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Transcript

SNB 4Q 2023 Earnings Call

Wednesday, 14 February 2024

Talal Al-Khereiji Good afternoon and a very warm welcome to everyone joining us today. Before I begin, it is with great pleasure I introduce our new Group Head of Strategy and Business Development, Mr Mustafa Ilyas, who will join us throughout the call today. Welcome. It's truly a pleasure to connect with you again and share a set of great results. 2023 was a banner year for SNB, delivering robust growth across the board to record levels. Total assets grew 10%, exceeding SAR 1.0 trillion, on balanced growth in both wholesale and retail financing. This drove operating income up 5% to SAR 35 billion which, together with healthy credit quality and improved domestic operating efficiency, generated 8% net income growth to above SAR 20 billion.

This strong financial performance was underpinned by successful execution on our strategic priorities. Firstly, and allow me to use Q3 2023 figures as full-year financials for all banks are still not published, we grew market share in retail lending by 90 basis points. Additionally and importantly, in the current high-rate environment we increased our market share of CASA balances by 150 basis points. We would continue to note that CASA ratios are a dynamic function of market developments but one of SNB's key objectives is to differentiate our competitive position by taking advantage of these opportunities in the market, thereby optimising funding costs.

Secondly, on the optimisation front we continue to realise benefits from our advanced digital capabilities and operational efficiency improvements, driving the domestic cost to income ratio down to 25.6% for the year. This was also aided by delivery of merger cost synergies, which now exceed SAR 1.5 billion on a runway basis or 110 over our revised target, while containing integration costs to SAR 900 million or 94% of the target.

Finally, and as mentioned before, digital advancement is at the heart of our strategy. Here, we continue to improve digital user penetration, which now reached 77% for wholesale and 85% for retail customers. This is also reflected in our retail mobile app rating improvement that accelerated to a whopping 4.7 and 4.8 score in the Apple Store and Google Store respectively on the back of our digital transformation.

We also successfully launched our Digital Ventures proposition pilot, where we are making good progress. A full launch is planned soon, subject to the regulatory approval process. We are very excited about this development, which will offer comprehensive digital experience to new target customer segments, complementary to SNB's existing portfolio of customer segments.

By delivering on our strategic priorities, we have met or exceeded our guidance across the board. Most importantly, the scale and diversity of our broad-based franchise allows us to generate a consistent return on tangible equity, reaching almost 17% for 2023. With that, I'll hand it over to our CFO for a discussion of our financial results in more detail. Please, go ahead.

Talal Al-Khereiji Thank you. Before covering guidance, I'd like to take you through our medium-term strategy covering 2024 and beyond. With the integration successfully executed, with significantly higher than expected synergies being delivered in excess of SAR 1.5 billion, our medium-term strategy is underpinned by an overarching theme of a customer-centric approach to elevate customer experiences and satisfaction, further optimise customer journeys and further simplify and digitise customer services and how we operate internally. This results in strategic priorities for 2024 and beyond that are focused on value creation, supported by our balance sheet mix, that gives resilience to deliver sustainable earnings through all cycles.

I will talk through each of our four strategic priorities in turn. The first is performance leadership in value capture and profitability. In wholesale, we will take a value-driven approach to growing the portfolio, while leveraging SNB's strong risk governance to maintain healthy credit risk and controls. Further diversification in priority segments and industries is also part of our agenda, which is expected to deliver enhanced yields and growth across all of our segments.

Project finance will be a key aspect of this and we have internally organised for this significant opportunity, including expanding our dedicated Corporate Finance division with strong project finance expertise. We will continue to focus on growing market share in retail and CASA balances. ESG is a growing mandate across the Kingdom and we intend to one of the leading banks in this space. Consequently, we've established a dedicated ESG function to drive this forward.

