

Saudi Banking Sector

2 December, 2024

Positive outlook amidst monetary easing tailwinds

Saudi Arabia's banking sector growth outlook remains positive, supported by a robust macroeconomic backdrop and accelerated giga project implementation. Monetary easing should provide further impetus to growth, especially in the retail sector. However, supply-side constraints with tight deposit liquidity remain a slight challenge, which we expect to be managed by Additional Tier capital and bond issuance. While the corporate sector would drive growth in the short term, banks with high retail sector exposure are relatively better positioned for margin expansion. We initiate coverage on six banks with Overweight ratings on Al Rajhi Bank, Saudi National Bank, Alinma Bank, Saudi Awwal Bank, and Riyad Bank.

The banking sector is relatively better positioned for this monetary easing cycle due to the increased contribution of a longer-term mortgage portfolio and the repositioning of investment portfolios. We expect banks with high retail exposure and a relatively high contribution of the investment book to see margin expansion with declining rates. For our assumptions, we have incorporated cumulative 125bps rate cuts by the end of 2025e, following the 75bps delivered, and expect Al Rajhi, SNB, and Albilad to benefit positively, with Al Rajhi seeing the most margin expansion. Meanwhile, Alinma, SAB, and RIBL would see their margins contract in a declining rate environment.

The growth outlook is positive, with long-term structural headroom as banking sector penetration still lags global peers. Vision 2030 offers strong tailwinds for credit expansion as opportunities from the Giga project are growing and remain vast in our view. Lower rates would provide further impetus for growth, especially in the retail sector, though we expect growth to be driven by the corporate sector in the short term. For our covered banks, on aggregate, we expect the lending portfolio to grow at a CAGR of 12% over the next five years.

Liquidity dynamics are slightly challenging, as credit expansion has outpaced deposit growth for the fourth consecutive year since 2020, and interbank spreads have been elevated. Banks have been quite active in bond and AT capital issuance, a trend we expect to continue in the short term to meet liquidity requirements. Banks that are aggressive on growth are more likely to tap for additional liquidity.

The focus on digitalization has been a pervasive trend across all the banks, forming an integral part of their corporate strategies. While the initial investment will keep spending elevated, it would help drive efficiency and facilitate balance sheet expansion, which we expect to be more visible in the medium-term.

Lower rates would be a catalyst for valuation re-rating. The Saudi Bank sector index slightly underperformed the broader market, with the sector index declining by 5% YTD vs. TASI down 3% YTD. Sector valuations have come off from their peak in 2022 and are trading at a discount to the historical average. We think lower rates and subsequent pickup in growth should catalyze valuation re-rating; the sector trades at a forward PBV of 1.6x, a 15% discount on its 5-year average.

Risks: Constrained liquidity is a key downside risk that, if it persists, could lead to pressures on margins and potentially result in scaling back on dividend payouts. Moreover, there is still a lot of uncertainty about the interest outlook, and in a scenario of delayed rate cuts, we note that corporate-heavy banks would benefit more.

SECTOR COVERAGE

	Bloomberg Code	Last Price (SR)	Rating	Target Price (SR)
Al Rajhi Bank	RJHI AB	91	Overweight	106
Saudi National Bank	SNB AB	32	Overweight	46
Alinma Bank	ALINMA AB	28	Overweight	33
Riyad Bank	RIBL AB	26	Overweight	31
Saudi Awwal Bank	SABB AB	31	Overweight	42
Bank Albilad	ALBI AB	35	Neutral	39

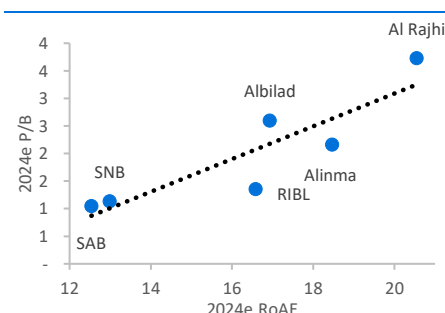
Last price as of November 28th, 2024

VALUATIONS (2024e)

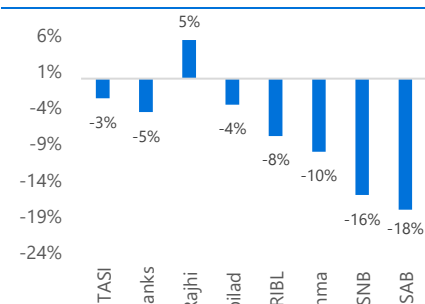
	PBV (x)	PER (x)	RoAE (%)	Div. Yld (%)
Al Rajhi Bank	3.7	19.9	20.5	3.0
Saudi National Bank	1.1	9.4	13.0	4.8
Alinma Bank	2.2	13.0	18.5	3.9
Riyad Bank	1.4	8.8	16.6	5.7
Saudi Awwal Bank	1.0	8.9	12.5	6.2
Bank Albilad	2.6	16.1	16.9	2.5

Source: Company financials and anbc research

VALUATIONS - PBV/RoAE



RELATIVE PERFORMANCE - BANKS (YTD)



Source: Bloomberg and anbc research

Muhammad Adnan Afzal

Head of Sell Side Research

Muhammad.afzal@anbcapital.com.sa

+966 11 4062500 ext:4364

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Valuation Table

Saudi Bank's valuation table:

		Al Rajhi	Saudi National Bank	Alinma	Riyad Bank	Saudi Awwal Bank	Albilad	Median
Last price (SR)		91	32	28	26	31	35	
Rating		Overweight	Overweight	Overweight	Overweight	Overweight	Neutral	
Target Price (SR)		106	46	33	31	42	39	
Upside/Downside (%)		16%	40%	20%	17%	32%	10%	
Dividend Yield (%)		3%	5%	4%	6%	6%	2%	
Total Return (%)		19%	45%	23%	23%	38%	13%	
Growth (2018-23)	Earnings	33%	16%	10%	20%	21%	31%	20%
	Lending	21%	18%	16%	13%	14%	15%	15%
	Deposits	14%	13%	16%	8%	13%	15%	14%
Growth (2024e-28e)	Earnings	16%	9%	11%	8%	6%	14%	10%
	Lending	12%	10%	14%	12%	14%	11%	12%
	Deposits	12%	9%	13%	11%	12%	11%	11%
ROAE (%)	2022	22.7	12.5	13.7	14.5	9.0	16.4	14.1
	2023	19.1	12.9	17.2	15.6	12.4	16.5	16.1
	2024e	20.5	13.0	18.5	16.6	12.5	16.9	16.8
	2025e	22.9	13.3	18.1	16.0	12.6	17.2	16.6
ROAA (%)	2022	2.5	2.0	1.9	2.0	1.6	1.7	2.0
	2023	2.1	2.0	2.2	2.2	2.1	1.7	2.1
	2024e	2.2	2.0	2.2	2.2	2.0	1.8	2.1
	2025e	2.4	2.0	2.1	2.1	1.9	1.8	2.1
PBV (x)	2022	4.3	2.0	3.3	2.1	1.5	4.4	2.7
	2023	3.3	1.3	2.8	1.7	1.3	3.3	2.3
	2024e	3.7	1.1	2.2	1.4	1.0	2.6	1.8
	2025e	3.4	1.1	2.0	1.3	1.0	2.3	1.6
PER (x)	2022	21.3	16.5	25.6	15.1	17.2	28.0	19.2
	2023	18.7	11.2	18.0	11.6	10.5	21.3	14.8
	2024e	19.9	9.4	13.0	8.8	8.9	16.1	11.2
	2025e	16.4	8.6	12.4	8.4	8.4	14.3	10.5
Dividend yield (%)	2022	0.0	3.0	1.9	3.0	2.4	0.0	2.1
	2023	3.3	3.6	3.2	4.3	4.7	1.0	3.4
	2024e	3.0	4.8	3.9	5.7	6.2	2.5	4.3
	2025e	3.7	5.8	4.0	6.0	6.6	2.8	4.9

Last price as of November 28th, 2024

Source: Company financials and anbc research

Executive Summary

- **Rate cuts to benefit banks with high retail exposure:** We expect banks with high retail exposure and a relatively high contribution of the investment book to benefit in a declining rate environment as fixed longer-term instruments offer a favorable asset-liabilities duration gap, which would result in margin gains from rate cuts. While the increased contribution of interest-sensitive liabilities would be supportive of this, amidst tight liquidity dynamics, there is a risk of further migration in current/saving accounts (CASA), which would offset some of the gains. In addition, narrower spreads amidst highly competitive pressures would also be margin dilutive, particularly for banks with high maturities in the corporate segment. We have modeled another 125bps rate cut by the end of 2025e on top of the 75bps cut already delivered and expect Al Rajhi, SNB, and Albilad to see positive expansion in net interest margins, while RIBL, SAB, and Alinma will be negatively impacted. We note high uncertainty about the interest rate outlook, and in a scenario of delayed cuts in interest rates, corporate-focused banks would perform better.
- **Structural headroom for solid credit expansion** A robust long-term outlook for Saudi Arabia's banking sector credit expansion remains intact, as banking penetration remains low. The economic backdrop has been positive, driven by a significant transformation away from the oil sector. Credit demand from this, coupled with project financing for Giga projects, has been growing, and the opportunity remains vast (estimated to be c57% of total private sector lending) in our view. We don't expect the momentum to slow down significantly in the medium term, underpinned by the renewed capex cycle. However, credit growth in the corporate sector will likely outpace the retail sector growth in the short term, driven by secular tailwinds of robust macroeconomic expansion and large financing requirements from the Giga projects. Retail sector loan growth would recover as rate cuts become more entrenched amidst an improved appetite for consumer lending, where mortgages would continue to be a major driving factor. For our covered banks, on aggregate, we expect the lending portfolio to grow at a CAGR of 12% over the next five years.
- **Liquidity dynamics are slightly challenging; improved asset quality cycle to sustain:** Liquidity dynamics in the banking system have been a slight challenge, particularly deposit liquidity. Private sector credit growth outpaced the growth in total deposits for the fourth consecutive year since 2020, leaving with elevated LDR. Liquidity had also been tight in the interbank market, as evidenced by elevated spreads between USD SOFR and SR SAIBOR, as banks actively used open market operations to meet their funding requirements. Additionally, banks have been raising liquidity through bond and AT capital issuance, a trend we expect to continue in the short term amidst tight deposit liquidity. Meanwhile, we expect the buoyant non-oil economic expansion to extend support toward the sustainability of the improved NPL cycle without any major asset quality concerns. Recent developments in the Saudi Binladen Group have been a key positive in this regard.

- **Al Rajhi Bank (Overweight, Target Price: SR106/share):** We believe Al Rajhi's retail heavy loan book, with a sizable portion contributed by long-term mortgages, positions it firmly to benefit from the monetary easing cycle. Net interest margins have been stable at the peak cycle, and we expect the bank to deliver the most robust margin and RoAE expansion. CASA migration could limit some gains as LDR remains relatively elevated, and the bank's loan growth will take time to accelerate as it focuses on driving value from its retail position while delivery expansion in corporate, where it has become the third largest bank by market share. We expect EPS to grow at a CAGR of 16% over 2023-28e. Despite premium valuations at 2024e PBV of 3.7x, we think there is still room for further re-rating as RoAE will likely expand throughout the monetary easing cycle.
- **Saudi National Bank (Overweight, Target Price: SR46/share):** Saudi National Bank is the largest bank in the country, with a 23% lending market share. It is leveraging its vast scale, brand equity, positioning in key sectors, and balance sheet strengths to drive expansion that supports profitability. It delivered a strong performance in maintaining an exceptionally strong CASA balance and offers significant operating leverage with a cost-to-income ratio, one of the lowest in the sector. The bank's margins are positively geared for rate cuts, though gains would be gradual. At a 2024e PER of 9.4x and PBV of 1.1x, we think current valuations do not reflect a bank of its vast scale and reach, driving growth and RoAE expansion in a declining rate environment.
- **Alinma Bank (Overweight, Target Price: SR33/share):** Alinma Bank offers a unique positioning: an Islamic franchise with a corporate-heavy loan book and pursuing an aggressive growth strategy underpinned by market share gains. It delivered one of the most robust balance sheet expansions in 2023 and has the headroom to support further growth following a strong deposit mobilization. However, this expansion was accompanied by the most migration in CASA balance and relatively elevated provisioning costs amidst rising NPLs. Margins' contraction with rate cuts, elevated credit cost, and increased Opex spending would limit some of its earnings expansion, which we estimate to grow at a CAGR of 11% between 2023-28e. At 2024e PBV of 2.2x, it is relatively cheap compared to other Islamic banks, though its RoAEs have recovered.
- **Riyad Bank (Overweight, Target Price: SR31/share):** Riyadh Bank has a strong foothold in corporate, SMEs (leading bank with a 22% market share), and project financing, benefiting from strong secular tailwinds of relatively robust economic expansion. However, the bank faces high repayment pressures this year, likely to result in subdued lending growth. While margin sensitivity to changes in interest rates is relatively low, it's negative, and there are funding pressures as well. Earnings growth is also being weighed down as it builds provisioning buffers with elevated CoR and high Opex spending. That said, the current valuation at a 2024e PBV of 1.4x is attractive for a RoAE still above 16%.

- **Saudi Awwal Bank (Overweight, Target Price: SR42/share):** Saudi Awwal Bank offers the most robust lending growth prospects supported by its corporate positioning, track record of financing large projects, a key financier for the Giga projects, international connectivity through HSBC, a vast client base, and aggressive retail expansion. The bank is also optimizing its infrastructure and improving cost efficiencies. However, this relatively strong growth would be offset by margin contractions and higher credit costs as recoveries normalize. However, part of its corporate strategy focuses on minimizing interest rate sensitivity through increased contribution of mortgages and non-funded income growth coupled with favorable investment portfolio placement. Valuation appears attractive post recent underperformance (post relatively weak 3Q24 earnings print) at FY24e PER of 8.9x and PBV of 1.1x for a RoAE, which would likely remain over 12.5% and has improved from 9% in 2022.
- **Bank Albilad (Neutral, Target Price: SR39/share):** Despite its small size, Bank Albilad has delivered above-sector average returns. It provides balanced lending exposure across retail and corporate, offering relatively better growth prospects vs. purely retail plays. That said, growth had been relatively weak, particularly in the corporate sector. The banks will deliver margin expansion from rate cuts, and there is room for further efficiency gains and improved operating leverage. However, despite the declining trend in NPLs, we remain cautious due to its high exposure to the real estate sector, which could quickly result in higher credit costs with any signs of a slowdown in activity. However, current valuations look slightly stretched at 2024e PER of 16.1x and PBV of 2.6x for a broadly stable medium-term RoAE between 17-18%.

Rate cuts to benefit banks with high retail exposure

Another 125bps rate cuts projected by 2025e end; uncertainty is high

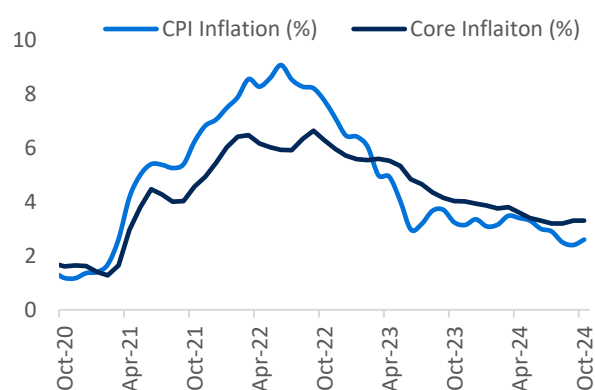
The Fed finally shifted its monetary policy stance by delivering its first rate cut in September of 50bps. This was followed by another rate cut in November by 25bps with benchmark rates at 4.5-4.75% range. This cumulative 75bps rate decline comes after keeping a very restrictive policy stance since July 2023, with rates at least two decades high levels. This shift in policy stance followed the Fed's increasing rates in one of the most aggressive paced tightening and kept a very tight monetary stance since July 23- the Fed raised interest rates 11 times between March 2022 and July 2023.

This commencement of the monetary easing cycle comes as inflation decelerated with pressures subsiding, growth slowed down, and unemployment rose. Fed Chair Jerome Powell linked the decision to balance the Fed's dual mandate with emphasis on sustaining low unemployment as inflation reverted back closer to its target. This is seen as the Fed lending monetary support to economic growth to keep unemployment from rising while a lower inflation and eased labor market conditions, something previously missing, providing the necessary room.

A restrictive policy stance had been weighing on underlying economic growth. High-frequency data, including the PMI, showed that US manufacturing activity's growth has continued to contract in 2024, and unemployment has risen. The US unemployment rate rose for the fourth consecutive month to 4.3% in July, the highest since late 2021, although it slightly improved to 4.1% in October. Non-farm payroll additions have been relatively weak recently, especially in July and August, which were nearly 50% lower than the average increase in 2023, and data showed that employment increases were predominantly supported by only a handful of sectors, namely the public and healthcare sectors.

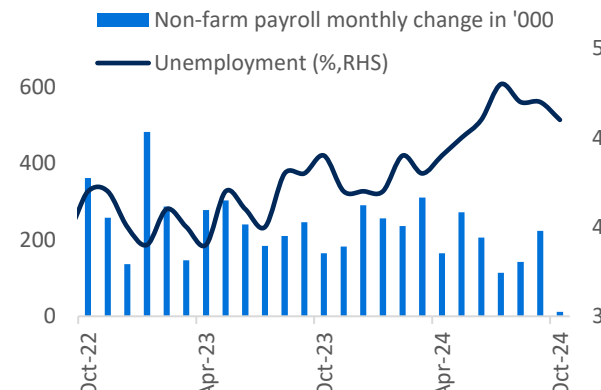
However, despite a recent increase in headline inflation in Oct'24 to 2.6% YoY from 2.4% in Sep'24, it has sharply decelerated from 3.2% YoY in the same period last year. Food inflation slowed to 2.1% YoY, while lower energy prices were a key catalyst for lower headline inflation. The Energy Index contracted 4.9% YoY as the Gasoline subindex fell 12% YoY. However, core inflation remained slightly stickier at 3.3% YoY, nearly the same level in the past six months. That said, core inflation is still down from 4.0% YoY in the same period last year and decelerated from 3.9% YoY in Jan'24.

Chart 1: Despite margin pick up to 2.6% in Oct'24, inflationary pressures remained contained



Source: US Bureau of Labor Statistics and anbc research

Chart 2: US labor markets showing signs of easing, with unemployment increasing to 4.1%



Source: US Bureau of Labor Statistics and anbc research

While the Fed cut rates by 75bps, its last Summary of Economic Projections released in September also projected that rates would come down to neutral levels much quicker than earlier projections, which had

envisioned a more gradual monetary easing. According to the last publications, Fed officials projected rates to decline by at least 100bps in 2024, followed by another 100bps in 2025, with median neutral levels of 2.9% to be achieved in 2026e. Earlier June projections showed only a 25bps rate cut in 2024, followed by 100bps cuts in 2025 and 2026.

In addition to the projection of the federal fund rate, the Fed sees GDP growth remaining relatively stable at around 2%, while unemployment is expected to decline in 2026 from 4.4% in 2024 and 2025. Meanwhile, Personal Consumption Expenditure (PCE) inflation is expected to slow down from 2.3% in 2024 to 2.1% in 2025 and 2.0% in 2026.

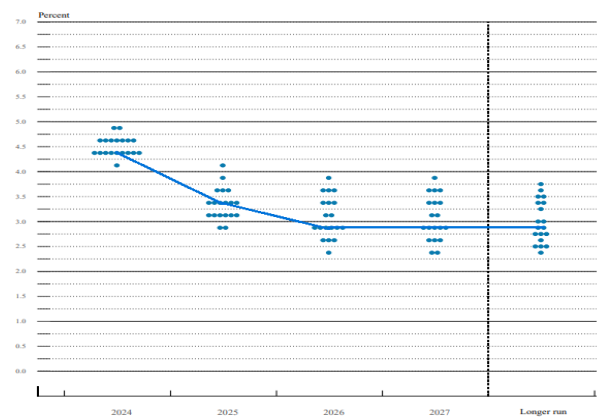
However, the markets have been quite volatile in pricing the future rate cut trajectory in light of recent data and continued to scale back on rate cut expectations. Looking at the implied rates from the SOFR (Secured Overnight Financing Rate) forward curve, the pricing at the end of October had been at par with the Fed’s Dot plot and implied 50bps more rate cuts in 2024e, followed by another 75-100bps in 2025e. These expectations tapered off from a bit more aggressive pricing at the end of September, with a 75bps rate cut in 2024 and up to 100-125bps rate cuts going into next year.

However, the latest implied rates from the SOFR forward curve in the last week of November showed expectations of a 25bps rate cut in the December meeting, followed by only 50-75bps rate cuts in 2025e, slightly lower than previous expectations. CME’s FedWatch tool, also based on SOFR pricing, still showed a nearly 70% probability of another rate cut of 25bps by the end of 2024 and a nearly 60% probability of cumulative rate cuts of over 50bps in 2025e.

However, there remains a lot of uncertainty regarding the pace and magnitude of rate cuts, as they would heavily depend upon the incoming data on unemployment and inflation, as indicated by the Fed Chair in his latest remarks. Moreover, the recent change in the US government administration adds to this uncertainty about how the new government’s policies would impact growth and inflation. The most recent remarks by the Fed officials indicate that an unexpected pickup in growth coupled with any signs of inflationary pressures would result in the Fed scaling back on its interest rate cuts. However, there has been increasing discussion on the level of a neutral rate, making the interest rate outlook even more uncertain.

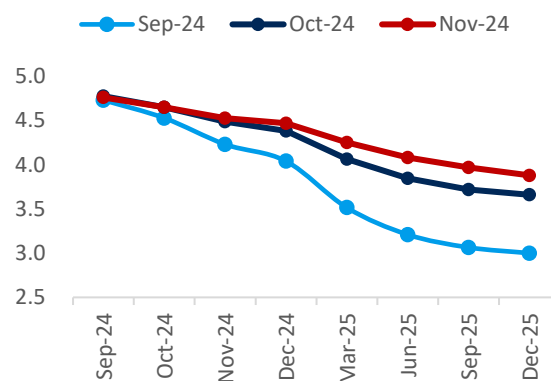
For our models and estimates, we opted to stick to the Fed’s projections in the dot plot and have incorporated a total 100bps rate cut in 2024e and another 100bps rate cut next year.

Chart 3: The latest Fed’s Dot plot shows another 125bps rate cuts by 2025e end



Source: FOMC and anbc research

Chart 4: SOFR future rates envision a slightly lower magnitude at 75-100bps by 2025e end



Source: Bloomberg and anbc research

The composition of the lending book would drive the pace and direction of the NIMs

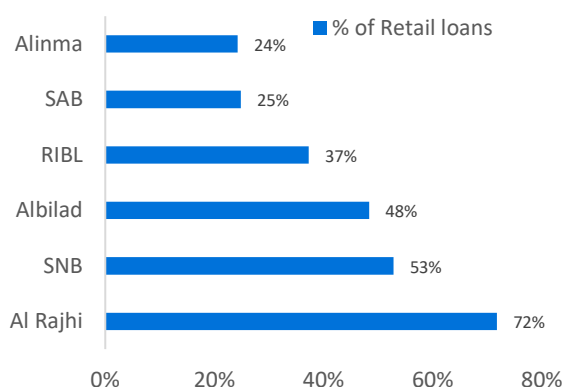
The composition of the lending book and the size of the investment portfolio relative to total assets are the two key factors that we expect to drive the pace and direction of net interest margins (NIM). Banks' lending assets tilted towards longer-duration retail sector loans would benefit the most from rate cuts due to delayed repricing of their interest-earnings assets. In addition, investment replacements have been increasingly geared towards fixed-rate instruments, a pervasive trend across the sector as banks have taken the opportunity to benefit from an elevated rate environment in recent years.

Retail loans, especially mortgage loans, which are long-term fixed lending instruments, have been a key contributor to narrowing the asset-liability duration gap, positioning the banks to benefit in a declining rate environment. In contrast, corporate loans are typically floating-rate instruments, which are usually repriced on a quarterly basis. This comes alongside a lower mix of CASA deposits in recent years, increasing the contribution of interest-sensitive liabilities for the banks. Overall, banks with a higher contribution of retail sector loans and investment portfolios would see a slower repricing of their gross yields with rate cuts.

Among our covered banks, Al Rajhi has the most retail-heavy loan book, accounting for over 72% of the total gross loans in 2023. This is followed by SNB, which has a retail contribution of nearly 53%. For both banks, mortgages are a key component of the retail credit book. Albilad has a more balanced composition between retail and corporate, but its retail book is nearly 75% comprised of mortgage products. Meanwhile, Alinma, SAB, and RIBL are more corporate-focused banks, with retail sector loans accounting for less than 40% for RIBL and less than 25% for Alinma and SAB.

In terms of investments, SAB's and SNB's portfolios relative to assets are the highest among our covered banks, with the investment book accounting for over 25% of total assets and nearly 30% of interest-earnings assets, based on our calculations. This is followed by Alinma and Al Rajhi, each with an investment portfolio contributing up to 18% of total assets while 20% of interest earnings assets for Alinma and 18% for Al Rajhi. Albilad and RIBL's contribution from investments is relatively lower than that of the other banks, with investments as a percentage of assets at 15%, though accounts for 17% of their interest-earnings assets.

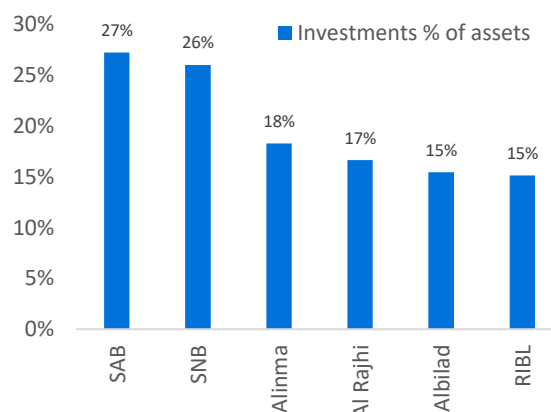
Chart 5: Al Rajhi has the highest composition of loan book tilted toward the retail sector



*For the year ended 2023

Source: SAMA, Financial Statements and anbc research

Chart 6: SAB and SNB both have a high contribution of investment book to overall assets



*For the year ended 2023

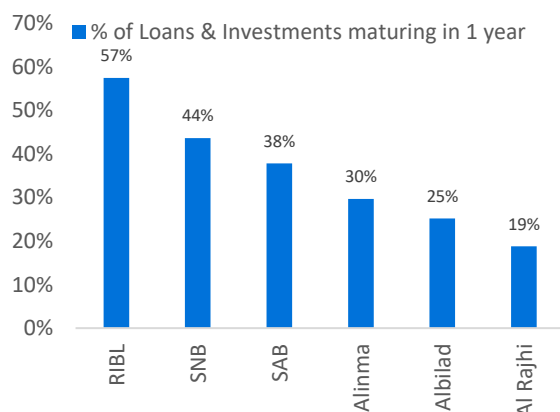
Source: SAMA, Financial Statements and anbc research

Another key factor contributing to the pace of change in net interest margins is the repricing of the older lending portfolio. While we think the refreshment of loans at higher rates would also be a key catalyst for improved gross yields, especially for the retail loans, which have been priced in the lower rate environment, it would be challenging overall amidst narrowing spreads in a tight competitive dynamic.

Spreads between the SAIBOR and gross yields have significantly narrowed against a very tight monetary policy stance and increased competitive dynamics at the peak rate cycle. While we note that part of the tight spreads is also due to slower repricing of retail loans, based on anecdotal evidence, competition has increased significantly, resulting in banks scaling back on pricing in some sectors.

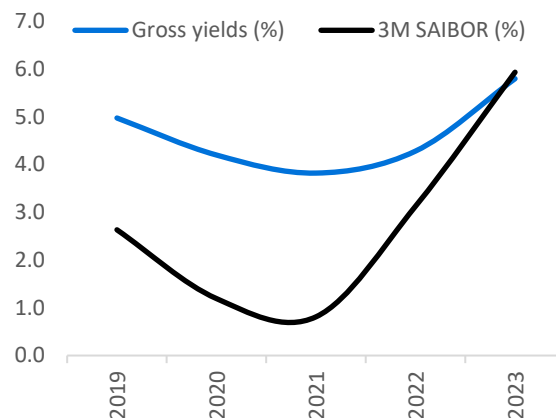
In our view, this puts banks with high maturities this year at some risk of margin pressures weighed by tighter spreads amidst strong but moderating loan growth. For retail loans, repricing loans from low rates likely dilutes the impact of lower spreads; this would be a more prominent risk for corporate sector loans.

Chart 7: However, some banks also face repayment pressures at the peak rate cycle



*For the year ended 2023
Source: SAMA, Financial Statements and anbc research

Chart 8: With spreads between the gross yields and SAIBOR narrowing down markedly

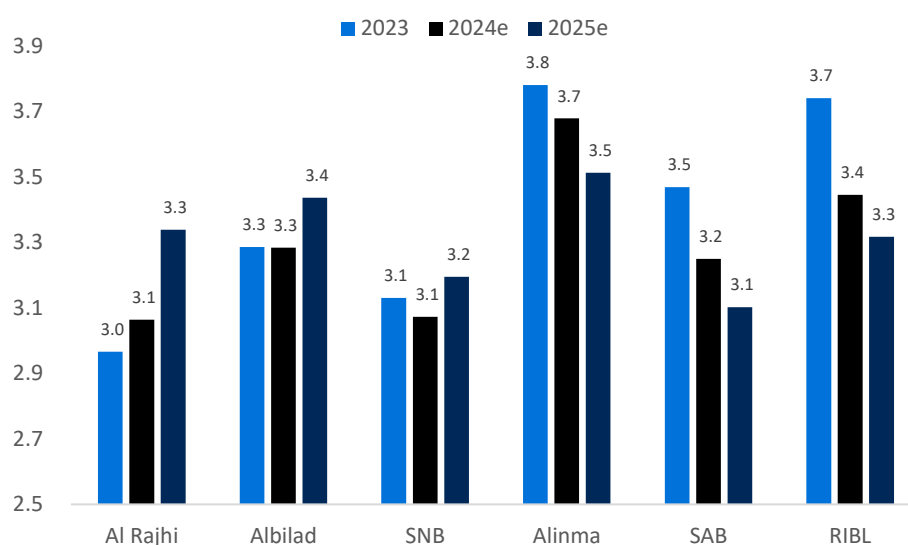


*Aggregate for our six covered banks
Source: SAMA, Financial Statements, and anbc research

On an aggregate basis, we estimate net interest margins to remain under pressure in 2024e (-6bps YoY), primarily from the higher cost of funding and rate cuts happening towards the end of the year. However, margins will likely expand by 8bps in 2025e as the impact of the positive asset-liability duration gap filters through. The aggregate expansion of margins for our covered banks primarily reflects the slightly higher tilt of the aggregate lending book towards the retail sector from the sizeable retail book of Al Rajhi and SNB. Among our covered banks, Al Rajhi, Albilad, and SNB are best positioned to record expansion in net interest margins next year, while rate cuts would negatively impact Alinma, SAB, and RIBL.

However, we note that we don't expect a similar magnitude of movement in net interest margins compared to the past two years as banks have continued to invest and reposition their investment portfolios to lower their net interest margin sensitivities to interest rates (discussed in the next section), especially for those with corporate loan books vulnerable to interest rate cuts. Moreover, we also highlight that corporate-focused banks, including SAB, Alinma, and RIBL, would likely benefit more in a scenario of delayed rate cuts.

Chart 9: Al Rajhi, Albilad, and SNB would see margin expansion from rate cuts



Source: Financial Statements and anbc research

- Al Rajhi Bank:** We expect Al Rajhi to deliver the most expansion in its net interest margins underpinned by an extended asset duration on the back of a large mortgage portfolio and a diversified funding base with a high composition of interest-sensitive liabilities offering an asset-liability duration gap, which would help improve margins with rate cuts in addition to the repricing of the legacy low-yielding portfolio. We expect Net interest margin to expand by 10bps in 2024e and 27bps in 2025e.
- The Saudi National Bank (SNB):** SNB is also positioned positively for gains on margins supported by a fixed-rate heavy loan book, repricing of the legacy portfolio on repayments, and contribution of its investments book. However, considering the uncertainty of international business and its relatively neutral sensitivity of margins, we think the margin gains would only be gradual. We estimate a 12bps expansion in net interest margins in 2025e, while margins will likely decline by 6bps in 2024e, primarily due to a higher cost of funds.
- Bank Albilad:** We estimate that Bank Albilad will deliver a 15bps expansion in margins in 2025e, though we expect it to be relatively flat in 2024e. While it has a balanced lending portfolio across corporate and retail, over 75% of its retail book is made of up mortgages, which accounts for 36% of total lending. In addition, we expect Albilad’s margin gains also to be supported by positive contributions from its treasury activities, with treasury income accounting for 19% of total NSCI in 9M24, up from 13% in 2023.
- Alinma Bank:** Margins are negatively geared for rate cuts due to corporate repricing, and the bank also faces pressures from CASA migration as it remains aggressive on growth. We estimate Alinma’s net interest margins will decline by 10bps in 2024e and 17bps in 2025e.
- Saudi Awwal Bank (SAB):** Despite its efforts to lower its earnings sensitivity over the last two years, its margins are most sensitive to changes in interest rates due to a corporate-heavy loan book and would be negatively impacted by rate cuts. Moreover, the bank is growing aggressively, and to fund its growth, significant CASA migration has weighed on its margins in the short term (the most among our covered banks). However, the bank is aggressively building scale in mortgage and has one of the highest contributions from the investment book, which would slightly offset the impact in the medium term. We estimate its margins will contract 22bps in 2024e and 15bps in 2025e.
- Riyad Bank:** We see Riyad Bank’s margins facing the most headwinds in the short term, with CASA migration and depletion of interest-free deposits adding to the funding pressures while repayments of corporate

sector loans amidst highly competitive dynamics and narrowing spreads. Despite the bank’s relatively low margins sensitivity, we expect, as a result of these pressures, its margins will fall by 30bps in 2024e, the highest among our coverage. However, as these pressures subside going into next year and interest-bearing liabilities reprice to lower rates, we expect margin contraction to moderate and estimate it to decline by 13bps in 2025e.

Overall banking sector margin sensitivity has relatively improved

We analyze the net interest margin’s sensitivity to interest rate changes based on our calculations using the 2023 balance sheet structure. Al Rajhi’s margins are most sensitive to changes in interest rates and positively impacted by rate cuts due to a high composition of fixed-rate assets and rate-sensitive liabilities, which account for nearly 50% of total funding. We calculate a 20bps NIM improvement for every 100bps rate cut. Among the other banks that would be positively impacted by rate cuts is Albilad, which should have an 11bps positive NIM movement thanks to a balanced lending portfolio and over 60% interest-sensitive liabilities. SNB’s margins sensitivity, however, is more neutral, which we calculate at only +4bps for every 100bps rate cut.

Meanwhile, our calculations also suggest RIBL, Alinma, and SAB will be negatively impacted, led by SAB’s margins being the most sensitive to rate cuts, followed by Alinma and then RIBL. While SAB and Alinma both have a similar composition of lending assets, Alinma’s lower sensitivity primarily reflects a lower mix of CASA balance (implying a high contribution from interest-sensitive liabilities) despite SAB’s high investment portfolio contribution to interest-earnings assets.

However, we note that our calculations of net interest margin sensitivity are based purely on the balance sheet structure without taking into account the exact duration of assets and liabilities and the mix of call deposits in CASA. Moreover, this also does not incorporate the pressures from repayments; for instance, in the case of RIBL, while its margin sensitivity to a rate cut is lower, the bank needs to replace the SR11bn interest-free deposits with interest-bearing funds.

