



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

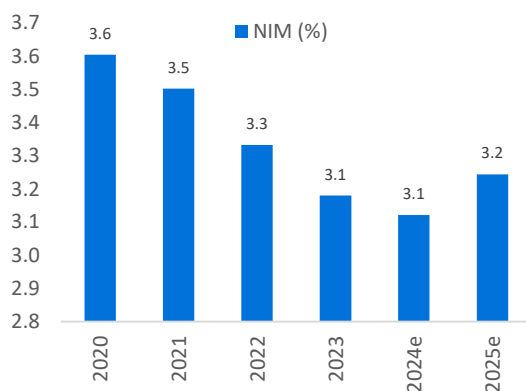
Saudi National Bank (SNB) is positioned positively for the monetary easing cycle, which would filter into margin expansion for the bank. A relatively higher contribution of longer-duration retail sector loans, repricing of its legacy portfolio (older loans issued at low rates), and an extended duration 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.

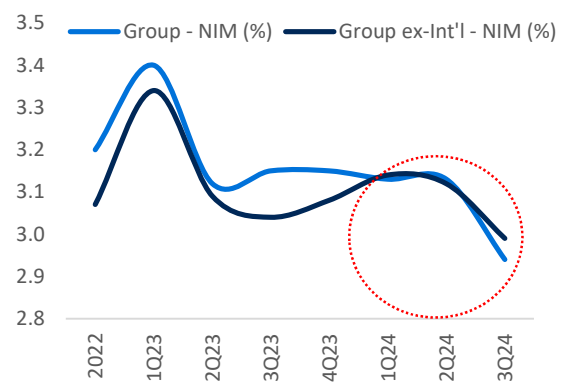
There has been substantial volatility in its international business, particularly in Türkiye, due to the hyperinflationary environment. This was evident in 1H24, when, according to the management, despite the bank witnessing an improvement in the domestic business, its overall net interest margins slightly 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



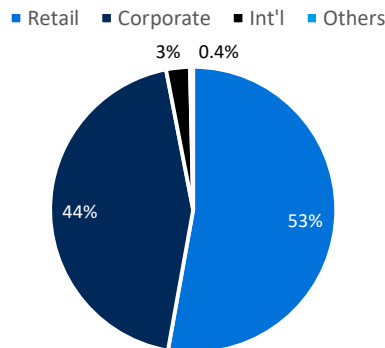
Based on the company’s calculation and will differ from our calculated NIMs estimates

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.

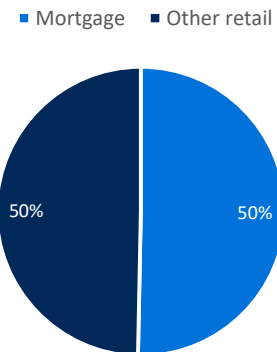
Looking at the maturity profile of its lending portfolio, nearly 50% of its outstanding loans are expected to mature within one year. While this indicates slightly higher repayment pressures, the management emphasized that it would take this opportunity to reprice the legacy portfolio at higher yields, 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

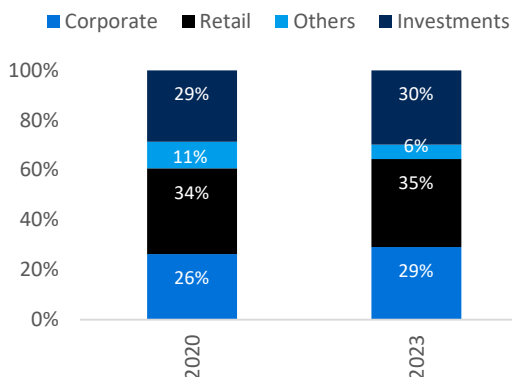


Source: Company financials and anbc research

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.

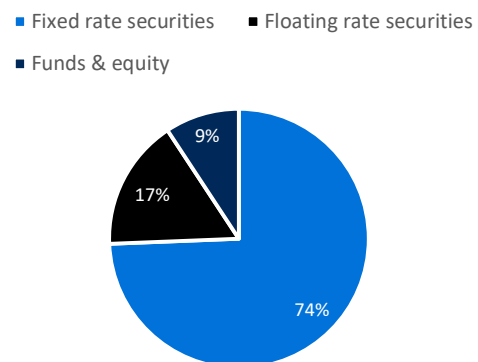
The bulk of this portfolio has been invested in fixed-rate securities, accounting for 74% of the total investment book, which will be key to supporting the bank's gross yields in a declining rate environment. Its contribution to income has also risen in the past two years, with NSCI generated from investments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



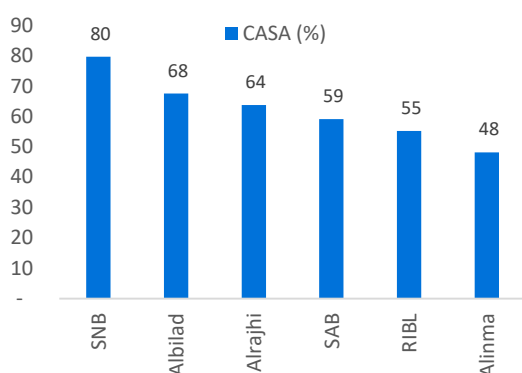
Source: Company financials and anbc research

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.

