Alinma Bank Q4-21 Earnings Conference Webcast Transcript **Wednesday, 16 February 2022**

Ribal Hachem: Hello, everyone, and thank you for joining us today. This is Ribal Hachem. And on behalf of Arqaam Capital, I'm pleased to welcome you to Alinma Bank Q4-21, earnings. With us today from Alinma Bank, Mr. Abdullah Ali Al Khalifa, CEO, Mr. Adel Saleh Abalkhail, CFO, Saleh Abdullah Al-Zamie, Senior VP and Head of Retail and Digital Banking and, Mr. Ahmed Sager, IR Manager. Now, without any further delay, I will turn over the call to the CEO, Mr. Abdullah Ali Al Khalifa. Mr. Abdullah.

Mr Abdullah Ali Al Khalifa, CEO: Hello, everyone. Welcome to our Q4 earnings call. I believe the earnings call presentation was sent to you earlier. So basically, in page four, is just to give you a glance on the digital snapshot of the bank, the market share, financial position and further information about the stock highlights. So I think it's worth mentioning that our stock is actually very liquid. It's the second highest traded in the market. Foreign ownership reached 14.21. In fact, yesterday, it increased to 14.26. So we have a very healthy habitat from our institutional investors overseas. If I start on page six on the financial performance, later on our CFO, Al Zamie, will give you detail presentation on the financial performance of the year. However, we had a 14% increase in our financing. 11% in our assets. Our operating income increased by 17%. Net income by 38%.

Our NPL Ratio reduced to 1.75 and our coverage ratio increased to 177%. What we did during the year is we have succeeded very well in growing our CASA deposits by 14%. And we managed to reduce, especially after also issuing the Sukuk, our time deposits, and that's what diluted the growth of customer deposit to only 1%, but the real success was growing our CASA by 14%, which now present close to 66% of top customer deposits. Cost income reduced to 35.5%.

Our NIMs reduced by 19bps to reach 342bps. And later on, we'll give the guidance. I believe this is now the bottom of that. And we expect improvement next year and our capital adequacy ratio on Sukuk is now 22.8%. If I direct you to page 11 and we talk. I'll just remind you on a high level about our strategy, basically being the youngest bank hence the most modern IT infrastructure, we want to leverage that by being the fastest and the most convenient bank in the country, especially in light of the high percentage of youth in this country who have strong penetrations, smartphones, and very much used to applications.

So, being the fastest and being the most convenient bank is very critical for us. We want to be the best service provider in the country in financials. And that's why we said we want to be number one in net promoter scores. And of course, we want to be the first employer of choice to attract the right talents. If you look at the left side, you'll find that we are actually compliant. We want to continue to be fully Sharia compliant. Digital is very critical for us to reach these goals that I mentioned before. In terms of retail, we want to be the most digitally advanced, fastest, and the most convenient bank and the best service provider in the country. In terms of corporates, we want to have the best customer experience with the shortest turnaround time. I'll talk later in more details on those ones. And for treasury, we want to be the most innovative, of course, Sharia compliant treasury in the country.

The next page gives you more details on our strategy. And by the way, the strategy actually translates into 66 initiatives. Originally, it was 63, we added more so now 66 initiatives. So in bank wide, we want to build a digital

factory there. I told you about the importance of investing in digital to reach these goals. So digital factory is a critical component of our strategy. We have a huge amount of data internally. In addition to getting data from external resources, we want to utilize that and leverage it to drive most of our decisions. Culture transformation is very important to become the employer of choice.

In retail, in addition to many other initiatives, the main focus would be on developing the affluent and high network in the segments. We want to focus a lot on the youth. And we'll talk specifically about what we've done so far on the youth. Youth is not just aspiration. We're taking solid action by introducing a separate app, considerate it as a digital bank in a way, but another channel with different brand and different features. And that's why I want to be number one in the promoter score.

In corporate, as I probably mentioned in my previous earning call, the bank initially would really focus on fast growth and the attention was given to the large corporates. Mid corporates was not really there nor do we actually cross-sell other products. We're very good in providing financing, but we were not focused on serving all segments as well as cross-selling and getting a better value from our relationship with our customers.

We want to develop high quality also, and more sort of sizable SME business. And we want to grow cash and trade finances. In terms of the treasury, we want to be the core partner for our corporate clients to protect themselves from interest risk and effects risk. We want to obviously leverage and increase in our relationship and finally maintain high quality element. So what we have, this is just high level and on page ten, shows you what we have achieved during the year. We were actually planning to finalize 21 initiatives out of the 66, and we end up the year finishing 23 initiatives. So we had done two more than what we planned for.

So digital factory, as I mentioned before, in my previous earning call, we got the right partner through IT model, resources on the ground. We've hired resources from third parties and as well as we have full term employees. We hired a chief digital officer for the first time. And we enrich the capability of the digital team by adding more talented and more experienced employees. We've achieved at least 41% of our IT projects done through an agile way. We delivered eight advanced analytics cases. We launched a woman empowerment office within HC and basically increased women workforce from 13% at the beginning of the year to 16%. And we've grown still further.

In retail, we basically set up a new private banking business units. We've hired an experienced private banker officer. We've enriched the number of RMs. We cut the time for personal finance by 50%. We reduced the turnaround time on mortgage to be 9%. I believe that's the best in the market so far. We've developed or installed 70 digital zones in all our branches, 70 branches. And hopefully we’ll finalize all branches to have the digital zone by middle of this year. We're focused on driving sales, through specific targets, through follow-ups, through dashboards, balance scorecards for different targets. We launched Revolving credit card, and we also launched Instant Personal Finance product. And this is just examples, by the way, just so you can see the numbers there and how much progress we've done and others.

