NCB CAPITAL

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Banking Quarterly

Saudi Arabia Banking Sector

1Q09: Margin-led growth

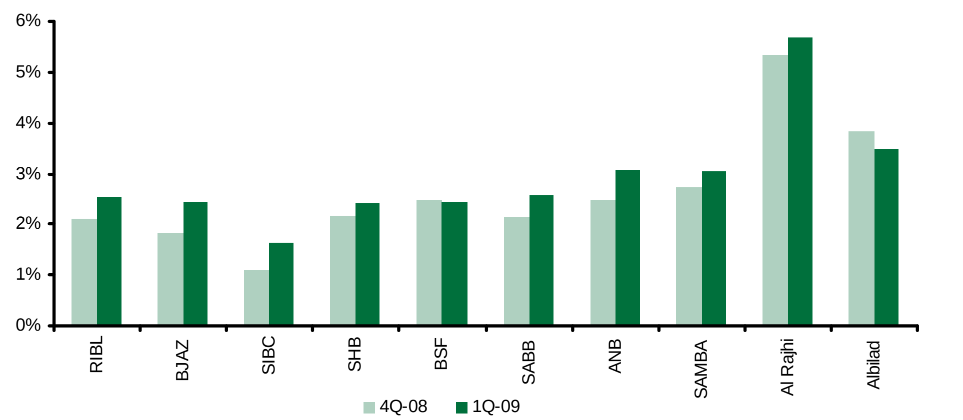
Cautious lending and low interest rates improved KSA banks' net interest spreads in 1Q-09, increasing net special commission income 6.3% sequentially. This, together with reduced provisions on impaired assets, enabled Saudi banks to post 87.1% QoQ growth in net income in 1Q-09.

Credit to deposit: In 1Q-09, customer deposits surged 4.3% QoQ whereas credit base fell 0.8% sequentially, with the credit-to-customer deposits ratio dropping to 83.7% from 88.0% in 4Q-08. This enabled Saudi banks to reduce dependence on external borrowings and help bring down special commission expenses.

Net interest spread: Aggregate net interest spread of Saudi banks widened by 30bp QoQ, enabling net special commission income to grow 6.3% QoQ and 9.1% YoY in 1Q-09, despite a contraction in credit portfolio. With the exception of BSF and Albilad, all Saudi banks saw an improvement in net interest spreads in 1Q-09.

In the near term, we expect Saudi banks to continue focusing more on protecting their net interest spreads rather than aggressively growing their credit books, given fears of NPLs and economic slowdown. Hence, we believe the growth in the next quarter would be margin-driven and not volume-driven unlike the growth during 2007-08 when banks expanded credit aggressively at the cost of their margins.

Chart of the quarter: Cautious lending and lower funding cost improves margins of KSA banks



Source: Company data, Tadawul, NCBC Research

Exhibit 1: Saudi banks – Valuation matrix

Banks	MCap ($ mn)	Stock Perf (%) YTD	Stock Perf (%) 2008	P/E (x) TTM	P/BV (x) Latest	Div Yld (%) 2008	ROE (%) TTM	ROA (%) TTM
Al Rajhi Bank (Al Rajhi)	28,200	25.9	(49.1)	15.9	4.1	4.8	26.9	4.4
Samba Financial Group (Samba)	13,920	8.3	(56.8)	11.5	2.7	3.1	24.0	2.6
SABB	11,100	28.5	(37.8)	14.2	3.3	1.6	25.6	2.4
Riyad Bank (RIBL)	10,200	20.3	(55.5)	16.0	1.5	5.7	12.5	1.6
Banque Saudi Fransi (BSF)	9,064	34.0	(59.7)	12.1	2.3	2.3	21.0	2.4
Arab National Bank (ANB)	8,580	58.7	(62.8)	12.8	2.6	2.3	21.3	2.4
Alinma Bank (Alinma)	5,780	30.2	11.0	52.8	1.4	-	3.2*	3.2*
Saudi Hollandi Bank (SHB)	3,766	33.4	(36.0)	11.5	2.4	1.7	23.1	1.9
Saudi Investment Bank (SIBC)	2,778	39.9	(65.5)	21.0	1.5	-	7.2	1.0
Bank Albilad (Albilad)	1,904	(15.0)	(29.6)	73.9	2.2	-	3.0	0.6
Bank Al Jazira (BJAZ)	1,892	57.1	(69.0)	41.4	1.5	2.1	3.6	0.7

Source: Company data, Tadawul, NCBC Research; All prices as of 20 May 2009 *operations for ten months adjusted

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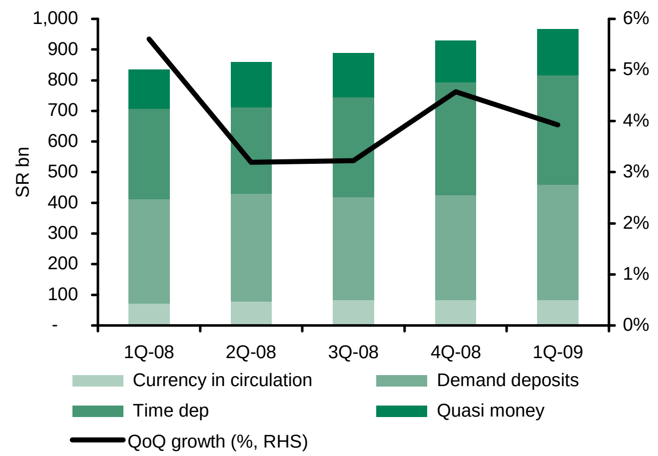
1Q-09 performance of the banking sector

Money supply and deposit growth

Despite gloomy global market conditions, money supply in the Saudi economy continued to rise in 1Q-09. Broad money – M3 – rose 3.9% sequentially to SR965.6bn, supported by a liberal monetary policy and lower inflationary pressures. Customer deposits (time deposits, demand deposits and quasi money deposits) grew 4.3% QoQ to SR882.7bn in 1Q-09. Furthermore, weekly money supply data shows an increase of 4.0% in M3 to SR1004.6bn from 31 Mar 09 to 14 May 09, indicating improved liquidity conditions.

With easing inflation and improved liquidity in the market, the deposit structure changed in 1Q-09. Time and demand deposits saw a reversal in trend of the past two quarters. Demand deposits showed robust growth (10.1% QoQ), as against a moderate growth of 2.7% in the previous quarter. Time deposits, which had grown 12.6% QoQ in 4Q-08, declined 3.1% sequentially in 1Q-09. Consequently, in 1Q-09, the share of demand deposits in customer deposits rose to 42.7% from 40.5% in 4Q-08 and share of time deposits declined to 40.4% from 43.4%.

