HSBC

HSBC Oman discussion session on Interim Financial Statements for H1 22

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[Text on screen] Disclaimer in English and Arabic

[Mel]
We're just waiting for the MSX representative to join this afternoon before we formally open the session.
Thank you.

Good afternoon, everybody!
And thank for joining us for our session today, which is the HSBC bank Oman review of its first half results for 2022.

I'm joined in the room by three of my colleagues. Muntadhar, who is our Chief Financial Officer; Thomas, who is our Chief Risk Officer; Rahma, who is sitting next to me, who is our Company Secretary.

I'm going to hand over to Muntadhar at the outset to run us through the financials but before I do, I would ask you all to read the disclaimer that we have on the screen, which we are required to display. I'm not going to read it out to you.

But two things I'll draw to your attention. Firstly, this is a review of our first half results. And therefore, it is backward-looking, not forward-looking. We won't be able to offer any information or opinion or view on anything that has taken place since the 30th of June 2022. And secondly, I'm sure you've all seen the disclosures that we made to the market recently around a possible merger with Bank Sohar. We will not be able to discuss that on this call either.

The disclosure contains all of the information that is available to the public as of today. And we will not be able to either answer questions or go into any further detail on what is already contained in the disclosure.

Our team is going to walk you through some of the key highlights on the financials and then we'll open up to Q&A. And whichever one of us is best placed to deal with your questions will hopefully address them.

If you have questions, please feel free to use the chat 'Raise your hand' through the Zoom application and we'll get through as much as we can.

So with that, Muntadhar, I can hand over to you. That would be great to walk us through the financials.

[Text on screen] Slide – Key highlights

[Muntadhar]

Salaam-Alaikum everyone. As Mel said, I will be walking you over the financials for the bank for the first six months and how we have performed when compared to the prior year.

If you look at the first slide, the slide provides a very high-level overview of our performance for the first six months. As you can see, our profit before tax stood at 46.2 million, an increase of just under 50% when compared to the prior year on the back of higher revenue, lower costs and a minor increase in our ECL releases. We'll look at these in more details in the following slides.

From a balance sheet perspective, our loans increased by 4.4% while our deposits increased by just under 1%. We'll look at this more closely on slide 7.

As a result of that, our JAWS, cost efficiency ratio and return on average equity all improved when compared to the prior year.

[Text on screen] Slide – PBT

The slide provides a more detailed visualisation of our performance for the first 6 months., As I had mentioned earlier, the reduction in our costs was the major contributor and reason behind our increase in PBT which reduced by 9.4 million. The increase in revenue by 4.9 million also supported this.

The increase in revenue is mainly due to higher NII and higher NFI which was partly offset by lower trading income. From an NII perspective, the increase is due to a combination of higher interest income on our assets and lower interest expense on our liabilities.

On NFI was higher on the back of higher fees generated mainly on our corporate credit card lending. Trading income was lower due to lower FX swap transactions.

[Text on screen] Slide – Expected credit loss

On ECLs, I'd like to handover to Thomas, who will provide more updates on how the market has developed and how this has impacted our portfolio and ECL movements.

Thomas, over to you.

[Thomas]

Thank you Muntadhar, and Mel. Good afternoon to all.

So, in June this year total exposure at default, which is essentially drawn loans and undrawn commitments for both retail and wholesale customers combined totalled 6.1 billion dollars vs 5.8 billion at the beginning of the year.

Over this period, we also released an aggregate of approximately 15 million dollars in expected credit loss provisions.

There have been a number of drivers leading to the ECL release year-to-date. The main ones that I would like to cite are the S&P upgrade of the Oman sovereign to BB-, which reflects the strong fiscal commitments of the government and has allowed us to re-evaluate the default probabilities in our portfolio.

Secondly, is the improvement in the macroeconomic environment for Oman and its impact on GDP growth expectations. This in turn was largely driven by sustained oil prices and the relatively contained impact of the war in Europe and of inflation.

And finally, the last significant driver for the release in ECLs was the full removal of COVID-19-related overlays, which we had taken conservatively at the beginning of the pandemic in order to compensate for potential ECL model limitations to fully cater for the impact of the pandemic.

So the credit book, both in retail and wholesale has showed continued resilience and defaults in the portfolio have been very largely contained.

From an ECL coverage perspective, levels have returned to those observed pre-COVID at around 1.6% on the aggregate loan book.

For stage 3, defaulted customers in particular, we continued to maintain a conservative provisioning approach with ECL coverage of approximately 70%.

The stage 3 names in themselves constitute a very small proportion of our asset base and the number of customers that are also being restructured and maintained in stage 2 special mention under the CBO concession rules is also very small and both segments combined represent circa between 2 and 3% of our asset base.

I'll hand it over back to Muntadhar for the rest of the presentation.

