EFG - Hermes

Slower Growth But at a Very Good Price

20 May 2007

Saudi Arabia| Banking

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- We re-initiate coverage of six Saudi banks; Samba, Riyad, ANB, SABB, BSF and SHB and initiate coverage of SAIB. After the market decline of 2006 (-52.5%), the sector has significantly underperformed the index 2007 Year-to-Date (-17.3% vs. -4.7%). We believe this to be a particularly opportune time to invest, with a medium to long-term perspective, in many of the banks covered in this note.

- Disappointing 1Q2007 results, with earnings declining at almost all banks, in some cases significantly, were the principal reason for the underperformance of bank shares so far in 2007. From the end of 2005, and throughout 2006, the Saudi banking sector has seen adverse developments that have included restrictions set by SAMA on consumer lending (historically, the principal growth driver for loans and accounting for c40% of sector loans), declining stock brokerage revenues, and an increase in competition as a result of the entry of foreign banks.

- However, we remain very confident regarding the underlying medium and long-term prospects for the sector. Our stance is based on our forecast of a strong economic environment that will enable a rebound in the growth of loans beyond 2007; driven primarily by growth in commercial lending, which is expected to accelerate in most sub-segments as a result of planned public and private investment projects. We also forecast consumer lending will continue to grow, at a faster rate than in 2006 (1.6%), but at a much slower rate than the historical trend (a CAGR of 57% for 2004 and 2005), driven primarily by an expansion in the size of the bankable population and the activation of the untapped mortgage finance sector.

- We forecast a two-year 2007-09 loan CAGR of 14.6%, strong profitability with ROAEs averaging 27% in 2008 and 2009, despite overcapitalization across the sector. We forecast a decline in earnings for the peer group (-12.7 %) in 2007, followed by a recovery in 2008 and 2009 (11.7% and 13.0% respectively).

- Discounted Equity Cash Flow (DECF) valuations determine our long term (LT) recommendation for each bank while our short-term (ST) recommendations are the result of our expectations for short term share price movements. We believe that short term price movements in the Saudi market are mainly driven by news and earnings momentum.

- The top three picks in our Saudi coverage universe to which we assign ST/LT Buy Recommendations are BSF (75% upside to our estimated LTFV of SAR101.2), ANB (71% upside to SAR113.2) and SHB (65% upside to SAR67.9). The three banks are characterized by their strong corporate banking franchises which, in our opinion, position them well to take advantage of the forecast growth opportunities. Additionally, BSF is currently expanding into non-banking segments that we believe will allow the bank to outperform its peers. ANB will benefit from its strong retail business, Islamic product development as well as investment in the housing finance sector. We believe the key attraction of SHB to be its very low near term multiple valuation (PEs of 11.2x 2007 and 9.9x 2008 and adjusted P/BVs of 2.2x 2007 and 2.0x 2008).

- We find SABB slightly less attractive at current levels and assign a ST Neutral/LT Accumulate recommendation (45% upside to SAR138.8). At the other end of our recommendation range, we assign a ST Accumulate/LT Neutral to Samba (12% upside to SAR148.5) and ST/LT Neutral recommendations to Riyad Bank (18% upside to SAR57.2), and SAIB (10% upside to SAR41.3).

Banks Analyzed in this Report

(SAR)	Price*	ST/LT Rec	LT-FV	P/E07e	P/E 08e	P/E 09e	P/B 07e**	P/B 08e**	P/B 09e**
BSF	58.0	Buy/Buy	101.2	10.8	9.5	8.2	3.0	2.7	2.3
ANB	66.3	Buy/Buy	113.2	11.6	10.3	8.9	2.9	2.5	2.2
SHB	41.3	Buy/Buy	67.9	11.2	9.9	8.4	2.2	2.0	1.8
SABB	95.5	Neu./Acc.	138.8	13.5	12.1	10.6	3.6	3.2	2.9
Riyad Bank	48.5	Neu./Neu.	57.2	12.8	11.7	10.9	2.4	2.3	2.2
Samba	132.3	Acc./Neu.	148.5	16.4	14.6	12.9	4.4	3.8	3.3
SAIB	37.5	Neu./Neu.	41.3	12.2	11.2	11.1	2.0	1.9	1.8

***BVs are adjusted by +/- loan loss provisions in excess of 100% NPL coverage*

**As at 16 May 2007*

KINDLY REFER TO THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGE 56.

EXECUTIVE SUMMARY

Economic Outlook

The rise in both oil prices and oil output between 2003 and 2006 has led to significant growth in nominal GDP from USD215 billion in 2003 to an estimated USD351 billion in 2006. Very strong budget and current account surpluses, despite strong growth in fiscal expenditure, have led to the accumulation of substantial fiscal and foreign reserves by the Saudi authorities. Saudi economic growth is expected to remain very buoyant. While oil revenues may not be sustained at current levels going forward due both to a decline in production and, possibly, a decline in oil prices, this will tend to only affect the size of the budget and current account surpluses and the accumulation of financial reserves, but not the level of domestic economic activity ex-oil. The latter is expected to continue to remain strong as a result of growth in both government expenditure and investment. The Saudi government is pursuing an expansionary policy in its 2007 budget and is set to continue with its policy of economic liberalization, which will further encourage private sector investment.

Overview of the Sector

The Saudi banking sector is the largest in the GCC as measured by banking assets. Starting 2004, the Saudi Arabian Monetary Agency (SAMA) opened up the sector for foreign competition by licensing nine foreign banks both GCC and non-GCC to operate branches in Saudi Arabia. Four of the nine licensed banks have not yet started operations. The sector currently comprises eleven banks and six branches of foreign banks.

SAMA, both the monetary authority and the banking sector regulator, has maintained a tight regulatory environment, characterized by a lack of irrational price competition, and helped banks to maintain high levels of profitability. The average Capital Adequacy Ratio (CAR) for our coverage universe reached 18% at the end of 2006 (minimum requirement is 8%). With asset growth having slowed significantly in 2006, down from the high growth levels achieved in 2004 and 2005, we believe there is an argument for a decline in the average CAR at Saudi banks going forward. Saudi banks are mostly characterized by very high levels of asset quality across the board with the average NPLs/Gross loans ratio in our coverage universe standing at 2.2% as at end-2006, with a conservative coverage ratio of 151%.

Over 2004 and 2005, the banking sector went through a tremendous period of growth, with most banks doubling their asset base over that time frame. Consumer lending growth was a significant driver, with the availability of funding significantly facilitated by the significant reduction in net claims by banks on the government. A supportive macro economic environment and outstanding capital market performance also helped. 2006 represented a challenge for the banking sector to sustain growth, with caps imposed by SAMA on consumer lending and the stock market's poor performance impacting fee income. As a result, profitability and asset growth dropped in 2006.

Consumer lending growth (2-year consumer loan CAGR of 57.1%), which drove loan growth in Saudi Arabia in 2004 and 2005, dropped significantly in 2006 (growth of 1.6%) as a result of the restrictions set by SAMA. Additionally, the mix of deposits has shifted more to 'Time & Savings' deposits, away from demand deposits, which has led to some pressure on net commission (interest) spreads. Spreads generally remained flat between 2003 and 2005, despite the growth in consumer lending.

Outlook for the Sector

We are relatively bullish regarding the fundamentals of the banks covered in this note. Our stance is based on our forecast of a strong economic environment. We expect growth in banking sector assets beyond 2007 to be driven primarily by growth in commercial lending, which is expected to accelerate in most sectors as a result of the government's planned development projects. The government's announcements imply total projects within Saudi Arabia worth some USD700 billion over the next twelve years. We expect the private sector to play an integral role in these planned developments which will accordingly involve banks.

Additionally, and despite the restrictions set by SAMA on consumer lending, we expect consumer lending to continue to grow, but at a much slower rate than the historical trend, driven primarily by an expansion in the size of the bankable population. We expect the real estate and mortgage finance law to be issued shortly, which will trigger housing finance activity. We forecast a two-year 2007-09 loan growth CAGR of 14.6%, with commercial loans growing by 17.0% over the same period. On the other hand, deposits are forecast to grow at a two year 2007-09 CAGR of 12.7%, at a slower pace than loan growth.

We expect the pressure on net interest (NI) spreads to continue over the short and medium terms, due to the increasing cost of funds, resulting from the rise in US rates, and the changing structure of the loan portfolio at banks, a result of stronger growth of commercial loans which are priced more tightly. We estimate NI spreads will decline slightly from current levels but remain relatively high compared to those at comparable GCC banks. We forecast non-special commission income will be a challenge for most banks in 2007 as net banking fees are set to drop significantly, as a result of a significant decline in brokerage revenue, resulting from a decline in brokerage volumes. Non-special commission income is expected to rebound from 2008 onwards, as a result of a recovery in brokerage revenue along with forecast growth in new ancillary services (asset management, corporate advisory, banc assurance, mortgage lending etc).

We foresee strong rises in operating expenses at Saudi banks in 2007, and that could extend to 2008. The expectation of increasing costs is based on the inflationary environment regarding remuneration currently prevailing in Saudi Arabia, the government's Saudization program, which is increasing the cost of skilled Saudi employees, and a network expansion effort undertaken by most banks to broaden their client base in order to revive growth in the retail segment. We foresee a small possibility that the massive growth of consumer lending that banks experienced in 2004-2005 will have a negative impact on asset quality. We do not believe that slight pressure on asset quality will affect profitability significantly going forward, as most banks are currently over-provisioned.

We believe the high degree of earnings retention that has prevailed historically will not be sustained going forward since most banks have constituted high capital adequacy ratios (CARs). We see increasing dividend payout ratios by most banks over the next few years, and more efficient capital structures with gradually declining CARs.

Overview of Recommendations

We re-initiate coverage on six Saudi banks (BSF, ANB, SHB, SABB, Riyad and Samba) and initiate coverage on Saudi Investment Bank (SAIB). Our long term fair values are based on Discounted Equity Cash Flow (DECF) valuations using a risk free rate of 5.0% (equal to the yield on a Saudi Government 10-year development bond) and a sector equity risk premium of 6.0%, which is then adjusted for each bank. Our risk free rate and equity risk premia together lead to a discount rate range of 11.0 - 11.5% for the seven banks under coverage. Our DECF valuations determine our estimated long term fair values (LTFV) and our LT recommendations. Our ST recommendations are driven by our expectations for short term share price movements. We believe that in the Saudi market, short term price movements are driven by news and earnings momentum.

Long-term, we are very bullish on the sector, and this is reflected in very strong upside for most banks from current levels and no Reduce or Sell recommendations. We assign LT Buy recommendations to BSF (75% upside to SAR101.2), ANB (71% upside to our estimated LTFV of SAR113.2) and SHB (65% upside to LTFV SAR67.9). We find SABB slightly less attractive and assign a LT Accumulate recommendation (45% upside to SAR138.8). At the other end of our recommendation range, we assign LT Neutrals to Riyad Bank (18% upside to SAR57.2), Samba (12% upside to SAR148.5) and SAIB (10% upside to SAR41.3).

In line with our LT recommendations, we have ST Buy recommendations on BSF, ANB and SHB as we expect these banks to outperform their peers in terms of bottom line growth in 2007. We believe this would be a major positive driver for their stock prices in the short term.

We expect BSF, ANB and SHB to be the only banks in our peer group to deliver positive earnings growth in 2007e. Our short term recommendation is slightly different for Samba as we see some positive short term momentum in Samba's share price reflecting acquisition news and the consolidation of Crescent bank in Pakistan. As a result, we assign a ST Accumulate recommendation on Samba. Finally, we have Neutral ST recommendations on SABB, Riyad Bank and SAIB as we expect these banks to be the most impacted by the slump in earnings growth in 2007, and we believe negative earnings growth will create negative sentiment on their share prices.

Banque Saudi Fransi (BSF)

BSF is 31%-owned by Calyon Corporate and Investment Bank. We expect the bank to outperform peers in terms of loan growth as a result of the strong corporate relationships supported by Calyon. Additionally, the bank is currently exploring new growth opportunities in the fields of Banc assurance, Investment banking, consumer finance, asset management and brokerage.

We forecast BSF to record a 3-year net loan CAGR of 17.1% (2006-2009) on the back of strong growth in both commercial as well as retail lending and believe customer deposits will grow at a 3 year CAGR of 15.2% over the same period. BSF is one of two banks in Saudi Arabia (other than SHB) with a reasonable (i.e. low) CAR of 14.4% compared to the sector average of 18% in 2006.

We re-initiate coverage on BSF with a ST / LT Buy recommendation. Our LT buy recommendation is based on a LTFV of SAR101.2 which implies upside potential of 75% from the current market price. BSF currently trades at P/E ratios of 10.8x 2007 and 9.5x 2008. On adjusted P/BVs, BSF trades on 3.0x 2007 and 2.7x 2008.

Arab National Bank (ANB)

ANB was established in 1980 after taking over the operations of Arab Bank Limited in Saudi Arabia. Arab Bank retains a 40% stake in ANB. The bank has a strong retail franchise and has lately developed a wide portfolio of products that has allowed the bank to maintain above sector average growth rates.

We estimate ANB's net loans will grow at a three-year 2006-09 CAGR of 16.8%, while deposits will grow at a slower pace of 15.1% for the same period. We expect the bank's net income to continue to grow strongly, recording a 2006-09 CAGR of 10.8%, with ROAE ranging between 28% - 30%.

We re-initiate coverage on ANB with a ST / LT Buy recommendation. Our LTFV of SAR113.2 per share implies upside potential of 71%. ANB currently trades on PEs of 11.6x 2007 and 10.3x 2008 and on adjusted P/BVs of 2.9x 2007 and 2.5x 2008.

Saudi Hollandi Bank (SHB)

SHB was founded in 1926 and was the first bank to operate in Saudi Arabia. ABN AMRO currently owns 40% of the bank, while Olayan Saudi Investment Company owns 20%. The bank has market share approaching 5.4% of sector assets.

We expect SHB to grow its loan book at a 2006-09 CAGR of 12.6% on the back of strong growth in commercial lending. Meanwhile, we believe net income growth will slow down, growing at an estimated 2006-09 CAGR of 10.9%, with ROAE ranging between 22%-23% over the period 2007-2009.

We re-initiate coverage on SHB with a ST / LT Buy recommendation. Our LT LTFV of SAR67.9 per share implies 65% upside potential. SHB currently trades on PEs of 11.2x 2007 and 9.9x 2008 and adjusted P/BVs of 2.2x 2007 and 2.0x for 2008.

Saudi British Bank (SABB)

SABB is 40% owned by HSBC Holding BV, which is a wholly owned subsidiary of HSBC Holding Plc. The bank is one of the strongest in the corporate segment, building on the strength of its parent company.

We expect SABB to grow its loan book at a 2006-09 CAGR of 14.8%, with deposit growth slowing down to a 2006-09 CAGR of 12.2% from a 2003-06 CAGR of 18.0%. We forecast net income will record a 2006-09 CAGR of 3.7%.

We re-initiate coverage on SABB with a ST Neutral / LT Accumulate recommendation. Our LTFV of SAR138.8 per share implies 45% upside potential. SABB currently trades on PEs of 13.5x 2007 and 12.1x 2008 and adjusted P/BVs of 3.6x 2007 and 3.2x 2008.

Samba Financial Group (Samba)

Samba is the largest bank in our coverage universe in terms of total assets and total shareholders' equity. Lately the bank's management announced an expansion strategy that will mostly take place through acquisitions in surrounding countries, with the bank having closed its first transaction through the acquisition of a 68% stake in Crescent bank in Pakistan in a deal worth USD100 million.

We forecast Samba's net loans to grow at a 2006-09 CAGR of 12.9%, while deposits will grow at 11.3% for the same period. We expect growth in net income to slow down dramatically to 5.7% over the same period compared to a 2003-06 CAGR of 53.6%.

We re-initiate coverage on Samba Financial Group with a ST Accumulate / LT Neutral recommendation. Our LTFV of SAR148.5 per share implies 12% upside potential. Samba currently trades at the high end of the multiples range with PEs of 16.4x 2007 and 14.6x 2008 and adjusted P/BVs of 4.4x 2007 and 3.8x 2008.

Riyad Bank

Riyad bank is the second largest bank in our peer group by total assets, with a market share of 10.9%. The Saudi Government holds a 29.0% stake in the bank.

We expect Riyad Bank to grow its loan book at a 2006-09 CAGR of 13.3% while deposits are expected to record a CAGR of 15.0% for the same period. We expect the bank's bottom line to grow at a 2006-09 CAGR of -1.6% with ROAE falling to a forecast average of 21.3%, down from 26.7% in 2006.

We re-initiate coverage on Riyad bank with a ST / LT Neutral recommendation. Our LTFV of SAR57.2 per share implies 18% upside potential. Riyad bank currently trades at PEs of 12.8x 2007 and 11.7x 2008 and adjusted P/BVs of 2.4x 2007e and 2.3x for 2008e.

Saudi Investment Bank (SAIB)

SAIB was established in 1976. The Saudi Government is the largest shareholder owning a combined stake of 39.2%. Management has announced their intention to convert the bank to fully Shariaa compliant status by end of 2008, which entails the offering of a wide range of new Islamic products.

We expect SAIB to grow its loan book at a 2006-09 CAGR of 7.0%, and deposits at a 2006-09 CAGR of 7.5%, while the bottom line is expected to record a 2006-09 CAGR of -12.9%.

We initiate coverage on SAIB with a ST / LT Neutral recommendation. Our LTFV of SAR41.3 per share implies 10% upside potential. SAIB currently trades on PEs of 12.2x 2007 and 11.2x 2008, and adjusted P/BVs of 2.0x 2007 and 1.9x 2008.

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I. MACRO BACKGROUND

Oil Revenue and Economic Growth

Economic growth is driven by both i) external demand and ii) domestic demand. Since 2003 in the GCC, the rise in external demand coming through higher oil revenue has impacted domestic demand with a lag. This is because revenues have risen faster than government expenditure. This is reflected in a significant rise in the current account surplus and an accumulation of government financial reserves. The large current account surplus and the accumulation of financial reserves are indicative of the fact that the government has been able to spend only a portion of the oil revenue windfall and that in the event of oil revenues flattening or falling, the government will still be able to increase, or at the very least sustain current levels of spending.

External demand a function of both oil prices and production

In 2006, Saudi crude output was 9.1MBD while oil prices rose to an average of USD58 per barrel compared to USD47 per barrel in 2005 and USD32 per barrel in 2004. We believe 2006 represents the year of peak oil revenue as i) average oil prices are expected to ease or remain stable assuming stable regional political conditions and ii) average oil output production levels are expected to decline, with production down to 8.8MBD at the end of 2006 from a peak of 9.6 MBD in 2005, in support of an OPEC decision to cut production so as to support declining oil prices. As a result of peak oil revenues achieved in 2006 and a continuing rise in government expenditure, we expect the current account surplus to have peaked in 2006 while it is projected to decline in 2007 and 2008.

Fig.1.1: Nominal GDP at Current Prices

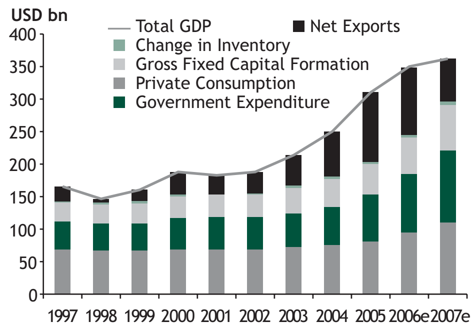
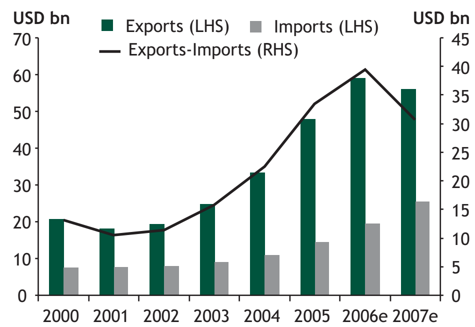


Fig. 1.2: Exports and Imports



Sources: SAMA and EFG-Hermes

Growth Drivers

Liberalization and competitive advantage attracts private capital

The Saudi private sector has been expanding at a fast pace, helped by liberalization and the accession to the WTO in December 2005 which has promoted FDI and the channeling of private capital into the economy. Liberalization has been a critical driver of investment and demand for capital as many sectors have been opened including telecoms, insurance, banking, and domestic airlines. Additionally, the petrochemical, refining and fertilizer industries have been expanding strongly supported by the rise in global energy prices.

Producers in oil-related industries are also enjoying a competitive advantage due to low and constant local energy prices (especially gas prices). We believe that going forward, investments in infrastructure, manufacturing and petrochemical industries, and the resulting output, will spur growth in GDP.

Real estate activity and investment boom

Infrastructure and real estate investments are also booming, underpinned by six new planned economic cities, the largest of which is King Abdullah Economic City with an estimated total investment cost of USD53 billion. In 2006, the Saudi Arabian General Investment Authority (SAGIA) licensed 1,389 joint and foreign projects with a total value of SAR253 billion, 25% up on 2005. SAGIA said it plans to issue licenses for investments worth USD80 billion in 2007. Investments in utilities such as water and electricity are also growing to support the rapid growth in population.

Fiscal Picture and Debt Dynamics

Deficit turned into surplus stimulating credit growth

Saudi Arabia's fiscal position has strengthened dramatically over the past 4 years (2003-2006) as is illustrated in Figure 1.3. Government revenues have risen from USD57 billion in 2002 to an estimated USD175 billion in 2006. Government expenditure has risen strongly as is illustrated in figure 1.4. Mirroring the trend in the current account, the fiscal surplus is likely to decline from the level reached in 2006, as strong growth in government expenditure continues (13.4% Y-o-Y growth suggested by 2007 budget vs. 2006 actual), and as oil revenues stabilize or start to decline.

