Bank Albilad

2 December, 2024

INITIATION OF COVERAGE

We initiate coverage on Bank Albilad with a target price of SR39/share and a Neutral rating. Despite its small size, Bank Albilad has delivered above-sector average returns, with a RoAE of 16.5% in 2023 vs. 12.8% for the sector. The bank's margins are positively geared for interest rate cuts while there is still room for further efficiency gain and increasing operating leverage. The NPL ratio has declined, and credit cost normalized, but we remain cautious due to high exposure in the real estate market. Moreover, the bank offers balanced exposure between the retail and corporate sectors, and despite the relatively muted corporate loan growth this year, we believe it will still be the key driver for overall lending growth in the short term. We expect lending growth to accelerate from next year and estimate earnings CAGR of 14% between 2023-28e. However, we see the current valuation slightly stretched at a 2024e PER of 16.1x and a PBV of 2.6x for a medium-term RoAE of around 17-18%.

Albilad is positively geared for rate cuts due to its balanced lending mix across the retail and corporate sectors (with nearly 36% in mortgages) and positive contributions from its investment portfolio, which offers a favorable duration gap. Income from the investment portfolio would be a key driver for the margin expansion, which we estimate will expand by 15bps in 2025e.

There is room for improving operating leverage. Despite the progress, a relatively elevated cost base offers significant headroom for further enhancing the cost-to-income ratio as the bank continues to scale up operations and optimize its branch networks. Albilad has one of the lowest deposits and financing per branch.

However, we remain cautious about banks' NPL ratios. While the NPL ratio declined in 3Q24 and credit cost continued to normalize with healthy coverage of over 200%, we think the bank's high exposure to the real estate market makes it vulnerable to activities in the sector. This poses a downside risk that NPLs could quickly increase if the economic outlook changes, though this is not our base assumption. In 2023, the bulk of the bank's NPL formation was in the real estate sector.

The bank is not too aggressive on growth while focusing on profitability and driving value from its positioning. Despite the relatively muted growth in the corporate sector, it would still be the key driving sector for overall lending. The bank has established a strong footprint in the SME sector and continues to retain its market share in retail. We expect lending growth to accelerate next year as lower borrowing costs improve lending dynamics for both the corporate & retail sectors; we expect the loan book to grow at a CAGR of 11% between 2023-28e.

Valuation: Albilad trades at a 2024e PER of 16.1x and PBV of 2.6x. We think this is a fair valuation for the expected medium-term RoAE of around 17-18%. Its above-sector average returns due to a leveraged balance sheet support its slightly premium valuations.

Risks: The bank has a high exposure to the real estate sector, accounting for over 43% of its corporate loan book. If the economic outlook shifts, NPLs, and the resulting credit cost could quickly rise and limit earnings growth. Moreover, while the bank's capitalization is adequate for its current size, unexpectedly strong growth or pursuing an aggressive strategy would require it to raise additional capital.

RATING SUMMARY	NEUTRAL
Target Price (SR)	39
Upside/Downside	11%
Div. Yield (%)	2%
Total Exp. Return	14%

ISSUER INFORMATION	
Bloomberg Code	ALBI: AB
Last Price (SR)	35.05
No of Shares (mn)	1,250
Market Cap bn (SR/USD)	44/12
52-week High / Low (SR)	40.9/29.2
12-month ADTV (mn) (SR/USD)	48/13
Free Float (%)	59%
Foreign Holdings (%)	10%

Last price as of November 28th

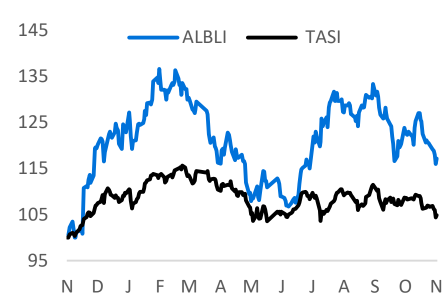
VALUATIONS

	2023A	2024e	2025F	2026F
EPS (SR)	1.9	2.2	2.5	2.8
PER (x)	21.3	16.1	14.3	12.5
PBV (x)	3.3	2.6	2.3	2.1
DPS (SR)	0.4	0.9	1.0	1.1
Div. Yield (%)	1.0	2.5	2.8	3.2
RoAE (%)	16.5	16.9	17.2	17.7
RoAA (%)	1.7	1.8	1.8	1.9