[Muntadhar]

Thank you, Thomas.

[Text on screen] Slide – Cost

As I had mentioned earlier, our costs reduced by USD9.3 million. As you can see on the slide, there are a couple of factors that have contributed to the reduction but the major ones are due to the non-repeat of the impairments that we had witnessed in the prior year in relation to our fixed assets, reduction in the inter-company expenses, lower depreciation, lower marketing costs and lower staff costs due to lower number of FTEs. This was partly offset by higher VAT and donation expenses in relation to Cyclone Shaheen which was not incurred in the first half of last year.

As a result of this, and due to increase in our revenue, our cost efficiency ratio dropped from 88.6% to 66%.

[Text on screen] Slide – Balance sheet

The slide provides the movement of our customer advances and customer deposits year-on-year. As I have mentioned earlier, our loans increased by 4.4% or USD150 million on the back of higher loan bookings in the CMB and Retail businesses. However, as Thomas had mentioned, due to the improvement in economic environment and improvement in the overall liquidity, we have seen some pre-settlements mainly from the Government and GRE. As a result, our GB loan book was impacted negatively. It is however worth noting that quarter-on-quarter, all lines of business showed growth.

On customer deposits, there was an increase of about USD50 million which was mainly in GB and CMB which was partly offset by the reduction in our retail deposits due to the opening up of the economy and the increase in spending.

As a result, our Advances to Deposits ratio increased 71.8%, which is still within our risk appetite.

[Text on screen] Slide – Liquidity, funding and capital

Moving away from our profitability, we have included some of the key ratios around liquidity, funding and capital.

As you can see on the top left-hand side of this screen, our capital adequacy ratio stood at 21.4%, which is significantly higher than the regulatory requirement of 12.25% demonstrating HBON's strong capital position.

From liquidity and funding perspective, our LCR and NSFR stood at 224% and 148%, respectively. It is also worth noting that about over a third of our asset book is invested in high-quality liquid assets, T-bills and bonds and short-term bank placements.

[Text on screen] Slide – Other key ratios (continued)

We've included here other key ratios as well and how these have moved year-on-year over the last several years. The one that I would like to draw your attention to is the cost efficiency ratio where it has dropped from 87% in December 2020 to 66% as I had mentioned earlier. Management recognises that this is still at the higher end when compared to our peers and management is focusing on reducing this further.

[Text on screen] Slide – Dividend and yield analysis

Finally, to our last slide. This slide shows our cash dividends over the last several years, except for 2020 where no cash dividend was made due to the losses incurred, HBON had made a cash dividend payment in the rest of the years at the highest possible payout ratio set out by the CBO regulations.

That brings me to the end of my presentation. Thank you.

[Mel]

Thank you both.

Over to those joining us, if you've got any questions please feel free to post them in the chat or to raise your hand and Rahma will let us know.

There's a question just come in.

[Caller 1]

Hello?

[Mel]

Hello! Hello, Bishen.

[Caller 1/Bishen]

Hi. Good afternoon. Thank you so much for the presentation, team. My question is with regards to the release in ECL. We've witnessed the trend where in 2020 the management took sort of a prudent call. That's why the ECL's on the higher side. And ever since first quarter of last year we've seen a revision; rather from Q4 2020 we've seen a reversal in sort of provisions. Going forward, how sort of, how do you see these ECLs panning out let's say over the next six months or in FY 23. When will the reversal plan continue? Just want your thoughts on the same.

[Mel]

So we can't really comment on the future trend I'm afraid. I'm not trying to be difficult. But what Thomas can do is just maybe go into a little bit more detail in terms of the key drivers for the first half of this year that enabled us to reach the decision that it was appropriate to write back some of the ECLs. And hopefully that will enable you to form your own opinion in terms of the forward-looking positions. So maybe Thomas you could take that in a little bit more detail in terms of maybe the weight of each that contributed to the release that we've made.

[Thomas]

I can do that. Perhaps just to explain, one of the components of the ECL calculation is the forward economic guidance. This is essentially based on macroeconomic variable outlook for Oman. In our models we utilise two main inputs. One, which is GDP growth for the country and the other is oil price. Since the end of the pandemic and the reopening of the economy in Oman what we're seeing is that the growth projections for the country have improved, and that that accelerated with the beginning of the conflict in Europe and the oil and gas supply difficulties that have been seen across Europe, which obviously [has] driven an increase in the price of oil.

Whereas most countries would have factored that in as a headwind. I think for Oman it has actually been a windfall. Because the sustained oil price [is] driving stronger fiscal revenues for the government and has allowed them to commit to their fiscal plan very strongly.

So what that means for us is over that first half period of time with the improvement of those macroeconomic variables that has translated to a mechanical release of ECLs. The logical process flows through, which is that as growth GDP and oil price improve, so does the performance of our customers. And so you see a reverse impact on defaults, which is the defaults appearing on the portfolio have lowered.