Fig.1.3: Gov. Revenue Decomposed

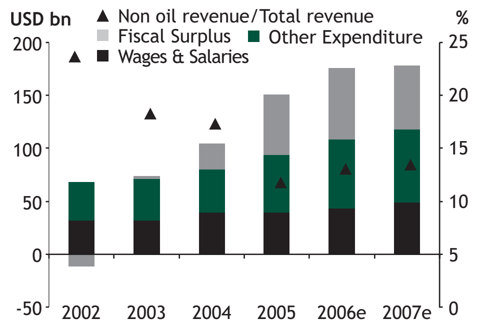
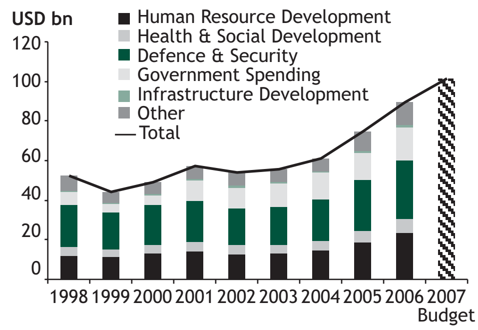


Fig.1.4: Government Expenditure*



*of SAR380 billion (USD101 billion) of budgeted expenditure, SAR140 billion (USD37 billion) is capital expenditure
Sources: IMF and EFG-Hermes

Debt reduction equals covert fiscal stimulus...

The Saudi government has also settled a significant portion of its domestic debt (the bulk of which is held by public institutions) over the past few years. This debt repayment is equivalent to additional covert fiscal stimulus. As illustrated in figure 1.6, in July 2005, the government turned into a net creditor vis-a-vis the banking system as a result of the accumulation of government deposits at banks. By the end of 2006, net domestic debt almost declined to zero while the government announced it will retire all debt held by commercial banks by the end of 2006 by calling in government securities worth SAR113 billion, which represents a strong liquidity injection.

Fig. 1.5: Domestic Debt

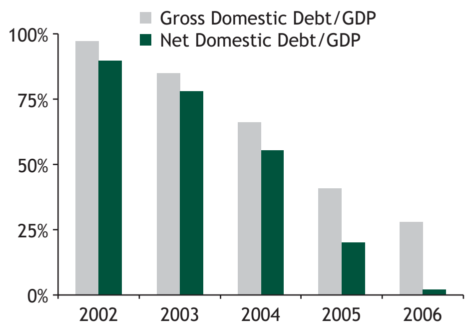
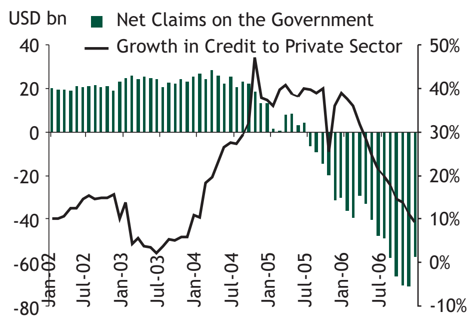


Fig.1.6: Net Claims on Gov. & Credit to Private Sector



Sources: SAMA and Ministry of Finance Budget Announcement

Net foreign assets and credit rating upgrades

Despite the growth in expenditure and the redemption of domestic debt, the oil revenue windfall has been so strong as to also allow for an impressive accumulation of net foreign assets, reaching USD247 billion in February 2007, which is equivalent to more than 60% of GDP. The rise in oil revenues and acceleration in economic growth, as well as the improvement in debt dynamics and the accumulation of foreign reserves has all led the three main rating agencies to significantly raise Saudi Arabia's credit rating over the past five years as is illustrated in Figure 1.8.

Fig.1.7: Net Foreign Assets

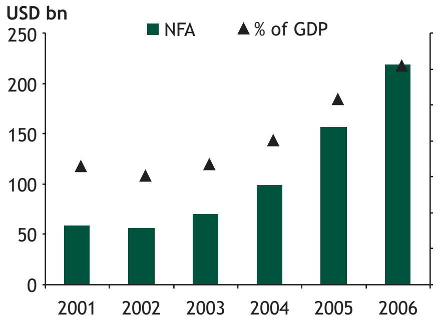
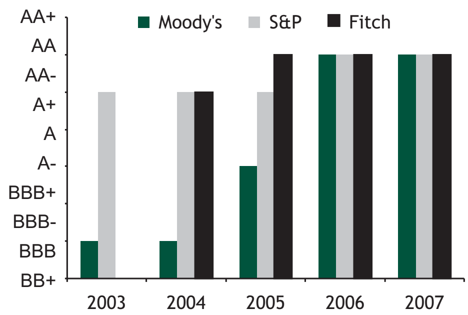


Fig.1.8: Credit Rating



Sources: SAMA and International Rating Agencies

Monetary Conditions

The fiscal stimulus and the redemption of domestic debt by the government have led to buoyant monetary conditions stimulated by a low interest rate environment. Average monthly Y-o-Y growth in domestic liquidity has risen to 17% and 15% in 2005 and 2006, respectively, up from 6% in 2001. The buoyant liquidity environment was associated with growth in credit to the private sector. However, since reaching a peak of approximately 40% in 2005, credit growth to the private sector has slowed dramatically owing to tighter restrictions on lending imposed by SAMA. Inflation has been primarily driven by the rise in food prices which was a result of a series of supply shocks (i.e. bad weather conditions and absence of agricultural labor). However, the infrastructure and real estate boom and related inflows of labor have also driven the rental and related components of the CPI in 2006, as is illustrated in figure 1.9. Inflation rose to 2.1% in 2006, from 1.1% in 2005, but remains low compared to other GCC states such as Qatar and the UAE. Inflation has also been driven by rising cement and steel prices, demand related to mega projects, new industrial cities and also speculative demand as many investors seem to have shifted their funds from the equity markets to the real estate sector. The mortgage law is expected to be approved by the end of 2007 and this is expected to fuel market demand going forward. We believe there is a possibility that the SAR may be revalued, especially within the context of a coordinated move by the GCC states. This would help contain inflationary pressures. Market expectations that this is a possibility helped drive SAR interest rates to below equivalent USD rates.

Fig.1.9: Inflation Rate

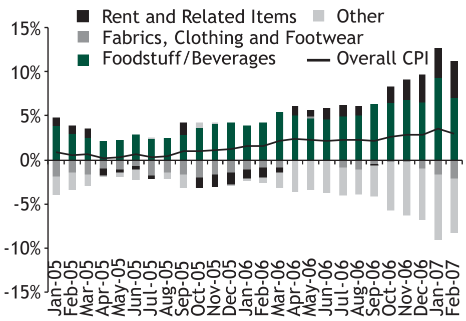
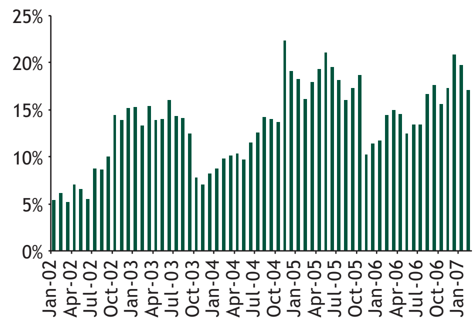


Fig.1.10: Y-o-Y Growth in Money Supply (M3)



Sources: SAMA and IMF

II. BANKING SECTOR STRUCTURE AND REGULATIONS

1. Banking Sector Structure

A. New Banks

Banks versus branches of foreign banks

The Saudi banking sector currently comprises of eleven banks and six branches of foreign banks. Additionally, the Saudi Arabian Monetary Agency (SAMA) recently opened up the sector, granting licenses to GCC and foreign banks to operate branches in the Kingdom. As of today, over and above the six branches of foreign banks that have begun operations, four additional GCC and foreign banks hold licenses to operate branches in Saudi Arabia but have not started operations yet, as is illustrated in Table 2.1.

Also, the Saudi Government approved in March 2006 the establishment of Inmaa Bank (a development bank) with a total paid-in capital of SAR15.0 billion to undertake normal banking and investment business. The ownership structure of the bank includes a 70% tranche to be subscribed to by the public (IPOed), while the remaining 30% is to be distributed equally among The Public Investment Fund, the Pension Organization and the General Organization for Social Insurance.

We expect the Saudi banking sector will consist of twelve banks and ten branches of foreign banks that will be fully operational by the end of 2007. We believe that this will lead to some competitive pressure in the sector going forward.

Table 2.1: Licensed Branches of Foreign Banks in Saudi Arabia

	Bank name	Country	Operational status and date
GCC Banks	Gulf International Bank	Bahrain	July-99
	Emirates Bank	UAE	August-04
	National Bank of Kuwait	Kuwait	May-06
	National Bank of Bahrain	Bahrain	Licensed / not operational
	Bank Muscat	Oman	March-07
Foreign Banks	BNP Paribas	France	October-05
	Deutsche Bank	Germany	April-06
	J.P. Morgan Chase N.A	USA	Licensed / not operational
	National Bank of Pakistan	Pakistan	Licensed / not operational
	State Bank of India	India	Licensed / not operational

Source: Saudi Arabian Monetary Agency (SAMA)

B. Ownership

The eleven banks that are currently operating in Saudi Arabia can be categorized either as Domestic banks or as Joint Venture banks (JVs). Domestic banks were originally established as Saudi banks with ownership and management resting with Saudi nationals, while Joint Venture banks were originally established as foreign institutions and at a later stage, in accordance with Saudi regulations, foreign partners (parent companies) were obliged to reduce their stakes to a maximum of 40%, while the remaining stake was transferred to Saudi nationals. Despite the transfer of majority stakes to Saudi shareholders, most foreign partners have maintained management control. The number of Joint Venture banks has declined to four after Citigroup pulled out of the Saudi market in 2004, selling its stake in Samba. The four JV banks are: Arab National Bank, Banque Saudi Fransi, Saudi Hollandi Bank and Saudi British Bank. Currently, National Commercial Bank (NCB) is the only bank that is fully owned by the Saudi government and plans to offer a considerable stake to the public before the end of 2007.

All banks in Saudi Arabia offer both conventional as well as Islamic products, with the exception of Al Rajhi Bank, Bank Al-Bilad and Bank AlJazira that are fully Shariaa compliant, offering only Islamic products. Meanwhile, NCB and Saudi Investment Bank have announced on more than one occasion their intention to become fully Shariaa compliant over the next two to three years.

With the exception of NCB, all Saudi banks have their shares listed on the Saudi Stock Exchange (Tadawul).

C. Market Share

Despite the large market share of NCB, that reached 18% of total assets in 2006, the Saudi banking sector is not very concentrated, with 65% of total sector assets being held by the five largest players, especially if one takes into account the fact that the banking sector in Saudi Arabia was closed for years with only ten players. With Al-Bilad bank having started operations in 2005, the smallest 6 players currently account for around 31% of banking system assets.

Table 2.2: Overview of Saudi Banks

		Ownership structure %			Market Share	No. of	No. of
		Saudi	Non-Saudi	Foreign Owner.	of Assets	Branches	ATMS
Joint Venture Banks	BSF	69%	31%	Calyon	9.2%	68	222
	ANB	60%	40%	Arab Bank	9.1%	116	534
	SABB	60%	40%	HSBC Bank	9.0%	61	308
	SHB	60%	40%	ABN AMRO	5.4%	41	166
Domestic Banks	NCB	100%	0%		18.1%	260	1048
	Samba	96%	4%		14.4%	63	398
	Alrajhi Bank	100%	0%		12.2%	390	1592
	Riyad Bank	100%	0%		10.9%	198	1262
	SAIB	100%	0%		4.7%	23	184
	Bank Aljazira	100%	0%		1.8%	23	112
	Bank Albilad	100%	0%		1.3%	40	240

Market share, no. of branches and no. of ATMs as at end 2006
Sources: SAMA, Banks' financial statements and EFG-Hermes

2. Latest Regulations

The Saudi banking sector has seen some changes to the regulatory environment over the past two years that were directed by SAMA in its efforts to closely monitor the changes taking place in the operating environment of the Saudi banks as well as the opening of the Saudi economy to global competition. We list in the following paragraphs the latest and most important regulatory changes that, in our view, have impacted the performance of Saudi banks and/or will have a significant impact on their future performance.

- **Consumer Credit Regulations (late 2005):** The most important changes were: (i) setting the maximum credit to be granted to a single borrower, whereby the total monthly payments of a borrower on the total amount borrowed (including credit card borrowings) does not exceed one third of net monthly salary, (ii) SAMA has also set the maximum term-to-maturity for a consumer credit agreement whereby it should not exceed 5 years and (iii) SAMA at its discretion, may put a limit on the ratio of banks' consumer credit portfolio to total loans portfolio. It would seem that the limit currently set by SAMA on the ratio of consumer loans/total loans is approximately 30%, which most banks currently surpass.

- **Loan to Deposit Limit (3Q2006):** SAMA issued a circular to banks regarding the method of calculating the rate of deposit lending (Loans/Deposits ratio) and raised the acceptable limit from 60% to 85% in order to accommodate the high growth phase that had occurred in the banking sector between 2004 and 2006.

III. SECTOR OUTLOOK

The performance of the banking sector in Saudi Arabia is best viewed over three time periods; (i) the historical performance over 2004 - 2005. (ii) 2006 - 2007e, where in 2006, some of the trends seen in 2004 - 2005 have reversed and we expect this reversal to be sustained in 2007e (iii) 2008e - 2009e representing our outlook for the banking sector and the basis for both our forecast and valuation.

Figure 3.1: Sector Outlook

	2004-05 Consumer Lending Rush	2006-07 End of Era of High Growth and Cooling Down Period	2008-2009 Higher Growth, Sector Maturing and Increased Competition
Loan Growth	- Loans growing at 30%+Y-o-Y, driven by consumer lending - Consumer lending growing at 50%+ Y-o-Y	- Loan growth slowing, the result of caps implemented by SAMA on consumer loans and sustained growth rates in commercial loans	- Accelerating growth environment driven by commercial lending and project finance - Housing finance could provide upside for growth assuming the mortgage law is approved and effectively implemented
Liquidity	- Tight liquidity environment a result of the massive loan growth - Loan/deposit ratios reaching 92%, leading banks to seek MTN financing	- Banks flushed with excess liquidity as a result of the settlement of government debt and the substantial growth in deposits	- Banks remain liquid as a result of sustained growth in government and private sector deposits. However, the loan to deposit ratio tightens slightly - Government debt continues to drop
Assets Quality	High asset quality maintained as the macro environment remains strong and most banks continue to improve their credit approval processes		
Spreads	- Mixed spreads as a result of the changing structure of banks' balance sheets	- Spreads maintained as banks continue to benefit from the accumulated consumer loans while cost of funds rises somewhat	- Spreads decline slightly as a result of a change in the composition of the loan portfolio (growth in commercial loans) and competition kicking in, while controls are exerted on funding costs especially with the contribution of Islamic banking products
Non Special Comm. Inc.	Non-special commission income on the rise mainly driven by stock market related profits	A slow down in non-special commission income as a result of lower market-related revenues especially in 2007	New products (such as insurance, leasing, mortgages and investment banking) help banks to restore non special commission growth
Provisioning	Over-provisioning across the board	Lower provisioning effort as most banks become significantly over provisioned and asset quality is under control	
Net Profits	Record profits, fueled by growth in both net special commission & non-special commission income	Bottom line growth slowing Support to earnings from a lower provisioning effort	Growth in profits resumes from core banking as well as ancillary products
Capital Efficiency	Profits mostly retained in anticipation of future growth and to maintain adequate capital adequacy ratios	Most banks becoming over capitalized	Dividend payout ratios rise and result in improved capital efficiency

Source: EFG-Hermes

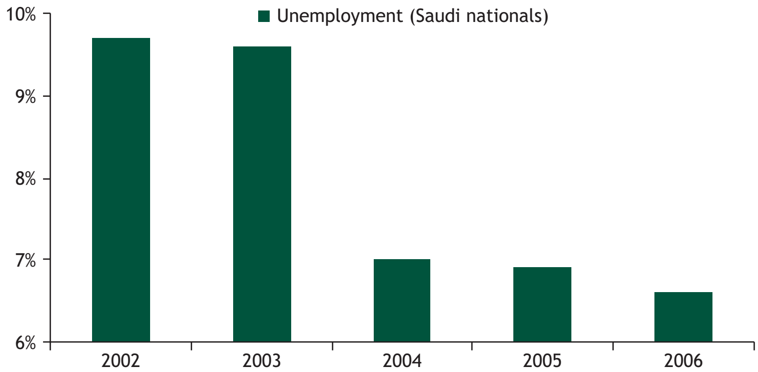
A. Loans

Record loan growth in 2004 and 2005...

Total sector loans grew tremendously in 2004 (+34.5%) and 2005 (+36.2%). Consumer lending, then less developed and subject to a lower level of restrictions by the regulator, SAMA, was the main driver of loan growth during the period. Consumer loans (including credit cards that represented 4% of total consumer credit in 2006) grew at c56% annually in both 2004 and 2005.

The very strong growth rates for consumer lending were the result of: (i) continued secular development in consumer lending after government salaries were domiciliated at banks, supported by strong growth in bankable consumers, (ii) a strong macro environment leading to soaring consumer demand and spending, (iii) a booming local stock market leading to growth in consumer credit, which was being channeled (indirectly) towards the stock market and (iv) falling unemployment rates among Saudi nationals (partly reflecting the impact of saudization) leading to growth in salary-backed credit.

Figure 3.2: Unemployment Rate Among Saudi Nationals



Sources: SAMA, Ministry of Economy & Planning and EFG-Hermes

... led the government to intervene to curb growth rates

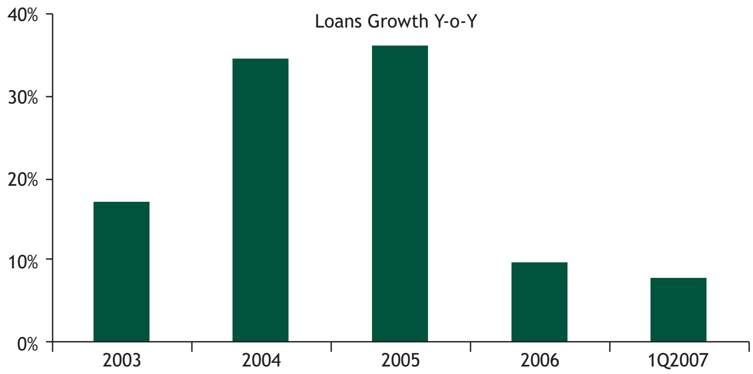
In late 2005, however, SAMA issued circulars and guidelines regulating consumer lending in an effort to curb growth (and perhaps also the level of stock market speculation). The main guidelines focused on limiting both the amount of credit granted to borrowers and the repayment period. Under the new rules, a borrower's credit limit halved, with the maximum amount of credit equal to 15 times the monthly salary, down from 30 times. Moreover, the repayment period was reduced to a maximum of five years, down from a maximum of 10 years previously.

Additionally, SAMA imposed a limit on the amount of credit granted to a consumer such that the aggregate monthly repayments (including credit card payments) do not exceed one third of the net monthly salary, and one-fourth of pension payments for retired persons.

On the supply side, SAMA instructed all banks to apply a 30% ceiling on the level of consumer loans to total loans. However, it should be noted that most banks currently exceed this threshold.

Following the new regulations, overall loan growth rates declined sharply in 2006 compared to the previous years as the total loan portfolio grew at 9.8% for the year, with flat/declining growth rates across all sectors and dropped further to 7.7% Y-o-Y growth in 1Q2007.
Additionally, growth of consumer lending which was a major growth driver for the sector in 2004 and 2005, as mentioned earlier, fell sharply in 2006 to 1.6% for the year

Figure 3.3: A Marked Slowdown in Loan Growth in 2006 and 1Q2007



Sources: SAMA, Banks' financial statements and EFG-Hermes

Despite the very high loan growth of 2004 and 2005, the loan/GDP ratio remains low as a result of strong nominal GDP growth

The tremendous growth in the loan portfolio of the Saudi banking sector between 2003 and 2006 has lifted the loan/GDP ratio to 36.5% in 2006, up from 28.4% in 2003. The loan/GDP ratio in Saudi Arabia remains at the low end compared to other GCC countries as well as other non-developed economies globally. However, it is important to bear in mind that if oil prices were to decline significantly, Saudi nominal GDP would fall and the loan/GDP ratio would rise as a result.

Fig. 3.4: Saudi Arabia Lies Towards the Bottom of peer Group in Terms of Loans/GDP

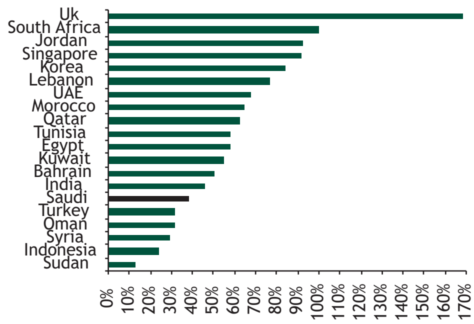
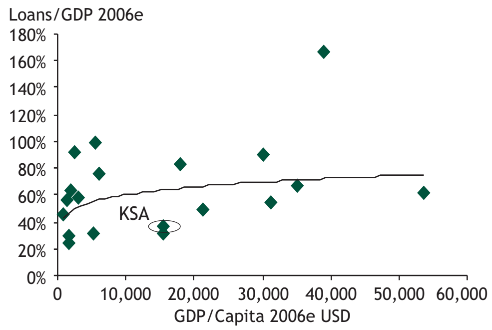


Fig.3.5: Loans/GDP and GDP/Capita for Different Countries



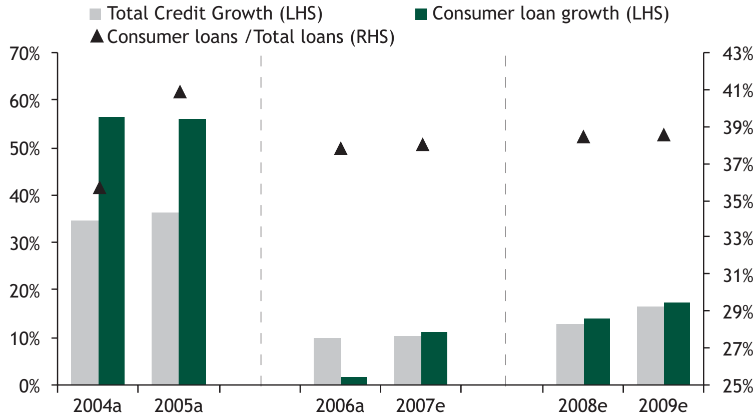
Sources: IMF and EFG-Hermes

Sector loans to record double digit CAGR over our forecast horizon

We expect loans to continue to grow strongly with an estimated 2006-09 CAGR of 13.2% with the expected growth in loans to be driven primarily by the private sector. We forecast that the consolidated loan book of Saudi banks will grow by a relatively slow 10.4% in 2007, the result of the extended effect of the restrictions introduced by SAMA on consumer lending. However, we expect growth in commercial loans to kick-in starting 2008, the result of government stimulus, which will mark the start of a phase of higher growth for banking sector loans. Despite the restrictions set by SAMA on consumer lending, we expect consumer lending in Saudi Arabia to continue to grow, but at a slower rate of 10.9% in 2007 before rebounding slightly in 2008 and 2009. The expected growth will be driven primarily by the acquisition of new banking clients rather than the extension of additional credit to the existing client base. The number of clients is set to increase as the demographics of the Saudi population sets the sector up for a rapid growth in the size of the bankable population.