Another strategic priority is operational excellence, where we strive for faster delivery through a highly-agile operating model and leaner organisation. This has entailed a detailed review across all elements of our business to identify opportunities to deliver operational efficiencies. As a result, we expect to deliver significant cost efficiencies and increased automation. Our next strategic priority is to achieve digital dominance through building best-in-class apps across all of our products, sales and services, both functionality and interface. We are investing in predictive analytics to enable our relationship teams to develop a data-driven mindset, ultimately to enhance the customer experience. And finally, we expect all of the above collectively to further drive our market-leading digital penetration and adoption.

Ultimately, to deliver on all these priorities we must continue to invest in our most important asset, our people, as we strive to be the employer of choice with an engaged, empowered and upskilled workforce. Ongoing enhancements within our human resource programme will play an important role in this, including boosting employee engagement and talent development through our newly established SNB Academy.

Moving on to outlook and guidance next. The outlook for the Saudi operating environment and macroeconomic backdrop remains strong and supportive. Overall GDP for 2024 is expected to grow 4.4%, supported by an average oil price of around $82 per barrel and, importantly, continued strength in non-oil GDP. On rates, we're expecting some rate cuts in the second half of the year, driving the US Fed fund rates, currently at 5.33% to 4.25-4.50% range by the end of 2024. This range is really meant as a general reference because the ultimate Fed funds, as you all know, will be data driven. At the same time, domestic inflation is expected to outperform global averages and remain well anchored at 2.2%.

Against this healthy economic backdrop, we again expect to deliver strong financial performance and maintain our superior return on tangible equity in the range of 16-17%. Unpacking some of the drivers behind this, first, and following a 10% growth in 2023, our guidance is for high single-digit in financing growth. Similar to last year, we expect this growth to be more weighted to corporate rather than retail. Next, for the NIM, given our limited rate sensitivity and expectation of rate cuts towards the end of the year, we expect broadly stable margins on a year-over-year basis within the 3.0-3.2% range. And on the opex side, as already mentioned, we continue to focus on efficiency and cost optimisation in 2024 while continuing to invest in our digital and IT infrastructure.

Aside from further inflationary effects in Turkey, this should limit domestic opex growth to a low single-digit level, taking the cost to income ratio below 27% for the entire group. We expect the credit environment to remain stable, with the expectation of normalised recoveries. On a conservative basis, this would result in a cost of risk between 30-

50 basis points. Finally, we will maintain strong, stable capitalisation levels, with Tier 1 CAR comfortably between 18-19%.

To conclude, I hope all this demonstrates the unique franchise enjoyed by SNB, which is sufficiently diversified and resilient to generate significant and sustainable value creation for many years to come as we compete in the Kingdom's economy with the kind of robust fundamentals that are the envy of the world. I thank you for your continued trust in SNB. Let's open it now for questions. Please, go ahead.

Operator Ladies and gentlemen, we will now start the Q&A session. If you wish to ask a question, please raise your hand through the webcast so that we can unmute you. Thank you for not exceeding one to two questions per caller. Please stand by until we have our first question. Our first question comes from Waleed Mohsin, from Goldman Sachs. Please, go ahead.

Waleed Mohsin Thank you very much for the presentation. Two questions, please, from my side and I hope you can hear me clearly. First question is on your net interest margin guidance. Great to see that the bank has revised the sensitivity. I just want to understand correctly. Your NIM guidance, which is 3.0-3.2%, the mid-point of this implies a pick-up in NIM versus the exit NIM, which was around 3%. So, if you could kindly unpack that. The increase that you're expecting towards the mid-point, perhaps, is it solely driven by your expectation of rate cuts or is there any other management action which should support net interest margin going up from the exit NIM, which was around 3%? That's the first question.

Second, thank you for sharing the strategic priorities for 2024 and beyond, which are extremely helpful. I wanted to understand how these would fit into some of your key operating metrics, for example your long-term return on tangible equity targets. The reason I'm focusing specifically on the return on tangible equity is that despite your upbeat 2024 guidance, I see that your return on tangible equity targets are now 16-17%, which were 16.5-17.5% during 2023. So, if you could please help us understand how these strategic priorities will enhance return generation going forward and why the targets have been revised down slightly for '24. Thank you.

