Alinma Bank Q3-22 Earnings Conference Webcast Transcript **Wednesday, 02 November 2022**

Lauren: Hello and welcome to the Alinma Bank Q3 2022 Earnings Conference Webcast. My name is Lauren, and I'll be coordinating your call today. There will be an opportunity for questions at the end of the presentation. If you would like to ask a question then please dial into the conference call and please press star followed by one on your telephone keypad. I will now hand you over to your host, Ribal Hachem from Arqaam Capital, to begin. Ribal, please go ahead.

Ribal Hachem: Hello everyone, and thanks for joining us today. This is Ribal Hachem, and on behalf of Arqaam Capital I'm pleased to welcome you to Alinma Bank Q3 2022 Earnings Call. With us today from Alinma Bank, Mr Abdullah Ali Al Khalifa, CEO, Mr Saleh Abdullah Al Zumaie, senior VP and head of retail and digital banking. Mr Adel Saleh Abalkhail, CFO, and Mr Ahmed Sager, IR manager. Now without any further delay I will turn the call over to the CEO, Mr Abdullah.

Abdullah Ali Al Khalifa: Thank you. Hi, everyone, welcome again for our earnings call for Q3, 2022. As usual I will give a high-level review of the financial performance, then a quick reminder of our current strategy, and the progress of our implementing the strategy. So I'm now already on the presentation sent to you. On page 4, just a snapshot of the financial position, the market share, stock highlights and the digital transactions statistics. If you flip to page 6, on the financing side we had very strong growth in Q3, almost 7% growth. As you recall, in the first half of the year we did not have much growth in corporate. On the contrary, we had some small decline. But utilisation was very strong in Q3, and obviously retail continued their strong performance in sales. As a result we have 11% year-to-date compared to, I think, 3.9% in the first half.

In assets we had also growth of 11% for total assets. For deposits it's 9% year-to-date. For operating income we've increased by 17%, while our net income increased by 31%. Our credit quality ratios, in terms of NPL coverage or NPL ratio all improved. NPL ratio stands at 1.67% and our coverage ratio is almost 156%. As I mentioned, customer deposits, 9% growth, but what's more important is the CASA growth. We have 9% year-to-date growth despite the difficult time in terms of high interest rates, which typically see a migration towards more timed deposits. The first nine months cost to income stands at 34.7%. Our NIM stands at 3.59 basis points. As I mentioned in a recent meeting with the investors and analysts, when we see strong growth in loans, naturally the percentage of CASA will dilute. So despite the fact that we continue to focus on growing our CASA balances, the percentage of those as of customer deposits will dilute, and now we stand at 65.5%. Our CAR is 20%.

A quick reminder of our strategy starting from page 8. As some of you recall, the bank is aiming to be...

Lauren: Apologies. We've lost connection with the speaker. Please stand by while we try to connect them. The call with resume shortly. The management team is now reconnected. Please continue.

Abdullah Ali Al Khalifa: Apologies for this technical problem. I was going through the presentation, apparently not realising that we were disconnected. So I don't know where I disconnected but let me start by quickly reviewing our reminders of the strategy that we have.

I said, we are focusing on being recognised as the fastest and most convenient bank in the country. And if you flip to page 9, it gives you more details on the delivery of businesses. So, for example, Retail want to focus on building and expanding our affluent and high net worth franchise, attract more and more of the youth customers, and offer the best customer experience within retail. For Corporate, want to be the main bank, not only for large and project finance, but also for mid corporates. We want to develop and enlarge our SME offering, and we want to, obviously, focus on cross-selling through the development and cross-sale for cash and trade. For Treasury, we want to be the main partner for our corporate needs in terms of hedging and investing, as well as growing our FI business and maintaining a strong ALM function.

To do this, obviously we needed to build a digital factory, the left side of the presentation. We want to develop our advanced analytics to take advantage of the wealth of information that is available to us. And obviously the cultural transformation required not only to attract but also to retain the good talent.

On page 10 of the presentation, it shows you what we have achieved so far. Out of the original 63 initiatives for under the strategy we added 12 more. So that was 75 total initiatives, of which we already delivered 36 initiatives. Some of the functions, some of the development that took place in Q3, for example, we launched digital credit card and personal finance journey, form more than 45% of our IT project that delivers through an agile model. Our female participation force reached 19%, up from 13% at the beginning of 2021. Retail, we've also introduced point-of-sale financing to leverage the network that we have in order to reach more customers in that product.

We will also enhance an automated refinancing, and we deployed 21 more of the self-service machines or digital zones. Now every single branch that we have in the country has a self-service machine. And we've also launched our auto leads financing.

In Corporate we have very strong growth. In mid-corporate, as you know, mid-corporate is something that we just literally focused on or built capability over the last 12 months. We have year-to-date 194% growth on the booked asset, 310% growth on non-funded. We also have strong growth on the point-of-sale financing, 78%. And 37% increase in kafalah. In Treasury we finally successfully launched our treasury system, and I think that's one of the record times in terms of implementation. So it's already in production and live, and being used. We've managed to increase our forward FX deals into more than 2.6 billion. I know it doesn't sound much, but when you consider we had nothing at the

beginning of the year, it's a very good achievement. We're focusing, also, on selling more products in profit-rate SWAPS, to expanding more of our customer base in derivatives.