Exhibit 2: Money supply - M3 (SR bn) and QoQ growth



Source: SAMA, NCBC Research

Exhibit 3: Customer deposits (SR bn)

Bank	1Q-08	4Q-08	1Q-09	% YoY	% QoQ
RIBL	96.7	105.1	119.2	23.2	13.5
BJAZ	15.9	20.9	21.4	34.2	2.3
SIBC	33.1	40.7	38.0	15.0	(6.5)
SHB	38.7	43.0	48.1	24.2	11.8
BSF	78.4	92.8	91.6	16.8	(1.3)
SABB	78.4	92.7	96.6	23.2	4.3
ANB	78.8	92.7	84.5	7.2	(8.9)
SAMBA	119.5	134.2	124.2	4.0	(7.5)
Al Rajhi	101.4	116.6	119.9	18.2	2.8
Albilad	13.2	11.0	12.9	(2.4)	17.7

Source: Company data, Tadawul, NCBC Research

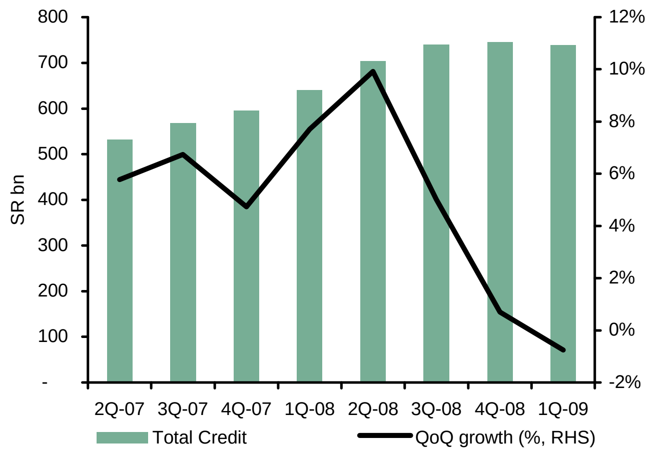
Riyad Bank and SHB took the lead in attracting higher customer deposits, compared with other Saudi peers, growing their deposit base at 13.5% and 11.8% QoQ respectively. On the other hand, Samba and ANB's customer deposits declined QoQ, showing single-digit growth on a yearly basis.

Credit growth

Continued worries about growing NPLs and fear of economic slowdown kept the lending environment depressed in 1Q-09. Total credit declined 0.8% QoQ to SR739.2bn in 1Q-09, the first sequential decline since 1Q-06.

Samba experienced a decline in its credit portfolio of 8.2% QoQ and 0.6% YoY. Riyad Bank, however, continued with its aggressive lending, supported by its customer deposits base, growing its credit base faster than industry peers by 3.9% QoQ and 41.4% YoY.

Exhibit 4: Credit (SR bn) and QoQ growth



Source: SAMA, NCBC Research

Exhibit 5: Credit (SR bn)

Bank	1Q-08	4Q-08	1Q-09	% YoY	% QoQ
RIBL	70.8	96.4	100.2	41.4	3.9
BJAZ	11.9	15.1	15.3	28.5	1.2
SIBC	24.6	29.6	30.1	22.6	1.9
SHB	30.7	38.0	39.3	28.0	3.4
BSF	68.5	80.9	81.3	18.8	0.5
SABB	66.6	80.2	79.3	19.0	(1.2)
ANB	65.3	74.7	72.8	11.5	(2.5)
SAMBA	90.7	98.1	90.1	(0.6)	(8.2)
Al Rajhi*	68.7	76.5	78.4	14.1	2.4
Albilad	7.2	8.3	9.1	26.4	9.8

Source: Company data, Tadawul, NCBC Research;

*We have excluded Mutajara investments of Al Rajhi bank for calculating credit

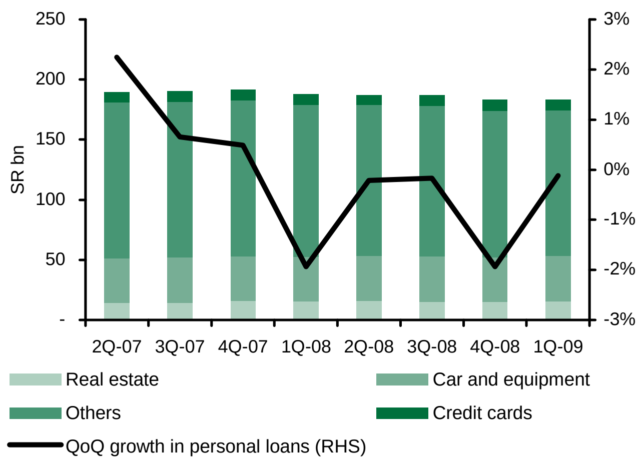
Credit to commerce, the second largest segment with 24.3% share of total credit, grew 1.6% QoQ, while manufacturing and building and construction, the third and fourth largest segments, declined 0.3% and 3.2% QoQ respectively. On the other side, transport and communication, services, and electricity and other utilities grew 14.5%, 15.2%, and 18.8% respectively. Personal credit continued declining in 1Q-09. However, a combined increase of 1.9% in real estate and car and other equipment loans (constituting about 29% of the total personal credit portfolio) resulted in only a 0.1% decline in total personal credit in 1Q-09.

Exhibit 6: Change in sector wise credit (SR bn)

Sector	4Q-08	1Q-09	% Chg	Abschg
Miscellaneous	289.4	274.0	(5.3)	(15.3)
Commerce	176.9	179.7	1.6	2.9
Manfg & Processing	79.3	79.1	(0.3)	(0.2)
Building & Construction	54.4	52.6	(3.2)	(1.7)
Transport & Comm	37.8	43.3	14.5	5.5
Services	32.3	37.2	15.2	4.9
Govt & Quasi Govt.	32.1	31.2	(2.6)	(0.8)
Finance	16.8	14.0	(16.9)	(2.8)
Agriculture & Fishing	11.0	10.7	(2.7)	(0.3)
Electricity Water Utilities	10.6	12.6	18.8	2.0
Mining & Quarrying	4.3	4.6	8.2	0.3
Total	**744.8**	**739.2**	**(0.8)**	**(5.6)**

Source: SAMA, NCBC Research

Exhibit 7: Personal loan composition (SR bn)

