



## 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

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

### OVERWEIGHT

### 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 28<sup>th</sup>*

### 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							CAGR	
Income Statement	2023	2024E	2025E	2026E	2027E	2028E	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%
<b>NSCI</b>	<b>10,341</b>	<b>10,985</b>	<b>11,716</b>	<b>12,593</b>	<b>13,532</b>	<b>14,603</b>	13%	7%
NII	2,369	2,986	3,261	3,528	3,780	4,009	6%	11%
<b>Operating Income</b>	<b>12,710</b>	<b>13,971</b>	<b>14,977</b>	<b>16,120</b>	<b>17,312</b>	<b>18,612</b>	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%
<b>Total Expenses</b>	<b>(4,676)</b>	<b>(5,207)</b>	<b>(5,689)</b>	<b>(6,307)</b>	<b>(6,805)</b>	<b>(7,305)</b>	14%	9%
NPBT	8,223	8,764	9,288	9,814	10,507	11,306	16%	7%
<b>Net Income*</b>	<b>7,002</b>	<b>7,167</b>	<b>7,613</b>	<b>8,061</b>	<b>8,651</b>	<b>9,331</b>	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%
<b>Total Assets</b>	<b>356,642</b>	<b>393,887</b>	<b>440,455</b>	<b>488,787</b>	<b>539,930</b>	<b>593,747</b>	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%
<b>Total Liabilities</b>	<b>294,742</b>	<b>328,762</b>	<b>371,905</b>	<b>416,609</b>	<b>463,860</b>	<b>513,477</b>	16%	12%
<b>Total Equity</b>	<b>61,900</b>	<b>65,125</b>	<b>68,550</b>	<b>72,178</b>	<b>76,070</b>	<b>80,269</b>	14%	5%
<b>Total liabilities and equity</b>	<b>356,642</b>	<b>393,887</b>	<b>440,455</b>	<b>488,787</b>	<b>539,930</b>	<b>593,747</b>	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

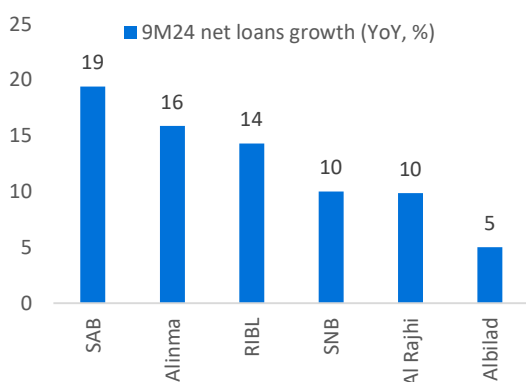
## Investment Thesis

### 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.

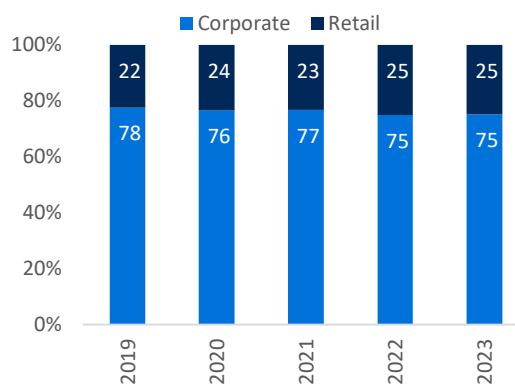
We believe SAB’s positioning within Saudi Arabia’s financial market as a key partner for infrastructure projects & Giga projects, supported by its long history of financing large projects, a vast multinational customer base, international connectivity through its partnership with HSBC, and retail expansion 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**



