Alinma Bank

2 December, 2024

INITIATION OF COVERAGE

Alinma Bank offers a unique positioning in the sector, being the only Islamic franchise with a corporate-heavy loan book. The bank is pursuing an aggressive growth strategy. The bank's corporate growth is supported by project financing, while in the retail sector, the bank is gaining market share. However, this strong growth came at the cost of significant CASA migration and a relatively elevated cost structure. While we expect the bank to sustain strong lending growth supported by favorable economic tailwinds, contraction in margins with rate cuts, elevated CoR, and increased Opex to support growth would marginally limit the earnings expansion; we expect earnings will grow at a CAGR of 11% over the next five years. While the bulk of the RoAEs expansion is behind us, it's still expected to improve to remain above 18% in the medium term. Current valuations at 2024e PBV of 2.2x are at a discount to other Islamic banks (median 2024e PBV of 3.2x) despite a strong lending outlook. Our target price is SR33/share, and we have an Overweight rating on the stock.

An aggressive growth strategy resulted in the most robust loan expansion (+19% YoY) in 2023, the highest among our coverage and well above the sector growth of 10% YoY. The bank is not only driving growth in the corporate sector, driven by expansion across project financing, SMEs, and large corporates, but also in the retail sector, where it has successfully increased its share in mortgage and personal loans. We expect strong momentum to sustain in 2024e, albeit at a moderating pace from last year (16% YoY in 2024e vs. 19% YoY in 2023), led by the corporate sector penetration.

However, this growth comes at the cost of CASA migration and an elevated cost structure. Alinma witnessed the most shift in its deposit mix, with a 48% CASA mix vs. the sector average of 53% and the lowest among our covered banks. In addition, though its cost of risk has normalized from very high levels, it remains elevated. Opex growth will also likely remain high to support the bank's ambitious growth plans.

Earnings growth is likely to moderate as the strong lending growth is offset by a margin contraction, elevated cost of risk, and only marginal improvement in operational efficiency. We expect earnings growth to be limited to a CAGR of 11% vs. growth of in excess of 30% over the last three years. We also see the bulk of RoAE expansion behind us, with RoAEs expected to average 18.3% between 2024-28e.

Valuation: At a 2024e PER of 13.0x and PBV of 2.2x for an RoAE of 18.5% in 2024e, Alinma is cheap relative to other Islamic banks; Albilad trades at a 2024e PBV of 2.6x despite a slightly lower RoAE below 17%, and Al Rajhi, with a RoAE of over 20%, trades at 3.7x 2024e PBV. While we note that the negative gearing of NIMs warrants some discount, we see the current valuation difference does not fairly reflect strong lending prospects.

Risks: While there haven't been any general signs of stress system-wide in asset quality, we remain cautious about Alinma's historically elevated NPL formation. Moreover, if lending growth slows down more than expected, it will negatively impact our earnings estimate.

RATING SUMMARY	OVERWEIGHT
Target Price (SR)	33
Upside/Downside	19%
Div. Yield (%)	4%
Total Exp. Return	23%

MARKET DATA	
Bloomberg Code	ALINMA AB
Last Price (SR)	27.8
No of Shares (mn)	2,500
Market Cap bn (SR/USD)	70/19
52-week High / Low (SR)	36.0/27.4
12-month ADTV (mn) (SR/USD)	164/44
Free Float (%)	90%
Foreign Holdings (%)	14%

Last price as of November 28th

VALUATIONS

	2023A	2024e	2025F	2026F
EPS (SR)	1.9	2.1	2.2	2.5
PER (x)	18.0	13.0	12.4	11.2
PBV (x)	2.8	2.2	2.0	1.8
DPS (SR)	1.1	1.1	1.1	1.2
Div. Yield (%)	3.2	3.9	4.0	4.5
RoAE (%)	17.2	18.5	18.1	18.2
RoAA (%)	2.2	2.2	2.1	2.0

FINANCIALS (SRbn)

	2023A	2024e	2025F	2026F
Oper. Income	9.7	10.9	11.9	12.9
Provisions	(1.3)	(1.2)	(1.6)	(1.7)
Net Income	4.6	5.4	5.6	6.2
Investments	43	48	52	55
Loans & Advances	174	202	232	264
Deposits	188	214	243	274
NIM (%)	3.8	3.7	3.5	3.4
Cost to Income (%)	31.3	31.0	30.3	29.7
NPL Ratio (%)	1.6	1.0	1.0	1.1
Simple LDR (%)	92	94	95	96

**Net Income adjusted for cost of AT Sukuk*

RELATIVE PRICE PERFORMANCE

Financial Summary:

SAR mn							CAGR	
Income Statement	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2018-2023**	**2023-2028e**
Interest Income	13,228	15,545	14,752	14,878	16,021	16,938	22%	5%
Interest Expense	(5,573)	(6,900)	(5,334)	(4,687)	(4,953)	(4,846)	38%	-3%
NSCI	**7,655**	**8,645**	**9,418**	**10,191**	**11,068**	**12,092**	15%	10%
NII	2,071	2,285	2,512	2,732	2,941	3,114	15%	8%
Operating Income	**9,726**	**10,931**	**11,930**	**12,924**	**14,009**	**15,206**	15%	9%
Operating expenses	(3,044)	(3,389)	(3,619)	(3,834)	(4,063)	(4,308)	10%	7%
Provisions	(1,299)	(1,208)	(1,552)	(1,664)	(1,962)	(1,779)	23%	7%
Total Expenses	**(4,342)**	**(4,597)**	**(5,171)**	**(5,498)**	**(6,025)**	**(6,088)**	13%	7%
NPBT	5,396	6,334	6,759	7,426	7,984	9,118	16%	11%
Net Income*	**4,639**	**5,359**	**5,619**	**6,216**	**6,717**	**7,734**	10%	11%
Shares Outstanding (mn)	2,500	2,500	2,500	2,500	2,500	2,500		
EPS	1.9	2.1	2.2	2.5	2.7	3.1		
DPS	1.1	1.1	1.1	1.2	1.3	1.5		

Balance Sheet	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2018-2023**	**2023-2028e**
Cash and balances with central bank	12,598	14,984	17,041	19,214	21,504	23,910	11%	14%
Due from banks and other financial institutions, net	1,701	2,293	1,658	1,117	720	3,369	-27%	15%
Investments, net	43,236	47,560	51,523	54,958	57,706	60,591	19%	7%
Financing, net	173,624	201,687	231,563	264,123	299,463	335,800	16%	14%
Other	5,555	5,562	5,562	5,554	5,539	5,517	9%	0%
Total Assets	**236,715**	**272,086**	**307,347**	**344,968**	**384,932**	**429,187**	14%	13%
Due to banks, central bank and other financial institutions	7,431	8,026	8,588	9,103	9,558	10,036	3%	6%
Customers' deposits	187,901	214,057	243,444	274,493	307,203	341,575	16%	13%
Other liabilities	7,050	9,076	11,578	14,527	17,968	23,506	13%	27%
Total Liabilities	**202,381**	**231,158**	**263,610**	**298,122**	**334,729**	**375,116**	15%	13%
Total shareholder equity	**29,334**	**32,176**	**34,986**	**38,094**	**41,452**	**45,319**	7%	9%
Total Equity	**34,334**	**40,928**	**43,737**	**46,845**	**50,204**	**54,071**	10%	10%
Total liabilities and equity	**236,715**	**272,086**	**307,347**	**344,968**	**384,932**	**429,187**	14%	13%

Growth (Y/Y)	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NSCI	26%	13%	9%	8%	9%	9%
NII	9%	10%	10%	9%	8%	6%
Total operating income	22%	12%	9%	8%	8%	9%
Net income	29%	16%	5%	11%	8%	15%
Financing	19%	16%	15%	14%	13%	12%
Deposits	29%	14%	14%	13%	12%	11%

Ratios	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NIM (%)	3.8	3.7	3.5	3.4	3.3	3.2
Operating cost to income (%)	31.3	31.0	30.3	29.7	29.0	28.3
Cost of risk (bps)	72.9	58.7	65.6	61.6	64.0	51.7
NPL coverage (%)	154.9	209.6	200.5	193.7	193.7	188.4
NPL ratio (%)	1.6	1.0	1.0	1.1	1.2	1.3
Simple LDR (%)	92.4	94.2	95.1	96.2	97.5	98.3
RoAA (%)	2.2	2.2	2.1	2.0	2.0	2.0
RoAE (%)	17.2	18.5	18.1	18.2	18.0	18.8
Assets to Equity (x)	92.4	94.2	95.1	96.2	97.5	98.3

Valuation	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
BVPS	11.7	12.9	14.0	15.2	16.6	18.1
P/B	2.8	2.2	2.0	1.8	1.7	1.5
P/E	18.0	13.0	12.4	11.2	10.3	9.0
Dividend yield (%)	3.2	3.9	4.0	4.5	4.8	5.6

