INITIATION OF COVERAGE

Riyad Bank

2 December 2024

We like Riyad Bank's strong positioning in corporate, SMEs (leading bank with a market share of c.22%), and project financing, which would benefit from strong secular tailwinds of relatively robust economic expansion. However, its retail sector loan growth has been under pressure, and the bank faces short-term headwinds for its margins. In addition, earnings growth is also being weighed down as it invests in growth with high Opex spending, a slightly elevated cost of risk, and a margin negatively impacted by rate cuts. This filters into moderate earnings growth, which we estimate to grow at a 2023-28e CAGR of 8%; RoAEs are also unlikely to see any meaningful expansion. However, beyond these short-term pressures, we believe the bank's relative positioning, scale, and adequate capital buffers offer better growth prospects in the medium term. Despite the recent gains in share price, we still think there is room for upside in the current valuations of FY24e PBV of 1.4x for a RoAE of over 16%. We initiate coverage on Riyad Bank with an Overweight rating and a target price of SR31/share.

All the right levers for growth: Riyad Bank is the second-largest corporate bank, third-largest retail bank, and the leading bank in SME financing, offering significant scale benefits and reach for expansion. It has a strong position in large corporations, SMEs, and project financing to benefit from the opportunities arising from the economic transformation under Vision 2030 and the relatively strong economic backdrop. While the bank recorded muted retail expansion in 2024e, we believe it will recover next year and carry adequate capital buffers to support its growth in the medium term. A potential IPO of Riyad Capital would also unlock value.

However, pressures are high this year, which we think slightly limits the bank's ability to grow aggressively. Over 65% of the loans mature within one year, leaving the bank with headwinds to expand at the peak monetary cycle when competitive pressures are high, and spreads have become tight. In addition, CASA migration and depletion of interest-free deposits add to its funding pressures.

Earnings growth will moderate as margins continue to be negatively geared to rate cuts due to the high composition of shorter-duration corporate loans coupled with pressures from CoF. Moreover, the bank's cost structure remains elevated as it invests in long-term growth by building up provision buffers and relatively high Opex spending. We estimate a 2023-28e net income CAGR of 8%.

Valuation: At 2024e PBV of 1.4x for a RoAE of over 16%, we think valuations have become attractive considering its relative positioning and large scale to deliver on lending growth. Despite the recent gains in share price, we still think there is room for upside in the current valuations.

Risks: With high repayment pressures, it is not easy to assess the extent to which the bank could grow. If lending growth exceeds our expectations, it will positively impact our earnings estimates. Moreover, increasing the contribution of relatively better-priced project financing and SMEs could mean better-than-expected spreads and margins.

RATING SUMMARY	OVERWEIGHT
Target Price (SR)	31
Upside/Downside	18%
Div. Yield (%)	6%
Total Exp. Return	24%

ISSUER INFORMATION	
Bloomberg Code	RIBL:AB
Last Price (SR)	26.25
No of Shares (mn)	3,000
Market Cap bn (SR/USD)	79/21
52-week High / Low (SR)	31.4/24.2
12-month ADTV (mn) (SR/USD)	71/19
Free Float (%)	59%
Foreign Holdings (%)	11%

Last price as of November 28th

VALUATIONS

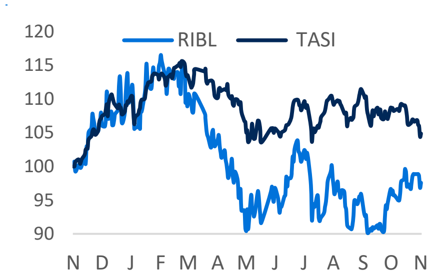
	2023A	2024e	2025F	2026F
EPS (SR)	2.6	3.0	3.1	3.3
PER (x)	11.6	8.8	8.4	7.8
PBV (x)	1.7	1.4	1.3	1.2
DPS (SR)	1.3	1.5	1.6	1.7
Div. Yield (%)	4.3	5.7	6.0	6.4
RoAE (%)	15.6	16.6	16.0	15.8
RoAA (%)	2.2	2.2	2.1	2.0

FINANCIALS (SRbn)