FINANCIALS (SRbn)

	2023A	2024e	2025F	2026F
Oper. Income	5.3	5.8	6.6	7.4
Provisions	(0.3)	(0.3)	(0.5)	(0.6)
Net Income	2.4	2.7	3.1	3.5
Investments	22	24	27	29
Loans & Advances	102	110	121	136
Deposits	113	127	142	158
NIM (%)	3.3	3.3	3.4	3.5
Cost to Income (%)	44	43	41	39
NPL Ratio (%)	1.4	1.3	1.3	1.3
Simple LDR (%)	90	86	85	86

RELATIVE PRICE PERFORMANCE



Financial Summary:

SAR mn							CAGR	
Income Statement	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2018-2023**	**2023-2028e**
Interest Income	7,544	8,470	8,641	8,790	9,656	10,294	23%	6%
Interest Expense	(3,434)	(3,895)	(3,346)	(2,765)	(2,874)	(2,770)	44%	-4%
NSCI	**4,110**	**4,575**	**5,295**	**6,025**	**6,781**	**7,525**	14%	13%
NII	1,193	1,245	1,303	1,379	1,474	1,565	-1%	6%
Operating Income	**5,303**	**5,821**	**6,598**	**7,403**	**8,255**	**9,090**	9%	11%
Operating expenses	(2,338)	(2,503)	(2,694)	(2,863)	(3,013)	(3,121)	5%	6%
Provisions	(324)	(284)	(489)	(627)	(755)	(838)	-8%	21%
Total Expenses	**(2,662)**	**(2,787)**	**(3,183)**	**(3,489)**	**(3,768)**	**(3,959)**	3%	8%
NPBT	2,641	3,034	3,415	3,914	4,487	5,131	19%	14%
Net Income	**2,369**	**2,721**	**3,063**	**3,511**	**4,025**	**4,602**	31%	14%
Shares Outstanding (mn)	1,250	1,250	1,250	1,250	1,250	1,250		
EPS	1.9	2.2	2.5	2.8	3.2	3.7		
DPS	0.4	0.9	1.0	1.1	1.3	1.5		

Balance Sheet	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2018-2023**	**2023-2028e**
Cash and balances with central bank	6,983	9,085	11,517	14,290	17,421	19,106	2%	22%
Due from other financial institutions, net	8,170	12,133	14,146	12,674	8,308	7,135	0%	-3%
Investments, net	22,080	24,288	26,717	29,388	32,327	32,974	28%	8%
Financing, net	102,080	109,959	120,902	135,893	154,294	174,292	15%	11%
Other	3,793	3,873	3,960	4,055	4,158	4,271	16%	2%
Total Assets	**143,106**	**159,338**	**177,242**	**196,301**	**216,509**	**237,778**	14%	11%
Due to other financial institutions	4,274	4,488	4,712	4,948	5,195	5,455	7%	5%
Customers' deposits	112,831	127,211	142,287	157,954	174,211	191,060	15%	11%
Sukuk	3,052	3,052	3,052	3,052	3,052	3,052	9%	0%
Other liabilities	7,691	7,697	8,463	9,513	10,801	12,200	17%	10%
Total Liabilities	**127,848**	**142,447**	**158,514**	**175,465**	**193,259**	**211,766**	14%	11%
Total Equity	**15,258**	**16,891**	**18,729**	**20,835**	**23,250**	**26,012**	14%	11%
Total liabilities and equity	**143,106**	**159,338**	**177,242**	**196,301**	**216,509**	**237,778**	14%	11%

Growth (Y/Y)	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NSCI	6%	11%	16%	14%	13%	11%
NII	-9%	4%	5%	6%	7%	6%
Total operating income	2%	10%	13%	12%	12%	10%
Net income	14%	15%	13%	15%	15%	14%
Financing	12%	8%	10%	12%	14%	13%
Deposits	19%	13%	12%	11%	10%	10%

Ratios	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NIM (%)	3.3	3.3	3.4	3.5	3.6	3.7
Operating cost to income (%)	44	43	41	39	37	34
Cost of risk (bps)	31	25	39	45	48	47
NPL coverage (%)	202	199	202	204	207	209
NPL ratio (%)	1.4	1.3	1.3	1.3	1.3	1.3
Simple LDR (%)	90	86	85	86	89	91
RoAA (%)	1.7	1.8	1.8	1.9	2.0	2.0
RoAE (%)	16.5	16.9	17.2	17.7	18.3	18.7
Assets to Equity (x)	9.4	9.4	9.5	9.4	9.3	9.1