**Net Income adjusted for the cost of AT Sukuk.*

Source: Company financials and anbc research

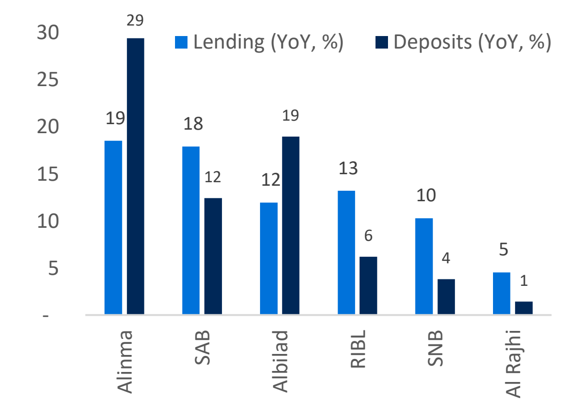
Investment Thesis

Delivering a strong balance sheet expansion

Alinma's balance sheet expansion was the strongest among our coverage in 2023. Assets and liabilities grew markedly, underpinned by significant market share gains as the bank pursued an aggressive growth strategy. While the sector's loan growth moderated to 10% YoY in 2023, Alinma's lending growth, in contrast, picked up in 2023, recording a double-digit expansion for the fifth consecutive year – net loan book grew by 19% YoY in 2023. Alinma's market share in terms of total banking assets rose to 6% in 2023 from 5% in 2019, and its total lending share increased to 7% in 2023 from less than 6%. The bank has now become the third-largest bank in terms of the number of customers in Saudi Arabia.

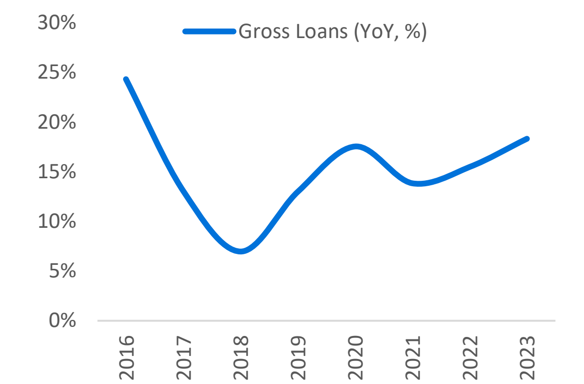
Alinma's 19% YoY lending growth in 2023 (18% YoY growth for gross lending book) was the strongest pace of expansion in the last seven years as it expanded its market share not only in corporate, where project financing volume increased but also grew its share in the retail sector. This momentum sustained 9M24 with a 13% YTD growth in net lending portfolio.

Chart 93: A very strong balance sheet expansion in 2023



Lending growth is YoY % change in net loan book
Source: Company financials and anbc research

Chart 94: Gross loan growth accelerated to 18% YoY in 2023, the highest in the last seven years



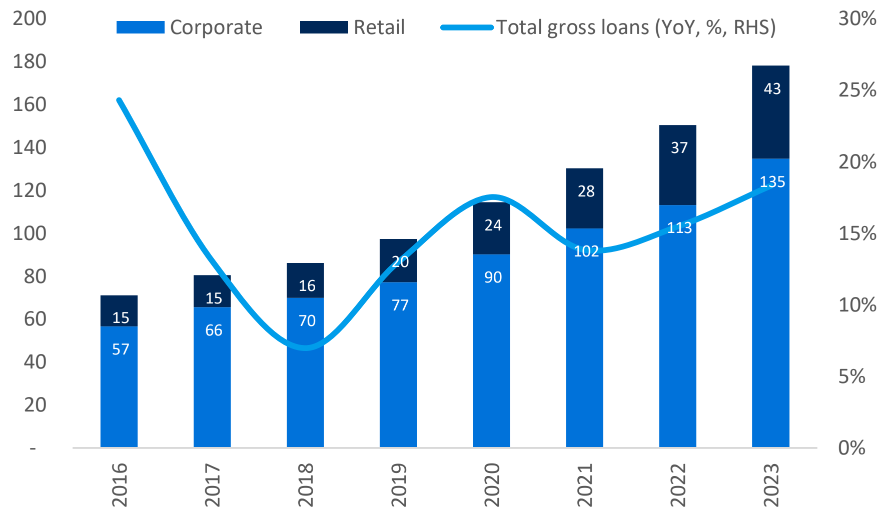
Source: Company financials and anbc research

Surprisingly, such relatively robust growth coincided with a period of decade-high levels of interest rates and a significantly tight monetary policy stance. Although sector loan origination has been slowing down within retail, Alinma's performance has been encouraging, indicating that the bank is capturing a significant market share.

Alinma's retail gross loans grew by 16% YoY in 2023, driven by 13% YoY growth in mortgages and, surprisingly, 19% YoY ex-mortgage retail book, including auto and personal financing. This had been well above the sector average where, according to SAMA data, retail loans grew by only 7% YoY; even taking cues from the largest retail bank, Al Rajhi Bank recorded a 5% YoY contraction in its ex-mortgage loan book, which implies that Alinma had successfully gained market share within the retail sector.

