

SNB Earnings Call – Q1 2023**Tuesday, 16 May 2023**

Iyad Ghulam Good afternoon. On behalf of SNB Capital I would like to welcome you to this conference call with SNB management regarding the bank's Q1 2023 results. Today's call is being recorded. Please note that this call is open for analysts, investors, and shareholders only. Any media personnel, please disconnect at this point. Today's speakers are Mr Talal Al-Khereiji, Acting CEO, Mr Ahmed Aldhabi, Group CFO, and Mr Abdulbadie Alyafi, head of Investor Relations and Market Intelligence. I will start by handing over to the SNB head of investor relations and market intelligence. Please go ahead.

Abdulbadie Alyafi Thank you very much, everyone. Good afternoon from Riyadh. Welcome to SNB's earnings call on Q1 2023 results. I would really like to thank SNB Capital for hosting the call. As usual, please take note of the earnings presentation on page two, which provides important information regarding today's discussions and disclosures, including the use of course of forward-looking statements. I would also like to highlight at this juncture that we are no longer using pro forma numbers. They're no longer considered necessary for understanding the performance of the bank. So all numbers in this presentation are presented on a reported basis only with any merger-related metrics or adjustments highlighted in the footnotes where required. With that, I'll hand over to Mr Talal Al-Khereiji, who will share the performance highlights for the year. Over to you. Please go ahead.

Talal Al-Khereiji Thank you, Abdulbadie, and good evening and a very warm welcome to everyone. Welcome back to SNB's IR call. It's always a pleasure to come and report such excellent performance as was the case in Q1 2023 as we witnessed broad and sustainable momentum across our key business lines. Looking first at the balance sheet, we delivered solid financing growth of 4% during the quarter, mostly balanced between wholesale and retail. This healthy growth has led to an increase in market share in both corporate and retail lending, in line with our strategic priorities for 2023 and a sign of things to come.

Balance sheet growth was funded mainly by CASA deposits, which grew at a significant 10% during the quarter, a great and remarkable achievement, especially in the context of a higher-rate environment. Naturally, this robust pickup in deposits has driven a strong increase in CASA ratio to 77% as well as to an even more comfortable SAMA loan-to-deposit ratio of 81.2% while boasting a strong and stable liquidity position overall. The improved asset mix along with higher rates drove margins by 14 basis points and NSCI by double digits. Moreover, combined with improved operating efficiency aided by ongoing synergy realization and a healthy domestic credit quality, we witnessed a 12% net income growth year over year to just over 5 billion riyals. Consequently, we delivered solid improvements on return on tangible assets to the tune of 2.18% and a return on tangible equity to 17.4% year on year.

Let's move now to page four, please. In terms of the merger, we continue to deliver merger benefits with accelerated synergy realization ahead of target. As you would recall from last quarter, we revised our target for total run rate synergies upward for the second time from 1.2 billion to 1.4 billion riyals. As of Q1 2023, we have realised almost 1.3 billion riyals of synergies, representing 92% of this revised target, and it sets the stage nicely for reaching the target by the end of this year. Integration costs also remain on track. So far we have committed 875 million Saudi riyals of integration costs. This represents 93% of the revised target and remains well below the original estimate of 1.1 billion riyals.

Moving on to the next page, as you know, a key tenet of SNB's strategy and competitive advantage is the continued focus on our digital agenda and leadership through customer adoption, growing digital sales, and scaling up

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innovation. Case in point has been the very mature level of digital migration for financial transactions, which has reached around 99% digital migration in both wholesale and retail. Looking to the future, we continue to drive forward aggressively in accelerating progress on our ambitious digital strategy as follows. In retail we prioritised fortifying our digital leadership by deploying a leading digital proposition empowered by rich capabilities with distinctive customer journeys. In this respect, we continue to improve digital penetration, now at 83%, digital account-opening at 92%, and digital sales at 63%.

Similarly, in wholesale banking we aim to solidify corporate relationships by facilitating digital platforms with leading functionalities and trade capabilities infused with digital sales. Here, 83% of our corporate clients transact digitally, 77% of accounts are opened digitally, and 71% of all POS sales are made through digital channels. Also as part of our long-term strategic digital considerations, our plan remains in place to launch digital ventures during the year, starting with a pilot in the first half of 2023 that leverages SNB infrastructure. Digital ventures will carry a comprehensive value proposition with full product suite to penetrate niche segments and build market differentiation.