Valuation	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
BVPS	12.2	13.5	15.0	16.7	18.6	20.8
P/B	3.3	2.6	2.3	2.1	1.9	1.7
P/E	21.3	16.1	14.3	12.5	10.9	9.5
Dividend yield (%)	1.0	2.5	2.8	3.2	3.7	4.2

Source: Company financials and anbc research

Investment Thesis

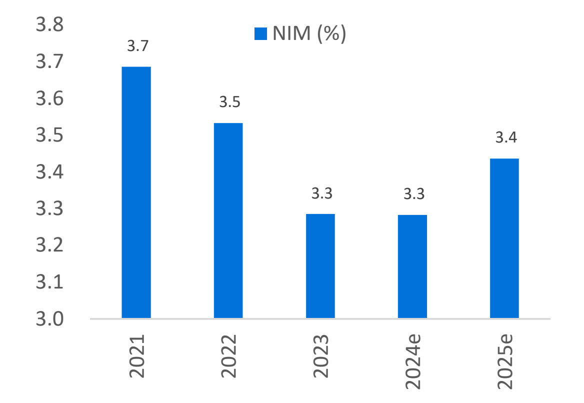
Margins are positively geared for a declining rate environment

Monetary tightening in the last two years negatively impacted Albilad as its margins contracted by over 40bps. However, that is set to reverse gradually as its margins are positively geared for rate cuts. We think i) a balanced portfolio between retail (48% in 2023) and corporate (52%), ii) cost of fund showing signs of easing pressures with ample room to fund growth (non-regulatory LDR at 90% at the end of 2023), and iii) increasing contribution of the investment book to slow the pace of decline in gross yields are some of the key supporting factors for the positive outlook on margins. We expect the net interest margin to expand by 15bps by 2025e, while broadly stable in 2024e.

Gross yields have been picking up as assets are repriced to incorporate higher rates, but interestingly, while SAIBOR was down 26bps YTD, gross yields slightly improved by 24bps in 3Q24 vs. 4Q24. The bulk of the growth in NSCI resulted from increased interest income from the investment portfolio, feeding into our view that the increased positioning of the investment book over the last two to three years would positively help improve margins.

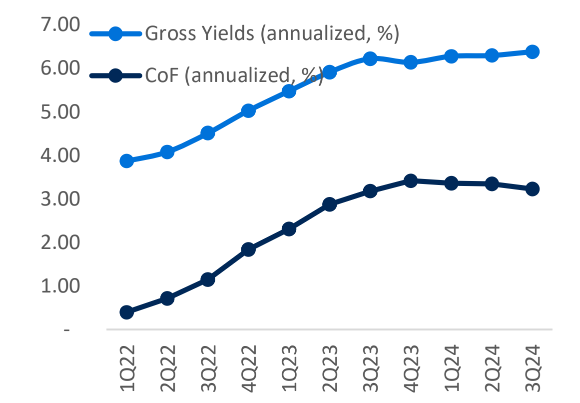
In addition, the cost of funds shows signs of some eased pressures. CoF declined in 3Q24, and low LDRs provide sufficient liquidity headroom.

Chart 148: NIMs expansion as rates decline – expecting 15bps in 2025e



Source: Company financials and anbc research

Chart 149: Gross yields improved as CoF showed signs of stabilizing



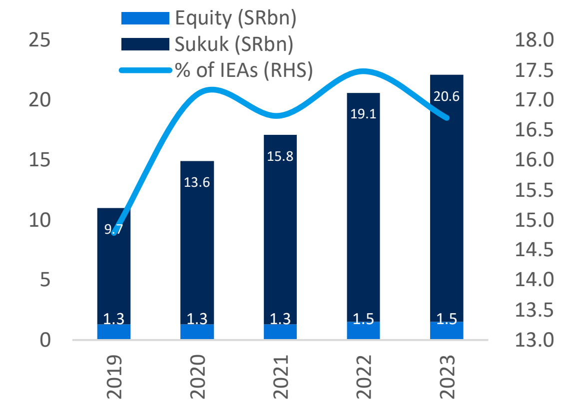
Source: Company financials and anbc research

Albilad's lending mix, balanced across the retail and corporate sectors, allows for positive gearing for the monetary easing cycle. Long-term retail loans provide a positive extension to the overall asset duration, coupled with interest-bearing liabilities, offering a duration gap that would benefit in a declining rate environment.