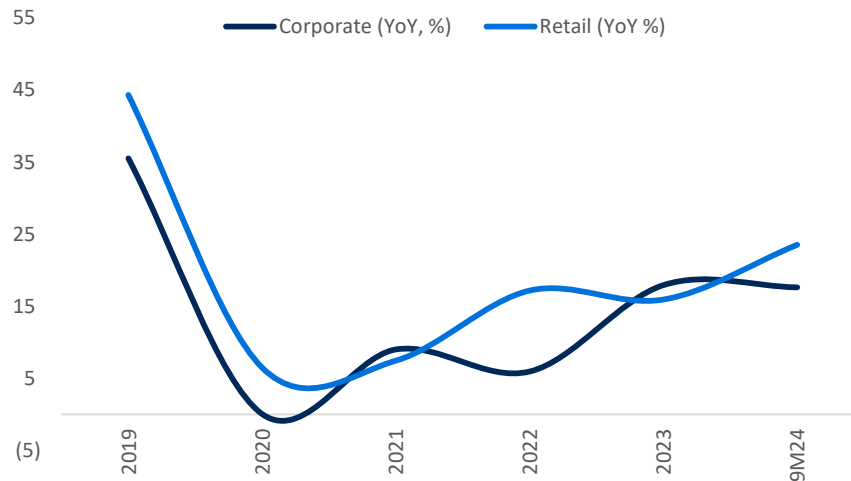
Source: Company financials and anbc research

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**



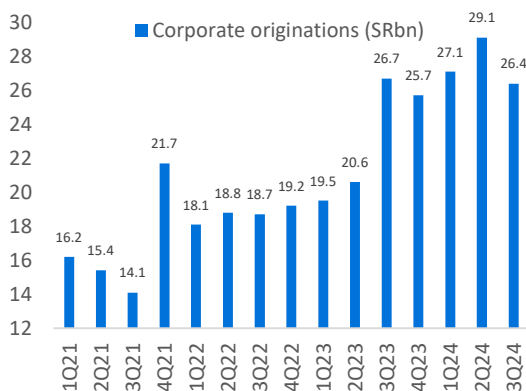
Source: Company financials and anbc research

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.

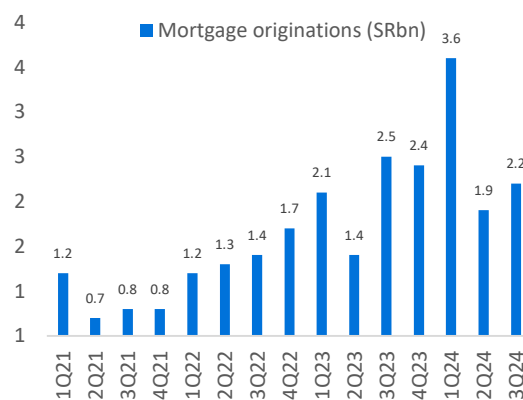
Meanwhile, in the retail segment, the key focus had been on mortgage lending, aiming to increase market share following the bank’s investments in its mortgage capabilities during 2021. The success of this strategy has been evident from the continuous pick-up in quarterly mortgage originations, which 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**

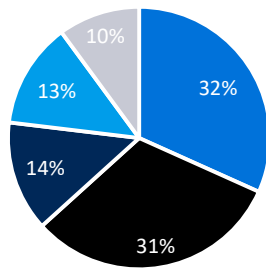


Source: Company financials, presentation, and anbc research

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**

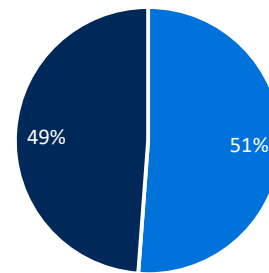
- Commerce
- Manufacturing
- Construction
- Others
- Utility



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

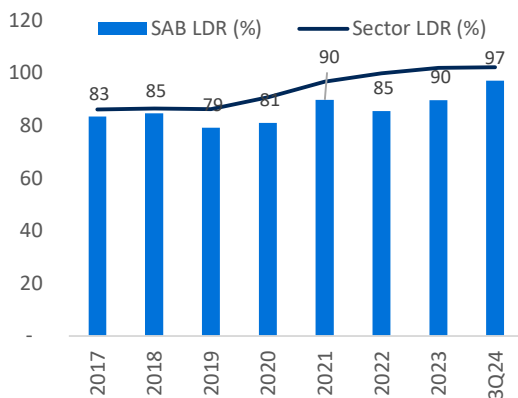


Source: Company financials and anbc research

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.