Moving on to the outlook and guidance on the next page, please, we expect the Kingdom's operating environment and macroeconomic backdrop to remain strong and supportive. With respect to interest rates, we expect US rates to peak in 2023 before declining in 2024. More specifically, the US federal funds rate range is expected to be 5% to 5.25%, maybe a little higher by the end of 2023, and then begin declining. Against this healthy economic backdrop and considering the strong start to the year, we remain optimistic and excited about the bank's financial outlook and its prospects going forward. As a result, we are leaving full-year guidance unchanged except for an upgrade to our financing growth guidance from high single-digit to low double-digits in light of the 4% lending growth already achieved during the first quarter and expectations for continued healthy growth for the remainder of the year. Our group CFO will explain this in more detail during the next section of the presentation. With that, I'll hand over the floor to you, Abu Faisal. Please go ahead.

Ahmed Aldhabi Thank you. Good afternoon and welcome, everyone. I'm pleased to report a solid start for the year. Beginning on page seven, the balance sheet grew 3% to 976 billion riyals, driven by financing growth and further supported by higher investments and interbank balances. Balance sheet growth was funded mainly by 8% deposit growth while interbank funding declined 11%.

We will cover this trend in more detail, starting with financing on the next page. Financing grew by more than 20 billion or 4% during the first quarter to reach 566 billion. The key drivers of this growth were as follows. Retail financing grew 3% or 9.3 billion riyals during the quarter on the back of 4% mortgage growth and 2% in other retail. Next, in terms of wholesale, this is up 4% year to date. Within wholesale, corporate grew by a healthy 5%, driven by strong underwriting activity, particularly in the global and large corporate segments. FI lending, which, as you know, is more short-term and opportunistic in nature, was broadly stable during the quarter. As our CEO alluded earlier, this momentum in financing growth leads us to upgrade our financing guidance. This is further underpinned by the healthy operating environment and the resulting robust business pipeline.

Moving on to the next page, the investment portfolio increased by 2% during the first quarter to reach almost 264 billion riyals. This resulted from the following. First, the other fixed income rose 10% or 7 billion during the quarter, mainly high-quality securities in developed countries. Second, as you know, we booked a mark-to-market loss of

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around 3 billion riyals in our stake in Credit Suisse, taking the carrying value of this investment to 1.3 billion riyals. This investment is accounted as part of our funds and equity portfolio and their valuation loss was booked under OCI as per the accounting standards.

Next, deposits grew 8% during the quarter to 611 billion riyals and CASA stands at 77%. It's worth noting that even though CASA is up 10%, keep in mind that a significant proportion of this growth was transitory in nature, some of which has since transitioned to time deposits and investments. Looking forward, we expect some non-cost-bearing deposits migration considering the interest rate environment. Nevertheless, attracting low-cost deposits remains a key focus of the bank.

Next page, to profitability, please. Net income for the quarter reached 5 billion riyals, increasing 12% year on year. NOI is up 8% as improved margin and financing growth boosted NSCI and this was partially offset by lower non-commissioned income. Profitability further benefited from stable operating expenses as strong synergy realizations and ongoing domestic cost optimisations were offset by higher cost in international. Finally, the risk cost increased modestly but remains at a very healthy 35 basis points.

Let's look at each of these components, starting with NSCI and margin. NSCI grew 11% year on year to 6.8 billion riyals from NIM expansion in combination with 8% growth in average earning assets. The margin improved 14 basis points year on year to reach 3.24%. The key drivers of this improvement are as follows. On the positive side, the overall shift in mix to retail mainly from mortgage growth and the improvement in investment yields supported by the higher rates. These positive factors were partially offset by higher funding costs from higher rates and the year-on-year deposit mix shift towards more cost-bearing funds, which is expected to put pressure on the NIM during the rest of the year. Our NIM sensitivity is updated to be between zero to two basis points for every 25bps increase in interest rates over two to three quarters. Regarding the NIM trajectory, the margin grew sequentially in Q1 and has likely peaked in the first quarter after capturing the full benefit from the rate hikes. Looking forward, NIM is expected to ease lower sequentially for the rest of the year, mainly due to funding mix pressures. Nevertheless, our full-year NIM guidance remains unchanged.