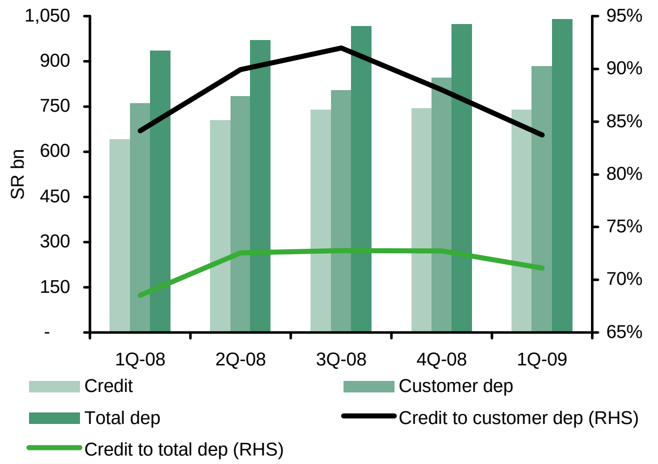


Source: SAMA, NCBC Research

Credit to deposit

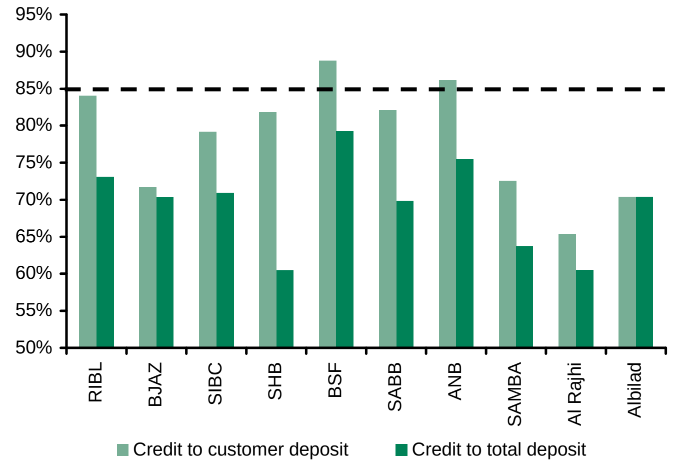
Improved liquidity in the economy and tight lending policies adopted by banks eased pressure for Saudi banks to maintain the credit-to-deposit ratio. In 1Q-09, credit to customer deposits stood at 83.7%, declining from 88.0% in 4Q-08. This helped the banks lower external borrowings such as foreign liabilities, which came down 23.8% QoQ. The share of external borrowings in total deposits reduced to 15.1% in 1Q-09 from 17.4% in 4Q-08, even as the credit-to-total-deposit ratio of 71.1% remained well below the statutory limit of 85%.

Exhibit 8: Credit, customer deposits and total deposits (SR bn)



Source: SAMA, NCBC Research

Exhibit 9: Credit to deposit (%)



Source: Company data, Tadawul, NCBC Research

*For Al Rajhi Bank, Mutajara investments are excluded to calculate credit

Due to a contraction in credit growth in 1Q-09, most Saudi banks were able to meet majority of their funding requirements from their main source of funds – customer deposits. However, BSF and ANB had higher credit-to-customer-deposit ratios, indicating their need to rely on other external deposits to fall within the SAMA prescribed limit of 85%. Although well below the 85% cap, SHB had higher amount of external borrowings on its balance sheet.

Total assets and capital strength

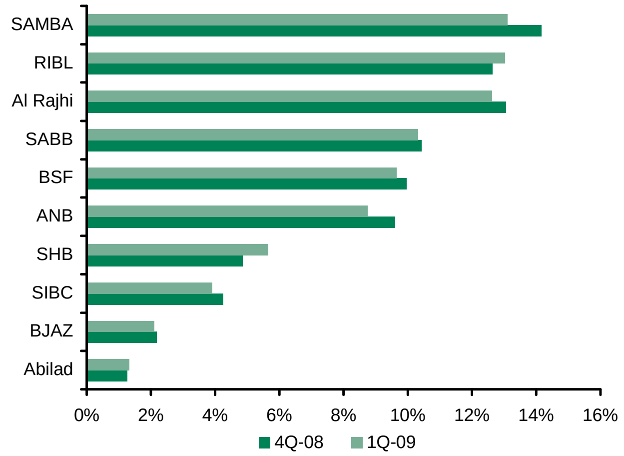
In 1Q-09, total assets of the Saudi banking system grew just 1.7% QoQ, the lowest in the past 12 quarters. While total assets of all major banks declined QoQ, Riyad Bank, SHB, and Albilad showed expansion in their balance sheet size during the quarter. Although Samba remained the largest listed bank in terms of total assets with market size of 13.1%, its balance sheet size reduced 6.4% on a yearly basis.

Exhibit 10: Total assets (SR bn)

Bank	1Q-08	4Q-08	1Q-09	% YoY	% QoQ
RIBL	134.3	159.7	167.2	24.5	4.7
BJAZ	22.9	27.5	27.1	18.2	(1.6)
SIBC	46.1	53.6	50.3	9.0	(6.2)
SHB	59.0	61.4	72.5	23.0	18.1
BSF	111.3	125.9	123.9	11.3	(1.6)
SABB	106.4	131.7	132.6	24.6	0.7
ANB	104.0	121.3	112.4	8.1	(7.3)
SAMBA	179.8	178.9	168.3	(6.4)	(5.9)
Al Rajhi	143.0	164.9	162.2	13.4	(1.6)
Albilad	17.1	16.1	17.1	(0.1)	6.3

Source: Company data, Tadawul, NCBC Research

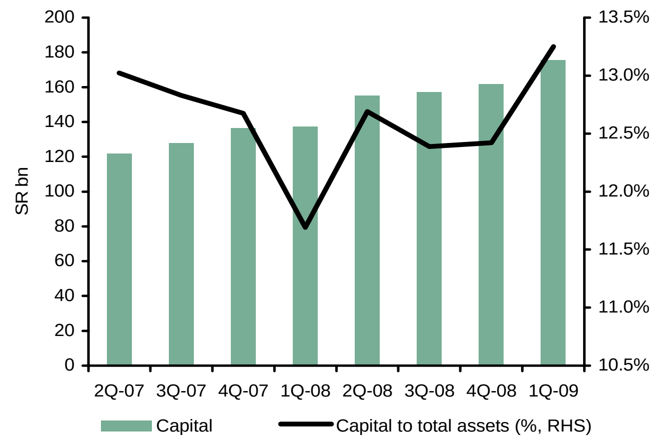
Exhibit 11: Market share in total assets