Ahmed Aldhabi Thank you, Waleed. It is good to hear your voice again. Taking first, your first question regarding NIM, it's a combination of many factors. Number one is the retail and investment refreshment portfolio on a higher yield. That will contribute to higher gross yield. And the second one is really we're focusing on current account and retention of current account and making sure that we are maximising the cost of fund. So, that is the ambition that we are targeting to maintain. Coupling with this is our now sensitivity to rates. Where we were neutral, now we're becoming more negatively correlated. So, these are together making us with the same range that we are living today.

In regard to the other questions, maybe I will comment on the ROE, maybe our CEO will comment regarding the strategy. Despite all these factors, as you can see, we have an improvement in the top line in terms of NIM and others, but you can see we have normalised cost of risk that will offset these things and we have an organic growth of capital that needs to be retained. As you know, we're always retaining organic capital of around 50%, so we're always keeping in hand that we wanted to be in the higher end of this range but this year, in particular, we have a one-off, as we explained, which is really in our corporate recoveries. So, you can normalise for this and you can see we will have an improvement in our ROE in the medium-term.

Waleed Mohsin Perhaps a comment on the long-term ROE, if possible, like how the strategic initiatives will drive the long-term ROE, like any quantification around that.

Talal Al-Khereiji Thanks, Waleed, for the question. I think it is probably premature, except to give you a sense of direction. As you know, when we come up with our annual guidance we are usually very conservative. As you saw last year, we revised a lot of things upwards. I would say this guidance is probably biased to be revised upwards as the year wears on and we execute on a lot of these priorities and it becomes more visible, but the direction is definitely better and up.

Waleed Mohsin Perfect. Thank you so much. Thank you very much. Very helpful.

Operator Thank you. Our next question comes from Chiro Ghosh, from SICO Bahrain. Please, go ahead.

Chiro Ghosh Hi. I also have a couple questions. The first one is related to your CASA. Your CASA is one of the best in the industry. In a declining interest rate environment, isn't it negative in the sense that you cannot lower your funding cost much beyond this level unless you have been paying some high [unclear] on your CASA, on your current account deposits only. If you can throw some light on that aspect of it. Also, the mortgage loans which you have dispersed over the last one year, which has been a big contributor, what kind of interest rate are you making on those loans? That's my first question. Second one is if you can give us some clarity on your non-interest income side of it. The fourth quarter your fee income was a little weak, which I can understand because the international part perhaps did not contribute enough, but how should we look at your non-interest income going forward?

Ahmed Aldhabi If you consider CASA and our strategy of last year of focusing on having the right proposition and revising the service model that we are having and, as a big bank, exiting or coming from a merger, we have retrieved some of the relationships that we lost during the integration period, that helps us a lot. Having said that, as you know and we mentioned on the pervious calls, some portion of this CASA is really call and I said in my script, they are attracting cost. So, we are targeting and we are having a combination of everything. We are having a very big focus on parallel acquisitions in retail, having really a one SNB aspiration of having the cross-selling between corporate and retail, of really penetrating all the corporate clients and having the right current account and vice versa from retail. So, we have sustainable and sticky deposits and we'll continue to focus on this. I understand it's really difficult to have this but this is really a franchise that we are having as SNB.

Chiro Ghosh Are paying interest on the current accounts?

Ahmed Aldhabi In call accounts only, and it's really an overnight rate.

Operator Thank you. Our next question comes from Mohammed Al-Rasheed, from Ashmore. Mohammed, please go ahead.

Mohammed Al-Rasheed As regarding your asset yield during the first quarter, in particular the corporate book asset yield. Based on the information in the presentation and the financials, your domestic corporate yield is around 7.2%, so above the current level of SIBOR by 98 basis points. Taking your historical split on corporate, that indicates that there is still room for your asset yield to pick up within the corporate sector and your retail asset yield has been going

up consistently. So, taking these factors into consideration, I wonder why do you expect that NIM expansion would be very limited in the case of an expansion. Are you expecting some build up time deposits, like what happened last year in the fourth quarter when deposits went down but then we witnessed that it went back up and increased during the first quarter and second quarter and the third quarter? Is the reason behind such a conservative NIM?

