1Q23 FINANCIAL RESULTS

EARNINGS CALL TRANSCRIPT

May 2, 2023

Madhu Appissa
Equity Research Analyst, Al-Rajhi Capital

Good afternoon, everyone, this is Madhu Appissa from Al Rajhi Capital. Al Rajhi Capital is proud to host Al Rajhi Bank's Q1 2023 earnings call. Welcome, everyone, to the call. Now I will hand over the mic to Mr Rayan, Head of Investor Relations, to introduce the management team.

Rayan Alshuaibi
Director Investor Relations, Al-Rajhi Bank

Thank you, Madhu. Good day, everyone, and thank you for joining our call. With us on the call today, our MD and CEO, Waleed Al-Mogbel; CFO, Abdulrahman Al-Fadda; and GM Treasury, Abdulrahman Al-Ajaji. As always, Our CEO will start with the financial highlights and strategy update, followed by our CFO, to give you more detail about our financial performance. I would like to remind everybody that today's presentation is available on our website. With that, I will hand over to Waleed.

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

Thank you, Rayan. Welcome, everyone, and thank you for attending our earnings call for the first quarter of 2023. We will go, as always through our performance highlights followed by an overview of our strategic performance. If we move to slide 3 for the first quarter of 2023, the Bank delivered a solid performance driven by non-retail portfolio, supported by our strategic initiative and improved economic activities.

Starting with the balance sheet, we were able to deliver 2% growth for the quarter and 18% year on year. On the asset side, the growth driven by financing portfolio growing at 19% year on year and now it is reaching SAR 577 billion as well as our investment portfolio growing at 12% year to date and 22% year on year. The non-retail book grew by 54% year on year, supported by 58% growth in our corporate book and 40% growth in SME.

In addition, mortgage recorded a growth of 21% year on year and now the mortgage is representing around 38% of our total book and around 52% of our retail book.

On the liabilities side, the liabilities stand now at SAR 677 billion, an increase of 17% year on year, which will bring the loan to deposit ratio to around 88%.

Net income edged up to reach now SAR 4.1 billion for the first quarter. Net yield income dropped by 4%, driven mainly by the higher cost of funding. However, the non-yield income grew by 2.4%. This results in a total operating income decrease by almost 2.5% in the first quarter of this year.

We continue to maintain a best in class asset quality, with the cost of risk now standing at 25 bps compared to 39 bps for the year of 2022. Additionally, the NPL also stands at 60 bps with a healthy coverage of 230%.

The Bank continued to maintain a market-leading cost to income ratio of 26.5% and a strong financial position with a healthy capital ratio of almost 21%, well ahead of the regulatory minimum.

If we move to slide 4, which we will highlight the progress of our strategy execution. Also, I need to remind all of you, this year is the end of our Strategy 2023. As you may know, we started this strategy at the beginning of 2021. We will start with the first pillar, which is building on the core. We continue to focus on retail as a core banking business. That resulted in our retail financing portfolio growth of above 70% since we introduced our strategy, Bank Of The Future.

Our corporate portfolio has witnessed an outstanding growth of 124% since we started our strategy, and now it is reaching around SAR 120 billion. That is a result of our continuous effort to expand our corporate portfolio and reposition ourselves. As of year-end 2022, the Bank ranked third in terms of corporate lending market share.

Being a bank of choice for SME is a main part of our strategy. The SME book has more than doubled since the beginning of the strategy, with a growth of 160%, representing now 18% of our non-retail book compared to 15% in 2020.

Moreover, we continue to see a shift in the deposit mix at the system level, driven by the current interest rate environment. However, the Bank was able to grow the demand deposits by almost 8% since the strategy inception. This will continue to be a priority, which will help us to reduce our cost of funding. In addition, we continue to improve our revenue mix with our non-yield income as a percentage of our total operating income standing now at almost 25% compared to 18.5% at the beginning of 2020.

On the second pillar of our strategy, outperforming our competition, the Bank continued to focus on delivering the best customer experience in the market across all business segments. We are proud now to maintain our NPS leadership at 73% compared to 66% in the fourth quarter 2020. Our loyalty programme continued to show a strong performance, with total registered customers of 7.5 million compared to 2.5 million in 2020.

