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Presentation

Amr Sager:

Hello, everyone. Thank you for dialling in to our Earnings call, full year 2019. With us today are our CEO, Waleed Almogbel, who is going to give us an update on the strategy and the highlights of the results, as well as our CFO, Abdulrahman Alfadda, who will go through our financial performance of the year 2019. Waleed, over to you.

Waleed Almogbel:

Thanks Amr, and thanks to everyone, for joining us on our Earnings call. I would like to give you a brief about myself, Waleed Almogbel. I have been with the bank for almost 13 years. And I was previously the CFO, the COO and the Deputy CEO. I was also leading our digital efforts last year.

So, let's go ahead and start with the first slide of the presentation. I believe you have seen from our results that our strategy implementation remains on track. We saw a very strong growth in mortgage and net profit margins. We continue to improve our customer experience and focus on our digital leadership.

In terms of performance, a very good performance in terms of net income before Zakat. We are up almost 12%. Also, a very strong improvement in NPM 47 bps higher. In terms of cost of risk, it remained stable. We are at 71 bps for 2019. NPL below 1% and good coverage ratio, above 300%.

In terms of the balance sheet, we continue to grow our assets, especially in retail. Strong growth in current accounts, almost 6% year on year. Our non-profit bearing deposit is almost now at 93%.

I then turn your attention to the next slide in terms of our strategic review. We have been running our strategy since 2015. It consists of A, accelerated growth, B, become employer of choice, C, customer focus, D, digital leadership, E, execution excellence. I will highlight just a few of these.

As you can see, we continue to do very well in mortgage. We grew almost 63% year on year and our book now stands at 55 billion which is roughly 21% of the total loan book.

Our employee, in terms of driving the engagement score,it reached 66%. We also launched last year the School of Banking and we have a very strong graduate programme in place. One is generic and the other one is focused on IT and digital. Over 80% of the graduates remain with the bank.

Customer focus. Our net promoter score continues to be number one. If I take you back to 2016, we were ranked as number seven. We will continue to monitor very closely to ensure that we maintain our leadership position.

For digital, it has been particularly a successful year. We have increased our market share in all digital payment channels. Number of active digital customers has reached almost 5.5 million. We are now getting over 60% of all new account openings on digital channels.

On execution excellence, we continue to focus on automation and robotics. As you can see, we reached almost 253 bots. We have also started moving into our new tier four data centre which should be finalised sometime during the second quarter. On volumes that we are processing right now as you can see it in the presentation it is continuing to increase. We reached 228 million per month, almost a 32% increase year on year.

Overall, very solid progress in terms of executing our strategy. However, our main focus will remain on mortgages as we see potential growth this year. Payments is one of our focus areas in 2020 and beyond. Also, we are sitting on a wealth of customer data and one of our priorities this year is to leverage from this data using data intelligence and machine learning. With that, I will pass it over to our CFO, Abdulrahman.

Abdulrahman Alfadda

Yes. Hello, ladies and gentlemen. Thank you very much for joining the call today. For the people who don't know me, I've been with Al Rajhi Bank for the last four and a half years, banking experience close to 22 years, and I've been appointed as CFO a couple of months ago. I'm glad to present our full year financial results 2019.

On the blance sheet strength slide number 4, again, great story and have managed growing our current accounts. We managed to grow our current accounts by 16 billion close to 6%. Total customer deposits have increased by around 18 billion, 6% higher. Total assets for the organisation have grown by close to 20 billion Saudi Riyal, mainly driven by the financing book which has seen an increases close to 18 billion.

To see a breakdown of the financing portfolio, again, as waleed has mentioned, the focus area for us in the last year was the mortgage. We managed to grow our retail book by close to 20 billion in 2019. Total assets for the organisation is around 384 billion Saudi Riyal.

Operating income has grown by close to 12.5%, reached around 19.5 billion Saudi Riyal. The main contributor for that increase is yield income. The growth on the yield income has a combination of a couple of items. Mainly the growth on the retail book which on the previous slide is around 20 billion.

On the financing we managed to improve our net profit margin by close to 47 basis points in 2019. This is despite the previous rate cut that happened in the US last year and SAIBOR as an average last year was around 2.63%.

On the next slide, you see the net income before Zakat. We managed to improve our return by around 12%. Again yield income, which I have explained in the previous slide contributed to the growth. One of the things that we are focusing on is growing our non-yield income, fee income, which Waleed highlighted that our key priorities for 2020 and beyond are basically payments and the digital field.