My second question is regarding your stages allowance, in particularly the retail book stage 2 allowance. I notice that it went down during the year by around seven percentage points, from 17 to 10 percentage points. I'm just wondering what's the driver. Is it some revision to macroeconomic variables and to the resale model? What has caused such a huge drop? Thank you.

Ahmed Aldhabi Thank you for the question. The first question, you are right. There is a change in overall mix in both assets and funding. I will start with the assets. We will have always a pick-up in retail because we are pricing the new origination at the current pricing and we have some repayments for the legacy portfolio, hence we will see always an uplift in the gross yield. In corporate, historically we do have this range of margin over SIBOR considering the concentration of our book towards the healthy and large corporate segments and we focus also on ancillary and cross-sell revenue to really improve the overall returns in corporate. So, in a nutshell, the majority of funding, as mentioned, is coming only from cost-bearing and in some cases we are also compensating from current account decline. So, that's why we are seeing a total mix that will have a muted, more or less, NIM. For the stage-wise allowance, you are right, it's a macroeconomic device that contributed to this down percentage.

Mohammed Al-Rasheed Just to follow-up on the second point because I noticed this is a trend across the industry, but when I go back to the beginning of 2023 and see the oil price assumption and the real GDP assumption and how accurate results came, I'm thinking it should be the other way around. Oil prices came lower than what most banks were expecting at the beginning of 2023 and the real GDP actually came negative for the year. So, I'm just wondering how we can see such decline in allowance ratio. I'm not talking specifically for SNB, I mean for the overall sector. Has there been some change? Did you change the variables incorporated in the ECL model or is it because now, the 2024 and 2025 forecasted variables are better than at the beginning of 2023 because I can't understand how this happen?

Ahmed Aldhabi I think the answer to the question lies in the statement that you made at the end. I think this is driven by the forecast that we have for '24, '25 and the years afterwards. Second thing is that there are no changes in the models. The same models have been retained. They have been recalibrated by taking into consideration the forecasts, which are forecasted to be better than 2023.

Mohammed Al-Rasheed Clear. That's the comment I have here. Thank you.

Operator Thank you. Our next question comes from Naresh Bilandani, from J.P. Morgan. Please, go ahead.

Naresh Bilandani Hi. It's Naresh Bilandani, from J.P. Morgan. Can you hear me?

Talal Al-Khereiji Yes, Naresh, we can hear you. Please, go ahead.

Naresh Bilandani Great. Hi, Talal, Ahmed. Thank you very much for the presentation. Just a few questions, please. One is how should we think of the NIM between your Turkish and the Saudi franchise over the course of this year in the context of the guidance that you provided? Any direction and thoughts that you can provide will be much helpful. Second, despite your favourable sensitivity, you're still guiding some decline in the NIM at the lower end of the guidance. Can you please highlight under what circumstances would you see this NIM decline as has been implied in the range that you have provided, simply because the sensitivity is definitely a lot more favourable and you are also basing it on some rate cuts expected over the course of this year? So, I'm just trying to understand what conservative scenario are you building in, in which despite the rate cuts you could potentially see a decline in the net interest margin.

And third is you stand out compared to your peers from the fact that you have managed to grow current and call accounts at a faster pace as compared to the time deposits, which is not generally seen in the industry over the course of 2023. Should we expect this trend to change in '24 because the rates are still elevated? Do you reckon the reality could be that time deposits this year grow faster as compared to the current and call accounts? Any thoughts that you can provide there would be very helpful. Thank you.