We estimate total loan growth of 12.7% in 2008 and 16.6% in 2009, and consumer loan growth of 13.9% in 2008 and 17.2% in 2009, driven partly by the development of housing finance.

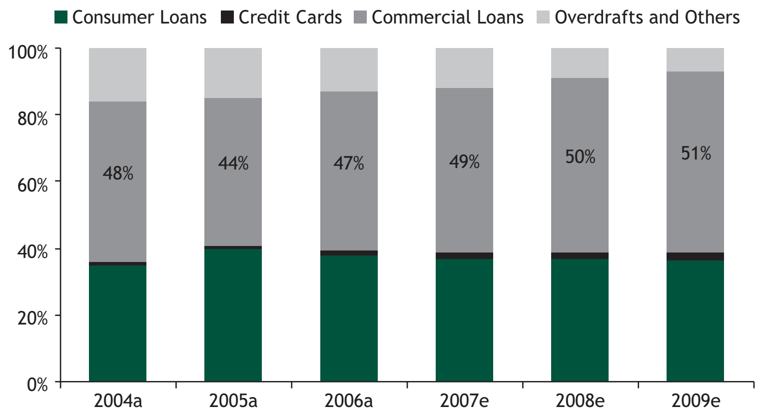
Figure 3.6: Consumer Loan Growth and Total Credit Growth



Sources: SAMA and EFG-Hermes estimates

Our growth estimates beyond 2007 are driven primarily by growth in commercial loans that is expected to accelerate in some sectors as a result of the government's planned development projects in infrastructure, oil & gas, petrochemicals, electricity, telecoms and tourism. The government's announcements imply total projects within the kingdom "worth" some USD700 billion over the next twelve years. We expect the private sector to play an integral role in these planned developments which will accordingly involve banks and create very strong demand for credit. We estimate commercial loans will grow to account for 51.0% of total loans in 2009, up from 44.2% in 2005. This is partly at the expense of "overdrafts and others" whose contribution we forecast will decline markedly as a result of low growth in margin lending balances going forward.

Figure 3.7: Breakdown of Loan Portfolio Skewed Towards Commercial Loans



Sources: SAMA, Banks' financial statements and EFG-Hermes estimates

Housing finance: a hidden potential growth driver

In addition to the traditional consumer lending areas, we expect housing finance to contribute significantly to consumer lending growth going forward. Saudi government officials expect massive demand for housing loans. Demand for real estate assets, in our view, will come from: (i) growth in the number of expatriates, and (ii) pent up demand by Saudis, who cannot afford to buy houses for cash. Increased demand has encouraged several private sector real estate developers to announce new housing projects to leverage on the expected housing shortage. The government estimates that new real estate developments would have a total value of USD290 billion over the coming 20 years, with private developers being the main contributors.

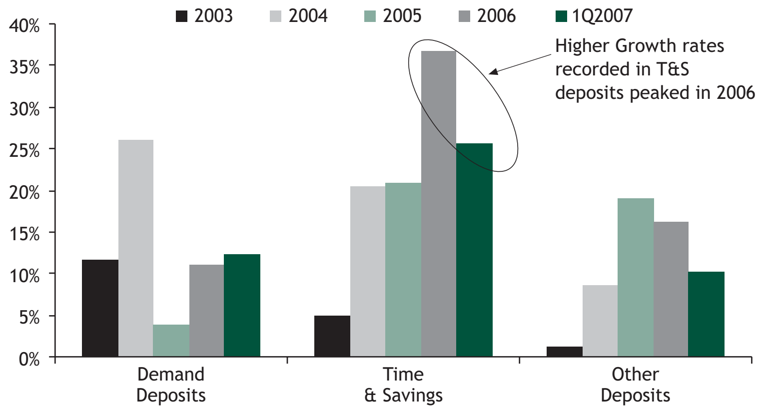
The government recently announced that the real estate and mortgage finance law will shortly be issued, which, we believe, will further stimulate the sector's activity. We expect banks to become actively involved in housing finance in Saudi Arabia, especially after the issuance of a new mortgage law or through product innovation to meet the needs of the growing Saudi population and its demand for housing finance products.

B. Deposits

Sector deposit mix getting less attractive

The deposit mix in the Saudi banking sector has recently witnessed a shift, unfavorable to the banks, towards the higher cost time and saving (T&S) deposits and at the expense of demand deposits. Growth in time and saving deposits started to accelerate in 2004 with growth of c21% in 2004 and 2005 before climbing strongly in 2006 with a growth rate approaching 37% Y-o-Y.

Figure 3.8: Growth of Time and Savings Deposits Accelerated Starting in 2004



Sources: SAMA and EFG-Hermes

The increased demand for time and saving deposits was influenced largely by four main factors: (i) a higher interest rate environment increasing the opportunity cost of keeping funds in non-interest earning accounts, (ii) a very poor year for local stock market returns in 2006 leading to accumulation of funds by retail investors seeking any kind of safe return, (iii) price competition by banks to attract new customers and (iv) strong growth in public sector deposits.

Fig. 3.9: Growth Trends in T&S Deposits

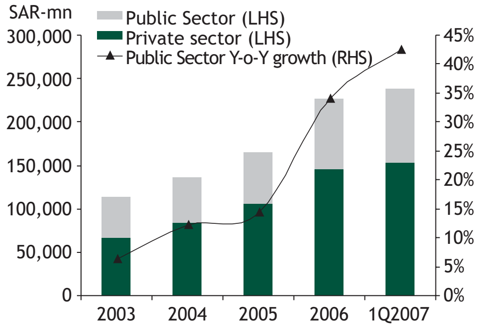
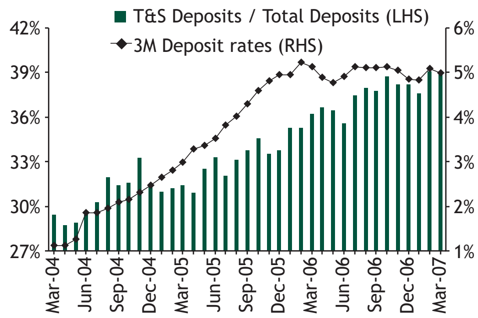


Fig 3.10: Interest Rates and Mix of Deposits



Sources: SAMA and EFG-Hermes

Banks to curb deposit growth as utilization rates drop...

Over 2004-2006, Saudi banks competed intensely for deposits in order to fill the financing gap resulting from the huge growth in lending. Due to the expected slowdown in asset growth, we expect banks to reconsider their growth strategies with regards to deposits going forward. Since most banks' funding strategies are asset driven, we expect deposit growth rates going forward to be much lower than the growth rates recorded by banks between 2004 and 2006. 1Q2007 marked the start of a phase of decelaration in deposit growth with total sector deposits growing at 16.8% down from the 20.8% recorded in 2006.

...and changing the deposit mix becomes a necessity

In line with the efforts to control the rise in their cost of funds, Saudi banks are expected to look further into the structure of their deposit mix. The increased contribution of time and saving deposits to total banking sector deposits over the past two years has reduced banks' margins from what they would have otherwise been. Going forward, we expect most Saudi banks to restructure their product mix to promote demand and Islamic deposits (non-interest bearing accounts) in order to benefit from the high spreads associated.

The reversal in growth trends that we expect to take place in the near future is a result of the expected change in the lending environment. Over the past three years, the shift in the deposit mix did not impact most banks significantly, at a time when they were striving for liquidity that was all channeled towards consumer loans which contributed very high yields overcoming the issue of cost of funding. Going forward, we expect credit expansion to be driven by commercial lending, which is characterized by lower yields, while consumer lending growth is expected to slow down relative to historical levels. We do foresee some resistance to this approach on the customer side in light of the current interest rate environment and the sluggish stock market performance. We believe this will encourage most banks to be more innovative in their product offerings and improve the quality of their services.

We expect a trend reversal in the growth of both time and saving deposits as well as demand deposits, which will lead to an easing up in the rise in funding costs for Saudi banks. As illustrated in Figure 3.11, we expect the growth in demand deposits to accelerate in 2007e reaching 12.5% before stabilizing thereafter, while on the other hand, we expect time and saving deposits growth rates to decline significantly in 2007e to reach a 16.6% Y-o-Y growth, down from the 36.8% achieved in 2006 and will continue to slow down at a slower pace going forward, growing by 13.1% in 2009.

Indeed 1Q2007 data suggests that this has started to happen; with growth in demand deposits accelerating to 12.3% Y-o-Y, up from 11.0% in 2006, and on the other hand, growth in T&S deposits growth decelerating to 25.7% Y-o-Y, down from 36.8% in 2006 as is illustrated in Figure 3.8.

Fig. 3.11: Deposit Growth by Type

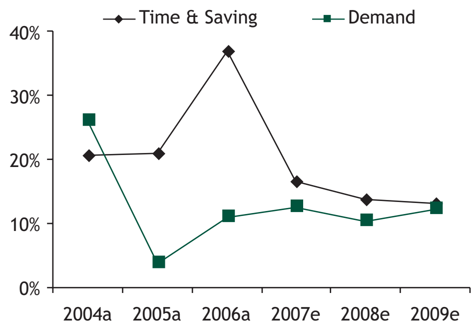
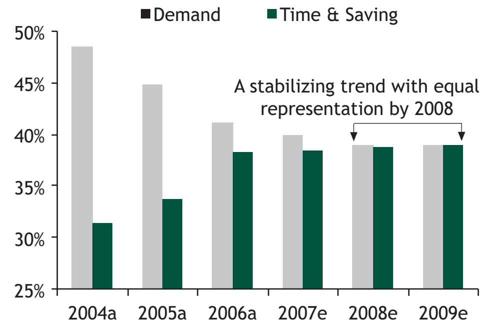


Fig. 3.12: Contributions to Total Deposits



Sources: SAMA and EFG-Hermes estimates

Meanwhile, the increased demand for Islamic products in Saudi Arabia could be a supporting element for banks to grow their non-interest bearing deposits. Currently, most retail services within Saudi banks are Shariaa compliant. With more effort on the product development side, banks can increase Islamic product representation in their funding base which could help to slow the deterioration of margins over the long term.

To conclude, the change taking place in the growth rates of different deposit types is expected to lead to a slowing down in the substantial increase in the representation of time and saving deposits in total deposits, where it has increased from 31.3% in 2004 to 38.2% in 2006. We expect this share to be maintained at 39% through to 2009.

C. Sector Liquidity

The double digit growth rates recorded by Saudi banking sector deposits, reaching 20.4% in 2004 and 12.3% in 2005 were more than absorbed by the surge in lending growth - especially consumer lending growth that reached c56% in these two years - leading to a loan/deposit ratio that reached a five-year high of 92.5% in 2005.

The loan/deposit ratio fell in 2006 as a result of the strong growth in banking sector deposits that was fueled by increased government deposits. On the other hand, loan growth took a dive; recording Y-o-Y growth of 9.8%, down from 34.5% and 36.2% in 2004 and 2005, respectively. The banking sector loan/deposit ratio consequently dropped to 84.1% at the end of 2006. During 1Q2007, deposits continued to record stronger Y-o-Y growth rates than loans (deposits grew at 16.8% Y-o-Y versus 7.7% growth in loans) leading to a further decline in the loan/deposit ratio to 82.1% in 1Q2007.

Fig. 3.13: Loan Growth vs. Deposit Growth

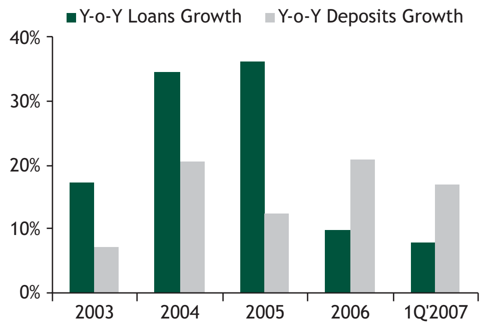
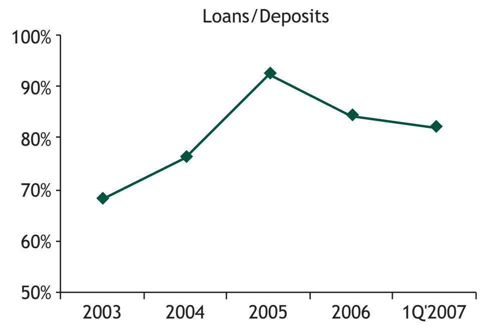


Fig. 3.14: Loan/Deposit Ratio Dropping in 2006

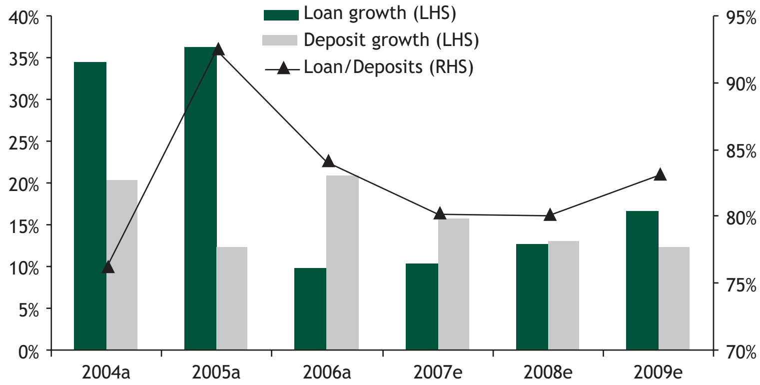


Sources: SAMA and EFG-Hermes

Similarly to 2006, we expect deposit growth at the sector level to continue outperforming loan growth in 2007, leading to a further decline in the loan/deposit ratio. We forecast the loan/deposit ratio will drop to 80% in 2007, down from 84% in 2006.

In our view, the pick-up in loan growth that is expected to occur starting in 2008 in addition to some control over deposit growth will lead to stability in the loan/deposit ratio in 2008 as is illustrated in Figure 3.15. Furthermore, we expect 2009 to see a rise in the loan/deposit ratio to 83%, up from 80% in 2008.

Figure 3.15: Loans and Deposit Growth versus Utilization Rates



Sources: SAMA and EFG-Hermes estimates

Increased tendency towards medium-term debt financing

We expect banks to continue to raise medium-term debt as an additional source of financing. Medium-term notes, if they are also "subordinated" debt, help banks to improve their capital ratios, since they are included in Tier Two capital, stabilize their utilization rates inline with SAMA requirements and provide a better maturity match to assets. Saudi banks have benefited strongly from the significant improvement in sovereign credit rating achieved over the past few years by Saudi Arabia, allowing them to raise funds at reasonable cost in international markets.

D. Asset Quality

Improved asset quality will eventually lead to lower provisioning ...

Saudi banks have, over the past three years, experienced exceptionally healthy and improving asset quality. Going forward, we expect the trend to continue with banks being extremely conservative with their credit procedures. In addition, we believe sustained economic growth, the creation of the Saudi credit bureau, the large investments in information technology infrastructure and the recruitment of experienced bankers will all improve credit quality.

Banking on the continuation of a benign asset quality environment, we expect banks to become less conservative in their provisioning effort. We expect most banks to continue taking provisions so as to remain over-provisioned, but on a lesser scale than before.

...a contributor to bottom line growth in 2007e

As stated earlier, Saudi banks have accumulated excess loan loss provisions over the past three years as a precautionary measure against any potential NPL fallout from the exceptionally high loan growth rates experienced. We estimate that the less conservative provisioning approach that started in 2006 will continue going forward across the board, with all banks lowering their loan loss provisioning effort relative to previous years. We expect this trend to contribute to bottom line growth at most banks.

E. Profitability

Tough competition will put slight pressure on spreads

The changing operational environment for Saudi banks is expected to lead to some slight pressure on net interest spreads going forward. From an asset perspective, we expect the yield on Interest Earning Assets (IEA) to decline as a result of: (i) a slowdown in overall loan growth, (ii) corporate loans (tighter spreads) driving growth, making up an increasing share of the total loan portfolio and (iii) increased competition within the banking sector. On the other hand, and from a funding perspective; the cost of funding is also expected to increase slightly as a result of: (i) the continued negative impact of the shift in the deposit base in 2004 and 2005 towards high cost T&S deposits, (ii) an environment of increasing interest rate and (iii) a more competitive environment due to the rising number of banks.

Net banking fees expected to dip in 2007 as a result of lower market related profits before rebounding

The contribution of net banking fees to total income has been rising over the past three years. The rise in net banking fees is mainly attributable to the substantial growth in stock market volumes as well as the increased number of IPOs in 2004 and 2005. In 2006, and despite the stock market's disappointing performance, trading volumes remained strong which helped most banks to grow the largest item in their net banking fees line; "brokerage and asset management fees". Since most banks do not provide a breakdown between brokerage and asset management (we believe brokerage fees contribute the lion's share), we estimate that there was a substantial drop in asset management fees that was compensated by the growth in brokerage fees in 2006.

Fig. 3.16: Growth in Net Banking Fees

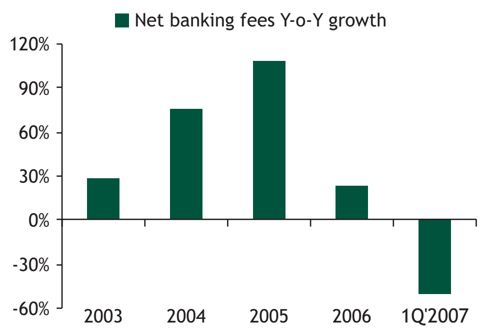
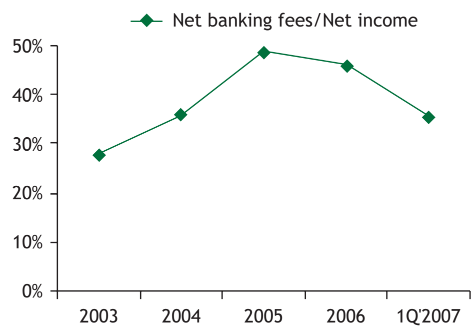


Fig. 3.17: Net Banking Fees / Net Income



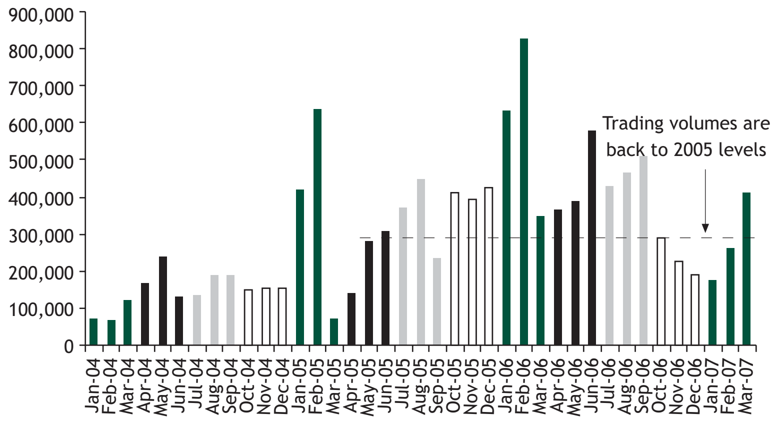
Sources: Banks' financial statements and EFG-Hermes

The stock market's negative performance in 2006 and early 2007 is expected to significantly impact the profitability of the banking sector going forward. We expect value traded to drop significantly in 2007 compared to 2006 - a peak year in terms of market value traded - before a rebound in 2008. This trend will negatively impact the profitability of the banking sector in 2007 as brokerage income is set to drop considerably. For the seven banks currently under our coverage, the contribution of gross brokerage and fund management fees reached an average c70% of net banking fees in 2006, and with the very low costs/very high margins associated, they directly filter to bottom line. We expect trading volumes to drop to the average levels prevailing in 2005, this will accordingly lead to a reduction of brokerage fees by some 30-40%. 1Q2007 results revealed 51% Y-o-Y drop in aggregate net banking fees, in our view as a result of the drop in brokerage activity on the Saudi stock market.

In 2007, the absolute impact of the expected drop in brokerage fees will be reduced through an improvement in other banking fees, most importantly trade finance and corporate advisory.

Starting 2008, we expect net banking fees to grow steadily, driven by growth from all fee-based income sources. Brokerage fees are expected to rebound, while trade finance and corporate advisory services are likely to grow on the back of strong economic activity, and accelerated integration into the global economy.

Figure 3.18: Monthly Value Traded on Tadawul (SAR million)



Sources: SAMA, Tadawul and EFG-Hermes

Operating costs on the rise

Of the new banking licenses granted to foreign banks to operate branches in Saudi Arabia, five banks have started operations over the past two years (National Bank of Kuwait, Deutsche Bank, BNP Paribas Bank and Bank Muscat), in addition, Bank Al-Bilad, a local fully shariaa-compliant bank, started operations in 2005. Four other foreign banks were also licensed by SAMA but have not yet begun operations. We expect the inauguration of operations by all these banks to put pressure on the salaries of bank professionals in the kingdom over the next two years, especially with the limited supply of quality employees in the sector and the level of sophistication that the industry has attained lately that is expected to further increase going forward with new global/regional players coming into the Saudi banking system.

Moreover, the retail expansions most banks are currently pursuing will also put additional pressure on other operating expenses, with expansion in the number of branches impacting the expense side with a jump in either rental expense in the case of branch rental or depreciation and foregone interest in case of branch acquisition.

Historical profitability growth levels (2004-2006) are not sustainable

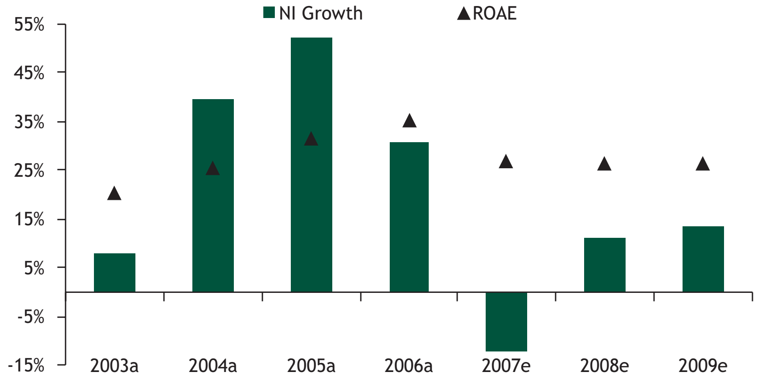
Saudi banks witnessed their best operational years in terms of bottom-line growth between 2003 and 2006, with net earnings growing very strongly. Aggregate net income for our banking universe grew at an estimated 2002-06 CAGR of 35%, with 2005 recording the highest growth of 52.3% Y-o-Y, with growth "dropping" to 30.5% in 2006.