Our operating expense, 733 million higher compared to the full year 2018 and impairments charged is around 240 million, higher than 2018. I'm sure that you recall that we had Zakat settlement that happened in 2018. That's beyond us. So going forward, we are going to report net income after Zakat There will be no differentiation between the net income before Zakat and after Zakat, so at least we will have a better comparison.

Moving to the expense trends that we have seen in 2019, in the previous slides, we have highlighted that our total operating expenses have gone up by 733 million Saudi Riyal. The main reasons behind that, one, is the one-offs that we have been communicated during our earning calls in 2019.

Also, on the depreciation, you have seen that there is an increase close to 456 million Riyal. The reason for that increase is, there was a backlog of capitalising some of the fixed assets and we have basically cleared that backlog, but incremental increases between 2018 versus 2019 is close to 450 million Saudi Riyal.

Finally, on the G&A, a 436 million Saudi Riyal increase. The main contributor is basically in the communications and utilities expenses. If you recall, in 2019, there was a change in the SMS formats that is sent to our customers, and that has an impact in that line of expense. In addition, to expenses that support in investing in our IT and our software infrastructure – as Waleed has mentioned our key priorities over the last few years, especially on the digital.

On the next slide, stable asset quality, our group NPL stands at 90 basis points, flat compared to 2018. In Q4, we recorded 665 million of net impairment charge. Basically, the reason for that is a couple of things. One is the growth that we have seen in the retail, and especially in the mortgage book, so we're providing our top-up on our provision.

In addition, we have seen a couple companies on the corporate side that are seeing some challenging market conditions, so we have topped up our provision for these specific companies in the fourth quarter. Our NPL coverage stands healthy at above 300%, well ahead compared to the competition. Cost of risk on an annualised basis for the full year is 71 basis points in 2019.

On the capital side, the shareholder equity has increased to 54 billion as of end of 2019, close to a 6% increase, compared to the same period in 2018. RWA, an almost 7% increase compared to 2018, mainly driven by the credit risk, i.e. on the financing book. Our tier 1 capital is at 18.8%, and tier 1 plus tier 2 at around 19.9%.

On our return metrics, our return on equity, we managed to improve to 20.5% in 2019 versus the 19.8% in 2018. And return on assets increased to around 2.8% and we will continue to focus on improving our return, our profitability, going forward.

Now, the guidance that we provided in 2019. We have basically managed to deliver on our guidance both on the financing, where we have a 7.7% increase, to reach around 250 billion Saudi Riyal, and also the net profit margins was basically exceeding the guidance that we provided in Q3. We managed to improve our NPM to increase by 47 basis points.

Now, for 2020, in line with what Waleed has highlighted as our key priorities' focus in 2020, our guidance for the remainder of the year is mid-single digit growth in the financing portfolio. Our NIM, we are basically forecasting a flat to ten basis-point addition to the NIM for the organisation. Cost to income below 31% and COR between 60 to 70 bps our capital adequacy is between 18% to 19%. And finally, our ROE after Zakat is between 21% to 22%.

That is our 2019 update, we are open for any questions that you may have. Please go ahead.

Operator:

Thank you. If you would like to ask a question, please press star one on your telephone keypad now. If you're listening to the call via a USB headset device, you can click on the flag icon on the web browser to raise your question. So our first question comes from Waleed Mohsin from Goldman Sachs. Please go ahead, Waleed.

Waleed Mohsin: Yes, thank you very much for the presentation. I have three questions from my side. The first question on your margin guidance. You're guiding for margins to improve during 2020 and it seems to me it's driven by the growth in the mortgage book which adds to the asset mix. I want to understand if there are any discussions with the regulator on any sort of pricing caps, whether it's on the broader retail book or any part of the book. So is there any pressure or discussion with the regulator on any pricing caps? That's my first question.

On cost of risk, you mentioned that you've increased provisions on the mortgage book fully, given the growth. Just want to understand the thinking. Is it just stage one provisions that you're taking, given what your model is telling you? And we also noticed that link to the cost of risk increase driven by mortgages, there was a write-off during the fourth quarter on the retail side. So if you can explain where that write-off was coming through, that would be very helpful.

And my third and final question. You talked about the push on the digital side. And when we look at the fee break-up, there's a pretty good increase in the electronic channel related fee. If you could just explain what's happening with some of the other fee line items. For example, there's a big jump in the other fee income, whereas if you look at the draft and the remittance fee as well as the credit card fee, they all declined on a year on year basis. Thank you.