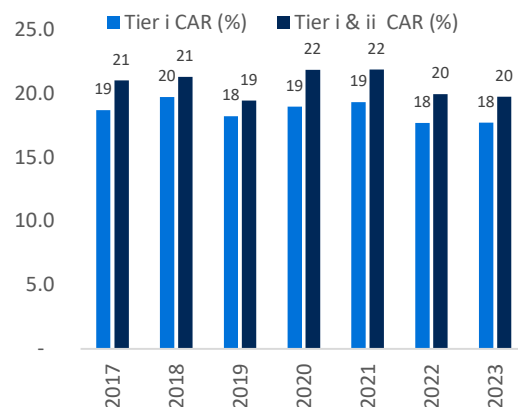
Moreover, SAB has a sufficient cushion on the capital front, supporting its growth—the bank last issued an SR4bn AT1 Sukuk in October 2023. Its Tier 1 CAR stood at 18%, while total capital CAR was nearly 20% in 2023. While we don’t expect capital injection in our base case, the bank could issue AT capital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



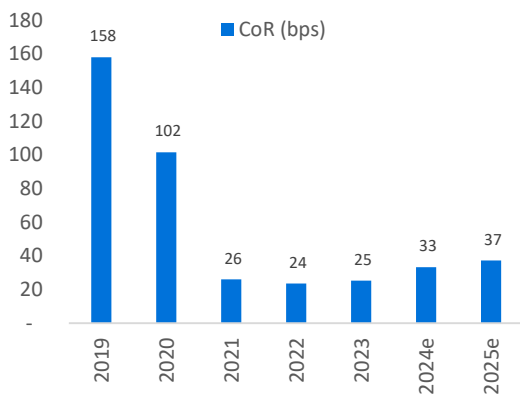
Source: Company financials and anbc research

### 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.

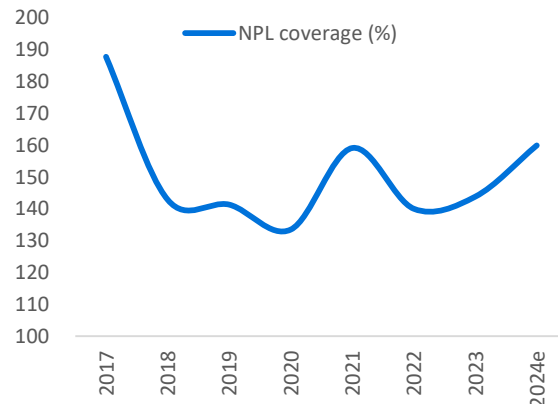
In 2019 and 2020, CoR rose to levels well above 100bps; however, since 2021, it quickly fell back to around 25bps. One of the key drivers for this was improved credit portfolio quality and the restriction of new NPL formation. Post the merger in 2020, the NPL ratio (excluding purchased or originated 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**

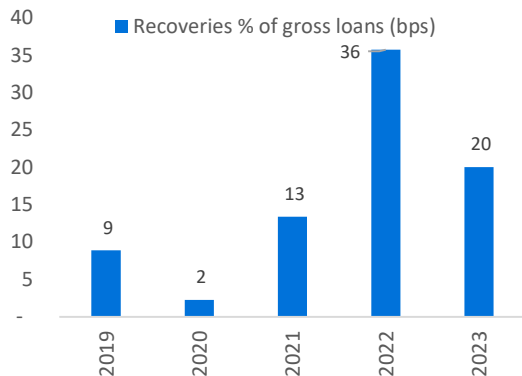


\*Excluding POCI  
Source: Company financials and anbc research

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.

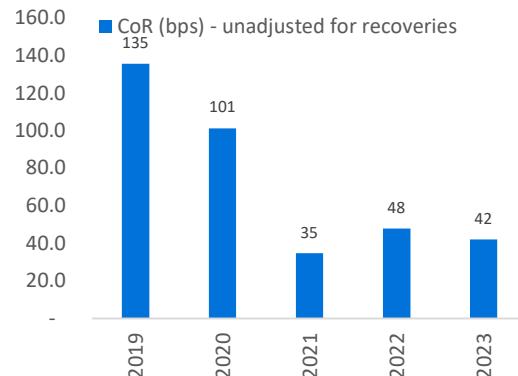
Recoveries of non-performing loans increased to 35bps of the overall gross lending portfolio in 2022 and remained high at 20bps in 2023. However, if we excluded the impact of these recovering, the unadjusted CoR would still be stable at around 40-50bps, more than half the levels reported in 2019 and 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**



