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 First Quarter 2022 Results Conference Call. All participants are in a 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 23rd, 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 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, risk 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. Mr. Kaplan, would you like to begin?

David Kaplan:

Hi. Thank you very much, and welcome to our first quarter 2022 earnings call. I'll turn it over to Barak now, who will go through our presentation, which is available on our website, and then we will open up for Q&A.

Bark Nardi:

Thank you, David. Good afternoon, everyone, I hope you are all well. Starting with slide 4 in our presentation, we will begin the review of our financial results. Our strong first quarter results show the clear execution of our strategy, with solid credit growth, especially in mortgages, that help generate net income of 983 million shekels, and an ROE of 18.3%. Adjusted for the sale of real estate assets, net income was 668 million shekels, and the ROE was 12.4%. Lastly, our CP1 ratio of 7.55 following the equity rate put us in an excellent position to continue to grow and to achieve our goals. Expectation for higher rates continue to be priced into the market, and we talk about that on slide 5. The yield curve in Israel and in the US continue to imply higher rates at all durations. Looking at the 5-year duration, the expectation for where rates in Israel will be has moved from 0.42% at the beginning of the year to 2.16% now. CPI expectations have also moved significantly, with the one-year forward expectation at 3.3% versus a 0.3% one-year forward expectation at the beginning of 2021. The expected increases in rates and CPI will contribute to the bank's financial results. At the same time, we are monitoring the ongoing development of the market situations and we will act accordingly. On slide 6 we present the financial highlights and the main factors that led to our strong result this quarter. First was the … execution across each of our subsidiaries, and I will touch on that a bit later in the presentation. Second was the focus on our targeted strategy to grow in the area that has the greatest impact and highest returns for the bank and its shareholders. Mortgages, our key strategic pillar, were up 5.2% year to date, and 27.7% over the past year. Our focus on mortgages and our tight risk management continue to produce low level of LLP and write-offs. At the end of Q1, we completed a successful equity raise in which we increase our equity capital by 1.4 billion shekels, and this was a major part of the 10.51% – 10.55% TT1 we reported this morning. The capital rate enables the bank to continue its growth momentum and realize its significant potential with an emphasis on the areas in strategic focus of the bank, mortgages and medium size businesses, taking advantage of the opportunities that currently exist in the market. Lastly, we announced a dividend in respect of Q1 2022 totaling almost 200 million shekels and equal to 20% of Q1 net income. Moving to slide 7, you can see that we delivered strong credit performance, especially in our targeted segments, mortgages and medium business. The growth of our mortgages, which is the main focus area of our strategy, was 27.7% over the past year, and 5.1% in Q1 alone. This growth would have been higher if not for the sale of a portion of our mortgage portfolio during the quarter. This growth and mix of mortgages to 25.4% of our total credit book, up from just under 22% at the end of 2020, when we set out on our new strategy. We also delivered significant growth in medium enterprises, another one of the core areas of our strategy During Q1 we deliberately held back corporate lending growth. Now, post our successful equity raise, we are well positioned to grow in this sector as well. Looking ahead, we see many additional opportunities for growth, and will examine each of them to make sure that our credit growth is sustainable, profitable, and responsible. Total income shown on slide 8 highlights the strength of the underlying business with NII growth of almost 20%, and … up 40% versus Q1 '21 rise in the growth. This was partly offset by a decrease in non-interest financing income as a result of our interest … and position, much of which will likely reverse and generate income in the rest of the year. Total income increase of 21.6% includes the sale of real estate assets. On the expense side, the main impact were increased activity at Cal that comes along with higher payments with partners, and salary increases that are part of the wage agreements. Slide 9 highlights our high quality loan book and conservative underwritings. LLP negative – LLP of negative … [16?? 60??] [06:24] million shekel and low levels of write-offs continue to contribute a positive impact. The negative LLP is a result of collections and re-specification of strategic customers and of new models and methodologies implemented through …. Moving on to the performance of our subsidiaries, starting with slide 11. Mercantile produced a set of very strong results with net income of 121 million shekels, and an ROE of 12.9% this quarter. This was mainly generated by robust loan growth, particularly in mortgages that were up 7.5% in the quarter. In New York, as seen on slide 12, we saw credit growth of 16.5% and deposits were up 13.3% in the past year. This growth, coupled with lower LLP, helped to deliver ROE of 9.7%. Cal, shown on slide 13, opened 2022 with a very strong Q1, delivering net income of 80 million shekels and ROE of 14.3%. The results were driven by 22.9% year over year consumer credit growth, 20.5% year over year transaction turnover, and low levels of LLP. In addition to the financial strengths, Cal also completed a number of strategic agreements with major players in Israel who provide credit and payment as a service. To finish up, we continue to focus on execution of our strategy, as we build toward achieving our 2025 financial target of more than 3.5 billion shekels in net income, more than 12.5% ROE, and a cost income ratio lower than 55%. As shown on slide 5, the interest rate expectations today are almost up a point higher than when we announced our target, and this gives us an additional tailwind toward achieving the target. Thank you all, and we can open now 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 have two, please. When you look at your growth rates combined with the fact that, you know, the expectations for … – I mean, what do you see as a sustainable level of growth? And without compromising your underwriting policy? And I guess my second question is related, I mean, when you also look at the LLP levels, what do you think is a sustainable rate once you factor in the – the rate going up in the foreseeable future?