This year we continue to focus on 34 initiatives, delivering 34 initiatives, some of which is obviously progressing on the automation and utilisation of RPAs. Obviously we want to focus on driving employee engagement. We've done this OHI, organisational health index, in February 2021, and we've done it again literally ten months later, and we managed to have an increase of seven points. Typically organisations take two years to reach an improvement of four to five points. So we've done seven points' improvement in ten months, and that's obviously a result of all this transformation that took place as far as the town hall, the training, the career development, the clear communications. That all helped.

Obviously we're trying to focus on improving our new app, our current application. We're launching hopefully within a month or two max our new app that will have a much better functionality and look and feel. In Retail, we're working to enhance the family account ecosystem. We are trying to continue improving our turnaround time to digitising the whole process, our strength in marketing effectiveness and efficiency. In Corporate we're looking at adding more products in order to attract more liability. We're also working with the new model to Originate-to-Distribute, working with some international names as well as our investment company to develop this new product. That will allow us, obviously, to underwrite more and offload later on, and enhance the return on the remaining portfolio through the scheming of the offloaded portion. Obviously we will also try to implement a new loan-origination system in Corporate.

In Treasury, obviously we continue to offer more products and enhance more structured deposit products. We're obviously focusing on cross-selling where we continue to sell more profit-rate SWAPS, profit-rate caps, and forward FX deals. And we are also working with some of the international players to offer some of those products through to through back-to-back deals to our customers.

So that's the efforts we'll focus on this year, and with that I'll give the floor to our CFO to take us through a detailed presentation on the financial performance.

Adel Saleh Abalkhail: Thank you. Good afternoon, all, and welcome again to our Earnings Call for Q3 2022. I'm happy to walk you through the financial performance for the third quarter, and that will be followed by our recent guidance for the remaining of the year. I'll be trying to run this a bit fast to allow more time for the Q&A session at the end.

In slide number 13, the balance sheet trend, let's see total assets to growth YTD 11%, and this was mainly driven by 11% growth in the financing, and also was driven by 15% growth in our investment portfolio. The total liabilities, we have seen a growth of 15% YTD, and this during the nine months, and this was mainly 52% increased SAMA and also interbank deposits. And another 9% also growth in the customers' deposits.

In the second slide, slide number 14 in the P&L the trend, as mentioned the CEO, net profit year-on-year has grown 15%, which is 7% on a sequential basis from Q2. The growth in total operating, this comes from 17% growth in total operating income. Non-solicited impairment charges to the P&L were 23%, but that was offset by 20% higher operating expenses year-on-year. So if you can see from the top-right chart, funded income has grown 15%. We have seen the non-funded income also year-on-year, we have seen a growth of 23%. And as mentioned earlier, 23% was lower impairment charges year-on-year, and this was, as mentioned, offset by 20% more OpEx.

In the next slide, slide number 15, a little bit diving deep in the financing, more details on the financing. I've seen on a net basis that growth YTD 11%, and the gross basis is 10% growth in financing on a sequential basis from Q2. Financing has growth 7% in the net. So as you can see from the top-right chart, as of September the Corporate portfolio represents 75% from the growth financing, and the remaining 25% for Retail. Corporate financing includes project financing, large corporate, and also includes mid-corporate and SMEs as well.

As you can see from the top-left chart the breakdown in the growth by segment. So we continue to see strong growth in mortgage, 25% YTD, and that's up 8% from last quarter. Personal financing, which also includes the credit cards as well, 10% growth on a sequential basis, 31% YTD growth. As mentioned earlier by the CEO, we started to see during Q3 a pick-up in the corporate financing, bringing the corporate growth YTD to 5%, and SMEs, also financing continued to have a strong growth by September YTD to 21%.

In the next slide, on the deposits, as mentioned, as mentioned earlier, CASA continued to grow. We have 9% growth YTD in CASA, despite all the challenges. Timed deposits, obviously with the financing growth increased by 10%. As you can see from the chart in the centre, CASA as a percentage of total deposits as of September represents 65.5%. This is down from what we have seen in the first half where this percentage was around 71%, as more timed deposits are being added to the deposits base.

In the next slide, slide number 17, on the NIMs and income from financing and investments, we have seen a strong pick-up the net income. The YTD financing net income growth 21%, 33% from investment. As you can see from the graph in the centre of this slide, the improvement in the sequential basis on the NIMs for the bank, very strong growth, 40 basis points, reaching the quarter-to-date for Q3 NIMs is standing at 3.89. As you might remember, our exit NIMs last year, December 2021, was 3.42. Looking at the YTD NIMs as end of September, standing at 3.59, that's a 17 basis point NIMs expansion YTD.