Table 1: 2023 NIM sensitivity to interest rate changes

Bank	Change in NIM for every 100bps rate cut	% of NSCI	% of operating revenue	% of net income
Al Rajhi	20 bps	7%	5%	8%
Albilad	11 bps	3%	3%	6%
SNB	4 bps	1%	1%	2%
RIBL	(6) bps	-2%	-1%	-3%
Alinma	(9) bps	-2%	-2%	-4%
SAB	(12) bps	-3%	-3%	-5%

**These sensitivities are based on our simple calculation without incorporating duration and will slightly differ from management guidance*

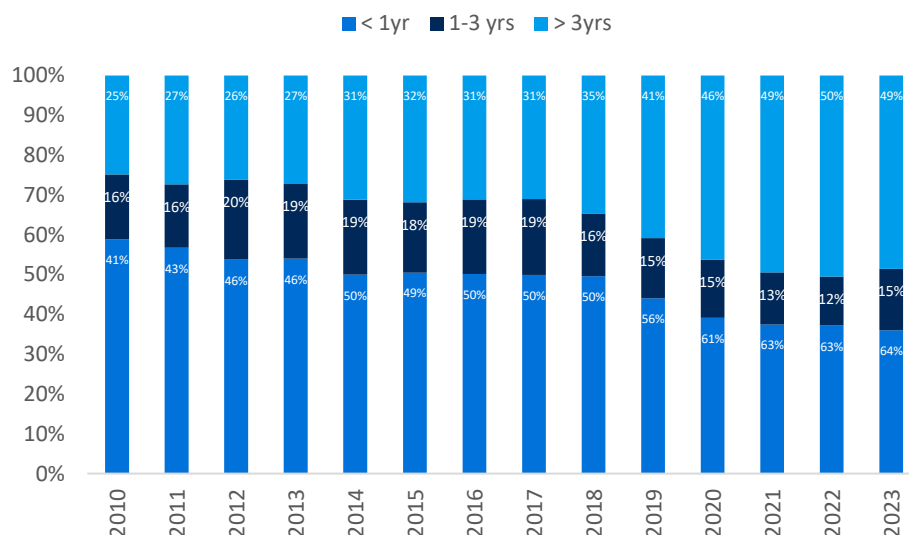
Source: Financial Statements and anbc research

However, overall, we see that the banking sector's margin sensitivity to interest rate changes has improved positively in recent years. We think the increasing contribution of fixed-rate assets, including mortgages and investment portfolios, coupled with a lower mix of CASA deposits, places the sector, in general, in a better position for a declining rate environment. The impact of rate cuts on margins has slightly increased for retail-focused banks, while for corporate-focused banks, their sensitivity has moderated.

One of the key sector transitions over the years has been an increasing mortgage portfolio, which is a longer-term fixed-rate instrument. A mortgage product in Saudi Arabia has a typical maturity ranging from 15 to 30 years, though Saudi Real Estate Refinance Co (SRC) only recently extended the maximum maturity to 30 years from 25 years previously. Based on our discussion, the typical duration of these loans is between 2 to 5 years, depending on the product though some have an even higher duration.

This is evident in the extended sector’s credit maturity, with loans maturing in less than one year accounting for less than 36% at the end of 2023 vs. 50% in 2016. This extended maturity supports an asset-liability duration gap, which benefits in a declining rate environment from a slower repricing of fixed-rate assets

Chart 10: Credit maturity has extended over the years, reflecting the higher contribution of mortgage loans

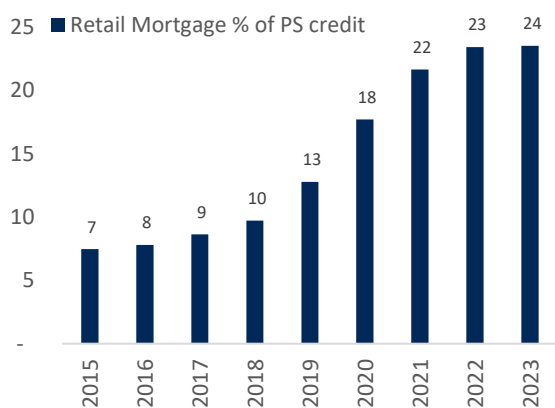


Source: SAMA and anbc research

Both mortgages and investment portfolios now account for an increasing portion of overall interest earnings assets. Retail mortgages alone contributed 24% to overall private sector lending at the end of 2023 vs. only 13% in 2019, as its size grew 3.1x from SR198bn in 2019 to over SR600bn in 2023. Overall, the mortgage loans (retail and corporate loans) grew at a CAGR of 27% over the last four years.

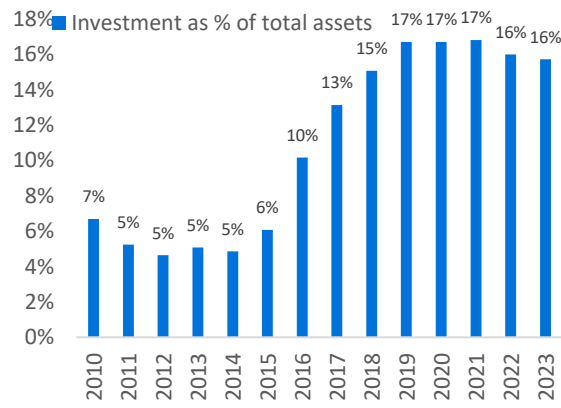
Meanwhile, rising government financing needs and increasing public debt levels offered banks the opportunity to actively grow their public investment portfolio as offerings became more widespread and supported their strategy during rising rates. Total investment portfolios, predominately composed of government and quasi-government sukus, have increased to over SR620bn and account for 16% of the total banking sector assets, increasing from less than 10% back in 2016.

Chart 11: Retail mortgages now account for 24% of the overall private sector lending



Source: SAMA and anbc research

Chart 12: Investment book contribution has also markedly increased since 2016



Source: SAMA and anbc research

However, risks of further CASA migration could offset some of the gains

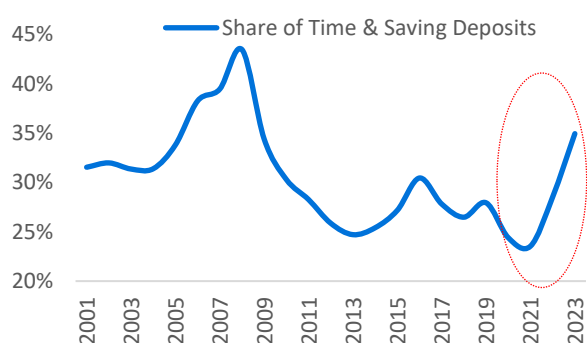
During the monetary tightening cycle over the last two years, the Saudi banking sector faced a double whammy: spreads narrowed, and pressure on the cost of funds (CoF) rose from CASA migration. While some banks, especially those with high corporate sector loans, witnessed expansion in NIMs from asset repricing during this period, pressures from a lower CASA deposit mix continued to offset some of the gains. This trend was even more prominent in 2024 at the peak rate cycle.

According to data from SAMA, the share of demand deposits in total deposits declined for the third consecutive year to 53%, while Time and Savings deposits nearly doubled over the last three years, and their share in total deposits rose to a fifteen-year high of 35% at the end of 2023.

There had been a significant money supply shift from Demand to Time deposits. We note that while the deposit mix remains a dynamic function of interest rates and consumer preference, with rates at very elevated and unlikely to go back to record low levels anytime soon, there is a high risk of further migration away from the CASA balance amidst tight liquidity in the system.

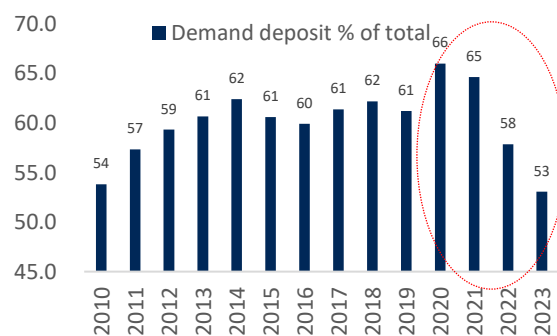
A further decline in the share of CASA balance would continue to pressure NIMs and even offset some of the gains from the rate cuts. During the previous monetary tightening cycle in 2008, the share of Time deposits peaked at 43%, while current interest rates are much higher than that. Even with the rate cuts, we think the CASA balance will remain sticky to some extent.

Chart 13: Deposit cost rose as money supply shifted from Demand to Time deposits



Source: SAMA and anbc research

Chart 14: Resulting in a sharp CASA migration with a share of demand deposit to 53% in 2023



Source: SAMA and anbc research

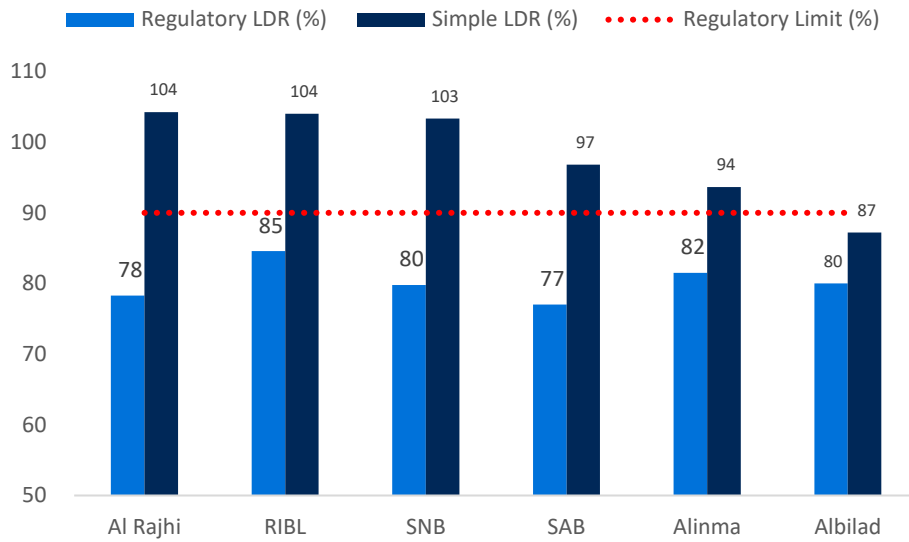
This risk of higher cost of funds from CASA migration becomes even more crucial when liquidity dynamics are not too supportive. Lending growth continues to outpace growth in deposits, pushing banks' LDRs to very high levels, where they have been slightly struggling to fund the growth. Even spreads between USD SOFR and SR SAIBOR rates remain elevated, indicating tight liquidity in the interbank market.

Non-regulatory LDRs have jumped to over 100% for the sector, while for all our covered banks, they remain over 90%. Meanwhile, regulatory LDRs stood around 80% below regulatory limits of 90%, but that's a reflection of active Tier 1 capital funding and increased contribution of other liabilities in recent years.

RIBL and Al Rajhi are the most vulnerable to the risk of further CASA dilution, with the highest non-regulatory LDR above 104%, respectively, by the end of 3Q24. RIBL also has one of the highest regulatory LDRs in our coverage despite the bank raising USD0.75bn in AT issuance during 3Q24. This is followed by SNB, which, too, has elevated non-regulatory LDRs, though considering the subdued retail growth outlook and additional funding from its AT1 issuance should support their growth in the short term. SNB has also issued AT1 Sukuks in 4Q24. Al Rajhi has been quite aggressive in raising additional liquidity this year. The most notable gains have been made by Albilad, Alinma, and SAB, who have been aggressive in their deposit funding by increasing their

deposit market shares. Alinma and SAB also have actively raised AT capital as well. However, Alinma and SAB's aggressive growth strategy, targeting growth ahead of the market, could further push the banks to compete for deposit funding aggressively.

Chart 15: Elevated LDRs could further tighten competition for deposit liquidity



*LDRs data as of 3Q24.

Source: SAMA and Company Financials

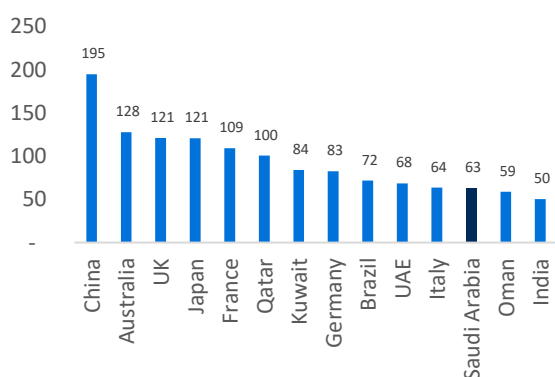
Structural headroom for solid credit expansion

LT structural growth opportunity as banking penetration remains low

Saudi Arabia's banking sector penetration lags vs. the regional and global standards, leaving us to believe there is still room for solid structural growth. Saudi Arabia's penetration, defined as private sector credit to GDP, markedly improved from less than 40% a decade ago to nearly 63% in 2023. However, we estimate it is still below the region's average of c75% and well below c.95% for the global average. There is also room for improving inclusion since, according to government statistics, in 2022, less than 80% of people over the age of 15 had a bank account. While this picked up from 76% in 2017, it still falls short of over 90% for developed countries.

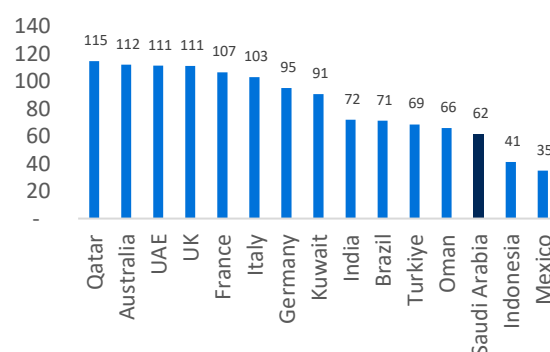
We see this as a long-term structural opportunity for growth in the sector as penetration improves, supported by increasing financing inclusion, a growing and young population (c.50% of the population is less than 30 years old), rising income levels, a strong regulatory framework and substantial credit generation in the economy with the planned vast infrastructure projects amidst a robust economic backdrop under Vision 2030. Credit demand is also growing from the ongoing economic transformation away from the oil sector.

Chart 16: Lending penetration remains low (Private sector credit % of GDP - 2023)



Source: IMF, World Bank, Central Bank, and anbc research

Chart 17: Even savings continued to lag (Deposits % of GDP)



As per the latest available data

Source: IMF, World Bank, Central Bank, and anbc research

The Financial Sector Development Program (FSDP), launched under Vision 2030, is seen as the key enabler in improving the country's financial sector, focusing on banking, insurance, stock markets, and debt markets. The emphasis is on innovation and strengthening the country's financial institutions to fund Vision 2030's objectives.

Some of the key targets for the banks set under FSDP include increasing financing inclusion by increasing the number of people with official bank accounts, growing total banking assets by at least 77% to SR4.6trn by 2030, and improving the share of SME lending from banks to 20% by 2030 from 5.7% in 2019 (8.4% in 2023). The program also focuses on digital transformation, targeting increasing the share of non-cash transactions to over 80% and supporting the fintech sector.

The core initiatives under Vision 2030 aspire to a significant economic diversification away from oil, targeting a 50% contribution from the non-oil sector; it has already risen from 18% in 2019 to 24.1% in 2023. In our view, this incremental growth from the non-oil sector would be a key catalyst in driving overall credit demand, especially for the corporate sector, in addition to credit demand from infrastructure projects. In this regard, SME financing would be important for banks as the sector is seen as the core driver for this economic transition.

The success of mortgage financing is the most recent example, indicating robust credit generation in a noticeably short period underpinned by successful regulatory push and improved penetration. Total real estate loans provided by banks grew 2.6x in the past four years and accounted for over 30% of the lending books of all banks in 2023, up from only 19% in 2019.

Table 2: FSDP banking sector targets:

Matric	Baseline	2030 Target	Description
Banking sector assets (SRtrn)	2.6	4.6	To enhance financial penetration. Target lending to increase to SR3.5trn by 2025.
Share of SMEs lending from banks (%)	5.7	20	To support the SME sector by improving lending and refinancing programs. Medium-term objective targets share SME lending from banks at 11% by 2025
Share of non-cash transactions (%)	36	80	Enable the use of digital payments to increase financial inclusion. The medium-term objective is to achieve a 70% share of non-cash transactions.
Number of Fintech companies	20	525	To develop an entire financial ecosystem and increase private sector competition to promote innovation. Targeting over 200 companies to operate in the fintech space by 2025.

Source: FSDP Delivery Plan 2021

We expect aggregate lending to grow at a five-year CAGR of 12%

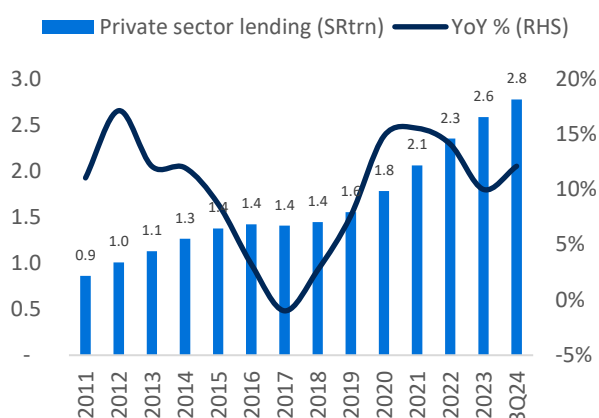
Overall, lending growth in Saudi Arabia remains strong despite one of the most aggressively paced monetary tightening, with rates at nearly three decades high levels. Growth in credit to the private sector only marginally moderated 4bps to 10% YoY in 2023, and the momentum slightly picked up in 2024, with growth at 12% YoY in 3Q24.

While growth in personal loans slowed as consumer appetite for lending weakened with very elevated borrowing costs, surprisingly, the strong momentum in the corporate sector lending showed no signs of abating, growing at double digits for the second consecutive year and nearly at the same pace it expanded in 2022 which was one of the strongest pace of growth in last eleven years. Moreover, the pace accelerated in 2024, with growth in corporate lending up 15% YoY in 3Q24. In our view, this strong growth in corporate lending indicated a pickup in project financing, increasing financing needs in the manufacturing and services sector, and a strong macroeconomic expansion.

Sector-wise, corporate lending growth continued to be supported by real estate, telecom, construction, and the utility sector. Manufacturing lending growth was nearly flat in 2023, but notably, this improved from a contraction in 2022. We see this as an inflection point as manufacturing sector financing needs will continue to grow with improved demand, especially with increased export orders as global economic activity picks up.

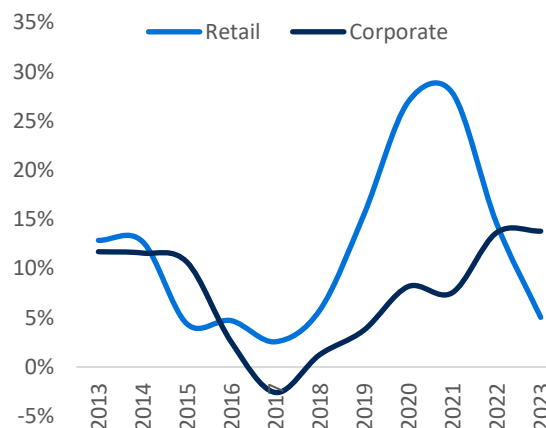
According to SAMA's data based on ISIC 4 standards, retail sector loan growth fell from 14% YoY in 2022 to 7% in 2023 and was up only 8% YoY in 9M24. If we only take retail mortgage lending and consumer financing the combined growth more than halved in 2023 to 5% YoY, though the pickup in 1H24 had been only incremental at 7% YoY. This sharp contrast in growth performance between retail and corporate lending primarily reflected the fixed nature of loans in the retail sector, prompting delaying the consumer preference for financing in the face of such high interest rates. Consumer financing, which predominately includes personal finance and auto leasing, contracted by 2% YoY in 2023, while retail mortgage lending growth slowed to 10% in 2023 and 1H24 from over 23% YoY in 2022.

Chart 18: Private sector lending has grown in double digits for the past four consecutive years



Source: SAMA and anbc research

Chart 19: Growth has been led by corporate sector loans amidst moderating growth in the retail sector



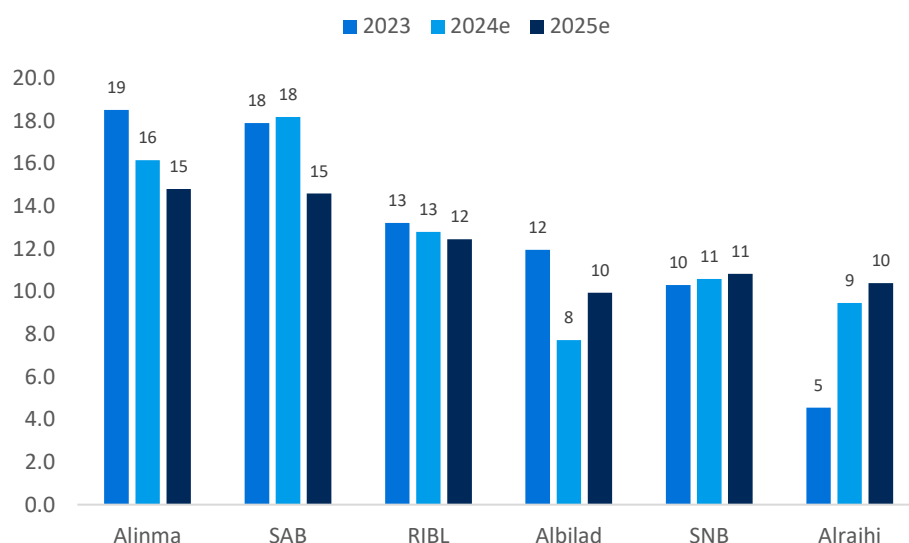
Retail is the sum of consumer loans, credit card loans, and retail real estate loans, Source: SAMA and anbc research

For 2024e, we see the lending dynamics broadly similar, as the underlying driver remains unchanged: corporate lending continues to drive overall credit growth. Growth momentum should be sustained going into next year as lowered interest rates provide additional impetus.

Some pressures on retail sector growth will likely remain but with improving dynamics. We expect growth to pick up going into next year, though it would be slightly challenging to see a robust expansion (similar to 2021-2020) until interest rate cuts are more entrenched, with expectations anchoring tapering off. Corporate growth would sustain its momentum, driven by project financing coupled with expansion in economic activity, particularly in the non-oil sector.

In the medium term, apart from the structural growth opportunities as discussed above, key themes that shape our positive outlook for credit growth include i) improved global growth dynamics filtering into expansion for the Saudi economy, ii) less restrictive monetary policy allowing for credit expansion, iii) retail portfolio growth to pick up as consumption improves amidst lower borrowing cost and iv) strong investment spending supported by growing FDI, PPP projects and further project implementation of the Giga projects.

Chart 20: Corporate-focused Banks to see higher growth in lending than those focused on the retail sector



* YoY % change in net lending portfolio

Source: Company data and anbc research

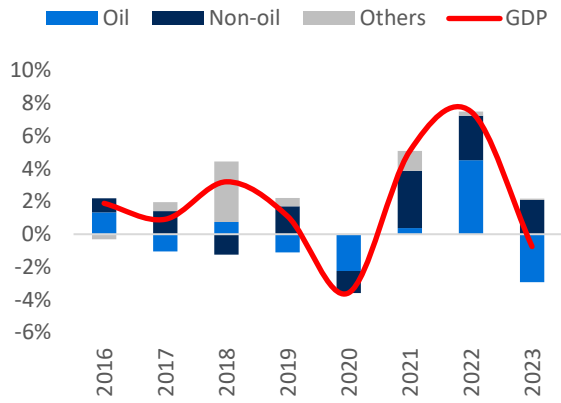
On an aggregate basis, for all six banks, we forecast the lending portfolio to grow at a CAGR of 12% over the next five years. Growth will likely remain broadly stable in 2024e, albeit marginally better paced. Corporate-focused banks, particularly SAB and Alinma, saw exceptionally strong growth in 2023 thanks to favorable positioning, which benefited from project-based lending in addition to market share gains in the corporate segment. We expect this trend to continue, underpinned by their aggressive strategy focused on growth. We expect Albilad and Al Rajhi to report single-digit growth in 2024e. Albilad growth will be the slowest among our coverage due to high exposure in the real estate sector without much contribution from project financing and relatively weak performance in 9M24; +5% YoY for Albilad vs. 12% YoY aggregate for our covered banks. However, deeper into the monetary loosening cycle in 2025-26e, we expect retail focus banks' lending growth to pick up pace and catch up with the other banks.

Growth supported by a strong macroeconomic backdrop

The economic backdrop has been positive thanks to industrial, legal, and social structural reforms implemented under Vision 2030. In addition, the supportive commodity price environment in recent years has significantly boosted overall expansion. In 2022, Saudi Arabia's economic growth was the highest among the G20 countries, and its GDP expanded at its fastest pace in the last decade. While overall growth slowed down in 2023 on oil output cuts, non-oil growth sustained its strong expansion momentum. This came despite the global headwinds of restrictive monetary stance and global inflation pressures, with non-oil GDP growth over the 3.5% mark for the third consecutive year.

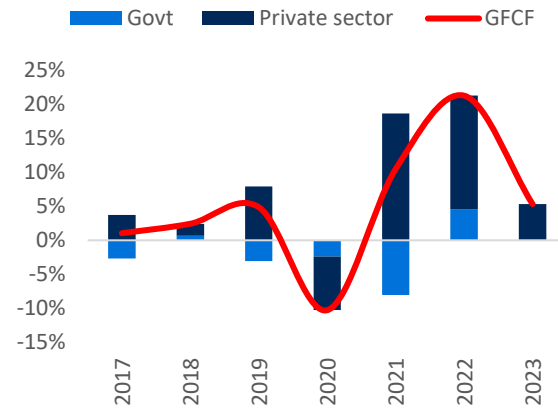
In our view, a resilient and buoyant non-oil expansion had been well supported by the government's commitment to Vision 2030 reforms, strong fiscal buffers, and a growing domestic demand underpinned by consumption and investment growth. GDP by expenditure for Saudi Arabia showed that gross fixed capital formation, a proxy for investments, grew over 5% YoY in 2023 in real terms, thanks to a 6% growth in private sector investments.

Chart 21: Overall GDP growth supported by expansion in the non-oil sector



*Weighted Average YoY growth in %
Source: GASTAT and anbc research

Chart 22: 5% YoY investment growth led by the private sector in 2023

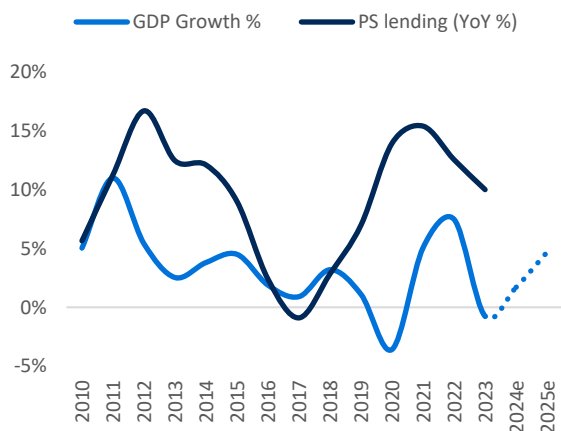


*Weighted Average YoY growth in %
Source: GASTAT and anbc research

Accelerated progress on infrastructure projects coupled with this strong macroeconomic environment and improved investment growth should bode well for credit generation, especially within the corporate sector. This is also evident from a strong historical correlation between GDP growth and credit growth. Since growth historically had been primarily banked upon oil activities, a strong correlation can also be seen with oil prices, as elevated oil prices resulted in a pickup in economic growth and, resultantly, in credit demand. From another point of view, increased fiscal spending also had been linked with commodity prices as increased spending followed growth in oil revenues historically.

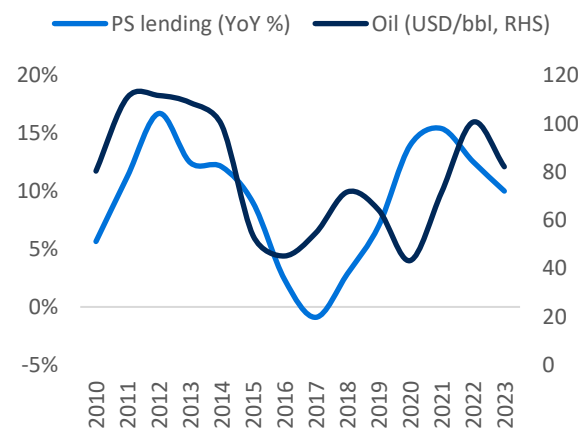
However, we don't necessarily expect commodity prices to be the core factor driving credit demand as the growth dynamics transition from oil output to non-oil sector growth. As economic growth picks up (IMF expects Saudi Arabia's GDP growth to increase to 4.6% in 2025, with non-oil growth remaining above 3.5% throughout), private sector credit growth will follow with an additional impetus from a less restrictive monetary policy stance.

Chart 23: Accelerated economic growth to support credit expansion



Source: IMF, SAMA, and anbc research

Chart 24: Lending growth historically followed oil prices



Source: Bloomberg, SAMA, and anbc research

The country's ambitious infrastructure development plans possibly provide the most favorable tailwinds for credit expansion from project financing. The government has earmarked cUSD1.3trn in real estate and

infrastructure development for the five giga projects, with over cUSD300bn in projects already commissioned since the launch of its National Transformation Plan in 2016, according to MEED. This has been accompanied by the newest addition of the Riyadh Expo 2030, where the government plans to spend cUSD7.8bn on staging the Expo, 2029 Asian Winter Games to be held in Trojena, Neom, and the country has also emerged as the sole bidder to host FIFA’s World Cup 2034, further anchoring the country’s strong investment drive.

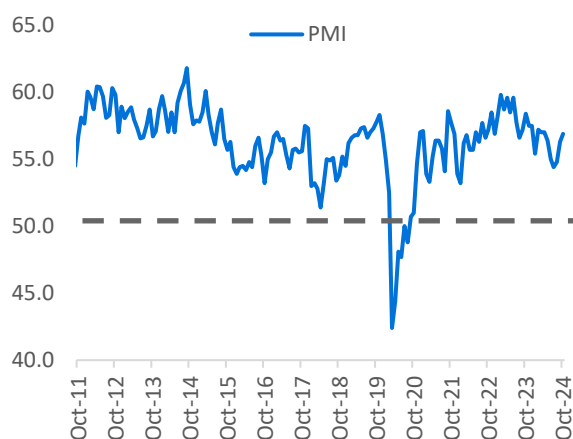
However, there have been recent announcements to delay some of the country’s giga projects past their initial timeline of 2030. According to various news reports, the shift in the timeline comes as the priority for project delivery changed and to avoid supply bottlenecks constraints. However, we see this delay in project completion as reprioritizing the most important projects, necessitating the need for project deliveries ahead of the Asian Winter Games, Expo 2030, and FIFA World Cup tournament in 2034.

Project awards have only started to pick up in recent years, especially post-COVID years, and high-frequency data supports accelerated project implementation. SAMA’s data showed that the new LCs for machinery and building materials imports averaged over SR3bn per month in 1H24, the highest since 2014, indicating an accelerating pace of civil works in the country. In this regard, it has also been encouraging that the Bank’s management continues to indicate an accelerated drawdown of financing facilities by contractors of some of the Giga projects, while some delayed projects are being offset by projects that are set to be completed earlier than previously planned.

Moreover, we see unprecedented credit opportunities from infrastructure projects under Vision 2030. To put into perspective, the planned USD1.3trn in project spending is nearly 3x the country’s total reserve assets and nearly 1.7x the estimated value of PIF’s 2023 assets under management. Saudi financial system alone cannot fund these projects; hence, we expect the utilization of the international debt and fixed-income markets to be crucial. This is evident from the recent bond issuance, where Saudi Arabia was ranked the top issuer of foreign bonds in 1H24, with over USD33bn in bond issuance ahead of China, which has historically been the most active in the global debt market.

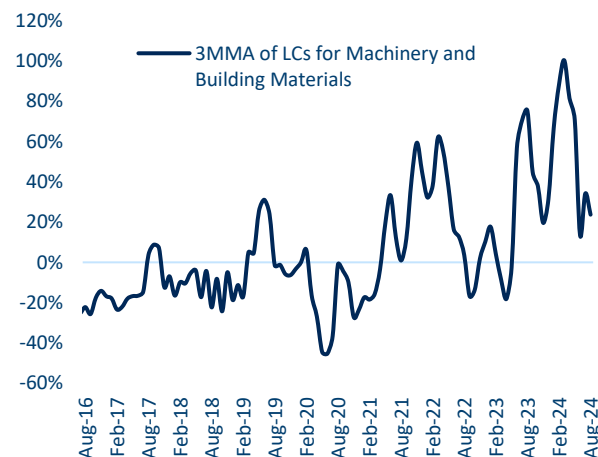
That said, funding for giga projects should still offer Saudi banks ample room for credit growth. According to the MEED Projects, out of the planned USD900bn construction projects, there is still a need for over USD600bn (SR2.25trn) in additional financing over the next five years. Based on our back-of-the-envelope calculations, even if 60% of this pipeline is funded through debt, this makes up for nearly c57% of current total private sector lending – at 70% debt to equity, this takes an additional credit requirement of 67% for project financing only.

Chart 25: PMI index showed continued momentum of expansion in non-oil business activity



Source: Reuters and anbc research

Chart 26: Imports for machinery and building materials markedly picked up in recent quarters



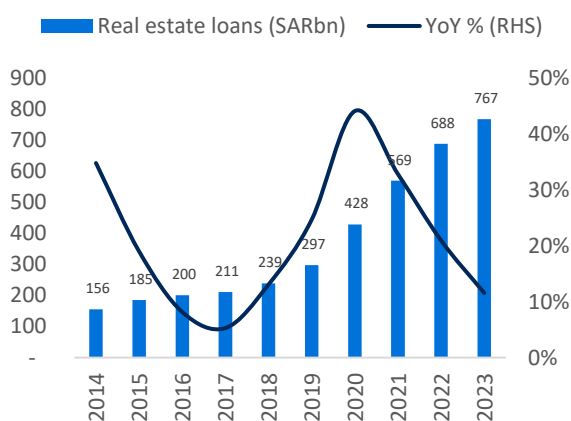
Source: SAMA and anbc research

In the retail sector, we think mortgages will continue to be the driving factor for growth as there is still room for improved penetration marred by supply constraints of ready units. This is supported by the government's homeownership targets of 70% and over 335K new real estate financing contracts by 2025e. According to the population consensus of 2022, nearly 40% of Saudi National households still don't own a house.

To illustrate the credit opportunity from mortgages, based on our back-of-the-envelope calculation, if the number of households grew at a CAGR of 2% from the 2022 baseline, the target of 70% ownership would imply nearly 890K new residential units, and if even 60% of these are financed by a mortgage that would require over 530K new contracts. At the current average mortgage finance per contract of SR750K, this translates into SR400bn in additional mortgage financing, which is 66% of current retail real estate lending. If the house ownership targets are met and the number of households continues to expand, this implies an 8% CAGR in retail mortgages by 2030.

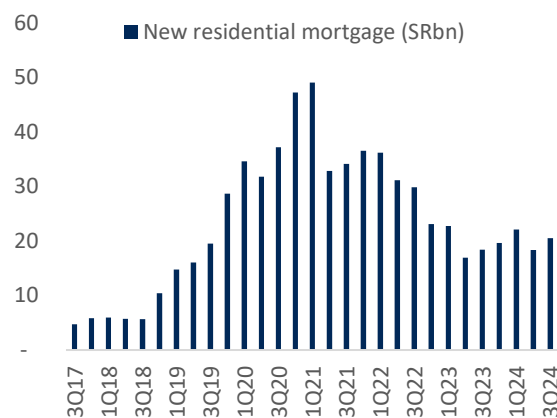
While retail mortgage loan growth moderated in 2023 from a very high base last year, the new origination trend has remained broadly stable, with over SR18bn/quarter since the start of 2023. Residential mortgage originations averaged SR20bn/quarter in 1H24, indicating still a relatively resilient appetite for mortgage financing in the country.

Chart 27: Total real estate loan growth moderated from a high base to 10% YoY in 2023



Source: Riyadh Bank and anbc research

Chart 28: Residential mortgage originations averaged over SR20bn per quarter in 9M24



Source: SAMA and anbc research

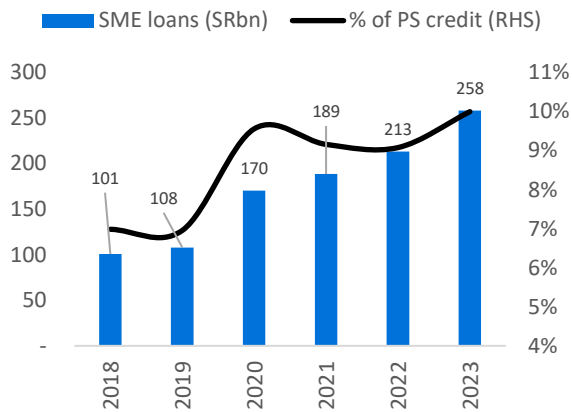
Post the success of the housing program, focus has recently shifted towards the SME sector, which is seen as the key to driving the government's economic transition away from the oil sector and potentially driving the next leg of very strong credit expansion. The FSDP aspires to increase the share of SME financing to the total private sector to 20%, a sizable contribution, vs. only 8% at the end of 2023.