Waleed Almogbel: Thanks, Waleed, for your question. I will take the first one and Abdulrahman will cover the second one. Regarding the mortgage, as I mentioned, we see a big growth potentially in 2020. And as you know, all the banks really compete for this market. However, based on the demand that we are seeing, we don't foresee pressure on the margins from what we are getting right now.

Abdulrahman Alfadda:

Now, on the other question on your point about the non-yield income, basically it's one of the focus areas in 2019. On the payments side, we have basically improved our value proposition into many aspects. One is on the point of sale, in the credit card offering, in optimising our ATM network and offering the electronic channels to our customers. You've seen our manual to digital ratio has improved and the number of transactions has been increasing. So I believe it is one of our key focus areas on the payments and related income for 2020 and beyond.

On your question related to the cost of risk, basically it's more of a general provision that we have topped up on the retail book where we have seen good growth in 2019.

Waleed Mohsin: Thank you very much. And the write-off on the retail side?

Waleed Almogbel: For the write-off in this year, we have a clear policy that we do a write-off once the retail loans reach 180 days and above, and we implement our policy.

Waleed Mohsin: Thank you very much. Thank you.

Operator: So the next question comes from Shabbir Malik from EFG Hermes. Please go ahead, Shabbir.

Shabbir Malik: Thank you very much. Just going back on the point of cost of risk, we noticed not just for Rajhi but some of the other banks had provisioning rows in the fourth quarter. So was there any common theme or common accounts which drove provisioning, particularly on the corporate side? If you can share some colour on that, that would be very good.

The other question is if I look at your stage two and stage three coverage, that's gone up compared to last year. And with this high coverage, do you feel more comfortable, going into 2020, that you may end up at the lower end of your cost of risk guidance?

And my final question is on your opex. We saw... I think you talked about this in the introduction but if we think about the more normalised cost growth for 2019, what would that be, stripping out these one-offs, particularly I think in other expenses? If we strip those out, what would be a normalise cost growth in 2019?

Abdulrahman Alfadda: We cannot comment on other banks, but from our perspective and we are a very conservative organisation we are applying our prudent risk management, and we applied for specific corporate names during the fourth quarter.

Now, on your question about the operating expense, usually, we don't provide any operating expense guidance. However, we will keep investing in our IT and digital infrastructure, and I believe it's important for us to improve our customer experience, improve our value proposition, providing efficiencies going forward.

Now, from our perspective, if you see our guidance for 2020 and the cost-to-income ratio, should be below 31; and also, we're driving our business by focusing on providing positive jaws between operating income and operating expense.

Shabbir Malik: So if I may ask again on the provisioning, was there any regulatory driven provisioning in anticipation of any changes in regulation on provisioning? Was there any provision taken for that, or it was your own decision to take provisions against certain accounts?

Abdulrahman Alfadda: From our perspective, no.

Shabbir Malik: Okay, thanks.

Operator: Our next question comes from Farid Aliani from NCB Capital. Please go ahead, Farid.

Farid Aliani: Hi. Thank you very much for the very insightful call. I had a question on the cost of funds line for the fourth quarter. The gross interest expense, if you compare it on a quarter on quarter basis, we're seeing about 29% uptick in the cost of funds. So I just wanted to see what were the drivers of that.

Secondly, on the cost of risk side, it might sound a bit repetitive, but if you could shed a bit more colour. In the fourth quarter, we've seen the retail cost of risk, from the retail side, rise to about 100-plus basis points, in the fourth quarter specifically. So I just wanted to get some colour on is this all general provisioning or is it something that was related to select retail accounts as such? Thank you very much.

Abdulrahman Alfadda: Well, I'm lucky. In Q4, I was wearing a couple of hats – a treasurer and also lately, in mid-December, as the CFO. If you recall, in December, we had the big Aramco IPO. There were a lot of uncertainties in terms of the liquidity, what's going to happen, when the money will be out, and so from our perspective, we have taken a prudent position to manage our liquidity. We have taken some of the short-term term deposits in Q4, which is basically short-term in nature.

I believe, on the second question, it's basically again the provision is, given that we've seen the growth in the mortgage, mainly on the stage one and the collective provision.

Farid Aliani: Thank you very much.

Operator: Our next question comes from Adnan Farooq from Jadwa Investment. Please go ahead, Adnan.

Adnan Farooq: Hi. Thank you for the call and congratulations on this strong set of results. Would the bank be interested in the large government-driven projects that we now hear are kicking off? Or the bank will continue to just focus on the retail segment, which is its strength? And my second question is would it be possible for you to quantify the one-off depreciation expense in the fourth quarter, please?