	2023A	2024e	2025F	2026F
Oper. Income	15.9	16.9	18.3	19.6
Provisions	(2.0)	(1.3)	(1.7)	(2.0)
Net Income*	7.7	9.0	9.4	10.0
Investments	58	67	73	77
Loans & Advances	274	310	348	392
Deposits	255	300	333	366
NIM (%)	3.7	3.4	3.3	3.2
Cost to Income (%)	31.3	31.0	31.5	30.9
NPL Ratio (%)	1.2	1.2	1.3	1.3
Simple LDR (%)	108	103	105	107

**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	20,606	23,305	22,008	21,758	23,019	23,859	20%	3%
Interest Expense	(8,192)	(10,455)	(8,152)	(6,947)	(7,127)	(6,783)	37%	-4%
NSCI	**12,414**	**12,850**	**13,856**	**14,811**	**15,893**	**17,076**	13%	7%
NII	3,485	4,033	4,444	4,796	5,105	5,357	8%	9%
Operating Income	**15,899**	**16,883**	**18,300**	**19,607**	**20,997**	**22,434**	12%	7%
Operating expenses	(4,969)	(5,234)	(5,764)	(6,059)	(6,362)	(6,663)	8%	6%
Provisions	(1,972)	(1,305)	(1,736)	(2,005)	(2,398)	(2,858)	16%	8%
Total Expenses	**(6,940)**	**(6,539)**	**(7,500)**	**(8,063)**	**(8,760)**	**(9,521)**	10%	7%
NPBT	8,971	10,344	10,799	11,544	12,237	12,913	18%	8%
Net Income*	**7,735**	**8,967**	**9,376**	**10,043**	**10,665**	**11,271**	20%	8%
EPS	2.6	3.0	3.1	3.3	3.6	3.8		
DPS	1.3	1.5	1.6	1.7	1.8	1.9		

Balance Sheet	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2018-2023**	**2023-2028e**
Cash and balances	26,175	30,029	33,293	36,647	40,092	43,627	10%	11%
Due from other financial institutions	15,434	21,007	16,886	9,432	5,244	2,440	7%	-31%
Investments, net	58,489	67,262	72,643	76,638	78,938	80,516	4%	7%
Financing, net	274,398	309,523	348,070	391,780	435,113	479,075	13%	12%
Other	12,353	12,751	13,090	13,356	13,536	13,621	33%	2%
Total Assets	**386,849**	**440,572**	**483,982**	**527,854**	**572,922**	**619,280**	11%	10%
Due to other financial institutions	42,464	44,587	46,817	47,753	48,708	49,682	38%	3%
Customers' deposits	254,908	300,291	332,929	366,472	400,919	436,271	8%	11%
Other liabilities	29,219	30,952	34,807	39,178	43,511	47,908	15%	10%
Total Liabilities	**326,591**	**375,830**	**414,553**	**453,403**	**493,139**	**533,861**	11%	10%
Total Equity	**60,258**	**64,742**	**69,429**	**74,451**	**79,783**	**85,419**	10%	7%
Total liabilities and equity	**386,849**	**440,572**	**483,982**	**527,854**	**572,922**	**619,280**	11%	10%

Growth (Y/Y %)	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NSCI	23%	4%	8%	7%	7%	7%
NII	-2%	16%	10%	8%	6%	5%
Total operating income	17%	6%	8%	7%	7%	7%
Net income	10%	16%	5%	7%	6%	6%
Financing	13%	13%	12%	13%	11%	10%
Deposits	6%	18%	11%	10%	9%	9%

Ratios	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
NIM (%)	3.7	3.4	3.3	3.2	3.2	3.2
Operating cost to income (%)	31.3	31.0	31.5	30.9	30.3	29.7
Cost of risk (bps)	71	41	49	50	54	58
NPL coverage (%)	142	140	142	143	144	145
NPL ratio (%)	1.2	1.2	1.3	1.3	1.4	1.4
Simple LDR (%)	108	103	105	107	109	110
RoAA (%)	2.2	2.2	2.1	2.0	2.0	1.9
RoAE (%)	15.6	16.6	16.0	15.8	15.6	15.2
Assets to Equity (x)	6.4	6.8	7.0	7.1	7.2	7.2

Valuation	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**
BVPS	18	19	21	23	24	26
P/B	1.7	1.4	1.3	1.2	1.1	1.0
P/E	11.6	8.8	8.4	7.8	7.4	7.0
Dividend yield (%)	4.3	5.7	6.0	6.4	6.8	7.2