In the next slide that's related to the fees and other income. We have seen lower on a sequential basis, 23%, in the non-yield income, but that was mainly a drop in the other income. But looking into the top-right chart, fees from banking services have increased year-on-year 7%. That's basically a 17% growth in income related to fees from banking services,

but that was offset by an increase in fees-related expenses. 50%, as mentioned, from volume and other cross-sell that was mentioned by the CEO. 50% FX income growth year-on-year. The composition of the fees, from banking services, as you can see from the bottom-left chart, fund management represented 32%. 33% from the fees from banking services. From card services, trade finance represents 10%, and the brokerage fees represent 9%. And the remaining is for others.

And the next slide, slide number 19, in the operating expenses, as you all know the bank is running through an investment cycle and we have seen 20% year-on-year growth in OpEx. The increase came from 17% relating to salaries and employee-related expenses. We have seen a pick-up in depreciation, 11% year-on-year as we capitalise most projects. And other G&A is increased to 27% year-on-year. So as you can see from the graph in the centre, cost-to-income ratio, it's 1% on a sequential basis drop from Q2. However, it's higher than where we were in the same period last year. So as of September, cost-to-income ratio stands as 54.7%.

On the next slide, slide number 20, on the impairment for financing, so the impairment charges during Q3, an increase of 10%, and year-on-year the impairment charge increased 21%. The composition of the total impairment allowance 15% relates to Retail, but obviously the majority, 85%, is relating to Corporate. Cost of risk stands at 74 basis points. Cost of risk for the nine month improved by 33 basis points, if you look at the cost of risk as of September last year.

The next slide, slide number 21, the NPL and NPL coverage ratio, we have seen NPL ratio decrease by 8 basis points during the nine months to reach 1.6%, and also an improvement of 60 basis points year on year. Also on the NPL coverage ratio, NPL coverage ratio increased by 9.1 basis points per thousand year-on-year. And also if you see stage 1 coverage remains stable at 50 basis points. Stage 2 coverage is at 18.9%. Stage 3 coverage as of September stands at 56.1%.

The next slide relating to the capitalisation and liquidity. Obviously with the growth that we have seen in the portfolio, including the pick-up in the corporate financing growth in Q3, with the increase in credit, risk credit weighted assets, the CAR stands at 20.1% as of September. If you can see also in the LCR, LCR declined by 2 points per thousand year-on-year, and that's due to the increase, obviously, in the shorter-timed deposits, and also the increase as we mentioned before 52% YTD growth in the interbank placements. Regulatory LDR stands at 87% by end of Q3, and also NSFR, NSFR has decreased 6.2 points per thousand year-on-year to reach 103.2. That's due to the increase in corporate financing that's mentioned, with slightly longer maturity, and also that's also followed with an increase in short-term timed deposits and also interbank placements.

The next slide is to give the guidance for the remaining of the year. On the financing we have seen, as mentioned, 15% growth year-on-year, and as you may recall we had a mid-teen guidance following our Q4 results last year. We have revised this in Q2 for the low teens. And with the pick-up we're seeing in corporate, we are revising the financing

growth now for high teens. All other guidance remain unchanged. Net profit margins stand at 3.59%, as mentioned, 14 basis points year-on-year, which is YTD 17 basis points. So the guidance remains 20 to 25 basis points expansion. Cost-to-income ratio stands 54.7%, and the guidance unchanged to be below 55%. Return on equity, 14% and the guidance remains unchanged above 13%. Cost of risk, 74 basis points, and the guidance unchanged for the range to be 65 to 75 basis points. Our common equity to 16%, and no change to the guidance, 16% to 17%.

Just to remind you that it's in the appendix to the presentation a couple of slides that is an update to the ESG that we are working on now, and it's [unclear]. With that, I will leave it for the Q&A.

Lauren: Thank you. If you would like to ask a question, please dial into the conference call and press star followed by one on your telephone keypad. If you change your mind, please press star followed by two. When preparing to ask your question, please ensure that your phone is unmuted locally. Our first question comes from Waleed Mohsin from Goldman Sachs. Waleed, please go ahead.

Waleed Mohsin: Yes, thank you very much for the presentation. Three questions from my side. First one, loan growth you had a very good quarter, and when we look at the break-up, not only did you improve your corporate book, but it was good growth on the retail side, SAR 3 billion. I was wondering, how do you think about the profitability of retail growth in this environment? What I'm thinking is, let's say at the end of September or maybe August, September, a bank originated a personal loan, SAIBOR plus 50 or SAIBOR plus 100, and it's a fixed rate loan. Given the move in SAIBOR, it seems that that loan is now not profitable, if this was funded through a timed deposit. So you're thinking on retail organisation would be very helpful. I know not all of the loans are funded, obviously a large part is funded through CASA, but still, given where SAIBOR is it just seems that regular origination is becoming less and less profitable, so your thoughts on that would be very helpful.

Another question on liquidity, your regulatory NDR is now 87%, closing in on the 90% cap. I was wondering how you're thinking about liquidity, and if you expect any action from the central bank to ease the current liquidity situation with six months' SAIBOR at 5.91 today, and 12 months beyond 6.