Moreover, we believe the margin gains would also come from its investment book. Albilad's investment portfolio's contribution to total interest earnings assets has increased from less than 15% in 2019 to nearly 17% in 2023. This comes as the bank positioned itself to benefit from a higher rising rate with increased placements in Sukuk.

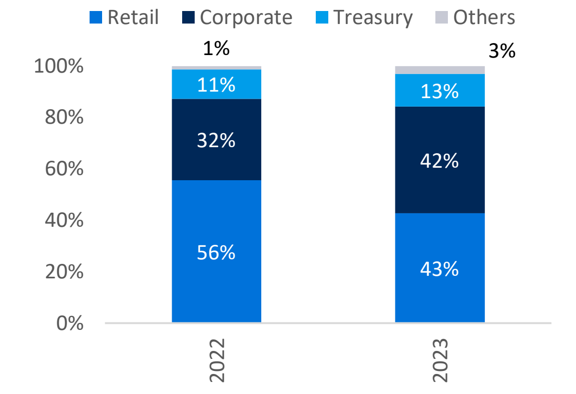
Moreover, in recent years, the bank's treasury has used the opportunity to position its book to increase the effective asset duration. The success of the bank's investment strategy is evident in 9M24, where net interest income from treasury grew 59% YoY and nearly drove the entire gain in overall NSCI.

Chart 150: Investment portfolio increased to benefit from the rising rate environment



Source: Company financials and anbc research

Chart 151: Boosting the share of treasury income to overall NSCI generated



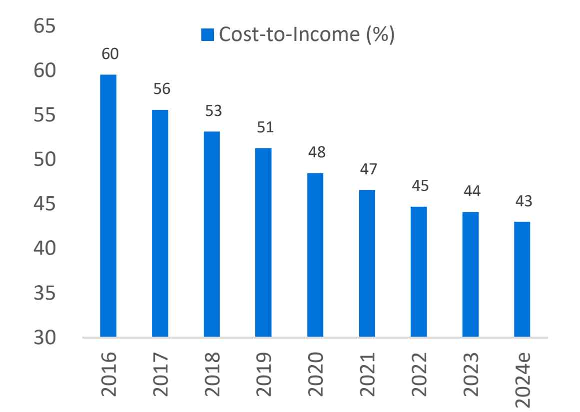
Source: Company financials and anbc research

Room for improving operating leverage

Despite much progress over the years, Albilad Bank still operates on an elevated cost base, with relatively weak operating gearing limiting the flow of higher interest earnings to the bottom line. That said, we see this as an opportunity and headroom for the bank to improve its operation leverage underpinned by digitalization and growing scales.

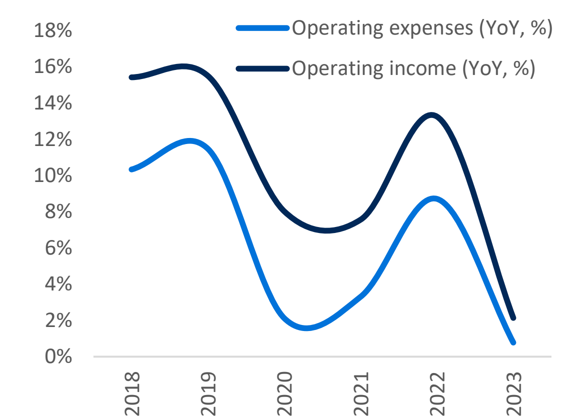
While the operating cost-to-income ratio improved from 60% in 2016 to 43% in 2023, it remains higher than the average of 30% of the other five banks (excluding Albilad). While operating income growth outpaced the growth in Opex, even as income growth slowed in 2023, management had been prudent in managing expenses through cost-efficiency programs.

