Israel Discount Bank Ltd. 2021 Conference Call

March 9, 2022

Operator:

Ladies and gentlemen, thank you for standing by. Welcome to the Israel Discount Bank Fourth Quarter 2021 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 March 9th, 2022. 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 risk 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, risk and product and technology development, and the effect of the company's accounting policies, as well as certain other risks, which are detailed from time to time in the company's filings with the various securities authorities. Mr. Kaplan, would you like to begin?

David Kaplan:

Thank you very much. Hi, everyone. We are pleased to share our 2021 results with you. With me on the call are Uri Levin, our CEO, Barak Nardi, our CFO, and Yossi Beressi, our Chief Accountant. Uri will open with an introduction, and Barak will take over to review – discuss the financials. With that, I turn it over to Uri.

Uri Levin:

Thank you all for joining us today. I'm very proud to present our 2021 results, and there's a reason to be proud. Discount Group achieved extremely strong results this year, with net income of over 2.7 billion, and return on equity of 13.6%, record results for the group. But, as we have continuously said, it is clear that 2021 results are not representative of our underlying performance, as the banking sector has benefited significantly for a reversal of credit provisioning. Hence, we take even more pride in our underlining – underlying robust performance. When adjusting and normalizing our figures, assuming average credit losses of the past years, Discount Group presents impressive underlying performance. Net income of over two billion shekels, return of equity of over 10%, which was demonstrated quarter after quarter, substantial credit growth of over 12%, significant increase in productivity of over 12%, and a 70% increase in mortgage origination.

However, this is not a story of a successful single year. Our story is a story of a successful journey, of consistent improvement, and execution of our strategy. A journey that has transformed the bank and delivered superb financial results. Our net income grew from 500 millions in 2014 to 2.7 billion today, while improving the return on equity from around 4% to over 13%, and reducing cost income ratio from 87% to 65. We have done this while reducing our workforce by almost two thousand FTEs, about 20% of the workforce. And the market has responded well, with market cap reaching over 24 billion shekels at the end of the year and while increasing price to do from 0.5 back then to 1.14 at the end of the year.

Our journey has been so successful due to several key pillars. The first one is our superior improvement potential. At the beginning, it was mainly due to our low starting points. But surprisingly, even today, we believe that we still have more potential for growth and for expense reduction than any of our peers. In addition, we realize today that we have superb potential due to our strategic positioning. In a banking industry that is changing, we believe that the medium size banks will prevail, as we are large enough to make a significant disruption, but also small enough to benefit from it. It also requires a bank that is agile, advanced and innovative, to capture this potential. And we have full belief that it is us who has the best potential within this change.

The second pillar is the change management platform that has been built in Discount, a platform that allows us to set stretching targets, and more importantly, to meet them. And also allows us to push financial results while delivering substantial strategic transformation.

And finally, probably most importantly, is the way we run the bank, focusing on delivering long term sustainable value to our shareholders; driving responsible, consistent, substantial profit growth; driving change, driving results. And continuously challenging ourselves to ensure we fully realize our potential.

These three pillars are the reasons that – are the reason that our journey has been so successful. And they are also the reason that 2021 results are so strong. But more importantly today, they are the reason we have high confidence in our ability to even increase the pace of change and deliver the ambitious target that we have posted today. We have set challenging targets for 2021. Sorry, challenging targets for 2025. Net income over 3.5 billion shekels, return of equity of over 12.5%, and efficiency ratio of 55% and below. But we have high confidence that our improvement potential, our strong change platform, and mostly our managerial approach of delivering superb value, will support our future journey and will enable us to meet these ambitious targets.

Thank you all for your trust. We will continue to work hard to justify it. Barak, please.