Moving to fees and other income, fee and other income declined 2% year on year to 2 billion riyals, driven mainly by a 14% decline in domestic, partially offset by higher international fee income. In this respect, domestic fee from banking services were down 11% on lower brokerage and asset management fees, which tracked market activities. Other operating expenses were higher year on year due to higher sales activities this year coupled with one-off cost optimisation benefits in 2022.

Moving onto the next page, operating expenses were stable year on year at 2.4 billion riyals. This resulted from strong synergy realizations and ongoing domestic cost optimisation, offset by higher international costs relating to inflation pressure at TFKB. Thanks to continued positive jolts from stable overall cost and higher operating income, we shaved another 1.7% off the cost-to-income ratio, dropping to 25.6 and in line with our guidance.

Next page, please. Cost of risk remains healthy at 35 basis points, four basis points higher than the previous year. The main drivers of the increase in impairment were 93 million riyals' increase from business-as-usual wholesale risk cost,

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keeping in mind the low-based effect. Also, retail impairments grew modestly while international impairments were stable.

Moving to credit quality on page 16, the impaired ratio remains healthy at 1.36% for the group. We wrote off over a billion riyals during the quarter after relatively lower write-offs during 2022, resulting in 17% lower wholesale impairs. Stage-wise, coverage ratios remained healthy across the board. To highlight this, stage-three coverage is above the 70% level.

Moving to capital and liquidity, risk-weighted assets increased 1% to reach 706 billion riyals while total regulatory capital increased 3% to 136 billion from net retained earnings generation and additional tier-one sukuk issuances during the quarter. These were partially offset by negative OCI movement mainly due to Credit Suisse negative mark-to-market. The net result was almost 30 basis points' improvement in both CAR and tier-one ratios, reaching 19.3% and 18.6% respectively. Moreover, please mind the following. We would like to highlight that the Credit Suisse impact on CAR from the negative mark-to-market decline was roughly 35 basis points. The 2022 second-half dividend of 2.7 billion riyals will be paid and deducted from the capital in the second quarter. Finally, today we announce a redemption of 1.3 billion riyals in tier-one sukuk, demonstrating SNB's robust capitalisation and liquidity, which remains strong and stable with all ratios comfortably within prudential threshold. The regulatory LDR of 81% at the end of the quarter continues to provide ample lending headrooms relative to the 90% ceiling.

This concludes the financial performance review and, with that, I will hand back to the CEO for a closing remark. Thank you very much.

Talal Al-Khereiji Thank you, Abu Faisal. To summarise, we reported an exceptionally strong and sustainable start to the year. This was achieved through solid financing growth in both wholesale and retail, improved margins, strong merger benefit realization, and healthy credit quality while maintaining robust liquidity and capitalisation well above prudential limits, thereby providing no constraints on growth. The economic environment and outlook for the rest of 2023 remain positive, which is why we are excited and energised by the opportunities in the Kingdom and achieving our strategic priorities in the fastest-growing economy in the G20 globally. Thank you.

Now we can move to Q&A.

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 we can unmute you. Please note you can also submit a written question using the Q&A chat box. 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. Please unmute locally, state your company name, and proceed with your question.

Waleed Mohsin Hi. Good afternoon. Thank you much for the presentation. A couple of questions from my side. Firstly, it's extremely pleasing to see the momentum on the credit growth side. It was broad-based, strong, solid growth on the corporate side. You achieved 10 billion in one quarter, which equals to almost the growth that you had for the full year on the corporate side. You've obviously upgraded the guidance. So I wanted to ask, in terms of project

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pipeline, etc., if you could actually comment on the pipeline. Because it clearly seems that over the last one quarter, your expectation around credit growth has actually gone up despite the fact that there has been some regulation around the mortgage side, which means there's going to be a slowdown on the retail side. So your commentary on corporate pipeline and the optimism around that would be highly appreciated.