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

Source: Company financials and anbc research

Investment Thesis

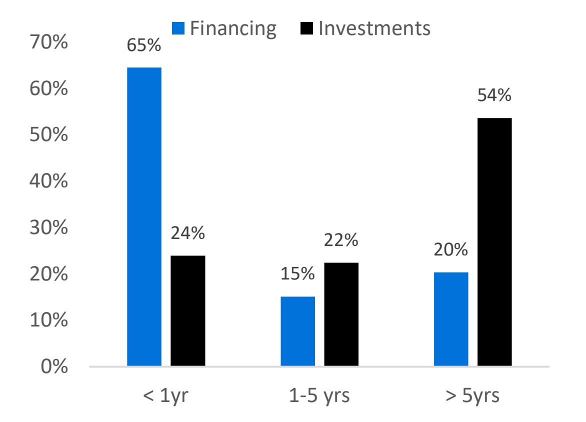
Pressures on net interest margins in the short-term

We see Riyad Bank's net interest margin declining the most in 2024 as repayment pressures are high amidst relatively low asset duration due to the high contribution of corporate sector loans. According to 2023 financials, 65% of loans would mature in under one year, and the combined lending and investment portfolio maturing in one year accounts for 57% of the overall portfolio.

Among our six covered banks, Riyad Bank has the shortest maturity vs. a median of c41% for our aggregate. While maturing loans typically allow for better pricing, at decade-high rate levels coupled with increased competitive pressures would make it difficult for the bank to improve its pricing significantly with spreads under pressure.

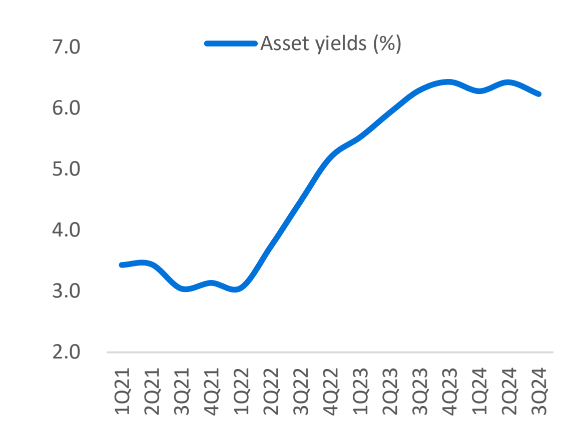
While a supportive asset-liability duration gap significantly benefitted Riyad Bank in a rising and even elevated rate environment, with net interest margins expanding by over 75bps cumulatively in the last two years, that will reverse during the monetary easing cycle. We estimate that asset yields have picked up from 3.1% in 1Q22 to 6.4% in 2Q24 and are much closer to where the 3M SAIBOR is currently trading, leaving little room for further material expansion even if SAIBOR remains stable at these levels. In 3Q24, asset yields declined by 20bps QoQ.

Chart 111: Most loans mature under one year – as of 2023 financials



Source: Company financials and anbc research

Chart 112: Asset yields have been slightly under pressure in recent quarters



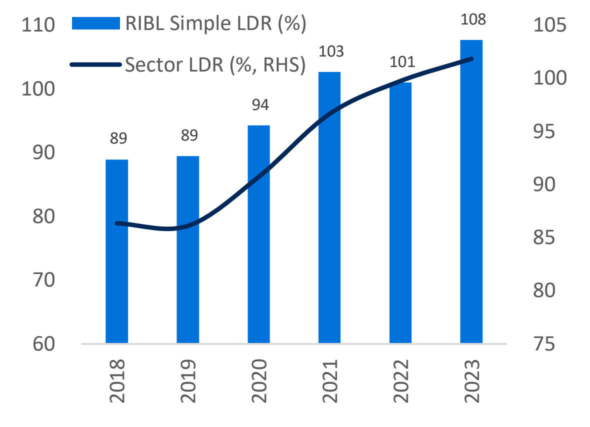
Source: Company financials and anbc research

However, net interest margin pressures are not only on the asset side, but there is also funding pressure. LDRs are very elevated, and we calculated the non-regulatory LDR at 108% at the end of 2023. While the regulatory LDR remained below the regulatory limit at 82%, it also picked up from 80% in 2022.