In corporate, we reduced the turnaround time as I mentioned on the credit approval, by 30%. We've introduced three tracks for credit approval, fast track accelerated truck, and normal truck, depending on the size, depending on the profile of the customers to really accelerate the process. We established a mid-corporate team in the country. We are building their resources in different regions. We've increased our SME portfolio with Kafalah, for example, by 64%. PoS financing by 160%. We created now Global Transaction Banking as a really profitable business unit. Before, it was fragmented in different area in the bank. Now, it's centralized. We have product owner for every product that we have.

In treasury, we've diversified the funding by issuing the SAR 5 billion Sukuk. We've increased investment to improve our FX offering. And we expanded the number of FI partners. And we are in the process of implementing treasury system that expected to go live before the end of the year. On page 11, we give you some more details about what we expect to focus on during this year. So we want to accelerate now, we have the digital factory team on place. We have chief digital officer. We have a team built, we want to accelerate the digitalization process. Hopefully, among the deliverables this year will be the new youth app that we talked about. We want to add more advanced analytics cases. I want to actually work towards establishing advanced analytics center of excellence, improve the engagement of our employees and the health of the organization, and continue to increase on the women participation in the workforce.

In retail, we want to continue to design exclusive private and affluent experience programs. We are building three private banking and branches in the country, which will be open this year. We try to enhance the family account by building ecosystem around it. Digital investments on savings products, for example, is very important. Especially now that you've seen how much cyber have increased. I think the proper focus on saving is the right strategy to do. We want to obviously strengthen the acquisition in terms of through partnership. The universities, I believe some are head of retail and digital is already in the region, talking to some other universities there. We want to continue our digital journey in terms of cross selling products.

In corporate, as I mentioned, we set up the mid corporate team, but we want to add more people in different regions to basically have a better coverage in mid-corporates through the whole country. We want to revamp the customer position. We want to be lead manager in a lot of these project finance. We're going to continue to add more program-based lending in SMEs and obviously some tech enabled tools that will help the RMs in terms of servicing and acquire a cross selling product.

Treasury, hopefully, as I said, we'll deliver the system this year, which allow us to go much more creative in terms of offering more products to our corporate customers. We want to improve the cross selling. By the way, on the cross sell, there is a weekly committee and I know that's excessive, but I think you must have this to improve the culture of cross sell and make it sort of a daily business. And I think after a while, maybe we'll cut on this meeting because it'll involve all the businesses on a weekly basis, but it's very important to do this at the beginning.

I want to incentivize obviously CASA growth and enhance saving and investment products. So that's just a snapshot

of the sort of delivery strategy as well as the focus for this year. And with that, I give the floor to our CFO to take you through the detailed presentation on 2021 performance.

Mr. Adel Saleh Abalkhail: Thank you. Very good afternoon, everybody. And welcome again to our Q4, 2021, earning call. I'll be glad to run you through the financial performance with Q4. And following that, I'll be also presenting our first guidance for 2022 financial year. So in the first slide, number 13 on the balance sheet, we have seen solid growth in the balance sheet. In total assets, 11%. We have growth in investments, 13% and also financing portfolio has grown 14%. And you'll see more details on this in the upcoming slides.

Also, total liability is 8%, mainly driven by 7.9 billion growth in the interbank and we see moderate growth in customer deposits as the CEO mentioned earlier that is mainly based time deposits that left the bank during the year. But it will compare to the growth in CASA, there was 14% growth as we will see later. In the second slide on the P&L, we've seen 38% growth in the net profit after the cut. This is mainly driven by 17% growth in the total operating income. So as we can see from the growth in the top right hand, funded income, we've seen the growth year on year 11%, 48%, growth in the non-funded income. This is basically offset by 14% growth in the operating expenses, and also have the profits also 11% less provision charges taken during 2021 in comparison to 2020.

And the next slide, on the financing, little bit deep dive into the financing portfolio. So we have seen 14% growth year on year. As you can see from the top right hand graph, 23% growth in the home financing. We have seen also 9% growth in personal and retail financing. We've also continuing to see strong growth in corporate, 13%, year on year. And also another good growth in SME, 13%, year on year. As you can see from the bottom left graph, the composition of the financing, non-retail, remains a big portion, 79% of the overall financing versus 21% retail. So we can see as of December, 2021, corporate represents 75%, 3% on SME financing and 11% on home financing, which is basically 50% of the overall retail portfolio, and 11% on the personal financing.
On the next slide, a bit more details on the deposits. And as we mentioned earlier, 1% growth year on year, but this basically has been impacted by 16% reduction by 8 billion on time deposits while we have seen very good growth in CASA, year on year, 14%. So this is healthy growth in the deposit, even though it's 1%, mainly coming from CASA growth to 14%. As you can see in the center of the slide, based on the growth of 14% on CASA, we have seen the CASA composition from the overall deposits as of December representing 65.8%. As mentioned by CEO earlier, this is up from the 58.7% back in December of 2020. So we are seeing CASA growing as a percentage of total deposit. Of course, the time deposit reduction has helped on that as well. And the composition in the bottom left graph in the customer deposit composition, the retailed deposits represent proportion, of course,

from the deposit 68% versus 32%.

In the next slide, to touch on the income from financing and investment. So we have seen 4% growth in the gross financing income year on year. As mentioned earlier, 11% in growth year on year, in the funded income. But the main story here is on the graph in the center of the slide on the net profit margin. Maybe it seemed like in Q3, an increase in net profit margin. And then in Q4, there was a slight reduction there. Just if you recall, in Q3, we had

talked about the one-offs that were booked in Q3. So Q3 basically, there were 30 basis points, one-offs additions to the top line, which has impacted the YTD net profit margin. 30 basis point again for Q3 was, 20 basis points really was relating to some of value benefits that were booked at that time. And also, three basis points were relating to lower modification losses booked in Q3 versus the previous quarter.