Barak Nardi:

Thank you, Uri, and good afternoon, everyone. I will open my part of the presentation with an overview of the financial results, and then discuss the successful execution of our strategy and touch on our targets. Starting with slide 9, we present the financial highlights and the main factors that led to our adjusted ROE of 14.8% in 2021. First was the increase in total income, up almost 6% in 2021, and driven largely by our core banking activities. The other key driver was a negative LLP and a significant reduction in people cost, all of which I will touch on later in the presentation. Over the course of 2021, we saw very impressive credit growth of 12.3%, and 4.5% during Q4. At the same time, the risk in our portfolio and the quality of our assets continued to improve. Another major accomplishment this year was the new wage agreement with the union, whose main achievement was the … flexibility that will allow us to more quickly adjust to the changes in the world of banking. Lastly, we announced a dividend in respect of Q4 2021 totaling 106 million shekel, and equal to 20% of Q4 net income.

Moving to slide 10, you can see that we delivered strong credit performance across all sectors, especially in our targeted segments, mortgages and medium businesses. The growth of our mortgages, which is the main focus area of our strategy, was 26.3% in 2021, and over 7% in Q4 alone. This brought the mix of mortgages to 25% of our total credit book, up from just under 22% a year ago. We also delivered significant 14.8 annual growth in medium enterprises, one of the core areas of our strategy as well. Consumer credit continued to recover post-COVID, showing a healthy growth rate. In corporate lending, we continue to see double digit growth as we find the best opportunity for us while maintaining our strict lending standards. Looking ahead, we see many opportunities for growth, and will examine each of them to make sure that our credit growth is both attainable and responsible.

Slide 11 shows the effects of the execution of our strategic plan and our focus on efficiency. Our core business income, composed of … and NII, increased almost 11%, while our expenses increased only 5%, producing positive … and another improvement in our efficiency ratio. What really stands out is the 5% lower people cost, excluding bonuses. This is a direct impact of the retirement program that we ran at the end of 2020. The increase in other expenses is mainly on account of fees paid by CAL to its partners as a result of an increase in … activity.

Slide 12 highlight our high quality loan book and conservative underwriting. I want to mention two main factors. The first is the low write-offs, only 0.03% of average credit in 2021, versus 0.23% pre-COVID. The other factor is the NPL as a percent of total credit that is lower than the pre-corona levels. Our LLP coverage ratio is also very near pre-pandemic levels.

Let’s move on to the strategic review on slide 14. As we have led out in the past, we are fully focused on being the best financial institution for our customers and delivering superior value to shareholders over time. After more than a year of successful execution of our strategy, today we introduced our ambitious 2025 financial targets. On the next few slides, I will present how the key pillars of our strategy have gotten us to where we are today, and will continue driving us to achieve our goals.

On slide 15, we present our first key driver, which is a significant credit expansion, mainly in targeted focus areas. As you can see on the left side, our total credit grew significantly over the last two years, with our focus areas of mortgages and medium enterprises growing 45% and 70% respectively. The success in mortgages is phenomenal. Within two years, our originations more than doubled, from 8.2 billion in 2019 to 17 billion shekels in 2021, and or market share in origination grew from 11.3% in 2019 to almost 14% in 2021, and our share in Q4 standalone was even higher, at 14.7%. This is just the beginning for us. All the steps we have taken, including improving our processes, introducing digital mortgages, and adding more advisors, will enable us to continue to grow in re market share in mortgages.

Another key driver for Discount is to increase our customer base, which we talk about on slid 16. Discount demonstrates its competitive approach by the stake it takes to offer out of the books value propositions for our customers. The combination of this approach and the introduction of Switch With a Click by the regulator, allows us to acquire new customers quickly and easily. The customers are already reacting. Since the introduction of Switch With a Click in September, we recruited 2.4 customers – 2.4 customers for every one that left the bank.

Slide 17 presents the next key driver, which is increasing efficiency to higher productivity and debt … reductions. These steps led to an improvement in our adjusted efficiency ratio, from 64% in 2019 to 61.6% in 2021. The combination of continued revenue growth along with pre cost management will bring further improvement to the results, and the increase in the value of the book.

Another important driver that will help us fulfill our strategy is the new wage agreement that we signed at the end of 2021, as presented on slide 18. This is a groundbreaking agreement, for which the management gained the flexibility to optimize the workforce and better direct the resources to meet the demands of the changing banking environment. Also included in the agreement is a new bonus structure, with increased hourly threshold in line with our financial targets.