Moving to the third pillar, Transform the Technology, strengthening and improving our technology and digital infrastructure across the Bank is a key to our success in capturing new business opportunities and maintaining our market leadership. Now, digital to manual ratio stands at 93/7 compared to 83/17 in 2020. Additionally, online account opening reached 95% of the total retail account opening.

The Bank continues to rely on technology to improve our operational excellence. As the number of bots now, we have almost 500 bots compared to 300 in the beginning of 2020. As a result, our average transaction per month has witnessed a significant increase and now reaching above 700 million transactions as of first quarter of this year compared to 300 million transactions by the end of 2020, with an increase of almost 140%.

Addressing new client needs is a key pillar of our strategy. Launching Emkan, our microfinance company, is a main item under this pillar to enhance the product offering for the Group. Emkan portfolio has more than doubled in terms of growth and now their portfolio stands at almost SAR 9 billion. For the payments side, we continue to improve our payment solution and further capture more point-of-sale market share, which has reached now almost 36% market share in the first quarter of 2023 compared to 28.4% in December 2020.

Lastly, the number of active customers at the Bank level continues to improve, supported by our best in class digital capability and now it’s reaching 14 million active customers in the Bank and also 18 million active customers as a Group compared to almost 9.5 million customers with an almost 50% increase since 2020.

If you allow me now, I will hand over to Abdulrahman, our CFO, to give you a detailed update of our financial performance for the first quarter of this year. Thank you so much.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

Good day, ladies and gentlemen, it is my pleasure to welcome you again in our Q1 earnings call. Without any further delays, I will start with the financial performance. Our total assets stand at SAR 776 billion, an almost 18% year on year increase and almost 2% on a sequential basis. To analyse the 2% year to date movement, as you can see on the bottom left-hand side of the chart, you have seen our interbank book has reduced by almost SAR 12.6 billion while our investment book has grown by a similar amount. This is part of the management initiative to improve further the return on the average earning assets.

Our financing book, have increased by almost 1.5% year to date, I will cover that in further detail in the following slide. If we move onto our funding profile, we continue to diversify our funding profile in order to manage our cost of funds efficiently where, as you can see on the bottom right-hand side of the chart, we have increased our interbank borrowing by almost SAR 17 billion. That is coupled with a reduction in the overall customer deposits by close to around SAR 9 billion. I will cover that in the following slide.

Zooming further into the main drivers of our balance sheet movement, our net financing book stands at SAR 577 billion, a 19% increase year on year and almost 1.5% increase year to date. It is worth to highlight that our retail book as a percentage of the overall financing book stands at 75% versus 76% at the end of 2022. To analyse the movement into the financing book, as you can see on the top right-hand side of the chart, our mortgage book has increased by almost SAR 3.2 billion, i.e. almost 1%.

If you recall, in Q1 we have announced that we have securitised almost SAR 5 billion of our mortgage book. So, the net growth is almost SAR 8.2 billion in Q1. That is coupled with de-growth in our ex-mortgage of retail book, mainly under personal finance. This is a function of the current repricing of our new origination, taking into consideration the interest rate environment, which has really impacted the demand as well as the customer eligibility from a DBR perspective. Hence the new originations are lower than the monthly repayments, which is explaining the de-growth that we have seen in Q1, where we are expecting that de-growth to continue further in the following quarters.

Corporate book has increased by 7%. We have seen the market data announced by the Central Bank a couple of days ago. We have seen the corporate book has increased by 3.8%, which indicates that we further improved our market share into the corporate book in Q1 this year.

On the total customer deposits, it stands at SAR 556 billion, where we have seen an almost 9.5% year on year increase and a drop of 1.5% on a sequential basis. To analyse the movement, as you can see on the bottom right-hand side of the chart, our CASA has increased by SAR 9.2 billion, i.e. 2.6%, while the overall market growth was only 2%, which indicates that we picked up market share. It is worth to highlight that the CASA as a percentage of the overall customer deposit for Al-Rajhi stands at 66.9% versus the market as of March, which is around 56.4%. The growth into the CASA as well as the interbank funding have led us to reduce further our time deposit in order to manage our cost of funds efficiently.

