Saudi British Bank (SABB)

Margin improvement positive but credit growth remains the key

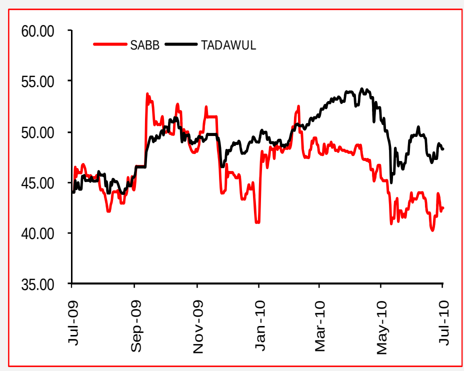
July 18, 2010
CMP: SAR 43.00

Report Purpose
Q2'10 Results Flash

Recommendation
Target Price SAR 49.25
HOLD

Stock Details

Exchange / Code	TASI / 1060
Bloomberg Code	SABB AB
Equity	SAR 7.5bn
Face Value	SAR 10
52-Week H/L	SAR 56.25/40.00
Market Cap	SAR 31.88bn



Credit growth still missing but deposit accumulation strong in Q2'10

Net loans continued their downhill trajectory as they declined by 1.2% (Q-o-Q) same as average quarterly rate of last 4 quarters to SAR 74.8bn. On Ytd basis, the loan book declined by 2.1%. This contradicts our view of 3.5% credit growth for 2010e. However, deposits saw a surge of 4.6% in Q2'10 after remaining flat in Q1'10 and could indicate early signs of expected credit off-take. As a result, SABB ended Q2'10 with deposit base of SAR 94.2bn which equates to our full year estimate of SAR 94.5bn thereby improving its Net loans to deposit ratio from 84.1% in Q110 to 79.4% in Q210.

We believe this surge in deposit base to be positive but revise our estimate for loan growth downwards to 2.2% for 2010e but increase our deposit growth assumption upwards to SAR 95.9bn. Total assets remained flat Q-o-Q while equity increased by 3.3% (Q-o-Q) thereby improving equity to assets ratio from 11.4% in Q110 to 11.8% in Q210.

Core banking income up – a positive surprise

SABB showed an improvement of 22.4% (Q-o-Q) in net special commission income as it grew to SAR 943mn reversing the downhill trend of last 3 quarters. Our calculations suggest margin improvement of 70bps (Q-o-Q) to be the main driver for this stellar growth in special commission income. H1 net special commission income came in at 55% of our full year 2010e estimate on back of strong Q2 performance. We thus revise our margin assumptions upwards in the range of 20-30bps over 2010e and 2011e.

Fee income and Operating income in-line

Fee income declined 4.1% Q-o-Q to SAR 417mn forming 22.6% of our full year 2010e estimate of SAR 1.8bn. Thus, contribution of fee income to total income declined from 36% in Q110 to 31% in Q210. However, strong core banking income more than offset the impact of sequential decline in fee income to boost the total income to SAR 1.36bn (up 12.9% Q-o-Q). Therefore, cost to income ratio improved marginally from 34% in Q110 to 33% in Q210. Total operating income of SAR 914mn was in-line with expectations and H1 operating income formed 52% of our 2010e estimate.

Higher provisioning pulled down bottom-line lower than expected

Our calculations suggest that LLP charges net of recoveries and share of associates has increased from SAR 176mn in Q110 to SAR 471mn in Q210. We assume the share of associates to be flat Q-o-Q at around SAR 4.3mn and thus conclude LLP charges to form the major chunk. This is in-line with our view that the bank would focus on ramping up their provision coverage level. Compared to our estimates, Q2 net profit of SAR 447mn (28% down Q-o-Q) formed 20.4% while H1 net profit formed 49% of our 2010e estimate. We thus maintain our stance on LLP charges to keep bottom-line under pressure

Re-iterating HOLD

We revise our credit growth estimate downwards and increase our deposit and margin assumptions based on Q210 results. As a result, our target price (based on residual income method) increased to SAR 49.25 translating to an implied P/B 2010e of 2.8x. At current 2010e P/B of 2.4x SABB seems pricey compared to local peer group average 2010e P/B of 1.9x and GCC average of 1.5x.

Though relatively higher ROE expectation of 16.1% as compared to 12.7% for local peers and 12.8% for GCC peers make SABB a premium stock; we believe that there are other local peers such as Riyad Bank, which continue to offer more value play on the sector and thus we maintain a HOLD rating on SABB. Our sensitivity analysis by varying cost of equity and return on equity assumptions yield a target price range of SAR 44.33 – 55.17 per share.