Source: Company data, Tadawul. NCBC Research

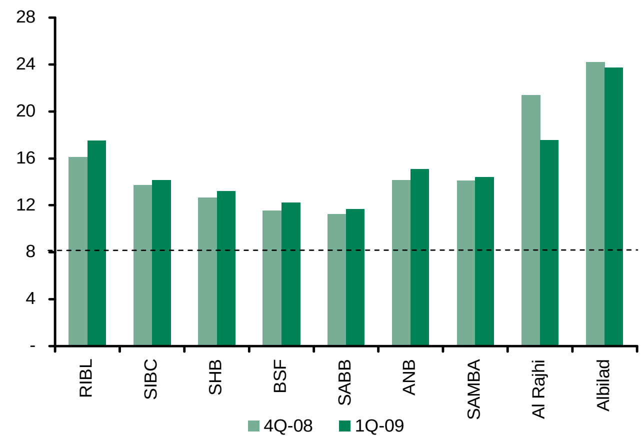
With a surge in net income and an improved equity base, capital strength of KSA banks as measured by capital-to-total-asset ratio, also grew to 13.2% in 1Q-09 from 12.4% in 4Q-08. With the exception of Albilad and Al Rajhi, capital adequacy ratio (CAR) of all other Saudi banks improved sequentially in 1Q-09; however, their CAR remained higher than other conventional peers.

Exhibit 12: Capital and capital-to-total-asset ratio



Source: SAMA, NCBC Research

Exhibit 13: Capital adequacy (%)



Source: Company data, NCBC Research

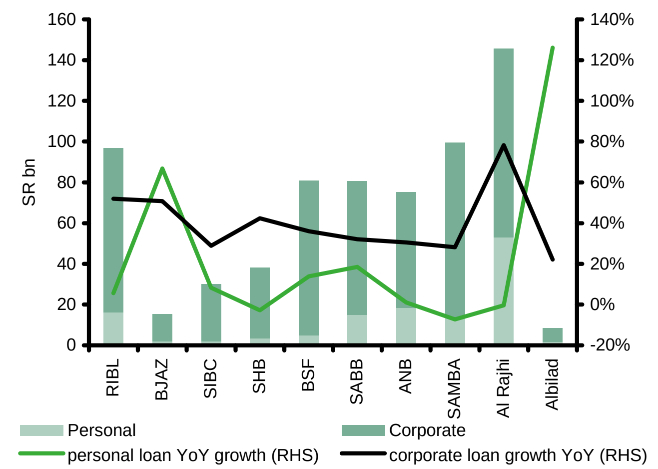
* Bank Al Jazira's financial statements for 1Q-09 are unavailable

Net special commission income and margins

A series of key rate cuts and improved liquidity in the economy helped the banks re-price liabilities quickly and reduce cost of funds more than their yields on earning assets. Consequently, net interest spreads of Saudi banks improved in 1Q-09, compared with 4Q-08 and 3Q-08.

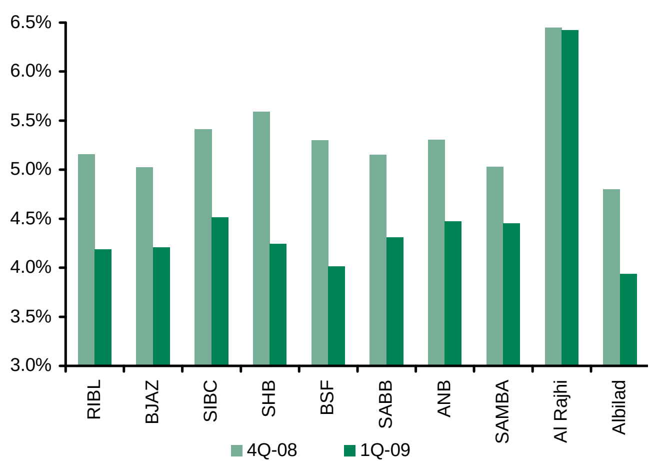
With falling SAIBOR rates, yields on earning assets of all banks declined, as the majority of corporate loans are on a SAIBOR plus basis. However, **Al Rajhi was able to maintain its higher yields during 1Q-09 because its loan portfolio has a high component of personal credit. On the other hand, SHB and BSF's yields on earning assets declined more than industry peers by 134bp and 129bp respectively due to a large proportion of corporate loans.**

Exhibit 14: Loan composition in 2008 (SR bn)



Source: Company data, NCBC Research

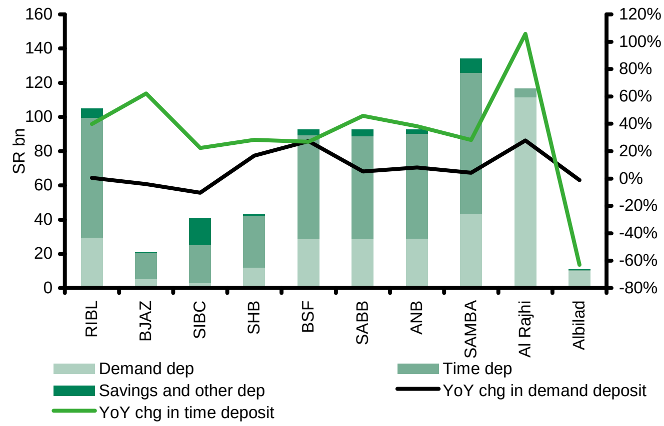
Exhibit 15: Yields on earning assets (%) (1Q-09)



Source: Company data, Tadawul, NCBC Research

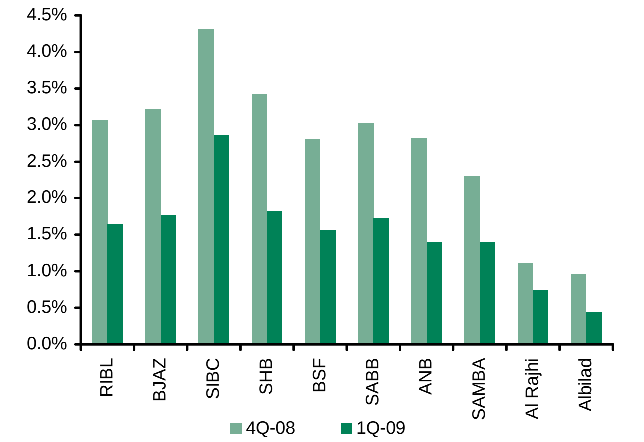
Albilad's and Al Rajhi's cost of funds remained the lowest in the industry because their deposit base is dominated by low-cost demand deposits, whereas SIBC had the highest cost of funds due to its greater dependence on relatively high-cost time and saving deposits.