If we move to the profitability section, our net income for the period stands at SAR 4.1 million, almost flat year on year and 6% lower on a sequential basis. As you can see on the bottom left-hand side of the chart, the 6% sequential drop is mainly coming from the NII which came down by almost 8% which is a function of the higher cost of funds, where we've seen the cost of funds have increased by 23.3% on a sequential basis while the asset yields have increased by only 2.7%.

Non-yield income has shown an almost 2% de-growth. Nevertheless, the core non-yield income, i.e. exchange fees, are showing a very good improvement for year on year. Expenses were lower by almost 10%. Impairments were flat. To analyse the net income driver from a year on year basis, as you can see on the bottom right-hand side, a similar story where the NII has shown a 4% de-growth, taking into consideration the higher cost of funds. Non-yield income around 2.4% growth, expenses is almost 1.8% higher while the impairments were lower by 38%.

Further zooming into the net income drivers, I will start with the operating income. Operating income for Q1 was close to around SAR 6.8 billion, 3% lower year on year and 7% on a sequential basis. To analyse the movement in the operating income, as you can see in the top right-hand side of the chart, NII were 4% lower, despite that the average earning assets have increased by 22% year on year but, given the NIM contraction, we have seen that de-growth.

Fees have shown a good growth of 5%. Take into consideration the payments and all the cross-sell initiatives that the Bank is doing to improve further the non-yield income. Exchange income, we've seen a 26% growth year on year while other operating income was close to 36% lower year on year. If you recall, Q1 2022 we had a one-off capital gain where we sold some of the Treasury book, taking into consideration the rate environment.

Our NIM for Q1 stands at around 3%, where we have seen a 26 basis point drop compared to Q4 and the reason behind the drop are mainly that we've seen the gross yield has improved 16 basis points on a sequential basis. Nevertheless, the cost of funds have increased by 41 basis points, which led to the NIM contract by 26 basis points. However, if you recall, in 2022 we have said this is probably the start of the gross yield enhancement where, if you recall, we expanded our gross yield by 9 basis points last year. In the first quarter, our gross yield has improved by 16 basis points and we will continue to see further pick up in the gross yield over the coming quarters.

The NIM trajectory for the remainder of 2023 were as follows. We believe that Q1 is going to be the bottom of a sequential drop in our NIM. Q2 is more of a flattish compared to Q1. Nevertheless, further pick-up is expected in Q3 with further pick up that we will see on sequential basis at the end of Q4.

Our NIM for Q1 dropped by almost 80 basis points compared to the same period last year. As you can see on the bottom right-hand side of the chart that all business lines have contributed to the expansion of the NIM. Nevertheless, the cost of funds had negatively impacted the NIM. One of the things that is interesting to see in Q1 this year, for the first time since 2020 we have seen the retail book expand the NIM on a sequential basis.

Our OpEx stands at SAR 1.8 billion, 1.8% higher year on year and 10% lower on a sequential basis. If you recall, in Q4 we had a couple of one-off items, mainly on the G&A, which we said are non-recurring. To analyse the movement on our OpEx, as you can see on the top right-hand side of the chart, mainly are coming from salaries and depreciation, taking into consideration the balance sheet growth of almost 18% year on year plus the higher transaction amount that Waleed mentioned earlier, and finally executing our strategic investment in order to deliver the Bank Of The Future strategy. Our cost to income ratio for Q1 came at 26.5%, almost 110 basis points higher compared to Q1 last year. Nevertheless, if you compare it against Q4, cost to income was almost 27.5%.

Our net charges for the period was around SAR 360 million, a 38% year on year drop and almost flattish on a sequential basis. Cost of risk for Q1 came at 25 basis points versus 48 basis points in Q1 2022. Nevertheless, if you recall Q4 2022, our cost of risk was almost 25 basis points. The year-on-year movement on our ECL, as you can see on the bottom left-hand side, are mainly coming from the release in our gross charge coupled with a better recovery by close to SAR 58 million.