Furthermore, ROAE has climbed from 23.6% in 2003 to reach a five year record high of 35.6% in 2006. This is despite the fact that all Saudi banks considered in this comparison are overcapitalized by international standards, with the Capital Adequacy Ratio (CAR) reaching above 20% in some cases, with capital being made up mostly of equity.

All banks under coverage, with the exception of Arab National Bank (ANB), recorded negative Y-o-Y growth rates on the net income line during the 1Q2007 which, as mentioned earlier, was a direct result of the significant drop in net banking fees on the back of very weak brokerage activity. Our banking universe recorded aggregate Y-o-Y net income growth of -22% in 1Q2007.

We do not expect the bottom line growth rates achieved by most banks in 2004 and 2005 to be achievable in our medium term forecast. We expect banks to begin experiencing healthy bottom line growth rates starting in 2008, based on a rebound in lending that will lead to higher net special commission income and growing non-special commission income.

Figure 3.19: Banking Sector Profitability

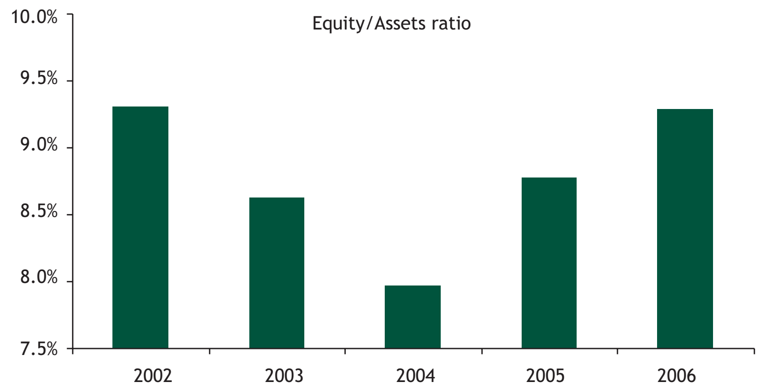


Sources: SAMA, Banks' financial statements and EFG-Hermes estimates

Despite the anticipated rise in dividend yields, we believe Saudi banks will continue to be over capitalized.

Banks have been accumulating equity over the past three years in anticipation of continued strong asset growth. Capital ratios have attained extremely high levels reaching, in some cases, beyond the 20% level while most banks have "rewarded" shareholders through bonus shares while retaining most of their profits leading to relatively low payout ratios. An indication of this is the rise in the ratio of Capital and Reserves / Total Assets (Note: Not Risk-Weighted Assets) which rose from 8.0% in 2004 to 9.3% in 2006, despite very strong asset growth.

Figure 3.20: Banking Sector Capital and Reserves / Total assets (%)



Sources: SAMA and EFG Hermes

We forecast a much higher dividend payout ratio across the Saudi banking sector going forward than has been the case to date. Since most banks expect a slowdown in asset growth rates, the need for the retention of net profits to support capital ratios will fade, thus allowing banks to increase their dividend payout ratios.

We remain confident that banks will maintain high capital ratios even after the expected hike in dividend payout ratios, as the sector average CAR is currently c18% - more than double the ratio set by SAMA. We expect a dividend payout ratio of around 50% going forward, while RWAs will not grow substantially, leading most banks to remain over capitalized (according to international norms) over our forecast horizon.

IV. PEER GROUP COMPARISON

Our peer group, for the purpose of this note, includes seven banks, namely; Arab National Bank, Banque Saudi Fransi, Riyad Bank, Samba Financial Group, Saudi British Bank, Saudi Hollandi Bank, and Saudi Investment Bank. We illustrate in this section the latest trends that have taken place at our peer group banks within the changing landscape of the Saudi banking sector. For the purpose of historical performance comparison, we also include National Commercial Bank in some of our comparable ratios as it represents the largest Saudi bank. NCB is not part of our sector outlook and valuation sections. Despite the size of Al-Rajhi bank and a market share that comes third after NCB and Samba, we opt to exclude Al-Rajhi from our peer comparison as it is a pure Islamic bank and therefore does not share the same balance sheet and income statement structures nor, arguably, the same market drivers.

A. Loan Growth

All banks covered in this section recorded double digit 2003-2006 loan CAGRs with rates ranging from 15.8% for NCB at the low end of the group and 35.1% for ANB at the high end. The substantial growth recorded over the past three years in the loan portfolios of banks led to a significant change in the balance sheet structure of these banks. The high growth rates recorded by ANB in its loan portfolio led to loans rising to 63.7% of total assets by the end of 2006, up from 41.0% in 2003. However, BSF was ahead of ANB in terms of loans to total assets, with the net loan portfolio representing 64.2% of the bank's total assets as of end of 2006.

Fig. 4.1: Three-year (2003-2006) Loan CAGR

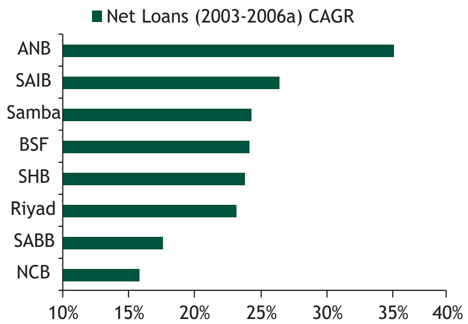
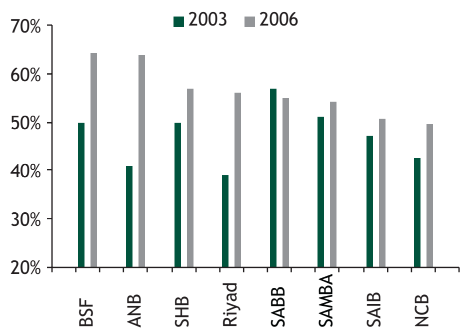


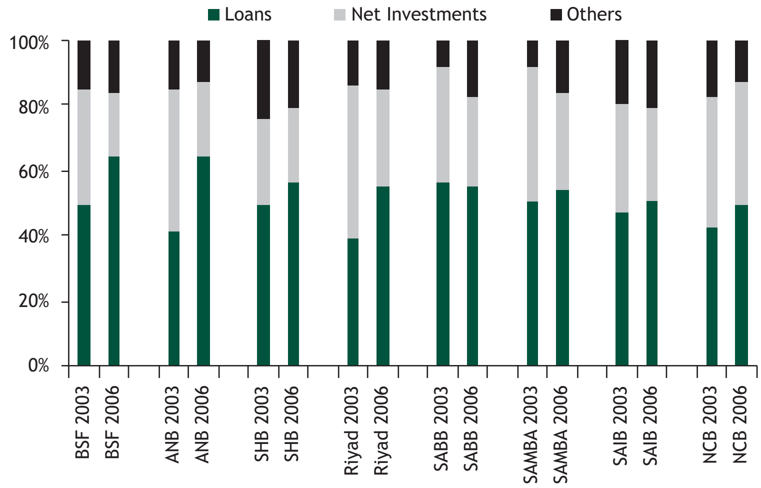
Fig. 4.2: Loans/Assets in Peer Group



Sources: Banks' financial statements and EFG-Hermes

At the other end of the group, banks with the lowest loans/assets contribution were SAIB and NCB with loans/assets ratios barely reaching 50% in 2006. SAIB's loans/assets ratio rose to 50.7% in 2006, up from 47.1% in 2003, while NCB's loans/assets ratio was 49.6% in 2006. We believe that the restraint on the loans/assets ratio is because both banks are more focused on Islamic financing with both managements announcing on more than one occasion their intention to become fully shariaa-compliant at some point over the medium term. The different growth trends in Saudi banks led to some changes in the structure of banks' balance sheets as is illustrated in Figure 4.3.

Figure 4.3: Asset Breakdown in Peer Group

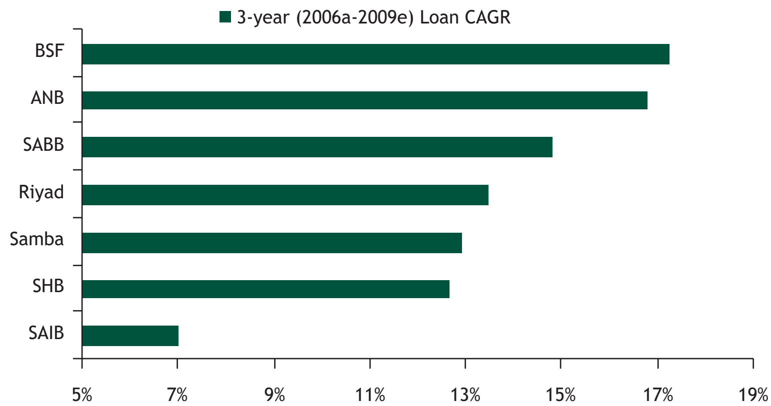


Sources: Banks' financial statements and EFG-Hermes

Loan growth recording double-digit 3-year (2006a-2009e) CAGR for most banks

As mentioned earlier in the section covering the outlook for the sector, we expect the loan portfolios of Saudi banks to record double digit growth rates beyond 2007. Loan growth will be driven by both commercial as well as consumer lending but with more focus on the corporate side of the business in addition to project finance and housing finance. Accordingly, we have incorporated these growth drivers into our forecasts as we expect banks with strong corporate banking franchises to attain higher loan growth rates, especially beyond 2007, as these banks were growing their corporate franchises while revamping their retail business in preparation for tough competition going forward. We expect BSF to lead the peer group in terms of loan portfolio growth over the next three years. Our forecast stems from the bank's very strong corporate franchise and its plans to invest heavily in its retail products backed by Credit Agricole. In addition, the bank is in the process of establishing five new subsidiaries and joint venture companies undertaking several ancillary banking activities in Saudi Arabia where we expect product cross selling opportunities to emerge. We expect BSF to record a 3-year loan (2006-2009) CAGR of 17.1%, followed by ANB and SABB with growth rates of 16.8% and 14.8%, respectively. At the other end of the peer group is SAIB, which is expected to record the lowest loan growth with a 3-year (2006-2009) CAGR of 7.0%.

Figure 4.4: Loan Growth in the Peer Group



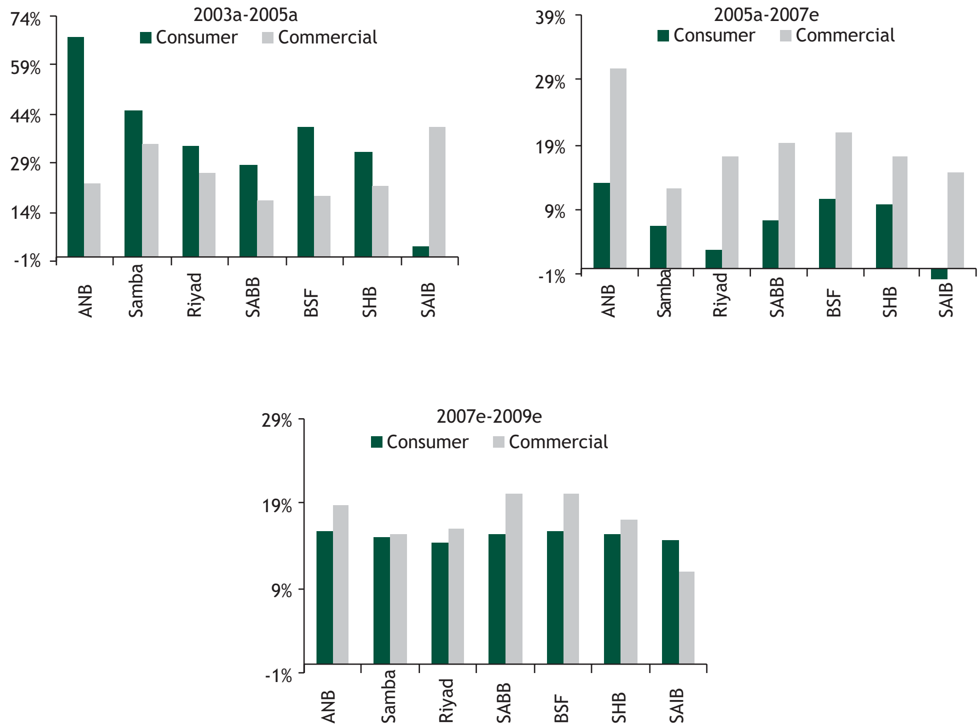
Sources: Banks' financials and EFG-Hermes estimates

Despite strong consumer lending historically, corporate lending will drive growth going forward at all our peer banks

The historical trend that took place in 2004 and 2005, where consumer lending was by far the major growth driver for the banking sector was reversed in 2006 as consumer lending recorded much slower growth rates, reaching 1.6% at the sector level. Starting 2007, we expect growth in commercial loans to accelerate and to drive overall loan growth going forward. We expect BSF and ANB to achieve the highest commercial loan growth rates over the next three years with 3-year (2006-2009) CAGRs of 19.8% for both banks as we believe these two banks have the strongest corporate franchise going forward. In addition, BSF and ANB are currently expanding the cross selling of their products, which helps to attract additional corporate clients and support growth on the consumer business side.

We also expect ANB to experience the highest growth in consumer lending over the next three years as a result of the bank's strong franchise as well as a strong allocation of investment and resources in that segment as the bank's management believe they can still generate growth in the retail business and especially from their new housing finance joint venture. We forecast that ANB consumer loans will record a 3-year (2006-2009) CAGR of 12.1% compared to an average of around 8.2% for the peer group.

Figures 4.5: 2-year Loan CAGR by Segment Over Three Time Frames for Peer Banks



Sources: Banks' financials and EFG-Hermes estimates

Have the outstanding loan growth rates negatively impacted asset quality ratios?

One would have expected that the ongoing changes in the structure of the balance sheets of Saudi banks to have negatively impacted overall asset quality in the banking sector, especially with most banks historically having aggressively promoted loan growth.

Saudi banks have gone through this period of growth with minimum damage to their asset quality ratios. Most banks have been affected by very low NPL/Gross loans ratios by international standards. Additionally, in the good years when profits were soaring and most banks recorded earnings growth rates exceeding 30%, a generally conservative provisioning approach prevailed, with banks accumulating loan loss provisions in excess of the levels required, leading to a rise in the sector's coverage ratios. SABB achieved the lowest NPLs/Gross loans ratio in 2006, of 0.7% while the highest ratio of 3.1% was recorded by Samba, which continued to suffer from the portfolio inherited from the United Saudi Bank (USB) following the 1999 merger.

In reality most banks, as is illustrated in figures 4.7 and 4.8, improved their asset quality ratios in the aforementioned period as a result of aggressive write-offs - in the case of SHB and ANB - or increased provisioning and coverage ratios in the case of SAIB and Riyad Bank.

Fig. 4.7: NPLs/Gross Loans in Peer Group

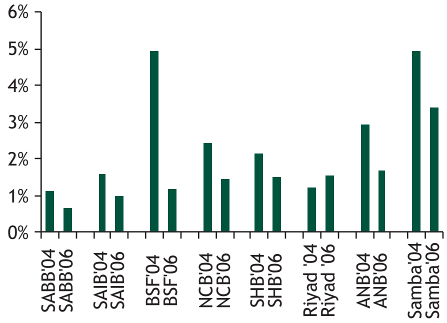
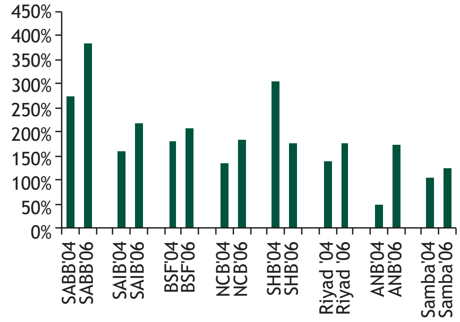


Fig. 4.8: Coverage Ratios in Peer Group



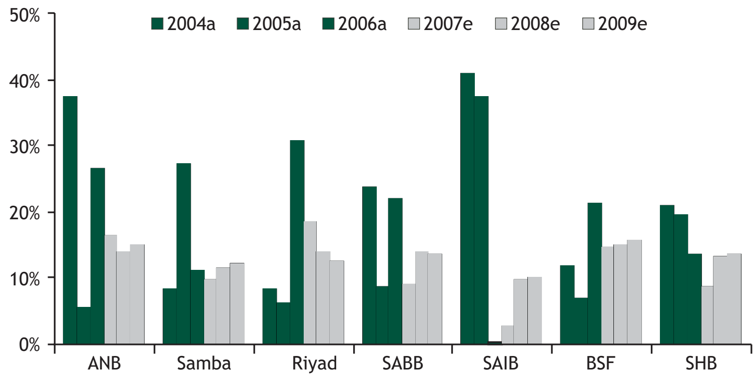
Sources: Banks' financial statements and EFG-Hermes

B. Deposit Growth

In general, and across all banks covered in this section, we do not expect the deposit growth rates achieved by Saudi banks over the years 2004 and 2006 to be sustained over the medium term. We expect most banks to be less aggressive in growing their deposit bases as a result of the increased liquidity in the sector, and the pressure on funding costs that started in 2006. We expect ANB to achieve a deposits growth rate that is higher than the peer average as a result of the bank's strong retail franchise, as well as the exclusive relationship the bank has developed with Saudi pensioners, which we expect will continue for another year as the government plans to end this exclusivity (ANB is the only bank in Saudi Arabia through which pensioners' payments are made). In addition, the growth in deposits at ANB is healthy as the bank is expected to promote non-interest bearing deposits to fund the growth expected in its loan portfolio.

Additionally, we forecast that BSF will be one the few banks to experience higher than historical average deposit growth rates over the forecast horizon. Our forecast stems from the expectation of high growth rates in the bank's portfolio and the diversified business activities that the bank is currently getting into, which we expect it will use as a way of growing its client base through cross-selling of products and transforming into a one-stop shop for all banking services, which will help the bank reach higher growth rates relative to peers.

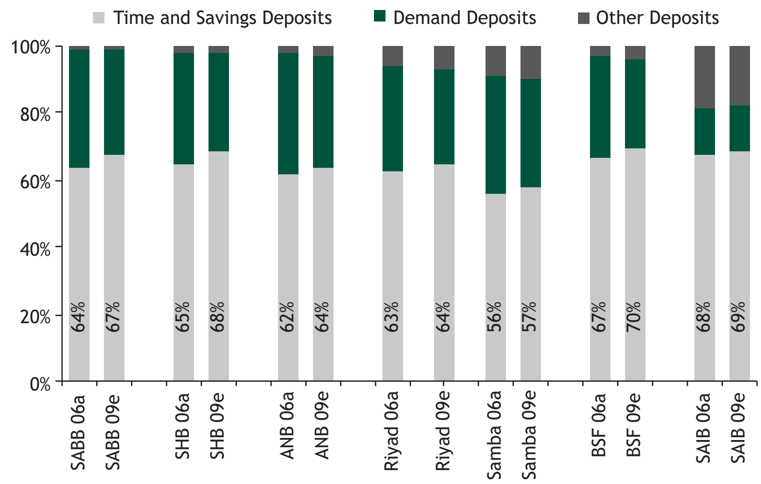
Figure 4.9: Deposit Growth at Saudi Banks



Sources: Banks' financial statements and EFG-Hermes

We expect growth to be higher for demand deposits relative to Time & Savings deposits, as a result of efforts by banks to promote non-interest bearing deposits so as to reduce their cost of funds. We expect the strong growth trend that prevailed between 2004 and 2006, and which led to a rise in the share of Time & Savings deposits, to slow at most banks going forward. As is illustrated in the Figures 4.9 and 4.10, we do not expect the deposit structure at Saudi banks to change significantly between 2006 and 2009.

Figure 4.10: Deposit Breakdown Among Peers 2006a



Sources: Banks' financial statements and EFG-Hermes estimates

Evolution of Net Loans/Deposits

The evolution of the net loans/deposits ratio is similar across most banks in our covered universe. Most banks have been through a high loan growth phase in 2004 and 2005 (where loans were growing at a much faster pace than deposits) which led to a rise in the net loans/deposits ratio before dropping in 2006 as a result of sluggish loan growth. We have categorized banks into two categories vis-à-vis their loans/deposits ratios; those with "volatile" net loans/deposits ratio - i.e. SABB, Samba, Riyad and SAIB - and those with less volatile net loans/deposits ratio - i.e. ANB, BSF and SHB. Over our forecast period we expect SABB to be the only bank to grow its net loans/deposits ratio in 2007, with the ratio dropping at all other banks with Riyad bank recording the largest drop from 75.4% in 2006 to 70.5% in 2007. We forecast BSF will have the highest net loans/deposits ratio over our forecast period, with this ratio reaching a peak of 86.7% in 2009.