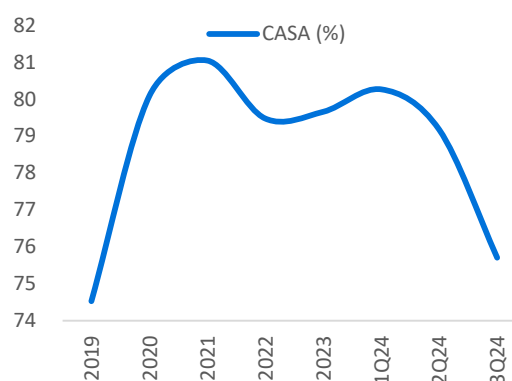
That said, a relatively strong CASA balance and its vast scale should allow the bank to manage the pressures of CoF and fund growth with ease through deposit mobilization. In addition, high interbank funding, which is mainly repriced very quickly to changes in monetary setting, should support a positive 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



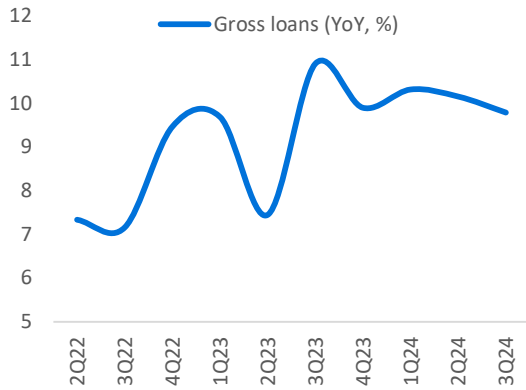
Source: Company financials and anbc research

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:

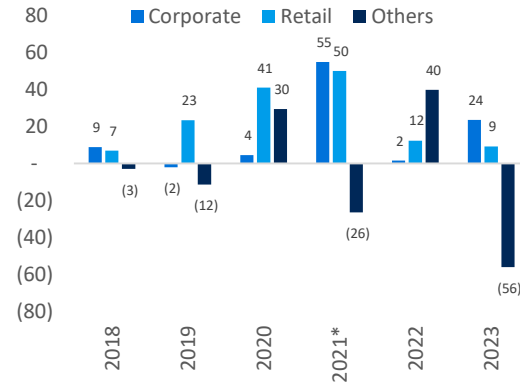
- **Value Capture:** The focus is on delivering balance sheet expansion, which would result in improved yields and diversification. For the corporate sector (or wholesale, according to the bank’s segmentation), this means further diversification with a particular emphasis on project financing while maintaining 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

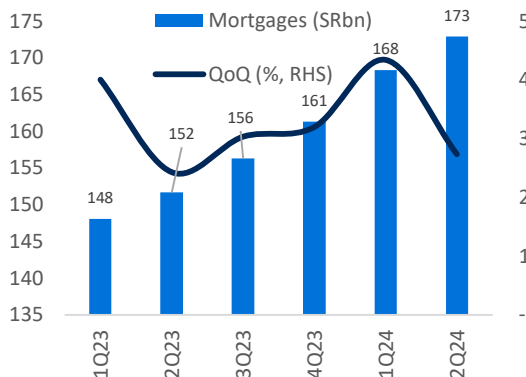
In a nutshell, the corporate sector would primarily drive lending growth amidst a moderating pace of retail expansion in the short run, a trend we expect to follow sector wide. However, it's unlikely SNB would witness double-digit growth, as seen between 2019 and 2021, barring another M&A, since its 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.