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Financial Statements

Income Statement (SAR mn)	FY08	FY09	FY10e	FY11e	FY12e
Special commission income	**5,865**	**4,574**	**3,958**	**4,538**	**5,495**
Y-o-Y Growth	*12.4%*	*-22.0%*	*-13.5%*	*14.6%*	*21.1%*
Special commission expense	**2,658**	**1,137**	**555**	**811**	**1,111**
Y-o-Y Growth	*23.0%*	*-57.2%*	*-51.2%*	*46.1%*	*37.0%*
Net special commission income	**3,207**	**3,437**	**3,403**	**3,727**	**4,384**
Y-o-Y Growth	*4.9%*	*7.2%*	*-1.0%*	*9.5%*	*17.6%*
Fee Based Income	**1,399**	**1,371**	**1,445**	**1,569**	**1,728**
Y-o-Y Growth	*43.6%*	*-2.0%*	*5.4%*	*8.6%*	*10.1%*
Investment & Trading Income	**306**	**353**	**373**	**418**	**459**
Y-o-Y Growth	*-10.4%*	*15.3%*	*5.9%*	*11.9%*	*9.9%*
Total Fee Based Income Incl Investment & trading Inc	**1,704**	**1,724**	**1,819**	**1,987**	**2,187**
Y-o-Y Growth	*29.6%*	*1.1%*	*5.5%*	*9.3%*	*10.0%*
Total Income	**4,912**	**5,160**	**5,222**	**5,714**	**6,571**
Y-o-Y Growth	*12.3%*	*5.1%*	*1.2%*	*9.4%*	*15.0%*
Total Operating Expenses	**1,642**	**1,678**	**1,686**	**1,834**	**2,042**
Y-o-Y Growth	*14.9%*	*2.2%*	*0.5%*	*8.8%*	*11.3%*
Total Operating Income	**3,270**	**3,483**	**3,536**	**3,880**	**4,528**
Y-o-Y Growth	*11.0%*	*6.5%*	*1.5%*	*9.7%*	*16.7%*
Share in earnings of associates	108	46	22	30	35
Profit before LLP and Inv Impairments	**3,378**	**3,529**	**3,557**	**3,910**	**4,563**
Y-o-Y Growth	*12.5%*	*4.5%*	*0.8%*	*9.9%*	*16.7%*
Provision for credit losses, net	371	1,496	1,341	1,185	1,126
Impairment of other financial assets	87	-	-	-	-
PBT	**2,920**	**2,032**	**2,216**	**2,725**	**3,437**
Tax	-	-	-	-	-
PAT	**2,920**	**2,032**	**2,216**	**2,725**	**3,437**
Y-o-Y Growth	*12.0%*	*-30.4%*	*9.0%*	*23.0%*	*26.1%*
Shares	600	750	750	750	750
EPS on Current Shares	**3.89**	**2.71**	**2.95**	**3.63**	**4.58**

Income StatementSAR (mn)	Q209	Q110	Q210	Y-o-Y	Q-o-Q
Net special commission income	**894**	**770**	**943**	***5.5%***	***22.4%***
Other Operating Income	489	435	417	*-14.7%*	*-4.1%*
Total Income	**1,383**	**1,205**	**1,360**	***-1.7%***	***12.9%***
Total Operating Expenses	399	412	446	*11.7%*	*8.2%*
Total Operating Income	**984**	**793**	**914**	***-7.1%***	***15.3%***
LLP Charges, Net & Share of Associates	**314**	**176**	**471**	***49.9%***	***167.1%***
PBT	676	621	447	*-33.9%*	*-28.0%*
PAT	**676**	**621**	**447**	***-33.9%***	***-28.0%***
Investments, net	24,380	22,389	26,000	*6.6%*	*16.1%*
Loans and advances, net	**78,718**	**75,699**	**74,800**	***-5.0%***	***-1.2%***
Total assets	**121,957**	**120,531**	**120,300**	***-1.4%***	***-0.2%***
Customer deposits	**91,536**	**90,016**	**94,200**	***2.9%***	***4.6%***
Total shareholders' equity	**13,101**	**13,732**	**14,179**	***8.2%***	***3.3%***

Return on Equity - Terminal

Cost of Equity	18.0%	19.0%	20.0%	21.0%	22.0%
10.3%	51.23	54.01	56.78	59.55	62.32
10.8%	47.73	50.21	52.69	55.17	57.65
11.3%	44.80	47.03	**49.25**	51.48	53.70
11.8%	42.33	44.33	46.34	48.35	50.35
12.3%	40.23	42.05	43.86	45.68	47.49