Chart 152: Cost-to-income markedly improved over the years



Source: Company financials and anbc research

Chart 153: As the operating income growth outpaced the growth in expenses



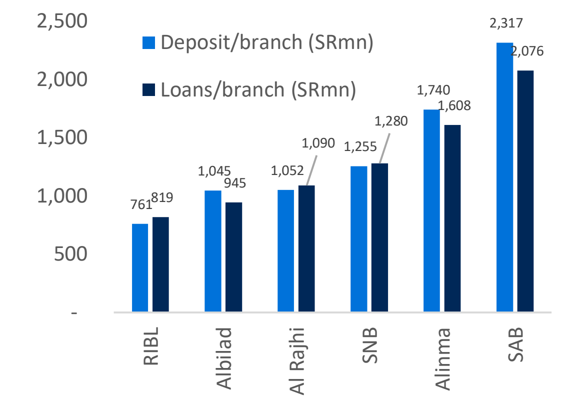
Source: Company financials and anbc research

We see improvement in operating leverage could potentially come from rationalizing branch operations and improving the efficiency of human resources supported by digitalization. Barring Riyad Bank, Albilad had the lowest financing and deposit per branch at SR945mn and SR1.1bn, respectively, in 2023. This is nearly 27% and 23% lower than the average for the rest of the banks.

In recent years, the bank has been optimizing its branch network, which has been reduced from over 120 branches to 108, as it effectively looked to increase efficiency and revamp the network across more asset-generating regions.

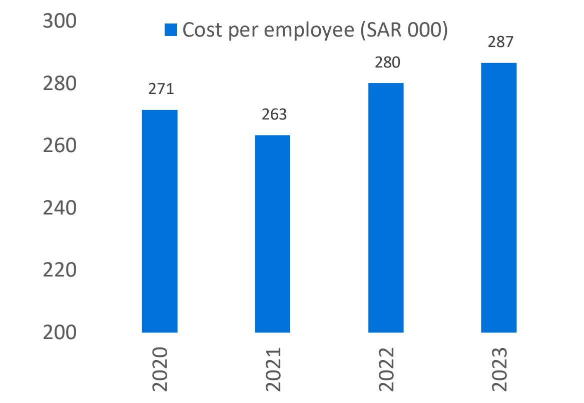
Moreover, its cost per employee should also improve as scale benefits filter in and operational efficiencies improve with increased digitalization across its operations.

Chart 154: Albilad has low financing and deposit per branch



Source: Company financials and anbc research

Chart 155: Cost per employee has increased in recent years

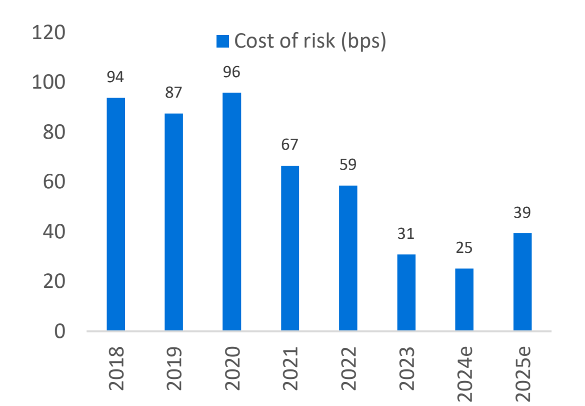


Source: Company financials and anbc research

Apart from the encouraging progress on operating efficiency, the cost of risk has also shown signs of normalizing from previously elevated levels. Between 2017 and 2020, the bank recorded a cost of risk above 90bps as it emphasized building buffers and increased its coverage levels amidst corporate-heavy books that had been marred by an economic downturn at that time with depressed oil prices.

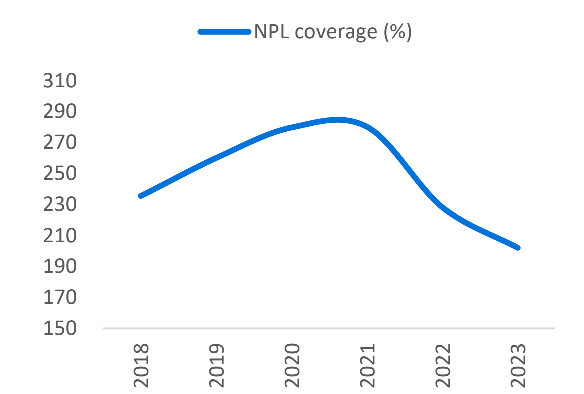
However, since then, retail contribution has increased, the economic backdrop has significantly improved, and its coverage has been healthy without increasing NPL formation. Since 2020, the CoR has come down to 32bps in 2023, which we see as normalized levels for the banks with healthy coverage (still above s200%).