While Alinma's retail expansion had been a positive upside surprise, its core corporate lending momentum also accelerated. Corporate gross loan growth increased to 19% YoY in 2023 from 11% YoY as the bank benefited from a renewed infrastructure CAPEX cycle in Saudi Arabia and expanded its large corporate loan portfolio and project financing (accounting for 36% of the overall lending book) to cater to the infrastructure financing needs.

Chart 95: Growth surprisingly resulted in both corporate and retail sector



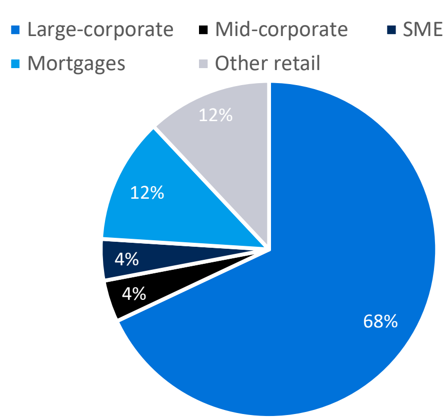
Source: Company financials and anbc research

Alinma's positioning in the sector is quite unique in that while all the other Islamic banks are either retail-heavy or balanced, Alinma is predominantly focused on corporate lending, accounting for 76% of its overall book. Under its 2021-25 core strategy, the bank is pursuing aggressive expansion, focusing on diversifying exposure while actively expanding project-based financing for the giga projects under Vision 2030.

The bank is also expanding its SME portfolio through targeted program initiatives and the Kafalah program. It is also revamping its internal loan origination process through digital integration to better penetrate mid-corporates and SMEs.

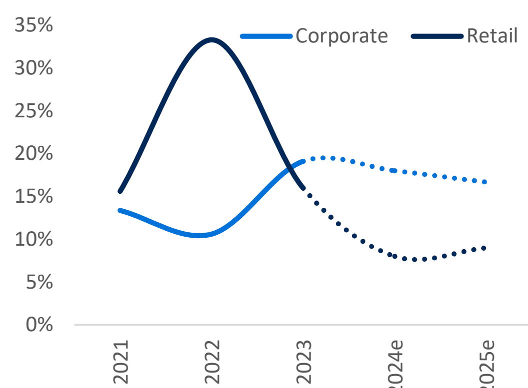
The bank's retail strategy is to widen its customer base by building a portfolio of HNW (high net worth) customers through improved customer experience. This would eventually allow the bank to expand its deposit base and lending exposure. The bank has recently launched mortgage refinancing products to enhance its market share further in home financing.

Chart 96: Large corporations account for most of the loan book, including project finance



Source: Company financials and anbc research

Chart 97: The strong momentum should largely sustained, albeit at a slower pace, in the retail sector



Source: Company financials and anbc research

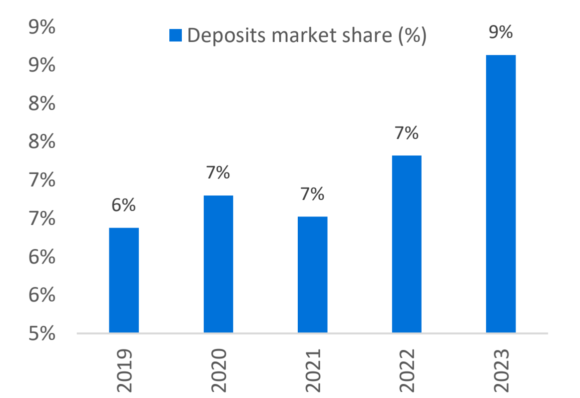
Overall, the bank's growth strategy is focused on aggressive penetration. In this regard, Alinma's past track record, including the performance delivered in the last four years and relatively strong positioning in the sector (Islamic franchise), supports these ambitious growth plans, in our view.

The strong momentum of credit expansion was sustained in 9M24, with a 16% YoY growth in gross loan book. Lending was up 13% YTD in 3Q24, driven by solid corporate originations (+13 % YTD), while retail lending was up 11% YTD, driven by a 9% YTD growth in mortgages and a 67% YTD growth in auto financing.

This robust asset expansion was also accompanied by growth on the funding side. Barring the tier 1 capital injection in 1Q24, Alinma predominately remains a deposit-funded bank, accounting for 93% of the total liabilities in 2023. The bank lending growth was supported by its substantial market share gains in deposits, which we estimate (excluding quasi-money deposits) markedly increased by over 130bps to 8.6% in 2023 and a further gain of c20bps in 1H24. Focus on retail HNW customer base and private sector penetration helped drive this deposit growth.

