn it back to the moderator to commence the Q&A session. I have no doubt there will be some lively questions. Moderator, over to you, please.

Operator: Thank you so much. And the first question comes from the line of Naresh Bilandani from J.P. Morgan. Please go ahead.

Naresh Bilandani: Hi. Thank you very much. It's Naresh Bilandani from J.P. Morgan. Just three quick questions, please. First of all, now, given that SABB has written off a sizeable portion of the Alawaal exposures and provided concurrently for your own exposures as you mentioned in the presentation, would you be comfortable in sharing some guidance that SABB could potentially outperform its peers on provisioning from this point on over the next 12 to 18-month timeframe. That's the first question.

Second is I'm just trying to understand your NIM trajectory into the medium term given that you have majority of your book as a corporate book, is it fair to assume that majority of the NIM pressure will be born in 2020 and the compression in the NIMs could likely be more limited in 2021. I'm just trying to understand where the interest gaps could be and how the overall NIM trajectory could look like. That's the second question.

And the third question is on the PV unwind. You kindly guided of the 2.3 billion number of the PV unwind expected over the loan life, does this only adjust for the 540 million of PV unwind gain that you have already recognized or this is 2.3 billion from this point on. Is that how we should look at it? Thank you.

David Dew: Thanks, Naresh. I'll take the first two questions. I'll ask Mathew then if he wants to add any comments to my responses and then if you can do the third question on the PV unwind.

So, in terms of first question and outperforming in terms of expected credit losses our peer group, two or three comments. Firstly, I would not be so bold as to comment on the outlook or the expectations for our peer banks. That is obviously for them to address.

But I would make a couple of comments. The first one is SABB is now very, very fully provisioned. What we have tried to do, I think you all understand that we adopt a conservative outlook as a general principle. Because of the merger accounting, we have effectively marked the Alawaal book to market. We have gone a step further as you well know. And essentially for the large significant common names, we have applied similar treatment to the SABB book. No other Saudi bank has to do that and, frankly, no other Saudi bank should do that and we would not have done that had we not done the merger.

And then we've added that additional conservative lens that Mathew spoke about, i.e. the COVID-19 lens. And you can say yes, but technically, you should be looking at legal day one and that was before COVID-19, that is quite correct. But we can review the lens on which we review these things, and that's what we did and we made that lens even more conservative.

So, if you take all of that into consideration and then you look at the fact that our NPL ratio at 5.8 percent is clearly an outlier, clearly – and we can explain that and I think there's general understanding on the call as to why that is – then it's certainly reasonable to assume that we are very, very fully provided.

And so, in terms of the industry and the peer group, either we're too conservative in which case you can expect to see some write backs, or if we're not, then logically, you could expect to see some level of catch up amongst the other banks. But I repeat, our starting point is different to all the other banks, so it should not simply be a read across well, that's what SABB thinks, so that's what all the other banks should be doing.

On your second question, on the NIMs, our view, you saw the decline in NIMs in the second quarter, that was almost entirely driven by the decline in global benchmark rates in March although, again, what we've just said in terms of NPLs and the fact that we have a significant portion of the loan book that's non-performing, that also has an impact on NIMs.

We believe that the full impact of that decline will be absorbed in the third quarter. So, our guidance is that we expect a similar level of decline in the third quarter to the decline we saw in the second quarter. And then we expect NIMs to stabilize. And absent any further changes in global interest rates, logically we would, therefore, expect that NIM level in the third quarter to be broadly consistent for the fourth quarter, and broadly consistent for 2021 absent any further changes in global rates.

My final comment on this is I do think banks and SABB have got to get used to an environment of low interest rates for longer and we certainly see that being the case over the next couple of years.

So, Mathew, if there's anything you'd like to add to that and then the question on the PV unwind, please.

Mathew Pearce: Yes. Thanks, David. I think it was pretty comprehensive. I know that Naresh extended his second question on NIM into next year. I think as we talk about next year, it would only be fair I think to wait for the finalization of our important five-year strategic plan this year and so we'll have a better chance for discussion at the end of this year that can impact NIMs. You can certainly see it happening in some of our peers now in terms of what they're doing in terms of growth and what this means for their NIMs.

The third question is actually the simplest of the three questions, Naresh. It includes everything to date, the 2.3 billion so it's not extra on top of what we've already booked. Thank you. And to our next question.

Naresh Bilandani: Thank you, David. Thank you, Mathew. That was very clear. Thank you.