This was accompanied by CASA migration, which fell from 65% in 2021 to 55% in 2023. While there had been a positive uptick for the past four consecutive quarters, that, too, was quite incremental and driven by the placement of public sector deposits systemwide. With already elevated LDR, funding the growth would remain a challenge without further CASA migration, especially as rate cuts would only be gradual over time.

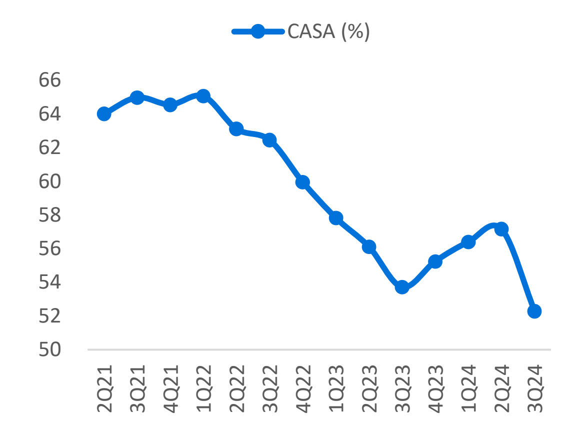
In addition, Riyad Bank is also witnessing depleting interest-free deposits from SAMA that were placed during the COVID. Nearly 43% of those deposits were redeemed during 2023, but SR11.2bn (4% of estimated total funding) remains, which would be replaced by interest-bearing instruments during 2024, increasing the cost of funds for the Riyad Bank. In the latest earnings presentation (9M24), management highlighted that most of SAMA's deposits have been paid back.

Chart 113: Non-regulatory LDR at elevated levels...



Source: Company financials and anbc research

Chart 114: ...accompanied by CASA migration

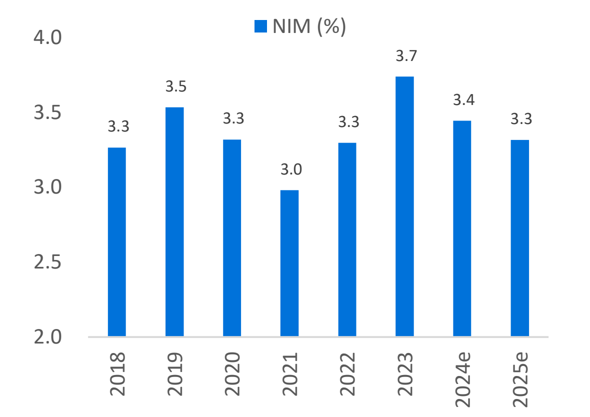


Source: Company financials and anbc research

With mounting pressure on both sides in the short term, Riyad Bank's net interest margins declined by over 24bps in 9M24. With a balance sheet negatively geared for rate cuts, we estimate that Riyad Bank's NIMs will contract by 30bps in 2024e and another 13bps in 2025e; within our coverage, this stands out as the most contraction expected in the NIMs across all banks.

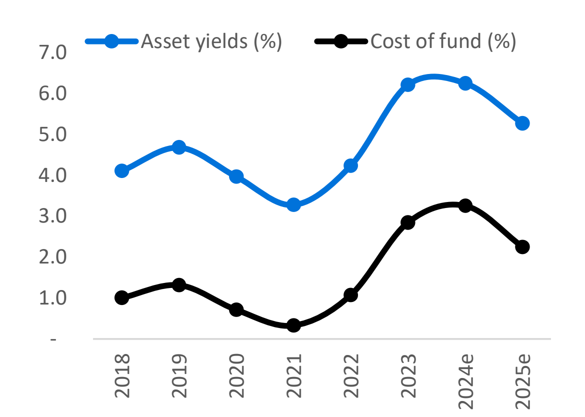
However, once these pressures subside, we believe the bank's corporate strategy of expanding into project financing and the SME sector would allow for relatively improved margins and better pricing in the medium term. It is also raising its retail footprint and has already become the third-largest retail bank in Saudi Arabia, which, combined with the increasing contribution of project financing, should support its margin. Its margin sensitivity to changes in interest is the lowest among the corporate-focused banks.