And my last and final question, if you could comment on the decline in Stage 3 coverage, is it mainly due to changes in the loan book mix which is driving the Stage 3 coverage, or because certain NPLs are asset-backed and you don't need that? Thank you very much.

Abdullah Ali Al Khalifa: Thank you, Waleed. I will leave the first question to Mr Saleh, but I'll take the second and third. In terms of liquidity and the LDR being at 87, I did communicate multiple times in earning calls and meetings with investors that we try to be efficient in liquidity without having to take risks on the level of liquidity. And I said that

intentionally we manage our liquidity to be within 85% to 86%. Obviously, why 85% to 86%? Because that reduces the need to take expensive timed deposits, especially nowadays. You've seen how expensive they are. As well as leave enough margin for any last-minute unexpected withdrawal of deposits or unexpected utilisation on loans. That's what happened. There were some last-minute reduction deposits. 87%, I think 87% is beyond our normal range, but we feel comfortable that that is under control. We're going to continue to target 85% to 86%. Obviously if we're getting cheap deposits, like CASA, and so on, if the rate should decline significantly, I don't mind. But we don't want to take out of expensive timed deposits just to show lower LDR.

And I think you also had a part of whether SAMA may inject liquidity or not. They've done this before. Are they going to do again? I don't know. We've seen some statistics like reverse amounts declining to 7 billion. That may be an indication. But to be fair with the Central Bank, Central Bank should not be seen as the main funding or the main source of funding. It should be for stability of the system, and so on. So it may or may not. We'll have to wait.

I think you also talked about decline in Stage 3 coverage. We had write-offs, and that's the main reason. That's the write-off. Obviously when you have a loan there sitting at Stage 3, before write-offs it's 100% already provided for. All of a sudden the amount as well as the provision disappears. So naturally what remains, they lose the percentage. But I think it's all under control. You've seen our all coverage ratio improved, our NPL ratio decline.

I leave the first question for Saleh. If you can take that question about the loan and stability.

Saleh Abdullah Al Zumaie: Hi. I think from the beginning we talk about this many times in the previous earnings calls. As a bank we did not go in this price war from the beginning. So the origination and the new sale profit rate are very well within our budget and within our strategy until 2025. So it is very healthy pipeline, and the new sales rate is well above the [unclear] today. This is one. We are focusing on the new high yielding products, for example the current discount, so we have very good sales, and the portfolio has grown significantly. This is two. Three, also almost 10% of our portfolio in Retail is re-priceable, so we can re-price every three months. This is going to go to the private banking customers. We could re-price the contract every three months, and this is three.

Number four, you know [unclear] happen after six months, so even if we booked deals at the beginning of the year, now we count above with a higher rate. And with both in mind that the lifetime of the retail, especially in the personal loans, is only 18 months maximum, so the customer is refinancing for full amount or he keeps above. Also we're having a new product for mortgage, so we could re-price much faster than before with the different sort of product that we have today.

Waleed Mohsin: Thank you very much. That's very helpful. Maybe I can just have one follow-up on liquidity on the deposit side. What trends are you seeing currently given the liquidity tightness? Are you seeing banks, competitors offer rates above SAIBOR? Is that the trend on the timed deposit rate, or are banks being a little bit more mindful in terms of what's developing on the timed deposits side?

Abdullah Ali Al Khalifa: No, obviously I think that was a continuation of what you saw before. We still see banks are following, and we're also included. I'm not saying we're totally innocent, but we have to take the pulse, we have to compete. So we've seen banks paying north of 30 basis points, 40 basis points, sometimes, to get deposits. And if you look at the market to be a loan growth, with the exception of one bank, every bank has a double-digit growth in loans. The whole industry increased 15%. That's a strong growth in loans that typically, obviously, will not see the similar growth in CASA, especially with this high interest rate, now. So naturally there is a clear competition on deposits, and that's driving the cost. And that's one of the reasons why we did not actually upgrade our NIMs outlook. We're doing very well in terms of the appetite, but obviously corporate funding is eating up on these NIMs, as well as certain cases you have to obviously, with high interest rates, some customers are no longer accepting the normal spreads that banks charge. So everybody is shopping around and getting good rates in terms of spreads. And we have to compete on some of those loans.

Waleed Mohsin: and then the margin guidance, as you said you did not revise. But on a sequential basis, because your exit rate for the quarter is significantly higher than your nine-month rate, do you expect sequential expansion or do you expect NIMs to start plateauing?

Abdullah Ali Al Khalifa: I'll leave it to Adel. You have the numbers.

Adel Saleh Abalkhail: what it does, we guided for the remaining of the year the 20 to 25. As you rightly said, we're seeing the quarterly sequential basis 40 basis points. That's a significant expansion in the NIMs in the quarter to date. And that's, again, what we have also maybe mentioned earlier, that Q2 and Q3 included most of the re-pricing that we were expecting in our corporate portfolio. So there will still be some re-pricing. It might not be as significant as we have seen maybe in Q3. And, maybe along with the reason mentioned by the CEO on the deposits mix and the customers' behaviour, that's why we're keeping the guidance as is. So we have 17, as mentioned, in basis points YTD, so the guidance is at 20 to 25.