To support the credit demand from the SME sector, the government rolled out different programs, including the SME bank and the Kafalah program, a financial guarantee scheme allowing access to cheap credit for the SME sector. In a recent interview, the CEO of the Kafalah program, Homam Hashem, indicated that the program issued financial guarantees of over SR12bn, resulting in a credit expansion of over SR15bn (c7% of the total private credit expansion in 2023), which increased 11% YoY.

A supportive regulatory environment, government-sponsored schemes, and a renewed commitment to enhance SME sector penetration, accompanied by a robust economic backdrop, remain key supporting factors for SME financing growth. While the magnitude of this SME lending would remain short of the project and sizeable corporate financing in the short run, we see this core part of most banks' growth strategy to position themselves in the SME sector to benefit from secular tailwinds of rising credit demand.

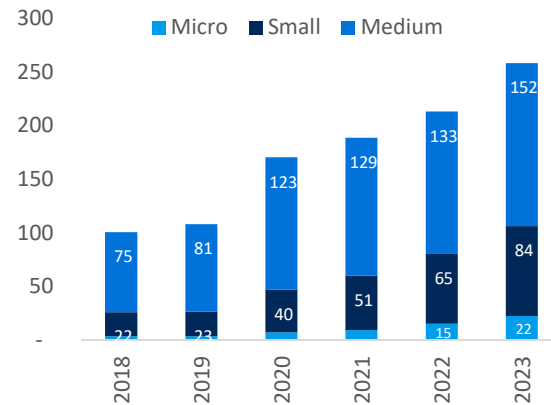
While nearly all banks have been expanding their footprint in the SME sector, the most notable has been Riyadh Bank. It is the leading bank in the sector, with a market share of 22% at the end of 9M24, and its SME financing portfolio is growing by 20% YTD. Despite a slightly higher NPL formation, the sector offers attractive spreads and better pricing.

Chart 29: SME sector loans now account for 8% of the total PS credit (vs. 20% target under Vision 2030)



Source: SAMA and anbc research

Chart 30: Composition of SME loans provided by Banks (in SRbn)



Source: SAMA and anbc research

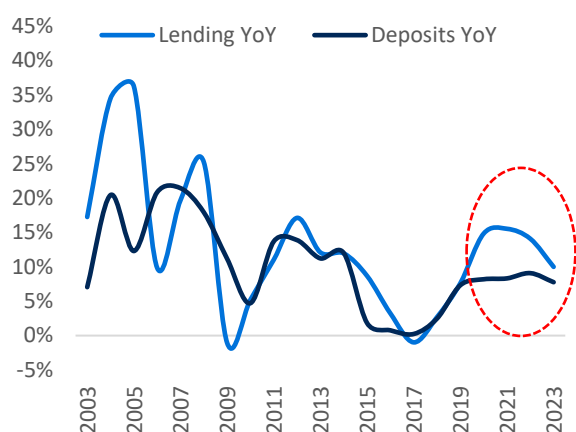
Funding remains challenging; there are no major concerns about asset quality

Liquidity dynamic remains tight managed by AT capital and interbank liabilities

Funding the relatively robust lending growth outlook has been a key question for the Saudi Arabian banking sector. These concerns have emerged more prominently as lending growth continues to outpace deposit growth, resulting in a sharp increase in headline LDRs amidst tight liquidity in the banking system. The latter is evident from the elevated USD SOFR and SR SAIBOR spreads in the interbank market, as banks have actively tapped interbank funding to meet their liquidity requirements. This has also come alongside banks actively pursuing additional tier (AT) capital and bond issuance in recent years.

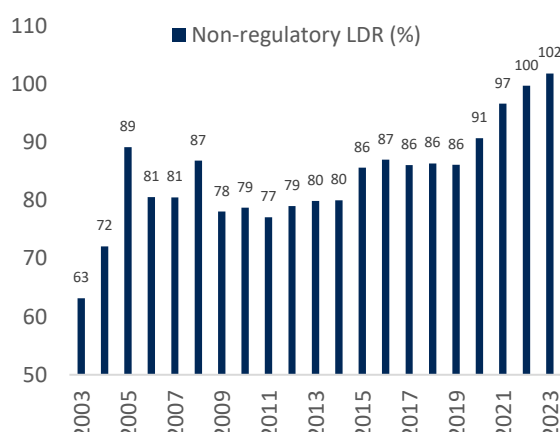
Overall, private sector credit growth outpaced the growth in total deposits for the fourth consecutive year since 2020, with credit expanding by a CAGR of 14% as opposed to only an 8% growth in deposits. This led to non-regulatory LDR (defined as credit to the private sector divided by deposits) increasing to over 101% at the end of 2023, which implies that credit exceeded total deposits in the system.

Chart 31: Lending growth continues to outpace growth in deposits



Source: SAMA and anbc research

Chart 32: Non-regulatory LDRs have exceeded 100% at the end of 2023

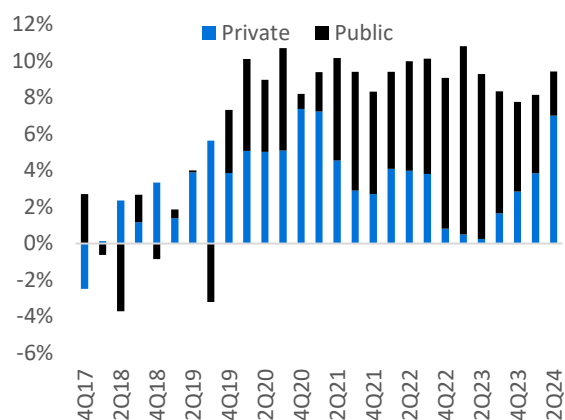


Source: SAMA and anbc research

While lending growth momentum had been relatively strong thanks to the renewed capex cycle fueled by giga projects and a very strong expansion in overall economic activity, deposits have failed to catch up. Data shows that the bulk of the deposit growth continued to come from the public sector, with its overall contribution increasing to nearly 38%, up from 29% in 2019, as government entities increasingly placed deposits with the local banks. Yet it had not been sufficient, which has come as a surprise considering the elevated oil price environment in recent years.

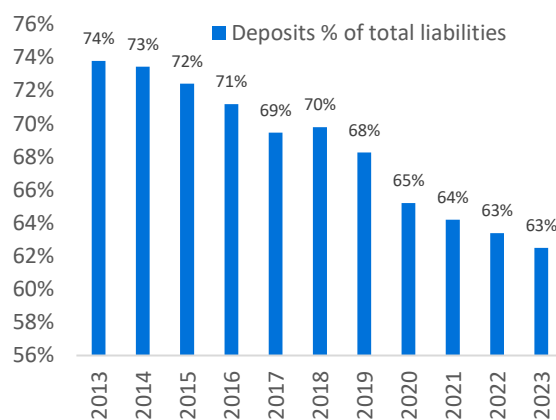
However, part of this could be explained by the government keeping surplus excess from the previous year in foreign accounts and rerouting it through PIF and NDF (National Development Fund) to support its Giga Projects as opposed to financing the budget. The drawdown is supposedly being done in a phased manner throughout the period of requirement rather than direct deposits in the local financial systems. Government direct deposit with SAMA has cumulatively declined by 27% in the past four years. This was compensated for by deposits from quasi-money and government-owned entities, which increased 67% during the same period, accounting for 24% of total liabilities.

Chart 33: Deposit growth in 2023 primarily came from the public sector placements



*Weighted average YoY growth in %
Source: SAMA and anbc research

Chart 34: Deposit contribution to overall sector liabilities lowest in the last two-decade



Source: SAMA and anbc research

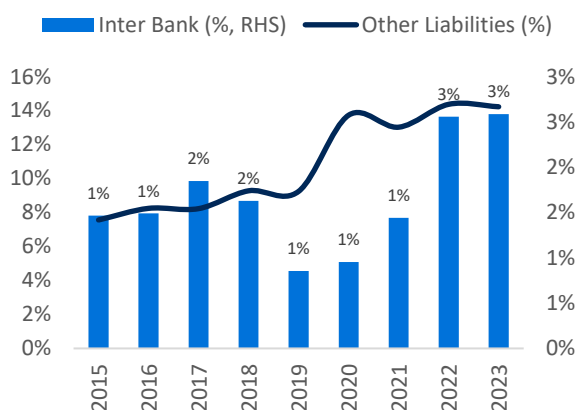
If we take total lending assets as a sum of loans provided to the public entities and the private sector, they have exceeded the total banking deposit for the second consecutive year; loans exceed deposits (funding gap) by SR110bn at the end of 2023. However, using the same numbers, that is, total credit without investments in government or private sector securities, the liquidity pressures have shown signs of some relief in 1H24. Total deposit growth increased by SR196bn in YTD (+8%) during 1H24, exceeding the 7%YTD growth in total credit, which grew by SR168bn, leaving the gap between total deposits and credit narrowed down to SR82bn.

However, this tight deposit liquidity led to an increasing utilization of other avenues. SAMA data shows a marked increase in interbank and other liabilities, which combined increased to 17% of total liabilities from slightly above 10% in 2019.

Increased demand for liquidity was also met with periods of very tight dynamics in the interbank market, which is evident from the sharply rising spreads between USD SOFR and SAIBOR. However, these periods of tight liquidity were quickly met with SAMA's regulatory interventions. The system-wide liquidity position improved significantly once SAMA provided relief with a reported SR50bn deposit in 2022, and later, SAMA stepped up Open Market Operations, resulting in spread normalization quickly towards its long-term average.

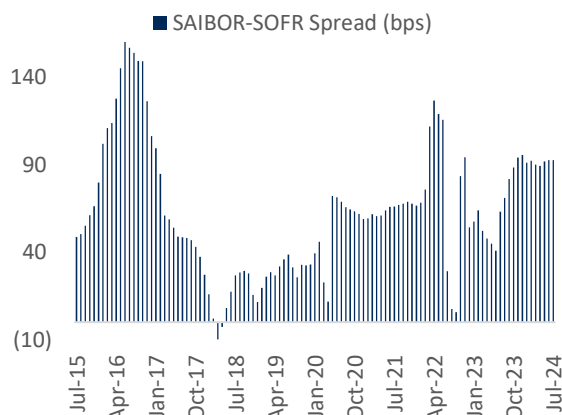
However, spreads have once again picked up in recent quarters and are estimated to be around 90bps by the end of 1H24 vs. the historical average of 50bps. While the dynamics haven't been as tight as seen in early 2022 when spreads exceeded 100bps, spreads have continued to increase over the past twelve months.

Chart 35: Interbank and other liabilities have increased as % of total liabilities



Source: SAMA and anbc research

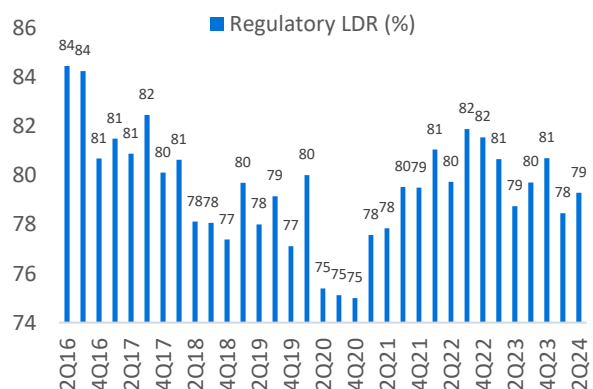
Chart 36: SAIBOR vs. SOFR spreads estimated around 90bps



Source: SAMA and anbc research

Besides relying on the interbank market, Saudi Banks have also raised liquidity through bond and AT capital issuance. Some of the most recent ones include Al Rajhi and Alinma’s USD1bn AT1 Sukuk capital raised in 2024; Riyadh Bank issued AT1 USD Sukuk in September. SNB and SAB were the latest additions to pursue AT1 issuance in 4Q24. Meanwhile, recent bond issuance includes Al Rajhi’s USD1.9bn syndicated loan raised in Oct’24 along with senior unsecured Sukuk, which was issued in April 2024 and amounted to USD1bn.

Chart 37: Regulatory LDR down 177bps to 79% in 2Q24 from its peak in 3Q22



Source: SAMA and anbc research

Chart 38: Nearly all banks under coverage have been active in AT capital and bond issuance

Bank	Month	Currency	Issuance	Size
SAB	Nov-24	SR	AT1	TBA
SNB	Nov-24	SR	AT1	6bn
Al Rajhi	Oct-24	USD	Sukuk	1.9bn
RIBL	Sep-24	USD	AT1	0.75bn
Al Rajhi	May-24	USD	AT1	1bn
Alinma	Mar-24	USD	AT1	1bn
Al Rajhi	Apr-24	USD	Bond	1bn
SAB	Oct-23	SR	AT1	4bn
SNB	Sep-23	SR	AT1	1bn
RIBL	3Q23	USD	Bond	1.2bn

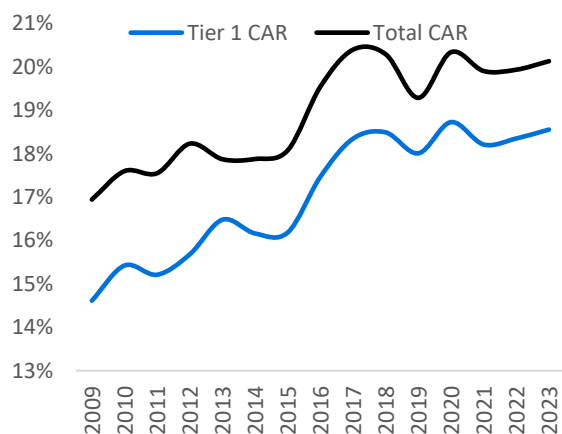
Source: SAMA and anbc research

However, the choice of debt/capital issuance has primarily been liquidity rather than improving the capital structure. Profitability continues to be robust, and Capital Adequacy levels have strengthened over the years, further boosted by the injection of additional capital in recent years. While some banks have indicated the need to strengthen their capital base in light of strong credit expansion, additional liquidity buffers remain a major catalyst for further capital issuance.

We think the demand for liquidity would continue to be met by additional capital/bond issuance by banks, in addition to continued reliance on the interbank market. Increasing spreads suggest tight dynamics but considering the active role of the central bank in the past, we believe any stress is likely to be met with regulatory interventions.

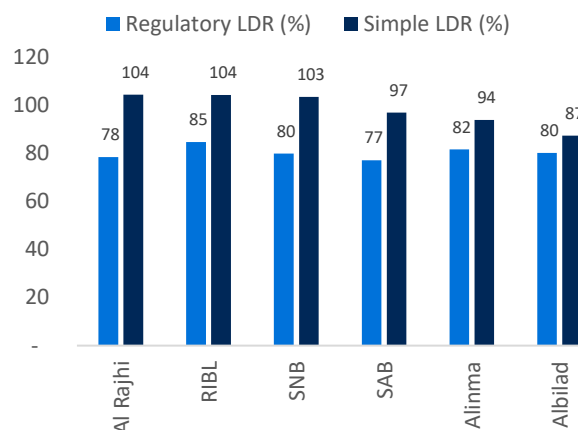
Moreover, there have been some signs of improved deposit liquidity in 1H24 (with additional pickup in private sector deposits growth), but a further pick-up would be even more necessary amidst a strong lending outlook. In this regard, we believed public sector deposits would continue to play a major role in driving deposit liquidity, coupled with a pickup in FDI, a key emphasis under Vision 2030, growing export orders, and rising income levels would support deposit growth in the medium term.

Chart 39: Capital ratios have continued to improve over the years



Source: SAMA and anbc research

Chart 40: LDRs remain relatively elevated across all banks



*As of 3Q24.

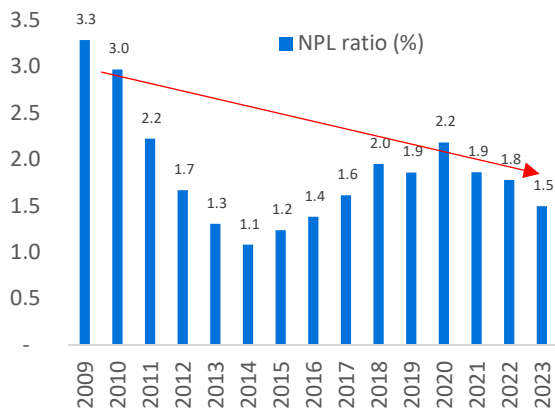
Source: SAMA and anbc research

Asset quality remains stable

The NPL cycle has consistently shown improvement in recent years, with overall NPL formation remaining largely subdued. An elevated oil price environment coupled with buoyant non-oil expansion has supported this NPL cycle, particularly during the post-COVID years. The graph below shows that the last cycle of uptick in the NPL ratio coincided with lower oil prices between 2015-18 and mundane growth overall. During the COVID period in 2020, the NPL ratio rose to 2.2%, which was the highest in the last decade or so, but massive regulatory support during that time prevented any significant stress to the country’s financial system. Since then, the NPL ratio has dropped to only 1.5% in 2023.

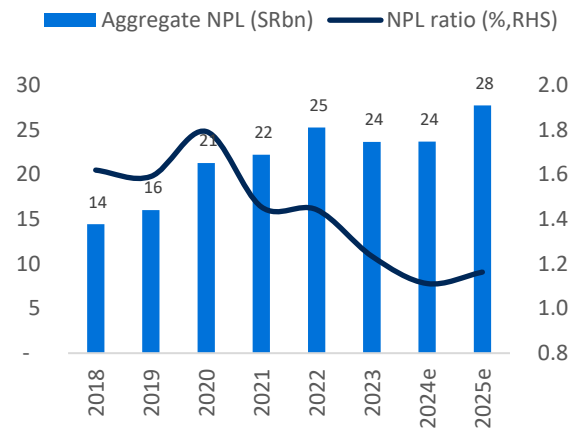
We see continued non-oil economic expansion coupled with structural improvement in the underlying economy to extend support towards the sustainability of the current cycle with the underlying trend in NPLs to continue. Apart from the legal and regulatory reforms, there has been a significant change in the lending mix as well, including an increased share of mortgages and project financing of the Giga project, both of which typically carry low default rates and a higher collateral value. In addition, economic transformation away from oil also lowers the susceptibility of NPL formation to global commodity cycles, which are volatile historically.

Chart 41: NPL cycle improved despite high levels of interest rates



Source: SAMA and anbc research

Chart 42: Within our coverage on aggregate, we expect NPLs to remain manageable

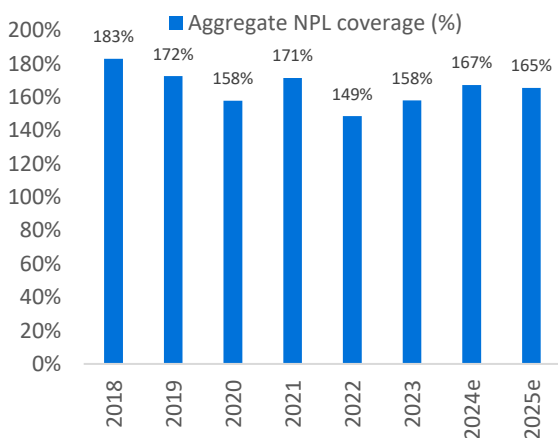


Source: SAMA and anbc research

For our covered banks, the aggregate NPL ratio improved from 1.6% in 2018 to 1.2% at the end of 2023. Not only have NPL formations been relatively subdued, but outstanding NPLs fell 8% YoY in 2023 thanks to improved recoveries. The most notable improvements in the NPL ratio were led by SAB, Alinma, SNB, and RIBL, delivering an improvement of up to c50bps, which predominately indicated an improved asset quality in the corporate segment.

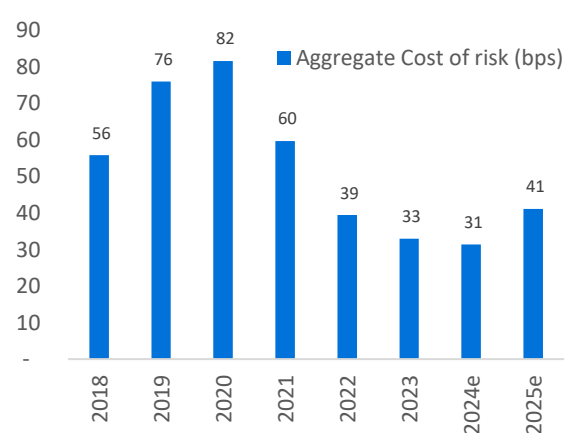
Meanwhile, proactive risk management by the banks meant that they utilized a strong economic environment to build up their provisioning coverage, which was true in most cases; the only exceptions were Al Rajhi and Albilad. On an aggregate basis, NPL coverage increased to 158% in 2023 from 149% at the end of 2022, though it has been slightly lower than the historical average, which we see as a function of improved asset quality in general.

Chart 43: NPL coverage remains adequate at over 158% at the end of 2023



Source: SAMA and anbc research

Chart 44: On an aggregate basis, the cost of risk has markedly declined over the last four years



Source: SAMA and anbc research

The latest developments on the Saudi Binladin Group (SBG) have been one of the key positives for the banking sector in improving asset quality. In Jul'24, Saudi Arabia's Ministry of Finance announced that it would take measures to assist the Saudi Binladin Group (SBG) in stabilizing its financial structure, involving a loan settlement with the banks. This had been a key overhang within the construction sector despite offering opportunities for solid growth. However, with this settlement, we think the bank's appetite to grow in the construction sector would further increase, and there could potentially be a reversal in provisioning.

There is very little public information and clarity on the magnitude of an impact on individual banks since disclosures on individual exposure are not available. However, we take cues from recent news reports and try to assess what could possibly be expected from this development. The National Debt Management Center (NDMC) reported raising syndicated loans for the Ministry of Finance amounting to SR23.3bn. Moreover, in a recent earnings presentation, Riyadh Bank and Saudi Awwal Bank's management indicated that the group's loans had been classified as Stage 2 under the ECL model.

Based on our back-of-the-envelope calculation, assuming the entire settlement amounts of SR23.3bn and the entire exposure is classified as stage 2 across all banks with an average 12.5% ECL allowance (typically between 10-15% for stage 2 loans), there could likely be c.SR2.3-2.8bn in a reversal of provisioning charge on a sector level. This accounts for 46% of the aggregate impairment charge for our covered banks in 2023. However, the impact on individual banks would vary depending on exposure, the classification under ECL models, and the extent to which the loans have been provided. Since NDMC financing was completed at the end of October, we might likely see this impact in 4Q24.

Digitalization in the banking sector

Digitalization efforts accelerating at an increasing pace

A key theme that has emerged in recent years has been the increasing focus on digitalization across the banking sector. This comes as efforts have been underway to improve operational efficiencies, which, in our opinion, would result in better cost-to-income over the medium term. Rapid advancement in digital infrastructure, including cloud and AI, has led to increasingly centralized operations and digital stacks, which have accelerated since 2019 and led to the optimization of banks’ physical branches as well.

The focus on digitalization is a pervasive trend across all the banks we cover, forming an integral part of their corporate strategies. While we anticipate that the initial infrastructure and system readiness costs may keep spending at elevated levels in the short term, the benefits of improved efficiencies are expected to become more pronounced in the medium term. Beyond operational efficiencies, digitalization also presents opportunities for customer acquisition through enhanced services and facilitates deposit mobilization and balance sheet expansion.

Another key driver of the digitalization wave in the banking sector is the emerging fintech industry. While still in its initial stages, the rapid expansion of this sector, particularly in the post-COVID era, has raised concerns about potential disruptions to traditional banking services. The number of fintech companies operating in the country is on the rise, and while their volumes are currently small, they are growing rapidly. We believe that certain areas of the fintech space, such as digital banks, digital wallets with Electronic Money Institutions (EMI), and Buy-Now-Pay-Later (BNPL), could potentially cause significant disruptions to traditional banking services.

In our analysis, digitalization progress at Al Rajhi Bank has been quite noticeable, which boasts a large active digital customer base, high digital penetration, and direct exposure to the fintech industry through its subsidiaries. SNB and SAB follow closely, with high digital penetration across their operations and customer base, along with notable improvements in their mobile applications and digital platforms for newer segments. Alinma is also progressing in digitalization, with improvements to its digital platform and a presence in fintech through Alinma Pay. Similarly, Albilad is making headway in the fintech space through its Enjaz application.

The table below compiles some of the digital statistics provided by the banks

Bank	Digital Statistics
Al Rajhi Bank	12.6mn active digital customers in 2023, up from 7.9mn in 2020 (vs. 15.8mn total customers) 80% of all active customers utilize digital channels 95% of new retail account openings through digital channels 86% of new corporate account openings through digital channels
Alinma Bank	70% of new deposit accounts were opened digitally in 2023 30% of sales of cards and personal finance digitally 40% growth in digital transactions
Bank Albilad	14% increase in mobile app users 71% of new retail accounts opened digitally 48% increase in total accounts opened digitally
Saudi Awwal Bank	Digital penetration increased to 86% in 2023 vs. 73% in 2021.
Saudi National Bank	85% of retail and 77% of wholesale digital penetration of customers 82% of new retail accounts were opened digitally, and 73% of sales of retail products digitally 70% of wholesale accounts opened digitally

Source: Company financials and anbc research

Al Rajhi Bank's mobile application has the highest number of downloads, reflecting its vast retail customer base and highest number of active digital customers at 12.6mn. Moreover, its new retail account opening through digital channels is nearly 95% and 86% for corporate clients in 2023, indicating robust digital penetration. This is followed by SNB, with an 85% retail and 77% wholesale digital penetration coupled with 82% retail accounts and 70% wholesale segment accounts being opened digitally. Meanwhile, Alinma and Albilad reported that nearly 70% of new accounts are being opened digitally.

Nearly all banks have been trying to improve their mobile applications and digital offerings. For instance, SAB recently launched an SME digital credit platform and expanded its payment connectivity with HSBC's global platforms. Similarly, SNB also launched a dedicated digital platform for MSEMs and enhanced services for its mobile applications. Meanwhile, Riyadh Bank launched a new retail application this year.

Looking at the bank's direct exposure in the fintech space, Al Rajhi Bank's presence is the most prominent. Through its subsidiary Neoleop, the bank offers a digital wallet under "UrPay" and other payment gateways, as well as solutions including international and local money transfer services. The bank also has a digital consumer finance lending arm under Emkan Finance Co, offering microfinance lending, auto leasing, and credit card products. Similarly, Alinma Bank's subsidiary also offers digital wallets under "Alinma Pay" and Albilad through its Enjaz application, both licensed by SAMA as Electronic Money Institutions (EMI) and offering payment services, including international and local transfers.

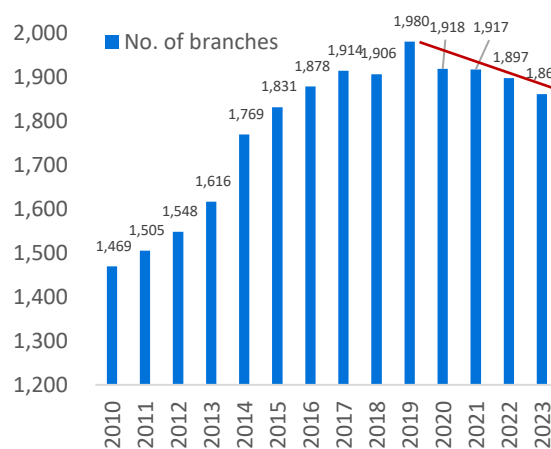
Table 45: Mobile Application Download and Ratings

Bank	Download	Ratings	No of reviews
Al Rajhi	10mn+	4.6	1.2mn
Albilad	1mn+	3.7	16.5K
Alinma	1mn+	4.9	86K
SAB	1mn+	4.4	40.1K
SNB	1mn+	4.8	226K
BJAZ	1mn+	3.9	10.4K
BSF	500K+	4.3	12.4K
ANB	100K+	4.8	10.1K
SAIB	500K+	4.5	6.25K

As of December 2, 2024.

Source: Google Play store

Chart 46: Digitalization also led to increasing optimization of banks' physical branches



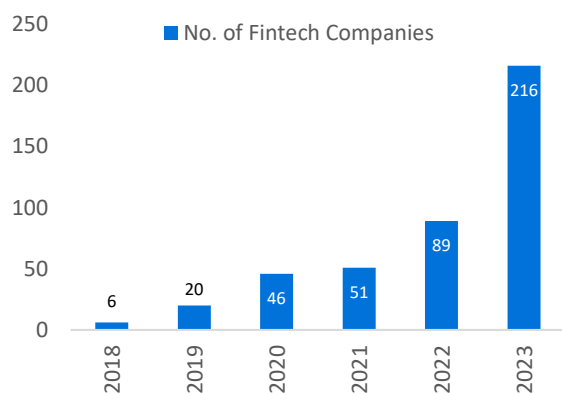
*No of physical branches of 10 local banks operating in Saudi Arabia
Source: SAMA and anbc research

Fintech could potentially emerge as a potential disruption

Traction in the fintech industry has markedly accelerated in recent years, with the total number of fintech companies operating in the country reaching 216 in 2023 vs. only 20 in 2019. A supportive regulatory environment with FSDP targeting 80% non-cash transactions in the country by 2030, a large proportion of the young population (51% below the age of 30), above 95% smartphone and internet penetration, and increasingly improved digital infrastructure and connectivity have been key supporting factors for the growth in the fintech industry. Now, with the open-banking services, which allow connectivity to financial sector data, it would further boost growth.

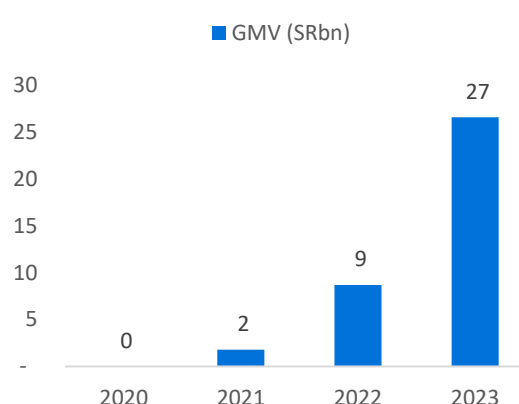
The fintech industry is growing rapidly, and we think it could potentially disrupt some of the traditional banking services. This includes international payment transfers and deposits taken by Electronic Money Institutions (EMI), BNPL serving as an alternative for credit card loans, and digital banks when they start operations, potentially adding to the tough competitive landscape.

Chart 47: The number of fintech companies increased from 20 in 2019 to 216 by 2023



Source: SAMA and FSDP

Chart 48: Gross Merchandise Value (GMV) of goods sold with BNPL nearly tripled YoY in 2023



Source: SAMA and FSDP

In the table below, we highlight some of the fintech companies in key areas that we think would be important from the banking sector’s perspective.

Table 3: Fintech companies

Company	Ownership	Description
Electronic Money Institution (EMI)		
STC Pay	STC Group	Services include integrated digital wallet, payments, and money transfers. Transitioning into STC Bank
International Financial Digital Solutions Company (Neoleap)	Al Rajhi Bank	Digital Wallet and Payment gateway. Services provided under its "UrPay" digital platform
Saudi Financial Technology Company- Alinma Pay	Alinma Bank	Digital wallet offering payment services and money transfers
Enjaz Payments Services Company	Bank Albilad	Integrated financial solutions that include payment services, digital wallets, international and domestic money transfers
Ethihad Fintech Company (Mobily Pay)	Ethihad Etisalat Co	Digital wallet offering payment services and money transfers
Payment Institution (PI)		
Sure Pay Company (Sure Pay)	Sure Global Tech Co	Payment solutions for POS
Alwans for Information Technology Company (Foodics)	Ahmad Al-Zaini	SaaS, including POS payment solutions for the F&B industry
Buy Now Pay Later (BNPL)		
MIS FORWARD	Al Moammar Information Systems Co	Offering BNPL services through its "MIS Pay" platform
Tamara finance company	Abdul Majeed Alsukhan, Turki Bin Zarah & Abdul Mohsen Al Babbain	Among the first companies to be licensed by SAMA for BNPL services
Tabby Saudi for Communication and IT Company	Hosam Arab	Offering BNPL services across UAE, Kuwait, and Saudi Arabia
Digital Banks		
STC bank	STC Group	The pilot version was launched for selective customers and transitioning from STC Pay into the digital bank's platform
Vision Bank		SAMA has approved the license, and the bank is in initial phases of commencing operations
D360 Bank	PIF & Derayah Financial Co	Set up by a consortium of investors led by Derayah Financial Co. It is in the process of commencing operations
Opening Banking Services		
Lean Technologies	Hisham Al-Falih, Aditya Sarkar, & Ashu Gupta	Offering B2B data and payments integration infrastructure and APIs and operating in UAE and Saudi Arabia with over 170 clients
Mod5r	Jubran Alshahrani & Waleed Almutairi	Offering banking integration solutions

Source: SAMA, Company website and anbc research

Digital Banks:

Digital Banks leverage IT infrastructure stacks to offer banking services that are entirely online without any physical touch points. Accelerated adoption of technology and increasing preference for digital channels offering ease of access to conducting financial transactions, particularly for retail clientage, has led to increasing acceptance of Digital Banks globally.

Reliance on digital infrastructure allows such banks to achieve significant cost efficiencies without bearing the cost of running physical branches. In addition, a high level of process automation offers flexibility and better customer service.

SAMA has so far provided licenses to three digital banks in Saudi Arabia, two of which have already started pilot projects and are expected to launch commercial operations soon. Considering the high digital penetration in Saudi Arabia (Al Rajhi reporting over 95% of new retail accounts opening digitally), these digital banks would add competition to traditional banking, especially for banks with large retail clients.

- **STC Bank:** Established by STC Group, the bank has already launched its pilot version for some selective customers and is expected to launch full commercial operations this year. After approval from SAMA, STC Pay, the digital wallet application, will be integrated into STC Bank.
- **D360 Bank:** It is owned by a consortium of investors, including PIF and Derayah Financial Co, which is expected to lead the bank's operations. The bank has launched the pilot application and is targeting to offer entire Islamic banking services for retail and corporate clients.
- **Vision Bank:** SAMA has officially licensed the bank, and it is in the initial phases of commencing full-scale operations.

Key Takeaways from 3Q24 Earnings

Lending growth remains strong, driving overall earnings growth

3Q24 earnings result table:

	Net Income			NIMs (%) annualized			Non-Interest Income			Opex-to-income (%)			Cost of risk (bps)			Lending			Deposits			Investments			Simple LDR (%)			RoE (%) - annualized			RoA (%) - annualized		
	3Q24	YoY	QoQ	3Q24	YoY	QoQ	3Q24	YoY	QoQ	3Q24	YoY	QoQ	3Q24	YoY	QoQ	YoY	YTD	YoY	YTD	YoY	YTD	YoY	YTD	3Q24	2Q24	3Q23	3Q24	2Q24	3Q23	3Q24	2Q24	3Q23	
Al Rajhi	5,107	23%	9%	3.2	15 bps	13 bps	2,042	39%	15%	25%	(253) bps	(109) bps	10 bps	4 bps	3 bps	10%	9%	10%	9%	26%	20%	10%	10%	104	100	104	21.5	20.0	19.4	2.3	2.2	2.1	
SNB	5,366	7%	3%	2.8	(24) bps	(15) bps	2,330	22%	25%	31%	(40) bps	37 bps	3 bps	5 bps	2 bps	10%	9%	2%	7%	9%	8%	10%	10%	103	101	95	12.7	12.6	12.9	1.9	1.9	1.9	
Alinma	1,571	19%	11%	3.6	(15) bps	0 bps	595	11%	0%	30%	15 bps	(10) bps	10 bps	(7) bps	(6) bps	16%	13%	16%	11%	15%	9%	10%	10%	94	92	94	19.4	18.1	18.6	2.4	2.2	2.3	
SAB	1,883	3%	-7%	3.1	(31) bps	(10) bps	767	15%	1%	30%	(172) bps	(34) bps	12 bps	5 bps	7 bps	19%	17%	14%	8%	10%	1%	10%	10%	97	91	93	12.5	13.7	13.2	1.9	2.1	2.2	
RIBL	2,654	27%	14%	3.3	(34) bps	(12) bps	1,252	39%	39%	29%	(388) bps	(188) bps	9 bps	(4) bps	3 bps	14%	11%	15%	15%	14%	13%	10%	10%	104	105	105	18.8	16.8	16.4	2.4	2.3	2.2	
Albilad	703	14%	5%	3.4	4 bps	11 bps	286	1%	-11%	42%	(102) bps	109 bps	5 bps	(2) bps	(3) bps	5%	5%	12%	8%	7%	4%	10%	10%	87	91	93	17.4	17.0	16.9	1.8	1.8	1.8	

*NIMs, RoE, and RoA calculations are based on annualized numbers without averaging. The cost of risk is calculated using net financing.