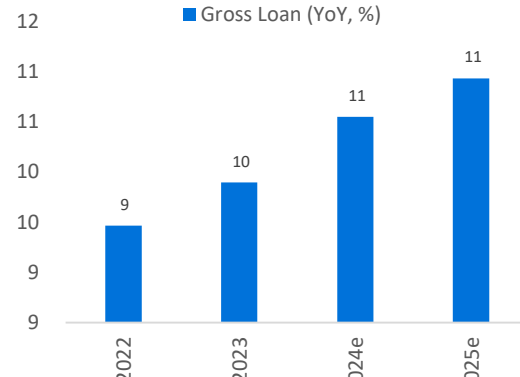
This remains the key part of its strategy to further boost its position in the retail segment by improving product offerings and consumer engagement. While corporate loan expansion would primarily drive growth in the short term, eventually, with lower borrowing costs and an increased appetite for consumer 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

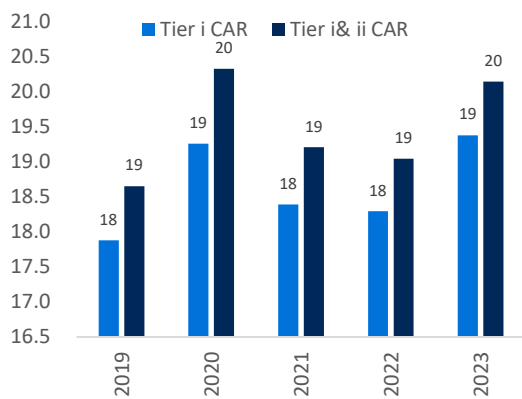


Source: Company financials and anbc research

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.

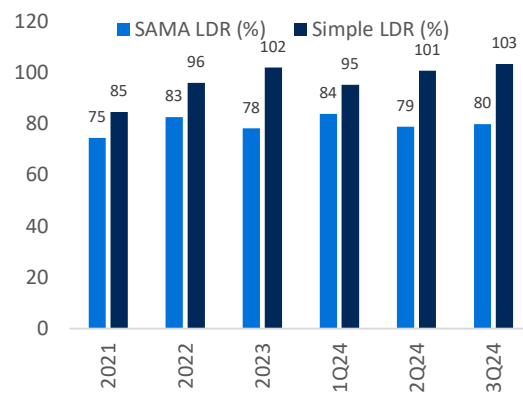
However, deposit mobilization was slightly weak, which we see because of the bank's strategy to sustain a strong CASA balance while funding growth through interbank and wholesale channels. This meant that LDRs remained elevated where, according to our calculation, non-regulatory LDR stood over 100% at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

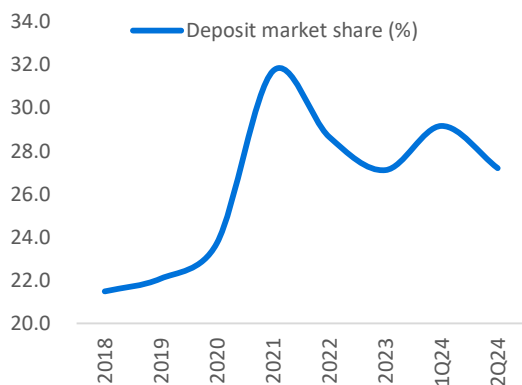


Source: Company financials and anbc research

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.

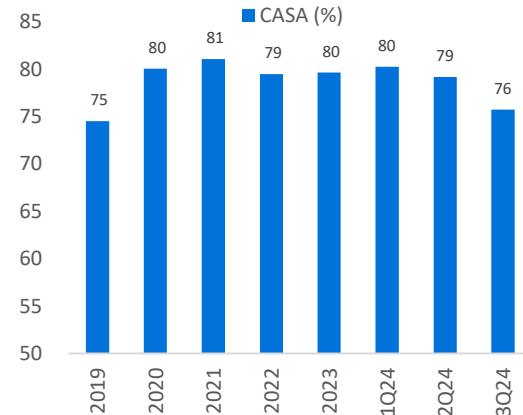
However, the bank would remain a deposit-funded institution, which would remain a primary source of growth funding. Its scale and strong positioning in the retail segment should allow the bank to deliver deposit mobilization albeit challenging liquidity dynamics.

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

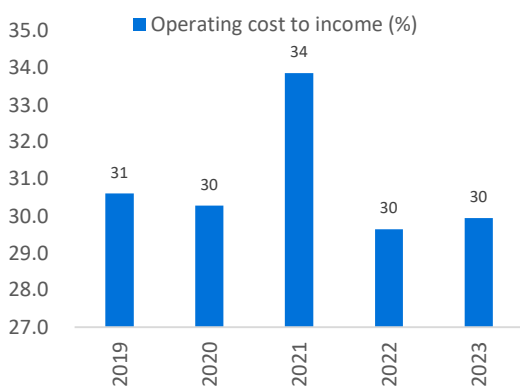
The bank delivered strongly on the targeted cost synergies, which, according to management, exceeded SR1.5bn, 110% of the revised target, and the costs were restricted to SR0.9bn, 94% of the target. The key areas of merger synergies were on the operational side, in addition to optimizing the technology 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%.