Barak Nardi:

Regarding growth rates, as you can see, in this quarter we grow a little bit more than 2%, and this is with corporate segments went down and because of equity – because of … we didn't – we are going to raise it in the future. So we expect, we think that our current rate of 2 – above 2% is sustainable also for the future. And regarding LLP – LLP, you know, negative LLP is not something that's sustainable. CISL is new, and we need to wait a little bit and to see within few quarters what is the new normal. The new normal of course is not negative, but I assume, or I – we expect that the new normal should be lower than historical LLP levels prior to Corona.

Tavy Rosner:

Okay, Thank you.

Operator:

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

Micha Goldberg:

Hi, good afternoon. First of all, congratulations on a – what looks like a stellar quarter. Another one, stellar quarter, I'm sorry. A couple of questions, if I may. The first question is regarding your risk weighed assets. They grew by 3.3%, while your credit grew by 2.2%. Could you explain what the difference is, and is this something we should consider to be a kind of, looking forward as well, so every, I don't know, 2% growth in credit will be accompanied with an additional 50% growth on your risk weighed assets on 3% growth?

David Kaplan:
[pause] … do you want to ask all the questions at once, and then we'll go through each of them as we answer.

Micha Goldberg:

Sure. My second question has to do with your capital ratios. So, you currently, after raising, are at 10.55. I understand that since the end of the quarter, the impact of capital markets and yields has reduced capital adequacy whenever it … bit. So you really at this point having so many bits above your internal target. So assuming a 1 per 1 ratio on a risk weighed asset growth and loan growth, that really supports something like a 6-7% loan growth. And if I take into account impact of new accounting practices and the Bank of Israel's real estate capital requirements, I'm just wondering, how much loan growth can you go, based on the current levels of capital ratio, and are you in a concern that if the capital markets continue to go south, you would need to be in additional need of more capital? That's my second question. My third question is, could you explain how the dollar impact on your P&L and your risk weighing assets? And lastly, I was just wondering as to recoveries. You know, one of the other banks have reported they had huge recoveries, and it's one of those things that seem to me elusive to Discount. I was wondering, are there significant recoveries in potential at Discount Bank, it's just a very different credit book, that's why that theme doesn't come through at Discount? Just wondering how that compares to some of the other banks. Thank you very much.

David Kaplan:

Sorry, could you just repeat the third question? It was a little hard to hear you.

Micha Goldberg:

I'm sorry. On the recoveries. I just – I was just wondering –

David Kaplan:

No, no, no. The one – the one before recoveries.

Micha Goldberg:

I think when it comes – when the – on the excess capital ratios? Is that the question? I'm just wondering –

David Kaplan:

Yes, yes. One on the salaries, I think. You asked in between, one on dollar.

Micha Goldberg:

Oh, I just wanted to know the dollar impact is on your P&L and your risk weighed assets. Nothing major.