In addition to the drivers from the traditional banking, we are also going to create value through disruptive innovation as presented on slide 19. Discount's unique position creates a competitive advantage as a player that is large enough to make an impact, and yet small enough to not fear cannibalization. One great example is collaborated – the collaboration with Shufersal to develop PayBox into Israel's leading digital wallet and payment platform. For the first time, and only six months after the … of PayBox, we are publishing KPIs for PayBox. Its first year as a standalone entity was a very successful one, with growing production volume over 1.6 million linked accounts, and 1 million active monthly users, more than 30% higher than a year ago.

The last driver I would like to highlight on slide 20 is maximizing the Group's value with a goal of empowering each of our subsidiaries and leveraging the synergies between them. As you can see, each of the subsidiaries achieved very strong results in 2021, and each of them has ambitious plans for the future.

The combination of each of these plans is incorporated in our Group financial target for 2025 as presented on slide 23. The main goal for our strategy is to deliver superior value for our shareholders over time, and this is reflected in our 2025 targets of 3 – of above 3.5 billion shekels of net income, 12.5% ROE, and less than 55% efficiency ratio. With that, let's open it up for your questions.

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 headset 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 Tavy Rosner of Barclay's. Please go ahead.

Tavy Rosner:

Hi, good afternoon. Thanks for taking my questions. I was disconnected for two minutes, so I apologize if I missed a point or two. Just touching on the – your targets, some of, you know, the 12.5 ROEs by '25, can you elaborate a little bit on the road maps, whether – if you are assuming gaining market share across different segments? Do you have so many, you know, NIMs going up, are you assuming that the Bank of Israel base rate will increase through '25, and if so, by how much? Thank you.

Barak Nardi:

So, the same – actually, we have set our strategy during 2020, and the same drivers that helped us achieve the great results in 2021 will drive the performance throughout this – until 2025. So, continue with substantial growth around mortgages, mid-size businesses and other areas, recruit more customers, continue with the efficiency effort and cost cutting effort, subsidiaries – our subsidiaries' performance. All of them are part of our strategy, and are part of our financial plan. On top of it, of course we took into consideration the current outlook of the interest rate. There are – there is positive – going forward, the view – the current view is positive outlook regarding the interest rate, and it's of course incorporated into the targets we are setting today.

Tavy Rosner:

Okay, understood. And looking at the – at the LLPs, I mean, where are we in the journey now on the – in terms of recoveries? Like, have you recovered everything that you set aside throughout the pandemic? And then, I guess, looking ahead to '22, do you see provisions returning to kind of a normalized level, that we saw pre-COVID?

Barak Nardi:

Yeah. I think you can see our negative LLP over the most of this year is clear indicator that we released a very big portion of our reserves already. I think what is more important, it's to look at the asset quality indicators, like the NPL ratio, which is down to lower than pre-COVID levels very low write-offs that almost around zero. For they are very positive indicators that demonstrate the quality of our portfolio. And going ahead, I think we are – we are in a very good situation and we feel comfortable with the portfolio. We take – you need to take also into consideration that we are starting now implementing CISL, and some of the – of the reserves we have made earlier, during 2020, we'll use that for the CISL implementation.

Tavy Rosner:

Right, got it. And then, lastly, just on the – on the long road. I mean, you know, with all those five large banks having reported, and everyone's talking about significant loan growth, mortgage being a key, key growing segments – what's happening to prices? I mean, I guess, with everyone putting so much, you know, fire power, is this coming at the expense of cost and margins?

