Israel Discount Bank Ltd.
Conference Call
November 27, 2023

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Israel Discount Bank Third Quarter 2023 Results Conference Call. All participants are at present in listen-only mode. Following Management's formal presentation, instructions will be given for the question-and-answer session. For Operator assistance during the conference, please press star-zero. As a reminder, this conference is being recorded November 27th, 2023. If you have not yet done so, please access the presentation on the bank's website, investors.discountbank.co.il. I would like to remind everyone that forward-looking statements for the respected company's business, financial condition, and results of its operations are subject to risks and uncertainties that would cause actual results to differ materially from those contemplated. Such forward-looking statements include but are not limited to product demand, pricing, market acceptance, changing economic conditions, risks and product and technology development, and the effect of the company's accounting policies, as well as certain other risk factors, which are detailed from time to time in the company's filings with the various securities authorities. I would now like to turn the call over to Mr. Gad Barlev, Head of Investor Relations. Mr. Barlev, would you like to begin?

Gad Barlev: Thank you. Good afternoon, and welcome to Discount Bank's third quarter conference call. Today's call is taking place against a backdrop of the tragic events on October 7th, and the ongoing situation in Gaza.

Our hearts go out to the families of the innocent victims, the kidnapped, the wounded, and those who have lost their lives in the unprecedented attack by Hamas-ISIS on the peaceful communities in the south. We sincerely hope for the safe return of all the children, mothers, men and women held hostage by Hamas. In a shift from the challenging circumstances, I would like to direct our attention to today's agenda. Participating in today's call are Assaf Pasternak, CFO, and Yossi Beressi, Chief Accountant. We are pleased to introduce Mr. Pasternak, as he participates in his first investor call in his capacity as CFO. Having been a part of the Bank for over two decades, Mr. Pasternak assumed executive management responsibilities in 2018. In his previous role, he served as the head of the Financial Markets division. Notably, in September, Mr. Pasternak was appointed as the head of Strategy division and CFO. We will start with a review of the financial results by Mr. Assaf Pasternak, and will then open it up for questions. I will now hand over to Assaf.

Assaf Pasternak: Thank you all for joining us today. In this extraordinary time, both for Israel and the Bank, I extend my warm welcome to this investor call. As we navigated unprecedented events in the country, my first appearance in this forum is marked by shared commitment to our customers, employees and their families, the residents of the south in Israel and all those who were affected by the war. I extend my deepest condolences to the families of the victims, the wounded and the displaced men, women and children across Israel. Discount Bank, along with its management and employees, is diligently working to assist those impacted and to pave the way for the cities, villages and kibbutzim in the south to recover and prosper. I would like to present our third quarter results, a glimpse into our company's response to the challenges ahead, and our resilience as a major bank in Israel. Starting with slide 4, we will begin the review of the financial results. Our third quarter results reflect a significant increase in Group provisions, due to the impact of the war in Gaza, coupled with a decrease in net interest income, due to the rising cost of funds. Consequently, there is – this resulted in a reduction of the return on equity to 12%, and a net income of 817 million shekels. As a result, our efficiency ratio climbed to 51.8%. In light of the results, and our anticipation of increased growth post war, we have chosen to temporarily reduce the dividend payout to 15%. Though our capital provision is strong, this measure is aimed at bolstering our capital cushion, and ensuring ample support for the future credit needs of our customers, once the war is over and economy comes back in track. Moving to slide 5. Before moving to discuss the financial highlights, I would like to touch upon the recent events in Israel, and the Bank's actions. As leading financial institution in Israel, we are committed to support the Israeli economy, and to stand by our customers in these challenging times. In an effort to assist its customers to cope with the economic challenges brought about by the war, Discount mobilized to help with a series of significant benefits and conch –concessions. We extended the Bank of Israel aid-outline to the residents in the south, and to other affected customers in several ways, with prem – primary ones – with the primary ones being – To customers residing along the borders' initial lines, up to 7 kilometers, the Bank has granted a full extension from mortgage payments for full six months, exemptions for – from some bank commissions for six months, free of charge credit balance up to 10 thousand shekels, and other benefits, deferrals and extensions.