That component of model-driven, macro-driven, ECL component, was quite significant until now. And with all these improvements that we've seen, we (now) do not hold a very large proportion of ECLs for this economic factor anymore.

The other element is on some of the overlays that we used to hold. When COVID hit, there was concern that our models would not be able to cater for the volatility that we were seeing in the market and the impact that it would have on some of our customers. And as you said, we did take some overlays there just in case more defaults materialised in the portfolio than our models could anticipate. Our assessment of that situation now, in alignment with the forward economic guidance, is that most of the industries in Oman are operating pretty much in BAU at this point.

Hopefully that answers your question.

[Caller 1/Bishen]

Sure, sure, I understand that. That's fine.

My next question is with regards to your restructured loans. We've seen, in fact, I'd like to commend that HSBC is probably the only bank out of the listed banks in Oman, which has actually seen a drop in restructured loans. Your restructured loans stood at 87.6 million as of 31st December. And that number currently as of June-end is 64.7 million. So while I understand the primary drivers of the ECL model, even the restructured loans, you're the only bank which has seen a sharp drop in sort of the overall restructured loans. If you would care to comment on this thing and if anything, going forward, once the moratorium ends in September from the Central Bank of Oman.

[Thomas]

So again, I'm not going to comment on the future but I will comment on what has happened to date.

From a retail perspective, my first comment is, a lot of this is linked to how we originate loans in our portfolio. The customers that we would tend to go for are really the ones which are highest-rated, showing resilience, (strong) financials etc. So I think inherently, in our portfolio, we have some resilient, strong, resistant customers.

Now in terms of those restructures which have occurred, I would say, on the retail side we only carry now a very small portion of customers who are still availing of the deferrals in line with CBO guidance. Those constitute only about 8 million in outstanding. And the remainder is on the wholesale side.

We’ve been, on the retail side, very active in our discussions with customers. So that has resolved itself quite well.

On the wholesale side, again, I think it’s been a very proactive engagement with our customers to discuss the restructures and to formalise them.

[Caller 1/Bishen]

So just for my understanding and this is more on the academic side, if you could help me out, when a customer has a problem in repaying its loan as per the original loan schedule, you enter into a restructure arrangement where you sort of alter either the time frame or some of the other parameters to help the customer sort of stick to the original sort of a modified loan schedule.

When I see your reschedule loans going from 87 million to 65 million one of the two things happen. One is, where in an absolute level you’ve written off a lot of the loans, which has not happened because we’ve seen reversals or sort of the cash flows have improved so dramatically that all these customers have moved from the restructured segment back to regular ECL segment is it?

Is that a correct assessment, if you could explain that part to me?

[Thomas]

You’re correct. The restructure process is the one that you described. Where a customer approaches us to avail of concessions or restructures. At the moment, we’re still in the window of opportunity granted by the CBO, which allows us to restructure these loans with the customers and to maintain these loans within the stage 2 performing book as Special mention

The amount of outstanding is also renegotiated at that point. So we have opportunity in certain cases to reduce the exposure of some of these customers if they’re not fully drawn. We take as part of the negotiation process, we’ll try as much as we can actively to reduce our exposure. And that can be through different means available to the customer. They may have other sources of funds, which they can bring in etc.

That’s the active part of the restructure/renegotiation process and of course where we can, we try to reduce the exposure which we hold against them.

[Caller 1/Bishen]

Alright. Thank you so much. If I ever need further questions, I’ll come back later.
Thank you.

[Mel]

Thanks, Bishen.

[Rahma]

We also have Ayisha from Ubhar Capital.

[Mel]

Ayisha? Would you like to ask your question?

[Caller 2/Ayisha]

Hi. Good afternoon. Thank you very much for holding this conference call. My question is regarding restructuring of loans also. I would just like to understand that once a loan is restructured, does the customer have a year before you will reclassify his account unless one or two payments are missed. If you can just elaborate on the procedure.

[Thomas]

Under our HSBC policy approach, we absolutely have a period of cure time. So if a customer defaults and a loan is restructured, there is a minimum 12-month period during which the customer has to remain in stage 3 defaulted status. If the customer has demonstrated impeccable debt servicing behaviour, then the customer can move back to stage 2 with an asterisk, kind of special mention still, for 24 months. After 24 months again, if there is impeccable behaviour on the account, the customer can be moved back to the performing book.

Now in terms of that mechanism under the COVID concession rules, I'm not sure of the answer. I'm not sure of the minimum cure period in place once a restructure has been agreed and when that account moves back to BAU. So I may have to get back to you on that one. But hopefully that answers your question.