Uri Levin:

Hi, Tavy. No, we have not been talking about growth. We have been talking about responsible growth. And I think that really matters. And we will continue and grow in segments where we believe we can grow responsibly in terms of credit, and where we can deliver superior results to our shareholders. The marginal credit should definitely generate more than the 10% underlying return on equity that we generate. And we believe this is the way going forward, and there's a lot of potential for us in these areas. We have grown in mortgages as a result, we have grown in commercial banking, but not as much as others. Because it is easy to grow, but it is harder to grow under the – under the caveats that I've just mentioned. So, looking forward – and again, clearly, we need to see what will happen at global market, and what will happen with Israeli economy generally. Even given what is currently happening, we feel comfortable that Israeli market will continue to grow, and we feel it, we feel comfortable that Discount will be able to grow faster than the peers, and we'll have opportunities to grow even if the market will slow down. We do see some impact on margins, due to the high competitiveness of the market. We hope that we've started to see the end of this competitiveness that goes into structure of credit and pricing, and from now on it will be more positive and more favorable for us. But in any case, we believe it will be strong enough for us to deliver superior results over the underlying return on … equity.

Tavy Rosner:

Great. Thanks, guys. Go back to the queue.

Operator:

The next question is from Micha Goldberg of Psagot. Please go ahead.

Micha Goldberg:

Hi, good afternoon. First of all, congratulations on a stellar quarter and a pretty amazing year. So, I just didn't really catch. You'd mentioned that infra strength in your assumptions are going up. Would you be able to elaborate, tell us, what the bottom line assumption is for infra strength and inflation toward that 2025 target?

Barak Nardi:

So, you know, our financial plan going ahead is composed of many different assumptions, one of them in infra strength. We are not – we are not publishing the different assumptions. But I can tell you that first of all, when we look at the different potential scenarios, we see that in most of the scenarios of – where the infra … could go, we are going to meet the targets we have set. So we feel very comfortable with the target. We didn't took into consideration the full expectation that currently is reflected in the market, so we feel comfortable that we can reach those numbers in the next few years.

Micha Goldberg:

Okay. I understand. I'm just wondering, because I remember that a 1% rate hike based on your numbers will give you, I think, close to over – only one half percent rate in return equity. So that entire increase could be due to just hike in rates, right? I mean is that the – is that the underlying assumption I should be thinking?

Barak Nardi:

1% is – is around – around what you have said. I think it a little lower it's around what you have said. And, yeah, assuming we do – you know, there is 1%. But – but, yes, this is more or less the impact, of 1%.

Micha Goldberg:

And just to clarify. An increase of 1% of interest rates, how much does that – if that adds to your return on equity, based on the numbers that you published in – on page 78 over there? *[pause]* That's 1.2 billion shekels of top line, right? I understand. 1% interest rate.

Barak Nardi:

It's what – I think it's around 1.5%, like you have said before, the net impact of 1% on our ROE.

Micha Goldberg:

Okay. I understand. Thank you very much. One other question. You know, I've seen the last couple of years, I think we all have seen, you have done a lot of effort in trying to reduce cost, and you have done a lot of efficiency measures. And as a result of that, in the last couple of years, we've seen significant so-called one-time expenses, both in last year and as well this year. And I'm just wondering, looking towards 2022, can we finally expect a year without one-time expenses, so that we can see if what, you know, what you have done, actually will be, for instance, to … the results? Or should we be expecting more wage agreements, one-time assembling costs, other issues? I know this is pretty much in looking at a future, but, again, I think you guys have done a lot of work on that, and I just want to see if it comes to your numbers, if you had any.

Barak Nardi:

Michael, we – we always are happy to take your advices and recommendations. And that's – and we believe that while there was a strong story of Discount executing big moves that actually improve the bottom line profitability, there was also a cost with – with this one-time event. And we understand going forward that there is a price that we pay for this type of adjustment that needs to be made. And definitely looking forward, this is something that we will try – try and avoid. If there will be a significant opportunity to really transform our business, then we will not hesitate and still do it. But if there will be a way to do it in a way to – while avoiding it, it's a preferred method. So … there's no strict answers to 2022, although there are no expectations for 2022. But I do believe that the journey going forward will be much smoother, taking aside –

Micha Goldberg:

Okay.

Barak Nardi:

– enough for economy play, than was the journey until today.

