Israel Discount Bank Ltd.
Conference Call
May 17, 2023

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Israel Discount Bank First 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 May 17th, 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 could 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 like to move first 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 first quarter financial report conference call. Today, we have the opportunity to reflect on our accomplishments in the last quarter, and provide you with an overview of our outstanding performance. Participating in today's call are Barak Nardi, CFO, and Yossi Beressi, Chief Accountant. We will start with a review of the financial results by Mr. Barak Nardi, and will then open it up for questions. I will now hand over to Barak.

Barak Nardi: Thank you, all, for joining us today. I'm very proud to present our first quarter results. Starting with slide 4, we'll begin the review of the financial results. Our exceptional first quarter results show the clear execution of our strategy, that combined with higher interest rates help us generate net income of almost 1.3 billion shekels, and ROE of 20.1%. Our efficiency ratio improved materially, reaching 46.1%. Given our strong results, and our confidence in the robustness of our core business, we have decided to raise the dividend payout to 30% of net income. This reflects our long term journey to increase value for our shareholders. Moving to slide 5. Before moving to discuss the financial highlights, I would like to briefly touch on some key macroeconomic indicators of the Israeli economy. The fundamentals of the Israel economy are solid, and the expectation is for economic growth to continue in 2023, but at a much slower pace than '22. As a result of the rising interest rate, we see some slowdown in the economic activity and the demand for credit. Given the recently published April CPI, rising by 0.8%, it is hard to accept at this stage what would be the inflation for 2023 and whether the next interest rate increase, that is expected to happen soon, will be the last one for the year. In slide 6, I would like to elaborate a bit on the financial highlights of the first quarter. Our 1.27 billion shekel net income and 20.1% ROE was largely driven by revenue increase from core banking activity, supported with an additional 1% rising of the interest rate during Q1. As a result, NII increased by 7.9% quarter over quarter, and by 52.1% year on year. This material revenue growth grow a substantial improvement in our cost income ratio that has reached 46.1% compared – compared with 55.3% in Q1 ’22. Total credit grew by 3.5% this quarter, and by 14.5% year on year. At the same time, we remain focused on the quality of our lending. In the first quarter, we have recorded credit loss expenses of 204 million shekels, which is about 33 BIPS of the average credit balance and is largely related to increase in … provisions. Other credit metrics continue to remain solid. Lastly, as mentioned before, we increase our dividend payout to 30% of Q1 net income. On slide 7, you can see our credit growth. As mentioned before, out total credit grew by 3.5% in the first quarter, led by 6.9% growth in Corporate, and by 5.6 growth in medium enterprises. At the same time, we already see the slowdown of the economic activity and the cool down of the demand. With mortgages growing only by 2.5% this quarter, at the housing market slowdown, and with consumer credit declining by 2% quarter over quarter. Looking ahead, we continue focusing on sustainable, profitable, and responsible lending opportunities, and on keeping a well balanced loan book. On slide 8, you can see a very good demonstration of the strength of our core business, and the impact of higher interest rates. The average interest rate in the fourth quarter climbed to 3.89% compared with 2.92% in the previous quarter, and close to zero in the first quarter of the previous year. As a result, and in line with our anticipation, our NII grew in the first quarter by 52.2% year on year, and by 7.9% quarter over quarter. In addition, free income grew by 7.5% year on year. As a result, total income grew by 16.5% quarter over quarter, and by almost 38% year on year. As you can see from the chart on the right hand side, we continue growing in what we define as financing income from current operations. This is the income from our core banking activity, our bread and butter. These numbers exclude the impact of few items such CPI derivatives and fair value adjustments. The income from regular financing activities grew this quarter by around 57% versus Q1 ’22, and our NIM increased to 3.18%. The average Bank of Israel interest rates is expected to continue rising, supporting another incline in NII at – in the following quarters of ’23. Moving to slide 9, we discuss expenses and cost income ratio. Our expenses were retained at the same level as the previous quarter, with reduction in salary expenses, and incline in other expenses, largely due to revenue related expenses and special items in Cal. Strong revenues alongside with restrained expenses. led to a material improvement in cost income ratio, down to 46.1% compared with 55.3% a year ago. As you can see on the right hand chart, we are constantly improving our cost to income ratio, showing positive jolts of 10.1% CAGR between 2019 and 2023, generated by 16.5% revenue CAGR with only 6.4% expenses CAGR. Switching to slide 10, you can see the evolution of credit loss expenses. This quarter, we are still not observing any material deterioration in specific … conditions, as evident by the low specific data provision. We have kept the … provision high to reflect the potential risk that exists with the current interest rate environment. Overall credit – overall credit loss expense stood at 33 basis point for the quarter. On the right hand side, you can see additional asset quality metrics. Non-performing loans remain relatively low with the NPL from total loans ratio at 63 basis points, compared with 67 basis points in previous quarter. NPL coverage is also very strong, as the … provisions covers non-performing loans by more than twice. These indicators reflect the solid quality of our loan book, and our conservative underwritings. Moving now to slide 11. We announced today that dividend payout is going up from 20% to 30%. This, coupled with the high profitability we are showing, generate a dividend deal of about 6%, substantially higher than before. As you can see on this slide, we are continuously growing our net income and dividend payouts, creating value for our shareholders. At the same time, capital ratios remain solid as well. Now, I would like to move on and quickly review our main subsidiaries. On slide 12, you can observe the record results of Mercantile Bank, with net income of 237 million shekels, and ROE of 23% this quarter. This is largely achieved by NII growth of around 57% year on year, and by 8% quarter over quarter. Cost to income ratio is substantially improved, to 37.9%. Mercantile grew its loan book by 2.6% this quarter, driven by well balanced growth across most segments. Moving to talk on IDB Bank on slide 13. The bank presents solid performance with a net profit of around 30 million dollars, in .line with previous quarters, and ROE of 10.5%. Loan books remain stable, and asset quality continue to be strong, with release of provisions for credit losses. On the deposit side, we were able to attract new customers. And as a result, the bank’s deposit base grew by 2.8% during this quarter, for a level – to a level of 10.8 billion dollar. On another topic, IDB is expected to sign on consent orders with the US regulators relating to issues that are required to be advanced in its AML BSA Compliance Program, following the findings of regular review held at IDB New York. These orders do not include restrictions on the ongoing activity of IDB New York, or on the implementation of its strategic plan, and they also don’t include any penalties. Moving now to slide 14 to discuss Cal. Cal is presenting strong results in the first quarter, with an adjusted net profit of 85 million shekels and ROE of