On a segmental basis, we have seen our retail book has increased the net charge by SAR 547 million while in the non-retail book we have seen a release of almost SAR 770 million. The release on the non-retail book are coming from two main reasons. We have updated our corporate ECL model in Q1 taking into consideration the macro outlook plus a better recovery, as I mentioned earlier.

Our NPL balance stands at SAR 3.5 billion, almost 13.7% higher year to date and the main contributors are coming from SAR 130 million on the retail side and SAR 293 million on the corporate side. On the corporate, we have seen a few names are coming from the SME book. On the NPL formation, our write-offs were SAR 700 million. If you recall, Q4 last year the write-off was almost SAR 1.1 billion. Nevertheless, the net inflows are flattish where we have a net inflow for Q1 with almost SAR 1.1 billion versus almost SAR 1 billion in Q4 last year.

Having said that, our NPL stands at 60 basis points, almost 2 basis points lower compared to the same period last year. Nevertheless, 60 basis points higher than Q4, mainly coming from the corporate book. Despite that, our NPL coverage came lower to 230% but Al Rajhi maintains a very healthy NPL coverage. If you recall in Q4, the market average NPL coverage were around 111%, excluding Al Rajhi Bank.

Our ECL stock stand at SAR 8.1 billion, almost 14% lower year on year. The movement as you can see on the top right-hand side of the chart are mainly coming from the release on the non-retail book. Take into consideration updating our ECL model in Q1.

Our gross financing book stands at SAR 585 billion, which is an almost 18.5% year on year increase. It is worth to highlight that our Stage 1 is almost 97.2%, which is almost flat compared to the same period last year. Our stage coverage, despite that we've seen a slight movement compared to Q4, nevertheless we still maintain a very healthy stage coverage, Stage 1 at 51 basis points, Stage 2 at 16.1% and, finally, Stage 3 at 63.3%.

On the liquidity side, although that our headline LDR at 103.7%, nevertheless our regulatory LDR stand at 87.8%, which is in line of our comfort zone that we are targeting of 86% to 88% range. The other liquidity ratios are at a very comfortable level, above the regulatory minimum requirement.

On the capital side, our total RWA stands at SAR 505 billion, an almost 13% year on year increase but mainly driven by the credit RWA which is a function of the financing book growth on a year to year basis. It is worth to highlight that RWA density for Q1 stands at 65.1%, which is considered one of the lowest levels we have ever seen over the last few quarters.

Our CET1 stands at 16.5%, an almost 50 basis point contraction compared to the year end, while our Tier 1 at 19.7%, 54 basis points lower, and, as you can see on the bottom right-hand side of the chart, the 54 basis points attributed mainly from the dividend declared for 2022 which has been paid recently.

Our overall return matrices, despite the sequential drop, are still leading compared to some of the market averages. RORWA for Q1 stands at 3.31% versus Q4 at 3.60% as the average RWA has increased by 2.6% while the net income has dropped by 5.9%. On the ROE, Q4 was 21.6% while in Q1 it stands at 19.6%. ROA, 2.17% and Q4 was 2.34% for a similar reason that we have mentioned related to the RORWA.

Before we jump into the guidance, it might be worth spending a couple of minutes on our outlook for the remainder of the year. The macro outlook is still positive, given the recent changes by the IMF with the GDP printed for Q4 as well as further improvement in the consumer spending which has increased by 7.9% year on year and almost 1.7% on a sequential basis. Nevertheless, the mortgage growth expected to slow down taking into consideration the recent subsidy programme change, which has impacted the new origination. Nevertheless, the growth outlook for the non-retail book is still positive.

On the interest rate side, Fed is expected to hike tomorrow by close to 25 basis points. As Waleed mentioned earlier, the higher interest rate environment will weigh in on the credit demand for the remainder of the year taking into consideration the eligibility criteria, especially on the retail customers as well as the deposit mix where we have seen some kind of a CASA migration has already happened.