Lauren: Thank you. Our next question comes from Nida Iqbal Siddiqi from Morgan Stanley. Nida, please go ahead.

Nida Iqbal Siddiqi: Hi, thank you for the call. I have two questions. My first question is on the funding side. A bit of a follow-up to what we've been discussing so far. Given your LDR ratios are now at 87% and the strong loan holds

aspirations that, how are you thinking about funding sources for Alinma until 2023, 2024? So that's my first question. And then secondly a follow-up on the NIMs side of things. Given the increase that we're seeing in funding costs, do you see a NIMs sensitivity that you have provided earlier this year to be lower going forwards, and if so, any quantitative colour on that would be much appreciated. Thank you.

Abdullah Ali Al Khalifa: I think if you could just repeat the last part, I'm not sure I follow. The last part of the question.

Nida Iqbal Siddiqi: Has the NIMs sensitivity for Alinma Bank decreased now versus the start of the year to rate hikes, given the increase in funding costs that we're seeing? And if that has decreased, would you be able to quantify what the latest NM sensitivity is to rate hikes, please?

Abdullah Ali Al Khalifa: Thanks for your questions. In the first part about the funding side, I was talking about the number of initiatives we're working on. Some of them are also focused on the funding side through diversification of sources of funds, through, also, getting longer duration deposits and funding. We're talking to multiple international partners or financial institutions to see if we can work out on certain deals that will provide long-term funding. We all have on the table, also, the ability to issue a sukuk, senior, most likely, not capital instruments. So this is obviously something that we look forward to continue our growth story. We're also, as you know, focusing as you've seen already, despite the competition, despite the price increase in SAIBOR, we still managed to increase our CASA balances.

Certainly I am not ignoring the issue of liquidity. Liquidity is, and I mentioned it in so many meetings, to me the biggest challenge that is faced by banks is about liquidity. And I think the demand is a huge comment on loans. So liquidity will be more important. The issue was obviously very well-known by the regulator. We recently, us banks, went to the Minister of Finance to say there could be weight on the liquidity in the market, and attract maybe more international funding coming to the market.

In terms of sensitivity, I agree. I think at the beginning of the year there was competition in the past, but not as now. The rate itself at that time was not high enough to impact the composition. If you recall, we were growing our CASA as personal deposits. But when the rate crosses in five months, three months, now, its 560-something, clearly that is encouraging customers to migrate to deposits, timed deposits. You've seen some news about some institutions issuing a sukuk at a very attractive rate. That also attracted more of the migration. The competition on not only the composition of deposits but also the composition of deposit meaning banks are paying more than the benchmark, have an impact, obviously, in the NIMs. As well as, as I mentioned also, there is also competition on the pricing of the assets, and that's forcing banks, especially with the customer saying, look, 560 or 565 SAIBOR, I can no longer accept 150 basis point or 140 basis point that used to be when the rate was very low. So that is something that is obviously some banks

are offering lower pricing on corporate, which in certain cases we have to compete. So, yes. The balance has changed compared to the beginning of the year, and I agree the sensitivity will be necessary.

Nida Iqbal Siddiqi: Thank you. Can I just follow up with one more question on the loan growth side of things? It's quite interesting that you lowered your guidance following growth in the second quarter and you have now increased it again. I just wanted to understand better what was the driver of the positive surprise during the quarter? Did competition decrease? Because that was cited as one of the reasons for the weaker loan growth in the second quarter. Or did demand surprise positively? Thank you.

Abdullah Ali Al Khalifa: The reason we reduced our guidance is that at the beginning of the year we were expecting good corporate loan growth. What happened is not only we had no growth. We had, I think, almost 500 million lower in Corporate. We're still about the longer term, but what we saw and experienced during Q3 was a very strong utilisation. Almost half of that came through project finance, for example. As you know, project finance is one of the inheritance that the bank has, and the level of competition is much less when it comes to project finance. On normal corporate loans you are competing maybe with 10 or 11 banks, 10 listed and 1 unlisted. And when it comes to project finance you find you are only competing with maybe two to three, max. So the level of competition is less. And that is contributed to this. And then you look at the outlook for Q4. The top four team we looked at the potential utilisation, the likelihood of the utilisation, as well as, obviously, from the corporate side, from mid-corporate, from project finance, from SME and of course from retail, and that's why we upgraded our guidance to be how it is.

Lauren: Thank you. Our next question comes from Naresh Bilandani from JP Morgan Chase. Naresh, please go ahead.

Naresh Bilandani: Thank you very much, thank you, Abdullah and Adel. It's Naresh from JP Morgan. Three questions, please. First of all, congrats on your treasury system announcement. I know you put in a lot of effort in this direction this year. Can you please just elucidate on how we should think of the liquidity and the product cross-sell benefit that could potentially come from this upgrade? We've seen similar developments in some of your peers a few years back and that's clearly helped them a lot. Clearly I think some guidance on this side would be very helpful. That's one.