Micha Goldberg:

Okay. Very much appreciate it. And just a … kind of question. You talk about a 12 and a half percent return on equity in ’25, that – somewhere three years from now. I’m just wondering, assuming that there is some kind of a path to that 12 and a half percent, so I don’t know where we are right now based on your business plan, but I guess somewhere lower. So anywhere between, I don’t know, 10 and 12 and a half percent, we’re going to next year’s – what growth, loan growth, do you think will allow you to get to a dividend payout of, let’s say, 40% as peers. I mean, if you grow 5 or 6% loan growth, of 80%, you know, … …, is that going to allow you to get your dividend payout to close to 40%? And if so, when is that likely to happen?

Barak Nardi:

First of all, I think the growth rate we have seen in the market in 2021, of course they are not representative going ahead. But I do think that if I look in the – for the near future, I think a more representative growth is high single digit, I don’t think it should be around 6-7, I think it should be – it could be higher. And – I mean, market perspective. And of course, we will find the right balance between the ability to – to have the growth and dividend payout, as long as we’ll believe that we – the – our credit growth can contribute a very significant return on equity for our shareholders, so I think we will remain at the lower level of dividend, and then a posit for work. But of course, always look for the right balance. And if it will be possible throughout those years, we will increase it. But I think we’ll look at it, you know, a quarter by quarter and make those decisions. Currently we do see a very big growth potential for us in credit, in very healthy and profitable places. And if we do this – if it will be – this will be the situation, of course it’s the right thing for us to invest the equity over there.

Uri Levin:

And I think you have seen – maybe I’ll just add one point. We do believe that superior growth, as long as we deliver, you know, about 10% marginal credit growth, is the best way for us to go forward. But we also understand that dividend yield and increasing the percentage of our dividends will have significant impact on the – on the attractiveness of our SOC to investors, and will end up having a very positive impact on the SOC. And we’ve added to the three targets that during these four years remaining until 2025, we will continue and explore the ability to go below the 30% current policy of dividend payment. And I think that the fact that we’ve added that line probably signals that with this increase in revenues and with this increase in – of return of equity, we do believe that the probability of us going to pay higher dividend yields is more relevant than it used to be in the past.

Micha Goldberg:

Okay. Thank you. Now it seems that you're in a fortunate position that your local business is returning a higher return, yields return equity, than your business in the US, which I think is somewhat relatively novel. And I'm just wondering, a, is that indeed the case, and 2, if so, what you think are you able, going to try and improve return equity on the US business as well? Is that something that you're planning?

Uri Levin:

I think it's great that we have a conversation about a 9% return on equity business, if you took the – the capital we actually need – and discuss it as something that takes the Group down, and yes, we do look at the US business currently as the one that produces return on equity that is lower than the Group. Happy that we have this conversation, because the Group is doing so well. And at the same time, clearly, similar to the other subsidiaries that we have, but also with greater focus, and yes, make sure that we have a very challenging strategic – challenging strategic program with very challenging financial results to drive the numbers up. We do believe that the model, the operating model, of IDB NY is probably more attuned to interest rates and the low interest rate in the US has had its toll on the results. And with increasing rates, we expect a significant change in US regardless of what we do. But we also believe that being the only Israeli-owned bank in the US, and having a great bank in the US, with an economy that looks very – that looks very good and is – and is growing nicely, we do believe that the potential of this business is very substantial, and intend to realize it.

Micha Goldberg:

Okay. Thank you very much. My last question is if you have any takeaways from what you think could be the impact of the current Russian Ukraine, you know, conflict, on the Q1 results? I mean, obviously, capital markets are not being so happy today, and I was just wondering what your exposure to that book directly, indirectly and through financial, are. Thanks very much.

Barak Nardi:

I think it's – it's too soon to see whether it's an impact or no, but it – we don't see currently any significant or direct impact from this current situation.

Micah Goldberg:

Thank you very much.

Operator:

The next question is from Michael Klahr of Excellence. Please go ahead.