Taking that into consideration, we have updated our 2023 guidance to be as follows. On the financing book, we kept the guidance unchanged at the mid-single digit growth. On the NIM, we downgraded the guidance by 10 basis points to be in the range between 25 to 35 basis point contraction. The reason behind the NIM contraction is the following three main factors:

1. The mortgage origination expected to be slower than our initial forecast, taking into consideration the recent mortgage subsidy programme change.
2. The ex-mortgage of the retail book, especially in the personal finance, where we have seen a de-growth in the first quarter, we are expecting that de-growth to continue further over the coming period, taking into consideration the rate environment.
3. Finally, although that we have grown our CASA by 2.6% in the first quarter. Nevertheless, the expectation and we have seen already, that there has been a very competitive pressure on growing the CASA, which will impact further the deposit mix.

Nevertheless, as I mentioned earlier, the NIM trajectory is flattish in Q2 but with an expansion in Q3 with a further even expansion in Q4. However, if you look at it from a long-term perspective, 2023 will be marked the last year of a NIM contraction on a year to year basis. We are expecting from 2024 and beyond a NIM expansion on a year to year basis. The NIM revision will definitely have an impact on the NII, which subsequently led us to revise our cost to income ratio to be below 27%. Also, our ROE to be above 20% while we kept the cost of risk and the Tier 1 ratio unchanged.

Waleed, back to you.

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

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

QUESTION AND ANSWER SECTION

Operator: Thank you. If you would like to ask a question and have joined us on Webex, please use the raise hand icon found on your Webex tool bar. If you have joined us on the phone, please press star followed by one on your telephone keypad. Our first question comes from Waleed Mohsin from Goldman Sachs. Please go ahead, your line is open. Please proceed with your question.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Thank you very much for the presentation. Three quick questions from my side, please. First question is on the funding side. We have seen with the Central Bank data that there has been around SAR 100 billion of deposit inflows, so wanted to get your sense on how you think this will help the liquidity situation in the market and perhaps reduce the cost of funding. That is the first one.

Secondly, on the lending side, thank you for the clarification regarding the impact of rates on the retail side of lending. However, if we back out the SAR 5 billion that you sold to SRC, you still had a pretty healthy loan growth of 2.5%, much of which is coming from the corporate side, the SME and also mortgages are still growing despite the change in the subsidy programme. So, I wanted to explore the upside risk to your guidance that you put out, which is mid-single digit, especially coming from, let's say, corporate/SME side of things. So, that's the second one.

Third and final question, given the rates and the impact on retail borrowing and also, obviously, on the corporate side, are you seeing any signs of stress on the borrowers? Obviously, your cost to risk is quite low, you are very well covered but you also mention that there is a pick-up in the ECL charge on the retail side. So, just wanted to get your sense on if you are seeing any signs of stress on the corporate portfolios, whether it is on the corporate side or on the retail side. Thank you.

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

Waleed, just on your first comment, you referred to SAMA liquidity. Could you elaborate more on which one is it?

Waleed Mohsin
Managing Director, Goldman Sachs

Q

No, I just meant the deposit inflow, I was saying that as per the Central Bank data we see that during the quarter, there was around SAR 100 billion of deposit origination and much of it is coming from the government sector. So, just wanted to get your thoughts on if this is going to help liquidity during the second half of the year.

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

Waleed, thank you for your question. This is Abdulrahman Al-Ajaji. I will touch base on the first question. What we have seen from SAMA perspective, and I believe we have mentioned this in the previous quarter and the quarter before, is that SAMA has extended their support from a short-term point of view by extending the term repo up to three months and that is what we have seen so far during the quarter.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I would like to add to my colleague, probably for the first time since many quarters we've seen the overall customer deposits have increased more than the loan portfolio. In Q1, our total customer deposits have increased by 4.6% while the loan portfolio has increased by close to 2.6%. We are encouraged by that trend, and it is safe to say only one quarter. We need to see how that will progress over the year but it is a very encouraging sign. We have seen the SIBOR/LIBOR differential narrowed to probably around 30/35 basis points but, again, that is a trend is yet to monitor over the course of the year.