Exhibit 16: Deposit composition in 2008 (SR bn)



Source: Company data, NCBC Research

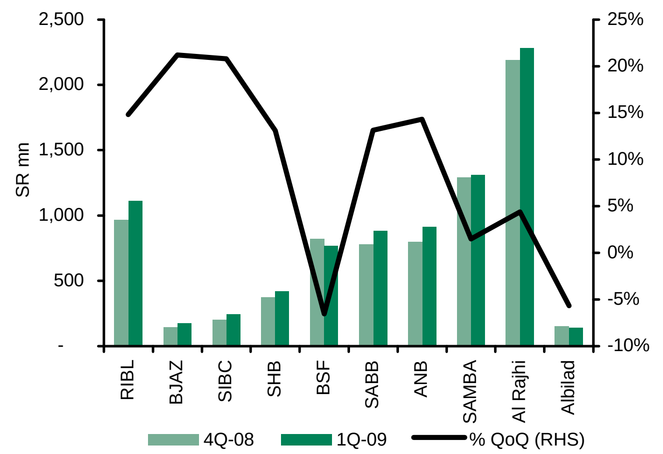
Exhibit 17: Cost of funds (%) (1Q-09)



Source: Company data, Tadawul, NCBC Research

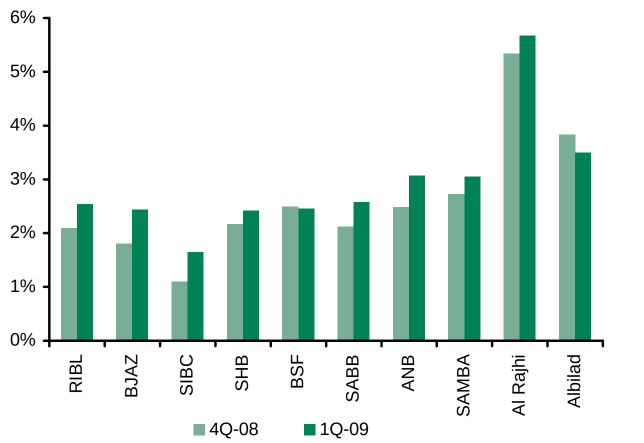
All banks except BSF and Albilad saw an improvement in net interest spreads. Lower spreads resulted in lower sequential growth in the net special commission income for 1Q-09 for BSF and Albilad, while net special commission income of other banks surged despite sluggish credit growth, mainly due to improved net interest spreads. I**n the near term, we expect Saudi banks to continue focusing more on protecting their net interest spreads rather than growing their credit books aggressively, given fears of NPLs and economic slowdown.** Hence, we believe the growth in the next quarter would be margin-driven and not volume-driven, as seen during 2007-08 when banks expanded credit aggressively at the cost of their margins.

Exhibit 18: Net special commission income (SR mn)



Source: Company data, Tadawul, NCBC Research

Exhibit 19: Net interest spreads (%)



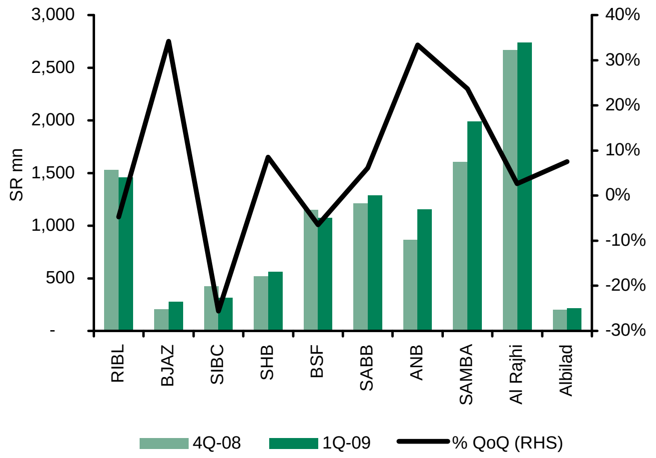
Source: Company data, Tadawul, NCBC Research

Operating efficiency

Total operating income of Saudi banks increased 13.7% QoQ, led by increased net interest income. At the same time, operating expenses declined 2.8%, improving operating efficiency of the banks. The aggregate cost-to-income ratio of Saudi banks improved from 37.1% in 4Q-08 to 31.7% in 1Q-09. Cost-to-income ratio was the lowest in the industry for Samba, Al Rajhi and BSF while for Albilad, the ratio was the highest at 78.9%. Al Jazira successfully reduced its operating costs and increased operating income, resulting in its cost-to-income ratio declining from 102% to 61% in 1Q-09. Bank Al Jazira's Cost-to-income ratio improved due to

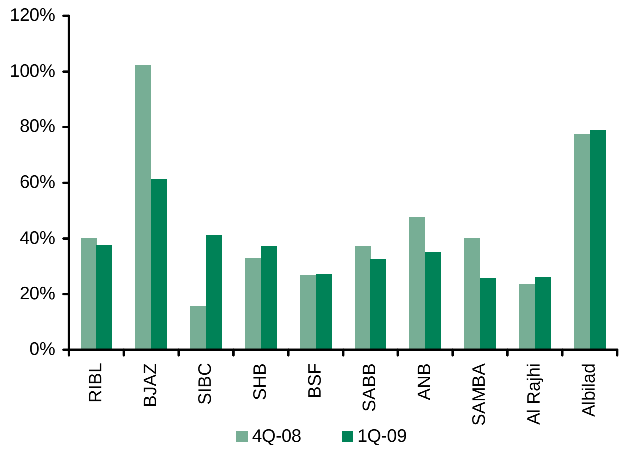
1. Increase in interest income by 21.2% due to widening spreads –63bp qoq (driven by declining funding cost)
2. Investment income of SR1.4mn against investment losses of SR51mn in 4Q-08
3. 21.4% qoq reduction in salary, rent and general administrative expenses

Exhibit 20: Total operating income (SR mn)



Source: Company data, Tadawul, NCBC Research

Exhibit 21: Cost-to-income (%)