Chart 156: CoR largely normalized



Source: Company financials and anbc research

Chart 157: NPL coverage remains adequate

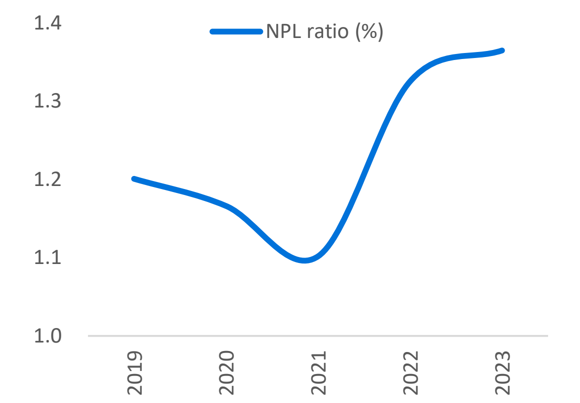


Source: Company financials and anbc research

Despite that, we remain cautious about NPLs. The NPL ratio has increased recently and jumped to 1.4% in 2023 vs. 1.1% in 2021. The bank has a high exposure to the real estate market, and its NPLs could be vulnerable to the pace of activity in the real estate market. According to financial statements, nearly 75% of its retail book accounts for mortgages (36% of the total lending book), while 43% of corporate loans are in the real estate sector, cumulatively contributing 59% to the overall loan book. Moreover, analysis of the economic concentration showed that most of the increase in NPL generations in 2023 had predominately been in the real estate sector.

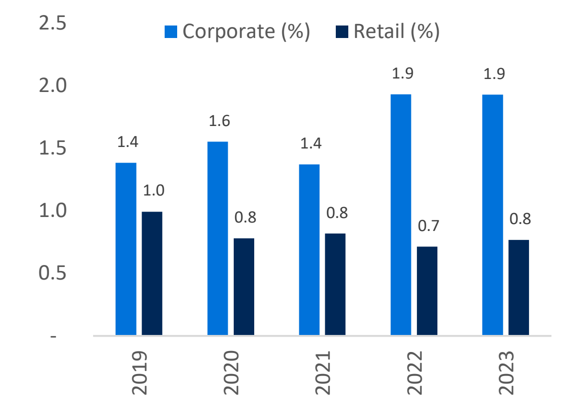
However, the NPL ratio slightly improved to 1.2% in 1H24 from 1.4% in 2023, a trend visible nearly across all banks. Moreover, we don't expect any sector-wide stress since the outlook for the real estate market remains positive, supported by growing demand. Bank coverage remains healthy, above 200% in 2023, boosted by prudent provisioning over the last three years, ensuring ample room to withstand any unexpected negative headwinds. We have penciled in a slightly higher cost of risk going into next year as it slightly normalizes, but we note any pickup in NPL formation could result in much higher than estimated provisioning.

Chart 158: However, the NPL ratio has been on the rise in recent years



Source: Company financials and anbc research

Chart 159: Driven by high generation in the corporate sector



Source: Company financials and anbc research

Net income growth to improve when lending growth recovers

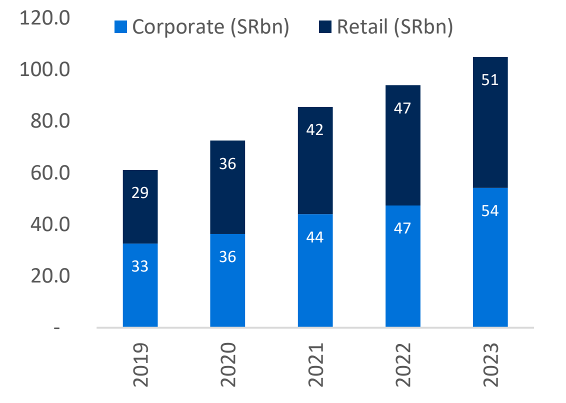
Albilad offers balanced exposure between the retail and corporate sectors. Apart from its retail positioning and mortgage portfolio, which account for 75% of its retail sector loans, it has a strong position in the real estate market. The latter accounts for 43% of total corporate sector loans, and the sector is seeing increasing demand for housing and tourism infrastructure.

Moreover, Albilad has also placed itself firmly within the SME sector. It was the first bank to sign with an SME bank for its lending program and work with Monshaat as the co-financing portfolio. The SME sector is expected to drive the next leg of solid growth supported by regulatory support and improved economic growth.