On the guidance of the financing portfolio, if you recall, in the Q4 earnings call we mentioned that the financing book guidance is mid-single digit growth, and we have modelled in securitisation. Securitisation was announced in the first quarter, which is around SAR 5 billion, and it is like to like from the previous guidance to the current guidance. That's number one.

Nevertheless, if you recall also in Q4 and through different communications with the market, we are focussing on the value rather than volume. For the retail book, our growth for the first quarter was almost flat on a percentage basis. It is almost an absolute, which is only SAR 500 million. The market overall growth on the retail book was close to around 1.5%. So, our focus for this year is more of a value rather than volume.

Final comment, over the data since 2010 we have looked at the financing data over the last 13 years. Q1 is, I would say, the highest financing book from a seasonality perspective. Q1 is, on average, around 3.1% followed by Q2, which is around 2.7% with a declining growth over the second half. So, I think that needs to be taken into consideration, Waleed.

On the cost of risk or any expectation on any further inflow, taking into consideration the rate environment, first of all, on the retail book the answer is no as it is fixed rate, so EMI has already been calculated. That's number one. Second, we have not changed our risk appetite. The majority of our customer base still are government-related employees plus salary assigned, so the major risk is the customer losing his job. So, we haven't seen that and we're not expecting any material change on the retail book over the course of the year.

On the corporate side during last year and in the second half specifically, we have updated our retail ECL model and we have decided to take into consideration the macro outlook. Although we could further update our corporate ECL model last year, nevertheless we decided to wait and do our stress analysis on our corporate exposure, especially in the highly leveraged customer, and once we were comfortable with that we have updated our ECL model.

So, overall cost of risk for Q1 is around 25 basis points. The guidance for 2023 in cost of risk is in the range between 30 to 40 basis points.

Waleed Mohsin
Managing Director, Goldman Sachs

Q

Thank you very much. That's very clear. Thank you.

Shabbir Malik
EFG-Hermes, Banks Analyst

Q

I have two questions. I just wanted to understand that if your revenue momentum improves let us say, in 2024, would you consider rebuilding your NPL coverage or it's going to be more driven by your ECL model and the macroeconomic backdrop? That is my first question. My second question is your retail book, especially the mortgage book which is fixed rate but as interest rates, let's assume if they start declining in 2024, is there a risk that customers may look to refinance at lower rates or other banks may look to acquire portfolio at a lower rate? So, is that the competition on that book? Could that potentially increase if rates start to decline? Any thoughts on that would be useful as well. Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Shabbir, regarding our NPL coverage, mainly there are two parameters to calculate the NPL coverage. Number one is the absolute level of the NPL and the second is on how much an ECL stock that we are having. On the NPL formation, we have mentioned earlier when addressed Waleed's first question, that on the retail we are not expecting any material NPL formation. On corporate, we have done our stress testing analysis and to some extent, we are quite comfortable. It is mainly driven by the ECL model, taking into consideration the macro outlook, given that we have seen a better macro outlook over the last few years, taking into consideration the transformational changes that have happened due to the 2030 Vision.

On the second part of the question, I will break it down into two parts. One is on the mortgage and one is onto the ex-mortgage of the retail book. On the mortgage, if you recall at the beginning of last year, REDF allowed the mortgage buyout and, if you recall, some of the analysts considered that one of the major risks for Al Rajhi Bank. Over the course from Q1 last year since the change has happened until today, we have not seen that material or actually very minimal cases. The reason is probably, we discussed that earlier specifically with you Shabbir, related to a certain segment, for example, it is not applicable to the self-construction along with other multiple criteria. So, we haven't seen any kind of a risk into that repricing that is happening so far.

Onto the personal finance, definitely, it is risk. As and when the rates decline, we are expecting further competitive pressure into the retail lending, especially in the personal finance. Nevertheless, from our perspective, given that we have the biggest market share on the retail, we do have all the tools as and when we believe that it is required to be able to defend. However from our perspective let me retreat, 2023 is more of value rather than volume. In 2024 and beyond, we will see the macro outlook and the interest rate environment.