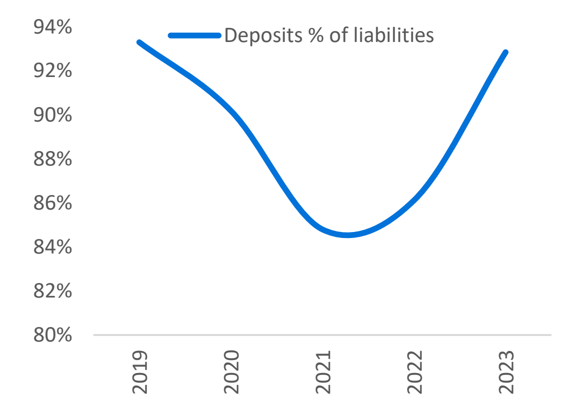
However, despite Alinma's issuance of USD1bn Tier 1 Sukuk in 1Q24, we think its Tier 1 capitalization remains under pressure amidst strong growth in risk-weighted assets. Tier 1 CAR fell for the second consecutive year to 16.3% in 2023 from 21.6% in 2021, and if the growth momentum sustains a similar pace, the improvement will only be incremental in 2024e.

Chart 98: Deposit market share has markedly increased in 2023…



Source: Company financials and anbc research

Chart 99: …as Alinma continues to focus on deposits to fund its growth



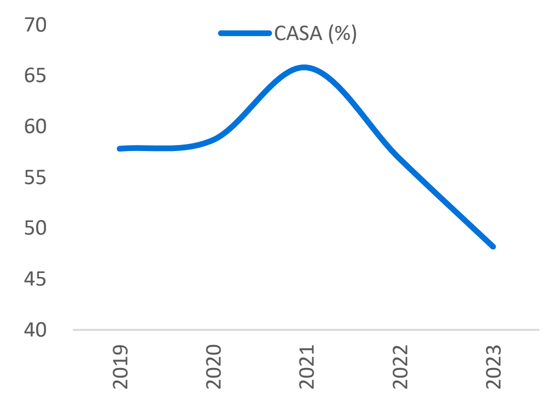
Source: Company financials and anbc research

This growth also came at the expense of elevated cost structures

However, such sharp expansion also came at the cost of CASA migration and a relatively elevated cost of risk. A strong deposit growth was accompanied by significant CASA migration over the past three years, which now stands lowest among our covered banks. CASA fell from 66% in 2021 to 48% in 2023, making it one of the most substantial declines among the other banks; system-wide CASA fell from 65% to 53% during the same period.

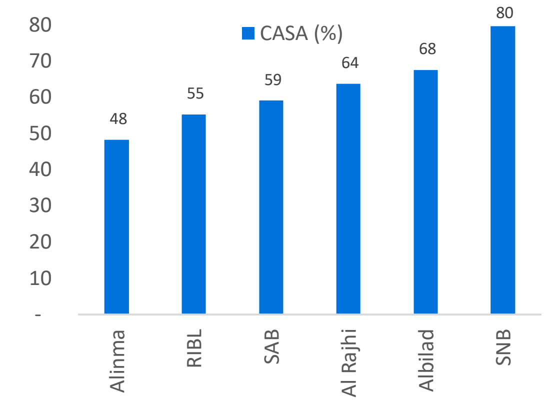
This could partially be explained by a large portion of the retail deposits, accounting for 63% of the overall deposits for Alinma, which are relatively more sensitive in a rising rate environment as households switch to savings and time deposits. In addition, to fund its well-above-the-sector average asset expansion during a period of elevated rates, the bank was left with little choice but to target costlier deposits,

Chart 100: CASA quickly fell to 48%, lower than the sector average of 53%



Source: Company financials and anbc research

Chart 101: Alinma's CASA mix is the lowest among our six covered banks

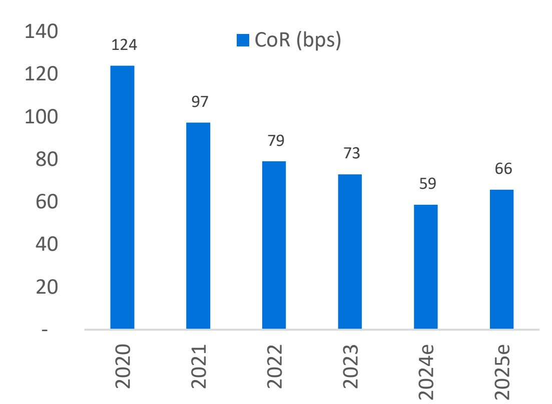


Source: Company financials and anbc research

Moreover, despite the encouraging progress made in normalizing its cost of risk since 2020, it remains elevated. Alinma's cost of risk stood at 73bps in 2023, the highest among our covered banks, vs. the median of 28bps.