Now, looking at Q4, Q4 standalone net profit margin is 3.49%. This is impacted by also seven basis points negative in Q4 that relates to one-offs related to refunds done as the central bank directions for some fees that were collected during the period where fees from customers, banks were supposed to waive, but it is being re-funded during Q4. So this is an impact of seven basis point. So in general, if we look at the funded income, if we look at the average side of during 2021 versus 2020, there was a deduction of 37 basis points. But with all of that, with better managing the funding cost, as we mentioned before, we had lower time deposit, and also we have a good growth and average interest earning assets by 17%. This all helped to have the contraction to be only 19 basis points as of December.

In the next slide for the non-funded income, we've seen good growth, 48% as mentioned, mainly driven by more than double gains in investments and also dividend income. Plus also we have seen 16% growth in fees from banking services and slightly less than last year on exchange income. So in the bottom left graph, fees form banking services, just to give an idea on the composition, this portion 53% is in fund management and other fees with card services related fees represent 25% and brokerage fees represent 11% and also trade related fees is 11%. On the next slide we have the operating expenses. On the operating expenses, we have seen 14% year on year growth. If you can remember the cost to income ratio in Q3, we had reported 33.7. And on a sequential basis, we have an increase 11% from Q3 in the Op-Ex, operating expenses.

And basically as an amount we can just touch upon this point, you might have seen an increase in Q4 expenses around 60 million increase in expenses. Half of that basically relates to an annual adjustment that we have to do to reflect the actual recoverability rate for VAT, value added taxes. Because as with the law, you'll always need tax regulation. You cannot reflect the actual recovery rate for the period until the end of the financial year. So this is an annual adjustment as one that we have to take in Q4. The other increase also related, as you know, with the transformation within the bank and in our movement to centralize the operation. Unfortunately, within this process, there were some back-dated invoices that has been missed for accrued, and we had to take them as expenses during Q4. So in the center of the slide, as you can see the cost income ratio remain lower than the 2020 year end position, but it's higher than Q3. Again, we have seen a 4% in quarter reduction and also the increase in 11% on the Op-Ex.
In the next slide, the impairments from financing was less than the provision charge than what has been taken, 2020. We have seen 4% growth in a sequential basis from Q3. But overall, if you can see in the top left graph, the cost of risk has gone down to 1.02% all the way from 1.3% that was reported in December. On the NPL and asset quality, we have seen again a reduction in the NPL as an amount. And also if you look at the NPL ratio, it has decreased to 1.75%. And basically this is a combination of both. We have seen as we mentioned before or 4% growth in the financing portfolio on a sequential basis from Q3. But also there were a right of exercise that was taken place in Q4.

So this further improve the NPL coverage ratio. We are at 177.1% as a coverage ratio up from 114.5% December last year. So stage wise coverages, as you can see, the stage one remains flat, but you can see some reduction to stage three. And basically this is because new NIMs that went out of the stages had higher provision than those in your accounts that's been migrated. And of course, savings account the collateral coverage is this and so on.

In the last slide, in the capitalization, the bank remains well capitalized as remember the Sukuk issuance took place July 1st. So the CAR ratios stand at 22.8%, tier 1, 21.6%, and CET1 stand at 18.2%. In the top right hand graph, the ROAA has improved to 1.6% from 1.4. And ROAE has reached 10.8% as of December. It's an improvement from 8.4% in December last year. So the bottom of the slide, you see the liquidity and regulatory requirements, our ratio is looking healthy. We're talking about LCR stands at 134.1% well above the regulatory minimum. The long depository ratio is 85.8% below the regulatory maximum. And again, as we always mentioned, this calculation of LDR, is not the simple division between of loans over deposits. There is certain way to be given for certain deposits, given the maturity to get to this ratio. But this is the regulatory required ratio based on Central Bank guidelines. And NSFR stands at 11.7%. Again, we're above the regulatory minimum.

So, on the Outlook and Guidance for 2022, and this is the first guidance we are given, and this will be updated as we go along in 2022. So in the first item in the balance sheet, the financing growth, the actual growth as mentioned was 14% and given the expected growth in corporate, along with mid corporate, as we mentioned, part of this strategy and also SMEs along with the expected growth in retail, our guidance for 2022 is mid-teens for financing growth. Talking about net profit margin, the actual is 3.42 with expectations of interest rates going up, and also the strong funding mix that would support the net profit margins. Our guidance for 2022 is 10 basis points to 15 basis points increase.

Cost income ratio is reported 55.5%. The expected growth during 2022 with the income, along with the digitalization of many processes, along with the efficiency, partly offset actually by expected strategy investment. So our guidance for cost income ratio for 2022 is below 35%. Return and equity stand at 10.8%. With expectation and improvement, mid profit margin, and also again, the expectation and cost of risk levels, which is the second next guidance, we expect ROE to other guidance above 13%.

Cost of risk stands as 1.02. We're cautiously expecting stable credit quality, and also the NPL coverage. We expect cost of risk as a guidance for 2022. Our guidance is 65 to 75 basis points. So our guidance for common equity tier one as of 2021 is 18.2. Obviously, the increasing risk weight of assets that, that's resulting from expected strong growth in financing. Our guidance from common equity tier one is between 16 to 17%. So with that, I think end of the presentation, and I think of now for the Q&A.