Source: Company data, Tadawul, NCBC Research

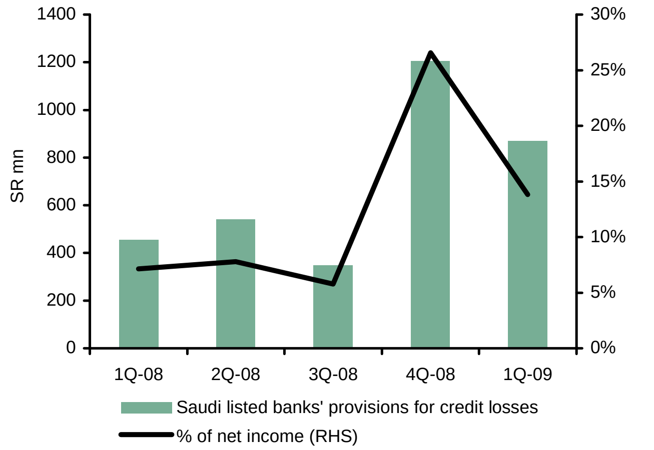
Net income

Net income of Saudi banks showed strong momentum, growing 87.1% QoQ, only 0.5% lower than the 1Q-08 net income. This is mainly attributable to a sharp reduction in provisions made for impaired losses and increased net interest income. We estimate provisions for impaired assets of listed Saudi banks[1] to have declined in 1Q-09 to SR428mn, as against SR1,537mn in 4Q-08. This indicates that most of the banks have made sufficient provisions against impaired investments in 4Q-08. We can expect further declines in provisions made for impaired investments as markets have shown sign of improvements globally.

On the other hand, while provision charges for impaired assets are reducing, the fear of credit losses is rising. The banks are increasingly providing for NPLs since the past two quarters. Provisions for credit losses transferred to income statement increased 90.5% YoY in 1Q-09 to SR870mn, although lower than 4Q-08 provisions that stood at SR1,206mn.

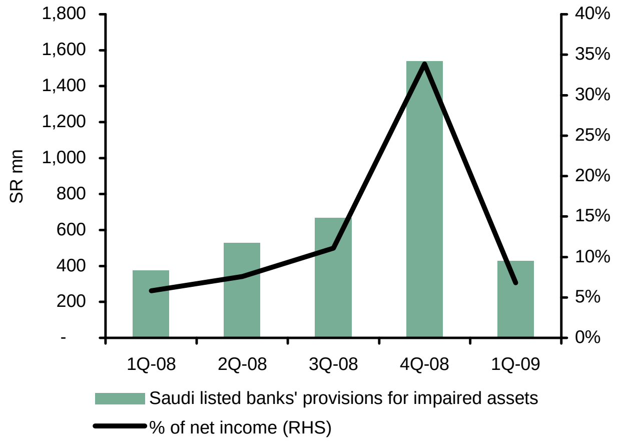
[1] excluding Alinma Bank

Exhibit 22: Provisions for credit losses (SR mn)



Source: Company data, NCBC Research

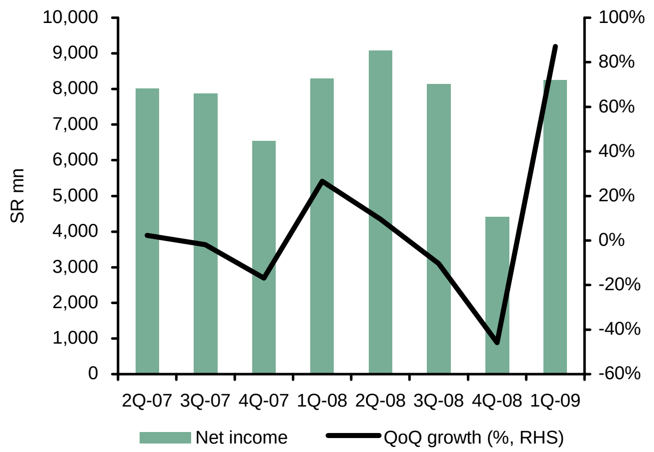
Exhibit 23: Provisions for impaired assets (SR mn)



Source: Company data, NCBC Research

All listed banks posted net income this quarter. This is significant for Al Jazira, SIBC, and Albilad since they were able to post profits as against quarterly losses in 4Q-08. Al Rajhi recorded a healthy growth in net income of 8.1% YoY while ANB showed good performance sequentially.

Exhibit 24: Net income (SR mn) and QoQ growth



Source: SAMA, NCBC Research

Exhibit 25: Net income (SR mn)

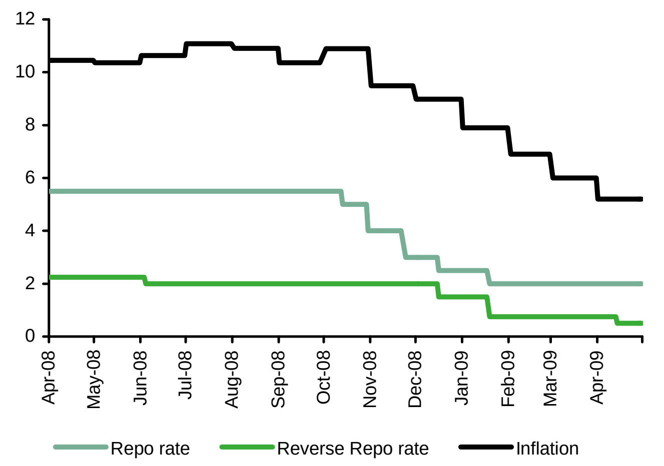
Bank	1Q-08	4Q-08	1Q-09	% YoY	% QoQ
RIBL	690.7	529.1	441.1	(36.1)	(16.6)
BJAZ	153.3	(91.8)	102.2	(33.3)	Nm
SIBC	258.2	(90.7)	240.6	(6.8)	Nm
SHB	282.4	308.9	284.4	0.7	(7.9)
BSF	732.5	570.5	740.8	1.1	29.8
SABB	757.0	656.8	760.0	0.4	15.7
ANB	672.2	434.1	694.8	3.4	60.1
SAMBA	1,201.1	825.7	1,271.6	5.9	54.0
Al Rajhi	1,601.8	1,423.9	1,731.7	8.1	21.6
Albilad	50.8	(27.5)	22.4	(56.0)	Nm

Source: Company data, Tadawul, NCBC Research

Change in monetary policy

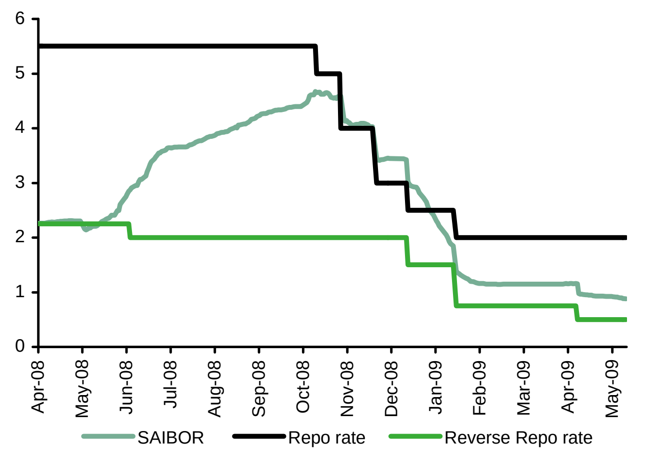
SAMA continued lowering its key rates during the quarter under review. On 19 Jan 09, the Central Bank lowered the repo rate by 50bp to 2% and the reverse repo rate by 75bp to 0.75%, which resulted in the SAIBOR declining 46bp to 1.38% on the same day. Furthermore, the Central Bank lowered the reverse repo by 25bp to 0.5% on 14 Apr 09. Currently, the interbank interest rate for Saudi Riyal stands at 0.87% (20 May 09). Easing inflationary pressure supported key rate cuts. Inflation declined from a peak of 11.1% in July 08 to 7.9% in Jan 09 and to 5.2% in April 09.