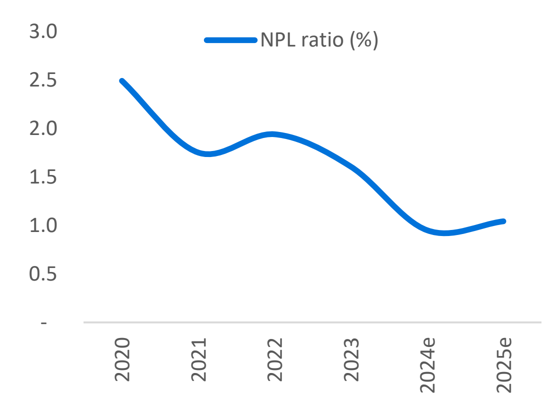
The cost of risk has been normalizing for the fourth consecutive year and is down from over 120bps in 2020 to 73bps in 2023. The bank's NPL ratio fell from 2.5% to 1.6% during the same period. Surprisingly, while the NPL generation significantly improved in the corporate sector, this came alongside a higher generation within retail - the retail NPL ratio jumped to 2% in 2023, the highest in the last five years. In 9M24 NPL fell 46% YTD with NPL ratio down to only 78bps.

Chart 102: Despite normalizing to c73bps, CoR still remain relatively elevated



Source: Company financials and anbc research

Chart 103: NPL ratio markedly improved, driven by performance in the corporate sector

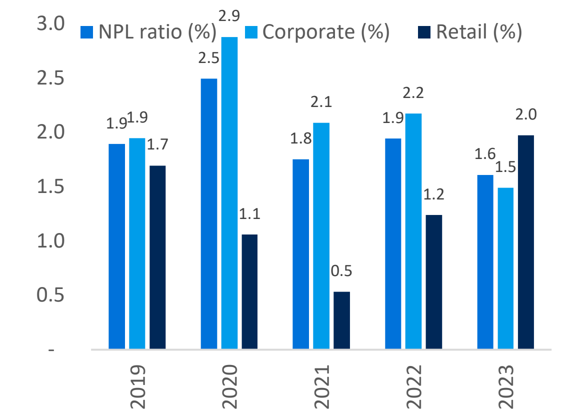


Source: Company financials and anbc research

While elevated NPL ratios typically indicate concern about asset quality, we highlight that this shouldn't be the case as the economic backdrop remains strong, and there has been structural improvement in the NPL sector wide. Moreover, the trend has been positive, where i) the overall NPLs fell 2% YoY in 2023 and further down 46% YoY in 9M24, and ii) there has been significant improvement in retail NPL formation.

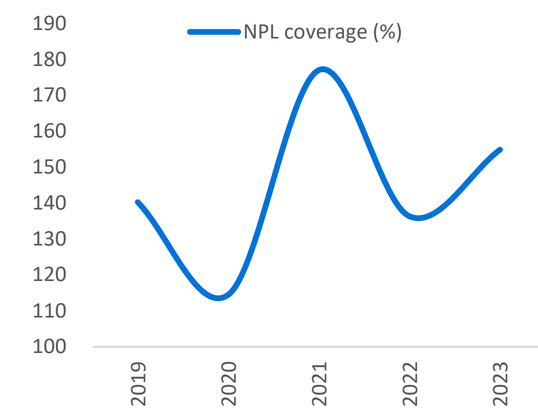
Meanwhile, coverage increased to 155% in 2023 from 136% in 2022 and was driven by expanded coverage in Stage 3, which should provide some cushion against any unexpected increase in NPLs. Stage 1 coverage has continued to trend lower in the past three years, attributable to higher-quality asset acquisition, particularly with the increased contribution of secured project financing. However, we remain cautious about Alinma's NPL formation, especially for any signs of distress in the next few quarters. For our models, we have penciled in slightly elevated CoR, around 65bps for the next two years, before normalizing around 50bps in the long run.