Secondly, on the CASA growth, you did mention that there is an element of transient deposits over there. However, if I look at your market share, out of almost 55 billion of CASA that was generated by the system this quarter, you had almost 42 billion. That's a very high market share. So if you could kindly comment on that. And finally, linked to this, the last part of my second question. Your net interest margin guidance, you mentioned that NIMs have peaked in the first quarter. Many of your peers are actually reflecting on the large impact of repricing and they expect NIMs to continue to expand going forward. Given your comfortable funding base and low cost of funding, I want to understand why you would not see a similar benefit. Thank you.

Talal Al-Khereiji Thank you, Waleed. I'll make a few comments and then hand it over to the CFO. Let me start with your question on liability and liquidity performance. As you rightly say, it was a very strong performance. Inevitably, some of these are transitory. That's the nature of the activity. However, I think I want to stress a couple of things that I can mention, which is, it truly speaks to the power of SNB's franchise as this liquidity and inflow was broad-based, representing a cross-section of our customer base and really a testament to how we are beginning to enhance customer journeys both digitally and physically.

Now, on the asset side we're very comfortable giving this guidance and upgrading this guidance because we've made some necessary and required adjustments to our operating model, our performance management techniques, and also our ability to cover clients more proactively and really cover them from a holistic point of view. The pipeline is very strong for the rest of the year and we're pretty confident that we will outperform and grab market share both in retail and in wholesale. Abu Faisal?

Ahmed Aldhabi Regarding NIM, Waleed... Thank you for the question. We've been saying, even in the last meet, that the trajectory of the NIM was really sequentially improving. Considering most of the rate hikes happening really during 2022, now is the time of really capturing the full rate hikes, which really falls in Q1, and we don't expect the interest rate to further increase during the year and that's really not giving us a benefit of our NIM. You can see that we have downgraded our NIM sensitivity to zero to two pips for the reason that now our asset mix or the net floating position that we are having between the asset mix, fixed and floating, vis-à-vis our funding mix, has now turned to be more into the neutral position. So we're not getting benefit and that's, I think, not a wrong signal considering the expectation that interest rates will go down. In the future on the outlook of this, if we are not getting benefit when interest rates are going down, we will be neutral.

Waleed Mohsin Thank you much. That's very helpful. Just one thing to confirm, please. In terms of your lending growth, would it be fair to say that although it will be broad-based going forward, corporate would outperform retail growth?

Talal Al-Khereiji Look. It remains to be seen. All we can tell you is that loan demand across the board remains robust. I can tell you one thing. Given where we are in the interest rate cycle, which... As we made it very clear, we

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think we're on the top side. We think it's going to be a bit more stubborn this time. We're not going to see a decline right away. It's going to begin declining. But what does that say? It means we are consciously and deliberately going to be more aggressive on the mortgage side because long-term fixed-rate assets at the top of the cycle is always where you want to be. So you should expect us to continue this outperformance on the retail as well as the wholesale, but it remains to be seen. But it's going to be broad-based and I think this is something that is very reasonable to expect.

Waleed Mohsin Thank you much. Very helpful. Much appreciated.

Talal Al-Khereiji Thank you, Waleed.

Operator Our next question comes from Shabbir Malik. Please state your company name, unmute locally, and proceed with your question.

Shabbir Malik From EFG Hermes. Can you hear me, please?

Ahmed Aldhabi Yes, Shabbir. Loud and clear.

Shabbir Malik Great. I have two questions, please. We've seen a pickup in provisioning for certain banks in the Kingdom. I just wanted to hear your thoughts. Is there any early signs of stress due to the uncertain global macro backdrop or high interest rates that you are seeing for your bank or generally for the sector? Any comments on that would be pretty useful. The second question, I guess, is on... If I look at your loan growth, an interesting thing that I noticed was that in terms of your international lending, there has been a pickup in that. Is that Turkey-related? If you can comment on that, that would be pretty useful as well. Thank you.

Ahmed Aldhabi Provisioning... We are expecting this to normalised and to be really within the 40 to 60 basis points. This is a normal trend historically that we've been seeing and what we are experiencing now is really a low base. That's not this year and maybe most of the years' post-COVID that we experienced and measure for us as a special case, but moving forward, 40 to 60 basis points is the normalised level. And for the international, yes, it is pure Turkey.