Second is, also I think on the project finance question that was asked previously, is this project finance growth related to giga projects, or is that not yet the case? How should we think of the giga projects-related growth going into 2023?

And my final question is just a follow-up to the reply that Adel offered on Waleed's question on the Q4 NM. Do I understand that right that you mentioned that a majority of the re-pricing is done for now and in Q4 the NM could come under somewhat of a pressure on higher funding costs first? Is that just a timing impact, and the higher SAIBOR

could be better-reflected in, let's say, Q1 next year? Or have I not understood this completely? If you could offer some clarification on that, that would be super-helpful. Thank you.

Abdullah Ali Al Khalifa: Thank you, Naresh. Obviously on the treasury system, the success of going live will allow us, and I think I was to mention that typically may be offering some rates of structured deposits that offer potential high upside for our customers, the reviews of options, and obviously you may be back-to-back with other banks. Something that we'll be able to offer without a proper system is very difficult to do. We can offer multiple structured deposits. Hopefully that will improve the diversification of the funding, and maybe attract new funds to the bank.

Project finance, no, actually, we have not yet seen strong demand. Let me rephrase that. We did not see strong utilisation come from CAGR projects. We have some potential big projects for employees of Neom. There are so many sites. It's a sizeable project. Some of our customers were bidding for it and they got awarded. But that's mainly start utilisation. So it's a 2023 story rather than Q4. And I leave the NIMs question to our CFO.

Adel Saleh Abalkhail: So Naresh, back to the NIMs question. If you recall, Q1 this year our NM for the first quarter, it was zero movement from our exit NIMs in 2021. We have seen an 18 basis points improvement in the second quarter from the year and also Q1. And this is, again, which we have been talking about on the re-pricing for Corporate and when the majority of the re-pricing is going to take place during Q2 and Q3. And of course, even if there are some re-pricings that take place in Q2, even if this happens, some of that would take place towards the end of the second quarter, so that you'll have a full quarter and back for Q3. So it's not surprising to see the 40 basis points. And also the fact that we are now looking at the YTD NIMs. As I mentioned, they're standing at 17 basis points as of September and the guidance, as we mentioned, 20 to 25, taking into account, again, that only the improvement that will continue in the pricing, but also the customer behaviour changes and also the increasing rate and to what level the cost of funding will be hurting the NIMs towards the year end. So that's why the guidance remained unchanged from last quarter.

Lauren: Thank you. Our next question comes from Rahul Bajaj from Citi. Rahul, please go ahead.

Rahul Bajaj: Hi thank you. This is Rahul Bajaj from Citi. Three questions from my side, if I may, please. The first one is on the OpEx, and really since 20% Y-on-Y growth in nine month OpEx, which I understand as you said earlier in the call is given by investments in the stock costs and other system enhancements. I just want to understand as I look forward into the next couple of years, at what rate should I think OpEx would normalise, and when? It's like a heightened 9%, 10% kind of growth rate in 2023. And I had a reasonable OpEx growth, or you think this high pace of investment would continue, at least for the foreseeable future? That's my first question.

The second question is on non-RDF mortgages, actually. Earlier this week one of your peers actually made a comment that they see a exciting opportunity in the normal RDF, so non-subsidised mortgage market. Just wanted to hear your thoughts around this topic, and what are you seeing in terms of subsidised versus non-subsidised mortgages? Probably these no rate caps, non-RDF mortgages become more attractive to banks in the current environment. So that's my second question.

And my final question is, on the overall strategy, I see that you talked about your retail operating business enhancement, and just following up on the questions previously asked by Naresh, how should I think about the business mix evolve over the next two to three years, given all the enhancement programmes? So if I look at your current asset mix, that is roughly, give and take, 15% Retail, 55% Corporate, and 20% Treasury. If I fast-forward to 2024 or 2025, do you think the business mix will be very different, asset mix will be very different, or in your view it will be similar to what we are at today? So those are my three questions. Thank you.

Adel Saleh Abalkhail: I'll be taking the first question on the OpEx. As mentioned before, as you know, Alinma is currently running an investment cycle related to the strategy execution, and also the need for investment across the bank operation. So when you say, just to correct the 20% growth was year-on-year, not really a YTD. It's not only during the nine months. Just to correct the percentage. Definitely last year and including this year OpEx has increased. We're talking about [unclear] and employees-related across the G&As. There are parts of these expenses is as I mentioned it's an investment for the future. But also some of the investments as we are mentioning there will be some expenses that it's coming related to telecommunications, SMS' that needs to be done, and other business-as-usual expenses. So expenses for 2021-2022, and obviously an investment done in 2022 mid-year or toward the year-end will definitely have a full impact the year after.