Chart 104: Retail NPL ratio picked up over the last two years



Source: Company financials and anbc research

Chart 105: However, this had been accompanied by improving coverage in 2023

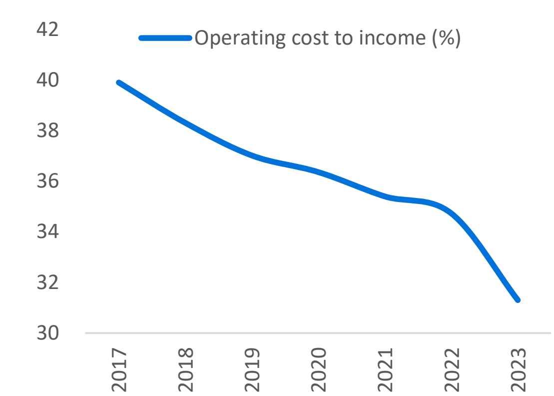


Source: Company financials and anbc research

Similarly, operating cost acceleration also provided no relief in the face of solid lending expansion. While the headline operating cost-to-income ratio fell from 35% in 2022 to 31% in 2023, the bulk of that has been due to an accelerated pace of growth in operating income underpinned by NIM expansion and lending growth. Operating expenses rose 10% YoY in 2023, higher than our covered banks' aggregate growth of only 6%, and the trend sustained in 1H24, up 11% YoY for Alinma vs. 7% aggregate for the sector.

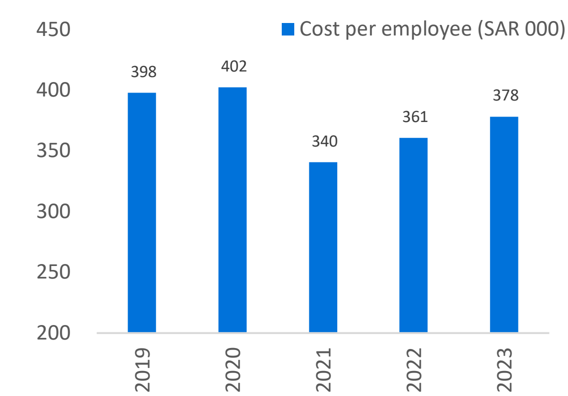
This sharp acceleration has been witnessed predominantly across employee-related expenses (+11% in 2023), which account for over 50% of all operating costs. However, we see this as much needed for its growth plans, particularly with expansion in the retail sector. The bank had historically focused primarily on corporate but aspired to gain market share in retail, requiring the necessary spending on its cost structures, including increasing its branch network (+8% YoY over the last two years) and increasing employee staff.

Chart 106: Improved operating leverage over the years was driven by margin gains



Source: Company financials and anbc research

Chart 107: Employee-related costs have accelerated in the past three years



Source: Company financials and anbc research

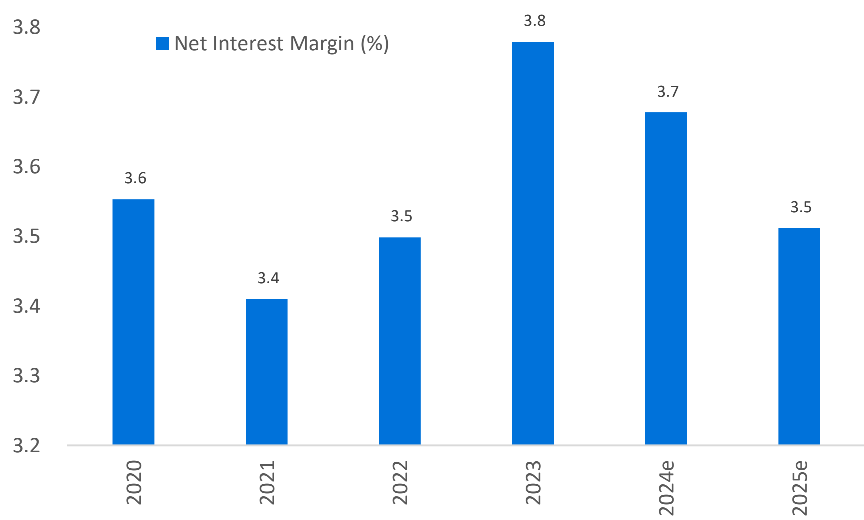
Net interest margins to contract, keeping a check on earnings growth

Alinma is the only Islamic bank expected to see a net interest margin contraction with lower rates, as it is heavily positioned in the corporate sector (accounting for 76% of the overall lending book). The bank benefited from the monetary tightening as margins expanded by nearly 37bps over the last two years. This period of rising rates, accompanied by a sharp expansion in the lending portfolio and improved margins, led to solid earnings growth; adjusted net income grew at a CAGR of 33% between 2020-2023.

However, we don't expect this relatively strong momentum to continue. Even if lending growth remains above the sector average, margins will contract, and elevated cost structures will likely remain, offsetting the very strong growth in assets.