Shabbir Malik Great. Thank you.

Operator Our next question comes from Edmond. Please state your full name and company, unmute locally, and proceed with your question.

Edmond Christou First question on the margin. If I hear correctly, you expect sequential decline in the margin. Just correct me if that's true. And that's mainly because of cost of funding. Just the second part of the question is, can you remind me of your sensitivity for a 25-basis-point increase or decline in interest rate on the margin? The second question is the right of that happen, just to reconcile the numbers in terms of the provision you have taken into the income statement. So I assume there has been some recoveries as well to be able to reconcile the numbers between income statement, the right of level and your coverage for stage three. Thank you.

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Ahmed Aldhabi Regarding sensitivity, Edmond, it has really been upgraded down to zero to two basis points for every two to three quarters for every 25 basis points. It will be down sequentially and not because of the sensitivity of rate, more really the change in funding mix toward more cost-bearing liabilities.

Salman Ahmed Edmond, your question about the write-off of loans and recoveries... So write-off loans were of course driven by corporate write-offs that we have done, which are fully provided and in accordance with our credit policy. Retail, as you know... We are writing it off systematically, the past date due as credit policy, we write them off automatically. In terms of the recoveries, yes, we do have some recoveries, but they are not really significant in the corporate area of wholesale. So there's nothing to talk about as such that is driving the ECL down or up.

Operator Our next question comes from Olga Veselova. Please state your company name, unmute locally, and proceed with your question.

Olga Veselova Thank you so much for taking my questions. I have two question today. One is about your strong deposit inflow. You commented that this inflow is transitional nature. What makes you think so? What part of the deposit inflow was coming from the government in the first quarter, if any? So this is my first question. My second question is not about first-quarter numbers. It is about dividends. You increase your loan growth outlook. You stick to your capital adequacy targets. Holistically, in the long run, do you think the bonus share issuance can be repeated at some point by the bank? Or that is the instrument which you would not want to use again? Thank you.

Ahmed Aldhabi Transitory CASA is more institutional. So it is a natural in our franchise that we experience this quarter over quarter to really receive deposits, that it will be transitory in nature. Then, regarding dividend, we don't foresee for the upcoming or foreseeable future that we are going to repeat the bonus issuances and we are going back to our earlier announcement about our dividend policy to be really 50% to 60% from our net-generating earning of the year.

Olga Veselova Thank you. There's a follow-up on the first question. Did you have any government funds which helped your deposit inflow in the first quarter?

Talal Al-Khereiji Look. Like we said earlier, it was broad-based between retail and institutional. We have statistical models that we run and track the behaviour of these type of deposits from different client segments that we have and that is why we said that some of them are expected to be transitory and some of them are expected to be sticky. This is just the nature of things. Like I said earlier, in this environment with high rates, you should always expect... It has happened already and it will continue to happen that you see a natural migration from current accounts to time deposits. So it's really been a mix and it's probably going to stay this way for the remainder of the year.

Olga Veselova Thank you so much. If I may, a quick question if possible, one more. Have you made sensitivity of your financials to Turkish lira weakness?

Ahmed Aldhabi It's very minimal. It's negligible because the size of the asset is really lower than 5%.

Olga Veselova Sure. Thank you. Thank you for the answers.

Ahmed Aldhabi No problem.

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Operator Ladies and gentlemen, I would like to remind you, if you have any questions, please raise your hand in the webcast platform. Alternatively, you can submit a written question using the Q&A chat box. Our next question comes from Aybek Islamov. Please state your company name, unmute locally, and proceed with your question. Aybek Islamov, please unmute locally and proceed with your question. Unfortunately we're not receiving any audio from Aybek's line, so our next question comes from Mohammed Al-Rasheed. Please unmute locally, proceed with your question, and state your company name.

Mohammed Al-Rasheed I just have two questions. The first one is regarding the assets yield and the effective interest on your interest-bearing liabilities. I wonder if you can provide these numbers excluding the Turkish subsidiary given that the current high interest rate in Turkey might distort the overall group number despite the low asset amount of the Turkish subsidiary. My second question is regarding your Bouki book. So I noticed that another bank who has conducted a merger... Most of their provisions in the last two years was oriented toward the Bouki book. So have you taken any further provision on Bouki and how do you see that evolving going forward? Can we see it as a downside risk to your provision outlook? Thank you.