Rahul Bajaj: Thanks for the call. This is Rahul Bajaj from Citi. I have three quick questions for you if I may.

The first one is on the Zakat and tax treatment in the second quarter and I see a big reversal there in terms of deferred tax. So and please correct me if my understanding is wrong here that the impairment charge, the goodwill impairment that you have taken, that does kind of result in lower tax/Zakat in 2020 anyway, is that kind of a benefit, unintended maybe, of impairment, so that's my first question.

The second question is around mortgages. I remember, I think in the previous call, I think David mentioned about how the REDF changes, the mortgage loans are probably closer to where SABB will be comfortable with, so given this kind of backdrop, are you thinking about that space and how are you approaching this space? Are you thinking of getting more active in that space? That's my second question.

And my third question is really around corporate lending growth. So just wanted to understand how are you seeing things from where you are in terms of growth outlook? Which sectors do you think will drive growth for the next 6 or 12 months? Thank you.

David Dew: Mathew, do you want to Zakat one first? And I'll take the second two.

Mathew Pearce: Yes, certainly. And thanks, Rahul. Yes, it does impact, so if you look at our disclosures on tax, you've got Zakat and income tax put there in terms of the current charge and then also you've got the deferred tax charge.

So booking a goodwill impairment did have an impact. You can imagine that at a Zakat level then it's reducing the equity base, so there's a benefit if you like there of reducing the equity base.

On the income tax, it's more around about the deferred aspect because it has a different kind of treatment. It's actually amortized over a period of time rather than you get the upfront benefit of having impaired it and, of course, then deferred tax comes in to just represent the difference between the tax P&L and the accounting P&L.

So, we recorded about a SAR300 million gain then. It would have swung to a charge the other way had we not been doing impairment at the time. Does that answer your question, Rahul?

David Dew: On the second two questions, so the mortgages and the corporate lending, essentially our answers are very similar to the answers we gave on the previous quarterly call. So in terms of mortgages, yes, we see signs that the market overall in terms of risk appetite and key risk factors if you like of the products has moved a little bit towards our position. And as we said at the last call, we have now actually moved our risk appetite a little bit towards the market position. And we did actually start booking more mortgages in June. And that trend has actually continued through July and August. And I expect it to continue through the rest of the year. In terms of impacting our overall balance sheet profile and the fact that we remain three quarters a corporate loan book, I don't think you should be expecting any material impact in terms of the overall metrics. But yes, we have begun to be more active in the mortgage market. And I think Mathew alluded to the point that the strategic plan we are embarked on may well have a view on mortgages. In fact, I'm sure it will have a view on mortgages. And we will communicate that view to you for next year as soon as it is finalized.

On the corporate lending piece, again, broadly similar, we are seeing generally subdued levels of corporate lending and corporate lending growth. So overall, the corporate lending market is pretty flat. It's possibly growing in low single digits, but it's pretty flat. And it's essentially being driven where there is growth by the government-related projects. And I'm sure you've all seen some of the announcements around the giga-projects. The good news is that SABB is well-positioned in that sector. And we actually have a very strong public sector business. We have a very strong multinational business. And we are keen to grow in that sector. That said, the point we've made on previous calls and we will make it again is the competition for quality assets remains fierce. And so, if the banks, including SABB are booking these quality assets and we are, typically, the margins are tight. And the borrowers should be very happy with the margins. But that's where we see the corporate lending growth, and certainly for SABB we continue our loan growth guidance in the low single digits through the rest of this year. We don't see a significant pickup in loan growth.

Waleed Mohsin: Thank you very much, David. Thank you, Mathew. It's Waleed here from Goldman Sachs. I have three questions. So first of all, if we use the pre-tax loss of SAR7.3 billion and then exclude the one-off impairment, the pre-tax profitability is still pretty low at only SAR50 million.

So, I want to check what you would classify as other one-offs excluding the impairment which impacted Q2 profitability. And the reason why I ask that is if you look at the provisions for this quarter, out of the 1.3 billion, 800 million is approximately related to stage three loans where the remaining 500 links to stage one, stage two. So that's the first question.

Then there's been a very good improvement in the RWA density. If you could talk about management initiatives to achieve that, that will be very helpful. And the third question. Curious to hear your thoughts on full year dividends. The one-off impairment obviously doesn't impact your capital. But does it in anyway influence yearend discussions around dividends? Thank you.