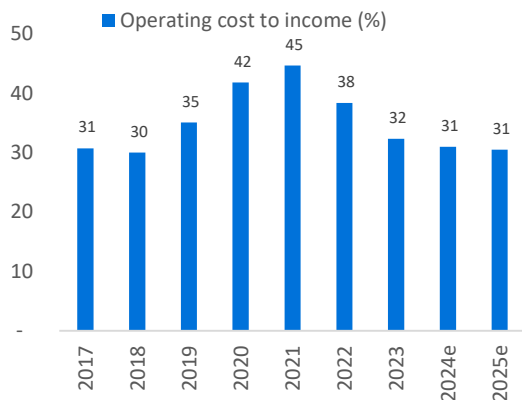
Excluding POCI  
Source: Company financials and anbc research

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.

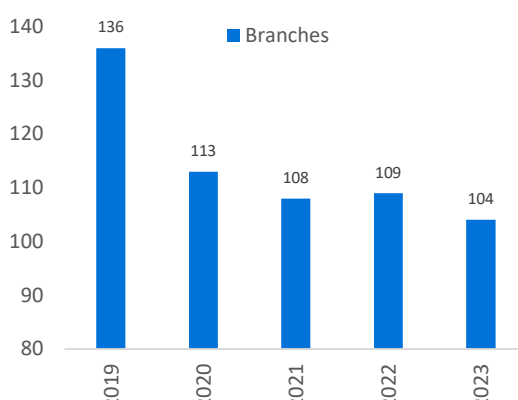
However, under its updated strategy, the bank now targets a more balanced approach, focusing part of its investments on automation and further increasing operational efficiency. Increased digitalization across all its segments would be a key catalyst for further improving its operating leverage, though 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

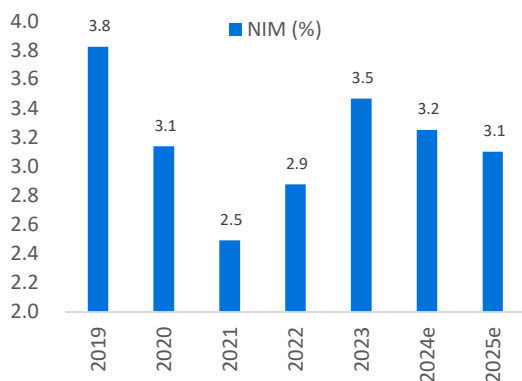
Meanwhile, part of its strategy focuses on minimizing interest rate sensitivity

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.

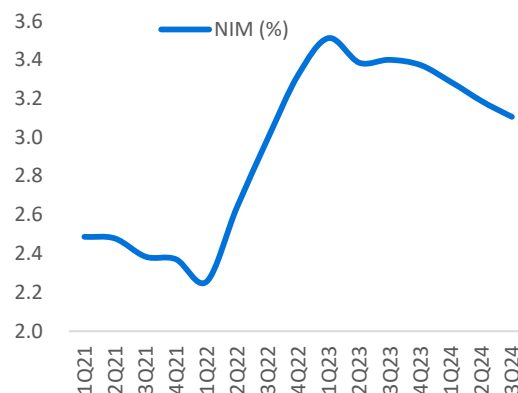
To maintain the sustainability of returns and lower its earnings sensitivity to rates, SAB focused on three key areas, namely: i) increasing its mortgage portfolio and ii) growing its investment placement to extend the overall duration with a greater proportion of the portfolio being fixed. and iii) 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



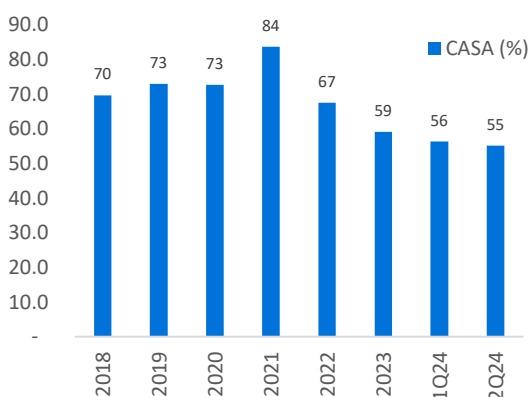
Source: Company financials and anbc research

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.