Balance Sheet (SAR mn)	FY08	FY09	FY10e	FY11e	FY12e
Cash and balances with SAMA	11,328	16,615	19,614	17,787	16,203
Due from banks and other financial institutions	6,200	6,005	5,104	5,359	5,788
Investments, net	29,604	23,818	25,544	27,626	30,251
Y-o-Y Growth	*99.2%*	*-19.5%*	*7.3%*	*8.1%*	*9.5%*
Loans and advances, net	80,237	76,382	78,167	83,484	93,332
Y-o-Y Growth	*29.4%*	*-4.8%*	*2.3%*	*6.8%*	*11.8%*
Investment in associates	148	180	202	232	267
Property and equipment, net	561	594	625	656	688
Other assets	3,581	3,245	3,959	4,750	5,606
Total assets	131,661	126,838	133,214	139,895	152,134
Due to banks and other financial institutions	16,069	13,606	13,878	14,780	15,888
Customer deposits	92,678	89,187	95,876	101,628	110,775
Y-o-Y Growth	*29.0%*	*-3.8%*	*7.5%*	*6.0%*	*9.0%*
Debt securities in issue	5,657	5,709	3,439	1,721	1,721
Borrowings	188	188	188	188	188
Other liabilities	5,436	5,103	5,282	5,255	5,176
Total liabilities	120,027	113,793	118,662	123,572	133,748
Share capital	6,000	7,500	7,500	7,500	7,500
Statutory reserve	4,480	4,988	4,988	4,988	4,988
Other reserves	(177)	(138)	(71)	(71)	(71)
Retained earnings	1,331	695	2,135	3,906	5,969
Proposed Dividends	-	-	-	-	-
Total shareholders' equity	11,634	13,045	14,552	16,323	18,385
Total liabilities and shareholders' equity	131,661	126,838	133,214	139,895	152,134

Ratios	FY08	FY09	FY10e	FY11e	FY12e
Capital Adequacy					
Equity/Assets	8.8%	10.3%	10.9%	11.7%	12.1%
Margins					
Operating profit/NII	102.0%	101.3%	103.9%	104.1%	103.3%
PAT/NII	91.1%	59.1%	65.1%	73.1%	78.4%
Earnings					
ROAA	2.5%	1.6%	1.7%	2.0%	2.4%
ROAE	26.5%	16.5%	16.1%	17.7%	19.8%
Liquidity					
Net Loans/Customer Deposits	86.6%	85.6%	81.5%	82.1%	84.3%
Customer Deposits/Equity	8.0x	6.8x	6.6x	6.2x	6.0x
Customer Deposits/Total assets	70.4%	70.3%	72.0%	72.6%	72.8%
Liquid Assets / Total Assets	31.1%	31.9%	33.9%	32.5%	30.5%
Due from Banks/Due to Banks	38.6%	44.1%	36.8%	36.3%	36.4%
Efficiency					
Cost to Income	33.4%	32.5%	32.3%	32.1%	31.1%
Credit Quality					
NPL/Gross Loans	0.2%	4.5%	4.4%	4.0%	3.8%
Provision Coverage Ratio	325.0%	50.3%	87.1%	124.1%	146.6%
Provisions / Gross Loans	0.8%	2.3%	3.8%	4.9%	5.5%
Valuation					
P/E			15.7x	14.4x	11.7x
P/BV			2.4x	2.2x	2.0x
Implied P/E			18.2x	16.7x	13.6x
Implied P/BV			2.8x	2.5x	2.3x

Source: Company Reports; Bank Muscat Equity Research
Note: Q210, LLP Charges – net of recoveries and share of associates is calculated and not reported in preliminary financials

Relative Comparison

QATAR BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
Qat. National Bank	10.6x	9.1x	2.3x	2.1x	23.6%	23.1%
Qat. Islamic Bank	9.4x	7.7x	1.9x	1.7x	17.6%	19.3%
Comm. Bank Of Qatar	8.7x	7.0x	1.3x	1.2x	13.8%	16.1%
Rayan	12.2x	10.7x	1.6x	1.5x	13.7%	14.2%
Doha Bank	7.9x	6.5x	1.4x	1.3x	17.7%	19.5%
Intl. Islamic Bank	9.5x	7.7x	1.6x	1.5x	16.6%	19.8%
Mean	**9.7x**	**8.1x**	**1.7x**	**1.5x**	**17.2%**	**18.6%**
Median	**9.5x**	**7.7x**	**1.6x**	**1.5x**	**17.1%**	**19.4%**