David Dew: Mathew, would you like to make a start on all of those? And I'll probably add some comments please.

Mathew Pearce: Certainly. Yes, Rahul, you're right, if you strip out the impairment of goodwill, and, yes, you will get back to, sort of – on a pre-tax basis, sort of SAR50 million for the quarter. So the swing factor there is expected credit losses, if you went more to operating profit, just topline revenue and our expenses, you would find the quarter was actually broadly flat. Now, there are different stories within those numbers but broadly flat. So the big swing factor was absolutely ECL in the second quarter. And I'll reference back to what David said about what we should be thinking about with cost of risk going forward. I'll just elaborate within the operating profit then for the period. Clearly, you can see that net special commission income took a hit from the rate cuts, so that started to feed through, although as David mentioned in one of his answers, not all of it fed through to fully to the second quarter.

So there's also more to come to the third quarter. And he provided a way of thinking about NIM going to the third quarter and beyond. We saw our non-funds income come down, if you think about fees and FX as the main flow items that is obviously about the second quarter lockdown curfews and the like.

And we saw some non-recurrence to our benefit then from the health care deferral charge that we saw in the first quarter coming into our operating income. In cost then, we saw some improvement in the second quarter, a combination of synergies and also management action in a curfew lockdown environment to manage cost benefit.

But that big swing factor down to an underlying c.50 million profit is definitely ECL.

David Dew: Perhaps, Mathew, if I – because this is an important subject, so let me add my perspective and a little bit more color on this one, please. So in the first quarter, we had what we felt was a reasonably normal non-surprise quarter pre-COVID-19.

In the second quarter, two key things happened. One, of course, we had COVID-19. Two, we had the final quarter of our merger accounting. Put the two together and as we’ve said now several times, we decided let's adopt, frankly, an even more conservative lens.

So, in that second quarter, we looked at the existing PPA names and did some top-ups. We looked at a handful of new PPA names where we applied more conservative assumptions. And we did some forward economic guidance and kind of drew forward some likely provisions for the rest of the year as a result of COVID-19.

So, I'll now say something really unhelpful for all of you, but I'll say it anyway. If you take the view that the first quarter was a reasonably sort of standard no surprise quarter, pre-COVID-19, the second quarter was a genuinely exceptional quarter and therefore unlikely to be repeated.

What we all have to figure out is the impact of COVID-19 on provisioning going forward. And I defy anybody that can tell you that with huge accuracy and say we know exactly what the impact is going to be because

I don't think any of us know the path of this global pandemic over the coming months.

What I would say is that it feels to us that the first quarter for SABB is certainly more reflective than the second quarter, but why I said this is an unhelpful comment is that kind of gives you a rather large range, but the key difference, the swing factor if you want to think of it that way is COVID-19. But we have really done as much as we think reasonably possible to bulletproof our balance sheet. So that's the additional color. Back to you, please, Mathew, for the RWAs and the dividend.

Mathew Pearce: Sure. RWA density is two-fold, one is management action around capital preservation and the second one then is actually related somewhat to the PPA. So on the first one, heading into that second quarter, we acted simply put and across many themes, including liquidity and funding as well as capital.

So, on the capital side we effectively did three main things. One is we looked at RWA in the sense of pure optimization of looking at what exposures were good, and looking at the things like that.

We also did a second kind of optimization piece, which also extends into credit risk management and liquidity management, which is actually looking at things like limits and appetites around the limits that we'd extended, so we curtailed them back which did have an impact in terms of our corporate loan growth in the second quarter, but to the other side in such a stressed and uncertain environment had a benefit on the capital side. And the third thing, of course, is we embarked on a journey to issue capital, which I know doesn't play into your RWA density point, but I also wanted to mention what we were also doing around capital in the sense of raising new additional capital.

So if you just focused on the RWA density point then. We did optimize some of the RWA and you can see in our analysis that we talk about RWA coming down. That's the optimization piece.

And also then there is an impact on RWA because there's an impact on loan values from applying the PPA. So, as we apply the PPA and goodwill increases, which is a deduction from capital, at the same time, you're effectively writing down the asset itself. And so, the like-for-like RWA reduces accordingly as you have effectively written off that part of the asset. So it's kind of two-fold between optimization, true optimization, and then also the PPA.

The third point on dividends, so I think it's fairly clear that for the interim dividend that the banks are not paying an interim dividend this year in terms of the yearend dividend, I'll honestly say, I think it's too early to say in the sense that that is a decision that the board needs to make when we get to the full yearend results.