However, corporate sector growth was slightly weak during 9M24, up only 5% YoY, though it was offset by a sustained expansion in retail sector loans, which grew 8% YoY. We think the relatively disappointing slowdown in corporate sector loan growth reflects the negligible contribution of project financing, which has been a key catalyst for strong growth in the sector.

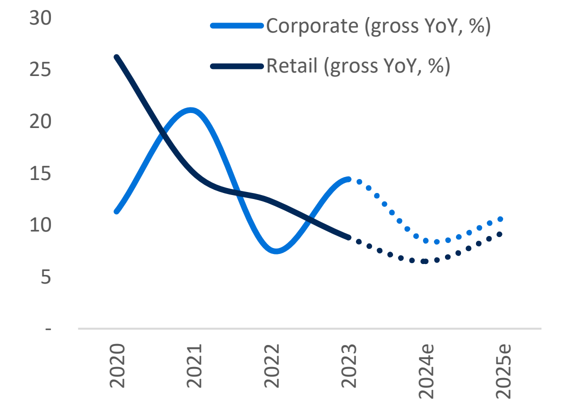
We expect Albilad gross lending growth to moderate in 2024e to 8% from 12% in 2023. Over the medium term, we expect it to grow at a CAGR of 11% between 2023-28e. The moderating growth in 2024e primarily reflects the pressures of slower growth in the corporate sector in 9M24. We still see the corporate sector as the primary driver for overall lending growth.

Chart 160: Lending books remain balanced between retail and corporate sector loans



Source: Company financials and anbc research

Chart 161: Despite weak growth, corporate loans should continue to drive overall lending growth

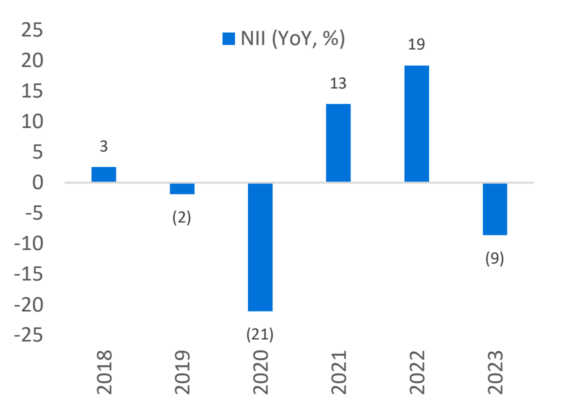


Source: Company financials and anbc research

While Albilad's non-interest income used to be a key earnings contributor, it has declined over the years; it contributed 20% to total operating income in 2019 vs. only 12% in 2023. While an increased contribution of interest income from lending activity as its lending portfolio rose led to this decline, it also faced headwinds in recent years, especially for its remittance business.

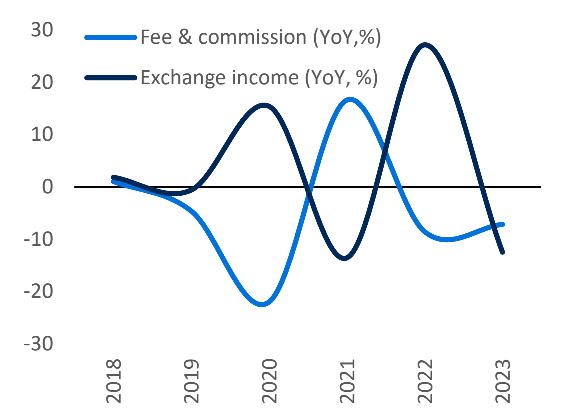
Fees from remittance declined by over 8% YoY in 2023, along with a 12% YoY decline in the exchange income. While competitive pressures will continue, we expect other pressures to dissipate with a reversal of policy stance as general remittance flow improves. However, we see Albilad's recent performance as relatively better than the sector, as its fee income from remittance declined by 8% in 2023, while overall outbound remittance from Saudi Arabia was 13% YoY. While we note that competition has significantly increased in this space, Albilad has a long operational history in the remittance business and a strong footprint through its Enjaz application, which should support a recovery in the non-interest income. However, we don't see any meaningful expansion in the near term.

Chart 162: NII performance had been weak in 2023, declining by 9% YoY...