Barak Nardi:

[pause] Yes. I'll answer your questions, I hope I won't miss anything. So regarding the second question of loan growth, yes. As you mentioned, we are well above our regulatory targets. The targets are 9.75, we are at 10.55. Even with the additional impact, negative impact of the – of 0.11, we are still well above. And when you are looking ahead, we don't think we have limitation for growth, because if we produce annual – if we are able to produce double digit ROE, it – on ongoing basis, it can support our loan growth. So we don't see currently, we don't see in the equity, as a limitation for future – for future loan growth. So this is regarding the loan growth. Regarding the risk weighted assets, I think they are – the excess growth in risk weighted assets versus – versus the loan growth, is coming from some off-balance – off balance sheet items. But overall, it's not something that is very significant, and overall, on a long term basis, we expect the risk weighted assets to grow at the same pace as the – as the loans. So it's something that is temporarily. Regarding the – the impact of dollar, it's not very significant. As we publish, there is a positive impact on equity, I think of around 80 million shekels, … equity and CD ratio. And in terms of – of P&L, it's not – it's not – currently, it's not something very significant. In terms of recoveries, as we published, some – around half of the negative LLP is coming from specific customers with some recoveries. It's not very significant, but it exists, and – but it's not – and it's a specific customer, we should mention.

Micha Goldberg:

Okay, thanks very much.

Operator:

The next question is from Joseph Dickerson of Jefferies. Please go ahead.

Joseph Dickerson:

Hi, good morning. Thank you for taking my question, or good afternoon, sorry. Thank you for taking my question. I just had a quick question on the cost income ratio target of 55%, given the adjusted business is at 63.7, and you had a pretty strong quarter for both loan growth and NIM expansion. So, I guess, what are the building blocks to get to the 55% target in 2025? Thanks.

Barak Nardi:

Well, first of all, if I'll start with the current number, the adjusted one, of a little bit above 63%, we need to take into consideration that it's higher – one of the reasons that it's higher than other banks is because we are consolidating the credit card company Cal, its operational company, and with high cost income ratio. Excluding Cal we are at around 60%. So it's still – but – it's a better number, but still with a great room for potential. And the way we are going to reach the 55% is growing revenue much faster than as in cost. We expect in the following – in the following years, that the pace, the revenue growth pace coming from loan growth with the backwind of interest rate and inflation, will grow much faster than expenses. So by that, we'll reach gradually the cost income ratio of lower than 55% in 2025.

Joseph Dickerson:

[Pause] Thank you very much.

Operator:

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

Michael Klahr:

Hi, thanks for taking my questions. Firstly, just, again, on the costs. So I see salary growth was up 3% year on year, excluding bonuses. I just wanted a bit of help, whether we should be expecting that kind of growth through the remainder of the year, at that kind of rate? And my second question was on the – on credit growth, and whether you're seeing any signs of a slowdown in – in mortgages, or corporate, as interest rates start to rise? And also, given, you know, more general market turmoil, et cetera, especially in the capital markets. Whether you're starting to see an impact there. Thank you.

Barak Nardi:

So, regarding sal – so regarding salaries, the 3% increase is more or less representing the – the wage agreement. So on ongoing basis, this is more or less the salary growth. And as I mentioned earlier, through answering Joe's questions, assuming that this is more or less the run rate of salary growth, we expect the revenue to grow much – in a much faster pace. The … slowdown, I think, if we look at the overall market conditions, overall they are favorable to the banks. The expectation around interest rate and inflation are positive. As we indicate in our financial statements, every 1% in terms of interest rate increase generates additional 1 billion shekels in terms of revenue. On the other hand, we need to take into consideration that there might be a decrease in demand. Currently, we don't see it yet, but it might – it might evolve. And specifically around mortgages, we think that even if there will be some decrease, some decline in the mortgage – in demand for mortgages, we believe that we'll be able to keep our fast pace because we still – at a low market share, we still are not working on the main side, we are solving our capacity issue. So we believe that even with a lower demand in terms of overall market, we will be able o continue our strong growth momentum around – around mortgages.

Michael Klahr:

Thanks. Can you – can you just remind us what the weighting, the risk weighting of your – or the rough, you know, roughly, is, of your mortgage portfolio?

Barak Nardi:

Mortgages, it is around 50%, as you – of – it's – so the translation to risk weighted assets is around 50%. You need to take into consideration that we are, from quarter to quarter we are increasing our mortgage mix. So, currently, we're like, 25, about 25% of total loan book, and we will continue to increase this – the mortgage mix.

Michael Klahr:

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

David Kaplan:
Yes. Thank you all for joining us for Q2. We look forward to talking to you again in August.

Operator:

Thank you. This concludes the Israel Discount Bank First Quarter 2022 Results Conference Call. Thank you for your participation. You may go ahead and disconnect.

[End of conference call.]