Michael Klahr:

Hi, everyone. Good afternoon, and well done on a nice report and a strong year. Most of my questions have been answered already. I just want to ask, perhaps, on the US, the growth. I saw your growth there in credit was 18% year on year, which I'm guessing is a lot faster than the market there. So if you could give us a bit of color on where that growth is coming from. You mentioned high tech. What type of high tech lending are we talking about? And secondly, I wanted to ask a bit more about the mortgage, your plans in the mortgage market. You're almost at 15% of market share in new originations. Do you continue to see that creeping up, in 2022? Should we expect another one and a half percent, 2% increase in market share there? And also, what percentage of your – of those new mortgages are customers versus non-customers from other banks? Thank you.

Uri Levin:

Thank you, Michael. I will take the US question, and Barak will answer the mortgages one. A definite significant growth in the US. I think what we do have seen in the US is the recovery of what has happened before, and a big part of this growth comes from our clients and their utilizing their lines, we have a significant amount of clients that are in the CNI business. And with the issues with supply change and high demand in the US, there was high need for credit and we have grown with our customers. But this is also coming from very robust growth, around real estate, robust growth in the regions. We have been able to make California and Florida growth engines, and that has – has been the work for many – for a long time and we are happy that this is becoming fruitful. And clearly, we do not see – we do not expect that type of pace going forward. But we definitely expect healthy credit growth in 2022 as well.

Barak Nardi:

Regarding mortgage, I think that the most – that the most interesting thing around mortgage is, beside the exceptional results we are seeing, that we are not even close to realize our potential. The potential we have over there is great. This year we are focusing mainly on improving or dealing with capacity issue. We still didn't advertise anything. And only by dealing with capacity issue, we were able to grow our mortgage generation from a quarterly run rate of around 2.5 billion shekels to more than 5 billion shekel of originations in Q4. And we have huge potential over there. I really believe that we can able – that we are able to continue and growth – grow over there, to outgrow the market, to gain more market share. Because you asked about the – what percentage is our customers. So, a big portion of our – of the mortgage generation is not coming from our customers. I think the good thing about mortgage that we are – there is not captive market. We are not limited only to our customers. Every customer that takes mortgage is going for shopping, and we want to be one of the preferred bank for the customers to take mortgage in. So we do believe we are able – we are able and we will continue and grow our market share in 2022 and behind, and to reach new heights, much – new height in the future, next few years.

Uri Levin:

And it's important to add, we're not market share players. We talked about responsible growth, and profitable growth. Market share is just a way for us to unite everyone here at the bank, and have a – have a target that they fight to achieve. We are – we were growing mortgages, as we see that as a profitable business. And it is very interesting that the market leader is actually, they are more expensive than anyone else. Hence we believe that the current market situation is not sustainable, and the market where everyone is coming for shopping, and shopping between the different banks – it is not sustainable that the leading bank will have a price advantage. And that price advantage that the leader has, also gives us confidence that mortgages will continue to be profitable. Because that market leader, since they reduce prices without harming us, hence we believe that we'll be able to deliver responsible, profitable growth in mortgages, that will have an impact on our bottom line.

Michael Klahr:

Can I just have just a quick follow up on the mortgages? What's the – from my understanding, the spreads are coming about 1.2%, I don't know if that's, you know, if that's right. But how much, you know – a couple of years ago, spreads went up quite sharply, you know, over quite a short space of time. So where would mortgages – how much would the spread need to fall for it to become less, you know, for it to become less interesting for you guys?

Barak Nardi:

You won't know. Even with the 1.2, it's a very even high double digit ROE figures. So it's a very profitable line of business, creates much, much higher ROE – much higher than 10% ROE. So there is still room to go down, and we don't see – actually, we don't see any reason why the prices should go down. But even if they will, there is still a big room until it won't be profitable.

Michael Klahr:

That's great. Thank you. Very helpful.

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. Mr. Kaplan, would you like to make your concluding statement?

David Kaplan:

Thank you all for joining us, and we look forward to speaking to you again soon. Have a good day.

Operator:

Thank you. This concludes the Israel Discount Bank Fourth Quarter and 2021 Results Conference Call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call.]