OMAN BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
Bank Muscat	10.2x	8.0x	1.4x	1.3x	14.6%	15.7%
Bank Dhofar	15.5x	13.6x	2.3x	2.1x	15.0%	15.4%
Nat. Bk. Of Oman	9.7x	8.3x	1.4x	1.2x	14.3%	15.5%
Oman Int. Bk.	11.5x	11.0x	1.5x	1.5x	12.9%	13.4%
Bank Sohar	16.6x	13.4x	1.8x	1.6x	11.2%	12.5%
Ahli Bank	13.9x	11.6x	1.7x	1.7x	13.2%	14.8%
Mean	**12.9x**	**11.0x**	**1.7x**	**1.6x**	**13.5%**	**14.6%**
Median	**12.7x**	**11.3x**	**1.6x**	**1.6x**	**13.8%**	**15.1%**

SAUDI BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
Al Rajhi Bank	15.8x	12.5x	3.7x	3.3x	24.3%	27.0%
Samba Financial Group	11.1x	9.3x	2.0x	1.8x	19.3%	19.7%
Riyad Bank	14.0x	12.6x	1.4x	1.3x	10.6%	10.9%
The Saudi British Bank	15.7x	14.4x	2.4x	2.2x	16.1%	17.7%
Banque Saudi Fransi	11.7x	9.9x	1.9x	1.7x	16.7%	17.7%
Arab National Bank	11.0x	9.3x	1.6x	1.4x	15.6%	16.3%
Saudi Hollandi Bank	19.8x	16.1x	1.8x	1.7x	9.6%	11.0%
The Saudi Investment Bank	12.9x	10.6x	1.1x	1.1x	7.1%	10.3%
Bank AlBilad	47.2x	24.4x	1.9x	1.8x	4.2%	7.6%
Bank AlJazira	32.4x	13.1x	1.1x	1.0x	3.4%	8.0%
Mean	**19.2x**	**13.2x**	**1.9x**	**1.7x**	**12.7%**	**14.6%**
Median	**14.8x**	**12.6x**	**1.9x**	**1.7x**	**13.1%**	**13.7%**

UAE BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
National Bank of AD	7.8x	6.4x	1.3x	1.1x	18.3%	19.1%
First Gulf Bank	6.2x	4.8x	1.0x	0.9x	15.6%	18.4%
Emirates NBD	5.7x	3.6x	0.5x	0.5x	8.1%	12.0%
Dubai Islamic Bank	8.0x	6.2x	0.8x	0.7x	10.7%	13.4%
AD Commercial Bank	-	6.0x	0.6x	0.6x	-0.5%	7.5%
Union National Bank	5.9x	4.8x	0.7x	0.6x	12.8%	13.5%
AD Islamic Bank	6.3x	4.5x	1.0x	0.9x	15.4%	19.8%
Mean	**6.7x**	**5.2x**	**0.8x**	**0.8x**	**11.5%**	**14.8%**
Median	**6.2x**	**4.8x**	**0.8x**	**0.7x**	**12.8%**	**13.5%**

BAHRAIN BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
Ahli United Bank	11.5x	8.9x	1.3x	1.2x	12.4%	14.8%
National Bank of Bahrain	9.9x	9.3x	2.0x	1.8x	18.9%	18.4%
Bahrain Islamic Bank	18.2x	9.4x	0.8x	0.8x	4.0%	7.2%
Mean	**13.2x**	**9.2x**	**1.4x**	**1.3x**	**11.8%**	**13.5%**
Median	**11.5x**	**9.3x**	**1.3x**	**1.2x**	**12.4%**	**14.8%**

KUWAIT BANKS	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
National Bank Of Kuwait	11.6x	10.7x	2.0x	1.8x	16.3%	17.5%
Commercial Bank Of Kuwait	32.4x	14.2x	2.4x	2.2x	6.0%	15.2%
Al-Ahli Bank Of Kuwait	16.6x	13.9x	1.6x	1.5x	11.4%	11.3%
Burgan Bank	16.5x	10.6x	1.1x	1.0x	7.2%	9.7%
Kuwait International Bank	26.5x	15.5x	1.0x	1.0x	4.5%	7.2%
Mean	**20.7x**	**13.0x**	**1.6x**	**1.5x**	**9.1%**	**12.2%**
Median	**16.6x**	**13.9x**	**1.6x**	**1.5x**	**7.2%**	**11.3%**

	PE 2010e	PE 2011e	PB 2010e	PB 2011e	ROE % 2010e	ROE % 2011e
Combined Mean	**14.2x**	**10.2x**	**1.5x**	**1.4x**	**12.8%**	**14.9%**
Combined Median	**11.6x**	**9.4x**	**1.5x**	**1.4x**	**13.7%**	**15.2%**

Source: Bank Muscat Research; Bloomberg

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