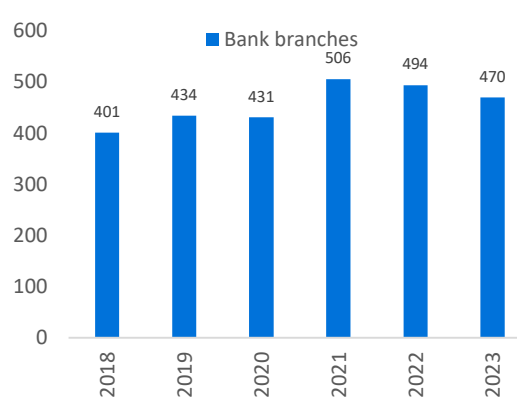
This is a significant cost advantage for SNB, placing it ahead of the sector. Management's guidance of further improvement in cost efficiencies is positively underpinned by its medium-term strategy, which focuses on a leaner operating model and value creation through economies of scale. These cost efficiencies, 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

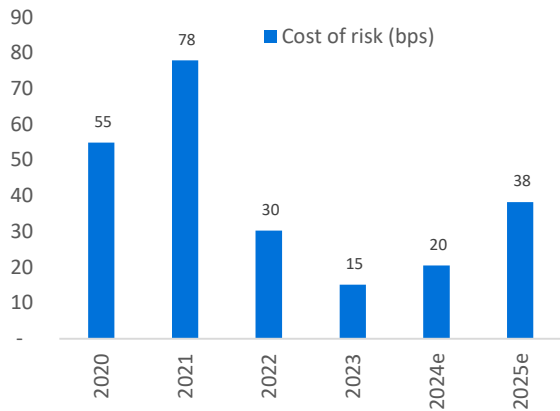


Source: Company financials and anbc research

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.

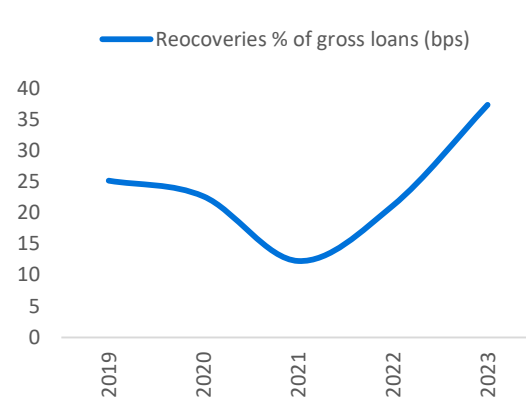
SNB's headline cost of risk fell to 30bps in 2022 and further down to only 15bps in 2023 from an average of 62bps between 2017-21. However, in the last two years, recoveries as a percentage of gross loans jumped to 37bps in 2023. The bulk of the lower provisioning charges was driven by improvement in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



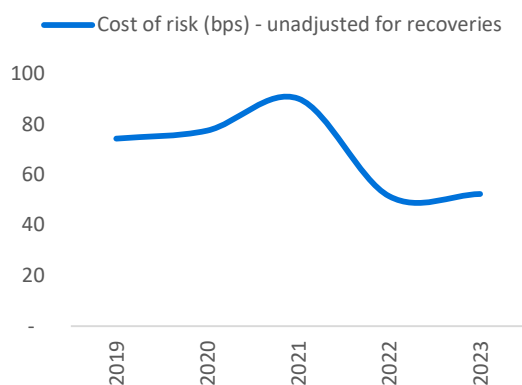
Source: Company financials and anbc research

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.

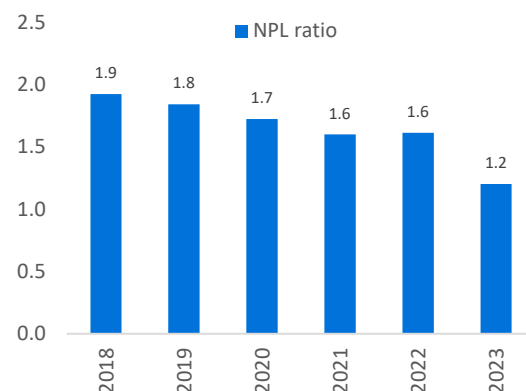
We estimate that the corporate NPL ratio stood at 2.2%, excluding the POCI portfolio, improving from above 3% in 2022. However, the asset quality is largely sustained in the retail portfolio with a stable NPL ratio of 0.5%. On a net basis, as recoveries normalize, we expect the cost of risk to be broadly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

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