Additional customers as impacted by the war, including customers residing up to 30 kilometers from the border, and army reservites – reservists – we voluntarily ex – voluntarily extended the Bank of Israel aid outline from six to three months without charges, which include postponement of mortgage payment, full ex– exception from interest and commissions on loans up to 24 thousand shekels, deferrals on loans up to 100 thousand shekels, up to six months with no additional charges, and exemptions from some bank commissions for six months, and other benefit as detailed in our financial reports. For the rest of the clients, and for SMEs, we allow payments deferrals up to three months without charges, and loans with preferred interest rates up to 400 thousand shekels, under the monetary aid program. We take a pride in announcing – in announcing that thus far, more than 44 thousand loans totaling 30 point – 13.7 billion shekels have availed themselves of the benefits we provided. The projected initial cost for these and other reliefs, assuming the – a complete realization of all benefits by the – all the relevant customers, is estimated to be, at this stage, between 270 and 280 million shekels. I would like to emphasize that this is an extreme assumption, and that we did not see full realization in the past, for instance in COVID. In the sphere of philanthropic endeavors, the Discount Group established the Keren Or Fund, a dedicated assistance fund with initial allocation of 50 million shekel, specifically designed to aid children and teenagers adversely affected by the war, from the border with Gaza. Though they st– through the establishment of Discount Bank and Mercantile Bank, the Fund endeavors to offer a comprehensive and enduring solution to the diverse needs of these young individuals, focusing on healing both their physical and emotional wellbeing, with the ultimate goal of restoring personal and communal security. The Foundation operates in collaboration with 'Leap to the Future' Association, and partners with the Israeli Trauma Coalition. Beside that, the Bank has donated until today approximately 10 million shekels to specific needs of people affected by the war. The total expense of our philanthropic activity amounted to 65 million shekel. Moving to slide 6, the Bank entered the war with solid fundamentals. Contingency plans were put into action on the first day of the war, in order to maintain work at full capacity, keeping all our branches and services available to our customers. To this point, all our employees returned to work from our offices. Considering the financial aspect, the Bank has sufficient capital cushion with Tier 1 capital ratio at 10.36%, ample liquidity, and LCR ratio amounting to 136% based on diverse deposit base, both in shekels and in dollars. With this strong base we continue to serve our customers and support the economy. The Board of Directors has decided to distribute 15% of our net income as dividends. This decision is in line with the Bank’s strong capital position and confidence in generating consistent profits, together with the aim to strengthen our capital in response to the projected post war credit demands. We believe that suppressed demand for credit will exhibit high growth in the quarters to come, once the war will be over. On the macro economic viewpoint, the local capitata – the local capital market demonstrates resilience, largely thanks to the early intervention of Bank of Israel in the forex, in the capacity of 30 billion dollars, and FX swap markets in the capacity of 15 billion dollars, bringing the exchange rate and the swap rates to the pre-war prices during the last two weeks. Moving to slide 7, looking ahead on some key macroeconomics indicators of the Israeli economy. The Israeli economy – economy has entered the war with solid fundamentals, historically low unemployment, low public debt, and inflation converging into range. The Bank's current expectation based on Bank of Israel review and our research, is for economic growth to slow down to 1.8 in the next twelve months, with unemployment reaching 5% in the short term. The interest rate is expected to move down to 4%, according to the market expectation even to 3.5% by the end of 2024, and inflation is expected to converge within Bank of Israel limit of 3%. Looking at former – former crisis, we believe that if the Israeli economy is resilient, and fast to recover, bringing steep demand for credit and an increase in private consumption. It is yet too soon to determine, but once the war will be over, we expect to see recovery along 2024. I would like to stress out at this point, that it is crucial that the government will intervene to support the economy by expanding its budget in order to give all the businesses, and the individuals, affected by the war, the needed air to breach the current slowdown and immediate damages caused by these unprecedented events. In slide 8, I would like to elaborate a bit on the financial highlights of the third quarter. Our 870 million shekel net income and 12% ROE was largely driven by the significantly higher Group provisions, and decrease in revenues from interest income. As a result, net interest income decreased by 7.7% quarter to quarter, but remained 18.7% higher versus the parallel quarter in 2022. The net interest income was impacted by higher cost of funds, as more current accounts balances migrated into interest bearing deposits, and better for the new deposits was largely – was largely adopting the higher rate environment. I would like to mention here that in the last quarter, we see a decline in the rates of this converge – between current account and deposits. CPI numbers were lower by 60 basis points compared to – with Q2, subtracting 100 million shekels from net income interest as well. In the third quarter, the demand for credit remains solid, with total credit growing by 2.2% this quarter, and by 9.3% year over year. At the same time, as expected, we see an increase in credit loss expenses. In the third quarter, we have recorded 596 million shekels of credit loss expense, which is about 92 basis points of the average credit. The vast majority of this amount is related to the Group basis provision, as we updated our macro assumptions according to the latest security events, with credit metrics showing higher risks. Our cost income ratio subs– subsequently reached 58.1 – 51.8% compared with 47.5% in Q2 and 55% in the parallel quarter last year. On slide 9, you can see our credit growth. As mentioned before, our total credit grew by 2.2% in the third quarter, led by 2.9 growth in Corporate, and 2.3 growth in Medium Enterprises. At the same time, we are seeing a slowdown in the economic activity, and a cool down of the demands, with mortgages growing only by 1.6% this quarter, as the housing market slows down, consumer credit growing by 1.5%, and Small Businesses declining by 1.3%, Q over Q. Looking ahead, we continue – we continue focusing on sustainable, profitable and responsible lending opportunities, a well balanced loan book and a prudent underwriting procedures. On slide 10, you can see the impact of the rising cost of funds on our net interest income. Our NII decline in the third quarter by 7.7% as I said before, as we grew our NII and our net interest margin higher than our peers in the last twelve months, we experience a strong correction as current accounts continue to migrate to deposits, and deposits are renewed in higher rates. As you can see from the chart on the righthand side, the higher beta on deposits affected what we define as financing – financing income from current operation. This is income from our core banking activities. These numbers exclude the impact of a few items, such as CPI derivatives and fair value adjustments. The income from regular financing activities declined this quarter for the first time since the Bank of Israel started this hike – this rate hike cycle by 4.7%, but is still higher than the – than Q3 in ’22 by 22%. Net interest margin was accordingly decreased to 3.02% from 3.33% Q over Q. I will move to slide 11 to discuss expenses and cost income ratio. Our cost rose – rose by 5.4% this quarter, primarily as a result of increased maintenance expenses, which increase in 18%, mainly led by increased depreciation expenses resulting from the reallocation of – to our new campus. As we have finished our transition to the new Discount Group campus, we have written higher depreciation cost, and expect to reduce some of this cost by selling the former buildings. Salary expenses grew by 1.9% Q over Q, and 10 point – 10.3% year over year, as a result of a new 3 year collective wage agreement with the Labor Union, and higher work force targeted to improve our availability to our customers. The increase in expenses was forecasted – forecasted by the Bank due to these planned steps, but as we enter 2024 we are focused on reducing cost by improving – by improvement for accruement processes, digitalizing corporational procedures, shifting activities from the branches to the back office, and optimizing IT resources. We understand that our efficiencies are critical for our future growth and success. And therefore, we raise the banner of cost and efficiency in our working plan, for 2024. Switching to slide 12. You can see that overall credit loss expense climbed sharply by – to 92 basis point in the third quarter, in line with macro assumptions related to the effect of the war in Gaza. The provisions are mainly driven by Group basis provision, based on model assumptions to – to reflect the potential risks that exist within the war situation. You can see in the slide, in this quart – as you can see in the slide, in this quarter we are not observing any material deterioration in specific debts, as reflected from the low provision for specific credit losses. On the right hand side, you can see additional asset quality metrics. Non-performing loans remain with the NPL of – at 0.84% compared – compared with 0.83% in the previous quarter, and 0.62% in Q3 ’22. The allowance to loss provisions from total credit increase to 1.54% as a result from the high Group basis provision, reflecting our conservative approach. Moving now to slide 13. You can observe our ample liquidity and diversified deposit base. On the left you can see that 46 of our deposits are from our retail and private customers, and only 12% are from institutionals. On the right hand side, we present the stability of our deposit base – base, while customers are shifting from non-interest bearing deposits to time deposits, as interest rate is climbing. Our liquidity ratio are well above the regulatory demand, presed– presenting a solid NCR of 136% and NSFR of 121%. Wh– now, I would like to move on and quickly review our main subsidiaries, on slide 14. Starting with Mercantile Bank, that presents a net income of 197 million shekels, and return on equity of 17.1%. The net income is reduced due to the higher cost of funds, and an increase in depreciation expenses. Mercantile grew its loan book by 6.5% year over year, a well balanced growth across most segments. Moving to talk on