Source: Company financials and anbc research

- Profitability:** The aggregate adjusted profitability of our six banks expanded by 15% YoY/6% QoQ in 3Q24, primarily driven by sustained strong lending growth and lower credit provision costs and margin gains for some banks. SAB profitability growth was the weakest, growing by only 3% YoY while it declined by 7% QoQ despite the most robust lending growth; lower NIMs and higher impairments resulted in this lower profitability. Meanwhile, Riyadh Bank's profitability expanded quite strongly, up 27% YoY/14% QoQ, primarily on a significantly lower C/I ratio, lower credit impairment charges, and a strong growth in NII.
- Net-interest Margins:** We estimate that net interest margins, on average, declined 14bps YoY, though they were broadly flat on a QoQ basis. Nearly all banks, except for Al Rajhi and Albilad, reported a YoY margin decline primarily due to the higher cost of funds. According to our calculations, RIBL saw the most contraction, down 34bps, followed by SAB, which also reported a 31bps YoY decline in net interest margins; SAB's and RIBL's margins also fell sequentially as the impact of CASA migration filtered through this quarter with a higher cost of funds. For SNB, net interest margins fell both on a YoY and QoQ basis, which we think has been weighed by pressures on its international business and the higher cost of funds for domestic business.
- Non-interest income:** Total non-interest income was up 26% YoY/17% QoQ in 3Q24. All banks reported positive YoY growth, led by RIBL and Al Rajhi, whose non-interest income sharply increased by 39% YoY for both. This was followed by SNB, whose non-interest income recovered 22% YoY after expanding 25% sequentially. Albilad reported the weakest growth in NII, up only 1% YoY, as it declined 11% QoQ.
- Opex:** Total operating expenses increased by 6% YoY/4% QoQ, slower than the growth in operating income. All banks reported an increase in operating expenses on a YoY and QoQ basis, except SAB, which was relatively flat sequentially. Despite this, the cost-to-income ratio for most banks improved, with the only exception being Alinma. Al Rajhi continues to have the lowest cost-to-income ratio at 25% in 3Q24, down 254bps YoY/109bps QoQ.
- Cost of Risk:** Total impairment provisioning charges increased by 50% YoY/39% QoQ, driven by higher impairment charges reported by Al Rajhi, SNB, and SAB. Both Al Rajhi and SNB recorded the highest increase in impairment charges. For SAB, the higher charges reflected lower recoveries during the quarter. Meanwhile, Alinma, RIBL, and Albilad

reported lower impairment charges. Resultantly, for these three banks, the cost of risk declined, led by Alinma, down 7bps YoY, followed by RIBL, down 4bps YoY. Meanwhile, SNB reported the highest increase in the cost of risk, up 5bps, followed by Al Rajhi.

- Lending Growth:** Lending growth has been markedly positive, with sustained strong momentum; the total lending portfolio of our covered banks grew by 12% YoY/10% YTD in 3Q24. Corporate-focused banks led the growth, driven by growing project financing, with SAB reporting a 19% YoY/17% YTD growth, followed by Alinma with a 16% YoY/13% YTD growth. Albilad reported relatively slower growth in its lending portfolio, which we think is due to its relative position in the corporate sector, without much contribution from project financing. Al Rajhi and SNB reported improved growth, up 10% YoY/9% YTD for both banks. Overall, the growth of corporate banks outpaced the expansion of retail-focused banks.
- Investments:** Surprisingly, the investment book picked up its pace of expansion as banks tried to benefit from the still elevated rate environment. The total investment portfolio of our cover banks grew by 13% YoY/10% YTD. Al Rajhi reported the strongest growth, with its investment book up 26% YoY/20% YTD, followed by Alinma, up 15% YoY/9% YTD.
- Deposits:** Deposits growth continues to lag the increase in lending, leading to elevated non-regulatory LDRs. Deposits were up 9% YoY and have grown 9% YTD. However, the deposit growth for 3Q24 was only 1% QoQ. RIBL and Albilad's performance in deposit mobilization has been most notable, with 6% and 7% QoQ growth, respectively. On a YoY basis, Alinma, SAB, and RIBL performance has been strongest with 16% YoY, 14% YoY, and 15% YoY growth in deposits, respectively. Barring RIBL and Albilad, nearly all banks reported a higher non-regulatory LDR QoQ, while SNB saw the highest increase in LDR from 95% in 3Q23 to 103% in 4Q24. Al Rajhi and RIBL have the highest non-regulatory LDRs at 104%.

Revised 2024 guidance (with 9M24 actual):

	Financing Growth	Net Interest Margins	Cost to Income	Cost of Risk	RoAE
Al Rajhi	Low Teen (+9% YTD)	+10bps to +20bps (+9bps YoY)	Below 25.5% (25.4%)	30-40 bps (33bps)	Above 20% (20.5%)
SNB	Low Double Digits (+9% YTD)	-15bps to +5bps (-12bps YTD)	Below 28% (28.4%)	15-25 bps (22bps)	16-17% (16.3%)
Alinma	High Teens (+13% YTD)	-10bps to 0bps (-9bps YoY)	Below 31% (31.0%)	50-60 bps (56bps)	Above 18% (18.6%)
RIBL	Low Double Digits (+11% YTD)	-10bps to -20bps (-21bps YTD)	Below 31% (30.7%)	55-65 bps (51bps)	Above 16% (17.1%)
SAB	Mid to High teen (+17% YTD)	-19bps to -09bps (-17bps YTD)	Below 31% (30.6%)	25-40bps (28bps)	15-16% (15.8%)
Albilad*	Low Double Digits (+12% YoY)	-1bps to +14bps (-30bps YoY)	+100 bps (44.1%)	30-40 bps (33bps)	Maintain (16.5%)

*For Bank Albilad, guidance is as of 4Q23 with 2023 actual in brackets. For SAB, it is Return on Tangible Equity.

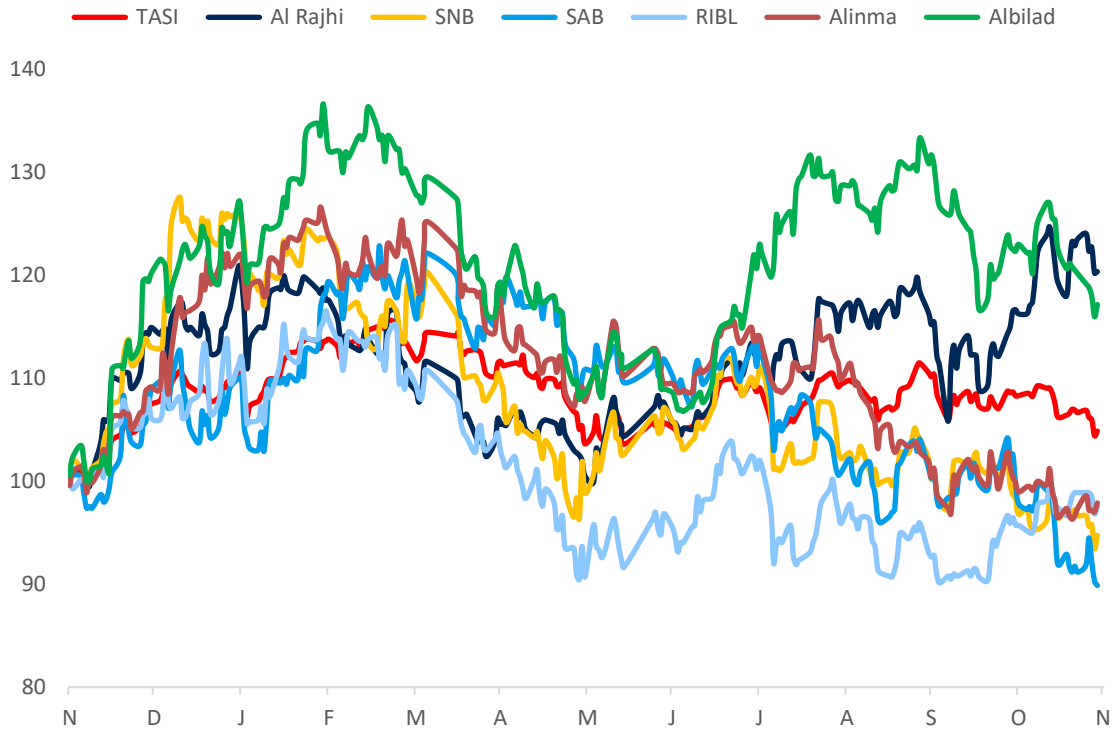
Source: Company Presentation and anbc research

Looking at the last revised guidance for 2024, issued in the 3Q earnings presentations, the most notable revision across all banks was the lower cost of risks and improved cost-to-income ratios. Barring Al Rajhi and Riyadh Bank, nearly all banks lowered their cost of risk guidance for 2024 on improved asset quality with declining NPLs, which had been supported by a strong macroeconomic backdrop. Alongside this, except for SNB and Alinma, banks also lowered their guidance for cost-to-income ratio on better-than-expected expansion in operating income. Meanwhile, Alinma and SAB also lowered their NIM guidance primarily on elevated pressures from the cost of funds, while Al Rajhi increased its margin expansion expectations on sharp cuts in interest rates in 2H24 and positive momentum in repricing of the legacy portfolio. Al Rajhi was the only bank to raise its guidance on loan growth, which is expected to be in the low teen digits vs. guidance of single-digit growth previously. This primarily reflected a pickup in the underlying growth trends in 3Q24. Previously, in the 2Q24 earnings calls, the most notable revision was upward guidance for loan growth, especially by corporate-focused banks.

Valuation

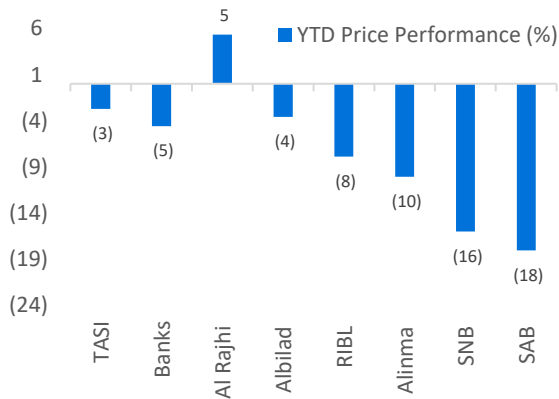
The Saudi Arabian banking sector slightly underperformed the broader market in 2024 since the Tadawul banking sector was down 5% YTD vs. TASI, declining by 3% YTD as of November 28th, 2024. This drag on the Tadawul Banking sector resulted from weak SAB, SNB, Alinma, and RIBL performance. Over the last twelve months, the sector was up 7%, outperforming TASI, which gained 5%.

Chart 49: Over the last twelve months, Al Rajhi has outperformed followed by Bank Albilad



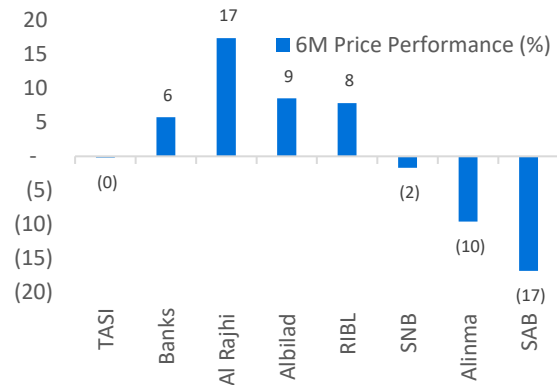
*Index to 100, priced as of the close of 28th November
Source: Bloomberg and anbc research

Chart 50: Al Rajhi is the only bank with positive share price performance in YTD



*Priced as of the close of 28th November
Source: Bloomberg and anbc research

Chart 51: in the last six months, Al Rajhi's share price gained nearly 17%



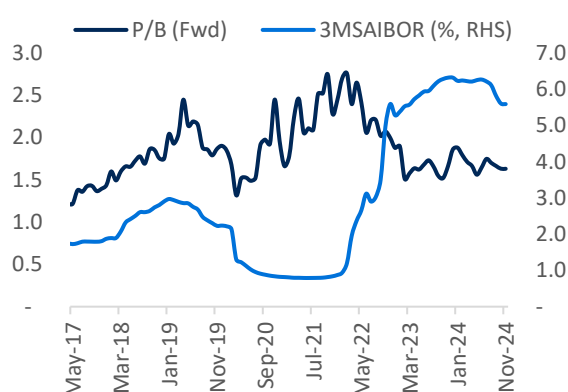
*Priced as of the close of 28th November
Source: Bloomberg and anbc research

Among our covered banks, Al Rajhi has outperformed the rest of the banks and the broader market in 2024, with Al Rajhi's being the only bank with positive share price performance, up 5% YTD. While both Albilad and Al Rajhi's share prices rallied since July, as expectations of sizable rate cuts emerged after US employment data showed rising unemployment rates and contained inflationary pressures, Albilad's 3Q24 earnings print weighed on the performance. Albilad's share price increased by 9% in the last six months, but those gains were quickly offset by an 8% decline in the last three months.

Meanwhile, Al Rajhi's share price has been up 17% in the last six months, with most gains seen in the last month after the 3Q24 earnings print showed strong margin expansion and recovery in lending growth.

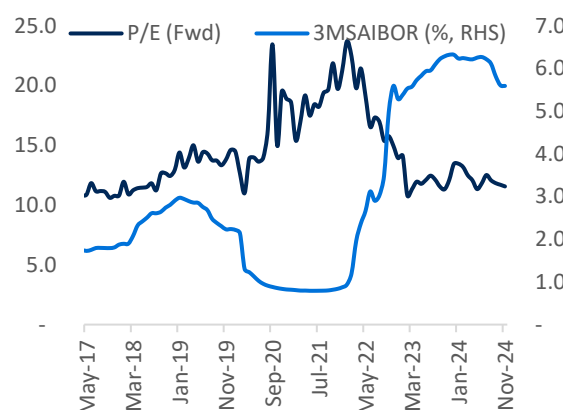
RIBL also recovered, with its share price gaining 1% in the last three months and is up 8% in the last six months. During the same period, i.e., in the last six months, the rest of the banks had negative share price performance. This was led by SAB, which declined by nearly 17%. This was followed by Alinma, which fell by 10%, and SNB, down by 2%. Looking at the YTD price performance, SAB lost the most, down 18% YTD, followed by SNB, down 16%, while Alinma and RIBL declined by 10% and 8%, respectively.

Chart 52: At 1.6x PBV, the sector trades at a 15% discount to its 5-year average multiple



Source: Bloomberg and anbc research

Chart 53: At 12x PER, it's at a 25% discount to its 5-year average multiple



Source: Bloomberg and anbc research

The sector's valuation multiples have contracted during the monetary tightening cycle, with rates increasing to decades-high levels. This is despite the lending growth momentum and profitability growth, which remained quite robust, especially for corporate-focused banks. The sector currently trades at a forward PBV of 1.6x, a 15% discount on its 5-year average of 1.9x multiple, while it trades at a 12x forward PER, a 25% discount on its historical average.

We believe the valuation multiple could quickly re-rate as we go deeper into the monetary easing cycle, which would be the case across the board, even for banks that would be negatively impacted since lending growth would drive profitability growth for those banks. That said, we think valuation uplift would be more prominent for banks whose margins would expand with rate cuts since they would also see a significant improvement in profitability returns with higher RoAEs.

Saudi Bank's valuation table:

		Al Rajhi	Saudi National Bank	Alinma	Riyad Bank	Saudi Awwal Bank	Albilad	Median
Last price (SR)		91	32	28	26	31	35	
Rating		Overweight	Overweight	Overweight	Overweight	Overweight	Neutral	
Target Price (SR)		106	46	33	31	42	39	
Upside/Downside (%)		16%	40%	20%	17%	32%	10%	
Dividend Yield (%)		3%	5%	4%	6%	6%	2%	
Total Return (%)		19%	45%	23%	23%	38%	13%	
Growth (2018-23)	Earnings	33%	16%	10%	20%	21%	31%	20%
	Lending	21%	18%	16%	13%	14%	15%	15%
	Deposits	14%	13%	16%	8%	13%	15%	14%
Growth (2024e-28e)	Earnings	16%	9%	11%	8%	6%	14%	10%
	Lending	12%	10%	14%	12%	14%	11%	12%
	Deposits	12%	9%	13%	11%	12%	11%	11%
ROAE (%)	2022	22.7	12.5	13.7	14.5	9.0	16.4	14.1
	2023	19.1	12.9	17.2	15.6	12.4	16.5	16.1
	2024e	20.5	13.0	18.5	16.6	12.5	16.9	16.8
	2025e	22.9	13.3	18.1	16.0	12.6	17.2	16.6
ROAA (%)	2022	2.5	2.0	1.9	2.0	1.6	1.7	2.0
	2023	2.1	2.0	2.2	2.2	2.1	1.7	2.1
	2024e	2.2	2.0	2.2	2.2	2.0	1.8	2.1
	2025e	2.4	2.0	2.1	2.1	1.9	1.8	2.1
PBV (x)	2022	4.3	2.0	3.3	2.1	1.5	4.4	2.7
	2023	3.3	1.3	2.8	1.7	1.3	3.3	2.3
	2024e	3.7	1.1	2.2	1.4	1.0	2.6	1.8
	2025e	3.4	1.1	2.0	1.3	1.0	2.3	1.6
PER (x)	2022	21.3	16.5	25.6	15.1	17.2	28.0	19.2
	2023	18.7	11.2	18.0	11.6	10.5	21.3	14.8
	2024e	19.9	9.4	13.0	8.8	8.9	16.1	11.2
	2025e	16.4	8.6	12.4	8.4	8.4	14.3	10.5
Dividend yield (%)	2022	0.0	3.0	1.9	3.0	2.4	0.0	2.1
	2023	3.3	3.6	3.2	4.3	4.7	1.0	3.4
	2024e	3.0	4.8	3.9	5.7	6.2	2.5	4.3
	2025e	3.7	5.8	4.0	6.0	6.6	2.8	4.9

 Last price as of November 28th, 2024

Source: Company Financials and anbc research

Al Rajhi Bank

2 December, 2024

We initiate coverage on Al Rajhi Bank with a target price of SR106/share and an Overweight rating. We believe the bank's retail-heavy loan book, with a sizable portion contributed by long-term mortgages, positions it firmly to benefit during the monetary easing cycle. Margins have mainly been stable at the peak cycle, and we expect the bank to deliver the most robust margin and RoAE expansion; CASA migration could limit some gains as LDR remains relatively elevated. Meanwhile, the bank continues to improve its operating leverage, leaving margin expansion to filter into the earning growth strongly; adjusted earnings will grow at a CAGR of 16% between 2023-28e. While we expect a recovery in the retail loan growth to accelerate in 2025e, corporate lending would drive overall loan growth in the short term. Despite a strong price performance after the 3Q24 earnings print, which showed a strong margin expansion and a pickup in lending growth, we still think there is room for valuation gain at 2024e PER of 19.9x and PBV of 3.7x. A premium valuation is justified, in our view, considering superior returns and a strong franchise with RoAE expansion likely throughout the monetary easing cycle.

We estimate NIMs to expand by 10bps in 2024e and another 27bps in 2025e. Al Rajhi's lending profile (with over 70% in retail sector loans and nearly 40% accounted by mortgages), with an extended duration and an interest-sensitive funding base, positions the bank firmly to gain in a declining rate environment. Repricing the legacy portfolio will provide a further boost to the gains. However, CASA migration could limit some of these gains, especially with elevated LDR, which would require strong deposit mobilization, which we think the bank could deliver given its past track record, vast network, and customer base.

Loan growth to pick up. We expect 2024e loan growth to slightly improve from last year, with a further pick-up in growth to accelerate as rate cuts are more entrenched, especially with the retail sector. However, while the bank focuses on driving value from its retail position, growth will likely be driven by the corporate sector as it repositions itself to increase market share and enters newer segments. It has already established itself as the third-largest corporate bank.

The bank benefits from its substantial operating leverage while utilizing its scale as the largest retail bank and having the country's most extensive customer base. It continues to rationalize its branch network, focusing on centralization to improve efficiency. Enhanced digitalization offers further improved leverage. Meanwhile, the bank's cost of risk is likely to gradually normalize as it continues to build up its buffers and enhance ECL coverage without any major signs of asset quality stress. Bank is also in the process of divesting its subsidiary, Ejada Systems Limited, to unlock value.

Valuation: In our opinion, despite rich valuations at a 2024e PBV of 3.7x, a premium to a median 2024e PBV of 1.8x for our coverage is justified, considering its superior returns and strong franchise (the largest bank in the retail space) benefiting from the monetary easing.

Risks: The key downside risk is pressures on NIMs from CASA migration, as LDR remains quite elevated. The dividend payout might also be short of expectations. As growth picks up, the bank would need to deliver on some strong deposit mobilization for funding which has been quite weak in recent quarters. Moreover, lower-than-expected spreads due to competitive pressures would limit its margin recovery.

RATING SUMMARY

Overweight

Target Price (SR)	106
Upside/Downside	16%
Div. Yield (%)	3%
Total Exp. Return	19%

ISSUER INFORMATION

Bloomberg Code	RJHI AB
Last Price (SR)	91.1
No of Shares (mn)	4,000
Market Cap bn (SR/USD)	364/97
52-week High / Low (SR)	94.4/75.3
12-month ADTV (mn) (SR/USD)	419/112
Free Float (%)	98%
Foreign Holdings (%)	14%

Last price as of November 28th

VALUATIONS

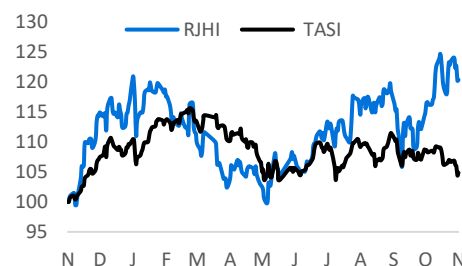
	2023A	2024e	2025F	2026F
EPS (SR)	4.0	4.6	5.6	6.5
PER (x)	18.7	19.9	16.4	14.0
PBV (x)	3.3	3.7	3.4	3.1
DPS (SR)	2.4	2.8	3.3	3.9
Div. Yield (%)	3.3	3.0	3.7	4.3
RoAE (%)	19.1	20.5	22.9	24.3
RoAA (%)	2.1	2.2	2.4	2.5

FINANCIALS (SRbn)

	2023A	2024e	2025F	2026F
Oper. Income	27.5	31.5	37.9	43.9
Provisions	(1.5)	(1.9)	(2.5)	(3.0)
Net Income*	15.8	18.3	22.2	26.0
Investments	134	168	181	196
Loans & Advances	594	650	718	803
Deposits	573	636	714	795
NIM (%)	3.0	3.1	3.3	3.5
Cost to Income (%)	27.2	25.5	24.8	24.0
NPL Ratio (%)	0.7	0.8	0.9	0.9
Simple LDR (%)	104	102	101	101

*Net Income adjusted for cost of AT Sukuk

RELATIVE PRICE PERFORMANCE



Financial Summary:

SAR mn							CAGR	
	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Income Statement								
Interest Income	38,738	45,916	47,015	49,516	55,602	62,246	21%	10%
Interest Expense	(17,468)	(21,644)	(17,179)	(14,562)	(15,188)	(16,309)	103%	-1%
NSCI	21,269	24,272	29,835	34,954	40,413	45,936	8%	17%
NII	6,262	7,235	8,088	8,917	9,660	10,433	17%	11%
Operating Income	27,531	31,507	37,923	43,871	50,074	56,369	10%	15%
Operating expenses	(7,498)	(8,034)	(9,386)	(10,529)	(11,642)	(12,683)	6%	11%
Provisions	(1,504)	(1,947)	(2,498)	(3,036)	(3,987)	(4,736)	0%	26%
Total Expenses	(9,002)	(9,981)	(11,884)	(13,565)	(15,629)	(17,419)	5%	14%
NPBT	18,529	21,526	26,039	30,306	34,444	38,950	31%	16%
Net Income*	15,800	18,344	22,220	26,048	29,760	33,801	33%	16%
Shares Outstanding (mn)	4,000	4,000	4,000	4,000	4,000	4,000		
EPS	4.0	4.6	5.6	6.5	7.4	8.5		
DPS	2.4	2.8	3.3	3.9	4.5	5.1		
Balance Sheet	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Cash and balances with central bank	41,768	46,356	52,011	57,909	64,900	72,253	-1%	12%
Due from other financial institutions, net	9,507	28,367	41,699	43,032	42,894	49,338	-22%	39%
Investments, net	134,299	167,873	181,303	195,807	205,598	209,710	26%	9%
Financing, net	594,205	650,428	718,005	803,244	912,581	1,025,814	21%	12%
Other	28,321	29,615	30,713	31,553	32,084	32,268	16%	3%
Total Assets	808,098	922,638	1,023,731	1,131,547	1,258,056	1,389,382	17%	11%
Due to other financial institutions	97,247	121,559	133,714	147,086	161,795	174,738	68%	12%
Customers' deposits	573,101	636,054	713,658	794,585	890,500	991,400	14%	12%
Other liabilities	27,202	29,239	31,684	34,782	38,764	42,726	13%	9%
Total Liabilities	701,339	802,425	894,629	992,026	1,106,631	1,224,437	17%	12%
Total Equity	106,759	120,214	129,102	139,521	151,425	164,945	17%	9%
Total liabilities and equity	808,098	922,638	1,023,731	1,131,547	1,258,056	1,389,382	17%	11%
Growth (Y/Y)	2023	2024E	2025E	2026E	2027E	2028E		
NSCI	-4%	14%	23%	17%	16%	14%		
NII	-2%	16%	12%	10%	8%	8%		
Total operating income	-4%	14%	20%	16%	14%	13%		
Net income	-7%	16%	21%	17%	14%	14%		
Financing	5%	9%	10%	12%	14%	12%		
Deposits	1%	11%	12%	11%	12%	11%		
Ratios	2023	2024E	2025E	2026E	2027E	2028E		
NIM (%)	3.0	3.1	3.3	3.5	3.7	3.8		
Operating cost to income (%)	27.2	25.5	24.8	24.0	23.3	22.5		
Cost of risk (bps)	24.9	29.5	34.3	37.2	43.0	45.5		
NPL coverage (%)	203	173	168	163	159	155		
NPL ratio (%)	0.7	0.8	0.9	0.9	1.0	1.0		
Simple LDR (%)	104	102	101	101	102	103		
RoAA (%)	2.1	2.2	2.4	2.5	2.6	2.6		
RoAE (%)	19.1	20.5	22.9	24.3	25.1	25.8		
Assets to Equity (x)	7.6	7.7	7.9	8.1	8.3	8.4		
Valuation	2023	2024E	2025E	2026E	2027E	2028E		
BVPS	22.6	24.4	26.6	29.3	32.2	35.6		
P/B	3.3	3.7	3.4	3.1	2.8	2.6		
P/E	18.7	19.9	16.4	14.0	12.2	10.8		
Dividend yield (%)	3.3	3.0	3.7	4.3	4.9	5.6		

*Net income adjusted for the cost of AT Sukuk

Source: Company Financials and anbc research

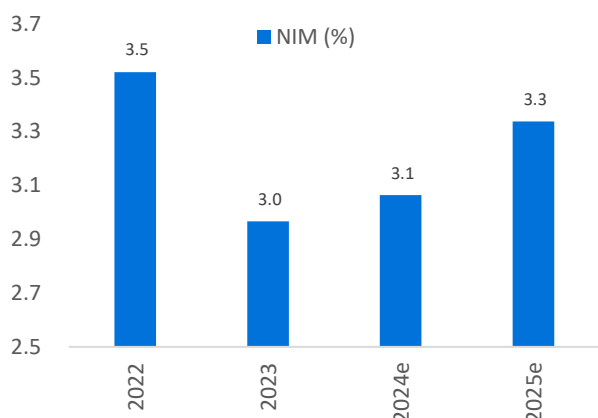
Investment Thesis

Best positioned to deliver the strongest margin expansion

Al Rajhi Bank is set to deliver the most robust net interest margin expansion (10bps in 2024e and 27bps in 2025e) and RoAE expansion (over 375bps during the same period) within our covered banks as it remains best positioned to benefit in a declining rate environment. We expect Al Rajhi Bank to reverse most of the lost ground within the next three years (its net interest margin has declined by over 120bps since 2021). We see an extended asset duration underpinned by its mortgage portfolio and a diversified funding base with a high composition of interest-sensitive liabilities offering an asset-liability duration gap, which would help improve margins with rate cuts in addition to the repricing of the legacy low-yielding portfolio.

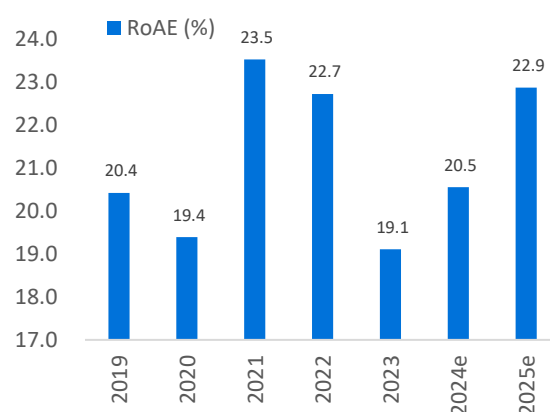
We expect 2023 to be an inflection point for NIMs, which have stabilized at the peak of the monetary cycle over the last few quarters. That said, we see rate cuts as necessary to drive this expansion and, subsequently, earnings growth amidst a relatively lower pace of lending growth. According to our calculations, NIMs staged a strong recovery in 3Q24, up 15bps YoY.

Chart 54: We expect NIMs to expand cumulatively 37bps by 2025e end



Source: Company Financials and anbc research

Chart 55: RoAE expansion, which we estimate to improve to 22.9% in 2025e



Source: Company Financials and anbc research

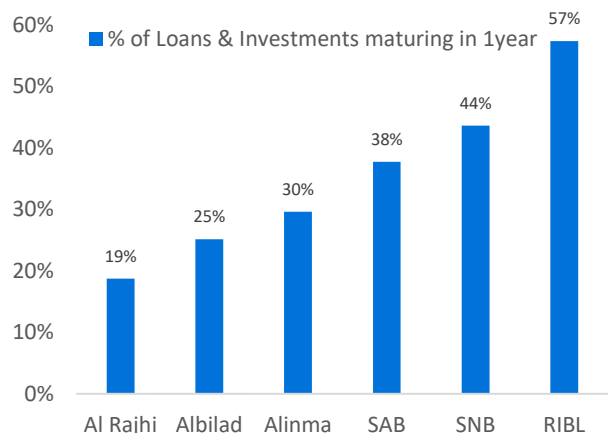
Al Rajhi Bank has the most extended asset maturity profile, with over 80% of lending and investment maturity after one year. This reflects the significant contribution of the long-term fixed-rate mortgage portfolio within its portfolio, accounting for nearly 40% of net loans at the end of 2023. This effectively allows the banks to lengthen the duration of the loan portfolio and slow asset repricing relative to shorter-duration liabilities to drive net interest margin expansion.

While much of this portfolio (mortgage lending grew nearly 3x between 2019 and 2021) was added in a low-rate environment around the COVID period, limiting any meaningful expansion in gross yields at that time, we note that c25% of the current gross portfolio was added during the period of rising origination rates, which was also accompanied by SRC raising its benchmark rates. This increased contribution of newer loans should help offset some pressure on the legacy portfolio and drive upward the gross yields, which had been lagging in a monetary tightening period.

In addition, repricing legacy low-yielding loan portfolios is also expected to improve margins. While competitive pressures would limit some gains from lower spreads, we think most of these older loans, particularly the fixed-rate ex-mortgage instruments, had been priced at very low rates. According to our calculations, taking into account installment sales and credit card loans, over 30% of the 2021 gross outstanding retail loans have already been

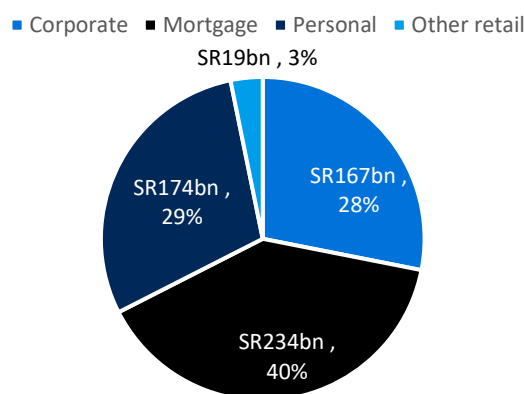
repriced in 2022 and 2023. Assuming these loans are repriced on maturity, typically five years, these should be completely repriced by 2026e at a neutral level interest rate which would be higher than the levels in 2021.

Chart 56: Al Rajhi has the most extended loan maturity



Source: Company Financials and anbc research

Chart 57: reflecting the contribution from its fixed rate retail mortgages

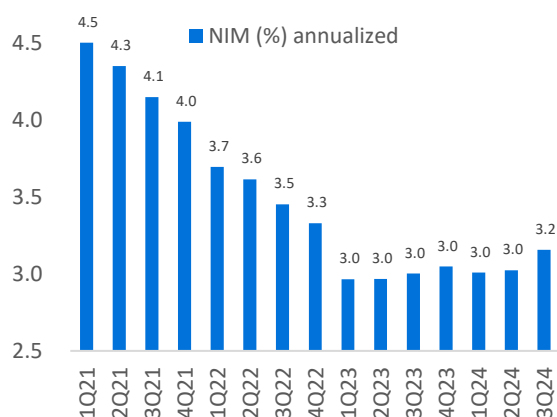


Source: Company Financials and anbc research

A retail-heavy loan book was also one of the key reasons Al Rajhi recorded such deep cuts to its net interest margins during rising rates. We estimate its net interest margins fell for nine consecutive quarters between 1Q21 and 1Q23, and on an annual basis, they have cumulatively declined over 120bps since 2021.

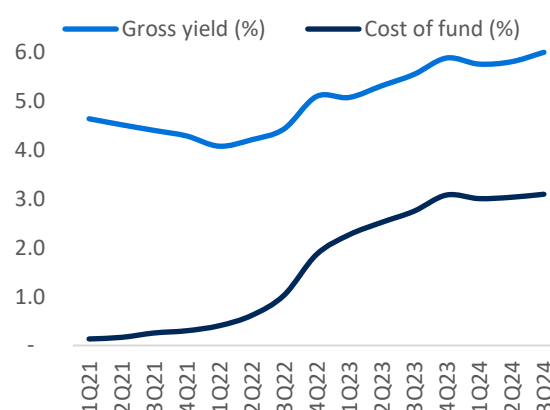
However, since 2Q23, when the monetary cycle peaked (only a 25bps rate increase vs. 450bps hikes between 1Q22 and 1Q23), net interest margins have broadly stabilized as gross yields picked up, offsetting the pressures from the rising cost of funds. Al Rajhi Bank also has 30% lending in the corporate sector with a relatively shorter duration and has been growing by over 20% YoY in 2023. This, coupled with growth in income from an investment portfolio, contributed significantly to driving upward the overall gross yield. In 3Q24, its margins improved as gross yields picked up amidst a relatively stable cost of funding.