Ahmed Aldhabi Thank you, Mohammed. Regarding your first question, we are going to provide you with a data supplement and it will be coming in the upcoming three to four days and they can really identify the segregation between the domestic and the international yields and NIM. Regarding Bouki, I think we see more upside than the downside. I think what we did is, during the merger, we have really done the fair value adjustment towards these Boukis carefully and more to the conservative side.

Mohammed Al-Rasheed Okay.

Ahmed Aldhabi Yes,

Operator We next have some written questions. The first written questions come from Rahul [unclear], asking, is the expected slowdown in mortgage demand visible already or do you think that it will be felt later in 2023? And then to what extent any margin compression in Turkey going forward is responsible for group NIM compression expectations.

Ahmed Aldhabi For the first question, we think the growth in mortgage remarkable and resilient considering the interest rate environment and considering the outlook of this in 2024 with the expectation of declining interest rates. I think we think there will be an ample room of really growth in 2024. For the margin compression going forward, between the domestic and the Turkish, I think it is really depending on really the outlook and the results of the election. I think really some changes might happen due to really the monetary front based on who is really winning the election, and that is really wait and see. But considering the rates, the composition that we are having vis-à-vis our domestic, it will have an impact. We will keep you posted and updated in Q2 on this.

Operator Our next written question asks, what's your outlook on the Turkish operations in 2023 and 2024 considering that post-election there could be change in monetary policy as well as currency depreciation?

Abdulbadie Alyafi Yes. Thank you. I think for us really the main consideration is the hyperinflation accounting. If you look at the standard, it really takes into account multiple years of track record before we see any changes. So, for

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example, we entered into the hyperinflation accounting regime after multiple years of high inflation. So I don't think this is really for us to comment on discrete events. It's really about the longer term.

Ahmed Aldhabi Adding to this, what we think about really Turkey is really... We see some positive momentum that is really coming. If you really see the contribution of our net income, it's becoming very minimal considering our size now. So what is really a matter for us? It's strategic investments that we continue to have and we think that everything now is going hopefully now into the upward trend and making sure that Turkish subsidiaries are really resilient and really doing their operation on a standalone basis and that has continued to be the case moving forward in stress scenarios and in good scenarios. They are continuing and has been doing a good job of contributing positively to the bank.

Salman Ahmed Just to add on what the CFO said, just to mention that TFKB in this quarter has made a net income of 1 billion-plus lira, which is a testament of their strategy working out very well in this inflationary environment.

Operator Our next question is a verbal question from Aybek Islamov. Please unmute locally, state your company name, and proceed with your question.

Aybek Islamov Hello?

Operator Hi there, Aybek. We can hear you.

Aybek Islamov You can. Perfect. Thank you. Well, I guess two questions from me. The first one is the write-off. Why is it so big in the first quarter? You mentioned during the call it's just over 1 billion Saudi riyal. It looks like it's a corporate write-off. Correct me if I'm wrong. That's the first question. The second question is, does the central bank in Saudi Arabia, SAMA... Do they regulate pay-out based on the capital surplus that you have over your core tier-one minimum? There are some jurisdictions which have these explicit regulations in place and that, I understand, is based on this Basel III reform. Is this the case in Saudi Arabia?

Ahmed Aldhabi For write-off, Aybek, I think last year we were on a really low base considering our size. This write-off pool is really created when it's really reaching certain days to be written off. So we did not do much in 2022 and that resides majority in really Q1. I think we expect to have similar things because now the size of our book is really almost double in terms of corporate and the write-off at the same time should be correlated with the size of the book. Regarding your second question, no, SAMA has no specific rules about really dividend pay-out ratio, but we are always encouraged to really be resilient and capitalised in a way that we really have considering our future growth and they are closely monitoring this through several forums.

Aybek Islamov Thank you. May I just add one follow-up question on asset quality? You talk about the NPO coverage and you take your total loan loss reserve divided by NPLs. But if you think about stage-three coverage by stage-three reserves, it's around 70% for Saudi National Bank. Is this a comfortable level? And if not, where would you like to see that stage-three coverage by stage-three reserves specifically?