Exhibit 26: Easing inflation supports key rate cuts



Source: SAMA, Bloomberg, NCBC Research

Exhibit 27: SAIBOR declines to match rate cuts



Source: Bloomberg, NCBC Research

Valuation

Saudi banking index is up 26.0% YTD, in line with the Saudi benchmark index TASI.

Small-size banks such as Albilad and Al Jazira and the newly listed Alinma are trading at high P/E multiples while Samba and SHB are trading at the lowest multiple of 11.5x. On P/BV, Al Rajhi and SABB are trading above the industry average of 2.6x.

Exhibit 28: Saudi banks – Valuation matrix

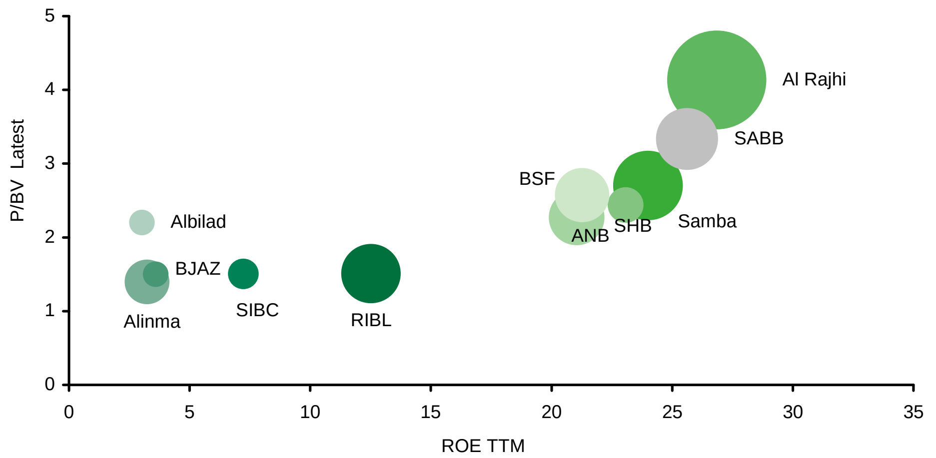
Banks	MCap ($ mn)	Stock perf (%) 2008	Stock perf (%) 1Q-09	Stock perf (%) YTD	P/E (x) TTM	P/BV (x) Latest	Div yld (%) 2008	ROE (%) TTM	ROA (%) TTM	Net inc ($ mn) 1Q-09	Net inc YoY (%)
Al Rajhi Bank (Al Rajhi)	28,200	(49.1)	(7.6)	25.9	15.9	4.1	4.8	26.9	4.4	462	8.1
Samba Financial Group (Samba)	13,920	(56.8)	(17.3)	8.3	11.5	2.7	3.1	24.0	2.6	339	5.9
SABB	11,100	(37.8)	15.5	28.5	14.2	3.3	1.6	25.6	2.4	203	0.4
Riyad bank (RIBL)	10,200	(55.5)	(3.3)	20.3	16.0	1.5	5.7	12.5	1.6	118	(36.1)
Banque Saudi Fransi (BSF)	9,064	(59.7)	23.1	34.0	12.1	2.3	2.3	21.0	2.4	198	1.1
Arab National Bank (ANB)	8,580	(62.8)	13.8	58.7	12.8	2.6	2.3	21.3	2.4	185	3.4
Alinma Bank (Alinma)	5,780	11.0	(5.4)	30.2	52.8	1.4	-	3.2*	3.2*	29	NA
Saudi Hollandi Bank (SHB)	3,766	(36.0)	6.3	33.4	11.5	2.4	1.7	23.1	1.9	76	0.7
Saudi Investment Bank (SIBC)	2,778	(65.5)	0.9	39.9	21.0	1.5	-	7.2	1.0	64	(6.8)
Bank Albilad (Albilad)	1,904	(29.6)	(7.1)	(15.0)	73.9	2.2	-	3.0	0.6	6	(56.0)
Bank Al Jazira (BJAZ)	1,892	(69.0)	11.3	57.1	41.4	1.5	2.1	3.6	0.7	27	(33.3)

Source: Company data, Tadawul, NCBC Research

All prices as of 20 May 2009 *operations for ten months adjusted

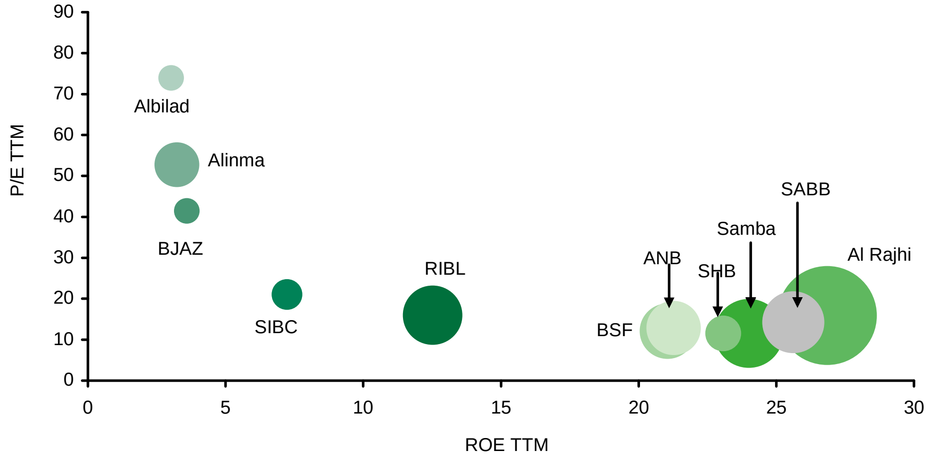
The following exhibits depict the current valuation of listed banks in Saudi Arabia.