Chart 115: We estimate margins to decline by 30bps in 2024e and 13bps in 2025e



Source: Company financials and anbc research

Chart 116: as funding pressures are high and duration gap negatively geared for rate cuts



Source: Company financials and anbc research

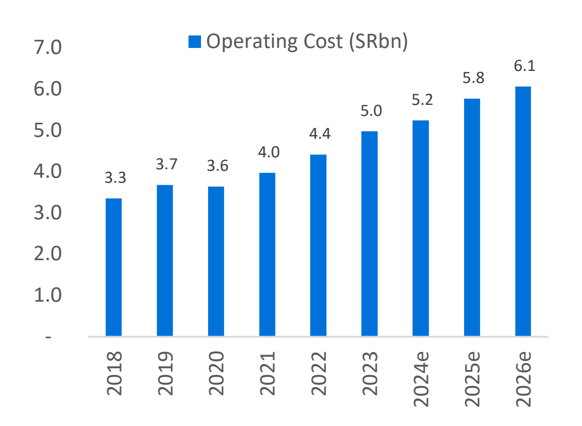
Cost structure relatively elevated to support growth

While lower margins and moderating operating income growth will continue to weigh on the bank's profitability growth, its elevated cost structure also provides no relief. Strong operating income growth over the last three years (2020-23 CAGR of 12%) overshadowed elevated Opex spending, which also grew at a CAGR of 11%. This was higher than the aggregate growth of 9% for our covered banks. However, even in 9M24, operating expenses growth continued slightly, up only 5% YoY.

In the recent earnings call, management attributed increased Opex to digital and infrastructure spending and other initiatives taken to support the Bank's overall strategy. While management indicated that several cost-efficiency measures have also been taken to optimize the cost base, pursuing its expansion would require increased spending outlay with more human resources and the necessary infrastructure.

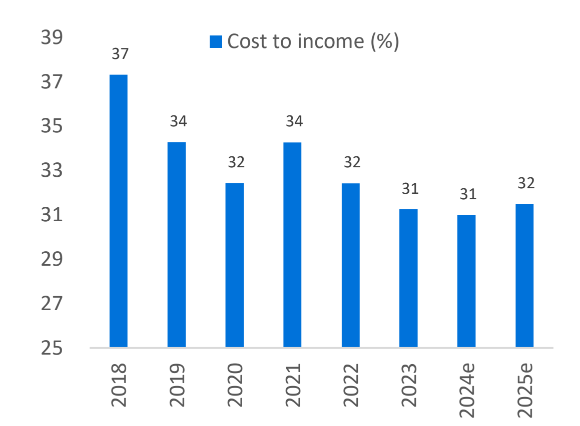
The bulk of this Opex growth resulted from employee-related expenses and premises, followed by G&A expenses. However, according to 3Q24 financial statements, the number of bank branches has been reduced to 334 compared to 338 last year, which could partially indicate cost optimization measures.

Chart 117: Operating costs have picked up…



Source: Company financials and anbc research

Chart 118: …limiting the gains in efficiency



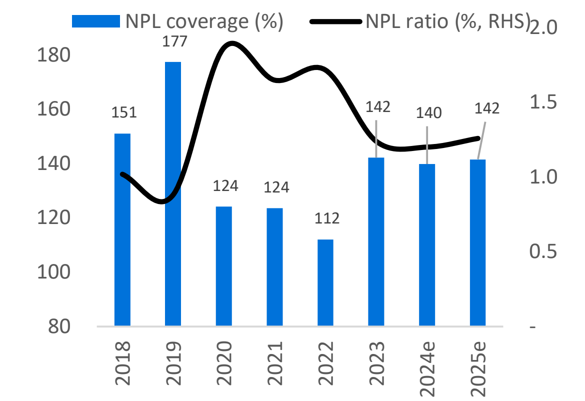
Source: Company financials and anbc research

Apart from the growth in Opex spending, the bank's impairment provisions have also increased in recent years. Its cost of risk increased from 38bps in 2021 to 71bps as it used strong macro conditions to enhance its coverage since the NPL ratio improved. NPL coverage enhanced to 142% at the end of 2023 vs. 124% in 2021. However, in 9M24, the cost of risk dropped to only 29bps from 55bps in the same period last year, according to our calculations, despite the relatively flattish NPL formation.

Asset quality remains manageable for the bank, which has improved due to strong economic activity and solid exposure to the corporate sector. The bank participated in Vision 2030 giga projects, including Neom, Qiddiyah, etc., offering strong project-based secured lending. The strong non-oil expansion also underpins its exposure in the trade and commerce sectors.