Melissa: Perfect. Thank you. If you would like to ask a question, please press star followed by one on your telephone keypad or the flag icon if you joined online. If you do change your mind, that will be star followed by two. We'll now pause briefly to allow for questions to be registered. We'll take our first question today from Adnan Farooq of Jadwa Investments. Adnan, please go ahead.

Adnan Farooq: Thank you for the opportunity and thank you for the presentation. I have like three questions. One is just a clarification. You mentioned fourth quarter expenses went up in regards of that and some backdated invoices. How much of that can be considered one off? If it's possible to narrow it down to a number, that would be very helpful. Secondly, if you could give some guidance on non-funded income, last year, the bank realize some gains from investments. Given that rates are going up and a large portion of the investment focus is fixed rate. Do you expect such gains in 2022 opportunistic gains or would that be more or less muted?

And the third question is regarding the balance sheet growth. I asked Mr. Abdullah last time around as well. The competition in the market is extremely strong, even in corporate and in retail. In retail, we see banks saying free personal finance, if you take mortgage with us, switch your bank. We are at the lower rate for personal finance and the rates are extremely low especially given interest rates are now going up. If this competition continues, would you change your growth trajectory or will you compete on pricing with other banks as we see in the market? Thank you so much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you. Thank you for the question. So I'll take the first question. So in the first question, we'll talk about the operating expenses increase in Q4. As I mentioned, the amount of increase between the quarters in the total Op-Ex is around 60 million. Half of that would relate to the VAT that I mentioned. We were talking about around 25 million of the remaining related to some expenses that were missed across. That's the response to the first question.

And the third point about balance sheet growth, obviously that competition, especially on the personal finance is obviously still there, which we're trying to differentiate ourselves by the customer experience, the turnaround time, the focus sales, the convenience of getting the product. All this is one we are working on. We're not in the price floor. I think what we did in 2020, still in 2021, staying away from matching these ridiculous prices that we've seen is absolutely the right strategy.

Three months SAIBOR, now stands at 127 basis points. This is increasing very, very fast nowadays. It used to be a fraction of basis point, day on day. Yesterday, it was like nine basis point difference between today and yesterday. So I think that's the right strategy that staying away from being extremely low priced. And I think in terms of ompetition in the corporate, my own assessment, seeing how much is the funding cost increasing, seeing how much banks are paid over and above SAIBOR to good deposits, what we hear in the market from our treasury dealers, I think it's clearly I expect that competition and pricing in corporate to die down significantly. On mortgage, I think the pricing is pretty much similar, but the mortgage for us is actually the turnaround time. As I mentioned, nine days, I think that's the best in the market. That's how we differentiate ourselves. I think the second point was relating to... Which one? Sorry, I missed your second point.

Mr. Adel Saleh Abalkhail: Competition.

Mr Abdullah Ali Al Khalifa, CEO: Competition.

Adnan Farooq: It's related to non-funded income.

Mr. Adel Saleh Abalkhail: Yeah. Okay. He's asking about the question. We're saying here, the gains, most of the-
Adnan Farooq: The non-funded income.

Mr Abdullah Ali Al Khalifa, CEO: Non-funded income includes, the portion is relating to the gains and investments. As you can see last year, with the drop in net asset values, these basically are not really fixed income, but most of it's mutual funds that is owned either by the bank itself or in our investment and with the improvement on the net asset values to the after market as these investments through the income statement. So, as long as the improvement in that as we go along, that will still be going to be booked and the deduction in that will be of course channeled to the income statement as well.

Adnan Farooq: Thank you so much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you.

Melissa: Thank you, Adnan. We'll take our next question from Waleed Mohsin of Goldman Sachs. Waleed, please go ahead.

Waleed Mohsin: Yes, thank you much. Thank you for the presentation. Three questions for my side. First, let's start on loan growth. So you are one of the few banks which had a relatively similar kind of loan growth, both on your retail side and the corporate side. So when we think about your mid teams loan growth guidance for 2022, shall we expect a certain tilt towards a particular segment? I mean, you mentioned various areas where you focused on, but I just wanted to see your perspective, is retail going to outpace corporate growth, or you expect corporate growth to outpace the retail. And if you could, perhaps on this point also talk about early signs of any capital expenditure or corporate spending picking up. So, that's the first question.

Secondly, I wanted to get a clarification when you give your net interest margin guidance, how many rate hikes are you factoring in into that number? And then third and final question, when we look at your provision coverage, it's gone up nicely. Your stage two coverage is above 20% and at the end of what we see across the Gulf banks. Is it just prudent or are you monitoring certain sector which you're mindful of? Thank you very much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you, Waleed. On the long growth, obviously, as we can see from the presentation, 75% of the portfolio is corporate... So we say obviously, the main player for the overall long growth of mid-teens would be corporate. But to be honest with you on retail, we're expecting higher growth rate than the mid teens. But because we'll only represent so far 21% of the portfolio, even higher growth rate does not translate to higher growth rate on the whole portfolio.

On your second point about the NIMs, I think you mentioned what rate hikes we assumed when we did this business plan in December. We took the forward rate yield curve in our assessment. To be honest with you at that time, the assumptions was two to three rate heights. I believe the story changed significantly now. But as you know, Waleed, we will continue to update our guidance on a quarterly basis. So we see things differently.

I mean, I didn't really expect to see SAIBOR growing that fast so soon. I think some time ago in late September, we were almost been low 80 basis point. And now we're 127 basis points as of today. I mean, that is significant. Part of it is obviously, the shift to this SAIBOR, which represent the actual transaction with customers. Previously, SAIBOR is only the interbank transaction. Now, as you said before, we see banks paying a lot more on deposits. You state the other questions about our coverage. As you know, Waleed, when we started the year, last year, we were below market average in terms of coverage.