Exhibit 29: P/BV vs. ROE (TTM)



Source: Company data, Tadawul, NCBC Research

Exhibit 30: P/E vs. ROE (TTM)

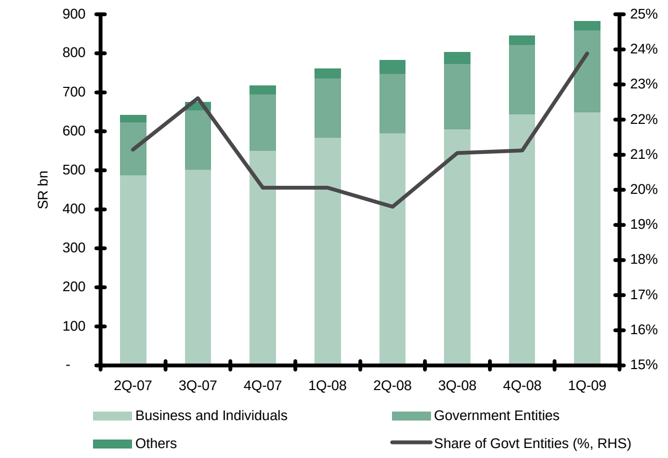


Source: Company data, Tadawul, NCBC Research

Annexure

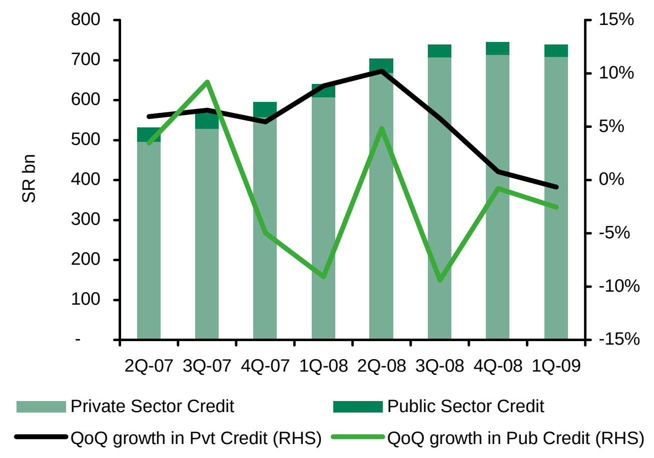
Government and private deposits and credit

Exhibit 31: Deposits by government and private sector (SR bn)



Source: SAMA, NCBC Research

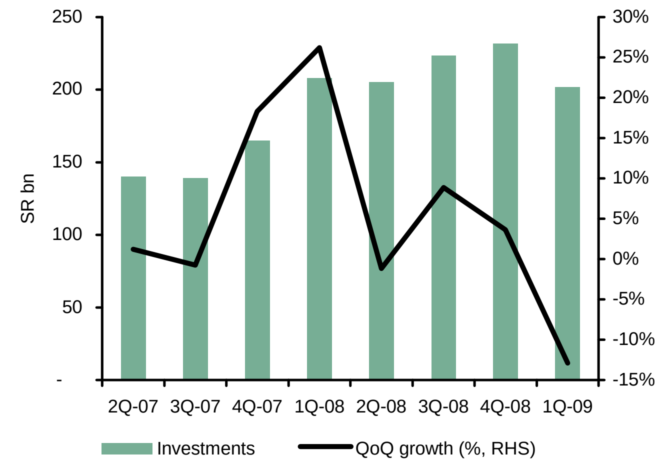
Exhibit 32: Credit to government and private sector (SR bn)



Source: SAMA, NCBC Research

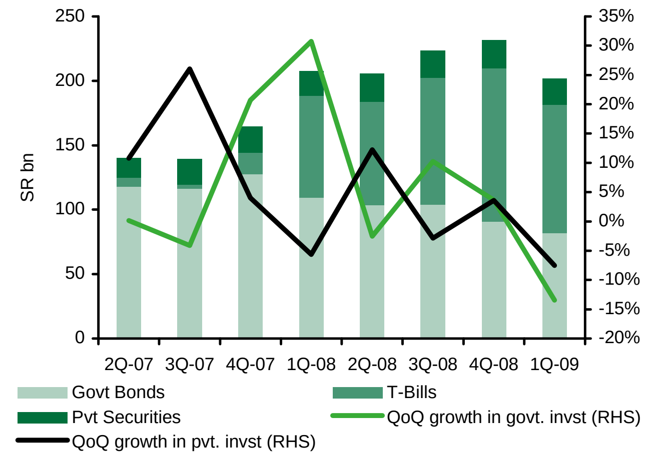
Investments

Exhibit 33: Investments (SR bn) and QoQ growth



Source: SAMA, NCBC Research

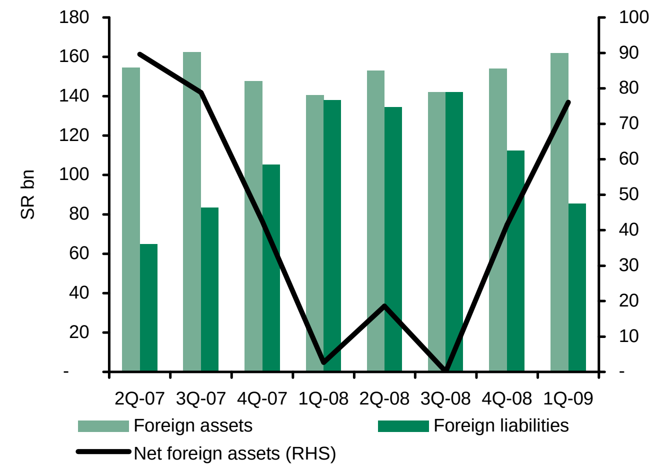
Exhibit 34: Investment composition (SR bn)



Source: SAMA, NCBC Research

Net foreign assets

Exhibit 35: Net foreign assets of commercial banks (SR bn)



Source: SAMA, NCBC Research

Exhibit 36: Net foreign assets of SAMA (SR bn)

Source: SAMA, NCBC Research

Glossary – abbreviations used

%Chg	% change	MoM	Month on month	ROA	Return on assets
Abschg	Absolute change	Net inc	Net income	ROE	Return on equity
bn	Billion	NIM	Net interest margins	SR	Saudi Riyal
CAR	Capital adequacy ratio	NPL	Non-performing loan	TTM	Trailing 12 month
Div yld	Dividend yield	P/E	Price to earnings	YoY	Year on year
MCap	Market capitalization	P/BV	Price to book value	YTD	Year to date
mn	Million	QoQ	Quarter on quarter		

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