15.6%. Consumer credit grew by 19% year on year and by 6.5% quarter over quarter, and transaction turnover is growing as well. Nevertheless, in light of the strong results of Discount Group, Cal attributes only 5% to the Group's net profit. The future separation of Cal is expected to have a very limited impact on Discount's ongoing profitability. To summarize, on slide 15, I would like to emphasize the key takeaways from this quarter results. First, we delivered yet again record results with net income of 1.27 billion shekels, and with ROE of 20.1%. Second, we generated a substantial revenue increase from core banking activity, driven both by our credit growth and by the increase of interest rate. This creates a very strong basis towards our future growth as well. Third, cost income ratio went down significantly, from 55.3% in Q1 '22 to 46.1% this quarter. Fourth, once again, we present a responsible credit growth, in line with the current macro conditions, without a … in metrics in any exponent. And lastly, given the very strong performance of Discount, and the confidence we have in our ongoing profitability, we have raised the dividend payout to 30% of net income, and we continue our long term journey to increase value for our shareholders. With this, I will finish the overview, and would like to open to Q&A.

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 Chris Reimer of Barclay's. Please go ahead.

Chris Reimer: Yeah, hi. Thanks for taking my questions. I wanted to ask about provisions, going forward. How should we be looking at provisions, considering the higher rate environment?