In the longer term we wouldn't be thinking to see the same percentages of growth for sure that you have seen maybe in the couple of years back. But definitely there will be some full impact of what I mentioned of some of the investment that we have done this year. Most importantly is what we are looking for in the cost-to-income ratio, and this is the ratio that we are monitoring closely, and that is set, as we mentioned in the guidance we will be giving the, also 2023 cost-to-income ratio guidance following Q4 results. So that is also something that is also expected to continue to improve.

So after this question, the medium-to-longer term OpEx growth shouldn't be compared to what the bank had to invest given the current investment cycle this year and what happened last year.

Saleh Abdullah Al Zumaie: I think from the beginning we did not really go on the price war for the RDF. I know some of the banks' RDF portfolio is almost 90%, 97% of their mortgage portfolio. Alinma is totally different. We have a very

good-sized portfolio for non-RDF where the price is not capped. And also we introduced commercial mortgage loans. This will add to the non-RDF portfolio. One of the products that we have also for non-RDF is equity release. So this is for customers who have already owned the house, so we can mortgage again as a bridge of their property. Today almost 25% of all portfolio is non-RDF, and I think we are one of the lowest banks in RDF mortgage portfolio.

Abdullah Ali Al Khalifa: Rahul, on your last point about how do we look at the business mix going forward, and I mentioned this in a couple of meetings at least. When we look at what's coming because of the 2030 vision, which called for private sector participation, private sector doing a lot of the projects that the government used to finance, plus the new sectors coming into the country again through private sector participation, clearly that's a huge amount. I've always mentioned that the combined lending capacity all depends on not being up, and that's why we should expect to see more capital market activity, and more international money coming into the country.

So in a nutshell, the retail growth will continue to be very healthy, both the mortgage and the consumer loans, supported obviously by continuous reduction of unemployment, meaning more bankable customers coming to the market, as well as demographics is very supported to retail growth. But the size of expected credit for corporate is going to be big. So I expect in two or three years even fewer retail banks. You see the weight of corporate loans is growing, and growing fast. So I don't think with this focus on Retail that banks will be close to more balance, 50/50. In fact 75, I expect, even with good growth in Retail, that this percentage of corporate loans will increase even further.

Lauren: Thank you. Our next question comes from Aybek Islamov from HSBC. Aybek, please go ahead.

Aybek Islamov: I wanted to ask you about the asset quality of the loan policy. You have quite decent write-offs you have in the third quarter and the second quarter. I think they are north of 1%, so I guess that says that if you were not to write off these loans your NPL ratios would have been higher in the last quarter. Could you elaborate on where the write-offs are happening? That's the first thing.

Secondly, it looks like your loan loss reserve to loan ratio has fallen. I think there was a comment earlier that your NPL coverage by Stage 3 has also declined a bit. How do you think about your loan-loss reserve ratios? What kind of level is comfortable for you and then how do you think about the asset quality outlook overall? Thank you.

Abdullah Ali Al Khalifa: Thank you, Aybek. Obviously a write-off is a normal process that banks do. We did not go aggressive in write-offs. These are loans that have been there for a long time. So the write-offs, we continue our legal efforts to recover. During the quarter we had, also, some settlements, not just write-offs. We had good settlements that happened. We're expecting very likely more settlements to come in Q4. That's why we're towards the top end of the range, 74 basis points in terms of cost of risk. And we actually maintain that our guidance for cost of risk to be between

65 and 75, knowing there's also going to be potentially more settlement coming in Q4, and most likely more settlements coming in the first half of next year.

The reason for the decline in coverage of Stage 3 is basically because of the write-off. We continue to be conservative. If you notice, we don't like huge volatility in terms of cost of risk, so we're always being conservative, even if things are rosy. And they are rosy now. We still want to build enough capacity in terms of provision, and be prudent in terms of provisioning for credit losses. I hope that answered your questions, Aybek.

Lauren: Thank you. Our next question comes from Chiro Ghosh from FICO. Chiro, please go ahead.

Chiro Ghosh: Hi, this is Chiro Ghosh from FICO. Thanks for the call. My first question is again a continuation of the previous questions which people asked. What is the loan growth pipeline over the next few quarters? Because even at this rate if you can grow at this kind of pace and have such low asset-to-NPL ratio, I just want to get a sense.

And the second part is also a continuation of this. It's a hypothetical question. If the interest would have actually gone up by 3% over the last six or seven months, if the customer can actually still service their loan at this rate, very effectively undercharging them for six months back, or competition would have come in and would have captured. I'm just trying to answer that, whether the corporate borrowers could have paid much higher than this. These are my two questions.

Abdullah Ali Al Khalifa: Sorry, the second question is not clear to me. Can you explain it, please?

Chiro Ghosh: Yes. The second question is just a hypothetical question. I am wondering that, even at current rates, if customers are willing to pay these kinds of rates and not default, so hypothetically, had the interest rate not gone up, would you have still increased your interest rate, or competition would have come in? Just to get a sense about the affordability of the customers, that's what I'm trying to ask.