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Ahmed Aldhabi Stage three... There is a timing factor for really covering the exposure by the time. So 70%, I think, is a quite good coverage level that we want and continue to have, but you can see this as an evolving thing, new NPL stage migration, and you can really... By the time, reducing and increasing the coverage against the exposure. Hence, it is a timing factor. In a simple term, if there is no increase in NPL coverage or NPL information by the time, the stage-three coverage will continue to be 100%.

Aybek Islamov Thank you.

Operator Our next question comes from Sharat Dua. Please state your company name, unmute locally, and proceed with your question.

Sharat Dua Hi. Can you hear me?

Operator We can hear you, Sharat.

Sharat Dua Great. Hi. Thank you very much. Two questions from me if I may. First of all, just a couple of items on your quarterly P&L which it would be great to understand a bit more where there's a little disclosure. So you have a line which is other operating expenses, which has almost doubled from the previous period, from 178 million to 336 and I've never quite understood what all is in there. It's quite a large item in the full year, so it'd be good to understand that. Offsetting that, there's a big reduction in your other non-operating expenses. So it'd be good to just address both of those, please, as a first up. That'd be great.

Salman Ahmed Of the other operating expenses that you can see in the operating income, that's basically the direct cost of some of the product that we have, for example, the insurance or the remarketing of the auto leased cars. So as we have all been telling, there are a lot of initiatives that we always take into consideration and execute. So as well as those initiated last year, we have got some other benefit that has reduced these costs in the operating income. So of course, if you exclude these one-offs, the cost for this year has gone up. Similarly for the other operating expenses, we have some one-off adjustments last year which are not repeated this year.

Sharat Dua So the last year or the last two years overall, this has been quite a large item. It's been over a billion and it wasn't clear to me what one-offs were included in that and whether it would normalise, but seeing it double in Q1... Does that suggest that we're still on quite an accelerated path?

Salman Ahmed I frankly don't know. We will get back to you on that to look into further details. A billion last year... I'm not sure I'm getting that.

Ahmed Aldhabi Are you talking about the absolute amount? It is really exceeding a billion? Or the delta is a billion?

Sharat Dua Absolute amount, what was addressed as other operating expenses. It increased significantly in 2021 and 22, so I don't know if it's merger-related or what, but it never used to be so big.

Ahmed Aldhabi So this line... It has some items that are really associated with the sales activity, in particular retail. For example, every new sale that you do, you have to really pay insurance against this, pay off auto lease, and

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some aftersales expenses that is really booked under this line. What Salman was saying... During last year we did have some one-off benefits. So we have a double effect here. This year we have more sales. That is really increasing the cost. Last year we had some savings that had been done. That's why you see the delta is around 115 million.

Sharat Dua So you would expect a similar run rate over the rest of the year.

Ahmed Aldhabi Yes, indeed. Yes.

Sharat Dua Because, like I said, as a full-year number in 21 and 22, it was big. So I'm just trying to understand. You're saying it's all sales-related. So it's because of high levels of activity that you're incurring these costs.

Ahmed Aldhabi The delta is associated with the higher sales activity, but the amount itself is really associated with the overall retail lending outflows. So it's a recurring thing. You are going to give an insurance on a fiscal basis.

Sharat Dua Yes. And on the non-operating expenses? That was 102 million in Q1 last year and 3 million this time around.

Salman Ahmed Yes. Again, those were one-offs that we have some adjustment here and there. There's nothing that significantly impacted our financials. The current year run rate is what we expect and what we have been forecasting, so there's nothing unusual this year.

Sharat Dua Thank you. If I may go back to the question around the net interest margin, I'm not sure I fully understood. Listening to a lot of your peers, the corporate banks are talking about NIMs continuing to expand over the course of this year. The more retail-focused bank are saying that their NIMs are at the bottom and are going to pick up. Clearly we've seen two further rate increases in Q1. So I don't understand why you'd be saying that your NIM has peaked given both of those factors unless there's a very significant change in funding costs which is not visible yet but is about to happen.