And we were really focused on making sure that we have very good coverage. Last time, we were aspiring to go above 150. Now, it's 177. That means obviously if you increase the coverage, you increase, obviously stage one. Stage one actually reduced, but because of the growth, the new loans only obviously attract a lot less cost of risk than the existing stage two or stage three. So the focus is obviously to improve the coverage is to improve also the coverage in stage two on stage three.

Waleed Mohsin: Got it. Very helpful. Just to confirm then. Then in terms of your NIM guidance that you said is based on December data. So obviously given where current rates are, there is upside risk to your net interest margin guidance.

Mr Abdullah Ali Al Khalifa, CEO: Yeah, easily, I would say now with this rate going so fast. Yes, of course. And your company issues the report about potentially seven rate types this year.

Waleed Mohsin: Yeah.

Mr Abdullah Ali Al Khalifa, CEO: For all the good news.

Waleed Mohsin: Indeed. Thank you so much, Abdullah. Thank you.

Mr Abdullah Ali Al Khalifa, CEO: Thank you, Waleed.

Melissa: Thank you. Waleed, we'll take our next question from Rahul Bajaj of City. Rahul, please go ahead.

Rahul Bajaj: Hi, thanks. This is Rahul from Citi. Thanks for taking my question. Two quick ones from my side. So first one is on capital and dividend policy. So I see that current CET is 18.2. You're guiding for 16 to 17% for this year, given higher RWA growth. I'm just trying to think maybe a couple of years down the line. And if we continue to see this kind of growth by the bank, just wanted to understand how you are thinking about maybe dividend payout ratio

or what kind of, I mean, capital preservation or capital buffer policy you could apply going forward. Because clearly 16 to 17 is not low, but as you move ahead in 2023, maybe, and it goes below 16 at the usual current growth rate, that is where I think you would start thinking maybe about your current dividend policy. That's my first question.

Rahul Bajaj: The second question is on the CI ratio guidance. Less than 35% is a bit, I would say, slightly vague because less than 35 could be anything to be honest with you. To what extent would cost be a lever? Or you think that the reduction in the cost to income ratio will come predominantly from the denominator, which is revenue increase with margins going up? Or you think there is levers on the cost aspect as well? Thank you.

Mr Abdullah Ali Al Khalifa, CEO: Thank you, Rahul. In terms, obviously on the capital, I've always mentioned that we need to really strike right balance between regulatory requirements being obviously well capitalized and also where the investors look at, which is the ROE. So obviously there's mid teen's growth, hopefully better dividend's distribution, the payout ratio. And especially now that hopefully, we're almost done with the COVID 19 issue as far as the sort of caution on dividend distribution. And that will continue to improve our efficiency of capital. In terms of cost to income ratio, obviously to me, it is always the best way to improve this. And the best option is obviously much faster growth on the top line versus the investments that you put on cost.
As you know, they grow in the top line sometimes or most of the time actually do require you to invest more. But you get much more return on investments by investing smartly. We had done an exercise, as I mentioned before in 2021, where we look at zero based spending exercise, how to identify it, significant saving on expenses. That significant saving obviously does not happen overnight. Some of it may take up to three years to achieve that investments, but we know the sort of road map required to have a better efficiency on the normal operating expenses.

On the other hand, we want to continue, as I mentioned in the presentation on the strategies, to enhance our capability in digital, our capability in of our employees, investing in training, hiring right resources, building teams in different areas. That also require some spending. So, I'm not going to say that we'll be reducing that expenses, but we're going to grow a faster growth on the top line versus the growth and expenses.

Rahul Bajaj: Thank you.

Melissa: Thank you, Rahul. We'll now move over to our next question, which is from Naman Khan of SMB capital. Naman, please go ahead.

Naman Khan: Thank you. I think a lot of my questions have been answered. Just a couple of things. One is the growth as they've talked about 10 to 15bps growth in the NIM guidance. And you've said that you factored in about two to three data hikes as well. Is there a cost pressure that you are foreseeing coming in as well as you said earlier? The cost that there is a competition to get new deposits. So how much is that a factor in your estimates? One.

The other thing again is you're guiding to a 65 to 75 basis point of cost of risk next year. How much will it be? And

the NPL cover ratio that you are looking at 177 previously guided to us about 150 to 155 range. So will you be targeting that range going forward? And lastly is the cost to income ratio, again, as you said earlier, that you'll be hiring new people, you'll be improving in your product source as well, and you talked about your digitalization drive as well. So I was just thinking, is it counterintuitive that you would be cost loading for the next two to three years before you actually start realizing the benefit of that rather than immediate? So these were my three questions.

Mr Abdullah Ali Al Khalifa, CEO: Okay. Thank you. I think your first point about the deposits or cost of deposits, because as you said, obviously, I mean, I'm not saying we live in different worlds. We are also competing in deposits, but we are more focused on driving the CASA. We had a very good story on growing the saving accounts, for example. We want to continue to drive this. We're acquiring more customers, especially on the affluent and private, which is helping the main sources of NIMs in the country. So, that will continue. Obviously, we already mentioned the guidance on the growth of loans in mid teens, whatever growth in NIMs, and we have significant target on the business on grow NIMs this year. However, there'll always going to be a need to take more deposit of time deposits. We want to now shift.

We try to encourage the shift to a longer duration time deposits because our forecast of interest rate is going up very fast. So if we can extend the duration of our liability, that will help us in terms of shielding some of the growth on this ones, on the interest rate. Your question about the cost to income ratio, as you know, we talked about it before. Investing, by the way, sometimes not necessarily investing for two years in order to see the benefit on year three. Some of the investments we've done already seen a good benefit of it. In 2021 things like, for example, when I mentioned, we set up a private bank department and we hire RMs, that's investments, right? And that's salaries and so on. But we've seen very good growth on number of customers on balances that come from those customers, on the business, the cross selling that we've done with those customers.