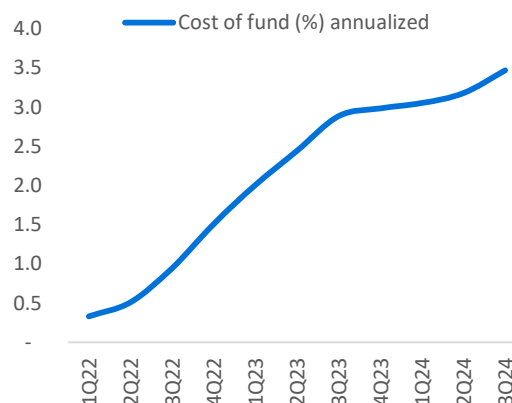


**Chart 142: Aggressive tightening led to CASA migration to 55% in 2Q24**



Source: Company financials and anbc research

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

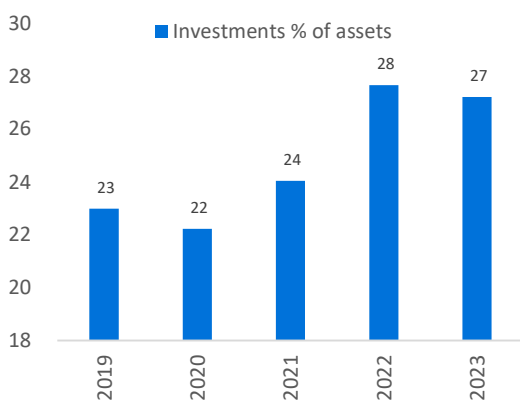


Source: Company financials and anbc research

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.

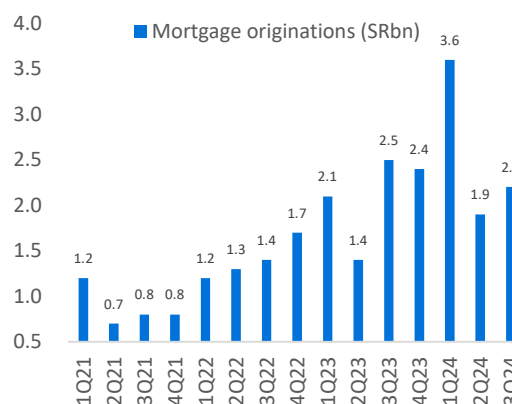
Moreover, SAB has been aggressively pursuing growth through mortgages. Its penetration has been aggressive, taking a market share of 16% of the new originations, which surprisingly, though, comes at the peak rate cycle. Its mortgage originations have markedly picked up since the start of 2022 and delivered 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**

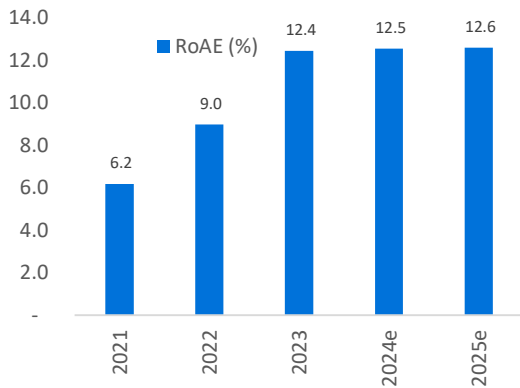


Source: Company financials and anbc research

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.

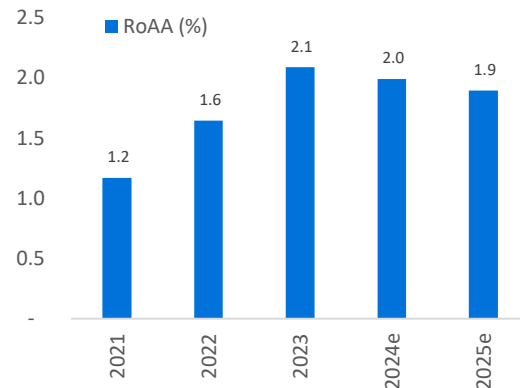
While the SAB turnaround story has been progressing well and delivering on its key strategy milestones, it is still negatively geared for a declining rate environment, which would dilute a strong growth outlook. Net income growth will moderate in 2024e as pressures on net interest margins continue to 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						
<b>Target Price</b>	<b>42</b>						

### Earnings Sensitivity:

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

Source: Company financials and anbc research