Ahmed Aldhabi Thank you, Naresh. For the first question I can decompose our NIM, which is the exit one today. Our domestic NIM is around 3% and international is a little above 5%, and combined they are 3.06%. How can we really see this in 2024? Considering all the rate cuts consideration is really end of this year, we will have very little impact, if it happens, to our NIM of '24. But what are the headwinds domestically we might have? It is really a shift in funding mix by keeping this level of interest rate and attracting more cost-bearing than what we are anticipating. That is, I think, the headwinds domestically. International, I think you know more. It's really volatile. In one quarter it is giving very positive news and the following quarter it's really coming down but if you see the contribution they're having, not so much negligible line by line but on an overall bases as I think of shareholders' value, they represent only 1%. I know it is very annoying, line by line explanations, but in total they contribute less than 1% in 2023.

Naresh Bilandani So, your lower end of the guidance is pretty much implying only the shift in the funding mix. Is that fair? Because the understanding is that the Turkish net interest margin, albeit small, should still be relatively improving in the second half of this year. Is that a fair assumption?

Ahmed Aldhabi Yes. Keeping in consideration the improvement that we're having during this year in the gross yield because, as said, it is related to the retail and investment refreshments.

Naresh Bilandani Understood. And, realistically, the favourable trends that you've had in the deposit segments, current and call versus time, do you expect this would continue in the course of 2024 or should we realistically start expecting time deposits to grow much faster as compared to the current accounts?

Ahmed Aldhabi I think that time deposits, it needs to really grow and, as I mentioned, also we ended the year with a SAMA LDR of 84% and we already saw some easing during January because we did not want, really, to get into this competitive pricing for the year-end markets.

Naresh Bilandani Makes sense.

Ahmed Aldhabi Yes. Realistically, the time deposits and other cost-bearing funding sources will remain the main source of funding for next year.

Naresh Bilandani Understood. That's very clear. Thank you very much.

Operator Thank you. Our next question comes from Gabor Kemeny, from Autonomous. Please, go ahead.

Gabor Kemeny On your high single-digit growth guidance for this year, can you give us a sense how much conservatism has been built into this guidance? I'm asking this in the context of this being a bit below last year's loan growth all-in margin but, still, in a slightly falling rate environment, when you're enhancing your project finance capabilities it sounds a little counterintuitive to expect slower loan growth. And the other question I had was on fees. What kind of fee dynamics have been embedded into the guidance, please, because I reckon this 9% decline in the domestic was relatively severe, partly market related, which is tough to predict, but it would be useful to understand your expectation for the current year? Thank you.

Ahmed Aldhabi For the financing growth, even last year we have guided the market to be high single-digit and it is almost what we were expecting and same with the market. There are two or three factors that need to be considered while we are talking about a big-size bank like us. I think number one is we are not only aiming for gaining volumes but we are really striking a balance between volume and value. If you have a 600 billion base of financing, 10% is around 60 billion and that is huge activities required. Number two, you know the eligibility is always impacted in retail and the appetite of customers, that is also considered in our assumptions. So, in a nutshell, the growth for financing for the market, we are considering high single-digit, more weight to corporate, less to retail this year, and we are going to be playing the same way that we played in the previous year, maintaining or increasing market share as mentioned by our CEO.

For fees, fees always have of factors. Lending fees are no longer being recorded in this line. We have other factors on fees, same as the market activities that are coming from our capital arm, that is depending, more or less, on the market activities. That is really the line. For the bank, itself, I mentioned that we have some strategic waivers to gain some market share in terms of payrolling, in terms of waivers for the other businesses that we wanted to attract and hook the customers first. We consider this as an outlook to be improved, nothing else except improving. So, we can more or less be thinking about the non-commission revenue with plus/minus 2.25 billion. That's always our range of the upcoming year. That is also including the investment income, of course, but other non-investments excluding the NSCI.

Gabor Kemeny That's helpful. Thank you.

Operator Thank you. Our next question comes from Olga Veselova, from Bank of America. Please, go ahead.