Abdullah Ali Al Khalifa: We cover the first part, the loan growth. It's a bit clear when we give guidance, the Q3 and we only have one quarter to go and we upgraded the guidance to be high teens. In a way you can almost calculate the expected growth in Q4. If you have two quarters to go, then maybe it's a bit difficult about next quarter growth. But we only have one quarter to go. We give guidance only for the full year. We don't give guidance for the first quarter next year. Until we finish, obviously, our business plan, our earning call and for Q4, that's the time we give guidance for 2023 loan growth, as well as others.

The second question I try to answer it as I, maybe, understood it. Maybe I misunderstood it. But typically a customer, when you look at EBITDA as a multiplier or a number compared to the interest expense, typically customers will have a

coverage ratio of three, four, whatever. It's obviously much less impacted. Obviously their margin declines, but nonetheless they're not going to go on red or not be able to serve the loan. So I think EBITDA, and that's why we'll be looking at our current portfolio of customers and see the ones that operate in a very thin margin. And then we can alter our strategy. Do we reduce pricing? Do we exit, if possible? Probably that. But I'm not sure I fully understand your second part.

Chiro Ghosh: No, it's quite clear. So you are saying the customers are not very far from very comfortable levels. They are slightly getting uncomfortable.

Abdullah Ali Al Khalifa: When interest rate goes from a SAIBOR of 70 last year to now 560, of course that's a big jump. Some of our customers or some other corporate customers do also have hedging. Not necessarily because of the outlook or the view of interest rates, just some people prefer to see stable cash outflow, so they do hedging. And whoever did it obviously are benefiting a lot from that hedging.

Chiro Ghosh: And just one quick one on the non-RDF. What would be roughly, [unclear] approximately.

Abdullah Ali Al Khalifa: Well, you don't have limits. You just basically have a free hand. Then you have to look at competition, other owners in the market. But you don't have a [unclear] as far as price.

Lauren: Thank you. Our next question comes from Mahmood Akbar from VCP. Mahmood, please go ahead.

Mahmood Akbar: Hi. Thank you for taking my question and congratulations on a very good set of results. I just have a very simple question. What is the marginal cost of funding now on the system? Is it sub-SAIBOR, is it above SAIBOR? If you could just explain that. And secondly, Mr Abdullah, you're a veteran in the industry, which can't be said about a lot of other bankers. I'm just wondering, in this tightening interest-rate cycle is it different than compared to 2004, 2005, and how is it different? When I ask this question I mean in terms of cost of risk, asset quality evolution, and also the stable level of NIMs, in case interest rates globally stay where they are at the moment. And thank you for taking my question.

Abdullah Ali Al Khalifa: Thanks, Mahmood, for your questions. 2004 I don't think I was in the banking sector, sorry. We've seen this cycle multiple times, if you compare it to, for example, something even more recent, 2016, when SAIBOR also increased significantly compared to the year before. At that time what banks did is they turned around and increased their spread on the asset side. So they went back to their customers and said, look, our cost of funding has increased and we have to pay a lot more now on deposits and we have to pass some of this. And that was the whole industry acted. Not in the cooperation, but basically it makes sense that's the normal prices that we do. That's what happened that time. 2004, again 2016, by the way, both cycles, we did not see the major demand on credit that we see

nowadays. After, really, the introduction of Vision 2030, especially over the last, I would say, 24 months, you can see a lot of the demand already coming to about the capacity of banks to lend.

Cost of funding, as I mentioned there is competition, because of loan growth, and banks are paying more than SAIBOR in all cases. Obviously sensitivity about the customers towards a basis point or a few basis points depends on the sophistication of some of the institutional depositors. These are very rate-sensitive. They shop around all the banks in the market and they get the best rate possible. Some are less sophisticated, so they deal with maybe two or three banks, and they'll be able to compete better there.

But truly as cost of funding, the increase is getting depositors more than the current SAIBOR, for sure. I hope that answered your question, Mahmood.

Mahmood Akbar: It does. Just a follow-up question, very quickly. Let's say interest rates remain where they are. Do you expect the marginal cost of funding to increase over time, simply because at the moment it seems like all the subordinated debt and Tier 1 issuances are coming at a tighter price. If some more Saudi banks borrow in the capital markets, the incremental cost of that will be even more.

Abdullah Ali Al Khalifa: It's true, because the outlook for loans to continue to grow and grow smoothly, and that means need to be funded because of the LDR, for example. At the same time, the loans do create deposits, but there are other factors that affect liquid in the market. Things like, for example, taxes collected in the monthly basis. You have also companies, including banks, issuing instruments. Also the normal migration, the natural migration you see from bank customers, whether corporates or individuals, move organisations, moving their money from sitting idle in current accounts now into timed deposits. All this will make more pressure on liquidity, for sure. As I said at the beginning of this, and I've said it multiple times, the biggest challenge then, and possibly the real challenge that the Saudi banks face is liquidity. I don't think it's a credit quality. I don't think it's lack of demand. I don't think it's technology, and so on. It's really the liquidity side.

Lauren: That is now the end of the Q&A session and this concludes the Alinma Bank Q3 2022 Earnings Conference Webcast. Thank you for joining us today. You may now disconnect your lines.