So there are examples where you invest and you get return on the same year. And I can give you multiple examples. I mean, even investing in digitalization. And in the back office, for example, the RPA process. You're investing, but the same time you're reducing expenses or the human capital and so on. But as I said, it's a process of building our capability in 2021. I would say 2022 will be another year of investing, but as well as we continue to reduce cost to income ratio, I believe, we're very successful in our journey. I think I missed the third question. It was what?

Naman Khan: The third question was regarding, towards the cost of risk of about 150 to 155 basis point. How much is the function do you think?

Mr Abdullah Ali Al Khalifa, CEO: Yeah, I've always believed that throughout the cycle, the normalized cost of it, in my view, as a banker for so long, it should have been in the 50 to 60 basis point. Normally, it may go down in certain years because of maybe sizeable recoveries. But typically, you should be prudent in terms of making sure that you have the protection, not just from capital on unexpected losses, but also potential expected losses. Do I target a certain coverage ratio? I said before, I need it to be above 150. Now, if the numbers go up to much higher than this,

I'm fine with it. I think we do have potentially some customers who may move from stage two to stage three, and which typically would require a lot more in terms of coverage than where it was in stage two.

Do we know these customers? We don't know, but we need to be prudent and expect it to have a normalized risk. I don't want to have this volatility on going... Because if you think about what's happening in the country, economic activities in terms of investment by the private sectors, in terms of price of oil, in terms of unemployment declining, they are all really very encouraging signals. You would expect that cost of risk go down, for all banks, but I think it's proven to keep a reasonable level of cost of risk.

Naman Khan: Thank you. I think that would be all from my side. Thank you.

Melissa: Thank you, Naman. We'll take our next question today from Mahmood Akbar of Value Capital Partners. Mahmood, please go ahead.

Mahmood Akbar: Thank you for taking my question and thank you for this presentation. My question relates to the 29.1 in the financial with the profit rate risk sensitivity analysis. In previous years, when you used to write when there's increase in the interest rate by 10 basis points, you will see a negative impact on the net income and also on the equity. But this year, it seems that that has been reversed. Just for me to understand, was there any change in assumptions or the way that you have been calculating the sensitivity of net income with respect to interest rates or was it a mistake in the previous years?

Mr Abdullah Ali Al Khalifa, CEO: Look, I do admit and I think definitely it was a mistake. As the bank who is reliant on corporate loans which are replaceable, when the interest rate goes up, of course, cost the funding will go up, but to a much lesser extent than the total impact on replacing your assets. It's been I think, before there was a mistake in that. I think we adjusted this year. Even if you look at 2020, that note we have adjusted. And that's how I explained it.

I mean, we do admit there was wrong numbers there. It didn't make sense for us to have a negative impact when rates goes up. If we are purely fixed rates assets or the bulk bar portfolio, significant size of our portfolio is not replaceable, then I would say yes. But in our case, we are able to replace 94% of our corporate laws. 94% of our corporate loans are replaceable within a year. And corporate loans makes up 79% of the old non-retail businesses, 79% of our portfolio. In the retail itself, there is a portion that is paid on a monthly basis, so you can argue that some of that maturity within a year can also reinvest it at a better rate.

Mahmood Akbar: Okay. Just a follow-up question on that. I mean, since you've mentioned like the last years of experience, there tends to be a narrative that when interest rate increases, it's going to be a very linear relationship. Interest rate increases, then we expand or we don't expand. But don't you think, historically over the past three to four decades, the demand deposits has been sensitive to large moves of the interest rates and the cost of risk was

very elevated when interest rates were high? So, looking at the averages of the last 10, 15 years, it may not be the best starting point. And that's it for me for today. Thank you very much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you. I think you're right. You have a good observation. Certainly in years, at least in my experience when I saw interest rate high, we always see a certain migration from non-interest bearing deposit into time deposits, but it's not very significant migration when you look at the whole market. Saudi Arabia though the interest rate cycle, non-interest bearing deposits, or CASA, obviously the Saudi banks historically didn't have much in terms of saving. So it was mainly current accounts.

But even with interest rates going higher, non interest, bearing deposits always make a sizeable portion of customer deposit compared to maybe other markets. The level of it obviously goes up when interest rate is very low and when interest rate goes to maybe 3, 4%, yes, the level is lower, but still a sizeable portion of the customer deposits. In terms of cost of risk or potential customer difficulties where interest rates is higher, yes, obviously depends on the business model or depends on the customer business. If their margin is very, very thin, then obviously 1% or 100 basis points in interest may be impacting them much more than a customer who has better margins. So certainly, there could be just customers who would do this.

Mahmood Akbar: Thank you, sir. Thank you very much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you.

Melissa: Thank you, Mahmood. We take our next question today from Edmund Christo of Bloomberg Intelligence. Edmund, over to you.

Edmund Christou: Thanks for the call today. First, thank you on updating the sensitivity notes 29.1, now it makes sense differently. Just looking at these first 10 basis point, if we try to calculate 25 basis point hike and then this rate, that will give us around 50 million. And that is around 3 to 4 basis point positive impact on your margin. Just looking at the other player in the market, this is probably at the lower end of the range. Just try to understand what is within the business makes you think that will get you on the lower end of the range in term of the interest rate hikes, and how can you maximize this going into this year? Just follow up on the same question is, when I look at your guidance, 10 to 15 basis point margin gain, so it seems to me that the 10 basis point is pricing and fully interest rate hike of 25 basis point each one.