Mohammed Al-Rasheed
Ashmore Group, Equity Research Analyst

Q

Mortgage figures during the month of March came at around SAR 7.2 billion. If we compare it to Feb, which was relatively flat, taking into consideration the new reduced government subsidy, I would say it is positively surprising. So, I would like to know your view on this. Do you think that this level might continue for the remainder of the year? My second question is just a confirmation regarding your guidance, specifically your ROE guidance. Is this after or before deducting Tier 1 Sukuk expense? Thank you.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Mohammed, related to your question on the mortgage, yes, we've seen March mortgage origination were almost flattish compared to February. Nevertheless, the changes were implemented since 19 February. So, I think that is still unclear but I will be frank, the changes into the mortgage subsidy are material, and our expectation is still that the growth will be lower than our initial forecast at the beginning of the year.

Also, SAMA data does not differentiate between REDF and non-REDF, which we haven't seen the result yet. It is wait and see but if you ask my humble opinion, we believe that the mortgage origination over the next few quarters will be definitely in our opinion, lower than Q1 mortgage origination. Mortgage origination in Q1 was close to around SAR 22.8 billion, which is almost 1% lower on a sequential basis.

Related on the ROE, it is in line of the previous treatment, which is adjusted for Tier 1 Sukuk cost.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

The operating expense seems to be quite well managed and in an inflationary environment, that is quite well. It is relatively better than most of your peers. So, I just want to know how sustainable is the operating expense and this kind of cost to income ratio. That is my question, yes.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On the OpEx, both Waleed and myself have mentioned several times that one of the main initiatives of the Bank is to improve our return matrices and we kicked off multiple initiatives back in 2020 to optimise our cost. Also, we have further improved our cost to income ratio in Q1 to be almost 26.5% versus pre-2020 which ranged between 30% to 33%.

Although our OpEx have been increasing close to around 6% on a CAGR basis over the last few years, nevertheless, the focus was delivering positive jaws between operating income growth versus operating expense. We are not shying away from investing as long as we are finding the right value and further improvement in our cost to income ratio.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

Just one more quick one. I think in the past you have also answered this, but the mortgage loan, so whenever you disburse a mortgage loan, is it in one shot or sometimes the loan is spread over the construction period?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

On the mortgage, depending on the type of product. For the Ready Unit, it's one shot. For the self-construction in line of REDF, it is almost in five tranches. For the off-plan, it will be disbursed after the real estate developer deliver the unit to the customer. So, it varies from product to product.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

So, the latter two categories, will it be a smaller part or a bigger part? I mean the self-constructed?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

I would say it varies from bank to bank but from our perspective unfortunately, that is not disclosed information and I think what we would disclose is that we have already focussed to improve further our mortgage market share accordingly.

Chiro Ghosh
VP, Financial Institutions Research, SICO

Q

That is it from my side. Thank you very much.

Farid Aliani
Security Analyst, SMBC

Q

Couple of questions around your cost of funding. The first question is has the momentum in the increase in the cost of funding, especially in the first quarter, is this something that actually surprised your expectations when your guidance was last communicated, the actuals came out substantially higher than what you were even expecting or is it something that is broadly in line with your plans?

And my second question would be, would it be fair to assume that the cost of funding that we saw in the first quarter is more or less there it will peak out and it would be fair to assume that no substantial increase should be expected going into the next three quarters, because the overall SIBOR we see at a peak level right now, closer to the peak level?

And, finally, around NIM, how do you expect the quantum of the NIM recovery to pan out over the medium term, especially in relation to your exit NIM for the year 2019 when your NIM was at the peak. So, these are my couple of questions.

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

So on the cost of funds, the cost of funds for Q1 were around 213 basis points compared to Q4 exit rate of around 172 basis points. So, the movements are in line with our expectations. That's number one. The point that you have mentioned is very valid and I think it will give me a further good entry point to the second part of your question.

We have mentioned earlier for a retail bank, usually the asset yield repricing will take longer than the corporate bank. From our perspective, we have seen the pick-up into the gross yield. As I mentioned earlier, for 2022 the improvement in our gross yield was 9 basis points. In the first quarter we expanded by almost 16 basis points and we are expecting that momentum to continue. Nevertheless, on the progression of the cost of funds, there will be a slight pick-up but the delta between the growth in the asset yield versus the cost of funds will further improve into the second half. So, on the second half of this year we are getting the benefit from two sides, the expansion in the gross yield as well as the stabilising on cost of funding.