[Caller 2/Ayisha]

Okay, that's fine. Thank you very much. My second question is about loan growth. What is your outlook … I mean I understand that you cannot give forward-looking statements but if you can just shed some light on what kind of activity you're seeing on the ground. Is there loan growth activity picking up and in which sectors are you seeing activity pick up?

[Mel]

So I'm not going to talk about the second half. I can talk about the first half. I think the reality was, if I look back to 2021, we all hoped that Oman would come out of the COVID restrictions a lot sooner than it did. The reality is, it was probably fourth quarter before I would say we started to feel like we were at the other side, started to see some momentum in terms of business returning to some form of normality.

What we've seen through the first half is really the momentum from the fourth quarter of 21 carried through the first half.

On the retail side, what we see are people spending. Not everybody obviously. We have to be conscious of the current environment and increased cost of living. But on the whole what we're seeing on the retail side, our customers are spending. So credit card spend going up. Loan growth on the retail side, across all of our loan products actually, personal loans and mortgages. As I would say, some normality and confidence returned to the market through the first half.

On the corporate side, I would say the same. Corporate customers were really waiting, they spent the COVID period I would say reassessing their strategies, consolidating, testing whether their strategies in the future remain true in a post-COVID world.

In many instances, accelerating transformation plans, looking at diversification opportunities in line with the Sultanate's 2040 vision. And I think we sort of in the first half we've seen some of that then start to transpire, come through in terms of an activity. And start to translate into growth in the balance sheet.

We have also been seeing government activity in the first half. We've seen government-rated entities go to the market. And that has also increased in some instances in the balance sheet and low growth.

I would also say it's been very competitive in the first half. The market remains very liquid. It has been throughout the first half. That has resulted I would say in margin depression. In aggressive pricing. For assets, as banks compete for customers.
I'm very pleased with the first half performance. I think those are the sort of key drivers. So hopefully that will give you some flavour for what we've seen. And you can form your views in terms of where that may take us.

[Caller 2/Ayisha]

Okay. Thank you very much. My last question is about HSBC's superior capital adequacy when it comes to comparing the bank with local peers as well as some of the GCC peers. Do you think that HSBC may release holdings or the parent company, would perhaps consider reallocation of this capital to put it to use in such a way that they can be, ROE can be improved? Would that be an option that the bank would consider going forward?

[Mel]

I wouldn't really want to comment on that, Ayisha. I really wouldn't want to speculate at this stage in terms of what that strategy could look like, but you're obviously right. We are very well capitalised and deliberately so. It's the way that the Group operates globally is to maintain a very healthy ratio. I'm sorry I can't really comment on the future strategy.

[Caller 2/Ayisha]

That's alright. Thank you very much.

[Mel]

Thank you.
Any other questions?
I'm just looking to Rahma. Somebody put their hand up.

[Rahma]

Joyce.

[Mel]

Joyce? Would you like to ask your question please?

[Caller 3 - Joyce]

Good afternoon and thank you for the call.
My question is on your deposits. When we look at the deposits you have reported that around 1.35 billion [in] current accounts and savings accounts combined. But when we look at the maturity profile of these deposits we see that almost a billion is committed for more than a one-year time period. How could you explain this scenario especially when we have, we are talking about almost 65% is, reporting 65% under the current and savings accounts.

[Muntadhar]

Joyce, could you please repeat the last sentence. Just so I understand, what is your concern about?

[Caller 3 - Joyce]

I just want to understand how you classify deposits. Because the deposits, current accounts and savings accounts combined is around 1.35 billion. At the same time, you're saying that aggregate majority profile, you're showing that almost a billion rials is committed for more than a year.

[Muntadhar]

So this will be our term deposits. We have quite a good portion of our deposits placed in long-term deposits.

[Caller 3 - Joyce]

But you have reported only 600 million as time deposits. If I look at the structure you're reporting current and call accounts almost a billion time deposits that's 600 million and then savings accounts at 400 million. If I look at the time profile also we're talking about 900 million under one year and almost a billion over one year.

[Muntadhar]

Right. Very good observation and on that we've got a dispensation of treatment of certain deposits where although they're falling under the current account, we may treat them for a long period above one year. Dispensation was approved by the Central Bank of Oman.

[Thomas]

It's based on behaviouralisation observation on the accounts. So even though they are in savings or current accounts, these are deposits where there is a portion of deposits, which is considered to be very sticky, long-term based on historical observation.

[Caller 3 - Joyce]

Okay. Okay. Could you through some light on the concentration profile of the depositors?

[Mel]

I'm afraid we can't. No.
Sorry, I don't want to be difficult but that's not something we can disclose.

[Caller 3 - Joyce]

Okay, fine. Thank you.

[Mel]

Any other questions?
Last chance to raise your hand.

Excellent!
So listen, thank you all for joining. Thank you for the questions. It's great to have you with us and we look forward to more of these sessions going forward.

Thank you very much.