And that will be consistent with your sensitivity on 29.1. So the 15 basis point, is it more rate hike or more CASA accumulation during the year? And the last one, I always appreciate your comment on the industry as whole. And when I look at the spread between the SAIBOR and the LIBOR, there's spikes in recent days. We are not back to the old days when we have a liquidity squeeze. But I just want to understand how we are going to fund this mid-teens credit growth in the industry and within your bank, in terms of the funding mix going into this year and the year after. Thank you.

Mr Abdullah Ali Al Khalifa, CEO: Thank you, Edmund. I think I would go back to point or note 29.1. I think the impact given was based on the timing, right? So they look at the existing portfolio saying, okay. A 10bps shift, when will it take effect? It's not a full year impact. I think when you're a typical analyst/investor, they say, what's a 25+ basis point impact on NIMs? That's really a full year impact. I think if you look at the cumulative gap, interest rate gaps, that we have in the same notes. Yeah, so the same note following the sensitivity, note 29.2, you'll see the overall commission sensitivity. So you'll see within a year, a positive yield sensitivity gap of around 60 billion. So this is maybe a different way to look at it on the other note where basically whatever you see as a 20 million is an impact of 10 basis points versus just a one time, but not taking the impact of time.

So holding everything equal as you know, actual maturity sometimes varies from what's been put in the bucketing there, but we are talking roughly keeping everything equal as we mention again, to say, 25 basis points increase on rates would be reflected by around 10 basis points expansion on NIMs. Now taking into account, as we mentioned, the one year cumulative gap of around 60 billion, as you see in the other note in the financials. So, just to add further note on this one, the 10 basis point for 20 million includes the actual timing of re-pricing those assets. While I think you guys always look at the full year impact, assume that rate has taken effect year at the beginning of the year, and everything is repriced accordingly, what will be the impact? That's what maybe the negative interest gap is right way for you to look at. In terms of-

Edmund Christo: Okay. So the 25 basis point is translated up to 10 basis point margin expansion for every 25 basis point increase on the NIM. Okay. [crosstalk]. Yes including the CASA.

Mr Abdullah Ali Al Khalifa, CEO: Yeah, in terms how to fund the growth, as I mentioned to you, that we are really focused on the... And we build the model and we're going to enhance the capability and the acquisition in terms of affluent and privates, which makes up easily in the 60%, at least of sources of NIMs. So we're continuing that. And we are going to increase focus on increasing CASA. As I mentioned to you before, we want, even the time deposits, to try and to extend the duration of those and to not take effect in the expected interest growth. Because if you make it very short, if you take one month and if you take it on three months, you'll have to reprice that quickly. So by building this we've taken even multiyear sometimes deposits that will help us to reduce the impact of the interest rate increase.

Edmund Christo: Perfect. Any comment on the liquidity within the market as you see after?

Mr Abdullah Ali Al Khalifa, CEO: Well, I mean, when you have the markets/ loans growing very fast and the NIBs already make up for a very high-percentage, the growth in NIBs can’t keep up with that level of loan growth. So you see banks taking more time deposits and especially institutional price sensitive deposits, they're really affected by any price offer in the market. They can move from one bank to another based on the pricing. We try to benefit more in terms of going to even time deposits, going to the affluent and private for also time deposits, because tend to be 5

million. For example, deposits is less price sensitive than the institutional deposit who can bring you a billion or two easily, but they are very price sensitive.

Liquidity in the market, I'm not really worried about it. It's a cost of liquidity. I think there was a period of time, maybe a couple of three years ago where some of that deposits actually left the country looking for better yields because banks were not taking. Banks had not experienced a sizeable growth so that money can come in. Don't forget. You have also, if that FI is coming to the country, you have price of oil in the 90 plus, which is all increasing liquidity in the market. You have, looks like more appetite for investors to buy debt instrument and equity instruments in Saudi, which also adds to liquidity. And I think the investments of PIFs and the investments of the government is also helping the liquidity. So I'm not really worried about liquidity. It's the price of liquidity that is concerning versus at the same time sort of aggressiveness on pricing of the assets.

Yeah, it’s the timing of both that worries me. It's not just the cost of the deposit. It worries me that, on the same time, there is also aggressiveness on pricing assets, which didn't make sense. It didn't make sense like for example in the period which we seen in 2016. 2016, yes, we had increased the cost of funding, all banks. But all banks took a price up sort of approach. We would increase the pricing. But now, on retail specifically, the pricing on personal loan is rock bottom. It is really free money, I would call it still.

Edmund Christou: Okay. All right. Very interesting. Thank you for that. And do you see the growth in personal loan on mortgage continuing given that it's favorable to move into floating with interest rate high, the appetite from bank on competing on these two products now?

Mr Abdullah Ali Al Khalifa, CEO: Yeah, it's true. I think mortgage will continue to be an important driver in terms of flow and growth this year. But obviously as a percentage, it will slow down because the base is getting bigger. Pricing, interesting enough nowadays... I remember the old days when the government or the ministry of housing started this subsidy on mortgage and all these incentives for homeowners to come and basically own a home. The pricing was very high in the beginning. I remember we seen over 9% APR, over 8% APR, easily. For a long time though, even though they did the price reduction, ministry of housing, at least there was no mechanism in place for banks for buyout of existing older mortgage. Now, this buyout is available. So that will be not necessarily the growth of the market overall because obviously buyout doesn't add incremental loans, but however, it allows you to maybe buy an 8% APR loan and bring it into your record, to your books at maybe better than what the current pricing on the streets out there.

Edmund Christo: Very insightful. Thank you very much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you.