Source: Company financials and anbc research

Chart 163: ...as fee and exchange income growth remained volatile



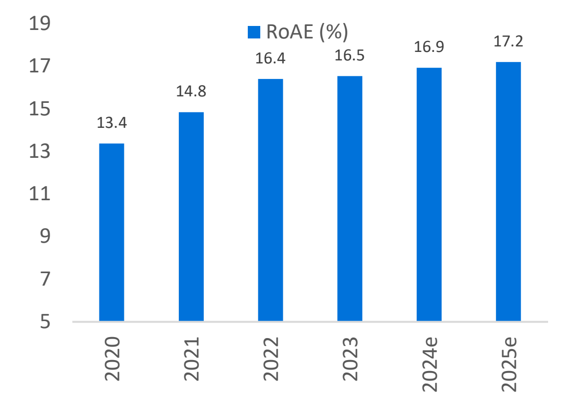
Source: Company financials and anbc research

While the recovery in non-interest income would provide critical support to profitability, we expect an accelerated pace of NSCI growth as margin expands, coupled with improved cost efficiency, to be the key drivers of profitability growth. Profitability growth would be further boosted by a pick-up in lending growth from 2025e. We estimate that Albilad's earnings would grow at a CAGR of 14% between 2023-28e.

Albilad's capitalization is relatively low compared to other banks, but we don't expect it to impede growth since the bank's corporate strategy focuses on prudent expansion while prioritizing profitability. In addition, the internal capital generation outlook is positive, and the bank has a relatively leveraged balance sheet—Albilad has an asset-to-equity ratio of 9.4x vs. a median of 6.7x for the rest of our covered banks. RoAEs, in the medium term, are likely to remain stable around current levels.

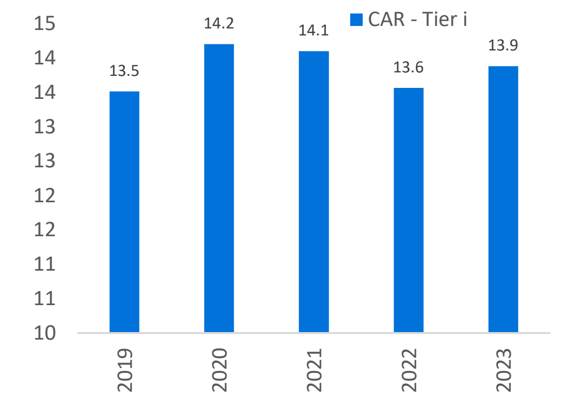
However, over the longer run, building capital buffers will become increasingly important as the bank continues to scale up its asset base and grow. Liquidity is another key factor, and while the bank has headroom in terms of LDRs, as lending growth picks up amidst tight deposit liquidity, the bank would need additional liquidity to fund its growth. As of 9M24, the bank has no Tier 1 instruments, while it issued SR3bn Tier 2 Sukuk in 2021.

Chart 164: RoAE expansion



Source: Company financials and anbc research

Chart 165: Tier1 capital ratio



Source: Company financials and anbc research

Valuations:

We have used a cost of equity of 11.3% and a terminal growth rate of 5% to value Albilad. Our target price for Albilad is SR39/share. We think the stock is fairly valued at the current valuation of a 2024e PER of 16.1x and a PBV of 2.6x for medium-term RoAE of 17-18%. Earnings growth will likely be driven primarily by margin gains, and while it offers balanced lending exposure between the retail and corporate sectors, its lending growth has been relatively weak in 2024.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	15,258	16,891	18,729	20,835	23,250	26,012	29,163
Cost of equity (%)	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%
Cost of equity	1,730	1,915	2,123	2,362	2,635	2,948	3,306
Net income	2,721	3,063	3,511	4,025	4,602	5,252	5,933
Excess equity return	992	1,148	1,388	1,663	1,967	2,304	2,627
Terminal excess equity return							43,546
Discount factor	1.03	1.15	1.28	1.42	1.58	1.76	1.76
PV of excess equity return	963	1,002	1,087	1,170	1,243	1,307	26,202
Equity invested	15,258						
PV of excess return on Equity	32,974						
Value of equity	48,232						
Number of shares (mn)	1,250						
Target Price	**39**						

Earnings Sensitivity:

		Growth rate				
		3.0%	**4.0%**	**5.0%**	**6.0%**	**7.0%**
CoE	**9.3%**	47	52	60	72	95
	10.3%	39	43	47	54	64
	11.3%	34	36	**39**	43	48
	12.3%	29	30	32	35	38
	13.3%	25	26	27	29	31

Source: Company financials and anbc research