Fig. 4.11: Net Loans/Deposits - Volatile

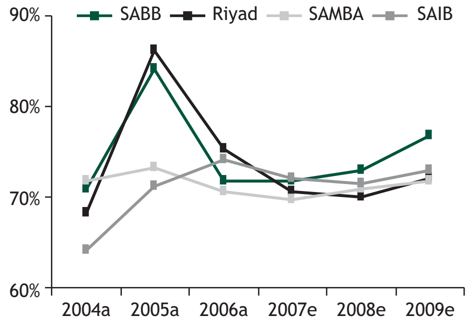
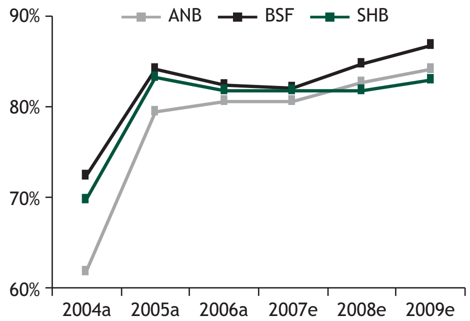


Fig. 4.12: Net Loans/Deposits - Non-volatile



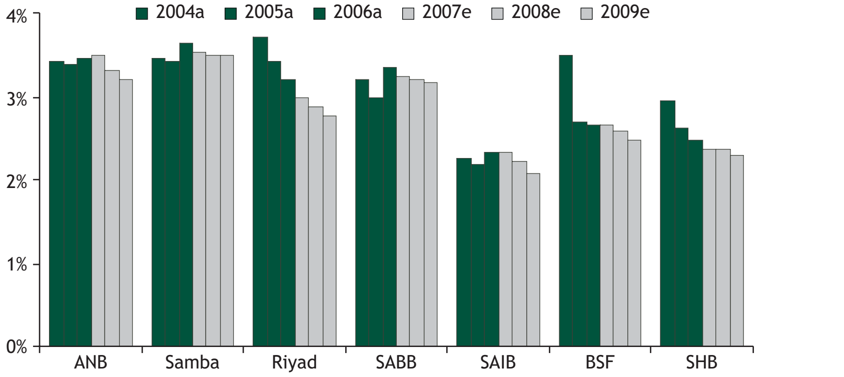
Sources: Banks' financial statements and EFG-Hermes estimates

C. Profitability

Net Commission Spreads tightening, leading to slower net special commission income growth

Most banks in our coverage universe have, over the past three years, focused on growth rather than spreads/margins as a result of the retail lending opportunity that existed in the Saudi banking sector, and that drove growth historically. Despite the growth-oriented strategies pursued by most banks, spreads were mixed as a result of the changing structure of banks' assets and liabilities, where expansion in high yielding consumer lending went hand-in-hand with growth in higher cost 'T&S' Deposits. ANB, Samba, Riyad and SABB enjoyed the highest net commission spreads - ranging between 3.21% and 3.64% in 2006 - while the other three banks in our universe, BSF, SHB and SAIB, had lower net interest spreads with SAIB at the low end of the group with 2.32% in 2006.

Figure 4.13: Net Commission Spreads On a Downward Trend Across the Sector



Sources: Banks' financial statements and EFG-Hermes estimates

Similar to the categorization of banks based on the volatility of the net loans/deposits ratio, we have grouped banks into similar categories when looking at the growth rates achieved in net special commission income as we expect the growth in net special commission income to follow the same volatility trend as the net loans/deposits ratio, as loans and deposits have always been the largest balance sheet contributors at Saudi banks, with an important impact on the net special commission income line.

The four banks with highly volatile net loans/deposits ratios have historically had unstable growth rates of net special commission income, with the exception of Riyad bank which had steady but low growth rates between 2004 and 2006 as illustrated in Figure 4.14, while the other three banks in this category have achieved volatile growth rates between 2004 and 2006 and we expect a strong decline of these growth rates starting in 2007 as a result of the sluggish loan growth in 2006. On the other hand, the three banks illustrated in Figure 4.15, ANB, BSF and SHB, have shown less volatility in the growth rates of their net special commission income and we expect this trend to be sustainable over our forecast period with BSF slightly outperforming the other two banks.

Fig. 4.14: Growth of Net Commission Income (banks exhibiting volatility ex. Riyad Bank)

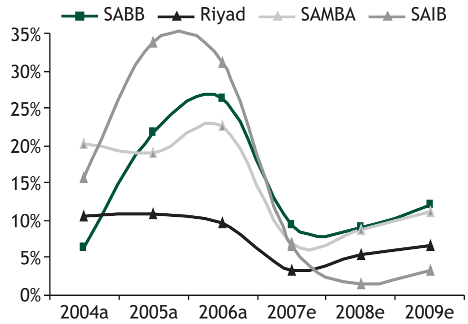
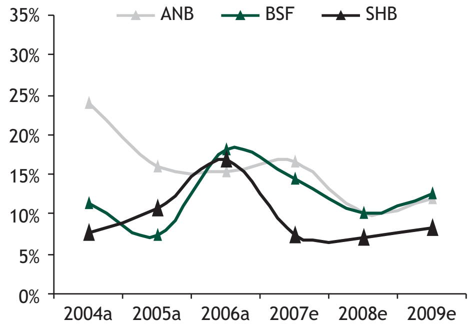


Fig 4.15: Growth of Net Commission Income (banks exhibiting lower volatility)



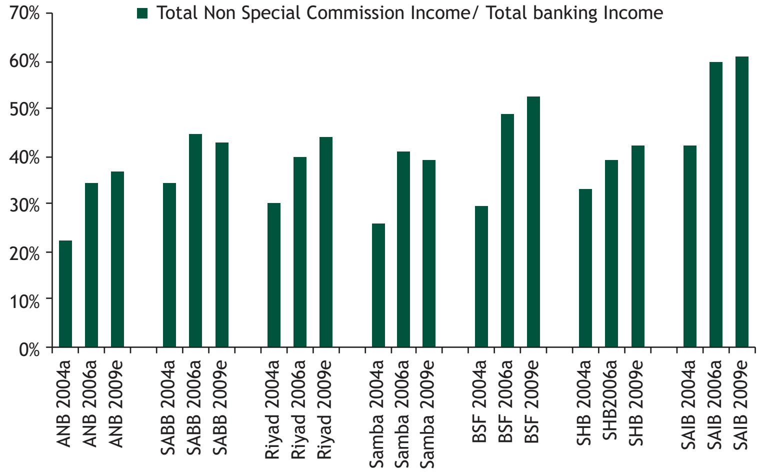
Sources: Banks' financial statements and EFG-Hermes estimates

Special Commission versus Non Special Commission Income

The contribution of non-special commission income (equivalent to non-interest income) to total income in Saudi banks grew across the board between 2004 and 2006. The reason lies in stock market related profits that accumulated, especially in 2005 and 2006, with most banks generating huge (and hugely profitable) brokerage revenue that drove their fee-based income.

For most banks under our coverage we expect this relationship to stabilize going forward with both special (equivalent to net interest income) and non-special commission income growing at more or less the same rates, as both growth rates will slow as a result of slower growth rates in loans and tighter spreads leading to lower net special commission income. We also expect newly licensed brokerage firms and lower stock market activity to lead to a fall in brokerage and fund management fees (relative to historical trends). This stream of fees is the biggest contributor to non special commission income.

Figure 4.16: Composition of Banking Revenues Across Banks



Sources: Banks' financial statements and EFG-Hermes estimates

Cost / Income Ratio

Saudi banks have historically maintained relatively low cost/income ratios (2006 sector average was 27.5%) which were a result of the low costs previously associated with personnel, and the very high net banking income achieved between 2004 and 2006, which also explains the drop in the cost/income ratio at all banks between 2004 and 2006 while their NBI was rising.

Going forward, with the increase in the number of banks operating in Saudi Arabia and the increased pressure from the government to implement the Saudization program, we expect increased demand for Saudi employees and accordingly a rise in personnel costs and the average cost/income ratio across all banks. Additionally, the rising competition between exiting banks has led most banks to put more emphasis on the training and development of their employees to better serve their clients which further adds to operating costs.

Looking at the banks individually, BSF and SAIB have historically had the lowest cost/income ratios. SAIB, in particular, reduced its cost/income ratio to a historical low of 17.7% in 2006 as a result of Y-o-Y growth of 69% in its total banking income which was principally the result of the sale of investments.

We expect the two banks, along with Samba, to continue to maintain the lowest cost/income ratios relative to their peers over our forecast horizon. With the exception of two banks, namely; Samba and BSF, we expect the cost/income ratio at all banks in Saudi Arabia to increase over our forecast horizon as a result of the increased spending on personnel as well as a slowdown in pre-provision income at most banks.

The forecast drops in cost/income ratios at Samba and BSF are mainly a result of these two banks recording higher 2006-2009 CAGR in pre-provision income, while the high pre-provision income growth helped ANB maintain its cost/income ratio over our forecast period. At the other end, we expect SAIB and SHB to have the highest cost/income ratio; SAIB is expected to see a slow down in income growth as illustrated in Figure 4.18, while SHB intends to continue spending on staff training and development as it foresees this as the main growth driver on the retail side going forward.

Fig. 4.17: Historical Cost/Income Ratio

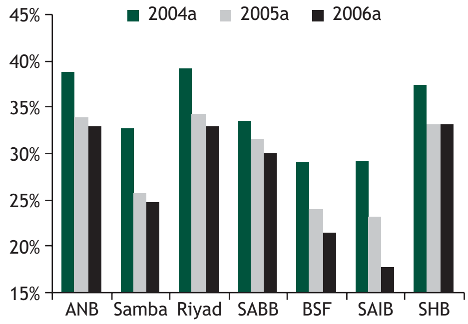
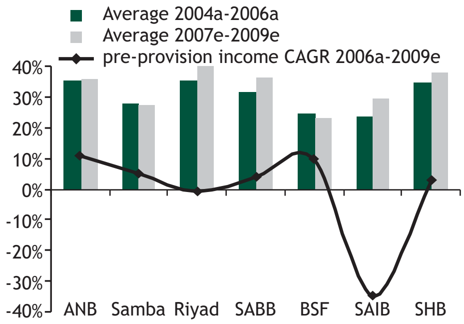


Fig. 4.18: Cost/Income - Forecast CAGR vs. Historical CAGR



Sources: Banks' financial statements and EFG-Hermes estimates

V. WHAT DO THE 1Q2007 RESULTS TELL US?

In this section, we analyze the key elements of the 1Q2007 financial performance of the banks under coverage as the results represent a useful marker for our 2007 estimates and also reflect a change in the operational environment for Saudi banks. The seven banks covered in this note delivered disappointing 1Q2007 results compared to their historical track record with regards to both the balance sheet and the income statement. This performance is the result of: (i) the fact that 1Q2006 was a very strong quarter for Saudi banks. (ii) Changes in regulations governing consumer lending put a brake on asset growth. (iii) There was a hefty Y-o-Y drop in brokerage income as a result of the decline in trading volumes on the Saudi stock market.

A. Balance Sheet

Banks have generally reported a significant deceleration in Y-o-Y growth of net loans in 1Q2007 compared to the growth rates achieved in both 1Q2006 and 2006. In the absence of a breakdown of the loan portfolio at the quarterly stage, we believe the deceleration is mainly the result of a slowdown in consumer lending growth. Our loan growth estimate for the sector is 10.4% for 2007, which is above the rate achieved in 1Q2007 (7.7% Y-o-Y and 1.2% Q-o-Q). Our assumptions are underpinned by our expectation of a pick-up in commercial loan growth during 2H2007 as a result of the roll out of the government's mega projects and a general increase in the demand for corporate credit. Furthermore, the Y-o-Y comparison will be helped by the relative strength of the growth achieved in 1Q2006 and the deceleration of growth rates during the rest of 2006. On a bank by bank basis, our 2007 loan growth estimates for ANB and BSF are below the numbers achieved in 1Q2007. While we believe that over the full year these growth figures are unlikely to be sustained, we still expect the two banks to achieve the highest growth rates among covered banks.

The high growth rates in deposits achieved between 2004 and 2006 (20.8% in 2006) continued, but at a slightly slower pace during 1Q2007 (16.8% Y-o-Y). We expect the deposit growth rate for the sector for the whole of 2007 to remain at approximately the same level (15.8%), with banks ending up with a higher level of liquidity and with less pressure to grow deposits.

Fig. 5.1: Loan Growth Expected to Improve by end 2007 for Most Banks

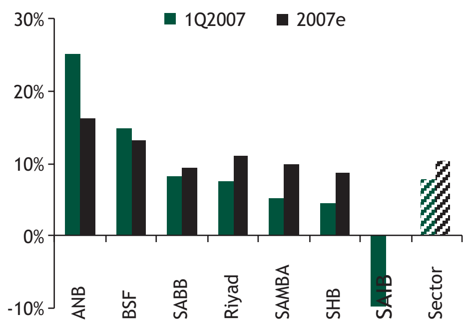
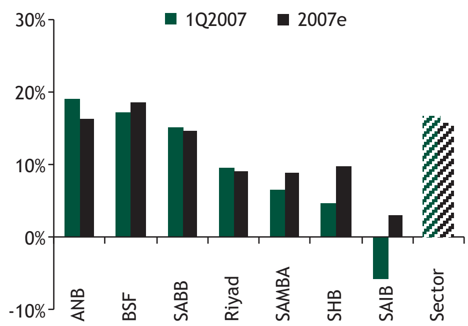


Fig. 5.2: 2007 Deposit Growth Expected to be inline with 1Q2007 for the sector



Sources: Banks' financial statements and EFG-Hermes estimates

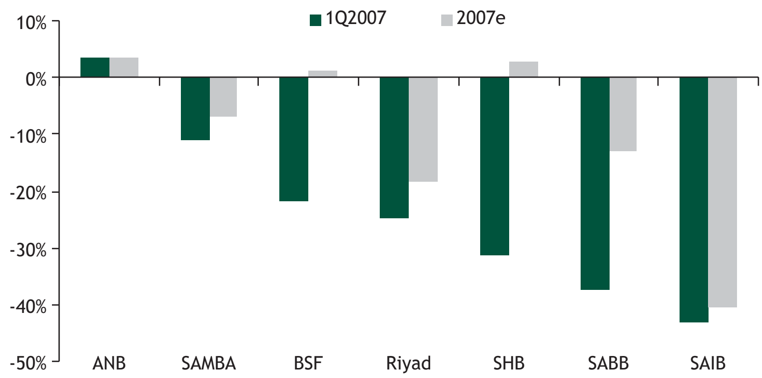
B. Income Statement

ANB: the only bank in our coverage universe to record positive Y-o-Y growth in net profit in 1Q2007

The aggregate net income of the banks under coverage was down 22% Y-o-Y in 1Q2007. ANB was the only bank in our coverage universe to record Y-o-Y bottom line growth in 1Q2007 (up 3.5% Y-o-Y and 14.9% Q-o-Q). On the other hand, SAIB reported the largest drop in net profit in 1Q2007, with a Y-o-Y decline of 43% as a result of the non-recurrence in 1Q2007 of a large one-off gain on the sale of investments in 1Q2006, which represented some 31% of the bank's bottom line.

We forecast that for the whole of 2007, Y-o-Y earnings growth at most banks will be better than the growth rates achieved in 1Q2007 as we expect the banks to deliver positive Y-o-Y growth for the rest of the year. We expect the improvement in performance to be both at the level of special commission income as well as non special commission income, while we also expect some banks to lower their provisioning efforts closer to year end.

Figure 5.3: We Forecast an Improvement in Y-o-Y Bottom Line Growth in FY2007 vs. 1Q2007

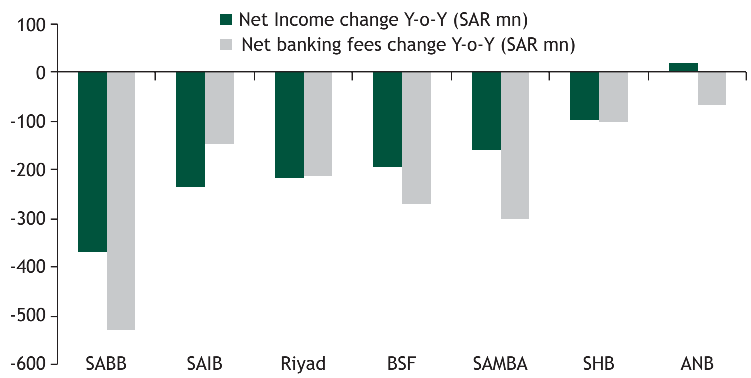


Sources: Banks' financial statements and EFG Hermes estimates

Decline in 1Q2007 net profit was a direct result of a 50% decline in net banking fees, which in turn, is a result of very low brokerage and asset management fees...

Net banking fees fell significantly at all banks on a Y-o-Y basis in 1Q2007. The drop is a result of a decline in average trading volumes on the Saudi stock market. This decline started in 2Q2006 and continued through to 4Q2006, with average value traded dropping c26% Q-o-Q in 2Q2006, coming in flat in 3Q2006 before declining 50% Q-o-Q in 4Q2006. In 1Q2007, total value traded was up 20% Q-o-Q while it was down by 53% Y-o-Y. The drop in brokerage activity has had a direct impact on Saudi banks as they accounted for more than 95% of total brokerage activity in Saudi Arabia in 2006, with the brokerage segment generating both high volumes and high margins.

Figure 5.4: Drop in Net Banking Fees Had a Significant Impact on the Bottom Line in 1Q2007



Sources: Banks' financial statements and EFG-Hermes

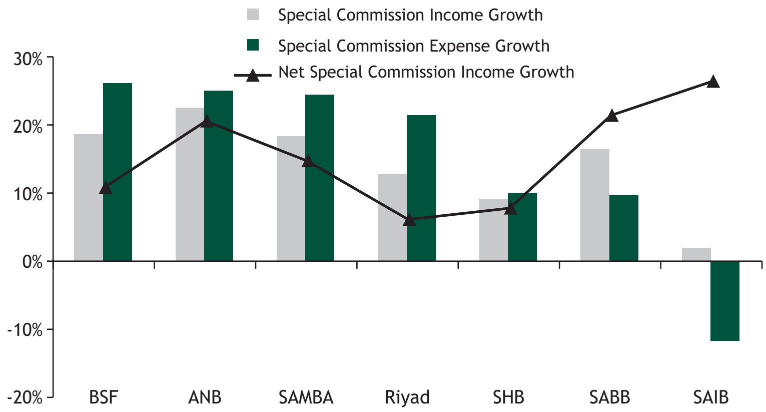
...while net special commission income recorded strong Y-o-Y growth for most banks, indicating strong growth in the core business

Despite the drop in net banking fees at all banks in Saudi Arabia as a direct result of the hefty decline in brokerage fees, the impact on bottom line was mitigated by relatively healthy Y-o-Y growth in net special commission income, which is the largest contributor to revenues at Saudi banks.

With the exception of SABB, all banks under coverage have seen pressure on funding costs. In the absence of a breakdown of the details of special commission expense in interim financial reports, we believe the rising funding costs associated with T&S deposits to be the underlying reason.

SAIB has recorded the highest Y-o-Y growth in net special commission income, of 26%, as a result of a considerable 11.6% drop in special commission expense and 2.0% growth in special commission income. We do not expect the 1Q2007 result achieved by SAIB to be sustained throughout the rest of the year partly because this was achieved by a shrinkage in special commission expense, which we believe is the result of a decline in the deposit base, rather than growth in special commission income.

Figure 5.5: Net Special Commission Inc. Grew but Under Pressure from Special Commission



Exp. Sources: Banks' financial statements and EFG-Hermes

Special commission spreads flat as consumer lending growth slows

Net special commission spreads were flat to declining at most banks in our peer group in 1Q2007 compared to 1Q2006. We expect this trend to be sustained in 2007 as a result of the changes taking place in the asset composition of Saudi banks. Most of the Y-o-Y asset growth in 1Q2006 was driven by consumer lending growth (with high yields, leading to high spreads). However, growth in consumer lending started to decelerate significantly in 2Q2006 and this had a negative impact on spreads, and will continue to do so for the rest of 2007.

Of course, as was mentioned earlier, in addition to the decline in consumer lending growth, the cost of funds has also been on the rise at most banks thereby putting further pressure on spreads.

Fig. 5.6: Net Interest Spreads Flat/ Declining at Most Banks

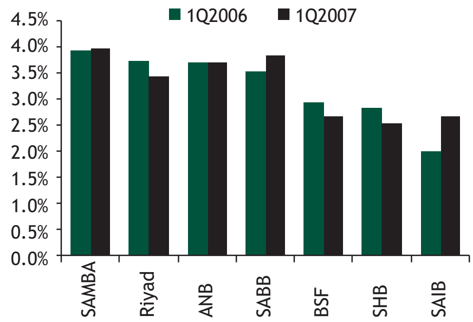
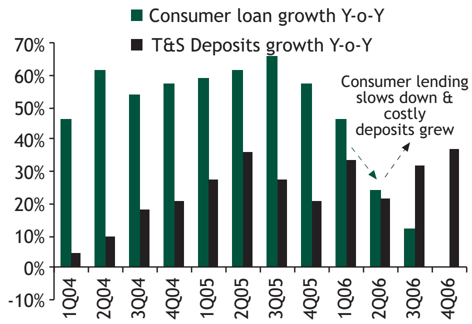


Fig. 5.7: Growth in Consumer Loans Vs. Growth in T&S Deposits



Sources: Banks' financial statements and EFG-Hermes

Cost/income ratio rises as operating expenses rise and net banking income growth slows

1Q2007 results revealed a rise in the cost/income ratio among Saudi banks. Most banks under coverage released a higher cost / income ratio, not only when compared to 1Q2006 but also relative to full year 2006. The aggregate cost/income ratio for the banks under coverage reached 30% in 1Q2007 compared to 32% in our 2007 forecast. The rise in cost/income ratio is a result of both the rise in operating expenses, especially employee-related and the relatively slower growth in net banking income.

Fig. 5.8: 1Q07 Y-o-Y Growth in Operating Costs and NBI

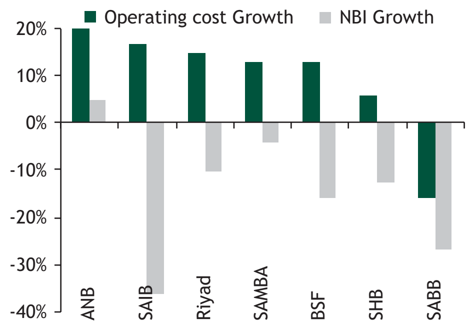
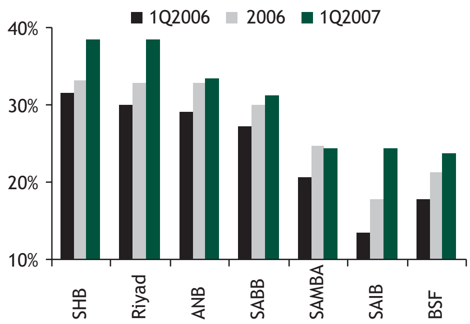


Fig. 5.9: Cost/Income Ratio Among Peers



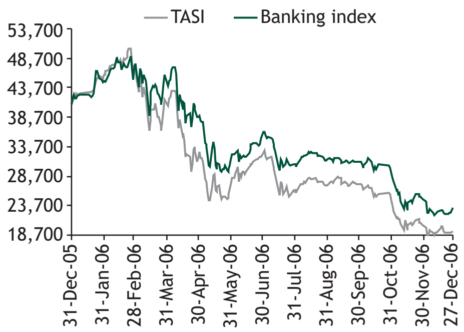
Sources: Banks' financial statements and EFG-Hermes

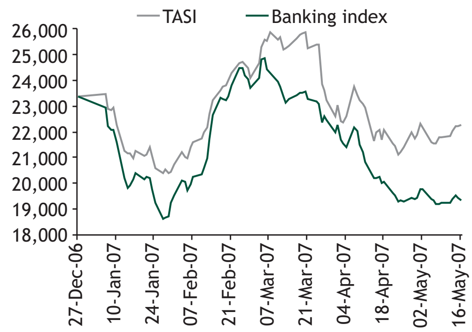
VI. VALUATION

A. Price Performance

2006 was an exceptionally a bad year in terms of price performance for the Saudi stock market. After a very strong multi-year rally, the benchmark TASI index was down 53% in 2006. Taking the peak of the market at the end of February 2006 as a starting point, the market declined 59% in the 10 months to December. The banking sector index fell with the market, and was down 44% over the course of 2006. While the Banking sector index outperformed the market index in 2006, it has underperformed the market index in 2007 year-to-date, with the TASI down 4.7% and the Banking sector index down by 17.3%.