But I will maybe point out something that is perhaps a bit obvious if anyone looking at our financials, you all know that banks traditionally pay dividends out of P&L and we've run a SAR6 billion loss for the first half of the year. And we've given you some general guidance around what the second half of the year should look like. And secondly, at this point in time, our attained earnings is negative by almost SAR1 billion. So, I'll leave it at those points and hand over to David for anything else he wishes to add.

David Dew: No. I think you've described that very well. Thank you, Mathew.

Waleed Mohsin: Thank you very much, David and Mathew. That's very clear. Just a couple of quick follow ups on this. On the RWA optimization point, it would also be a function of, as you talked about some that are sitting in stage three, so as your provisions for certain accounts went above 50 percent that would have meant that the risk weight on those particular NPLs would have dropped. Would that be a fair assessment?

Mathew Pearce: Yes. Certainly, as you move loans to default then the RWA falls away in the calculation, so that's in there as well. But I'm quite cognizant of what we did on PPA too.

Waleed Mohsin: Yes. And then the final question from my side, if we look at – I mean, there are certain sectors, obviously that you've talked about, which are showing stress. But if you look at a certain category, which is others in your loan book, what's interesting is that over the last six months, there's been a SAR600 million increase. And you've taken around SAR350 million of new provision for that since December. So curious to hear which sector is that and what constitutes the 'Other' there?

David Dew: Can you do that one, Mathew?

Mathew Pearce: Yes, sure. It's mainly, sort of, some of the private banking and some of the other kind of sectors put together that don't neatly fit into the other ones. It's a bit of a combination of things, Waleed, in terms of what's in there, but I'm not going to break out exactly which exposure that is on the call.

Edmond Christou: Hi, David and Mathew. This is Edmond Christou from Bloomberg Intelligence. I think most of my questions have been answered, just a follow up on the NIM. When you think about what you have done on the cost of funding, which is flat and a large part of the book will be re-priced fully by Q4. So next year, do we have an upside on the NIM given that all this liquidity you have on the balance sheet has to be deployed somewhere? This is on the NIM. The cost of risk, it seems to me that the elevated level for 1H, it will not be repeated in the second half unless we see second wave or sector-wide default in the Kingdom.

Otherwise, you are well provisioned and you are maintaining good coverage on all stages. Is this a very reasonable assumption to make? Thank you.

David Dew: OK. Thanks, Edmond. Certainly, on your second point, I would agree with you. I think that's a reasonable assumption. I've said all I want to say on NIM, so Mathew, I don't know if you want to add anything on either question please.

Mathew Pearce: Yes. So the second one that would be a pretty good assumption, on NIM heading forward into next year, I think I'd go back again to the strategic plan and looking at the strength of our balance sheet data. So, I think our balance sheet is in really great shape. We've got good capital. We've got a really good solid stable funding base, plenty of liquidity, a good franchise. We think we're well-positioned. We're in good shape, clearly from the returns perspective going forward is going to be a matter of how we deploy that balance sheet. And that will be a very important theme of the upcoming strategic plan which will be finalized later this year. And we'll be able to talk about it more at the yearend and beyond.

Edmond Christou: Just to follow up on this. So, the effective yield on your portfolio, now do you believe when you start deploying liquidity into the market you are able to generate slightly higher than what you have on the existing book since your book has been de-risking for a while now, so, it's probably coming from a lot higher compared to the market, if you get to see this from the number.

Mathew Pearce: Well, what David described, just very briefly walk you through was he talked about the third quarter versus the second quarter, there should be some compression and that extent of compression should be similar to what you saw second quarter versus first quarter and then as he said from the third quarter then we're expecting flat then towards the end of the year.

So, to your question what happens beyond that? How do we expand NIM beyond that and how would we deploy this funding base differently than we're currently doing it, it's going to be how we deploy that with customers, which segmentation that we do it in, what kind of pricing we can achieve. And then clearly, we don't have an expectation of much benchmark rate increases next year to help us out. So really, it's going to be about the mix of that portfolio across all interest earning assets from our investments and cash in the bank portfolios and within the loan portfolio itself.

So, really, it will be a kind of purist asset deployment matter going into next year and beyond at which we'll define what happens with that NIM, I believe.