Chart 58: NIMs at an inflection point and broadly stable since 2Q23 – margins improved in 3Q24



Source: Company Financials and anbc research

Chart 59: As assets yields caught up and some pressures subsided



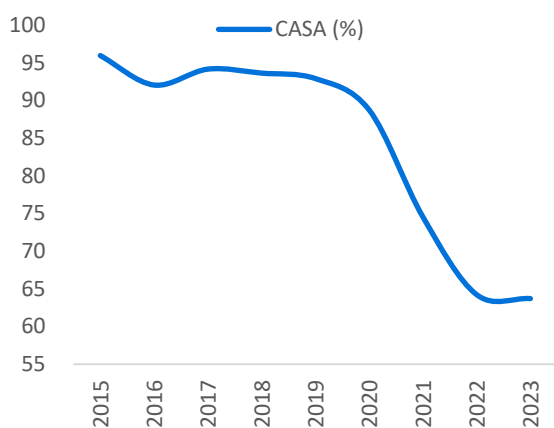
Source: Company Financials and anbc research

In our view, over the last two years, Al Rajhi Bank lost a significant competitive edge in deposit mobilization with substantial CASA migration, resulting in a sharp uptick in the cost of funds. Al Rajhi used to have a CASA mix of over 90% before 2020, which was the highest across the sector and a key catalyst for below-sector-average cost of funds, a core competitive edge the bank enjoyed over many years. It offered it a solid competitive power in effectively

pricing its products and maintaining a robust margin profile (net interest margins used to be well above the 4.5% mark between 2018-20).

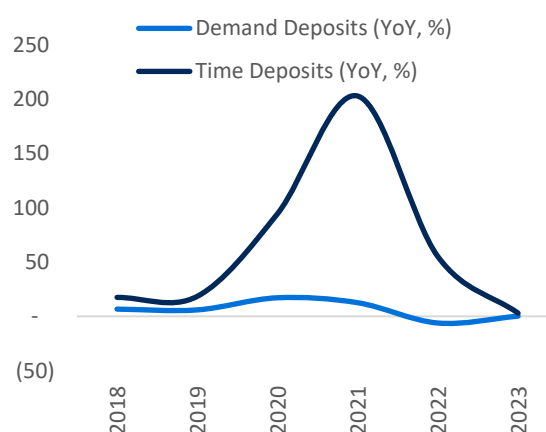
However, CASA migration accelerated quickly as the bank needed to fund the very strong lending growth. Between 2020 and 2023, demand deposits grew only by 6% cumulatively, while time deposits were up 4.8x, resulting in the CASA mix declining to 64% at the end of 2023 vs. 90% in 2020.

Chart 60: CASA fell to 64% at the end of 2023 vs. 75% in 2021



Source: Company Financials and anbc research

Chart 61: as deposit growth primarily resulted from Time deposits



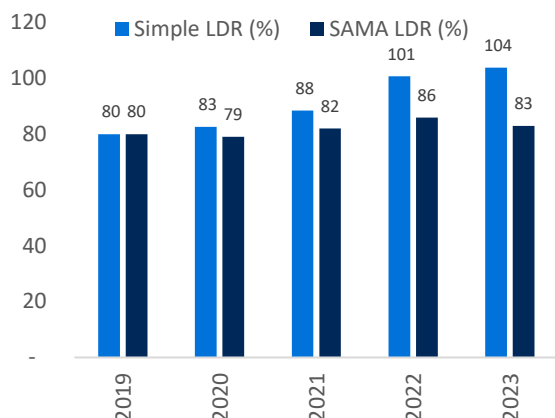
Source: Company Financials and anbc research

LDRs quickly rose as deposit mobilization failed to match lending growth, with Al Rajhi Bank's non-regulatory LDR expanding to 104% at the end of 2023, up from 88% at the end of 2021. With already elevated LDRs, the bank found itself between a rock and a hard place with the need for quick deposit mobilization at a time when rates had been increasing at one of the most aggressive paces of tightening. This left the bank to fund its growth through expensive time deposits and other liabilities.

In light of tight liquidity dynamics, Al Rajhi Bank has also been diversifying its funding sources during this period, tapping the wholesale funding market, including interbank, and has issued AT1 instruments. Its treasury liabilities as a % of total liabilities increased from less than 5% in 2021 to over 19% at the end of 2023, with the bulk of this coming from interbank funding.

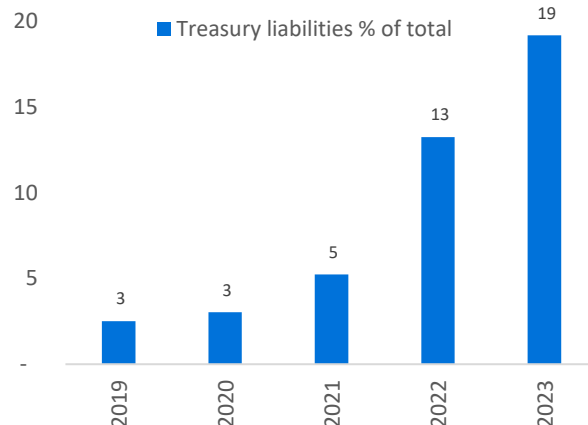
In addition, Al Rajhi also issued SR16.5bn Tier 1 Sukuk in 2022 and, more recently, dollar-dominated USD1bn Sukuk in 2Q24, in addition to USD1.9bn in syndicated loan issued in 4Q24. The latter offers much-needed liquidity support and alleviates some pressures through equity-generated funds while capitalizing its books. Meanwhile, increased interest sensitivity liabilities, particularly interbank funding, also drive a favorable asset-liability duration gap for the bank.

Chart 62: Non-regulatory LDR at elevated levels, estimated at 104% in 2023



Source: Company Financials and anbc research

Chart 63: But the bank put much effort into diversifying its funding base



Source: Company Financials and anbc research

While we remain positive on Al Rajhi Bank's net interest margin direction, we highlight caution regarding elevated LDRs requiring the bank to deliver strongly on deposit mobilization amidst continued tight liquidity. Its past track record of increasing market share in deposits (which we estimate increased by 6.8ppt in last five years to 26% at the end of 2023) and significant scale with the largest retail branches of over 500 branches across Saudi Arabia alone and a large customer base (15.8mn active customers), offers some comfort in the bank's ability to easily finance its liquidity needs and positions it for additional market share gains. However, this could potentially come at the cost of further CASA migration as rate cuts would be gradual.

Lending growth to accelerate in 2025e

While we think the bank is positioned firmly (in terms of lending profile and loan book mix), lower rates are much needed for any meaningful earnings expansion amidst relatively slower lending growth. Overall lending slowed to 5% YoY in 2023 from one of the prime years in 2022 and 2021, and while we expect growth to recover in 2024e, it will remain relatively short of the levels of corporate-focused banks.

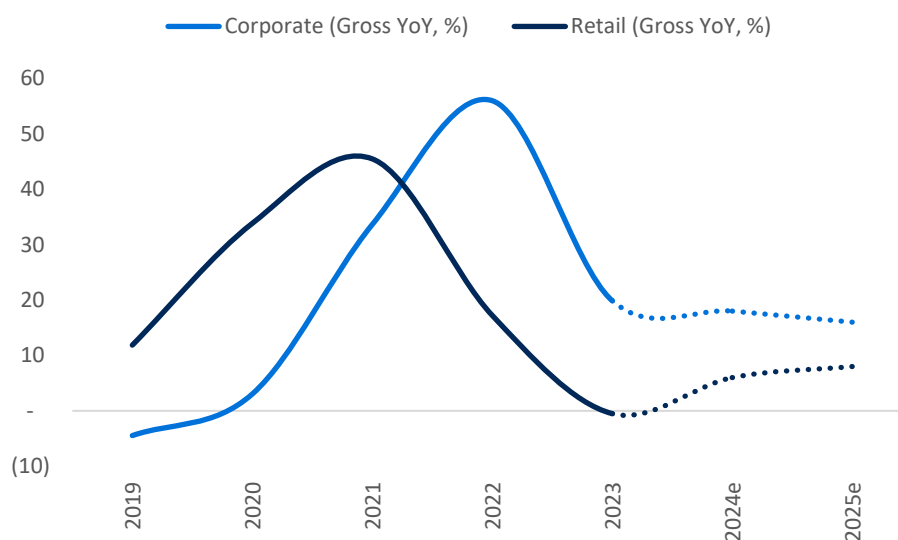
Moderating growth in 2023 had been primarily driven by the muted performance of the retail portfolio, which, in net terms, was nearly flat on a YoY basis in 2023. While retail mortgage lending rose 6% YoY, the pressure was primarily from the ex-mortgage retail portfolio, particularly personal loans, as high rates weighed on consumer appetite for financing.

We expect loan book growth to further accelerate in 2025e and beyond as monetary easing becomes more entrenched and filters into the accelerated attraction of consumer lending. The macroeconomic backdrop is positive, accelerating growth and increasing income levels with an additional boost from a relatively less tight monetary stance. This would also continue to support the bank's corporate lending portfolio, which the Bank's new corporate strategy focuses on to expand its footprint and drive overall growth.

As such, the management initiated a new strategy under "Harmonizing the growth," which effectively utilizes this period to optimize its growth levers and position the bank once lending growth accelerates. Key aspects of this new strategy are to focus on increasing its customer base and entering newer segments to diversify its risk base. This is in addition to stabilizing its operations and improving further efficiencies, including spending on digitalization as the bank focuses on profit growth. The four key pillars of the strategy include:

- **B2C:** Under a business-to-customer strategy primarily for the retail business, Al Rajhi focuses on cross-selling to increase growth in NII as it leverages its large customer base. In addition, it is targeting to enter new business segments by expanding its product and service portfolio.
- **B2B:** Within the corporate segment, the key target is to increase market share and become a leading corporate bank. It also emphasizes SME lending and growing the contribution of SME lending through specialized and tailored banking solutions for the sector.
- **Business Support:** Under this, the bank aims to centralize its operations further and increase efficiency by enhancing its operating leverage.
- **Digital:** The bank’s digital strategy focuses on expanding digital capabilities to improve customer journey and customer satisfaction and become a leading digital bank in the country.

Chart 64: Loan growth sharply slowed down amidst elevated interest rates



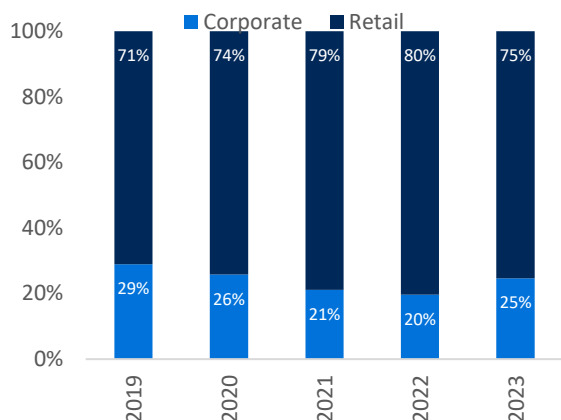
Source: Company Financials and anbc research

One of the key focus areas under the bank’s new corporate strategy has been developing its corporate segment. We believe Al Rajhi's prominent retail positioning often overshadows its corporate penetration, as it is the third largest bank in Saudi Arabia in corporate lending with a market share of over 12%—later increased from less than 9% in 2021.

Subdued retail origination (flat YoY in 2023) was offset by a 20% YoY corporate lending growth, providing crucial support to its overall book. According to the bank’s disclosures on economic concentration, the corporate portfolio is focused on the commercial, industrial, and services sectors, providing strong and well-diversified exposure to non-oil economic activity.

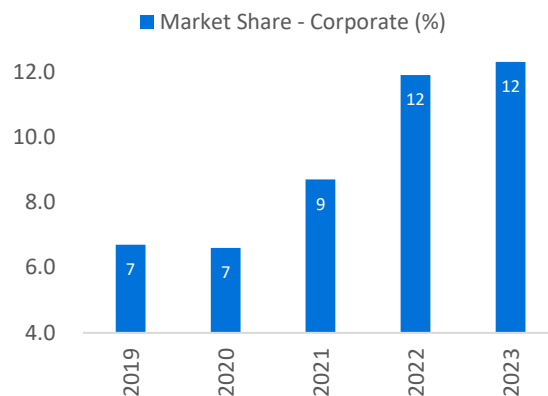
During 2024e and 2025e, we expect corporate lending to drive growth for the overall Al Rajhi portfolio since any pickup in retail lending will continue only after rate cuts have become more entrenched. We estimate Al Rajhi's lending portfolio to grow at a CAGR of 12% between 2023-28e vs. 21% in the last five years. Corporate sector lending will likely outpace growth at a CAGR of 16% vs. retail sector loan growth of 10% in the next five years.

Chart 65: Contribution of the corporate book has slightly increased to 25% in 2023



Source: Company Financials and anbc research

Chart 66: Its market share has been increasing in corporate; ranked third largest bank



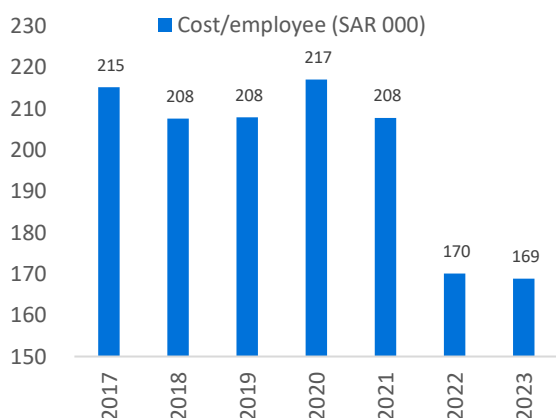
Source: Company Financials and anbc research

Significant scale benefits to support earnings expansion

Al Rajhi Bank still carries significant scale benefits, being the largest bank in terms of bank branches and number of customers. It also has the widest network of ATMs and POS terminals and is the leading bank with the most remittance centers. Its efforts in digitalization have also been notable, with 95% of new retail accounts opening through digital channels. The bank's large scale, coupled with the cost-effectiveness of digital capabilities, offers the most competitive cost structure and significant operating leverage - it has the lowest cost-to-income ratio among our covered banks.

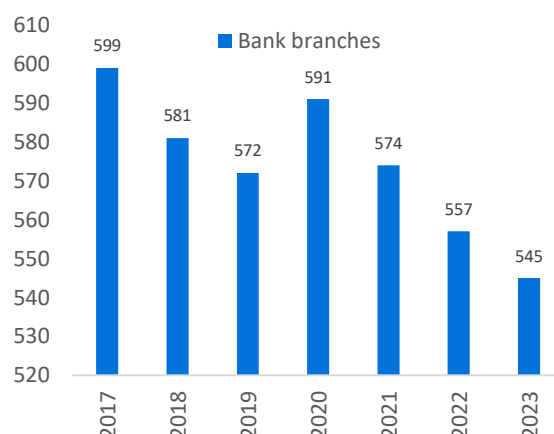
The bank's cost per employee has declined over the past two years as it rationalized its branch network to slightly below 550 branches in Saudi Arabia alone. Under the new strategy, the bank intends to focus on this to continue yielding positive benefits from improved efficiencies and improving cost structure. Its operating cost-to-income ratio is down to 27% in 2023 from over 30% in 2020. This was also accompanied by rising interest rates, which negatively impacted the bank's margins, and despite that, its cost-to-income only increased by 100bps YoY in 2023 as the bank well-managed its Opex growth. With margins recovery to pick up in the coming years, we pencil in at least a 2ppt improvement in the bank's cost-to-income ratio over the next two years. The downside risk includes materially increasing digital spending that could limit some of the gains in the initial years.

Chart 67: Improving efficiency as cost per employee has seen a marked decline



Source: Company Financials and anbc research

Chart 68: Rationalizing bank branches to improve efficiency



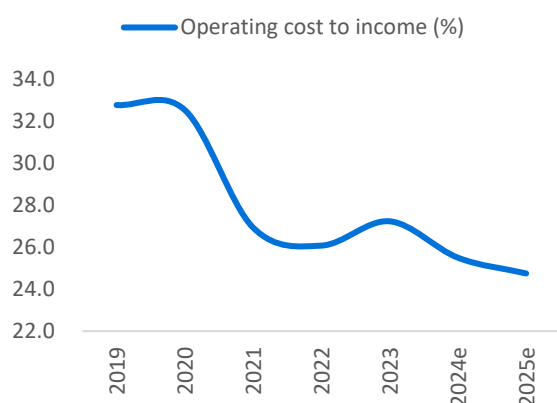
Source: Company Financials and anbc research

In addition to substantial operating leverage, NPL formation has been well managed despite the high rates. While coverage has fallen to less than 200% from above 300% in 2021, this reflects an improved economic outlook. The headline number has dropped, but Al Rajhi still maintains strong coverage on its retail portfolio, over 350% in 2023. On the overall portfolio, the Bank’s stage 2 allocation of gross loans rose to 2.3% in 2023 from 1.7%, while for stage 3, it increased to 1.2%, leaving a slightly higher NPL formation.

However, coverage for expected credit loss for both stages remained stable, which management attributed to an improved business outlook without significant signs of asset quality stress. Recoveries remained strong, while NPL formation was predominantly within the corporate sector, while retail witnessed improvement.

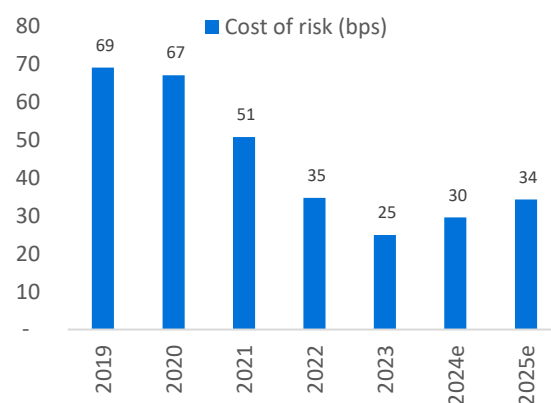
The bank’s asset quality remains robust without any major signs of stress. While corporate showed some increased NPL formation, we don’t expect it to continue amidst a solid macroeconomic backdrop. In addition, according to the company’s economic concentration report, 20% of the gross corporate loans are public sector loans, providing some protection against any unexpected headwinds. That said, the bank's cost of risk is likely to gradually normalize upward as it continues to build up its buffers and enhance ECL coverage.

Chart 69: Cost to income ratio has sharply improved over the years



Source: Company Financials and anbc research

Chart 70: CoR to normalize though asset quality shows no signs of stress



Source: Company Financials and anbc research

Valuations:

We have used a residual income model to value Al Rajhi Bank, which has a cost of equity of 10.9% and a terminal growth rate of 5%. Our target price of SR106/share values Al Rajhi at a 2025e PER of 19x and PBV of 4.0x, with a median RoAE of 24% between 2024e-28e. We have an Overweight rating. Despite a strong rally in the share price after the bank posted a 3Q24 earnings print, which showed a strong margin expansion and recovery in lending growth, we think there is still further room for valuation gains. We expect adjusted earnings to grow at a CAGR of 16% over the next five years, likely outperforming the rest of the banks in our coverage. We note that Al Rajhi's premium valuation (median 2024e PBV of 1.8x for our coverage) reflects its superior profitability (2024e RoAE of 20.4% vs. median 16.8%) and its strong franchise (largest retail bank) in our view.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	90,259	97,694	106,582	117,001	128,905	142,425	157,594
Cost of equity (%)	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%
Cost of equity	9,809	10,617	11,583	12,715	14,009	15,478	17,126
Adjusted net income	18,344	22,220	26,048	29,760	33,801	37,921	42,347
Excess equity return	8,535	11,603	14,465	17,045	19,793	22,443	25,221
Terminal excess equity return							451,332
Discount factor	1.0	1.1	1.3	1.4	1.5	1.7	1.7
PV of excess equity returns	8,382	10,278	11,557	12,283	12,862	13,155	264,543
Equity invested	90,259						
PV of excess return on Equity	333,061						
Value of equity	423,320						
Number of shares (mn)	4,000						
Target Price	106						

Earnings Sensitivity:

		Growth rate					
		3%	4%	5%	6%	7%	
CoE	9%	124	141	167	212	305	
	10%	103	114	130	154	195	
	11%	88	96	106	120	142	
	12%	76	82	89	98	111	
	13%	67	71	76	82	90	

Source: Company Financials and anbc research

Saudi National Bank

2 December, 2024

After completing merger integration with SAMBA in 2023, Saudi National Bank's strategy focus has shifted towards profitable growth, delivering value and balance sheet expansion that supports profitability. We think SNB is all set to leverage its scale (being the largest bank in the country), positioning in key sectors, and strong brand value to drive lending expansion, which would be led by the corporate segment in the short term. Moreover, the bank has strong capital buffers and offers significant operating leverage. Its margins would positively expand with declining rates, but gains would be only gradual due to uncertainty in international business and cost of funding pressures. Slightly higher provisioning would also dilute some of this expansion; we estimate adjusted earnings to grow at a 2023-28e CAGR of 9%. At a 2024e PER of 9.4x and PBV of 1.1x for a RoAE expected to expand to over 13.5% in the medium term, we think the current valuation discounts its vast scale and brand equity. We initiate coverage with an Overweight rating and a target price of SR46/share.

Growth focuses on profitability: After the merger, SNB has positioned itself in the market with scales that have become unmatched, being the largest bank in the country with a 23% lending share. The focus has turned to profitable growth by leveraging its vast infrastructure and driving balance sheet expansion that supports profitability. We think this also targets increasing the bank's NIM sensitivity to rate changes. The bank aims to expand its retail portfolio, particularly mortgages, while in corporate, the strategy focuses on diversification and project financing.

Its scale benefits filter into operational efficiencies: The bank delivered on merger synergies, exceeding SR1.5bn, which was more than initially targeted. Its operational efficiency remains a key positive with significant operating leverage; the domestic business' cost-to-income is less than 26%. Meanwhile, the core strategy aims to enhance efficiencies further and drive profitability growth. The bank's credit cost has also normalized from high levels in the past thanks to recoveries and sustainable improvement in the NPL ratio.

NIMs to expand with rate cuts: The bank is positively geared for rate cuts from its mortgage and investment portfolio contributions in addition to the repricing of the legacy portfolio. However, the sensitivity remains limited, and there is still a lot of uncertainty in the international business coupled with cost of funding pressures, leaving us to expect that margin gains will be gradual; we expect a 12bps NIM expansion by the end of 2025, following a 6bps decline in 2024e.

Valuation: SNB trades at a 2024e PBV of 1.1x for a medium term RoAE of over 13.5%. We think current valuations do not fully reflect the bank's vast scale, brand equity, and balance sheet strengths, which offer decent growth prospects in addition to its positive gearing for interest rate cuts.

Risks: The bank's slightly higher lending maturities during the year could restrict lending growth and result in lower-than-expected yields from competitive pressure. Also, the international business, especially its Turkish business, could surprise negatively if the hyperinflationary environment persists, weighing on earnings growth. Also, the bank's non-regulatory LDRs are high, requiring some strong deposit mobilization to fund growth.

RATING SUMMARY	OVERWEIGHT
Target Price (SR)	46
Upside/Downside	42%
Div. Yield (%)	5%
Total Exp. Return	47%

MARKET DATA	
Bloomberg Code	SNB:AB
Last Price (SR)	32.45
No of Shares (mn)	6,000
Market Cap bn (SR/USD)	195/52
52-week High / Low (SR)	43.7/32.0
12-month ADTV (mn) (SR/USD)	196/52
Free Float (%)	63%
Foreign Holdings (%)	15%

Last price as of November 28th

VALUATIONS	2023A	2024e	2025F	2026F
EPS (SR)	3.2	3.5	3.8	4.2
PER (x)	11.2	9.4	8.6	7.8
PBV (x)	1.3	1.1	1.1	1.0
DPS (SR)	1.3	1.6	1.9	2.3
Div. Yield (%)	3.6	4.8	5.8	7.1
RoAE (%)	12.9	13.0	13.3	13.7
RoAA (%)	2.0	2.0	2.0	2.1

FINANCIALS (SRbn)	2023A	2024e	2025F	2026F
Oper. Income	34.6	37.4	42.0	46.3
Provisions	(0.9)	(1.4)	(2.9)	(3.5)
Net Income	19.2	20.7	22.7	25.1
Investments	269	299	317	331
Loans & Advances	602	665	737	810
Deposits	590	648	709	771
NIM (%)	3.1	3.1	3.2	3.3
Cost to Income (%)	29.9	29.5	28.8	28.2
NPL Ratio (%)	1.2	1.0	1.1	1.1
Simple LDR (%)	102	103	104	105

*Net Income adjusted for cost of AT Sukuk

RELATIVE PRICE PERFORMANCE



Financial Summary:

SAR mn							CAGR	
	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Income Statement								
Interest Income	49,857	55,905	53,180	53,257	56,797	59,059	21%	3%
Interest Expense	(22,848)	(26,805)	(20,322)	(16,954)	(17,075)	(15,970)	42%	-7%
NSCI	27,009	29,100	32,857	36,303	39,721	43,089	12%	10%
NII	7,580	8,307	9,192	10,028	10,767	11,319	15%	8%
Operating Income	34,589	37,407	42,050	46,330	50,488	54,408	13%	9%
Operating expenses	(10,357)	(11,035)	(12,124)	(13,050)	(13,884)	(14,599)	9%	7%
Provisions	(923)	(1,386)	(2,868)	(3,540)	(4,214)	(5,048)	-8%	40%
Total Expenses	(11,280)	(12,421)	(14,992)	(16,589)	(18,099)	(19,648)	7%	12%
NPBT	22,773	24,425	26,637	29,361	32,067	34,510	16%	9%
Attributable Income*	19,237	20,738	22,685	25,084	27,467	29,619	16%	9%
Shares Outstanding (mn)	6,000	6,000	6,000	6,000	6,000	6,000		
EPS	3.2	3.5	3.8	4.2	4.6	4.9		
DPS	1.3	1.6	1.9	2.3	2.5	2.7		
Balance Sheet	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Cash and balances with central bank	47,499	52,187	57,091	62,026	66,989	71,983	8%	9%
Due from other financial institutions, net	34,563	24,715	13,981	6,531	7,504	11,735	17%	-19%
Investments, net	269,375	299,006	316,947	331,209	341,146	347,968	18%	5%
Financing, net	601,527	665,256	737,334	810,355	880,580	952,279	18%	10%
Other	84,116	84,037	83,885	83,663	83,376	83,028	33%	0%
Total Assets	1,037,081	1,125,201	1,209,238	1,293,784	1,379,595	1,466,994	18%	7%
Due to other financial institutions	211,666	222,249	226,694	231,228	235,852	240,569	36%	3%
Customers' deposits	590,051	648,286	709,211	770,506	832,170	894,204	13%	9%
Other liabilities	58,736	66,526	73,733	81,035	88,058	95,228	22%	10%
Total Liabilities	860,452	937,060	1,009,639	1,082,769	1,156,081	1,230,001	17%	7%
Total Equity	176,629	188,141	199,599	211,015	223,515	236,993	22%	6%
Total liabilities and equity	1,037,081	1,125,201	1,209,238	1,293,784	1,379,595	1,466,994	18%	7%
Growth (Y/Y)	2023	2024E	2025E	2026E	2027E	2028E		
NSCI	3%	8%	13%	10%	9%	8%		
NII	13%	10%	11%	9%	7%	5%		
Total operating income	5%	8%	12%	10%	9%	8%		
Net income	7%	8%	9%	11%	9%	8%		
Financing	10%	11%	11%	10%	9%	8%		
Deposits	4%	10%	9%	9%	8%	7%		
Ratios	2023	2024E	2025E	2026E	2027E	2028E		
NIM (%)	3.1	3.1	3.2	3.3	3.3	3.4		
Operating cost to income (%)	29.9	29.5	28.8	28.2	27.5	26.8		
Cost of risk (bps)	15.1	20.5	38.2	42.9	46.9	52.0		
NPL coverage (%)	140	164	162	160	158	157		
NPL ratio (%)	1.2	1.0	1.1	1.1	1.2	1.3		
Simple LDR (%)	102	103	104	105	106	106		
RoAA (%)	2.0	2.0	2.0	2.1	2.1	2.1		
RoAE (%)	12.9	13.0	13.3	13.7	14.1	14.3		
Assets to Equity (x)	5.9	6.0	6.1	6.1	6.2	6.2		
Valuation	2023	2024E	2025E	2026E	2027E	2028E		
BVPS	26.8	28.7	30.6	32.5	34.5	36.7		
P/B	1.3	1.1	1.1	1.0	0.9	0.9		
P/E	11.2	9.4	8.6	7.8	7.1	6.6		
Dividend yield (%)	3.6	4.8	5.8	7.1	7.8	8.4		

*Attributable Net Income adjusted for the cost of AT Sukuk

Source: Company financials and anbc research

Investment Thesis

Margin gains are likely to be gradual over the rate cycle

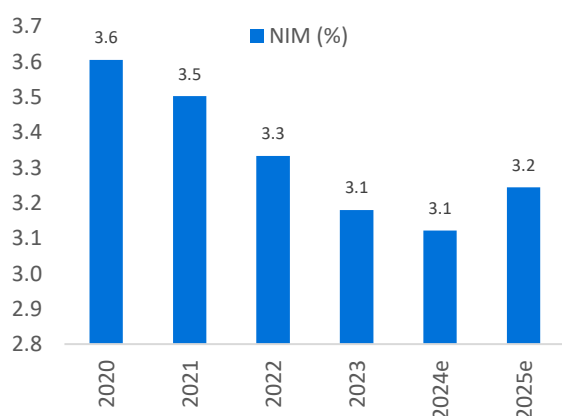
Saudi National Bank (SNB) is positioned positively for the monetary easing cycle, which would filter into margin expansion for the bank. A relatively higher contribution of longer-duration retail sector loans, repricing of its legacy portfolio (older loans issued at low rates), and an extended duration of its vast investment portfolio are key factors supporting the bank’s outlook for margin gains; we expect NIMs to expand by 12bps in 2025e.

However, despite positive gearing, margin gains over the cycle will be relatively gradual, in our view. This reflects the uncertainty regarding its international business, a relatively neutral sensitivity, and some pressures on the cost of funds from CASA migration. With respect to the latter, delivering a strong CASA balance, even if it includes call deposits, provides some comfort in mobilizing low-cost deposits quickly when rates have normalized to neutral rates.

SNB’s net interest margin sensitivity to changes in interest rates has only changed to a marginally positive impact from largely neutral last year; according to management, every 25bps cut in interest rates would result in a net interest margin expansion of 2bps. This was also driven by replacing the investment portfolio with instruments of longer duration in recent quarters.

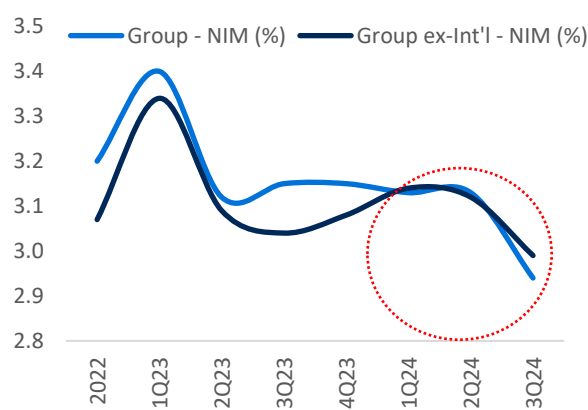
There has been substantial volatility in its international business, particularly in Türkiye, due to the hyperinflationary environment. This was evident in 1H24, when, according to the management, despite the bank witnessing an improvement in the domestic business, its overall net interest margins slightly declined, weighed down by the international business. The trend followed through in 3Q24, where pressures from the cost of funding further weighed down on margins.

Chart 71: Margins are positively geared for a declining rate environment



Source: Company financials and anbc research

Chart 72: Margins on international business has been quite volatile



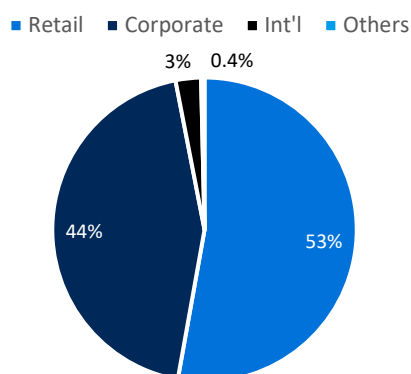
Based on the company's calculation and will differ from our calculated NIMs estimates

Source: Company Presentation

The domestic business outlook remains favorable to lower rates from its loan book tilted towards the retail sector, with a significant contribution from the longer-duration mortgage portfolio. Retail loans account for nearly 53% of SNB's overall lending, which is almost balanced across the mortgages and ex-mortgage portfolio comprising personal and auto loans; the mortgage portfolio accounts for 26% of the overall loan book. Meanwhile, corporate loans make up 39% of the total lending.

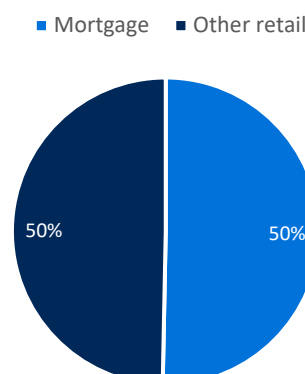
Looking at the maturity profile of its lending portfolio, nearly 50% of its outstanding loans are expected to mature within one year. While this indicates slightly higher repayment pressures, the management emphasized that it would take this opportunity to reprice the legacy portfolio at higher yields, especially for the retail business. However, we note a potential downside risk of lower-than-expected spread yields from increased competitive pressure.

Chart 73: Retail book accounts for 53% of the total lending



Source: Company financials and anbc research

Chart 74: Retail book is equally balanced between mortgages and ex-mortgage portfolio

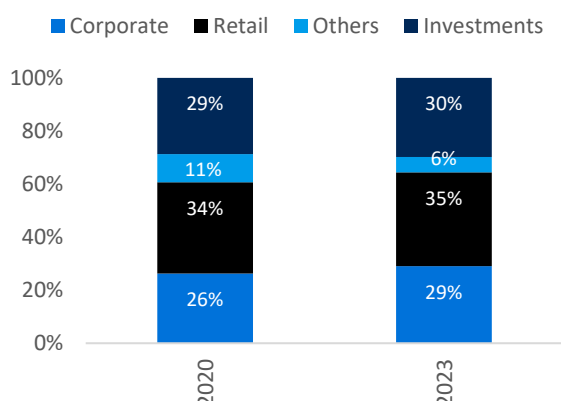


Source: Company financials and anbc research

Another key supporting factor for the bank's positive margin outlook is its relatively high contribution from its investment portfolio. According to our calculation, SNB's investment portfolio accounts for 30% of total interest-earning assets vs. 23% for our aggregate coverage.

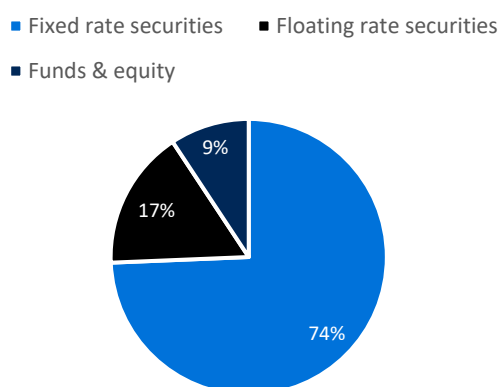
The bulk of this portfolio has been invested in fixed-rate securities, accounting for 74% of the total investment book, which will be key to supporting the bank's gross yields in a declining rate environment. Its contribution to income has also risen in the past two years, with NSCI generated from investments accounting for 23% of total NSCI in 2023 vs. 20% in 2021.

Chart 75: Investment book accounts for 30% of interest earning assets



Source: Company financials and anbc research

Chart 76: With most of the investments placed in fixed-rate securities



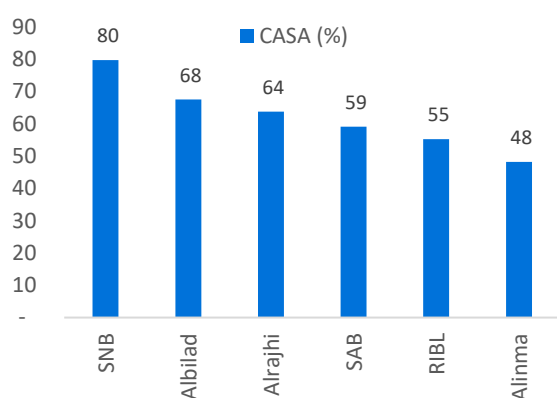
Source: Company financials and anbc research

Lastly, the bank's most exceptional strength is its CASA balance, which is the highest among the covered banks. While we note that its CASA balance includes call deposits with associated costs, its delivery of CASA growth or even call deposits as opposed to Time deposits has been relatively surprising in the current rate environment.