IDB Bank. In this quarter, the bank has presented lower net income of 17 million dollars, and return on equity of 5.9%, mainly due to higher salary expenses and rising cost of funds. The Bank maintain total asset of 12.4 million – billion dollars, with asset quality continue to be strong. Cal is maintaining strong results in the third quarter, with a net income of 79 million shekels and return on equity of 13.2%. Consumer credit grew by 15.8% year over year, and transaction turnover is growing as well. Cal results were also affected by the higher credit provision, standing at 93 million shekels in the third quarter, most of the increase coming from the Group basis provisions. Nevertheless, in light of the strong results of Discount Group, Cal attributes only 7% of – to the Group's net profit. Therefore, the future separation of Cal is expected to have a limited impact on Discount ongoing profitability. Moving now to slide 15. In light of the current situation, we would like to elaborate about the stability of our capital ratio in volatile capital markets. As you can see in this slide, we are continuously growing our capital ratio and our buffer. At the same time, our capital ratios remain solid and well hedged against various market scenarios, such as interest rate, exchange rate and CPI, and credit downgrade of the State of Israel. The scenario of sovereign downgrade will deduct 20 basis points from our Tier 1 capital ratio and is being considered within the capital buffer. To summarize my overview, on slide 16, I would like to emphasize the key takeout – takeaways from this quarter results. First, we delivered solid results, with net income of 817 million shekel, and return on equity of 12%, after a substantial provision for expected – for expected credit losses. Second, we present a reasonable – sorry, a responsible credit growth, with asset quality remaining high, reflecting the current situation. Our higher Group provision, under CESL, reflects a prudent risk approach, and our stable NPL shows solid loan book and conservative credit approach. Third, the decrease in NII by 7.7% comes after – after continued strong growth in financial income, and represents the market adaptions to the rate environments. Fourth, we see our efficiency as a key success factor for the Bank's future growth, and would work to restrain our expenses throughout 2024. And lastly, at this point, dividend payout is reduced to 15%, in consideration with our projection for the future increase in credit demand, alongside our ability to generate stable long term profitability. With this, I will finish, and would like to open to Q&As.