Shabbir Malik: Thank you. Thank you very much for this presentation. My first question is about Zakat and tax rate. How should we think about your Zakat and tax rate for the second half and maybe over the medium term?

My second question, in terms of your exposure that is subject to deferral, can you shed some light on how much of your portfolio has been subject to deferral because of this (SAMA) program?

And finally, a question on credit quality, I think you talked about it but if you can maybe provide some more details, what were the key considerations made this quarter in terms of – which drove your provisioning and the – account balance both in stage two and stage three. If you can maybe talk a bit more about that, that will be very useful. Thank you.

Mathew Pearce: Sure. So I think if you look at our financials you will see that we took a charge of around about 300 million and what you've got is that you've got a pretty large deferred tax credit, so you should look at that as non-recurring into the second half of the year and you should go back very much to the purest current Zakat and tax rate. I think that's a pretty good base going into the second half of the year. But clearly, we've reported a pretty low underlying profitability for the second half of the year. We've given guidance around NIM expectations. We've given guidance around like cost of risk broadly into the second half of the year. If you're going to remodel the profitability level, I think I would be looking at a Zakat tax percentage rate that's more akin to the first quarter, then I'd be thinking about the second quarter. I think that would be a pretty good starting point to get to.

Shabbir Malik: What is the size of your SME portfolio and what proportion of your loans are subject to deferral?

Mathew Pearce: So quite a lot of the loans that they were additional loans that SAMA asked to be deferred in the second quarter, effectively the sort of first and second stage loans. Those that are not in trouble, so that they will be in subject to deferral for six months, obviously that six-month period is still going on. I mean, a very small part of our overall portfolio. And if you look at the yearend accounts and how much we've disclosed there on MSME then you can basically, kind of, take the majority of that and assume that it's deferred.

David Dew: Yes. I don't think we want to give anymore disclosures on the deferral than is in the published accounts. I will say, of course, that SAMA has placed balances with all the banks as compensation, so in reality the net impact of these deferrals is pretty modest.

On the provisions, we, as always will not go into specific names. But I think it's fair to say that building and construction remains our biggest area of concern and our biggest area where we have experienced the provisions. And that fundamentally didn't really change in the second quarter. So, that is the area of the economy that probably remains under the greatest level of stress, at least from a bank provisioning perspective.

Hootan Yazhari: Hi, gentlemen, I have a question regarding your cost base. You've obviously been moving in the right direction in line with your synergy targets. However, given that you expect there to be more modest growth in the system, and given the COVID overlay, has there been a move to reconsider your synergy targets? Are you the right size of a bank for the current environment, or do you need to address the cost base further? That's my first question.

The second question that I have is really regarding the loan book. Again, you were alluding to a pretty slow pedestrian rate of growth. How much of that, if any, has been driven by market share losses on account of the merger, people wanting to reduce exposure to the new combined entity, and the like there, and maybe management time being taken up by the integration process. Have you seen any of those sorts of pressures featuring in your relatively pedestrian rate of growth, or is it just a reflection of risk appetite and you haven't been going in as aggressively as some of your peers? So I'd love to get your thoughts on that.

And in line with that if you can give us any guidance in how you think you might be looking at modifying the risk appetite in order to optimize your returns, these would be your optimized NIMs.

David Dew: Sure. Thanks, Hootan. I will address them and Mathew can add. So on the cost base we've given our guidance, our public guidance on synergies including cost synergies and we have no reason to change that, so we remain comfortable with that guidance, but we are certainly not at this point changing that guidance in either direction and we are not increasing it.

But your broader point that in a world of lower growth and you didn't mention it but quite honestly, lower growth and low interest rates for longer. I believe all banks have got to look at their cost base and SABB is no exception to that, and in a digital world, we will increasingly use technology and technology will provide better and better customer experiences, but it will also drive reductions in the cost base. So I think all banks as a matter of course will have to keep their cost base under review beyond anything we've done with the merger or any synergies that we are going to create, and I have no doubt that that will be an important theme in the strategic plan that we are presently conducting.

In terms of our loan growth or lack thereof and our market share, I think being very candid it's a combination of everything you've mentioned, Hootan. So, yes, in terms of overall risk appetite I think it is fair to say that we are the conservative end of the risk spectrum. This is a subject that you would expect that we discussed with the Board, every single Board meeting and ultimately it is the Board that approves our overall risk appetite. But we've always felt that the impact of COVID-19 was severe and serious, and so, that has definitely had an impact and a bearing on our risk appetite.