However, this came at the cost of heavy reliance on interbank funding, which increased by 40% YoY in 2023 and accounted for over 26% of total funding. Call deposits, in addition to the interbank funding, meant that the bank still faced pressures in the form of rising CoF, which increased from 1.1% in 2022 to slightly over 3.0% in 2023.

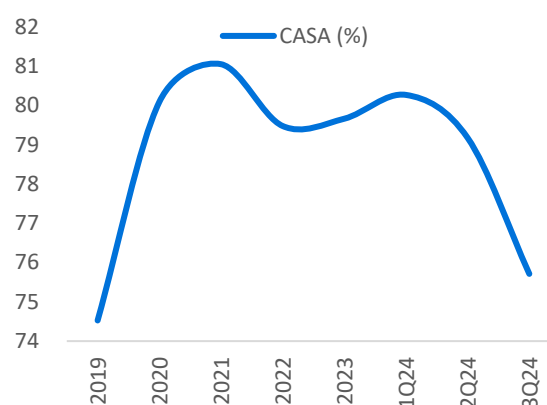
That said, a relatively strong CASA balance and its vast scale should allow the bank to manage the pressures of CoF and fund growth with ease through deposit mobilization. In addition, high interbank funding, which is mainly repriced very quickly to changes in monetary setting, should support a positive margin outlook. However, we note that the CASA balance has declined in recent quarters, which has been the key pressure on the margins.

Chart 77: SNB has the highest CASA balance among our covered banks (2023)



Source: Company financials and anbc research

Chart 78: However, it has declined in recent quarters, weighing on margins



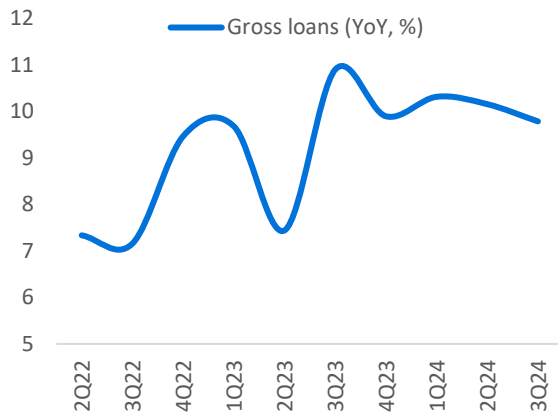
Source: Company financials and anbc research

The focus of strategy has now turned to value growth

SNB merged with SAMBA at the start of 2021, and the integration process was completed in 2023. Now, the focus has turned to profitable growth, primarily centered around creating value and supporting a balance sheet mix that would result in sustainable earnings through the next monetary cycle. According to the SNB’s medium-term strategy, the four key pillars include:

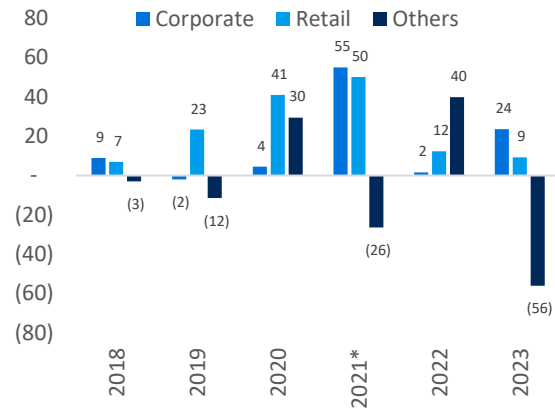
- **Value Capture:** The focus is on delivering balance sheet expansion, which would result in improved yields and diversification. For the corporate sector (or wholesale, according to the bank’s segmentation), this means further diversification with a particular emphasis on project financing while maintaining credit risk and asset quality. Meanwhile, the bank envisions market share gains in retail, particularly in mortgages.
- **Operational Excellence:** The primary target is to achieve cost efficiencies and generate value from its vast scale. The focus would be on leaner operating models and increased digitalization.
- **Digital Dominance:** The key objective is to enhance digital penetration. According to the management, this would be achieved through digital platforms across all service areas and segments.
- **Employer of Choice:** Lastly, the bank aims to invest in its human resources.

Chart 79: Growth in gross loans improved since the start of 2022



Source: Company financials and anbc research

Chart 80: Loan growth in 2023 was led by the corporate sector



*2021 growth resulted from its merger with SAMBA
Source: Company financials and anbc research

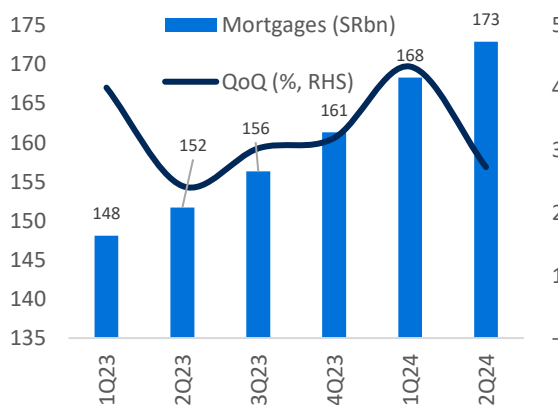
In a nutshell, the corporate sector would primarily drive lending growth amidst a moderating pace of retail expansion in the short run, a trend we expect to follow sector wide. However, it's unlikely SNB would witness double-digit growth, as seen between 2019 and 2021, barring another M&A, since its vast loan book size means a significant expansion in economic activity for new loan origination. The bank's outstanding gross loans represent 23% of the total credit lending in the sector.

That said, SNB enjoys significant scale benefits, allowing it to finance large-scale projects. In corporate, we believe growth will be delivered through project financing, benefiting from tailwinds of increased capex spending in the country. In addition, expansion into newer sectors would also drive growth for the bank.

SNB has a strong position in mortgages. Its new mortgage originations have continued to grow at an accelerated pace, ending up with a portfolio of SR172.9bn in 2Q24, up 14% YoY, which was higher than the sector growth; its mortgage loan portfolio was up 9% YTD in 9M24.

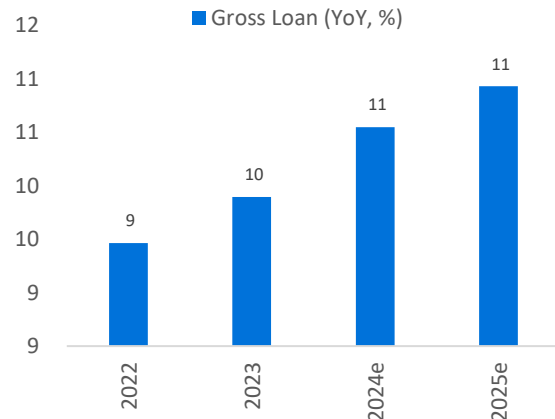
This remains the key part of its strategy to further boost its position in the retail segment by improving product offerings and consumer engagement. While corporate loan expansion would primarily drive growth in the short term, eventually, with lower borrowing costs and an increased appetite for consumer lending, we expect retail growth to catch up. We estimate a lending CAGR of 10% between 2023-28e for SNB.

Chart 81: The mortgage portfolio growth continues to remain relatively strong



Source: Company financials and anbc research

Chart 82: We estimate gross loans to grow by 11% YoY in 2024e

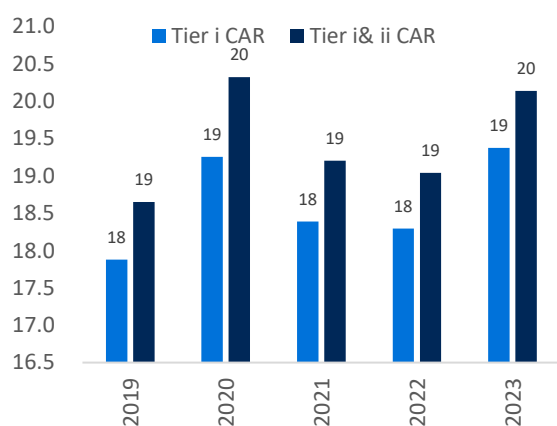


Source: Company financials and anbc research

SNB remains a well-capitalized bank for its size, supporting growth and allowing it to fund large-scale project financing. Its Tier 1 capital recovered to its pre-merger levels at 19.4% at the end of 2023. This comes despite the foreign currency losses, where a strong internal capital generation supported improved capital ratios. The bank recently issued SR6bn AT1 capital in Nov'24.

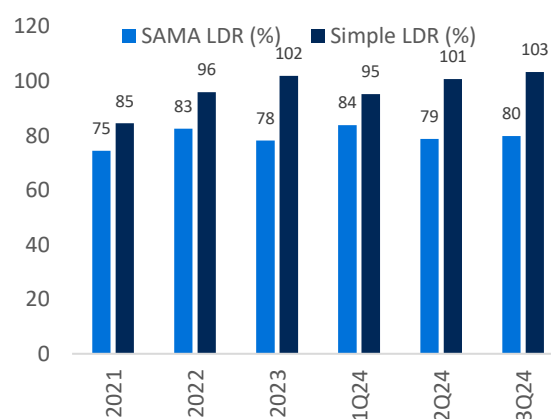
However, deposit mobilization was slightly weak, which we see because of the bank's strategy to sustain a strong CASA balance while funding growth through interbank and wholesale channels. This meant that LDRs remained elevated where, according to our calculation, non-regulatory LDR stood over 100% at the end of 3Q24, though SAMA regulatory LDR was broadly stable at 80%.

Chart 83: Capital Adequacy ratios improved in 2023 thanks to strong profitability



Source: Company financials and anbc research

Chart 84: Regulatory LDR has been broadly stable so far despite muted deposit growth

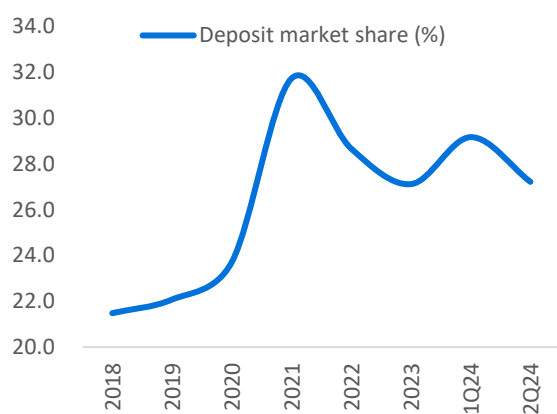


Source: Company financials and anbc research

SNB lost its deposit market share, especially between 2021-23, as the focus had been on merger integration rather than pursuing growth. We estimate that its market share (excluding quasi-money deposits) fell from 32% in 2021 to 27% in 2023.

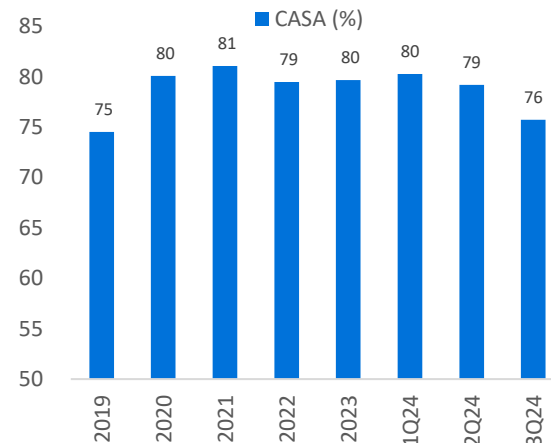
However, the bank would remain a deposit-funded institution, which would remain a primary source of growth funding. Its scale and strong positioning in the retail segment should allow the bank to deliver deposit mobilization albeit challenging liquidity dynamics.

Chart 85: The bank lost some market share between 2021-23 as the focus was on the merger



Deposit market share calculated excluding quasi-money deposits
Source: Company financials and anbc research

Chart 86: Also, sustaining the CASA balance had been a key part of the strategy



Source: Company financials and anbc research

Scale benefit filtering into operational efficiency, credit cost normalized

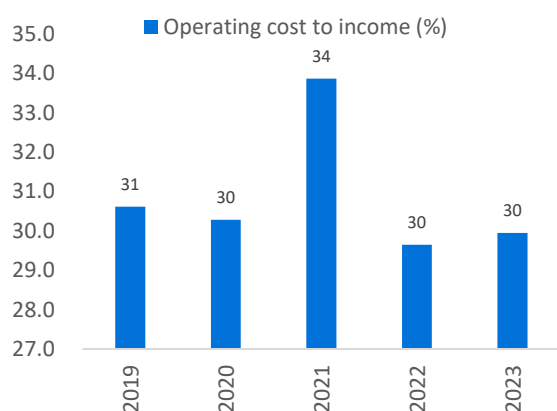
The bank delivered strongly on the targeted cost synergies, which, according to management, exceeded SR1.5bn, 110% of the revised target, and the costs were restricted to SR0.9bn, 94% of the target. The key areas of merger synergies were on the operational side, in addition to optimizing the technology stack of both banks. Whereas most of the integration costs were primarily related to capital expenditure, accounting for 63% of overall costs.

The merger and subsequent integration of the two banks' operations are behind us. However, with SNB's significantly enhanced scale, the largest bank in the country, and second largest in the GCC region, its operating leverage stands out as a key positive for the bank, especially considering the prospectus of margin expansion on the horizon.

SNB has the lowest domestic operating cost-to-income ratio among our covered banks, though the headline number is slightly higher. Excluding the amortization of intangibles (related to Samba's deposit relationships, which will be amortized over ten years), it stands at 28%. Moreover, excluding international business, the operational leverage of the domestic business is even better, with a cost-to-income ratio of less than 26%.

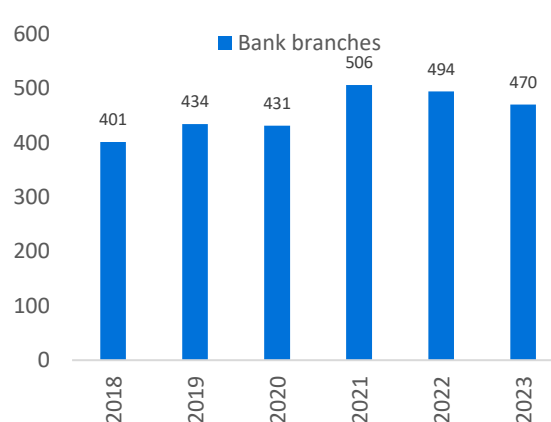
This is a significant cost advantage for SNB, placing it ahead of the sector. Management's guidance of further improvement in cost efficiencies is positively underpinned by its medium-term strategy, which focuses on a leaner operating model and value creation through economies of scale. These cost efficiencies, coupled with increased income growth from margin expansion, offer even further improvement in the bank's cost-to-income ratio.

Chart 87: Robust operational leverage with operating cost to income at less than 30% in 2023



Source: Company financials and anbc research

Chart 88: The bank has the widest branch network and continued to optimize it post-merger



Source: Company financials and anbc research

Moreover, the bank's credit cost has also improved in recent years from elevated levels in years prior to 2021, marred by slightly higher NPL formations. However, the very low CoR for 2023 was also supported by a sharp increase in recoveries as the bank continued to unlock value from its legacy portfolio and extract value from loans under POCI. In our view, improved macroeconomic activity in recent years also supported this.

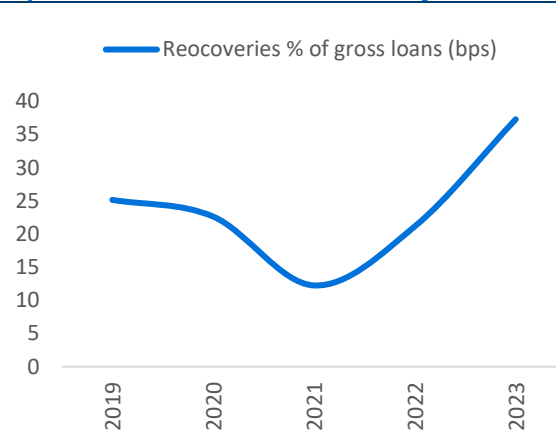
SNB's headline cost of risk fell to 30bps in 2022 and further down to only 15bps in 2023 from an average of 62bps between 2017-21. However, in the last two years, recoveries as a percentage of gross loans jumped to 37bps in 2023. The bulk of the lower provisioning charges was driven by improvement in the corporate sector, with its impairment charges falling 2.2x YoY in 2023.

Chart 89: Cost of risk improved sharply in the last two years, down to only 15bps in 2023...



Source: Company financials and anbc research

Chart 90: ...as recoveries of non-performing loans improved for the second consecutive year



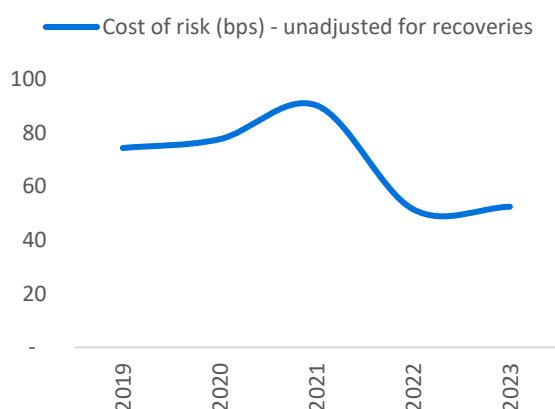
Source: Company financials and anbc research

However, even if we exclude recoveries from our calculation of CoR, it stood at 51bps in 2022 and 52bps in 2023, levels that we see as more normalized for the bank in the current environment. It also reflects the management’s prudent strategy to manage its credit risk and NPL formations. A lot of the focus of the bank’s corporate strategy now revolves around value and maintaining healthy asset quality.

The NPL ratio has also shown improvement, especially in 2023. It dropped to 1.2% in 2023 from 1.6% in 2022 and fell below 1.5% for the first time in the last seven years. The bulk of the NPL origination in the previous years had been concentrated in the commerce and manufacturing sectors, resulting in a higher corporate NPL ratio.

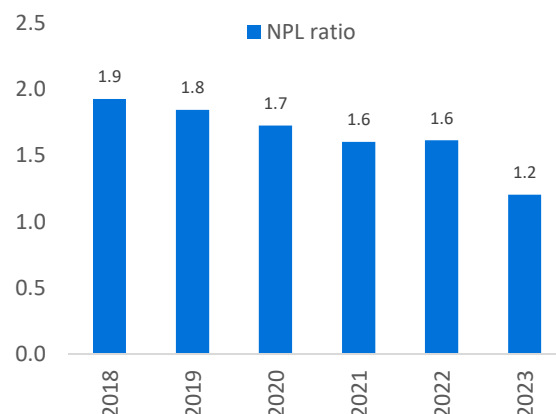
We estimate that the corporate NPL ratio stood at 2.2%, excluding the POCI portfolio, improving from above 3% in 2022. However, the asset quality is largely sustained in the retail portfolio with a stable NPL ratio of 0.5%. On a net basis, as recoveries normalize, we expect the cost of risk to be broadly stable at around 40bps.

Chart 91: Excluding recoveries, CoR stood around normalized levels of 50bps



Source: Company financials and anbc research

Chart 92: NPL ratio witnessed improvement primarily in the corporate segment



Source: Company financials and anbc research

Valuations:

We have used the residual income method with a cost of equity of 11% to value SNB at a target price of SR46/share. The stock trades at a 2024e PER of 9.4x and PBV of 1.1x. While we do not expect the bank's RoAE to recover back to pre-merger levels, we think the stock is still currently undervalued for a RoAE that is expected to expand to over 13.5% in the medium term with an estimated adjusted earnings CAGR of 9% between 2023-28e. Moreover, we do not see the current valuation justified for the SNB's scale and strong brand value. Our target price values the stock at a 2025e PBV of 1.5x.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	160,717	172,123	183,466	194,754	207,114	220,442	234,999
Cost of equity (%)	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%
Cost of equity	17,660	18,914	20,160	21,401	22,759	24,223	25,823
Net attributable income	20,738	22,685	25,084	27,467	29,619	32,348	34,849
Excess equity return	3,077	3,772	4,924	6,067	6,860	8,125	9,026
Terminal excess equity return							158,266
Discount factor	1.03	1.14	1.27	1.41	1.56	1.73	1.73
Present value	2,991	3,302	3,885	4,312	4,392	4,687	91,300

Equity invested	160,717
PV of excess return on Equity	114,869
Value of equity	275,586
Number of shares (mn)	6,000
Target Price	46

Earnings Sensitivity:

CoE		Growth rate				
		3%	4%	5%	6%	7%
	9%	59	64	72	85	112
	10%	49	52	56	63	73
	11%	42	44	46	49	54
	12%	36	37	38	40	42
	13%	32	32	33	34	35

Source: Company financials and anbc research

Alinma Bank

2 December, 2024

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

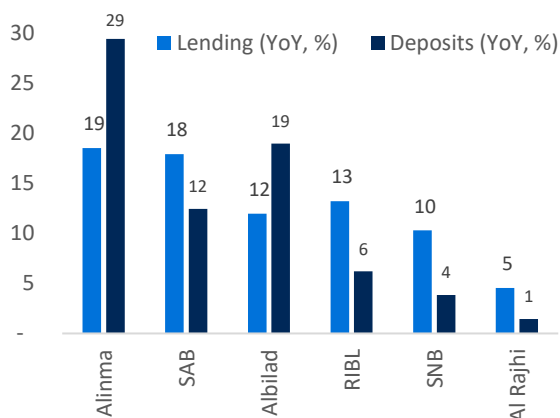
Investment Thesis

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.

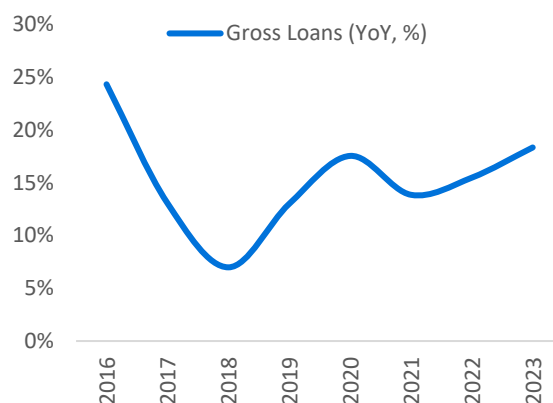
Alinma's 19% YoY lending growth in 2023 (18% YoY growth for gross lending book) was the strongest pace of expansion in the last seven years as it expanded its market share not only in corporate, where project financing volume increased but also grew its share in the retail sector. This momentum sustained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



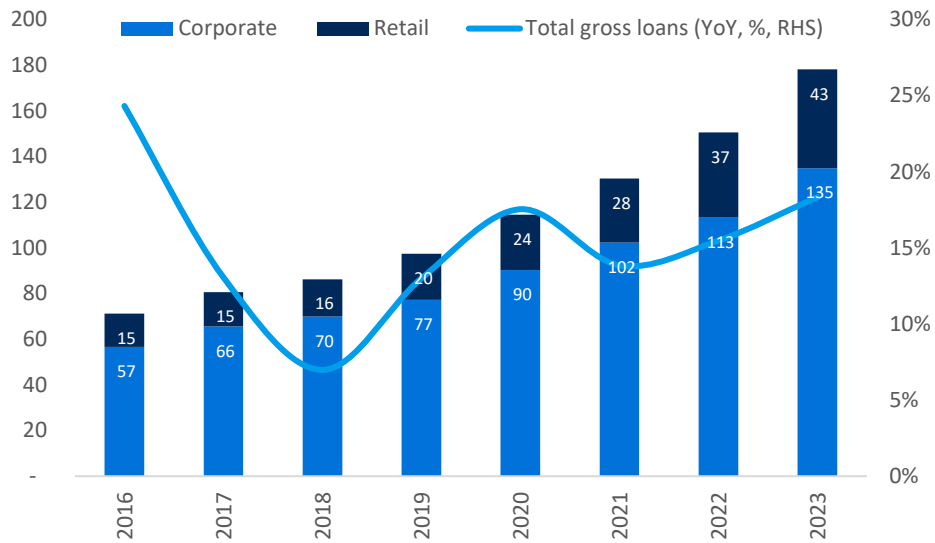
Source: Company financials and anbc research

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



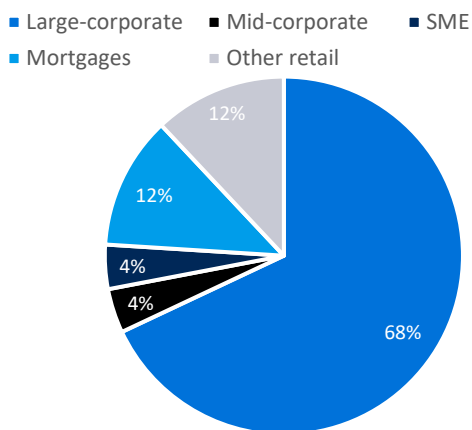
Source: Company financials and anbc research

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.

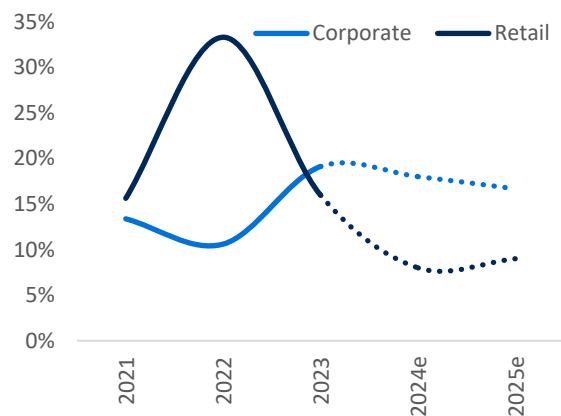
The bank's retail strategy is to widen its customer base by building a portfolio of HNW (high net worth) customers through improved customer experience. This would eventually allow the bank to expand its deposit base and lending exposure. The bank has recently launched mortgage refinancing products to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

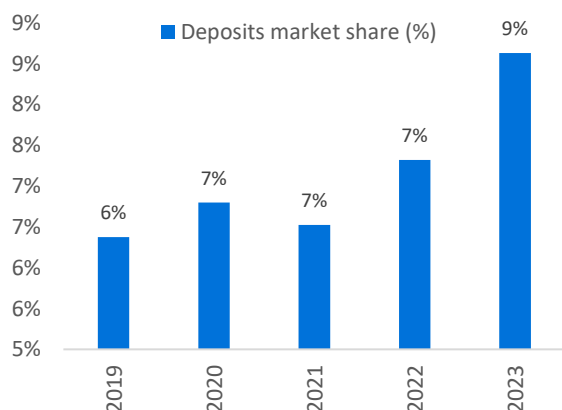
Overall, the bank's growth strategy is focused on aggressive penetration. In this regard, Alinma's past track record, including the performance delivered in the last four years and relatively strong positioning in the sector (Islamic franchise), supports these ambitious growth plans, in our view.

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.

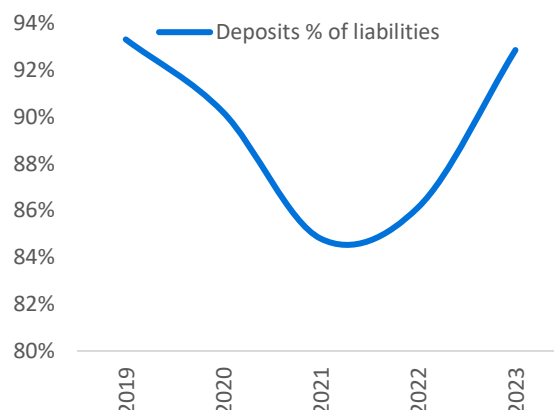
However, despite Alinma's issuance of USD1bn Tier 1 Sukuk in 1Q24, we think its Tier 1 capitalization remains under pressure amidst strong growth in risk-weighted assets. Tier 1 CAR fell for the second consecutive year to 16.3% in 2023 from 21.6% in 2021, and if the growth momentum sustains a similar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



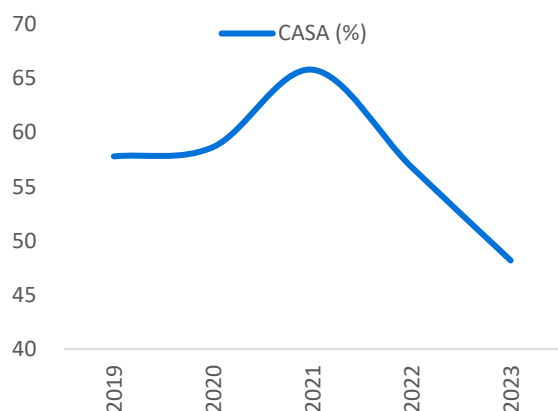
Source: Company financials and anbc research

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.

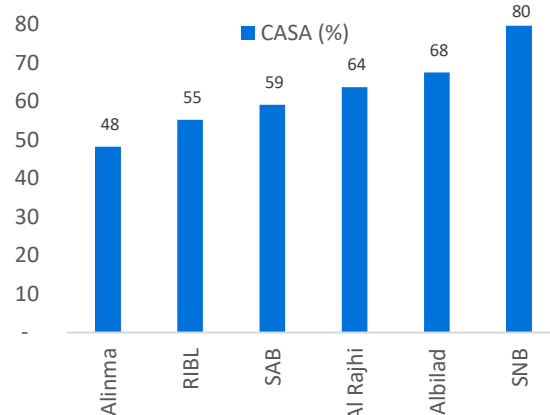
This could partially be explained by a large portion of the retail deposits, accounting for 63% of the overall deposits for Alinma, which are relatively more sensitive in a rising rate environment as households switch to savings and time deposits. In addition, to fund its well-above-the-sector average 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

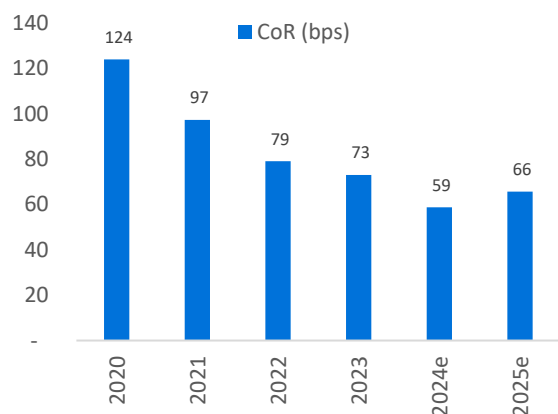


Source: Company financials and anbc research

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.

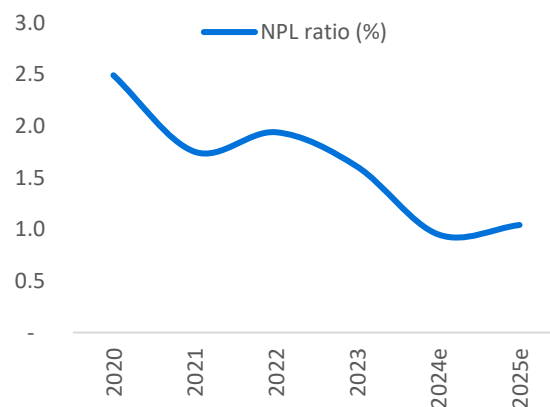
The cost of risk has been normalizing for the fourth consecutive year and is down from over 120bps in 2020 to 73bps in 2023. The bank's NPL ratio fell from 2.5% to 1.6% during the same period. Surprisingly, while the NPL generation significantly improved in the corporate sector, this came alongside a 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



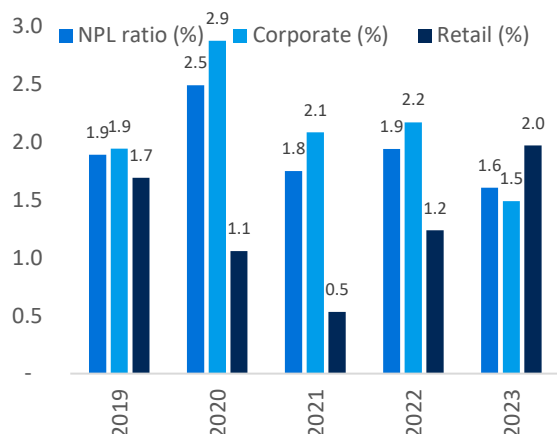
Source: Company financials and anbc research

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

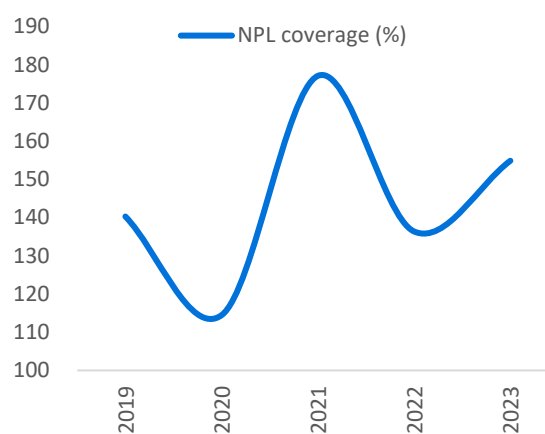
contribution of secured project financing. However, we remain cautious about Alinma’s NPL formation, especially for any signs of distress in the next few quarters. For our models, we have penciled in slightly elevated CoR, around 65bps for the next two years, before normalizing around 50bps in the long 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

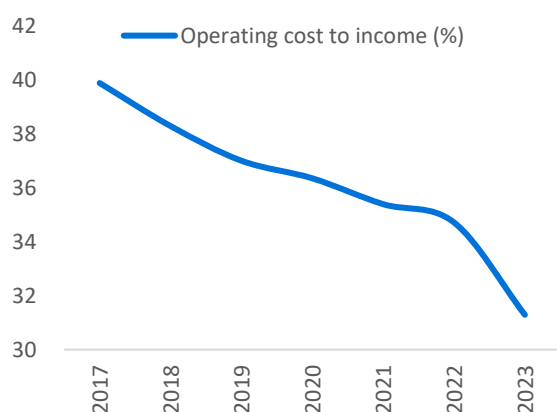


Source: Company financials and anbc research

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.

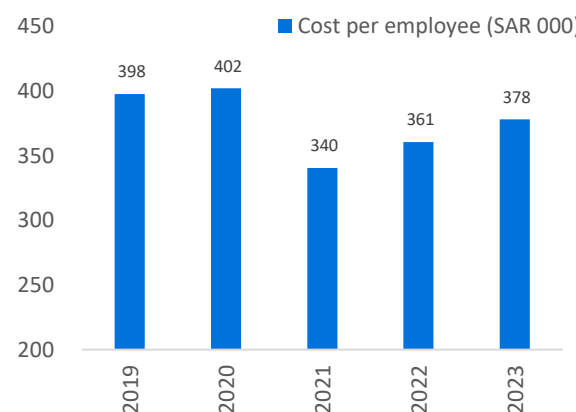
This sharp acceleration has been witnessed predominantly across employee-related expenses (+11% in 2023), which account for over 50% of all operating costs. However, we see this as much needed for its growth plans, particularly with expansion in the retail sector. The bank had historically focused primarily 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

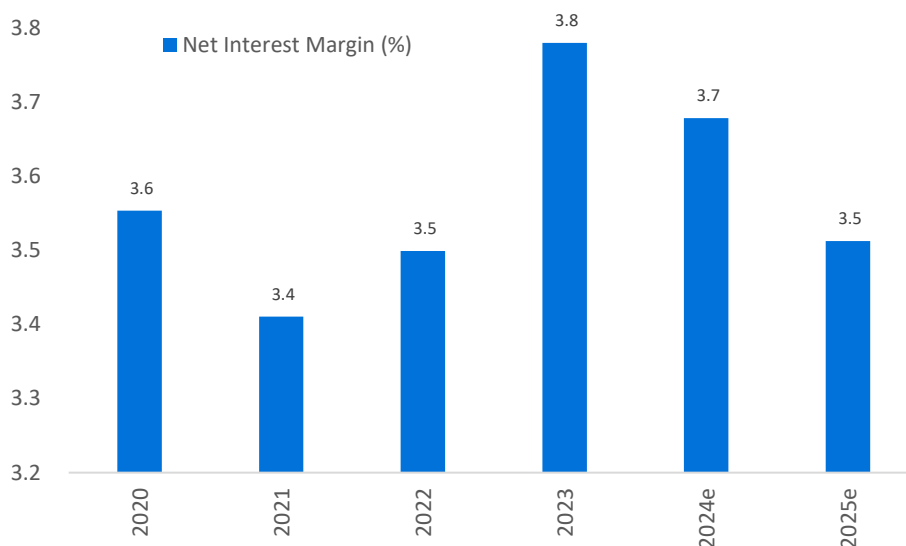
Net interest margins to contract, keeping a check on earnings growth

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

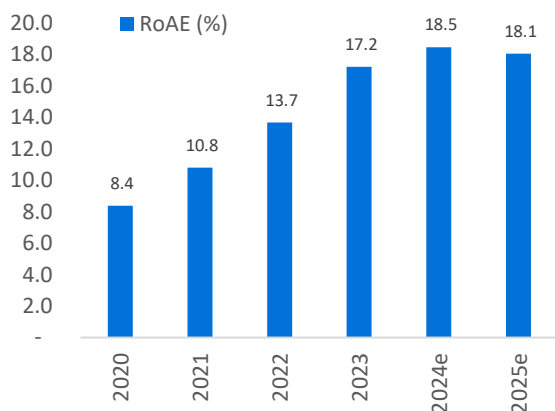


Source: Company financials and anbc research

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.