Ahmed Aldhabi We are a balanced asset-mix bank between wholesale and retail and you can now see the retail mix is exceeding 50%. That put us insensitive to interest rate when interest rate is going up or down. There is no impact that is coming for this portfolio. On the other hand, you can see that the funding mix, which is really cost-bearing over the total liability percentage, is really changing because of really the migration toward the cost-bearing liability. In a net-net, your net floating position is going to change, which is really the amount that it's going to give benefit to your interest margin. If you can see, maybe two banks now are saying either neutral or the other bank is saying negative due to this, the net floating positions. The wholesale-dominated banks are more into really winners because it is really their net floating position. It's more into positive and, considering the size in absolute terms, it's giving them benefit in terms of really margin. Any new commerce to retail will have this benefit because they have a huge change in asset mix that also will give them positive in their yield and their NIM.

Sharat Dua I understand that, but like we're saying, 50% of the book is still corporate-focused. On the funding side, your CASA ratio has still gone up from where it was previously. So I just don't see where the significant change is happening now.

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Ahmed Aldhabi Yes. When we say the funding mix... Because now you can see the spot of the balance sheet. So that's why we said we have some transitory nature. So these cannot be considered as a deposit that will give us a benefit, number one. Number two, interbank, you have to be really considering as some of which are cost-bearing in nature or maybe the majority is really cost-bearing in nature. So when you assess the balance sheet, you have to assess both cost-bearing along with really the asset mix that we're having. So people think that the only funding that we're having is coming from the customer deposits, but we have a big portion that is really under bank, which is exceeding the 150 billion.

Sharat Dua Sorry. Did you disclose how much of the deposits you were labelling as transitory?

Ahmed Aldhabi We said of which that we saw some, but anyway, it is not going to be considered for us as something that we put in terms of our sensitivity because it is really sensitive to leave at any time. So it's hot money that we cannot really deploy for long-period assets.

Sharat Dua But you're... Okay. So due to banks has... Your balances with banks have fallen from December, but you're saying the cost of that has increased markedly. Yes?

Ahmed Aldhabi Yes.

Sharat Dua And on the customer deposits, it has optically gone up a lot and CASA ratio looks like it's up, but you expect some of that to leave and therefore the real CASA ratio is not the 77% that we see. It's a fair bit lower if that's taken into account.

Ahmed Aldhabi Yes.

Sharat Dua Fine. All right. Thank you.

Ahmed Aldhabi Thank you.

Operator We next have a written follow-up question from Edmond asking, please, can you explain to me how the sensitivity is reduced to none to 2bps' impact on margin from 25bps' rate changes on margin versus what you have reported in 2022?

Ahmed Aldhabi Two things, the asset mix more towards fixed assets and the funding mix more toward cost-bearing.

Operator And our next written question asks, does your NIM guidance factor any rate cut during the rest of the year?

Ahmed Aldhabi Toward the end of the year. So no impact is coming for NIM.

Operator And our next written question from Fawad Khan asks, does the bank plan to issue a fresh tier-one bond sukuk in second half to reprofile or does management believe the level of capital post-recall of tier-one sukuk would be sufficient?

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Talal Al-Khereiji As was mentioned earlier, we're very well capitalised with a strong liquidity position even in the context of our upgraded guidance and prospects for the rest of the year. Having said that, our wholesale funding strategy is dynamic and ready to go as needed and is flexible in terms of currency, jurisdiction, and instruments. So we retain the right should we need it, but the plan is... There's probably going to be no need for it for the year.

Operator Thank you. Our next written question is from Talal asking, are you seeing government borrowing accelerating to finance the mega projects? What is SNB's plan to participate in such project financings? And have you updated or changed your previous statement regarding M&A policy?

Talal Al-Khereiji As mentioned before, this year, in the second half of the year, we expect significant pickup for these types of projects and funding means. The pipeline is looking extremely strong. SNB, as the leading Saudi bank, will naturally play a pivotal role in funding these activities and, more importantly, providing end-to-end service for customers and clients in terms of advisory and the entire value chain around these activities. So expect it to pick up in the second half of the year.

Operator And there are no further questions, so Mr Iyad Ghulam, back to you for the conclusion.

Iyad Ghulam Thank you, Sam. SNB Capital would like to thank SNB management for taking their time to conduct this call. We would like also to thank all participants for attending. We wish you a pleasant day. Thank you.