Equally I've heard and I'm sure you've heard as well our competitors say that we are somehow distracted by the merger. I think that's a harsh comment, but to say that all the mechanics of the merger have had zero impact or and those will also be an exceptionally optimistic way to look at it. So we have been extremely busy in the last year or more since legal day one, running two banks because we are still running two banks until we get to customer day one. Running a very, very significant integration project and now having to do a big chunk of that remotely because of COVID-19 and doing everything we've done around COVID-19 and some of the work we've described there.

So if that has meant that, say, we've missed some growth opportunities and some lending opportunities, possibly. I don't think we can say to you honestly that the impact of the integration has been precisely zero.

Is this the desired outcome, are we perfectly happy losing market share? Of course we are not and the key theme of the strategic plan will be a growth theme, and I actually think that that will coincide very nicely with recovery in the economy, the ongoing implementation of Vision 2030. Hopefully a way of managing and living with COVID-19 with or without a vaccine, although obviously we all hope there will be a vaccine. And so, when we get to this better world in 2021 after a tough 2020. I do believe that SABB will be very and is very, very well positioned and we will capitalize on those opportunities.

So hopefully that gives a flavor. I am mindful of time, but Mathew, anything you'd like to add because they are quite important strategic questions.

Mathew Pearce: Yes. I agree, very good strategic questions. I would just add in there within that loan growth market share that, no, I don't see that customers have looked at the merged bank, compared the two separate banks and reduced their exposure to us, so we have been subject to that kind of dis-synergy in our view. I think in terms of what's our market share done because of coming together, that there's been, I don't think much impact on the corporate portfolio other than thinking about the fact that we have effectively written down a lot more assets so that's been more of the impact, otherwise we've largely held our head above water I feel in our corporate lending position. That and the overall market share issue has been more around the mortgage story which obviously we have talked about an awful lot and I will just leave it at that.

I know that on your third point you were getting to NIMs and the interplay of modifying risk appetite with NIMs. I also note that some competitors who are growing in the corporate space are moving up one way or the other of the credit curve, they are either going for top end credit quality and effectively diluting their NIMs and they are guiding that in the full-year guidance or they are kind of going the opposite way and taking up assets that perhaps are less interesting to do some more conservative plays in the market and maybe picking up some NIM in that perspective, but of course on a risk adjusted basis we should think about future ECLs as well.

I agree though on costs, synergy targets, feel very comfortable about but clearly the direction of costs will be to continue to find opportunities going forward. I think we should be mindful that less headcount doesn't necessarily mean the same correlation of less staff cost, if you need more sophisticated people to actually run a more sophisticated bank, there can be some offset there, but the benefit of doing a lot of that should be on the top-line, and so, we should look more around the interplay of our net margin as opposed to just the cost line itself. Those would be my comments. Thank you.

Farid Aliani: Hey, gents, thank you for your time, Farid Aliani here from NCB Capital. One question from my side, can we get some color on the attrition rate and how is it trending especially as you are celebrating the anniversary?

David Dew: So is this the staff attrition rate you mean?

Male: Yes.

David Dew: Yes. As our attrition rate it's something we track very, very closely, very closely in line with the market, so we are not seeing our attrition rates much out of line with the market at all. And our perspective on this is people will always be looking for different opportunities, new opportunities, different stages of their lives, different stages of their careers. It's healthy, it's good, and actually we are not seeing anything out of line with the rest of the market on that.

Mahmood Akbar: Hello I have a question with respect to the existing SABB shareholders prior to the merger who had no exposure to Alawwal. And so, what's in it for them, so now that for whatever reason that value was destructed can they ever recuperate that amount with the strategic five-year plan that you will put in place, sometime this year?

David Dew: OK. I am pleased you asked that question as the final question, because actually I fundamentally disagree with your hypothesis, but it's good to discuss these things. Nothing that has happened and certainly nothing that has happened in connection with our headline loss has any bearing or resulting from the merger at all other than a pure accounting perspective. And so, basically had we done the merger a few months either side of when we did it in terms of legal completion, we wouldn't have been having the discussion around goodwill impairment. We find it bizarre that because we happened to choose a month, we have this conversation and that's why we spent 12 months trying to argue our point and we failed in the end, but it has no bearing on the strategic rationale of the merger at all, on all the reasons we did it including scale and efficiency and actually on the value that we believe we will create for all shareholders including the SABB shareholders at the time of the merger that's voted in our favour of the merger.