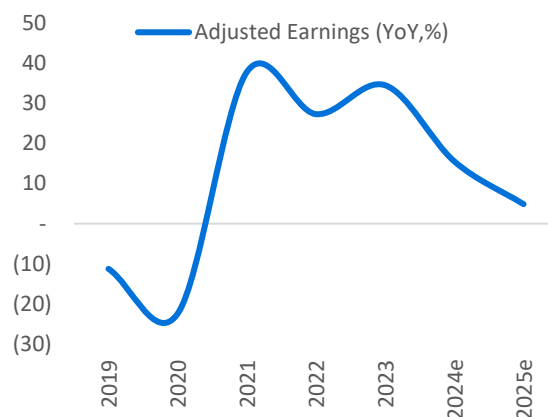
Meanwhile, we expect the bulk of RoAE expansion to be behind us, with little room for further expansion. RoAE increased from 11% in 2021 to over 17% in 2023, thanks to improved margins and strong lending growth. Based on our calculations, the bank's profitability returns have been the strongest on record. 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:

CoE	Growth rate					
	3%	4%	5%	6%	7%	
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

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%

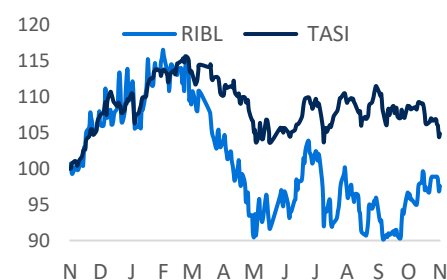
Last price as of November 28th

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	
	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Income Statement								
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

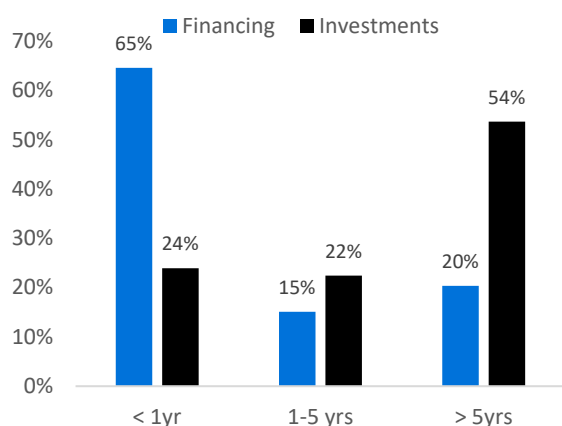
Pressures on net interest margins in the short-term

We see Riyadh 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, Riyadh 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.

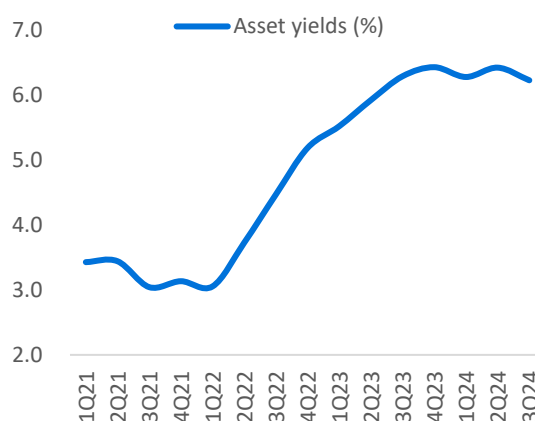
While a supportive asset-liability duration gap significantly benefitted Riyadh Bank in a rising and even elevated rate environment, with net interest margins expanding by over 75bps cumulatively in the last two years, that will reverse during the monetary easing cycle. We estimate that asset yields 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



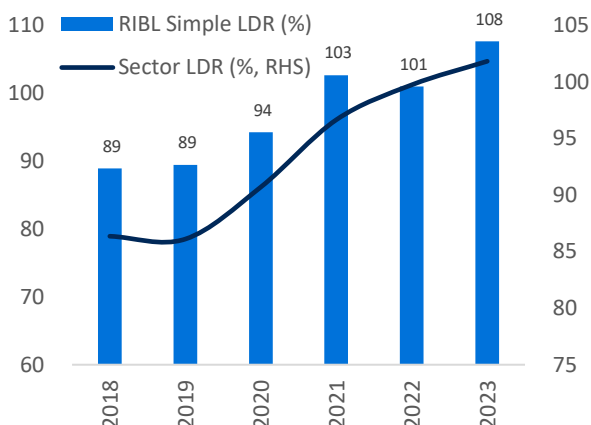
Source: Company financials and anbc research

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.

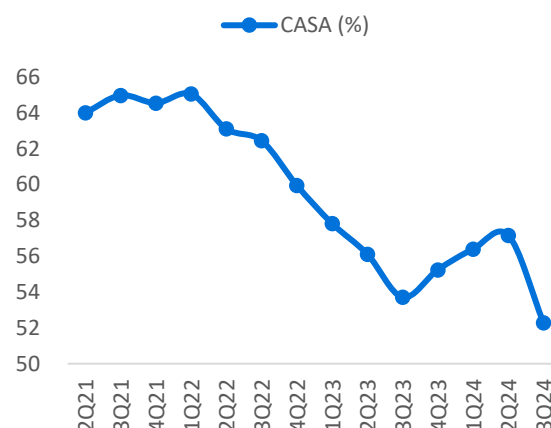
In addition, Riyadh Bank is also witnessing depleting interest-free deposits from SAMA that were placed during the COVID. Nearly 43% of those deposits were redeemed during 2023, but SR11.2bn (4% of estimated total funding) remains, which would be replaced by interest-bearing instruments during 2024, increasing the cost of funds for the Riyadh 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

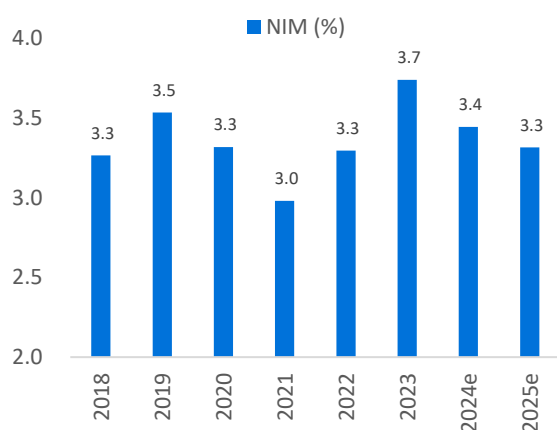


Source: Company financials and anbc research

With mounting pressure on both sides in the short term, Riyadh Bank’s net interest margins declined by over 24bps in 9M24. With a balance sheet negatively geared for rate cuts, we estimate that Riyadh 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.

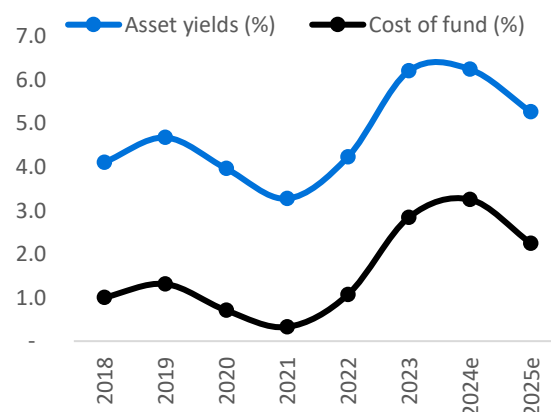
However, once these pressures subside, we believe the bank’s corporate strategy of expanding into project financing and the SME sector would allow for relatively improved margins and better pricing in the medium term. It is also raising its retail footprint and has already become the third-largest retail 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

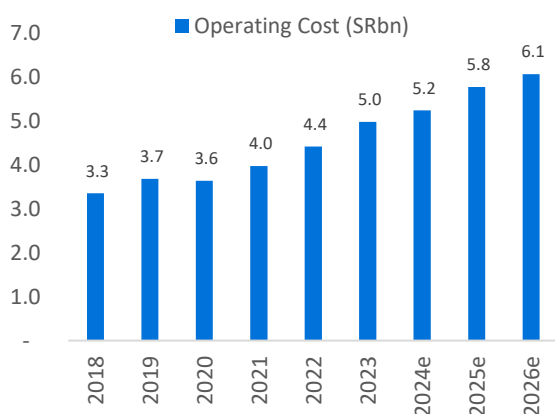
Cost structure relatively elevated to support growth

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.

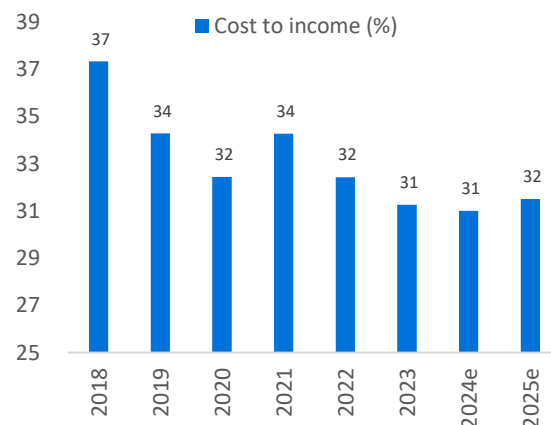
The bulk of this Opex growth resulted from employee-related expenses and premises, followed by G&A expenses. However, according to 3Q24 financial statements, the number of bank branches has been reduced to 334 compared to 338 last year, which could partially indicate cost optimization measures.

Chart 117: Operating costs have picked up...



Source: Company financials and anbc research

Chart 118: ...limiting the gains in efficiency



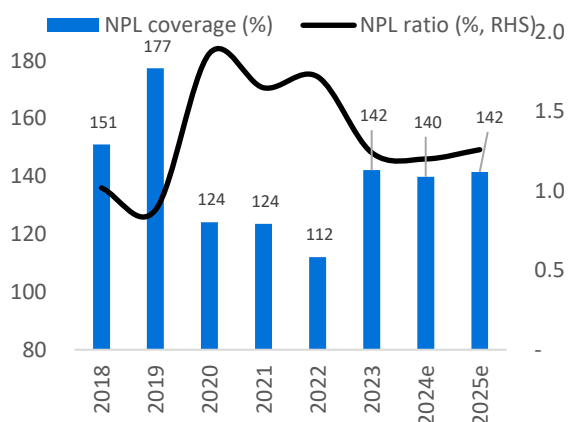
Source: Company financials and anbc research

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.

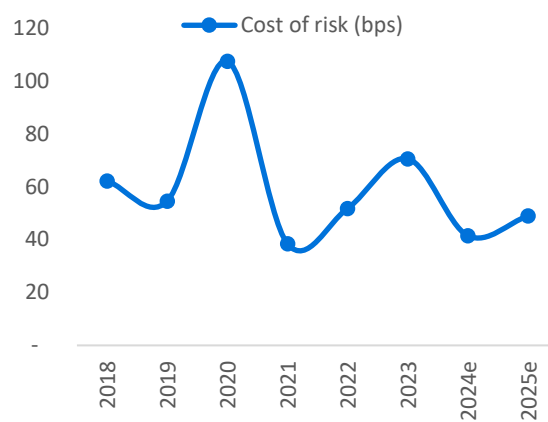
While there are no signs of asset quality stress, the bank will continue to use this opportunity to further build up its coverage buffers. This remains in line with the management guidance of proactive risk management by enhancing coverage.

Chart 119: NPL remains manageable



Source: Company financials and anbc research

Chart 120: CoR will likely remain low



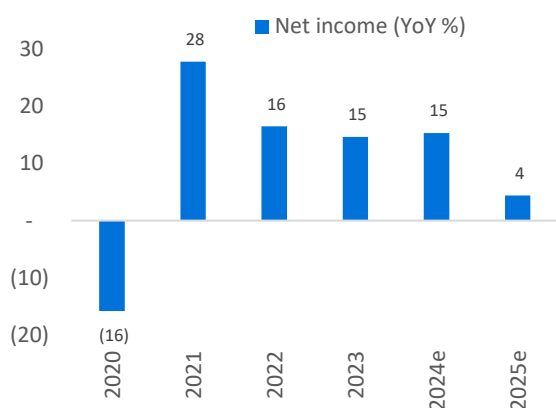
Source: Company financials and anbc research

However, Riyadh 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.

Riyadh 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.

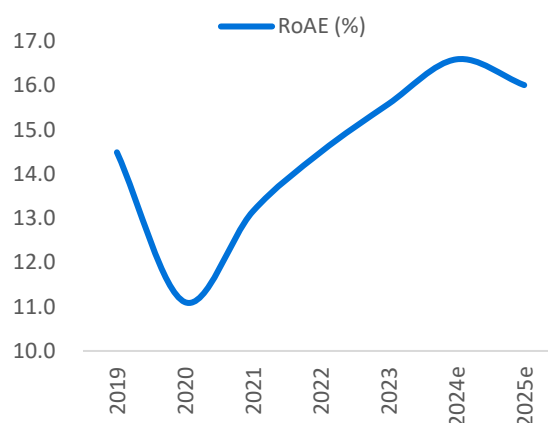
However, on a net basis, despite robust loan growth prospects and sustained non-funded income performance, we still expect Riyadh Bank’s profitability growth to moderate primarily on margin contraction. We project adjusted net income to grow at a CAGR of only 8% over the next five years, slowing down 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 Riyadh Bank’s loan growth as we see the bank having all the right levers to deliver some strong expansion. Riyadh 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, Riyadh 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

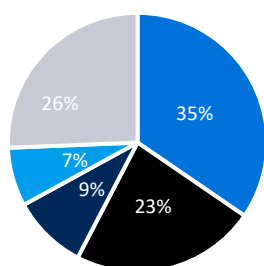
all the sectors, accounting for 16% of the lending book. Riyadh’s Bank has a high exposure to the trade and commerce sectors, followed by manufacturing, both of which should expand as non-oil economic activity growth picks up pace in the coming quarters.

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. Riyadh 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 Riyadh Bank between 2023-28e, with growth likely to increase beyond 2025e once the short-term pressure subsides and liquidity dynamics improve.

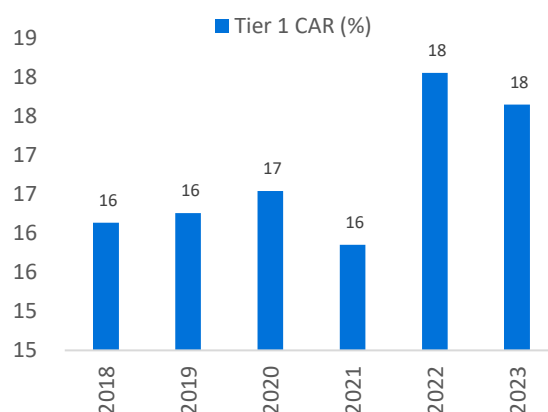
Chart 123: Commerce and manufacturing make up most of loan book

- Consumer
- Commerce
- Manufacturing
- Construction
- Others



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

CoE	Growth rate					
	3%	4%	5%	6%	7%	
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

Saudi Awwal Bank

2 December, 2024

Saudi Awwal Bank's turnaround story has been progressing well, with accelerated growth, improved cost structure, and margins benefitted from rising rates. In 9M24, its loan book growth outpaced the sector by a wide margin, underpinned by strong corporate origination and market share gains in retail. We believe its corporate positioning, track record of financing large projects, being a key financier for the Giga projects, international connectivity through HSBC, a vast client base, and retail expansion offers strong lending growth prospects, which we estimate at a five-year CAGR of 14%, highest among over covered banks – recent AT1 issuance also supports this. The bank is also optimizing its infrastructure to improve cost efficiencies, and NPLs, though still slightly elevated, are trending lower. However, we think this strong lending growth would be partially offset by lower margins as the bank is geared negatively towards rate cuts, and we estimate higher impairment charges as recoveries normalize. That said, valuations have become attractive (post share price underperformance after relatively weak 3Q24 earnings print) at FY24e PER of 8.9x and PBV of 1.0x for a medium-term RoAE, which would likely be between 12-13%. We initiate coverage with an Overweight rating on the stock and a target price of SR42/share.

Post-merger progress has been well, while delivering on key growth strategic targets. Following the completion of the integration process, the bank delivered an accelerated pace of lending growth amidst an improved cost structure. Its lending growth picked up markedly in 2023, and the momentum was sustained in 9M24, with the highest pace of expansion in the sector, as corporate loan originations picked up significantly and the bank improved its market share in retail. Its operating leverage has been enhanced as the bank continued to optimize its resource base, and its CoR fell as recoveries improved.

Offering strong lending prospects: We like SAB's strong positioning in the corporate segment, benefiting from strong economic activity. It has a track record of financing large projects and is a key financier for the Giga projects, including Neom. It has a strong operational connectivity with HSBC, allowing enhanced product capabilities and a vast client base of MNCs in the country. Its retail expansion has also been quite aggressive, increasing its market share in mortgage new loan origination by over 3x in the last two years. We expect SAB to deliver one of the strongest lending growth among our coverage: a 2023-28e CAGR of 14%.

However, margin contraction and higher credit costs would be growth dilutive: Despite the bank's efforts to lower its earnings sensitivity, it is still negatively geared toward rate cuts. We estimate that its margins will contract 22bps in 2024e (another 15bps decline in 2025e), and its CoR will likely increase to 40-50bps as recoveries normalize in the medium term.

Valuation: At 2024e PBV of 1.0x, the bank's valuation is attractive for RoAE, which will likely be 12-13%. SAB offers the most robust lending growth prospects, and while earnings growth would be slightly diluted because of lower margins and higher CoR, we still think it's the best play for Saudi Arabia's lending sector growth.

Risks: While the bank's core strategy has focused on reducing earnings sensitivity to changes in interest rates, rate cuts negatively impact the bank's margins, which may exceed our expectations. Moreover, provisioning costs can also surprise negatively in a scenario where recoveries normalize quickly from current elevated levels.

RATING SUMMARY	OVERWEIGHT
Target Price (SR)	42
(Upside/Downside)	35%
Div. Yield (%)	6%
Total Exp. Return	41%

ISSUER INFORMATION	
Bloomberg Code	SABB:AB
Last Price (SR)	31.05
No of Shares (mn)	2,055
Market Cap bn (SR/USD)	64/17
52-week High / Low (SR)	42.5/31.1
12-month ADTV (mn) (SR/USD)	50/13
Free Float (%)	49%
Foreign Holdings (%)	16%

Last price as of November 28th

VALUATIONS	2023A	2024e	2025F	2026F
EPS (SR)	3.4	3.5	3.7	3.9
PER (x)	10.5	8.9	8.4	7.9
PBV (x)	1.3	1.0	1.0	0.9
DPS (SR)	1.7	1.9	2.0	2.2
Div. Yield (%)	4.7	6.2	6.6	6.9
RoAE (%)	12.4	12.5	12.6	12.6
RoAA (%)	2.1	2.0	1.9	1.8

FINANCIALS (SRbn)	2023A	2024e	2025F	2026F
Oper. Income	12.7	14.0	15.0	16.1
Provisions	(0.6)	(0.9)	(1.1)	(1.5)
Net Income*	7.0	7.2	7.6	8.1
Investments	97	99	101	103
Loans & Advances	216	255	292	333
Deposits	241	269	307	347
NIM (%)	3.5	3.2	3.1	3.0
Cost to Income (%)	32.4	31.0	30.5	30.0
NPL Ratio (%)	1.9	1.7	1.7	1.7
Simple LDR (%)	90	95	95	96

*Net Income adjusted for cost of AT Sukuk

RELATIVE PRICE PERFORMANCE



Financial Summary:

SAR mn Income Statement	2023	2024E	2025E	2026E	2027E	2028E	CAGR	
							2018-2023	2023-2028e
Interest Income	17,088	20,108	18,917	18,944	20,210	21,109	21%	4%
Interest Expense	(6,747)	(9,123)	(7,201)	(6,352)	(6,678)	(6,506)	45%	-1%
NSCI	10,341	10,985	11,716	12,593	13,532	14,603	13%	7%
NII	2,369	2,986	3,261	3,528	3,780	4,009	6%	11%
Operating Income	12,710	13,971	14,977	16,120	17,312	18,612	12%	8%
Operating expenses	(4,113)	(4,331)	(4,568)	(4,836)	(5,020)	(5,211)	13%	5%
Provisions	(562)	(876)	(1,121)	(1,470)	(1,784)	(2,094)	17%	30%
Total Expenses	(4,676)	(5,207)	(5,689)	(6,307)	(6,805)	(7,305)	14%	9%
NPBT	8,223	8,764	9,288	9,814	10,507	11,306	16%	7%
Net Income*	7,002	7,167	7,613	8,061	8,651	9,331	21%	6%
Shares Outstanding (mn)	2,055	2,055	2,055	2,055	2,055	2,055		
EPS	3.4	3.5	3.7	3.9	4.2	4.5		
DPS	1.7	1.9	2.0	2.2	2.3	2.5		
Balance Sheet	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Cash and balances with central bank	16,741	18,698	21,318	24,092	27,019	30,101	3%	12%
Due from other financial institutions	7,407	1,487	6,235	9,254	11,769	15,444	-9%	16%
Investments, net	97,029	98,969	100,949	102,968	105,027	107,128	23%	2%
Financing, net	215,936	255,204	292,484	333,116	376,923	422,093	14%	14%
Other	19,528	19,528	19,471	19,357	19,192	18,981	44%	-1%
Total Assets	356,642	393,887	440,455	488,787	539,930	593,747	15%	11%
Due to other financial institutions	32,196	34,128	35,834	36,551	37,282	38,028	100%	3%
Customers' deposits	240,940	269,100	306,806	346,728	388,865	433,217	13%	12%
Other liabilities	21,606	25,535	29,265	33,330	37,713	42,233	15%	14%
Total Liabilities	294,742	328,762	371,905	416,609	463,860	513,477	16%	12%
Total Equity	61,900	65,125	68,550	72,178	76,070	80,269	14%	5%
Total liabilities and equity	356,642	393,887	440,455	488,787	539,930	593,747	15%	11%
Growth (Y/Y)	2023	2024E	2025E	2026E	2027E	2028E		
NSCI	40%	6%	7%	7%	7%	8%		
NII	11%	26%	9%	8%	7%	6%		
Total operating income	33%	10%	7%	8%	7%	8%		
Net income	45%	2%	6%	6%	7%	8%		
Financing	18%	18%	15%	14%	13%	12%		
Deposits	12%	12%	14%	13%	12%	11%		
Ratios	2023	2024E	2025E	2026E	2027E	2028E		
NIM (%)	3.5	3.2	3.1	3.0	2.9	2.8		
Operating cost to income (%)	32	31	31	30	29	28		
Cost of risk (bps)	25	33	37	43	46	48		
NPL coverage (%)	144	160	161	162	163	164		
NPL ratio (%)	1.9	1.7	1.7	1.7	1.6	1.6		
Simple LDR (%)	90	95	95	96	97	97		
RoAA (%)	2.1	2.0	1.9	1.8	1.7	1.7		
RoAE (%)	12.4	12.5	12.6	12.6	12.8	13.0		
Assets to Equity (x)	5.8	6.0	6.4	6.8	7.1	7.4		
Valuation	2023	2024E	2025E	2026E	2027E	2028E		
BVPS	28.2	29.8	31.4	33.2	35.1	37.1		
P/B	1.3	1.0	1.0	0.9	0.9	0.8		
P/E	10.5	8.9	8.4	7.9	7.4	6.8		
Dividend yield (%)	4.7	6.2	6.6	6.9	7.5	8.0		

*Net income adjusted for the cost of AT Sukuk.

Source: Company financials and anbc research

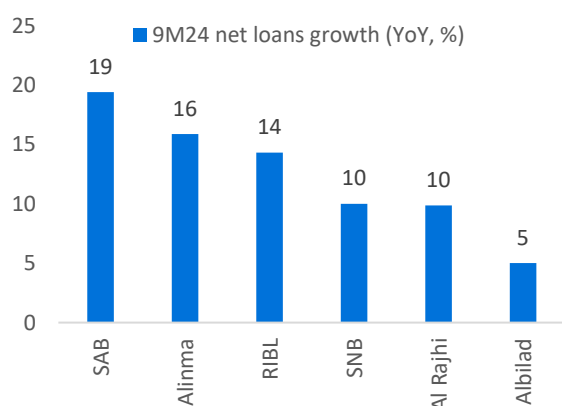
Investment Thesis

The turnaround story is progressing well, with a focus on growth now

Saudi Awwal Bank’s (SAB) leading growth has been an exception in 2023, outpacing the sector by a wide margin. The strong momentum from 2023, with loan growth of 17% YoY, followed through into 2024, with a growth of 19% YoY in 9M24, making it the fastest pace of expansion among our banking coverage. Surprisingly, SAB's lending growth has been broadly balanced across the retail and corporate sectors.

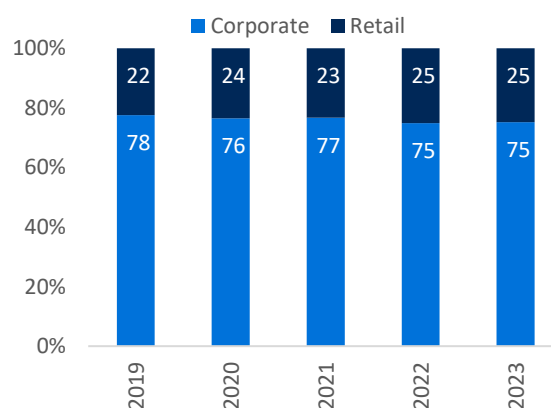
We believe SAB’s positioning within Saudi Arabia’s financial market as a key partner for infrastructure projects & Giga projects, supported by its long history of financing large projects, a vast multinational customer base, international connectivity through its partnership with HSBC, and retail expansion through market share gain remain key factors driving the robust growth outlook. We estimate a financing CAGR of 14% between 2023-28e for SAB, the highest among our covered banks with Alinma, which we expect to grow broadly at a similar pace.

Chart 125: SAB recorded the fastest pace of lending growth in 9M24



Source: Company financials and anbc research

Chart 126: Corporate sector loans account for 75% of the overall lending book



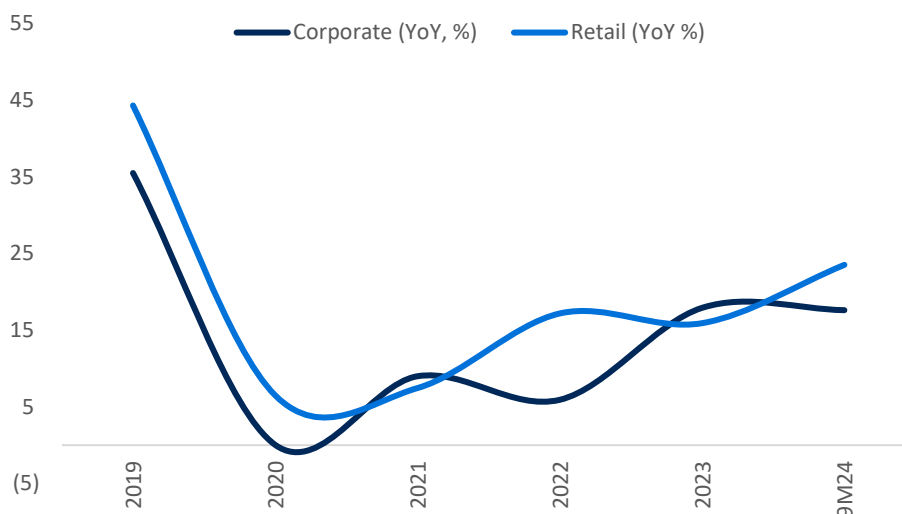
Source: Company financials and anbc research

After the merger with Alawwal Bank in 2019, growth significantly slowed as the key focus was on the merger transition. The bank’s performance had been overwhelmed by cost inefficiencies, high NPL ratios, and lower profitability returns.

However, the turnaround story progressed well two years after the integration phase completed. SAB witnessed accelerated growth and improved profitability as it invested heavily in a strategy that drove a culture around growth. This involved investments in human resources, technology, and product capabilities. The bank invested over SR1.5bn in the last three years across rebranding and digital infrastructure, including enhancing its product capabilities.

Resultantly, lending growth accelerated from a CAGR of 6% between 2019-22 to 17% YoY in 2023 alone. This robust growth was balanced between the corporate and retail sectors while delivering an accelerated pickup in the corporate sector, a key focus area of the bank’s corporate strategy; corporate gross loan growth picked up to 18% YoY in 2023 from only 6% YoY in 2022. In retail, the bank largely sustained its strong momentum, with gross loans up 16% YoY in 2023, a similar pace of expansion compared to 2022.

Chart 127: The growth (in gross loans) had been broadly balanced across the retail and corporate sector



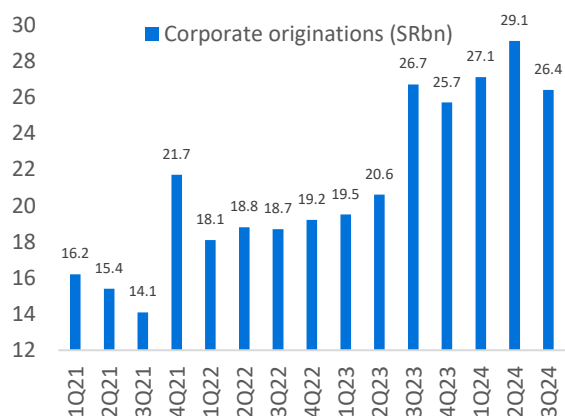
Source: Company financials and anbc research

Growing its loan book and aggressive penetration had been an imperative part of the bank’s 2021 core strategy. Within the corporate segment, apart from growth in short-term commercial lending for working capital requirements, the real catalyst had been project financing. According to the Board of Directors report, the bulk of the growth in the corporate segment resulted from supporting MNC financing involved in the Giga projects coupled with direct project financing.

Some prominent projects the bank financed included Spine, a railway line along the Neom project; Shuaiba, an extension of the world’s largest power projects; and Marjan, an offshore oil field. This led to a sharp pickup in corporate originations, which have consecutively exceeded SR25bn per quarter since 3Q23. To put it into perspective, this is nearly 65% of the 2023 corporate gross lending outstanding.

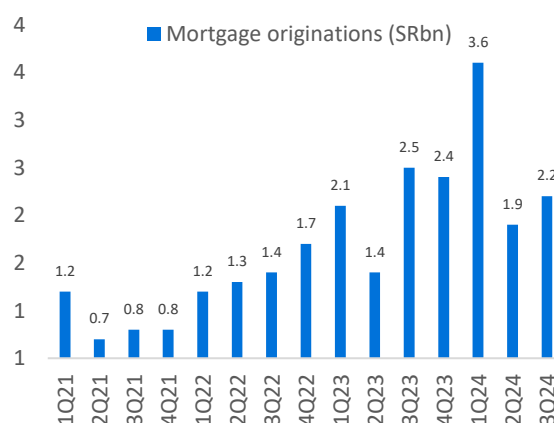
Meanwhile, in the retail segment, the key focus had been on mortgage lending, aiming to increase market share following the bank’s investments in its mortgage capabilities during 2021. The success of this strategy has been evident from the continuous pick-up in quarterly mortgage originations, which increased to a record high SR3.6bn in 1Q24. According to the company’s presentation, its market share in mortgage new loan origination increased to 12.5% in 9M24 vs. 10.8% in 2023 and only 4.7% in 2022.

Chart 128: Corporate loan origination consecutively exceeded SR25bn since 3Q23



Source: Company financials, presentation, and anbc research

Chart 129: There have been market share gains in the mortgage new originations

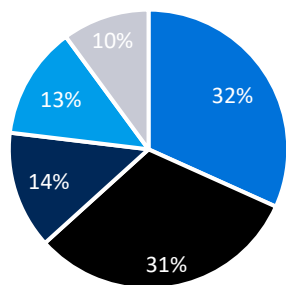


Source: Company financials, presentation, and anbc research

The recent update on the bank’s corporate strategy emphasizes driving growth through market share gains. Per management, the lending growth CAGR for 2024-26 is targeted at low double digits. We believe its international partnership with HSBC significantly benefits from shared capabilities and global reach. This would be crucial in supporting growth from inbound investments into the country. In this regard, the National Investment Strategy (NIS), the core strategy within the overall Vision 2030 framework, aims to raise annual FDI in the country to over USD100bn (SR388bn) while increasing its contribution to GDP to nearly 6% by 2030. SAB maintains full operational connectivity with HSBC's vast worldwide network along with global product and service capabilities, allowing it to tap a significant share of these inbound investments.

Chart 130: Corporate exposure across commerce, manufacturing, construction, and utilities

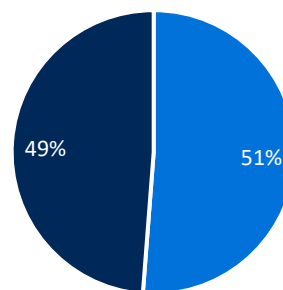
- Commerce
- Manufacturing
- Construction
- Others
- Utility



Source: Company financials and anbc research

Chart 131: Mortgages now account for over 51% of the retail lending (13% of overall loan book)

- Mortgage
- Other retail

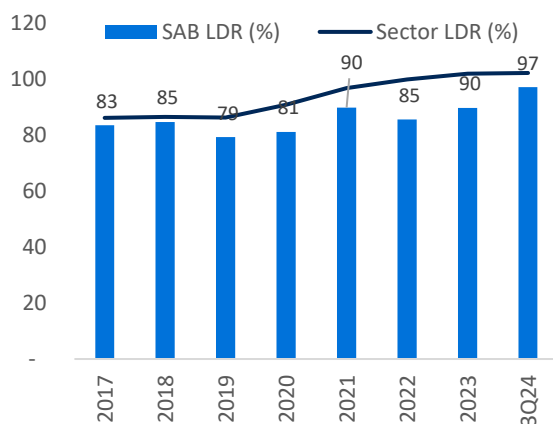


Source: Company financials and anbc research

One key positive for SAB is the headroom available in terms of capital and liquidity to support its growth ambitions. Its non-regulatory LDR stood at 90% at the end of 2023 vs. an average of 98% for our coverage and 102% for the sector. We believe its strong deposit mobilization, which, though it comes at the cost of CASA migration, provided crucial liquidity support.

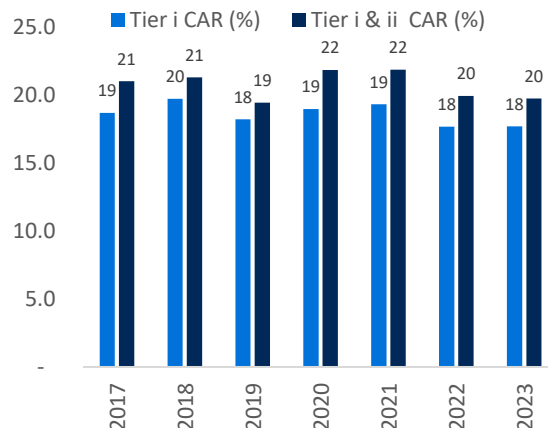
Moreover, SAB has a sufficient cushion on the capital front, supporting its growth—the bank last issued an SR4bn AT1 Sukuk in October 2023. Its Tier 1 CAR stood at 18%, while total capital CAR was nearly 20% in 2023. While we don’t expect capital injection in our base case, the bank could issue AT capital if growth continues to surprise on the upside and RWA accelerates more than expected.