Operator: Thank you. Ladies and gentlemen, at this time we will begin the question-and-answer session. If you have a question, please press star-one. If you wish to cancel your request, please press star-two. If you are using speaker equipment, kindly lift the handset before pressing the numbers. Your questions will be polled in the order they are received. Please stand by we poll for your questions. *[pause]* The first question is from Irit Bar of HaPhenix. Please go ahead.

Irit Bar: Hi, thank you again for taking my – for taking my call, and thank you for your presentation. And I would like only to ask one question about the credit growth in Q4, what do you see? Do you see a higher … of credit lines, available credit lines from customers? Or – and – or a high authorization of overdraft lines, or demand – higher demand for credit? From customer, due to – so – as a result of the war situation?

Assaf Pasternak: Hi, Irit, thank you for – for the question. And, so far, in Q4, we see – a – lower base of credit growth. It seems like everyone is in a sit-and-wait position. But as I said in my presentation, we expect 2024 to be much stronger.

Irit Bar: So, so far, since the breakout of the war, you don't see a higher demand for credit, even though many people many don't – maybe don't work, or need more liquidity.

Assaf Pasternak: No. It's not – it's not affected in the big numbers. For sure, in the small numbers, are events here and there, but in the big numbers we don't see that.

Irit Bar: Okay. Thank you very much.

Operator: *[pause]* If there are any additional questions, please press star-one. If you wish to cancel your request, please press star-two. Please stand by while we poll for more questions. The next question is from Micha Goldberg of Psagot. Please go ahead.