Waleed Almogbel: I will take the first one, and Abdulrahman will cover the second one. We are interested in some selective projects as structured finance that we believe we will meet our risk appetite and margins.

Abdulrahman Alfadda: On the depreciation, again, the reason why we have seen the spike in 2019, as I have highlighted in my opening slides, is clearing the backlogs that we have, some of the projects were capitalised, and it's within the forecast actually, going forward, as further depreciation policies are implemented by the organisation.

Adnan Farooq: Thank you.

Operator: Our next question comes from Jagdish Bathija from Lazard Asset Management. Please go ahead, Jagdish.

Jagdish Bathija: Hi. Thank you for hosting the call. I had a couple of questions with regard to mortgages. We have seen fee rate cuts already and given the scenario, do we see the yield on mortgages coming down? Because it's already on the higher side of things right now. So going forward, is it a possibility that the government or the REDF may be coming in and talking to the banks, saying, you know what, the yields, the spreads need to decline? And how would that impact NIMs?

And secondly, you mentioned you expect mortgages to be the key driver going forward in 2020 as well. What are the other sectors that would be driving loan growth to achieve that mid-single digit target? Thank you.

Abdulrahman Alfadda: Okay. So we don't see a large pricing compression in the mortgage book, on mortgage sales. Again, we have seen a huge demand and we also have seen a further supply of affordable units that came into the market over the last couple of years. The mortgage market is growing and the demand is growing as well, and probably, once the demand is going lower, probably that might be a reason to reduce prices, but we don't expect it in the short to longer end.

In addition, we keep monitoring our mortgage sales and monitoring our market share on a regular basis, and if we see a sustainable market share decline, then we might need to be repriced accordingly to position ourselves, but in the short to medium term, we don't believe that.

Abdulrahman Alfadda: Can you repeat, sorry, your second question, please?

Jagdish Bathija: Sure. My second question was with regard to the key drivers of lending growth, going forward. You mentioned one leg would be mortgages. I want to know what are the other sectors? Corporate? We are hearing of the major projects coming through. Do we see things moving on the ground, or we still have the design and all these phases going through, so another year of delays on that front?

Waleed Almogbel: As you may know, we will always remain a retail bank. However, we will diversify our portofolio towards corporate whenever the price is right and the asset quality intact.

Jagdish Bathija: Got it, thank you.

Operator: Our next question is from Yavuz Uzay from Fiera Capital. Please go ahead, Yavuz.

Yavuz Uzay: Thanks for the presentation. A quick question on your cost-to-income ratio targets on slide 11 of your presentation. So basically, you're saying you're targeting mid-single digit balance sheet growth, a flat to small, slightly increasing margin. Assuming you'll be delivering 4% or 5% revenue growth, a cost-to-income ratio below 31% versus 33% in 2019 suggests a decline in operating expenses.

Can you elaborate more on that, saying whether it will be coming from some cost-cutting in non-HR costs or some optimisation in number of personnel? Can you just elaborate more on that, what kind of opex momentum should we be targeting?

Abdulrahman Alfadda: Thank you for the question. Again, we manage our business in the organisation by providing positive jaws anywhere between 250 to 350 bps. In addition, we have started in late Q4 some further initiatives to look at our operating expense. We have 35 plus of initiatives to review our expense line. Again, the guidance that we're providing on the financing is on mid-single digit growth, and our key focus for us by providing the value to the shareholder, where we are targeting to be below 31% on the cost-to-income ratio.

Yavuz Uzay: But that most probably suggests an absolute decline in costs. Is that a realistic target?

Abdulrahman Alfadda: We might see a push on the growth side. So again, we don't provide any specific guidance neither on the income nor the expense. But again, the cost-to-income ratio, our guidance for 2020, is below 31%.

Yavuz Uzay: Okay, thank you.

Operator: Our next question is from Edmond Christou from Bloomberg Intelligence. Please go ahead, Edmond.

Edmond Christou: Hello. Thanks for the call today. Most of my questions have been answered. I will just flag two questions, please. I think the cost of risk has been discussed already. I just want to understand, this is in the new fresh management review on the mortgage loan books, and you're saying this is mainly coming from stage one.

Do you assume now, going forward, that the cost of risk for this mortgage is higher than had previously been anticipated in the books? And also, are you able to remind me how this structure of the mortgage works, who is paying the down payment and the LTV on it?