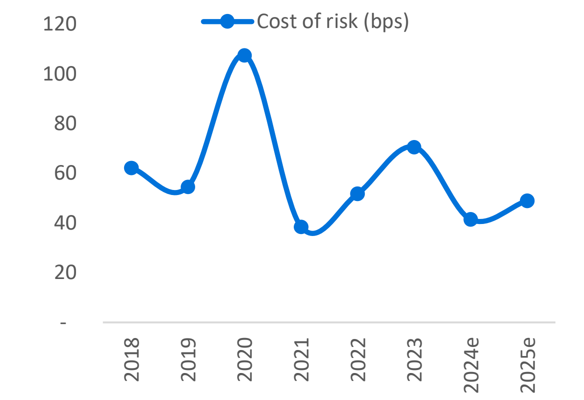
While there are no signs of asset quality stress, the bank will continue to use this opportunity to further build up its coverage buffers. This remains in line with the management guidance of proactive risk management by enhancing coverage.

Chart 119: NPL remains manageable



Source: Company financials and anbc research

Chart 120: CoR will likely remain low



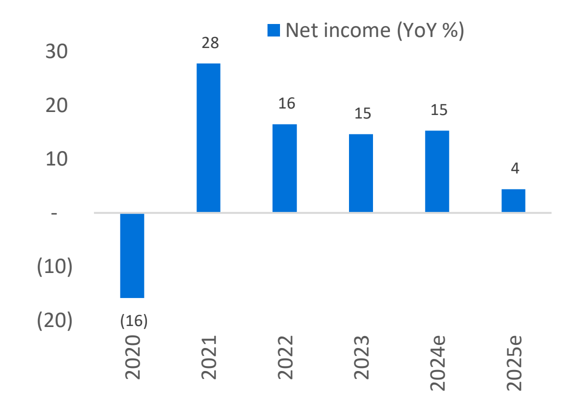
Source: Company financials and anbc research

However, Riyad Bank's performance of delivering strong non-funded income growth has been quite encouraging. This has been well supported by its lending growth and strong expansion in fee income, which is underpinned by a solid capital market (second largest asset manager by AUMs) and trade and payments businesses.

Riyad Bank has a strong fee engine, with non-funded income accounting for 0.9% of assets vs. the median average of the rest of the banks at 0.8%, which offers some cushion against the short-term headwinds. This was evident in 1H24 when the entire operating income growth banked upon an 8% YoY expansion in non-funded income amidst a decline in NSCI; fee income grew by 21% YoY.

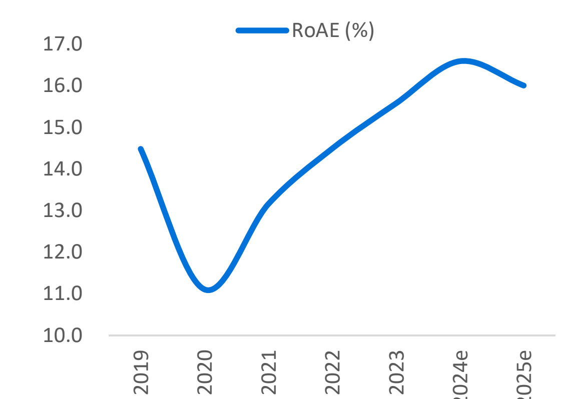
However, on a net basis, despite robust loan growth prospects and sustained non-funded income performance, we still expect Riyad Bank's profitability growth to moderate primarily on margin contraction. We project adjusted net income to grow at a CAGR of only 8% over the next five years, slowing down from 21% between 2018-23.

Chart 121: Profitability growth to moderate



Source: Company financials and anbc research

Chart 122: With slightly lower RoAE



Source: Company financials and anbc research

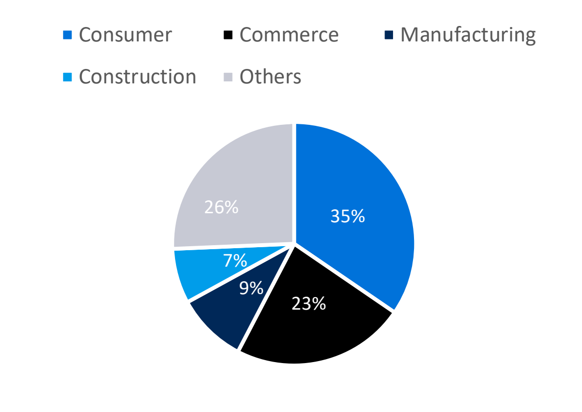
Favorable economic activity to support loan growth