Melissa: Thank you, Edmond. We'll take our final question today from Ibrahim Shamsi of TIB Capital. Ibrahim, please

go ahead.

Ibrahim Shamsi: Thank you gentlemen for the good presentation. Couple of questions on my side. First, regarding the saving deposits that's in your balance sheet. How different is the saving deposits from time deposits in terms of interest paid in that? And should we consider these accounts as time deposits? The second question is regarding the mortgage book, the current mortgage book of your bank. What is the current mortgage book? And lastly is regarding your guidance on our money. Does that exclude the tier one cost or not?

Mr Abdullah Ali Al Khalifa, CEO: Okay. Thank you, Ibrahim. On the savings, I'll take the first question and maybe Adel will take the second. On saving accounts, what we notice honestly in the country is the incentive for people to open savings accounts, not purely for the return. It's actually to be able to achieve certain financial targets in the future, to able to sort of have a better control over their spending habits, by having certain portion of their income goes saving. So we saw that price sensitivity is not very high on saving. I can't obviously comment on the exact pricing that we pay in. But it's significantly less than what time deposit's generating, significantly less than the current SAIBOR.

Mr. Adel Saleh Abalkhail: So the second question, if I heard correctly, you're talking about the current mortgage book in the bank. So as of December, this represents around 14.2 billion outstanding mortgage financing in the balance sheet. I missed the last question.

Mr Abdullah Ali Al Khalifa, CEO: That was, did you include the cost of tier one in the calculation or not?

Mr. Adel Saleh Abalkhail: No.

Mr Abdullah Ali Al Khalifa, CEO: So always-

Ibrahim Shamsi: So the guidance is always without [crosstalk] Thank you.

Mr Abdullah Ali Al Khalifa, CEO: Yeah, without the tier one. Yes.

Ibrahim Shamsi: Okay. Thanks so much.

Mr Abdullah Ali Al Khalifa, CEO: Thank you. But it's on the same basis as 2021, right? So we're comparing apples to apples.
Melissa: Okay. Thank you, Ibrahim. As that was our final question for today, I'd like to hand back to Mr. Abdullah Ali Al Khalifa, CEO, to conclude.

Mr Abdullah Ali Al Khalifa, CEO: Melissa, would you mind taking the last question please? Since we have Ali Patel on

the line. She's the last one.

Melissa: Yeah, of course. We'll take our last question from Ali Patel from Bearings. Ali, please go ahead.

Ali Patel: Yeah. Hi, guys. Hi, Abdullah. It's been a while since we last spoke. Hope you've been well. I just have one question, actually. The mid teens loan growth guidance. Could you give us some sort of substance behind it? This is on the corporate side. What sectors it's going to come from? Whether you can actually have some visibility or you're seeing some draw down in facilities. It's just that, I think some of your competitors had guided in the last year for sort of higher growth, but then with a high all price, you do get corporate repayments. They tend to be lumpy. And if it's your strategy to not just chase market share at the expense of spreads and also taking into account these corporate repayments, is there any sort of downside risk to mid-teens corporate growth? Perhaps, you can mention some sectors or even specific projects that you are lending on as part of a syndicated facility or even by yourself.

Mr Abdullah Ali Al Khalifa, CEO: Yeah. Thank you. Obviously, when we look at the Corporate growth, it's not really coming from one sector. However, there is an important theme for all this growth is coming in. It's the PPPs, it's the public private partnerships. We've seen very good demand of credit coming from these related projects. Things like, for example, we have something in the pipeline for private sector to build a whole hospital and then sign off that lease agreement. Long term particularly with agreement with ministry of health. We have a host number of schools to be built by the private sector with the off-take lease agreement with ministry educations. We have housing compounds for certain government agencies that's no longer financed by them or, I have to say, quite the government entities that is built by the private sector and leads on off-take agreement leads for a long term with those beneficiary companies.

We have projects in water. We have projects in water treatment, water desalination. We have projects in different sectors, wholesale trades. So I wouldn't really say it's coming from a specific sector. However, these PPPs, which is basically sort of 2030 sort of vision outcome, privatization doesn't happen by just selling an existing asset, it's actually by leasing assets or asking the private sector to build things that typically are built for the government. So that I would say is one of the main drivers for corporate loan. And as we mentioned, we're focusing on building a mid corporate on SME, all that,

Ali Patel: And maybe just a quick follow up. These projects that you've highlighted, are you past sort of preliminary stages in these projects? I imagine they're obviously going to be bid for by a whole range of banks. Is it something that you are mid stage in or can you comment on that?

Mr Abdullah Ali Al Khalifa, CEO: Yeah, sure. Look, I think I mentioned before and I can possibly have some credibility when I say this because I worked in five banks. The project finance team here is very, very strong. It's always among the top when any customers have the opportunity to bid for projects. Whether it's schools, as I said, and all these types of projects, if they don't come to us only, they always have us on the top list. So we have a very strong and experienced team. You build track record. We have built track record throughout the years. Like for example, even

privatization this grain silos, so it's privatized, it's all packed by us. And so, our customers know when it comes to this sort of PPP project, we have the capabilities and knowledge to drive this because they don't want to prolong it by having to go through a length process. For us, it's much faster because of the experience team that we have.

Ali Patel: Okay. Thank you.

Mr Abdullah Ali Al Khalifa, CEO: Thank you.

Melissa: Thank you, Ali. I'd like to hand it back to our CEO to conclude.

Mr Abdullah Ali Al Khalifa, CEO: Well, I thank everyone for taking the time to dial into our Q4 earning call. I think today we added at least the guidance for 2022. And I promise we will continue you to look at this guidance and update them if needed every quarter. Thank you again for your time.