Chart 132: We estimate non-regulatory LDR stood at 97% in 3Q24, up from 90% in 2023



Source: Company financials and anbc research

Chart 133: Healthy Capital adequacy ratios with Tier 1 CAR at 17.7%



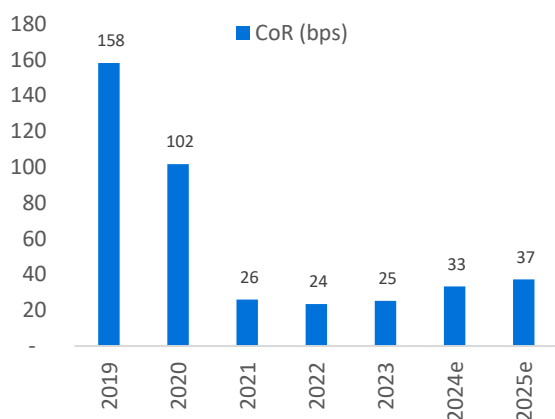
Source: Company financials and anbc research

The cost structure is heading in the right direction

Three years ago, rising NPLs, high impairment provisioning charges, and inefficient operating cost structures significantly weighed the bank's financial performance. However, since then, the bank has made significant progress in improving its cost base—CoR has normalized to a large extent as NPL formation declined and operating leverage improved.

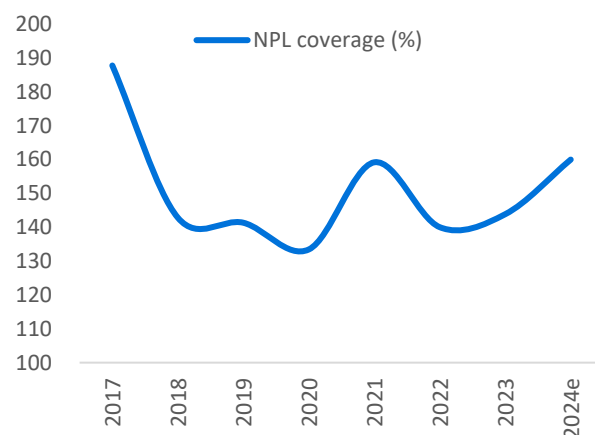
In 2019 and 2020, CoR rose to levels well above 100bps; however, since 2021, it quickly fell back to around 25bps. One of the key drivers for this was improved credit portfolio quality and the restriction of new NPL formation. Post the merger in 2020, the NPL ratio (excluding purchased or originated credit-impaired portfolio (POCI)) jumped to above 3%. However, with the successful transition and under the new strategy in 2021 amidst an improved macroeconomic backdrop, it was limited to only 1.7% in 2023, with coverage remaining above 150%, allowing stable impairment charges.

Chart 134: CoR to normalize to 40-50bps over the medium-term



Source: Company financials and anbc research

Chart 135: As the bank continued to build up its NPL coverage levels



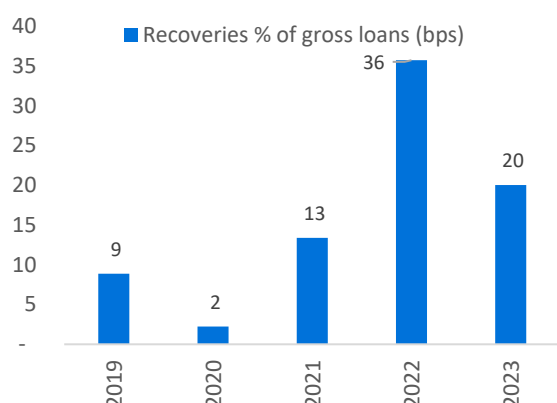
*Excluding POCI

Source: Company financials and anbc research

However, we note that substantial recoveries overshadowed the low CoR between 2021-2023. The bank continued to extract value from its POCI portfolio, and with continued efforts amidst a rise in macroeconomic activity, a certain portion of this portfolio was reevaluated back into performing loans, resulting in a substantial jump in recoveries.

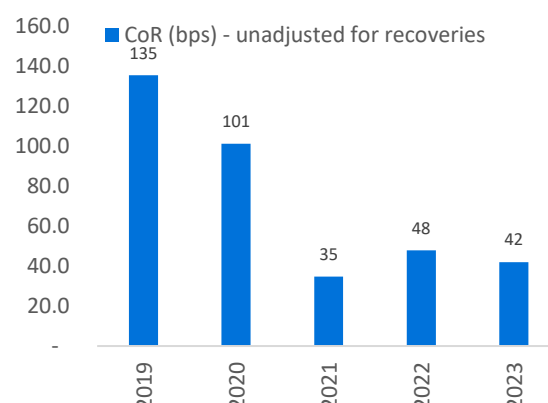
Recoveries of non-performing loans increased to 35bps of the overall gross lending portfolio in 2022 and remained high at 20bps in 2023. However, if we excluded the impact of these recovering, the unadjusted CoR would still be stable at around 40-50bps, more than half the levels reported in 2019 and 2020. We see this as normalized impairment charges for SAB, where the economic outlook is robust, and asset quality remains generally stable.

Chart 136: High recoveries drove the low CoR to a large extent



Source: Company financials and anbc research

Chart 137: Unadjusted CoR is estimated between 40-50bps



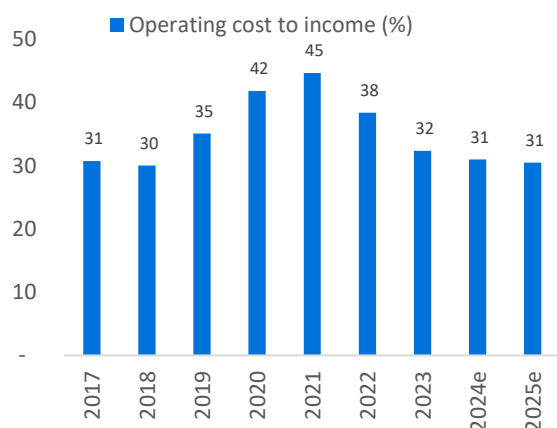
Excluding POCI
Source: Company financials and anbc research

Another notable improvement the bank has delivered is improving its operating leverage. Its Cost-to-income ratio rose to nearly 45% in 2021, but since then, optimizing the resource base and infrastructure, increasing digitalization, and improving asset efficiency have allowed for marked improvement in operating efficiency, with the cost-to-income ratio declining to 32% in 2023.

Optimizing the resource base and improving operating efficiency is evident from reducing the number of branches from over 130 to 104 in 2023 as SAB enhanced infrastructure efficiency.

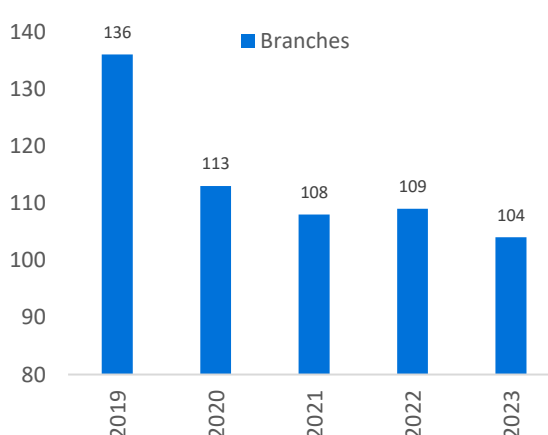
However, under its updated strategy, the bank now targets a more balanced approach, focusing part of its investments on automation and further increasing operational efficiency. Increased digitalization across all its segments would be a key catalyst for further improving its operating leverage, though the benefits would be more visible in the long term. Under the medium-term targets, the bank aims to sustain a 30-32% cost-to-income ratio.

Chart 138: The operating cost-to-income ratio has markedly improved post-merger



Source: Company financials and anbc research

Chart 139: As the bank continued to optimize its resource base and infrastructure



Source: Company financials and anbc research

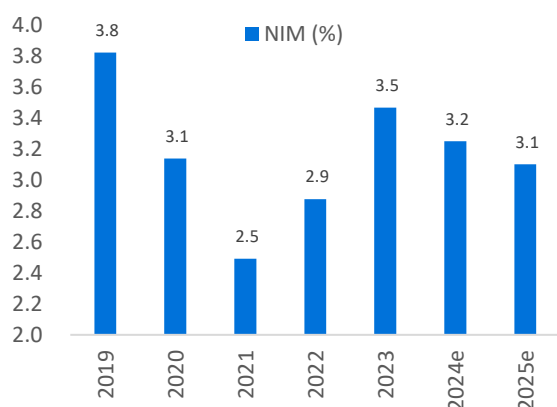
Meanwhile, part of its strategy focuses on minimizing interest rate sensitivity

A low retail contribution coupled with short-tenor corporate lending argues for negatively gearing to rate cuts—75% of lending is dominated by corporate loans. We see this potentially as the key growth dilutive for SAB, which otherwise would have filtered through profitability quite strongly. A robust lending outlook coupled with improving operating efficiency would be offset by margin contraction, which we estimate would decline by 22bps in 2024e and another 15bps in 2025e.

However, a key part of SAB’s 2021 strategy had been to minimize interest rate sensitivity as rates increased. SAB benefited from a rising rate environment; barring some competitive pressures, its net interest margins expanded by 98bps cumulatively over the last two years, according to our calculations.

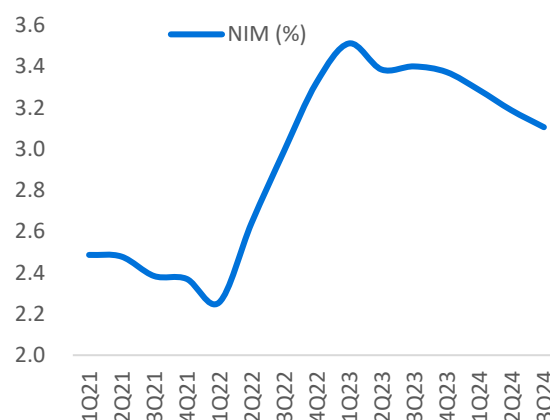
To maintain the sustainability of returns and lower its earnings sensitivity to rates, SAB focused on three key areas, namely: i) increasing its mortgage portfolio and ii) growing its investment placement to extend the overall duration with a greater proportion of the portfolio being fixed. and iii) focus on cross-selling to increase its non-funded income. According to the management in the last earnings call, the bank’s NIM sensitivity has been reduced to 1-3bps contraction for every 25bps cut in the policy rate.

Chart 140: We estimate SAB’s NIMs to decline by 22bps in 2024e end



Source: Company financials and anbc research

Chart 141: NIMs had already been under pressure since the start of 2023

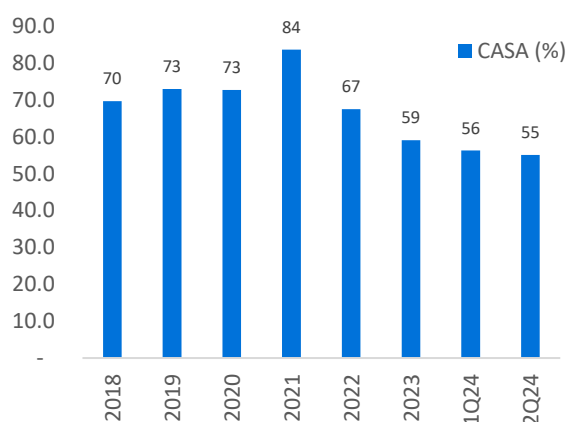


Source: Company financials and anbc research

Our calculation suggests that NIMs have been under pressure since early 2023. After expanding to 3.5% in 1Q23 vs. less than 2.3% at the start of monetary tightening, they showed signs of weakness and contracted cumulatively by 41bps on a quarterly basis until 3Q24. We think this reflected the growing competitive pressure weighing on product pricing and leaving with lower spreads and pressures from the rising cost of funds due to CASA migration, a cost that accompanied the strong growth.

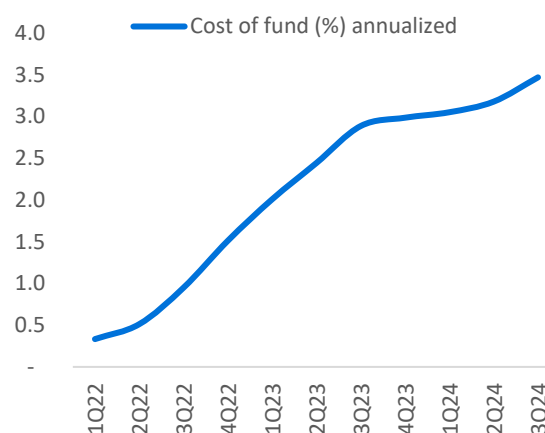
Since the CASA peaked at 84% in 2021, deposit mobilization in a rising rate environment drew more demand for interest-bearing deposits against CASA deposits. Since then, it has fallen to 52% in 1H24, driving the CoF sharply higher amidst gross yields marred by rising competition.

Chart 142: Aggressive tightening led to CASA migration to 55% in 2Q24



Source: Company financials and anbc research

Chart 143: Pressures from CoF showed no signs of abating, even up QoQ in 3Q24

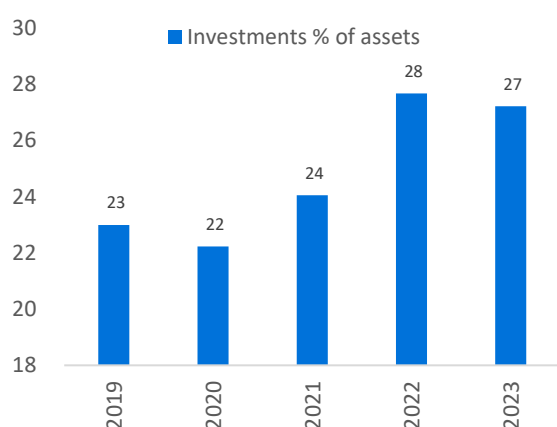


Source: Company financials and anbc research

Since 2021, SAB has been growing its investment placement and now accounts for 27% of the assets vs. less than 23% in 2019. The majority of these placements have been placed in fixed-rate instruments as the bank took the opportunity in a rising rate environment to extend the duration of its book. According to 2023 financials, over 89% of the investment book has maturity beyond one year.

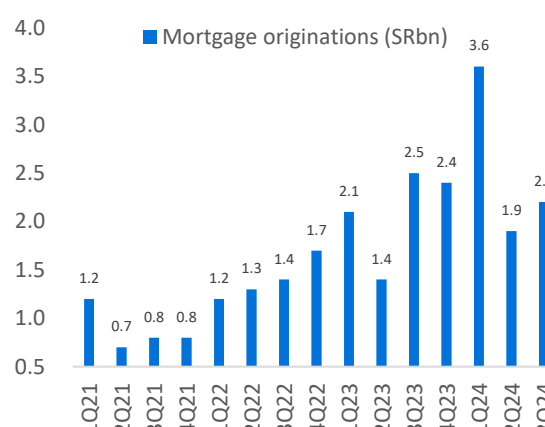
Moreover, SAB has been aggressively pursuing growth through mortgages. Its penetration has been aggressive, taking a market share of 16% of the new originations, which surprisingly, though, comes at the peak rate cycle. Its mortgage originations have markedly picked up since the start of 2022 and delivered an even stronger penetration during 1Q24, with new loans amounting to over SR3.5bn. While the overall contribution of mortgages to the total lending book remains relatively low at only 13% (51% of the retail book), it has been an integral part of the SAB strategy, allowing it to lower the impact of rate decline in operating income.

Chart 144: Investment as a % of assets has increased to 27% in 2023 from 23% in 2019



Source: Company financials and anbc research

Chart 145: Aggressive mortgage penetration, with SR3.5bn in new loan originations in 1Q24

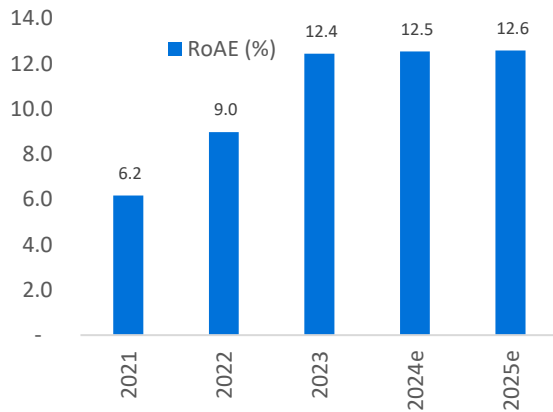


Source: Company financials and anbc research

Lastly, it has a strong positioning in trade finance, a vast network of MNC clients, and a growing wealth and private business, which offers increasing opportunities for cross-selling products and generating non-funded income growth. This entails capturing international opportunities and leveraging trade, receivables, and payment capabilities for corporates. For the retail segment, SAB is developing products for private banking customers and growing its remittance business. Meanwhile, its capital market business will also drive growth in fee income as it accelerates its asset management and brokerage after acquiring its asset management business from HSBC SA.

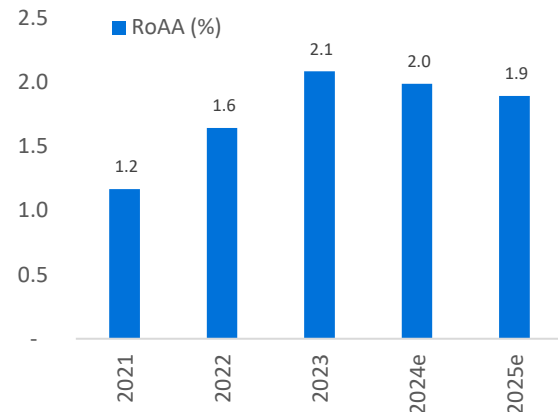
While the SAB turnaround story has been progressing well and delivering on its key strategy milestones, it is still negatively geared for a declining rate environment, which would dilute a strong growth outlook. Net income growth will moderate in 2024e as pressures on net interest margins continue to build up from CASA migration. We estimate an adjusted net income CAGR of 6% between 2023-28e vs. a 14% CAGR in lending.

Chart 146: RoAEs to remain broadly stable as margin contractions offset lending growth



Source: Company financials and anbc research

Chart 147: Similarly, RoAA would likely contract, albeit only incrementally



Source: Company financials and anbc research

Valuations:

We have used a cost of equity of 11.1% and a terminal growth rate of 5% to value Saudi Awwal Bank and arrived at a target price of SR42/share. We see the current valuation attractive at a 2024e PBV of 1.0x and PER of 8.9x for RoAE, which will likely remain stable at 12-13%, well above that vs. only 9% in 2022. We think that despite slight earnings dilution from lower margins and higher impairment charges, SAB is still the best play on Saudi Arabia's lending growth and offers robust lending prospects. We expect its lending growth to be one of the highest among our coverage.

Valuation Table:

SARmn	2024e	2025e	2026e	2027e	2028e	2029e	Terminal
Beginning BV of equity	57,915	61,140	64,565	68,193	72,085	76,284	80,848
Cost of equity (%)	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%
Cost of equity	6,437	6,796	7,176	7,580	8,012	8,479	8,986
Net income	7,167	7,613	8,061	8,651	9,331	10,141	11,312
Excess equity return	729	817	884	1,071	1,319	1,662	2,326
Terminal excess equity return							39,933
Discount factor	1.03	1.14	1.27	1.41	1.57	1.74	1.74
PV of excess equity return	709	715	696	759	840	953	22,898
Equity invested	57,915						
PV of excess return on Equity	27,569						
Value of equity	85,484						
Number of shares (mn)	2,055						
Target Price	42						

Earnings Sensitivity:

CoE	Growth rate					
	3%	4%	5%	6%	7%	
9%	54	58	64	75	95	
10%	45	48	51	56	63	
11%	39	40	42	44	47	
12%	34	34	35	36	37	
13%	29	30	30	30	31	

Source: Company financials and anbc research

Bank Albilad

2 December, 2024

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%

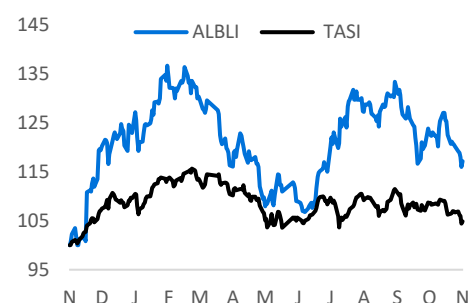
ISSUER INFORMATION	
Bloomberg Code	ALBI: AB
Last Price (SR)	35.05
No of Shares (mn)	1,250
Market Cap bn (SR/USD)	44/12
52-week High / Low (SR)	40.9/29.2
12-month ADTV (mn) (SR/USD)	48/13
Free Float (%)	59%
Foreign Holdings (%)	10%

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	
	2023	2024E	2025E	2026E	2027E	2028E	2018-2023	2023-2028e
Income Statement								
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

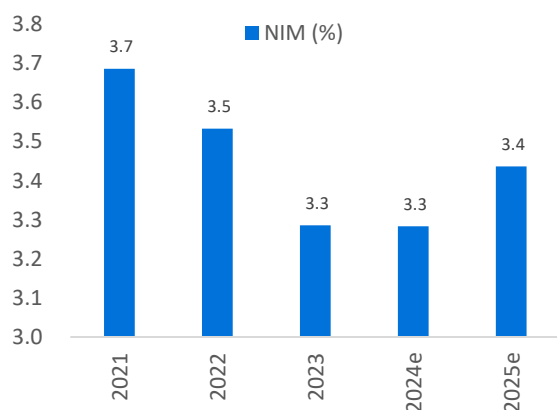
Margins are positively geared for a declining rate environment

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.

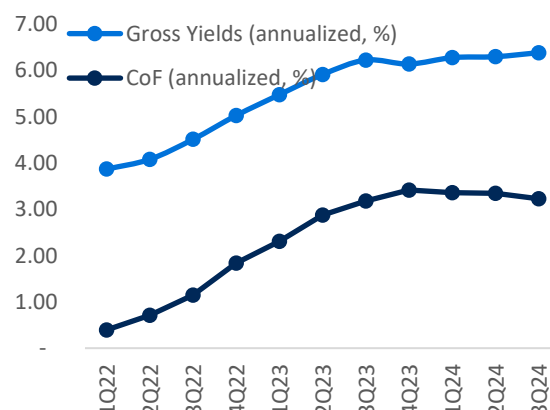
In addition, the cost of funds shows signs of some eased pressures. CoF declined in 3Q24, and low LDRs provide sufficient liquidity headroom.

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



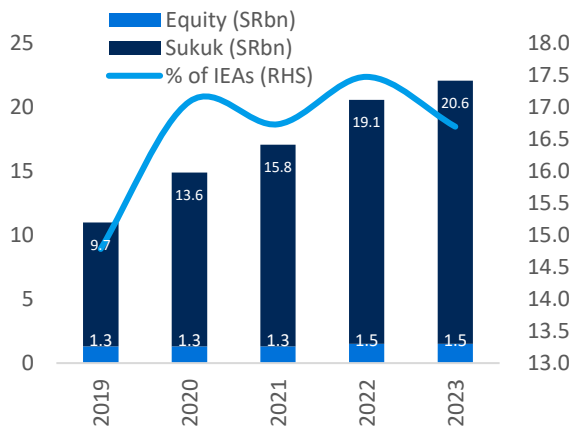
Source: Company financials and anbc research

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.

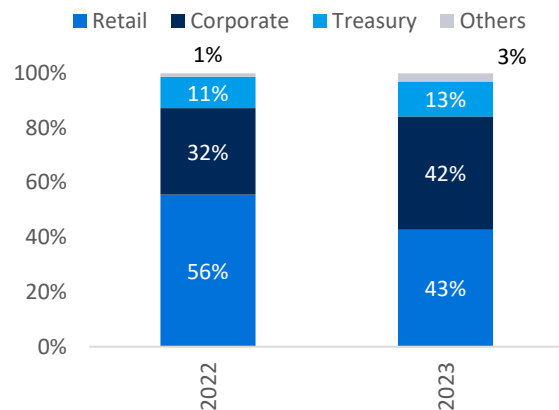
Moreover, in recent years, the bank’s treasury has used the opportunity to position its book to increase the effective asset duration. The success of the bank’s investment strategy is evident in 9M24, where net interest income from treasury grew 59% YoY and nearly drove the entire gain in overall NSCI.

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



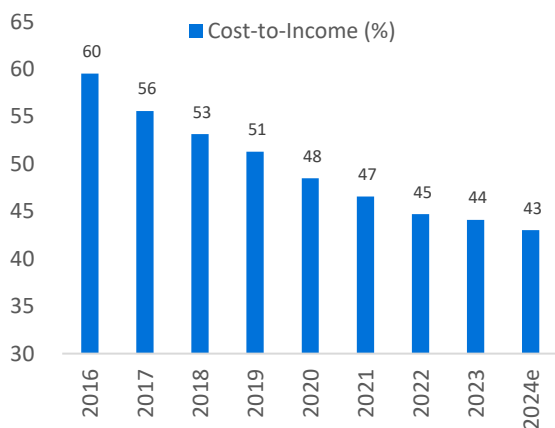
Source: Company financials and anbc research

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.

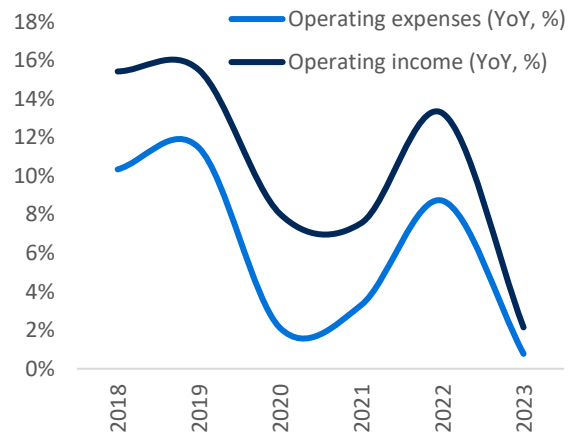
While the operating cost-to-income ratio improved from 60% in 2016 to 43% in 2023, it remains higher than the average of 30% of the other five banks (excluding Albilad). While operating income growth outpaced the growth in Opex, even as income growth slowed in 2023, management had been prudent in managing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



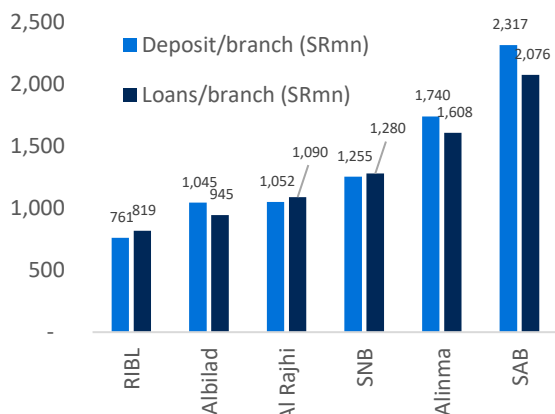
Source: Company financials and anbc research

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.

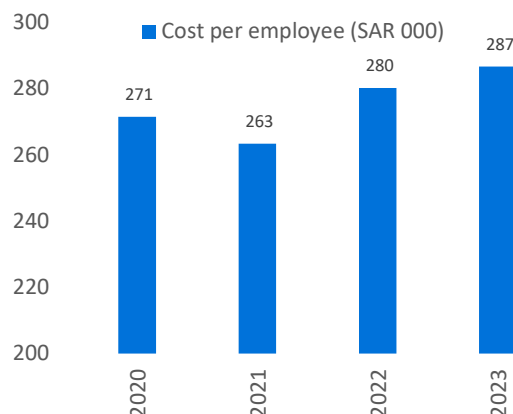
Moreover, its cost per employee should also improve as scale benefits filter in and operational efficiencies improve with increased digitalization across its operations.

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.

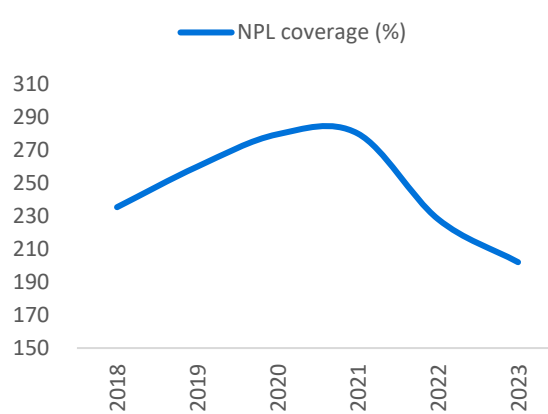
However, since then, retail contribution has increased, the economic backdrop has significantly improved, and its coverage has been healthy without increasing NPL formation. Since 2020, the CoR has come down to 32bps in 2023, which we see as normalized levels for the banks with healthy coverage (still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

Chart 156: CoR largely normalized



Source: Company financials and anbc research

Chart 157: NPL coverage remains adequate

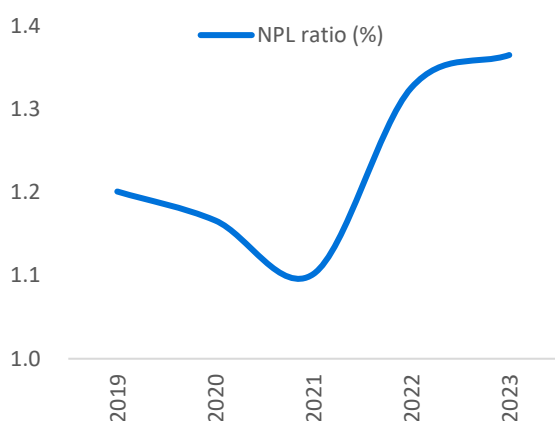


Source: Company financials and anbc research

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.

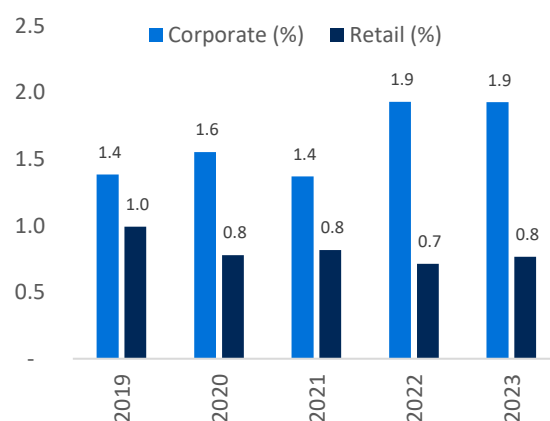
However, the NPL ratio slightly improved to 1.2% in 1H24 from 1.4% in 2023, a trend visible nearly across all banks. Moreover, we don't expect any sector-wide stress since the outlook for the real estate market remains positive, supported by growing demand. Bank coverage remains healthy, above 200% in 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

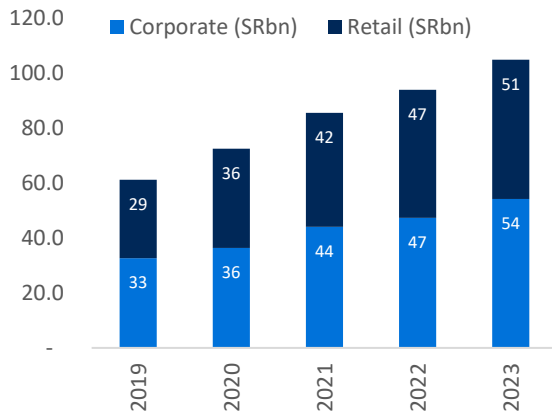
Albilad offers balanced exposure between the retail and corporate sectors. Apart from its retail positioning and mortgage portfolio, which account for 75% of its retail sector loans, it has a strong position in the real estate market. The latter accounts for 43% of total corporate sector loans, and the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

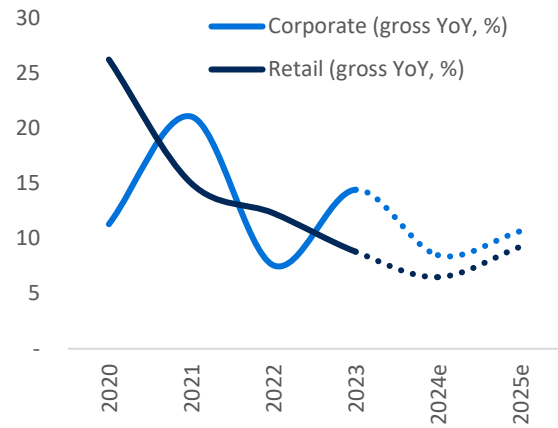
We expect Albilad gross lending growth to moderate in 2024e to 8% from 12% in 2023. Over the medium term, we expect it to grow at a CAGR of 11% between 2023-28e. The moderating growth in 2024e primarily reflects the pressures of slower growth in the corporate sector in 9M24. We still see the corporate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

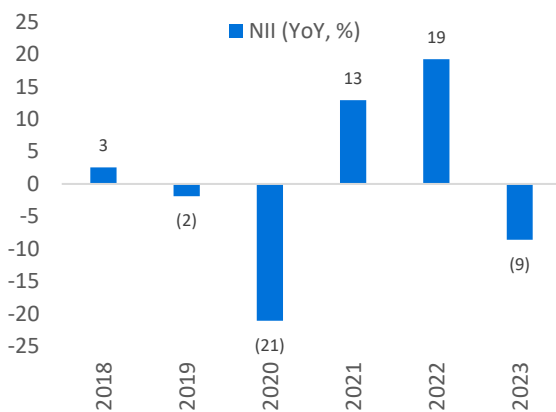


Source: Company financials and anbc research

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.

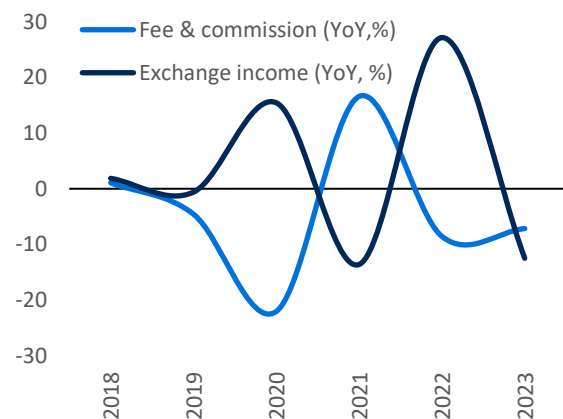
Fees from remittance declined by over 8% YoY in 2023, along with a 12% YoY decline in the exchange income. While competitive pressures will continue, we expect other pressures to dissipate with a reversal of policy stance as general remittance flow improves. However, we see Albilad's recent performance 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



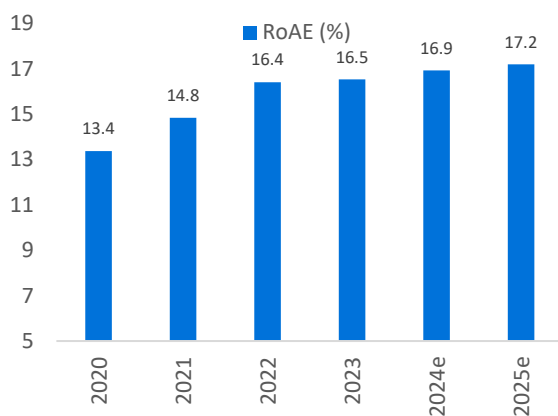
Source: Company financials and anbc research

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.

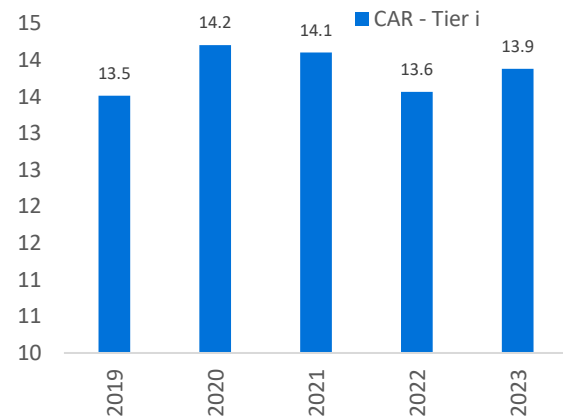
However, over the longer run, building capital buffers will become increasingly important as the bank continues to scale up its asset base and grow. Liquidity is another key factor, and while the bank has headroom in terms of LDRs, as lending growth picks up amidst tight deposit liquidity, the bank would 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:

CoE	Growth rate					
	3.0%	4.0%	5.0%	6.0%	7.0%	
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

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Contact

ANB Capital Head Office

3581 Al Mouyyad Al Jadid, Al Murabba, Riyadh 11311,

PO Box 22009, Kingdom of Saudi Arabia

Tel: +966 11 406 2500, 800 124 0055

Email: research@anbcapital.com.sa

Web: www.anbcapital.com.sa