Figure 6.1: Banking Sector Index Outperformed in 06 Fig 6.2 While Underperformed Market YTD





Sources: Tadawul and EFG-Hermes

However, the performance of the different banks within our peer group has been very different over the same time frames. YTD, only two banks in our peer group have outperformed the banking sector index; Samba down 5.4% and ANB down 15.1%. The other five banks in our peer group were down 18.9% to 34.7%.

On a one year basis, Riyad bank and SHB were the worst performers with a 52-week drop of 52% and 45% for the banks, respectively. At the other end of the scale, ANB was the best performing bank within the seven banks under coverage, with a decline of only 15.3%.

Samba financial group is the most active of the banks in our peer group. The average monthly value traded for Samba has been SAR859 million YTD, representing some 40% of the aggregate value traded of the banks in our coverage universe. Meanwhile, SHB has been by far the least active bank in terms of average monthly value traded, with SAR106 million.

Table 6.3: Trading Data of Covered Banks

	Samba	ANB	SABB	Riyad	BSF	SAIB	SHB
YTD Change	-5.4%	-15.1%	-18.9%	-24.8%	-30.0%	-31.1%	-34.7%
52-week Change	-21.7%	-15.3%	-44.7%	-52.0%	-37.0%	-40.3%	-45.0%
52-week High (SAR)	187.0	89.3	198.8	114.0	104.4	83.1	85.0
52-week Low (SAR)	99.25	60.18	92.50	45.50	56.75	36.00	40.0
Average Monthly Traded Value (SAR mn)	859.0	170.5	179.9	245.0	249.0	276.9	106.6

Sources: Tadawul and EFG-Hermes

B. Valuation

We rely principally on the Discounted Equity Cash Flow (DECF) method to value Saudi banks. In addition to using the DECF method, we also use market comparables to support our view and recommendations on the Saudi banks covered in this note.

i) Discounted Equity Cash Flow (DECF) Valuation

Our DECF valuation is based on discounting forecast future dividends (free cash flow) generated by a bank. These dividends broadly represent the earnings generated by a bank minus our estimate of the incremental capital required to fund growth in risk assets. We use a risk free rate of 5.0% which represents the rate on the Saudi long term development bond and a core equity risk premium of 6.0% for the Saudi banking sector. We adjust this risk premium for each bank depending on factors such as our perception of the risk profile, franchise strength, and the historical track record. The result of our DECF valuation exercise is the main determinant of our LT recommendation for a covered bank.

Our cash flow assumptions have taken into consideration two main factors that we believe are a significant determinant of banks' valuations in Saudi Arabia and these assumptions have been incorporated into our forecasts after discussions with the different banks' managements.

- High capital adequacy ratios resulting from high earnings retention: Excess equity represents hidden value for most Saudi banks with CARs having reached an average of 18% in 2006 for our covered banking universe, compared to a minimum regulatory requirement of 8.0%. Since the current levels of equity at Saudi banks support further growth in RWAs with no need for additional retention of earnings, we have built-in, over our forecast horizon, an increased dividend payout ratio for most banks in order to lower long term CARs to a range of 13%-15%, which remains conservative compared to peer banks across the region.

- Over-provisioned NPLs are also a source of value: Similarly to the excess equity accumulated over the past years, most Saudi banks are currently over provisioned, which also represents hidden value. We have opted to deal with this issue by lowering our estimated NPL provision charges going forward to an extent that lowers the NPL coverage ratios for most banks to an average level of 130%-150% by the end of our forecast period, which we still consider conservative. This also normalizes the base year for our terminal value. Figures 6.4 and 6.5 illustrate the levels of excess provisions and excess equity for each of the covered banks.

Fig. 6.4: Provisions in Excess of 100% Coverage

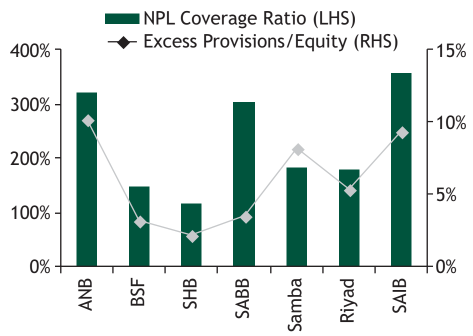
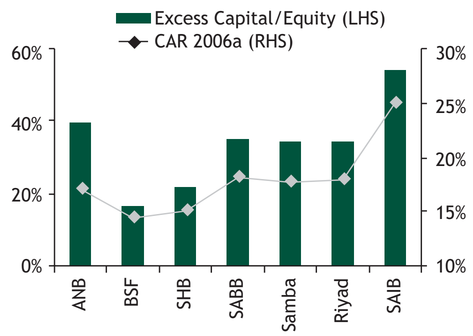


Fig. 6.5: Excess Equity Assuming a CAR of 12%



Sources: Banks' financial statements and EFG-Hermes estimates

Table 6.6: Summary of our DECF Valuation and Implied Multiples

Bank	Market price	Est.LT FV	Upside	2008e Implied P/E Ratio	2008e Implied P/BV Adjusted*
BSF	58.0	101.2	74.5%	16.5	4.6
ANB	66.3	113.2	70.9%	17.7	4.3
SHB	41.3	67.9	64.6%	16.2	3.3
SABB	95.5	138.8	45.4%	17.6	4.6
Riyad Bank	48.5	57.2	17.9%	13.8	2.7
SAMBA	132.3	148.5	12.3%	16.4	4.3
SAIB	37.5	41.3	10.1%	12.3	2.1

*Adjusted BV represents estimated BV +/- loan loss provisions in excess of 100% coverage ratio
Sources: Banks' Financial Statements and EFG Hermes estimates

Sensitivity Analysis

In Table 6.7, we test the relative sensitivity of the results of our DECF to changes in discount rates (equity risk premia) and the terminal growth rate.

Tables 6.7: DECF Sensitivity Analysis

ANB	Cost of Equity				
Terminal Growth \ Cost of Equity	10.0%	10.5%	11.0%	11.5%	12.0%
3.0%	116.7	108.8	101.9	95.8	90.4
3.5%	123.9	114.9	107.2	100.4	94.4
4.0%	132.3	122.0	**113.2**	105.6	98.9
4.5%	142.3	130.3	120.2	111.6	104.1
5.0%	154.2	140.1	128.4	118.5	109.9

BSF	Cost of Equity				
Terminal Growth \ Cost of Equity	10.0%	10.5%	11.0%	11.5%	12.0%
3.0%	104.3	97.3	91.2	85.8	81.1
3.5%	110.6	102.7	95.9	89.9	84.6
4.0%	118.0	109.0	**101.2**	94.5	88.6
4.5%	126.8	116.3	107.4	99.7	93.1
5.0%	137.3	124.9	114.5	105.8	98.3

SHB	Cost of Equity				
Terminal Growth \ Cost of Equity	10.0%	10.5%	11.0%	11.5%	12.0%
3.0%	69.9	65.3	61.2	57.6	54.4
3.5%	74.2	68.9	64.3	60.3	56.8
4.0%	79.1	73.1	**67.9**	63.4	59.5
4.5%	85.0	78.0	72.0	66.9	62.5
5.0%	92.0	83.7	76.8	71.0	65.9

Samba	Cost of Equity				
Terminal Growth \ Cost of Equity	10.0%	10.5%	11.0%	11.5%	12.0%
3.0%	152.9	142.7	133.6	125.7	118.6
3.5%	162.4	150.7	140.6	131.7	123.9
4.0%	173.4	160.0	**148.5**	138.5	129.8
4.5%	186.4	170.8	157.6	146.3	136.5
5.0%	201.9	183.5	168.2	155.3	144.2

SABB	Cost of Equity				
Terminal Growth \ Cost of Equity	10.0%	10.5%	11.0%	11.5%	12.0%
3.0%	143.0	133.4	124.9	117.4	110.7
3.5%	151.9	140.9	131.4	123.0	115.7
4.0%	162.3	149.7	**138.8**	129.5	121.3
4.5%	174.5	159.9	147.4	136.8	127.6
5.0%	189.2	171.9	157.5	145.3	134.8

Riyad	Cost of Equity				
Terminal Growth \ Cost of Equity	10.5%	11.0%	11.5%	12.0%	12.5%
3.0%	58.8	55.2	52.0	49.2	46.7
3.5%	62.1	58.0	54.4	51.3	48.5
4.0%	65.8	61.2	**57.2**	53.7	50.6
4.5%	70.1	64.8	60.3	56.3	52.9
5.0%	75.2	69.1	63.9	59.4	55.5

SAIB	Cost of Equity				
Terminal Growth \ Cost of Equity	10.5%	11.0%	11.5%	12.0%	12.5%
3.0%	42.5	39.9	37.6	35.5	33.7
3.5%	44.8	41.9	39.3	37.0	35.0
4.0%	47.5	44.2	**41.3**	38.7	36.5
4.5%	50.6	46.8	43.5	40.7	38.2
5.0%	54.3	49.9	46.1	42.9	40.1

Source: EFG-Hermes estimates

ii) Multiples Valuation

We have used both P/E and P/BV multiples as our main peer group comparable multiple ratios. Theoretically speaking, the market should start valuing banks based on 2008 and 2009 multiples to reflect the potential growth opportunities for Saudi banks beyond 2007. However, in reality, short-term price movements are based on news releases and quarterly earnings momentum. In setting our ST recommendations in the following section, we do pay heed to what we believe to be the drivers of short-term price performance.

We have adjusted our P/BV multiples to reflect excess loan loss provisions by adding back to the banks' equity all provisions in excess of 100% of NPLs. For the Saudi banks under our coverage, NPL coverage ratios in 2006 were within a range of 114% to 358%.

In addition, we have also taken into consideration the Market Capitalization/Deposits ratio so as to have a measure of how the market values the different banks relative to their deposit franchises.

Table 6.8: Trading Multiples of Covered Banks

	Price	P/E				P/BV Adjusted*				P/BV				MKT. Cap/Deposits			ROAE		CAGR
	(SAR)	06a	07e	08e	09e	06a	07e	08e	09e	06a	07e	08e	09e	06a	07e	08e	07e	08e	(07e-09e)
BSF	58.00	10.8	10.8	9.5	8.2	3.4	3.0	2.7	2.3	3.6	3.1	2.7	2.4	52.6%	45.9%	39.9%	30.6%	30.3%	14.3%
ANB	66.25	12.0	11.6	10.3	8.9	3.4	2.9	2.5	2.2	3.8	3.1	2.6	2.3	48.8%	41.9%	36.8%	29.4%	27.7%	14.5%
SHB	41.25	11.5	11.2	9.9	8.4	2.5	2.2	2.0	1.8	2.6	2.3	2.1	1.9	33.7%	31.0%	27.3%	21.7%	22.1%	15.2%
SABB	95.50	11.8	13.5	12.1	10.6	4.0	3.6	3.2	2.9	4.2	3.7	3.3	2.9	60.4%	55.4%	48.6%	29.3%	28.9%	13.2%
Riyad	48.50	10.4	12.8	11.7	10.9	2.6	2.4	2.3	2.2	2.8	2.6	2.4	2.3	43.8%	36.9%	32.4%	20.9%	21.3%	8.0%
Samba	132.25	15.2	16.4	14.6	12.9	5.1	4.4	3.8	3.3	5.6	4.7	4.1	3.5	83.7%	76.2%	68.2%	31.2%	29.8%	12.7%
SAIB	37.50	7.3	12.2	11.2	11.1	2.2	2.0	1.9	1.8	2.4	2.2	2.0	1.9	52.5%	51.0%	46.5%	19.0%	18.8%	5.2%

*Adjusted BV represents estimated BV +/- Loan loss provisions in excess 100% coverage ratio
Sources: Bank's financial statements and EFG-Hermes estimates

Based on P/E ratios, and with the exception of Samba that is trading on relatively high multiples, we believe most Saudi banks to be attractively priced with 2007 P/Es ranging between 10.8x at the low end (BSF) and 13.5x at the high end (SABB). Looking further out in time, at 2008 and 2009 P/E multiples; BSF is the most attractive stock within our peer group with a 2007-2009 NI CAGR of 14.3% and P/E multiples of 9.5x 2008 and 8.2x 2009. On the other end, Samba is the most expensive in terms of P/E trading at 16.4x 2007, 14.6x 2008 and 12.9x 2009 earnings, which is higher than at peers.

Fig 6.9: 2007 P/BV vs. 2007 ROAE

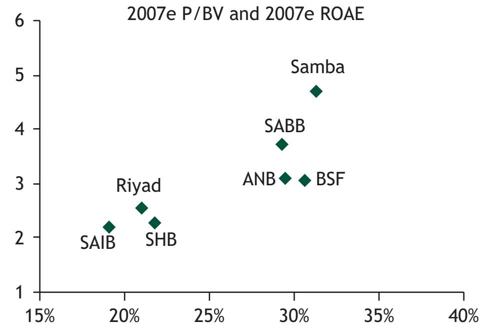
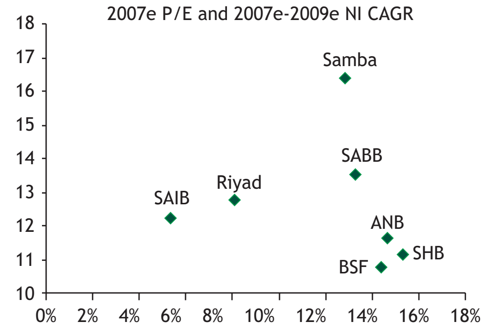


Fig 6.10: 2007 P/E vs. 2007-2009 NI CAGR



Sources: Banks' financial statements and EFG Hermes estimates

P/BV multiples adjusted for excess NPL provisions do not significantly change the relative ranking of the banks: Samba remains relatively expensive when compared to its peer group. Samba's market price translates into a 2007 Adjusted P/BV multiple of 4.4x. Similarly, on 2008 and 2009 multiples the bank remains the least attractive, with adjusted P/BV multiples of 3.8x 2008 and 3.3x 2009. Furthermore, and as is illustrated in Figure 6.8, Samba's 2007 ROAE of 31.2%, which is slightly higher than that at peers, does not justify a P/BV that is significantly above the average.

As well as on P/E multiples, BSF and ANB are also the most attractive banks on Adjusted P/BV multiples compared to their ROAE levels. The two banks trade on 2007e P/BV multiples of 3.1x, while their 2007 ROAEs are 30.6% and 29.4% for BSF and ANB, respectively.

In conclusion, based on our comparable multiple valuations, and considering the profitability of our peer group banks as illustrated in Figures 6.9 and 6.10 , our top stock picks are BSF and ANB, and then SHB. Since the P/BV multiple is a very useful measure in assessing the valuation of financial institutions, we have modified the multiple, removing excess capital from both the book and the market capitalization. Doing so allows to arrive at a price to "operating" book multiple (or a "modified" price to book). We subjectively consider excess capital to be that amount which would push the CAR above 12%. This exercise results in a modified P/BV multiple that is illustrated in Figure 6.11.

Table 6.11: Banks' Modified P/BV multiples

Bank	Actual CAR (2006a)	P/BV (efficient capital)	Actual P/BV
SAIB	25.0%	4.15	2.44
SABB	18.2%	5.30	3.81
Riyad	18.0%	3.32	2.53
Samba	17.7%	7.39	5.19
ANB	17.1%	5.58	3.78
SHB	15.0%	3.00	2.56
BSF	14.4%	3.96	3.47

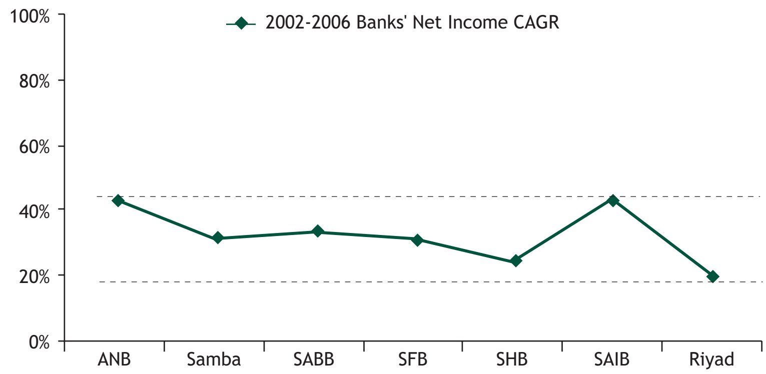
Sources: Banks' Financial Statements and EFG-Hermes estimates

iii) Clustering of Forecasts

It is interesting to note that our forecasts for net earnings growth for our coverage universe are bunched together in a range of 5.2% to 15.2% for the 2007-09 CAGR. The rationale behind this grouping is that the structure of the banking sector itself is concentrated and that SAMA seems to be in favor of banks maintaining a certain level of profitability so as to maintain financial strength. This may also extend to providing a certain degree of protection against foreign competition. We expect this trend to continue as we believe that competition from new entrants will take considerable time to reach levels where it would represent a threat to the current market players.

To test our theory and to validate the bunching of our forecasts, we have looked at the historical performance of the seven banks covered in this note to measure the level of divergence in profitability growth between banks over the period 2003 to 2006. We measure 2002-2006 net income CAGR of the seven banks which results in a range of 20%-44% and supports the view that there is a clustering of performance at Saudi banks. We have made some adjustments to banks' net profits to exclude one off gains, namely at SAIB and SHB where 2006 numbers included a one-off provisioning charge for SHB and an extraordinary gain on the sale of investments in the case of SAIB. A narrower range of growth rates in 2007-2009 is justified given the lower forecast earnings growth.

Figure 6.12: Growth in Net Income Has Historically Been Clustered at Saudi Banks



Sources: Banks' financial statements and EFG-Hermes

C. Recommendations

We break down our recommendation for each Saudi bank covered in this note into two main components; i) the Long Term (LT) recommendation, which is based entirely on our DECF valuation, and ii) a Short Term (ST) recommendation. We believe that drawing a distinction between the two recommendations is important in the Saudi market. We believe that news releases and earnings momentum are important short-term drivers of share price performance.

Long Term Recommendations: Fundamentally, we are positive on the prospects of the Saudi banking sector as we see growth potential in all business lines, and our LT recommendations range from Neutral to Buy. Our estimated LT fair values and recommendations are summarized in table 6.13 below.

Table 6.13: Long Term Recommendation for Saudi Banks

	Market price	LT Value	Upside	LT Recommendation
BSF	58.0	101.2	74.5%	Buy
ANB	66.3	113.2	70.9%	Buy
SHB	41.3	67.9	64.6%	Buy
SABB	95.5	138.8	45.4%	Accumulate
Riyad Bank	48.5	57.2	17.9%	Neutral
Samba	132.3	148.5	12.3%	Neutral
SAIB	37.5	41.3	10.1%	Neutral

Sources: Tadawul and EFG-Hermes estimates

Short Term Recommendations: As we mentioned earlier, our ST recommendations are based on our expectations for the short term performance of our covered banks and the catalysts that could trigger such performance. We have summarized the rationales behind our short term calls in Table 6.14.

Table 6.14: Short-Term Calls on Saudi Banks Stocks

Bank	ST Rec.	Rationale
BSF	Buy	We expect the bank to record no earnings growth/decline in 2007e versus negative growth for most of the other banks covered which, we believe, could create a positive sentiment towards the stock in the short-term.
ANB	Buy	Our ST Buy call on ANB builds on our expectation that the bank will outperform its peers in 2007 due to our forecast of a relatively strong operational performance leading to growth in earnings in what is likely to be a difficult year.
SHB	Buy	The ST Buy call on SHB is based on our expectation of out performance in 2007 earnings, especially beyond the second quarter. The out performance will mainly be a result of flattering comparables due to depressed profits in 2006 as a result of a one-off provisioning charge in 2Q2006 as well as the lower contribution of brokerage income to the bank's bottom line in that same year.
Samba	Accumulate	We expect Samba to show some positive short term momentum based on acquisition news and the consolidation of Crescent bank. Additionally, we also expect the bank's cross border expansion strategy to translate into a valuation premium in the short term specially that Samba is currently viewed as the only Saudi Bank that is likely to be successful in carrying out significant expansions outside of Saudi Arabia.
SABB	Neutral	Our Neutral call is a result of our forecast of negative growth in the bottom line in 2007 that started in 1Q2007 and could continue until the third quarter. In the long term, our recommendation reflects the relatively strong forecast performance of the bank.
SAIB	Neutral	We have a short term Neutral call on SAIB as we don't see a catalyst for the bank outperforming in the short term. Furthermore, the high bottom line growth rates achieved historically were on a smaller earnings base. We believe investors should assign a risk factor in the short term as a result of the aggressive growth achieved historically that could lead to some rise in the NPL ratio.
Riyadh Bank	Neutral	Riyad bank is expected to perform weakly in the short term as a result of slower forecast growth in the loan portfolio, and therefore NII, as well as lacking of the catalyst for a positive surprise.

Source: EFG-Hermes estimates

EFG - Hermes

Banque Saudi Fransi

Has What it Takes

20 May 2007

Saudi Arabia | Banking

ST Rec. : Buy **Current Price*: SAR 58.0**
LT Rec. : Buy **LT Fair Value : SAR 101.2**

• BSF is our equal top pick within our Saudi banks coverage universe. We expect the bank to outperform peers in terms of loan growth as a result of the support of its 31% shareholder Calyon, in addition to the low representation of retail loans in the bank's portfolio which offers room for growth in that segment. In 2005, BSF started to aggressively grow its Islamic franchise, with the percentage of Islamic loans to net loans having grown from 14.3% in 2005 to 20.5% in 2006, with most of the retail business being Shariaa compliant.