The last question related to the NIM. The peak in our NIM was in 2019. It was 5.19%. If you recall, the cost of funds in those days were only 6 basis points. So, the gross yield is around 5.25% in 2019. So far, as I mentioned, gross yield for Q1 is 5.14%. We are not far away. The real impact is on the cost of funds. Given the rate environment where in 2019 SIBOR were close to average, if I recall, close to 70/80 basis points versus a Q1 average of almost 540 basis points. Plus, in 2019 time deposits were only, if I recall, close to SAR 20 billion. Currently we are almost SAR 170 billion. So, those two factors need to be taken into consideration.

Farid Aliani
Security Analyst, SMBC

Q

Sure. Thank you so much for this insight.

Nauman Khan
Vice President Equity Research, SNB

Q

…clarity on the deposit trends as well. I think it was asked earlier as well, that overall I think deposits, on a Q-on-Q basis, in Q1 was increased by about SAR 105 billion for the industry. And I think what we have seen across the other results has been that there has been a substantial pick-up of deposits by other banks, excluding Al Rajhi. I think Al Rajhi was the only bank that I have seen an attrition on the reduction in the deposit base on a Q-on-Q basis as well. I just wanted a bit of clarity on the deviation of trends that was largely with the other banks, if you had any thoughts on why there were these diversions and do you think this will continue going forward as well?

Abdulrahman Alajaji
General Manager Treasury Group, Al-Rajhi Bank

A

This is Abdulrahman Al-Ajaji, by the way. If you look at the banking system total deposits, there has been a growth of 4.6%, and if we look at the demand deposits, it has recorded a 2% growth. However, we at Al Rajhi, we show the growth in demand deposits by 2.6% which, as mentioned by the CFO, is higher than the market and we were able to increase our market share. Now, the drop in the Bank's customer deposits was driven by a reduction in time deposits, however it was offsetted by an increase in wholesale funding as part of our cost of funds management.

Nauman Khan
Vice President Equity Research, SNB

Q

So, is it safe to assume that you will be forgoing…? Because at the end of the day the liquidity profile of other banks have substantially improved versus yours as well. So, do you think that will impact the market share going forward? Because I think your liquidity continues to remain slightly on the tighter side whereas other banks have actually improved a lot on the liquidity side. So, do you think that may have an impact on the market and your change strategy as well?

Abdulrahman Alfadda
Chief Financial Officer, Al-Rajhi Bank

A

Sorry, let me clarify to what my colleague also mentioned to address your question. When you say that there is a deviation from the market, if you look at the slide that shows the movement in our customer deposits, yes, I agree that there has been a close to around 8 billion reduction of our total customer deposits. Nevertheless, if you look at the breakdown, our CASA have increased by 2.6%, which increased the market share by around 10 basis points, which is a very positive trend. We have shed some of the time deposits in order to reduce the dependency on the customer time deposits and focus into the other funding profile. If you recall, Al Rajhi Bank in 2022 issued a couple of tranches on our Tier 1 Sukuk. We have also tapped in the dollar syndicated market into the second half of last year.Recently we have issued a USD 1 billion senior unsecured five-year at a very competitive spread. So, overall to some extent the comment that you've mentioned that our liquidity position is different or might deteriorate compared to the market, I would maybe slightly disagree with the statement. We will do whatever it takes from our perspective in order to manage our cost of funds efficiently to further improve the profitability over the medium term.

Nauman Khan
Vice President Equity Research, SNB

A

Thank you that will suffice. I think you answered the question very well. Thank you.

Operator:

This completes the Q&A session. If you do have any further questions, please direct these to the Investor Relations team. I will now hand back to MD and CEO, Waleed Al-Mogbel, for any closing remarks. Please go ahead.

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

Thank you everyone for dialling in and for your trust in us. We look forward to meeting you in the next quarter earnings call. Thanks.