Micha Goldberg: Hi, thank you very much, and welcome aboard, Assaf, happy to be able to … you on the call. A couple of questions, if I may. First of all, you mentioned the 15% dividend payout, which is in line with what you guys are looking for, growth, in the next couple of quarters, and cetera. I'm just wondering, when should we anticipate that 40%, or up to 40% dividend payout to be reinstated? Is that something that's likely to happen during 2024? Or, based on your estimate, were the demand for credit is going to grow, and profitability is where it is right now, that's likely to have to wait a little longer?

Assaf Pasternak: Thank you, Micha. *[pause]* It's difficult to say right now. I mean, we didn't think 15, would be 15 a month ago. So, I can – I can't really forecast for next year what will happen. I believe that 40% is relevant for return on equity of 14, 15%, also. So as long as that we have provisioned in the – in the neighborhood that we did this quarter, I don't think we'll get there. But, we'll have to – to wait for next year.

Micha Goldberg: Thank you, thank you for that. Now, it seemed to me that you mentioned, I think, around slide 11, that you mentioned something about a new strategic plan in order to cut costs. Did I misunderstand that, or is there something that was said like that? And if so, what does that include for 2024?

Assaf Pasternak: So, yes. It's – we are putting into our strategic project, project of banking efficiency, and we are working on it right now. We cannot give the numbers to the public, of course, but it will be a very big focus for the next year.

Micha Goldberg: Understood. Okay, thank you very much. Now, you mentioned all the different support items that you did for the war – the exemptions and deferrals and donation. Could you explain, more or less, how the … will be accounted for? Like, if there's going to be, pretty much, up front, is this going to be throughout the period of time, that it's going to be utilized? How's this going to work? You know, there's an exemption, there's deferrals, and there's some – there've been donations, and – and a fund. Can you explain how that is going to be calculated, and how much of that should we be looking for in Q4, and how much of that in Q1? Thanks.

Assaf Pasternak: Thank you, Micha. It's a good question. I don't have the answer right now. I mean, we – we are checking the different accounting aspects of writing it down for the fourth quarter. We still have – don't have a clear answers for that. So, I guess – I mean, I can't tell from now if we – for sure we will put, you know, we will mark down everything that is relevant to this quarter, for sure. But as for the losses that the pro– it's not provisions. The losses that – for the – for the following year, we don't have the final answer yet.

Micha Goldberg: Okay, very clear. Now, do I remember correctly, there is another uptick in your wa– according to your wage agreement, coming in 2024? And if so, would you be able to quantify how much that would be, and when that's likely to be?

Assaf Pasternak: I – it's not something that we put in our – in our report, so I can't – I can't give you the number, I'm afraid. Sorry about that.

Micha Goldberg: Okay. No problem. And my last question is, is, you know, there's been a lot of, I think, a lot of press, around the exposure of Discount Bank, and some … to, you know, specific large real estate loans. Which, I think the numbers quoted in some of the press at close to two billion shekels of exposure to one specific borrower. I was just wondering, looking at your NPLs not going up at all, you know, how – how should we be looking at that exposure? Is that, from your point of view, no risk? Is that – or are you all provided for? How does one look at that exposure, or similar kind of, you know, real estate company that might have, some kind of a potential risks for you? Thanks.

Assaf Pasternak: Yeah, it's a good question, as well. I think, so – the situation in – in the housing sector, was under – under light already before the war, because of the interest rate environment, jumping from – you know, prime jumping from 1.6 to 6 and a half, in twelve months or so. So, we are – we have – you know, we are – we took managem– management steps, looking deeply into each one of our loans already the first part of the year. As you recall, in the second quarter, we increased our NPL significantly. And this was part of this move, as I said. And so far in the fourth quarter, looking now, at the situation now, we don't see any more moves that we need to do, right now. Therefore, I think that, more than anything else, it reflects – our prudent and responsible risk management in this aspect.

Micha Goldberg: Okay, thank you very much, and good luck for your new position. Look forward to working with you.

Assaf Pasternak: Thank you, Micha.

Operator: *[pause]* There are no further questions at this time. Thank you. This concludes the Israel Discount Bank Third Quarter 2023 Results Conference Call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call.]