Olga Veselova Three questions. One is again on loan growth. Looking beyond this year, do you think you can visibly accelerate your financing growth? And, of course, I'm not asking to give us 2025 loan growth guidance but I'm trying to understand the philosophy, if you will want to preserve this approach of value growth or you will want to go more actively into volumes expansion. So, that's my first question. My second question is on deposits. Deposits

dropped across different categories quarter-over-quarter. What was behind that? Were there any sizeable repayments and do you have any similar repayments in 2024, maybe SAMA deposits related to COVID support? And my last question is on repo. The bank more than doubled repo operations in liabilities last year. Was this repo with SAMA or with other banks? And can you give us a sense what is the average blended cost of repo for you now? Thank you.

Ahmed Aldhabi Again, for us, as a bank our strategy is always to be in the market with a desirable market share and we're always aiming to increase market share but with the balancing of value. We cannot comment on beyond 2024, as of now, but we're always aiming for gaining market share. This is always internally the discussions and the KPIs. But there is always a thin line between really gaining volumes and expansion because you can buy market share by having some discounts but this is not always favourable because we have a minimum threshold, we have a minimum RAROC required that we need to always meet.

For deposits, as for the previous quarter and continuing for years, we are a big bank. We have transitory deposits that we are always having ins and outs. We're considered to be a primary bank for semi-government for big corporations, so you can see this volatility up and down during the quarter ends. Repo operations, it's across, diversified. We have multi sources of funding that is within Saudi and overseas, through our branches, so there is no single counterpart that we are getting funding or repo rent on banks. Blended rate, I think you can do it more or less with the repo rate that we're having. Sometimes we get some discounts due to our rating and our healthiness of the balance sheet.

Olga Veselova Thank you for the answers. On the second question, do you have any big repayments, maybe SAMA deposits, in 2024?

Ahmed Aldhabi Not anticipated but, again, it's volatile due to the nature of our deposits and volatility but nothing specifically that big repayments are coming, neither from SAMA nor from others.

Olga Veselova Thank you very much.

Operator Thank you. Our next question comes from Abdulaziz Alnaim, from Mayar Capital. Please, go ahead. Abdulaziz Alnaim, please can you unmute your line and proceed with your question.

Abdulaziz Alnaim Thank you so much. Amazing results. Congratulations on a tremendous year. Given your results and the transformation that has happened in the past couple of years, the market doesn't seem to appreciate that and reward it in the stock price. I'm wondering is there scope for you to be more aggressive in buying back your shares. I know there are some limitations that are regulatory but is there the willingness and ability to do more buybacks to try to capture some of that discount that is in your shares?

Ahmed Aldhabi Abdulaziz, thank you. My apology, we cannot comment on share price. We, as management, are caring about really growing the book value of the shareholders.

Abdulaziz Alnaim Is there a regulatory reason why you can't buy back shares?

Ahmed Aldhabi I'm not aware of reasons but we do only this for our internal incentives for our employees.

Abdulaziz Alnaim And you don't have a plan to do more of it just to create value?

Ahmed Aldhabi We can't comment and I don't think so.

Abdulaziz Alnaim Thank you very much.

Operator Thank you. Ladies and gentlemen, I'd like to remind you, if you have any questions please raise your hand on the webcast platform. We have a text question from Shabbir Malik, who asks can you shed some light on the outlook for fee income and other income? Do you see scope for high investment income if rates decline this year?

Ahmed Aldhabi I answered this question before but it's plus/minus 2.0 billion a quarter, including investment income.

Operator Thank you. We also have a question that asks what is the main reason for decrease in customer deposits quarter-on-quarter?

Ahmed Aldhabi This is also already answered.

Operator Then, just one last question. Are there any notable trends in deposit growth rates or deposit mix shifts?

Ahmed Aldhabi For market, low single-digit and shift in funding mix, it has continued to be a bit declining but we do not see a huge deterioration in CASA ratio, neither for the market nor for us.

Operator Brilliant. Thank you. We have no further questions. Mr Iyad Ghulam, back to you for the conclusion.

Iyad Ghulam SNB Capital would like to thank SNB management for taking the time to conduct this call. We would like also to thank all participants for attending. We wish you a pleasant day. Thank you. You may now disconnect.