• BSF has recently applied a strategy aiming at diversifying its revenue stream, with the bank going into joint ventures to take advantage of under-served segments in Saudi Arabia. The new JVs target several markets including Banc assurance, investment banking, consumer finance, asset management and brokerage. We expect these new JVs to contribute significantly to BSF's non special commission income going forward.

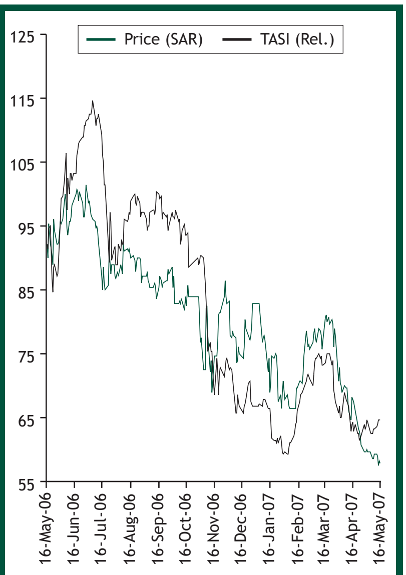
• We forecast BSF will achieve a CAGR of 17.1% (2006-2009) for net loan growth on the back of strong growth in both commercial as well as retail lending and believe customer deposits will grow at a 3-year CAGR of 15.2% over the same period. BSF is one of two banks in Saudi Arabia (other than SHB) with a reasonable (i.e. low) CAR of 14.4% compared to the sector average of 18% in 2006.

• We re-initiate coverage on BSF with a ST/LT Buy recommendation. Our LT buy recommendation is based on a LTFV of SAR101.2 which implies upside potential of 75% from the current market price. BSF currently trades on P/E of 10.8x 2007 and 9.5x 2008. On an adjusted P/BV basis, BSF trades on 3.0x 2007 and 2.7x 2008.

• Despite the 22% drop in the bank's net income in 1Q2007, we expect BSF to outperform most of its peers in terms of bottom line growth throughout the rest of 2007 to end the year with net income equal to that achieved in 2006. Strong earnings for the remainder of 2007 and a low multiple valuation both underpin our ST Buy recommendation.

December year end	*2006a*	*2007e*	*2008e*	*2009e*
Net Special Commission Inc. (mn)	*2,017*	*2,308*	*2,545*	*2,862*
Inc.before Provisions (IBP)(mn)	*3,097*	*3,110*	*3,576*	*4,100*
Net Income	*3,007*	*3,032*	*3,448*	*3,958*
ROAE	*36.7%*	*30.6%*	*30.3%*	*30.5%*
Net Commission Spread (NIS)	*2.67%*	*2.67%*	*2.56%*	*2.49%*
EPS	*5.35*	*5.39*	*6.13*	*7.04*
EPS Growth	*35.7%*	*0.8%*	*13.7%*	*14.8%*
P/E	*10.8*	*10.8*	*9.5*	*8.2*
DPS (Gross)	*1.20*	*3.00*	*3.50*	*4.00*
Dividend Yield	*2.1%*	*5.2%*	*6.0%*	*6.9%*
BVPS	*16.36*	*18.90*	*21.53*	*24.57*
P/BV	*3.55*	*3.07*	*2.69*	*2.36*
Market Cap. / Deposits	*52.6%*	*45.9%*	*39.9%*	*34.5%*
Net Loans / Deposits	*82.5%*	*82.0%*	*84.6%*	*86.7%*
NPLs / Gross Loans	*1.16%*	*1.15%*	*1.10%*	*1.00%*
Provisions / NPLs	*148.3%*	*128.0%*	*120.0%*	*120.0%*
CAR	*14.4%*	*14.5%*	*14.4%*	*14.2%*

Fig in SAR unless otherwise stated



Estimate Changes

(SAR mn)	*2006a*	*2007e Old*	*2007e New*	*2008e Old*	*2008e New*
Net Special Comm. Inc. (mn)	*2,017*	*N/R*	*2,308*	*N/R*	*2,545*
Total Banking Income	*3,939*	*N/R*	*4,022*	*N/R*	*4,655*
IBP	*3,097*	*N/R*	*3,110*	*N/R*	*3,576*
Net Attributable Income	*3,007*	*N/R*	*3,032*	*N/R*	*3,448*

Stock Data:

Last Ex-Div Date	*SAR0.5 on 25 Mar 2007*
Mkt. Val. (Local mn)	*SAR32,625*
Shares (mn)	*563*
Av. Mthly Liqd. (mn)	*SAR249.0*
52-Week High / Low	*SAR104.4 / 56.75*
Bloomberg / Reuters	*BSFR AB / 1050.SE*
Est. Free Float	*69%*

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As at 16 May 2007

Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	2,317	2,437	3,399	7,034	3,765	4,334	5,869
Due from Banks	2,277	6,517	6,223	5,204	6,798	7,427	7,799
Loans and Advances, Net	42,979	44,599	51,130	51,177	58,271	69,162	82,034
Investment Securities, Net	18,128	18,137	16,013	19,300	18,038	18,871	19,822
Fixed Assets, Net	475.9	505.9	552.4	560.2	635.2	698.8	768.6
Other Assets	1,325	1,375	2,263	2,012	2,716	3,123	3,592
Total Assets	**67,501**	**73,571**	**79,581**	**85,286**	**90,224**	**103,617**	**119,885**
Customer Deposits	51,093	56,912	61,998	65,511	71,044	81,778	94,667
Due to Banks	4,946	4,435	3,658	5,226	3,780	4,913	5,318
Term Loan (Debt)	2,438	2,438	2,438	2,438	2,438	2,438	3,656
Other Liabilities	1,839	2,029	2,284	2,185	2,330	2,377	2,424
Total Liabilities	**60,316**	**65,814**	**70,378**	**75,360**	**79,591**	**91,505**	**106,065**
Shareholders' Equity	**7,185**	**7,757**	**9,203**	**9,926**	**10,633**	**12,112**	**13,820**
Total Liabilities Shareholders' Equity	**67,501**	**73,571**	**79,581**	**85,286**	**90,224**	**103,617**	**119,885**
Income Statement							
Special Commission Income	3,012	972.6	4,257	1,152	4,896	5,466	6,257
Special Commission Expense	(1,306)	(487.5)	(2,240)	(615.3)	(2,589)	(2,921)	(3,395)
Net Special Commission Income	**1,706**	**485.1**	**2,017**	**537.2**	**2,308**	**2,545**	**2,862**
Exchange Income	143.4	35.7	144.3	41.1	158.8	176.2	197.4
Fees from Banking Services, Net	1,110	521.5	1,572	252.7	1,255	1,492	1,785
Investments Income, Net	124.3	54.5	200.3	92.3	293.5	434.2	486.8
Other Operating Income	9.8	1.1	5.3	0.8	6.6	7.6	8.7
Total Non Special Commission Income	**1,388**	**612.8**	**1,922**	**387.0**	**1,714**	**2,110**	**2,478**
Total Banking Income	**3,094**	**1,098**	**3,939**	**924.1**	**4,022**	**4,655**	**5,340**
SG&A, Rent and Depreciation Expense	(341.4)	(84.6)	(373.5)	(93.1)	(409.9)	(466.2)	(532.8)
Salaries and Other employees Expense	(394.9)	(109.4)	(462.9)	(125.4)	(495.8)	(606.1)	(698.8)
Other Operating Expenses	(6.9)	(0.0)	(5.0)	(0.3)	(6.6)	(7.6)	(8.7)
Total operating Expenses	**(743.2)**	**(194.0)**	**(841.4)**	**(218.8)**	**(912.4)**	**(1,080)**	**(1,240)**
Income before Provisions	**2,350**	**903.9**	**3,097**	**705.3**	**3,110**	**3,576**	**4,100**
Provisions for Possible Credit Losses	(134.9)	(22.2)	(90.5)	(15.7)	(77.6)	(127.9)	(141.3)
Net Income	**2,216**	**881.7**	**3,007**	**689.6**	**3,032**	**3,448**	**3,958**
Dividends (Gross)	585.0		675.0		1,688	1,969	2,250
Ratios							
Growth in Loans	24.7%	20.2%	19.0%	14.7%	14.0%	18.7%	18.6%
Growth in Deposits	7.1%	20.8%	21.3%	15.1%	14.6%	15.1%	15.8%
Net Loans / Deposits	84.1%	78.4%	82.5%	78.1%	82.0%	84.6%	86.7%
Net Interbank Borrowing / Total Assets	-4.0%	2.8%	3.2%	0.0%	3.3%	2.4%	2.1%
NPL / Gross Loans	1.20%	N/A	1.16%	N/A	1.15%	1.10%	1.00%
Write-Offs / Gross Loans	0.04%	N/A	0.31%	N/A	0.17%	0.10%	0.08%
Loan Provisions / NPLs	181.8%	N/A	148.3%	N/A	128.0%	120.0%	120.0%
(Loan Provisions-NPLs) / Equity	6.0%	N/A	3.2%	N/A	1.8%	1.3%	1.2%
Net Commission Spread	2.68%	2.93%	2.67%	2.65%	2.67%	2.56%	2.49%
Net Commission Margin	2.86%	3.13%	2.94%	2.92%	2.94%	2.83%	2.75%
Growth in Net Commission Income	7.3%	15.9%	18.2%	10.7%	14.4%	10.3%	12.5%
Growth in Non Commission Income	106.9%	174.7%	38.5%	-36.9%	-10.8%	23.1%	17.4%
Growth in Expenses	13.1%	16.6%	13.2%	12.8%	8.4%	18.4%	14.9%
Growth in Provisions Made	99.5%	-50.8%	-32.9%	-29.5%	-14.3%	64.9%	10.4%
Growth in Net Profit	44.3%	105.1%	35.7%	-21.8%	0.8%	13.7%	14.8%
Cost / Income	24.0%	17.7%	21.4%	23.7%	22.7%	23.2%	23.2%
ROAE	34.8%	52.0%	36.7%	31.2%	30.6%	30.3%	30.5%
ROAA	3.5%	5.2%	4.1%	3.5%	3.6%	3.6%	3.5%
EPS	3.94	1.57	5.35	1.23	5.39	6.13	7.04
BVPS	12.77	13.79	16.36	17.65	18.90	21.53	24.57
DPS (Gross)	1.04	N/A	1.20	N/A	3.00	3.50	4.00

Sources: BSF and EFG-Hermes estimates

EFG - Hermes

Arab National Bank

Retail Remains Key

20 May 2007

Saudi Arabia | Banking

ST Rec. : Buy **Current Price*: SAR 66.3**

LT Rec. : Buy **LT Fair Value : SAR 113.2**

• ANB is a 40%-owned subsidiary of Arab Bank Jordan and commenced operations in Saudi Arabia in 1980 by taking over the operations of Arab Bank Limited. The bank has a strong presence in Saudi Arabia with a 9.1% market share of sector assets.

• The bank is one of the strongest in the retail segment having grown its market share of consumer loans from 7.9% in 2004 to 9.1% in 2006 as a result of a 2003-2006 CAGR of 44% vs. a sector CAGR of 35%. Additionally, the bank's credit card business has grown aggressively to reach a market share of c21% at the end 2006. Strong retail business growth is a function of its strong retail franchise, attractive product portfolio, and the exclusive relationship the bank has with Government pensioners.

• ANB is currently tapping into the housing finance sector through a 40%-owned JV with SAR2.0 billion in equity that is being established with Dar Al-Arkan, one of the largest domestic real estate developers. ANB's management puts great emphasis on the growth opportunity available for the bank in the housing finance sector.

• ANB has outperformed all peer group banks in terms of earnings growth in 1Q2007, with the bank growing its bottom line by 3.5% Y-o-Y and 14.9% Q-o-Q on the back of strong growth in net special commission income, which came in 20.5% higher than in 1Q2006, offsetting a 19.5% Y-o-Y decline in non special commission income.

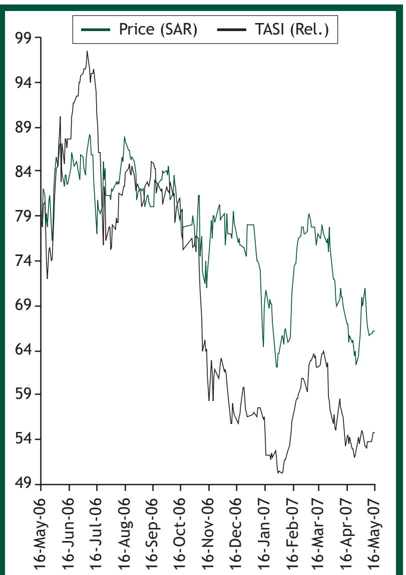
• We forecast net loans at ANB will grow at a three-year 2006-09 CAGR of 16.8%, while deposits will grow at a slower pace of 15.1% over the same period. We expect the bank's net income to continue to grow strongly, recording a 2006-09 CAGR of 10.8%, with ROAE ranging between 28% and 30%.

• We re-initiate coverage on ANB with a ST/LT Buy recommendation. Our LTFV of SAR113.2 per share implies upside potential of 71%. ANB currently trades on PEs of 11.6x 2007 and 10.3x 2008 and on adjusted P/BVs of 2.9x 2007 and 2.5x 2008.

• We assign a ST Buy recommendation on ANB, which rests on our expectation that the bank will outperform peers in 2007 due to a relatively strong operational performance leading to growth in earnings in what is likely to be a difficult year for most Saudi banks.

December year end	*2006a*	*2007e*	*2008e*	*2009e*
Net Special Commission Inc. (mn)	*2,525*	*2,945*	*3,244*	*3,632*
Inc.before Provisions (IBP)(mn)	*2,588*	*2,694*	*3,030*	*3,543*
Net Income	*2,505*	*2,595*	*2,918*	*3,405*
ROAE	*35.0%*	*29.4%*	*27.7%*	*27.6%*
Net Commission Spread (NIS)	*3.45%*	*3.49%*	*3.31%*	*3.21%*
EPS	*5.50*	*5.70*	*6.41*	*7.48*
EPS Growth	*37.0%*	*3.6%*	*12.5%*	*16.7%*
P/E	*12.0*	*11.6*	*10.3*	*8.9*
DPS (Gross)	*0.71*	*2.00*	*2.50*	*3.50*
Dividend Yield	*1.1%*	*3.0%*	*3.8%*	*5.3%*
BVPS	*17.54*	*21.20*	*25.11*	*29.09*
P/BV	*3.78*	*3.13*	*2.64*	*2.28*
Market Cap. / Deposits	*48.8%*	*41.9%*	*36.8%*	*32.0%*
Net Loans / Deposits	*80.5%*	*80.5%*	*82.5%*	*84.1%*
NPLs / Gross Loans	*0.73%*	*0.75%*	*0.65%*	*0.60%*
Provisions / NPLs	*320.5%*	*270.0%*	*250.0%*	*220.0%*
CAR	*17.1%*	*16.4%*	*16.5%*	*16.3%*

Fig in SAR unless otherwise stated



Estimate Changes

(SAR mn)	*2006a*	*2007e Old*	*2007e New*	*2008e Old*	*2008e New*
Net Special Comm. Inc. (mn)	*2,525*	*N/R*	*2,945*	*N/R*	*3,244*
Total Banking Income	*3,855*	*N/R*	*4,130*	*N/R*	*4,754*
IBP	*2,588*	*N/R*	*2,694*	*N/R*	*3,030*
Net Attributable Income	*2,505*	*N/R*	*2,595*	*N/R*	*2,918*

Stock Data:

Last Ex-Div Date	*SAR1 on 30 Jun 2006*
Mkt. Val. (Local mn)	*SAR30,144*
Shares (mn)	*455*
Av. Mthly Liqd. (mn)	*SAR170.5*
52-Week High / Low	*SAR89.29 / 60.18*
Bloomberg / Reuters	*ARNB AB / 1080.SE*
Est. Free Float	*60%*

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*As at 16 May 2007

Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	2,495	3,032	3,216	4,561	3,989	4,548	5,227
Due from Banks	3,934	6,767	4,633	5,348	5,306	6,078	6,964
Loans and Advances, Net	38,779	40,291	49,747	50,417	57,832	67,610	79,187
Investment Securities, Net	20,423	19,931	18,292	19,764	21,173	22,623	24,235
Fixed Assets, Net	418.1	589.5	586.3	778.8	820.8	943.9	1,038
Other Assets	1,444	1,295	1,561	1,312	1,577	1,592	1,608
Total Assets	**67,492**	**71,905**	**78,035**	**82,181**	**90,698**	**103,396**	**118,259**
Customer Deposits	48,832	53,159	61,773	63,254	71,868	81,940	94,175
Due to Banks	8,377	8,581	3,099	5,179	3,982	4,807	5,603
Term Loan (Debt)	1,313	1,313	3,188	3,188	3,188	3,188	3,188
Other Liabilities	2,634	2,221	1,996	1,850	2,016	2,036	2,056
Total Liabilities	**61,155**	**65,274**	**70,055**	**73,471**	**81,053**	**91,969**	**105,021**
Shareholders' Equity	**6,337**	**6,631**	**7,980**	**8,710**	**9,645**	**11,426**	**13,238**
Total Liabilities & Shareholders' Equity	**67,492**	**71,905**	**78,035**	**82,181**	**90,698**	**103,396**	**118,259**
Income Statement							
Special Commission Income	3,445	1,059	4,659	1,297	5,379	6,122	7,004
Special Commission Expense	(1,256)	(487.1)	(2,134)	(608.2)	(2,434)	(2,878)	(3,372)
Net Special Commission Income	**2,189**	**571.7**	**2,525**	**689.0**	**2,945**	**3,244**	**3,632**
Exchange Income	114.0	30.6	135.0	39.6	150.9	174.1	202.6
Fees from Banking Services, Net	693.9	281.5	986.5	215.2	851.6	1,079	1,313
Investments Income, Net	110.9	57.3	138.4	45.5	149.9	218.5	326.8
Other Operating Income	33.8	10.0	70.6	5.4	32.7	38.0	44.2
Total Non Special Commission Income	**952.6**	**379.3**	**1,330**	**305.7**	**1,185**	**1,510**	**1,886**
Total Banking Income	**3,142**	**951.0**	**3,855**	**994.6**	**4,130**	**4,754**	**5,518**
SG&A, Rent and Depreciation Expense	(389.0)	(100.8)	(496.6)	(133.6)	(582.6)	(655.5)	(730.7)
Salaries and Other Employees Expense	(657.7)	(177.1)	(770.5)	(199.6)	(853.3)	(1,068)	(1,245)
Other Operating Expenses	(19.0)	(0.0)	(0.6)	(0.0)	0.0	0.0	0.0
Total Operating Expenses	**(1,066)**	**(277.9)**	**(1,268)**	**(333.2)**	**(1,436)**	**(1,724)**	**(1,975)**
Income before Provisions	**2,076**	**673.1**	**2,588**	**661.4**	**2,694**	**3,030**	**3,543**
Provisions for Possible Credit Losses	(248.4)	(51.8)	(83.0)	(18.5)	(99.2)	(111.5)	(138.1)
Net Income	**1,828**	**621.3**	**2,505**	**642.9**	**2,595**	**2,918**	**3,405**
Dividends	500.0		325.0		910.0	1,138	1,593
Ratios							
Growth in Loans	35.8%	33.7%	28.3%	25.1%	16.3%	16.9%	17.1%
Growth in Deposits	5.4%	22.6%	26.5%	19.0%	16.3%	14.0%	14.9%
Net Loans / Deposits	79.4%	75.8%	80.5%	79.7%	80.5%	82.5%	84.1%
Net Interbank Borrowing / Total Assets	-6.6%	-2.5%	2.0%	0.2%	1.5%	1.2%	1.2%
NPL / Gross Loans	2.09%	N/A	0.73%	N/A	0.75%	0.65%	0.60%
Write-offs / Gross Loans	0.41%	N/A	1.17%	N/A	0.15%	0.28%	0.24%
Loan Provisions / NPLs	200.6%	N/A	320.5%	N/A	270.0%	250.0%	220.0%
(Loan Provisions-NPLs) / Equity	13.4%	N/A	10.2%	N/A	7.8%	5.9%	4.4%
Net Commission Spread	3.37%	3.71%	3.45%	3.69%	3.49%	3.31%	3.21%
Net Commission Margin	3.53%	3.83%	3.70%	3.88%	3.72%	3.56%	3.48%
Growth in Net Commission Income	16.1%	11.3%	15.3%	20.5%	16.6%	10.1%	12.0%
Growth in Non Commission Income	75.9%	124.8%	39.7%	-19.4%	-10.9%	27.4%	24.9%
Growth in Expenses	13.4%	11.9%	19.0%	19.9%	13.3%	20.1%	14.6%
Growth in Provisions Made	-22.7%	-27.7%	-66.6%	-64.2%	19.5%	12.4%	23.9%
Growth in Net Profit	56.6%	71.4%	37.0%	3.5%	3.6%	12.5%	16.7%
Cost / Income	33.9%	29.2%	32.9%	33.5%	34.8%	36.3%	35.8%
ROAE	33.2%	42.0%	35.0%	33.5%	29.4%	27.7%	27.6%
ROAA	2.9%	3.8%	3.5%	3.3%	3.1%	3.0%	3.1%
EPS	4.02	1.37	5.50	1.41	5.70	6.41	7.48
BVPS	13.93	14.57	17.54	19.14	21.20	25.11	29.09
DPS (Gross)	1.10	N/A	0.71	N/A	2.00	2.50	3.50

Sources: ANB and EFG-Hermes estimates

Saudi Hollandi Bank
Growth, Cheaply Priced

19 May 2007

EFG - Hermes

Saudi Arabia | Banking

ST Rec. : Buy **Current Price*: SAR 41.3**
LT Rec. : Buy **LT Fair Value : SAR 67.9**

• SHB is a 40% owned subsidiary of ABN AMRO, founded in 1926 as the first bank to operate in Saudi Arabia. Olayan Saudi Investment Company is a major shareholder in the bank with a 20% stake.

• The bank has a market share approaching 5.4% of sector assets. SHB is characterized by a strong corporate franchise as a result of the bank's strong corporate relationships as well as its ties to large Saudi family-owned corporations resulting from the bank's long presence in Saudi Arabia.

• In 2006, SHB saw a rise in provision expense which negatively impacted its bottom line. Management explained that the provision charges in 2006 should be considered a one-off charge resulting from transferring one of the bank's large accounts into the non-performing category and that the NPL amount was fully provisioned for. We have incorporated in our forecasts a small increase in the bank's NPL ratio over the next two years.