Barak Nardi: So, thanks …. I mentioned before, at this stage, we don’t see a deterioration, and we are already, you know, around one year into a higher interest rate environment. But since we do expect that going forward, the higher interest rate will create some deterioration, this is the reason why for a few quarters in a row, we already put some Group provisioning for it. So, you know, I can’t tell you whether it will be next quarter, or two or three quarters from now, but we do expect – we will see some negative impact going forward. But nevertheless, we do believe that the positive impact of the higher interest rate on our NII will be significantly more significant than the negative future impact from higher loan …

Chris Reimer: Got it. Thanks. And, just regarding the capital adequacy requirements. This quarter, you only had a buffer of 40 basis points. How comfortable are you that – are – are you with that – that buffer level?

Barak Nardi: You mean for tier 1 or for total – total … ?

Chris Reimer: For total – total …

Barak Nardi: Yeah, so it – so it’s around 40. We feel very comfortable, because given the high – the high, on one hand, the high profitability, and we are at a high double-digit profitability on one hand, and on the other – on the other hand, we do expect to be a credit growth at a slower pace than what we have evident in the last quarter, we do think that we have a sufficient capital to continue distributing a dividend, and on the same time, keeping sufficient – sufficient equity buffers.

Chris Reimer: Great. Okay, thanks. That’s for me.

Operator: *[pause]* The next question is from Micha Goldberg of Psagot. Please go ahead.

Micha Goldberg: Hi, congratulations on an excellent quarter. A good start to the year. A couple of questions, if I may. The first one, just …, I think I notice that the risk rate actually grew by 5% in this quarter? Like almost double of – of credit growth? What is the reason for that? Or am I mistaken.

Barak Nardi: So, first, you are not mistaken. Part of it is – is driven by – by credit risks that are – are off – off balance credit risks, so this is one – one portion. The second piece is some market risks and …[CPA??] risks that grew, some of it because of the real estate activity and other. So, it's – it's not a very big gap, and for the year basis, we assume it will be more or less the same, it will grow more or less at the same pace of the overall – overall credit.

Micha Goldberg: Okay. Thank you very much for that clarification. Now, another thing I notice on the balance is that, I mean, among the banks that have reported today locally, you are the only one that has a quite a drop in deposits. By 1%. I saw the other banks actually increased their deposit. I'm just wondering what the reason for that is. Are we seeing increased switching, is beta growing? And how is that impacting your margin?

Barak Nardi: So, overall, when you look at the – you are right. In total deposits, we were down a little bit. But in consumer deposits, we went up. We went down mainly in – in corporate deposits. And it was a pricing issue. We decided to – not to take those deposits, we had a sufficient liquidity. We felt cost comfortable not to take those deposits in both sides, but we are fine with it. And when you look at – at the … deposits, which did the most significant bit, we were able to grow this – this quarter as well.

Micha Goldberg: Okay, thank you. Do you see continued switching, and increasing beta? Or is that – are we past that now?

Barak Nardi: We don't –

Micha Goldberg: … seeing deposit move out of – of current account deposits.

Barak Nardi: We are – it's actually – it's in the same pace that we have seen in previous quarters, it's very moderate, it's not something very significant. All – you can see it, actually, in all banks that published that non-interest-bearing deposits were down this quarter, but not in a substantial – not in a substantial amount.

Micha Goldberg: And the qua– Q over Q is around 10%, is that correct?

Barak Nardi: *[pause]* Which – which … ?

Micha Goldberg: For current account deposits. …

Barak Nardi: 10% Q on Q? No. It's substantially less. It's – year on –

Micha Goldberg: Okay.

Barak Nardi: – year, it's around 10% year on year, not – not Q on Q.

Micha Goldberg: Okay. Sorry, I saw … different … Okay, thank you for that. Could you tell us a little about what the process is for the course of vestiture of Visa? ICC. You know, what's the time frame, what needs to be done? And how quick can you move that in the current market, and – et cetera.

Barak Nardi: So, actually, the legislation – so, the decision was made at the end of January. So we have three years to do it. So, actually. we have enough time. I'm not sure that we'll utilize the entire time, but we have three years to do it. And the good news is, that just recently, the Ministry of Finance decided that we are allowed to also to sell Cal to institutionals, which is create good opportunity for us, and will help us, most probably, to get a better deal. So, it's a good – it's a good news. Now, we will start – we will start the process. I can't tell you now whether it will take one year, two years, we'll make sure that we'll get the best – we'll get the best value we can, and we have the sufficient time to do it.