We are positive about Riyad Bank's loan growth as we see the bank having all the right levers to deliver some strong expansion. Riyad Bank has also been participating in financing infrastructure projects under Vision 2030 and offered various project-based financing for the Giga projects, including the Neom. Moreover, Riyad Bank is also a leading bank in the SME sector, with a market share of 22%. Its SME loans grew 20% YTD in 9M24, the fastest pace among all the sectors, accounting for 16% of the lending book. Riyad's Bank has a high exposure to the trade and commerce sectors, followed by manufacturing, both of which should expand as non-oil economic activity growth picks up pace in the coming quarters.

However, following a strong performance within the retail sector in 2023 (with an 11% YoY growth in mortgages, a 5% YoY growth in personal loans, and a 41% YoY growth in auto loans), where the bank significantly expanded its market share, it faced pressure on growth in 2024. In 9M24, retail sector growth was relatively muted, with only a 4% YoY uptick in mortgage while ex-mortgage was down 1% YoY. We believe this reflects the pressures of high maturities this year.

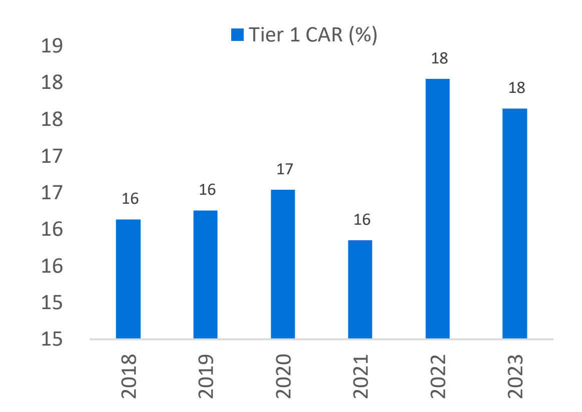
While we think the bank is firmly positioned for growth, management is not too aggressive on the growth levers in 2024e. Its core corporate strategy focuses on the sustainability of profitability and efficiency, which filters into pursuing profitable growth and value creation. Riyad Bank is an exception, unlike other corporate-heavy banks, including Alinma and SAB, which are more focused on market share gain. We think high repayment pressures limit the bank's ability to grow, which should recover next year, especially in the retail sector. We penciled in a 12% CAGR in lending for Riyad Bank between 2023-28e, with growth likely to increase beyond 2025e once the short-term pressure subsides and liquidity dynamics improve.

Chart 123: Commerce and manufacturing make up most of loan book



Source: Company financials and anbc research

Chart 124: Capital buffer adequate to support lending growth



Source: Company financials and anbc research

Valuations:

We have used a cost of equity of 11.5% and a terminal growth rate of 5% to value Riyad Bank at a target price of SR31/share. The stock trades at a 2024e PER of 8.8x and PBV of 1.4x. While we think the bank faces short-term headwinds for margins and profitability growth to moderate, the recent underperformance of the stock price already priced that – while the Tadawul Bank's sector index fell 3% YTD, Riyad Bank share price was down 8% YTD. Beyond these pressures, we are optimistic about Riyad Bank's lending outlook and relative position in the sector and see current valuations as attractive.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	53,696	58,179	62,867	67,889	73,221	78,857	84,844
Cost of equity (%)	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%	11.5%
Cost of equity	6,175	6,691	7,230	7,807	8,420	9,069	9,757
Adjusted Net Income	8,967	9,376	10,043	10,665	11,271	11,974	12,780
Excess equity return	2,792	2,685	2,813	2,858	2,851	2,906	3,023
Terminal excess equity return							48,835
Discount factor	1.03	1.15	1.28	1.43	1.59	1.78	1.78
PV of excess equity returns	2,710	2,337	2,197	2,001	1,790	1,636	27,496

Equity invested	53,696
PV of excess return on Equity	40,167
Value of equity	93,863
Number of shares (mn)	3,000
Target Price	**31**

Earnings Sensitivity

		Growth rate				
		3%	**4%**	**5%**	**6%**	**7%**
CoE	**10%**	40	43	47	54	66
	11%	34	35	38	41	47
	12%	29	30	**31**	33	36
	13%	25	26	27	27	29
	14%	22	23	23	23	24

Source: Company financials and anbc research