According to management, they have been working to minimize the impact of lower rates by pushing clients for longer-duration products and hedging to some extent. However, the cost of funds pressures are also relatively high due to very sharp CASA migration. We estimate Alinma's net interest margins will decline by 10bps in 2024e and 17bps in 2025e. However, in the long run, we think building scale in mid-corporates (+140% YoY in 2023), SME (+31% YoY), and project financing should offset the pressure from lower rates, which offer better pricing.

Chart 108: Net interest margins to decline by cumulatively 27bps by 2025e

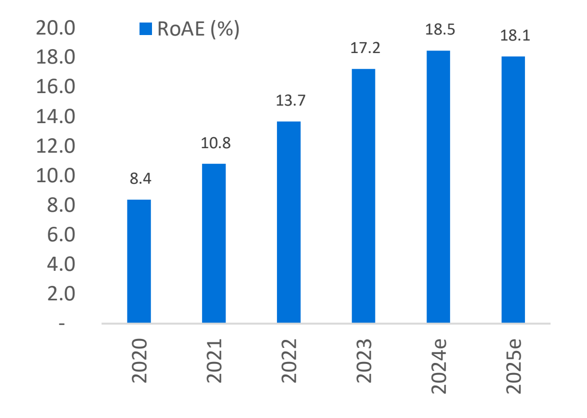


Source: Company financials and anbc research

On one end, the bank delivers on its ambitious growth plans with robust balance sheet expansion, offset by margin decline, an elevated cost base, and an elevated cost of risk. In net terms, these factors restrain earnings growth to a CAGR of 11% between 2023-2028e, with earnings growth to moderate over the next two years from a very strong base of last year.

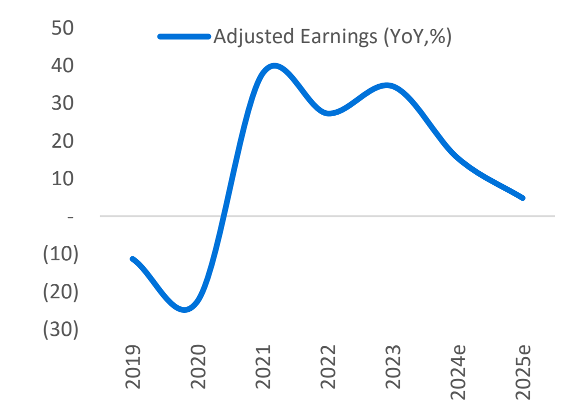
Meanwhile, we expect the bulk of RoAE expansion to be behind us, with little room for further expansion. RoAE increased from 11% in 2021 to over 17% in 2023, thanks to improved margins and strong lending growth. Based on our calculations, the bank's profitability returns have been the strongest on record. However, with earnings growth slowing down, we don't expect a similar pace of RoAE expansion and estimate an average RoAE of 18.3% between 2024-2028e.

Chart 109: Bulk of RoAE expansion behind us...



Source: Company financials and anbc research

Chart 110: ...as earnings growth is likely to moderate



Source: Company financials and anbc research

Valuations:

We have used a cost of equity of 11.0% and a terminal growth rate of 5% to value Alinma Bank with a target price of SR33/share. At 2024e PBV of 13.0x and a PBV of 2.2x, Alinma is cheap compared to other Islamic banks, namely Albilad and Al Rajhi; Albilad trades at a 2024e PBV of 2.6x despite a slightly lower RoAE below 17%, and Al Rajhi with a RoAE of over 20% trades at 3.7x 2024e PBV. While some discount is warranted, considering the negative gearing to interest rate cuts and elevated cost structure, the valuation gap at current levels seems unfair. Our target price for Alinma implies a 2024e PER of 15.4x and a PBV of 2.6x.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	29,334	32,176	34,986	38,094	41,452	45,319	49,612
Cost of equity (%)	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
Cost of equity	3,218	3,530	3,839	4,180	4,548	4,972	5,443
Adjusted net income	5,359	5,619	6,216	6,717	7,734	8,585	9,595
Excess equity return	2,140	2,088	2,378	2,537	3,186	3,613	4,152
Terminal excess equity return							72,998
Discount factor	1.03	1.14	1.27	1.41	1.56	1.73	1.73
PV of excess equity return	2,080	1,829	1,876	1,804	2,041	2,086	42,144

Equity invested	29,334
PV of excess return on Equity	53,861
Value of equity	83,194
Number of shares (mn)	2,500
Target Price	**33**

Earnings Sensitivity:

		Growth rate				
		3%	**4%**	**5%**	**6%**	**7%**
CoE	**9%**	41	45	53	65	89
	10%	34	37	41	47	58
	11%	29	31	**33**	37	42
	12%	25	26	28	30	33
	13%	22	23	24	25	27

Source: Company financials and anbc research