Actually if anything, now you might say, yes, but COVID-19 has reduced future value, that is true, but its future value has been reduced for the entire market. And we would argue as a result of the merger, and the scale, and the efficiencies that we will deliver on, we are actually better positioned now than we were before the merger, so actually this idea that somehow there's value destruction and the SABB shareholders are not happy, we don't, and I don't agree with that hypothesis. And I think if you look at our shareholder base and you look at the consistency in our shareholder base I think you'd find that the vast majority of our shareholder base don't actually subscribe to that view either.

But it's a great question. It's a very important question and it's important that we give our views and I hope you get a sense that I actually believe this very strongly. Of course you are at liberty to disagree, but that's our perspective.

Mahmood Akbar: Sure. Can I just very quickly just a have a follow-up question, so that SAR7 billion goodwill loss that you've reported, so my understanding is that this is purely an impact from COVID-19 because otherwise that impairment would have been booked at the end of 2019. So if that is the case then it is not entirely correct then to suggest that the value on the date of the transaction was wrong, right, because if that view was valid, then the impairment cost would have come at the end of 2019?

David Dew: No, no, because we have 12 months to finalize the accounting and we've spent 12 long months discussing and debating this issue ad nauseam and we have lost, but we never gave up until the full 12 months. So, no, it's not correct to say, well, we should have done it at the end of 2019. We've done it at the end of the period, but unfortunately we've finally run out of all options.

But, Mathew, I don't know, this is an important point, whether you want to add anything and then we will draw to a close?

Mathew Pearce: What we've said is that the inflation and the goodwill which is not a real thing makes it more difficult to pass goodwill impairment tests, so at the year ends we have this goodwill inflation, we have this high hurdle. It was an extra challenge but we passed it fine. So there was plenty of value in the deal to pass it even with this inflation, this unreal kind of number.

Then when you get to COVID-19, of course there should be an impact in the calculation of the intrinsic value of the company as it would be for any company that calculated its own intrinsic value, but what we are saying is that we are comparing it to a goodwill number that is inflated for no good reason, and had it not been inflated, we would actually not have booked an impairment, that is that we still saw enough value in the deal even with the prospect of COVID-19.

Mahmood Akbar: So one, just very quickly, just one last question, so would you say that the fair value of SABB cannot exceed 41.7. As things stand today?

David Dew: What we are saying is the value on the legal day one when we closed was artificially inflated. That was not a real underlying value on that day, it was inflated by the run-up in shares as a result of the MSCI inclusion, and as soon as the final charge was completed in August the shares started going down again. And more or less at the end of the year they ended up where they started the year, more or less. So all we are saying is right at that peak point that's when we closed, that's when we value the shares, that was never right, that was never fair value, and finally we've corrected it. That's what we are saying.

We are most definitely not saying that the share price of SABB can never get to 41 riyals again, in any time in the future. In fact, I seriously hope that it will and we are going to produce a strategic plan that will ensure share growth. We are talking about the share price at a given point in time when we closed our merger.

Mathew Pearce: I think Mahmood will appreciate, when you do this kind of intrinsic value calculation I am sure you are doing them all the time, a lot of the value is in the terminal value, and so, trying to predict that in the future, what's going to happen. Our prediction model doesn't bake in anything that we are going to do differently in the future, it's just a pure economic anchor. So back to this point about the strategic plan, that becomes very important. We are not able to factor that into our calculation at the half year.

Would it have been better to wait until we have that strategic plan? Yes, we believe so, but we are constrained by accounting standards, so effectively we have pretty much marked it down at the low point of the market right now, which isn't a very long term strategic view of things, but accounting drives you to that kind of checkpoint and then that's pretty much what we have been forced to do, we put in projections of our expectations, of profitability particularly of the short term but it's pretty well stressed and in fact it's not our base case, just to factor in a heightened degree of uncertainty and not factoring at all into the future how the shape of the bank might look differently than it is today through the application of strategy and things we might do differently. But hopefully that provides you some sense of our view of why we think of the future, it doesn't mean that the share price can never get above 41.7. It will depend on how we respond to things going forward.

Mahmood Akbar: Right, thank you very much, thank you.

David Dew: OK. Thank you. If we can hand back to the moderator for closing please. I know we've overrun but I found the questions very, very interesting and hopefully we've been able to give you some informative answers.

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