Micha Goldberg: Okay, thank you. And the recommendation by the Minister of Finance, is that a final one? Or does it require additional legislation before you can actually go at with that, or can that be done in parallel?

Barak Nardi: No. So, actually, it's a final recommendation. It's now be – had to go – will have to go through its legislation. But since everyone are supporting it, we don't expect, you know, any issues, it's only a – a matter of technicality. And of course, we are not – we can start the process. But we assume that within the next few months, we will finish the legislation process.

Micha Goldberg: I understand. Okay, very nice. Now, I mean, there's been some – there are issues in the US regional banks recently, and one of your competitors have significantly written off its stake in a sizeable bank in the US. And I'm just wondering, how do you see your holding in IDB New York, … you know, the high increased liquidity in the US, and what else is going on with regulatory requirements over there is that imposing more on … and is it going to reduce profitability over … a long term. And could there be a chance … that you will have to write off some value of that as well?

Barak Nardi: First of all, we don't need to write value. You might need to write value when you have, like, an equity – equity investment. We are fully consolidating IDB New York, so we don't need to write off anything, you know, even in the future. IDB Bank is very solid bank, they show a very strong result. I think they are – the good news that while we saw in – in some of the competitors, the deposit base was declining, IDB New York was able to grow their deposit base. They were able to recruit new customers as well. Some of them were moving from the banks that, you know, are, you know, that got …. So overall the bank is perceived, you know, as – for some, it's safe haven, and people – customers move their money over there. So we feel very comfortable, first of all, with the bank, and with their current performance. Especially around their deposit base growth.

Micha Goldberg: Okay, thank you very much. Any update on the process of finding a new CEO? Is that – I mean, are we – should we be expecting, you know, a final candidate in the next couple of weeks, a month? Can you give it any color on that?

Barak Nardi: Yeah, you know, the chairman already announced that has – they have put together a committee to recruit a new CEO. The committee that it will take, it will be a quick process. So, you know, I can't tell you if it will be, you know, two weeks, three weeks, or four weeks. But it should be a relatively quick process. And I'm quite sure that no matter who the CEO, that the successful journey of Discount Group will continue.

Micha Goldberg: Yes. I agree. One final question, if you can. Once Visa has been installed, what is the impact on your common equity tier 1? What's the capital release that you expect, for get– not including the capital gain, just the risk rate assets change?

Barak Nardi: So, we – actually, we have not disclosed it. But it's – it's quite – it's quite significant. You know, maybe in future quarters we will disclose this number. But what we have disclosed, that – if we'll distribute this excess capital that will be created as dividend, the impact on – of – on ROE and net income is – is going to be insignificant. And actually, the – being separated from Cal, cost income ratio is going to improve significantly, by around three points, or – it will be significant.

Micha Goldberg: Thank you very much, and good luck.

Barak Nardi: Thanks, Micha.

Operator: *[pause]* The next question is from Hilit Bar of Excellence. Please go ahead.

Hilit Bar: Hi, thank you for taking my questions. I just wanted to ask about your credit portfolio in – IDB New York, how comfortable you with – what – any exposure you have on real estate, … real estate. Can you please elaborate on that a little bit?

Barak Nardi: *[pause]* For – I'm not sure that we are providing disclosure to the mix. But overall, I can say you – tell you, that IDB Bank is a very – solid and conservative bank. They know, in more – fourth time, they actually even not growing their credit portfolio, because they don't want to take any excess risk. And you can see that in the last quarter, their credit book was not growing, it was more or less stable. Their loan loss over – are very low, and actually they have a negative LLP this quarter. So, overall, the book is conservative, the performance is good, it's actually a well – a very well diversified between real estate and other – CNI elements. So it's very well spread, and also in different geographies. They have activity on focus New York, also in Florida, and California. So, overall, it's – it' a good and solid portfolio.

Hilit Bar: With no much concentration on any difficult … for the moment?

Barak Nardi: *[pause]* It's – you know, they have their internal limitation. So – so they are not crossing the limitation, and they are not over concentrated in – in one specific – in one specific sector or segment

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

[End of conference call.]