The second question is on your M and A. New management in place, a fresh review on the bank. You have the capital buffer, the ability to observe smaller Islamic lenders. What's your view on M and A? It could be a good catalyst for the stock.

The last question is corporate. It seems that the old management and the new management is still of the same view that corporate margin or the spread on credits has been compressed over the years and you want to be very selective in the corporate lending.

But the question is, is this something that doesn't improve? Will you just stick to mortgages, unable to diversify your book? Because your target on the lending mid-single digits never changes. And it seems to me you are just beating it. And probably, if you grow your corporate, you're going to beat it this year. I just want to understand your view on diversification when it comes to the lending book. Thank you.

Waleed Almogbel: Thanks for your question. Regarding the mortgage, just let me clarify one or two things. First, the mortgage is from the customers themselves. They apply to the bank and they get the loan; they pay their down payment. The government has certain criteria where they subsidise the interest on behalf of the customer. So we expect this to continue, as I mentioned, for this year, 2020, and we're expecting the growth will remain as the second half of last year.

For your second question, we will remain as organic growth.

Edmond Christou: Just to follow up on the mortgages. So the customer pays a down payment. It's not a loan being taken for the down payment, correct? It's cash, so your LTV is 90%?

Waleed Almogbel: Yes, it is.

Edmond Christou: Okay. The second one is on corporates. We always thought that you don't want to go onto the corporate because the margins are tight. And we are hearing from other banks that they expect margins to stabilise on corporate in the second half of the year. This could be good news for you.

But I just want to understand how you are thinking about diversification within the books. Most of the Saudi banks now, concentration is with mortgages from the retail side, and especially for you, since this is a large chunk of your loan books. So what's your appetite for corporate? What's your strategy for the corporate? Thank you.

Abdulrahman Alfadda: Okay. So let me remind you, from our perspective, we have the lowest cost of fund in the world, and probably, we can win any transaction if we want to participate in at any margin, but we do have our internal risk appetite that has been discussed in various committees within the organisation, be it the ALCO, the Credit Committee, or the Risk Committee, etc.

So we are looking at the corporates from our perspective as, if the asset quality is good and pricing is attractive, we will be more than happy to participate. Now, whether the demand will come now or later, that's yet to be seen from our perspective.

Also, I'd like to highlight that both myself and Waleed are members the Credit Committee. So from our perspective, the strategy is looking to improve our value to our shareholders, pricing and the markets.

Edmond Christou: Okay, thank you. Very useful, thanks.

Operator: Our next question comes from Junaid Farooq from FIM Partners. Please go ahead, Junaid.

Junaid Farooq: The first question is what is the current size of your mortgage book? My second question is, is there an internal limit on how big you will allow the mortgage book to grow, given the asset-liability duration mismatch that it brings with it? And third question is, would you be looking to do a long-dated paper just to resolve the asset-liability mismatch created from the mortgages?

Abdulrahman Alfadda: Thank you for the question. Currently, our mortgage book stands at around close to 55 billion Saudi Riyal. We don't have an internal limit per se for the percentage of the mortgage book. However, let me clarify that. Internally, we do have again from our perspective our internal risk parameters, covering both liquidity risk, market risk, credit risk versus others. Those risk appetites are much more conservative than from the regulatory perspective. And that's on the mortgage book side.

Now, on the second part of your question, the asset-liability mismatch historically has always been there for all the Saudi banks. From our perspective, our current accounts are sticky and we have been delivering a good track record of growing our market share and growing our balances in the current accounts over the last few years.

We will keep focusing on growing our current accounts, and in case there is a requirement later on, probably we can capture the debt market via the sukuk. However, for the time being, we are comfortable for the time being within our internal risk appetite.

Junaid Farooq: Okay. So just to make sure that I got it right, the bank does not have any internal limit as such on the extent of how big they would allow mortgages to grow to, so theoretically, your mortgage book, which is currently 55 billion, can double if demand continues to be strong. Would that be a fair assessment?

Waleed Almogbel: Well, comparing to international developed banks we see higher split in retail banks in mortgages, we aim to be the same.

Junaid Farooq: Okay, thank you very much.

Operator: We have no further questions registered, so I'll hand back to the management team to conclude.

Waleed Almogbel: Thank you very much, everyone dialling in. From our side, I just want to thank all of you for your continued support. We are very proud of the results of the bank. And we remain very confident of our ability to continue to deliver this year and beyond. We will continue to keep you informed on our execution and performance. However, in the meantime, you can always reach our IR department. Thanks.