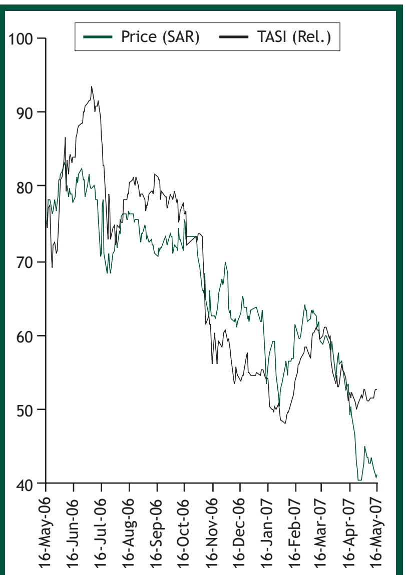
• We expect SHB to grow its loan book at a 2006-09 CAGR of 12.3% on the back of strong growth in commercial lending. Meanwhile, we believe growth in net income will slow down to an estimated 2006-09 CAGR of 10.9%, with ROAE ranging between 22%-23% over 2007-2009.

• We re-initiate coverage on SHB with a ST / LT Buy recommendation. Our LT LTFV of SAR67.9 per share implies 65% upside potential. SHB currently trades on PEs of 11.2x 2007 and 9.9x 2008 and adjusted P/BVs of 2.2x 2007 and 2.0x 2008.

• We have a ST Buy recommendation on SHB as we expect the bank to outperform with regard to 2007 earnings, especially after the second quarter. The out performance will mainly be a result of flattering comparables due to depressed profits in 2006, partly as a result of a one-off provisioning charge in 2Q2006 and due to the lower contribution of brokerage income to the bank's bottom line.

December year end	*2006a*	*2007e*	*2008e*	*2009e*
Net Special Commission Inc. (mn)	*1,180*	*1,267*	*1,355*	*1,467*
Inc.before Provisions (IBP)(mn)	*1,301*	*1,221*	*1,290*	*1,428*
Net Income	*952.8*	*978.5*	*1,106*	*1,298*
ROAE	*24.0%*	*21.7%*	*22.1%*	*23.3%*
Net Commission Spread (NIS)	*2.49%*	*2.38%*	*2.36%*	*2.30%*
EPS	*3.60*	*3.70*	*4.18*	*4.91*
EPS Growth	*-9.4%*	*2.7%*	*13.1%*	*17.3%*
P/E	*11.5*	*11.2*	*9.9*	*8.4*
DPS (Gross)	*1.67*	*2.00*	*2.25*	*2.50*
Dividend Yield	*4.0%*	*4.8%*	*5.5%*	*6.1%*
BVPS	*16.09*	*17.95*	*19.88*	*22.29*
P/BV	*2.56*	*2.30*	*2.07*	*1.85*
Market Cap. / Deposits	*33.7%*	*31.0%*	*27.3%*	*24.0%*
Net Loans / Deposits	*81.7%*	*81.6%*	*81.7%*	*83.0%*
NPLs / Gross Loans	*2.51%*	*2.40%*	*2.35%*	*2.20%*
Provisions / NPLs	*113.6%*	*130.0%*	*130.0%*	*125.0%*
CAR	*15.0%*	*14.0%*	*13.9%*	*15.3%*

Fig in SAR unless otherwise stated



Estimate Changes

(SAR mn)	*2006a*	*2007e Old*	*2007e New*	*2008e Old*	*2008e New*
Net Special Comm. Inc. (mn)	*1,180*	*N/R*	*1,267*	*N/R*	*1,355*
Net Banking Income	*1,946*	*N/R*	*1,921*	*N/R*	*2,097*
IBP	*1,301*	*N/R*	*1,221*	*N/R*	*1,290*
Net Attributable Income	*952.8*	*N/R*	*978.5*	*N/R*	*1,106*

Stock Data:

Last Ex-Div Date	*SAR0.85 on 27 Jul 2006*
Mkt. Val. (Local mn)	*SAR10,915*
Shares (mn)	*264.6*
Av. Mthly Liqd. (mn)	*SAR106.6*
52-Week High / Low	*SAR85.00 / 40.00*
Bloomberg / Reuters	*AAAL AB / 1040.SE*
Est. Free Float	*32%*

*As at 16 May 2007

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Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	1,205	1,684	2,673	4,127	2,574	2,799	3,185
Due from Banks	3,335	3,655	6,020	6,362	6,123	6,287	6,459
Loans and Advances, Net	23,777	25,488	26,480	26,616	28,782	32,678	37,780
Investment Securities, Net	10,484	10,920	10,463	10,331	10,904	11,306	11,818
Fixed Assets, Net	313.3	311.2	309.0	311.5	370.9	426.5	490.5
Other Assets	845.4	740.5	795.4	774.6	803.3	811.4	819.5
Total Assets	**39,958**	**42,798**	**46,740**	**48,522**	**49,557**	**54,308**	**60,552**
Customer Deposits	28,565	30,444	32,414	32,411	35,255	39,988	45,505
Due to Banks	5,797	6,331	8,298	9,995	7,750	7,202	6,534
Term Loan (Debt)	700.0	700.0	700.0	700.0	700.0	700.0	1,400
Other Liabilities	1,225	1,573	1,070	931.0	1,102	1,157	1,215
Total Liabilities	**36,287**	**39,048**	**42,482**	**44,036**	**44,807**	**49,047**	**54,655**
Shareholders' Equity	**3,672**	**3,750**	**4,258**	**4,485**	**4,750**	**5,261**	**5,897**
Total Liabilities Shareholders' Equity	**39,958**	**42,798**	**46,740**	**48,522**	**49,557**	**54,308**	**60,552**
Income Statement							
Special Commission Income	1,839	622.4	2,668	678.8	2,953	3,180	3,512
Special Commission Expense	(829.8)	(347.2)	(1,488)	(382.3)	(1,686)	(1,826)	(2,045)
Net Special Commission Income	**1,009**	**275.2**	**1,180**	**296.5**	**1,267**	**1,355**	**1,467**
Exchange Income	64.0	15.0	50.0	13.8	53.0	60.3	70.4
Fees from Banking Services, Net	589.3	187.1	632.6	87.6	509.0	579.6	677.8
Investments Income, Net	55.8	12.6	82.9	26.0	92.5	102.3	115.8
Other Operating Income	1.9	0.2	1.2	3.5	0.0	0.0	0.0
Total Non Special Commission Income	**711.0**	**214.8**	**766.7**	**130.9**	**654.5**	**742.1**	**864.1**
Total Banking Income	**1,720**	**490.1**	**1,946**	**427.4**	**1,921**	**2,097**	**2,331**
SG&A, Rent and Depreciation Expense	(241.4)	(67.2)	(274.0)	(66.0)	(303.1)	(336.0)	(377.6)
Salaries and Other employees Expense	(327.3)	(86.2)	(368.8)	(97.9)	(396.8)	(470.7)	(525.1)
Other Operating Expenses	0.0	(2.0)	(2.3)	0.0	0.0	0.0	0.0
Total Operating Expenses	**(568.7)**	**(155.4)**	**(645.1)**	**(163.9)**	**(699.9)**	**(806.7)**	**(902.7)**
Income before Provisions	**1,151**	**334.7**	**1,301**	**263.5**	**1,221**	**1,290**	**1,428**
Provisions for Possible Credit Losses	(99.2)	(20.9)	(348.6)	(48.1)	(242.9)	(183.7)	(130.2)
Net Income	**1,052**	**313.8**	**952.8**	**215.4**	**978.5**	**1,106**	**1,298**
Dividends (Gross)	378.0		441.0		529.2	595.4	661.5
Ratios							
Growth in Loans	42.9%	46.8%	11.4%	4.4%	8.7%	13.5%	15.6%
Growth in Deposits	19.7%	26.3%	13.5%	6.5%	8.8%	13.4%	13.8%
Net Loans / Deposits	83.2%	83.7%	81.7%	82.1%	81.6%	81.7%	83.0%
Net Interbank Borrowing / Total Assets	-6.2%	-6.3%	-4.9%	-7.5%	-3.3%	-1.7%	-0.1%
NPL / Gross Loans	1.24%	N/A	2.51%	N/A	2.40%	2.35%	2.20%
Write-Offs / Gross Loans	0.58%	N/A	0.17%	N/A	0.32%	0.24%	0.24%
Loan Provisions / NPLs	158.4%	N/A	113.6%	N/A	130.0%	130.0%	125.0%
(Loan Provisions-NPLs) / Equity	4.8%	N/A	2.2%	N/A	4.5%	4.5%	3.6%
Net Commission Spread	2.63%	2.82%	2.49%	2.54%	2.38%	2.36%	2.30%
Net Commission Margin	2.86%	3.00%	2.82%	2.72%	2.72%	2.70%	2.65%
Growth in Net Commission Income	10.8%	14.4%	17.0%	7.7%	7.4%	6.9%	8.3%
Growth in Non Commission Income	57.4%	75.0%	7.8%	-39.0%	-14.6%	13.4%	16.4%
Growth in Expenses	11.5%	13.9%	13.4%	5.5%	8.5%	15.3%	11.9%
Growth in Provisions Made	-9.4%	-13.1%	251.3%	130.0%	-30.3%	-24.4%	-29.1%
Growth in Net Profit	41.6%	54.6%	-9.4%	-31.3%	2.7%	13.1%	17.3%
Cost / Income	33.1%	31.7%	33.1%	38.3%	36.4%	38.5%	38.7%
ROAE	32.1%	36.9%	24.0%	20.9%	21.7%	22.1%	23.3%
ROAA	2.9%	3.3%	2.2%	1.9%	2.0%	2.1%	2.3%
EPS	3.98	1.19	3.60	0.81	3.70	4.18	4.91
BVPS	13.88	14.17	16.09	16.95	17.95	19.88	22.29
DPS (Gross)	1.43	N/A	1.67	N/A	2.00	2.25	2.50

Sources: SHB and EFG-Hermes estimates

EFG - Hermes

Saudi British Bank
Prepared for the Future

20 May 2007

Saudi Arabia | Banking

ST Rec. : Neutral | **Current Price*: SAR 95.5**
LT Rec. : Accumulate | **LT Fair Value : SAR 138.8**

• Saudi British Bank (SABB) was established in 1978 by taking over the operations of The British Bank of the Middle East (an HSBC affiliate) in Saudi Arabia. Today, SABB is 40% owned by HSBC Group and is one of the strongest in the country in the corporate segment, building on the strength of its parent company. In 2005, SABB established SABB Takaful (32.5% owned by SABB, 32.5% owned by subsidiaries of HSBC Group and the balance was IPOed) offering Islamic insurance products in the Saudi market, which is deemed to be an underserved segment with considerable growth potential.

• In addition to the corporate banking segment, management believes that growth in project finance and syndications will place the bank at an advantage going forward; building on the expertise of HSBC Group. On the retail side, HSBC is well known in the region for its strong Islamic brand, and lately the bank started to aggressively promote its Shariaa compliant products.

• During 1Q2007, the bank's profits were hit hard; with net income dropping 37.5% Y-o-Y as a result of a 72% drop in net banking fees. Meanwhile, at 21.3% Y-o-Y, the bank reported one of the strongest growth rates in net special commission income indicating strength in the core business.

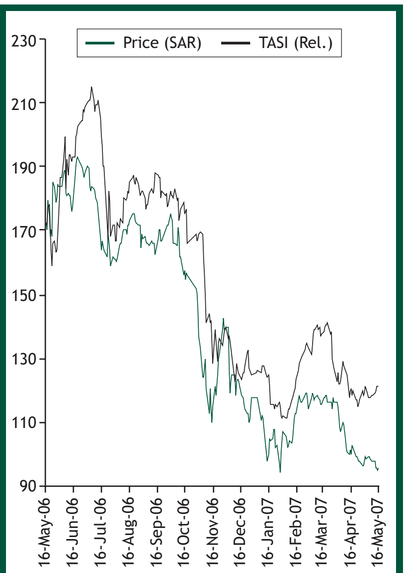
• We forecast SABB will grow its loan book at a 2006-09 CAGR of 14.8%, with deposit growth slowing to a 2006-09 CAGR of 12.2%, down from a 2003-06 CAGR of 18.0%. We forecast net income will grow at a 2006-09 CAGR of 3.7%.

• We re-initiate coverage of SABB with a ST Neutral / LT Accumulate recommendation. Our LTFV of SAR138.8 per share implies 45% upside potential. SABB currently trades on PEs of 13.5x 2007 and 12.1x 2008 and adjusted P/BVs of 3.6x 2007 and 3.2x 2008.

• We assign a Neutral ST recommendation on SABB as we forecast negative growth in the bottom line in 2007. This began in 1Q2007 and we forecast it to continue throughout the year, putting downward pressure on the share price all other things being equal.

December year end	*2006a*	*2007e*	*2008e*	*2009e*
Net Special Commission Inc. (mn)	*2,584*	*2,828*	*3,084*	*3,454*
Inc.before Provisions (IBP)(mn)	*3,265*	*2,811*	*3,145*	*3,644*
Net Income	*3,040*	*2,649*	*2,957*	*3,393*
ROAE	*37.7%*	*29.2%*	*28.9%*	*29.4%*
Net Commission Spread (NIS)	*3.33%*	*3.25%*	*3.19%*	*3.17%*
EPS	*8.11*	*7.06*	*7.88*	*9.05*
EPS Growth	*21.4%*	*-12.9%*	*11.6%*	*14.8%*
P/E	*11.8*	*13.5*	*12.1*	*10.6*
DPS (Gross)	*4.00*	*4.00*	*4.50*	*5.50*
Dividend Yield	*4.2%*	*4.2%*	*4.7%*	*5.8%*
BVPS	*22.70*	*25.58*	*28.97*	*32.51*
P/BV	*4.21*	*3.73*	*3.30*	*2.94*
Market Cap. / Deposits	*60.4%*	*55.4%*	*48.6%*	*42.8%*
Net Loans / Deposits	*71.6%*	*71.9%*	*72.9%*	*76.7%*
NPLs / Gross Loans	*0.38%*	*0.45%*	*0.50%*	*0.50%*
Provisions / NPLs	*301.4%*	*275.0%*	*225.0%*	*185.0%*
CAR	*18.2%*	*16.6%*	*16.8%*	*16.5%*

Fig in SAR unless otherwise stated



Estimate Changes					
(SAR mn)	*2006a*	*2007e Old*	*2007e New*	*2008e Old*	*2008e New*
Net Special Comm. Inc. (mn)	*2,584*	*N/R*	*2,828*	*N/R*	*3,084*
Net Banking Income	*4,669*	*N/R*	*4,447*	*N/R*	*4,958*
IBP	*3,265*	*N/R*	*2,811*	*N/R*	*3,145*
Net Attributable Income	*3,040*	*N/R*	*2,649*	*N/R*	*2,957*

Stock Data:	
Last Ex-Div Date	*SAR2.25 on 27 Mar 2007*
Mkt. Val. (Local mn)	*SAR35,813*
Shares (mn)	*375*
Av. Mthly Liqd. (mn)	*SAR180*
52-Week High / Low	*SAR198.8 / 92.50*
Bloomberg / Reuters	*SABB AB / 1060.SE*
Est. Free Float	*39%*

**As at 16 May 2007*

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Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	3,029	8,291	7,795	13,700	8,604	9,802	11,141
Due from Banks	4,234	5,553	3,138	3,274	3,699	4,333	5,033
Loans and Advances, Net	40,847	39,505	42,450	42,748	46,483	53,759	64,258
Investment Securities, Net	16,373	18,334	21,775	17,697	23,690	24,389	24,945
Fixed Assets, Net	527.7	547.3	541.2	561.6	557.5	574.2	591.4
Other Assets	917.4	1,436	1,491	1,551	1,714	1,972	2,267
Total Assets	**65,928**	**73,666**	**77,189**	**79,533**	**84,748**	**94,829**	**108,235**
Customer Deposits	48,534	54,523	59,258	59,666	64,692	73,699	83,769
Due to Banks	4,050	4,627	3,062	3,200	4,223	4,006	4,014
Term Loan (Debt)	2,434	2,435	4,041	4,041	4,041	4,041	6,061
Other Liabilities	3,417	3,923	2,315	3,541	2,199	2,221	2,199
Total Liabilities	**58,435**	**65,507**	**68,675**	**70,448**	**75,155**	**83,967**	**96,043**
Shareholders' Equity	**7,493**	**8,159**	**8,514**	**9,085**	**9,593**	**10,862**	**12,193**
Total Liabilities & Shareholders' Equity	**65,928**	**73,666**	**77,189**	**79,533**	**84,748**	**94,829**	**108,235**
Income Statement							
Special Commission Income	3,170	1,014	4,437	1,180	4,995	5,491	6,190
Special Commission Expense	(1,197)	(427.4)	(1,853)	(469.0)	(2,167)	(2,408)	(2,736)
Net Special Commission Income	**1,974**	**586.3**	**2,584**	**711.2**	**2,828**	**3,084**	**3,454**
Exchange Income	178.3	39.1	160.5	38.0	170.2	194.2	226.8
Fees from Banking Services, Net	1,532	732.3	1,650	204.8	1,205	1,422	1,641
Investments Income, Net	135.9	62.7	219.7	87.4	241.7	256.3	265.5
Other Operating Income	1.1	0.4	54.3	0.1	2.0	1.5	1.7
Total Non Special Commission Income	**1,847**	**834.5**	**2,085**	**330.4**	**1,619**	**1,874**	**2,135**
Total Banking Income	**3,820**	**1,421**	**4,669**	**1,042**	**4,447**	**4,958**	**5,589**
SG&A, Rent and Depreciation Expense	(491.7)	(165.0)	(623.1)	(149.0)	(706.8)	(777.7)	(859.2)
Salaries and Other Employees Expense	(716.0)	(220.2)	(778.9)	(176.1)	(926.0)	(1,031)	(1,082)
Other Operating Expenses	(0.6)	(1.7)	(2.0)	0.0	(3.3)	(3.7)	(4.2)
Total Operating Expenses	**(1,208)**	**(386.9)**	**(1,404)**	**(325.2)**	**(1,636)**	**(1,813)**	**(1,946)**
Income before Provisions	**2,612**	**1,034**	**3,265**	**716.4**	**2,811**	**3,145**	**3,644**
Provisions for Possible Credit Losses	(107.8)	(47.7)	(224.6)	(100.1)	(161.6)	(188.4)	(250.4)
Net Income	**2,504**	**986.2**	**3,040**	**616.3**	**2,649**	**2,957**	**3,393**
Dividends	750.0		1,500		1,500	1,688	2,063
Ratios							
Growth in Loans	29.2%	22.4%	3.9%	8.2%	9.5%	15.7%	19.5%
Growth in Deposits	8.7%	28.9%	22.1%	9.4%	9.2%	13.9%	13.7%
Net Loans / Deposits	84.2%	72.5%	71.6%	71.6%	71.9%	72.9%	76.7%
Net Interbank Borrowing / Total Assets	0.3%	1.3%	0.1%	0.1%	-0.6%	0.3%	0.9%
NPL / Gross Loans	0.48%	N/A	0.38%	N/A	0.45%	0.50%	0.50%
Write-Offs / Gross Loans	0.54%	N/A	0.13%	N/A	0.16%	0.29%	0.40%
Loan Provisions / NPLs	194.3%	N/A	301.4%	N/A	275.0%	225.0%	185.0%
(Loan Provisions-NPLs) / Equity	2.5%	N/A	3.9%	N/A	3.9%	3.1%	2.3%
Net Commission Spread	2.99%	3.52%	3.33%	3.84%	3.25%	3.19%	3.17%
Net Commission Margin	3.27%	3.83%	3.72%	4.02%	3.60%	3.54%	3.51%
Growth in Net Commission Income	17.5%	30.6%	30.9%	21.3%	9.4%	9.1%	12.0%
Growth in Non Commission Income	108.6%	224.4%	12.9%	-60.4%	-22.3%	15.7%	13.9%
Growth in Expenses	40.7%	67.9%	16.2%	-16.0%	16.5%	10.8%	7.3%
Growth in Provisions Made	77.8%	141.3%	108.4%	110.0%	-28.1%	16.6%	33.0%
Growth in Net Profit	52.2%	116.3%	21.4%	-37.5%	-12.9%	11.6%	14.8%
Cost / Income	31.6%	27.2%	30.1%	31.2%	36.8%	36.6%	34.8%
ROAE	39.0%	56.2%	37.7%	28.6%	29.2%	28.9%	29.4%
ROAA	4.1%	6.0%	4.2%	3.2%	3.3%	3.3%	3.3%
EPS	6.68	2.63	8.11	1.64	7.06	7.88	9.05
BVPS	19.98	21.76	22.70	24.23	25.58	28.97	32.51
DPS (Gross)	2.00	N/A	4.00	N/A	4.00	4.50	5.50

Sources: SABB and EFG-Hermes estimates

EFG - Hermes

Riyad Bank

Big and Safe But No Catalyst

20 May 2007

Saudi Arabia | Banking

ST Rec. : Neutral **Current Price*: SAR 48.5**
LT Rec. : Neutral **LT Fair Value : SAR 57.2**

• Riyad Bank is the second largest in our peer group by total assets, with a market share of 10.9% as at end 2006. The bank has 198 branches in Saudi Arabia, one branch in London, an agency in Houston and a representative office in Singapore. The Saudi Government holds a 29.0% stake in the bank's capital while the balance is widely held.

• Riyad bank has recently lost market share in the consumer segment, where we estimate market share to have dropped from c10% in 2004 to c8% as at end 2006.

• The bank's net profits were down 25.0% Y-o-Y in 1Q2007, impacted by a 46% drop in net banking fees. Furthermore, Riyad bank experienced the slowest net special commission income growth of the peer group. Net special commission income growth of 6.2% Y-o-Y in 1Q2007 was mainly impacted by the jump in commission expense on the back of above average growth rates in deposits. Also, at 38.3%, the bank had the highest cost/income ratio of the peer group in 1Q2007.

• We forecast Riyad bank's commercial lending growth to exceed its consumer lending growth over the medium term. We believe the bank's retail business needs particular attention to achieve growth in line with the sector.

• We expect Riyad Bank to grow its loan book at a 2006-09 CAGR of 13.3% while deposits are expected to achieve a CAGR of 15.0% over the same period. We expect the bank's bottom line to grow at a 2006-09 CAGR of -1.6% with ROAE falling to a forecast average of 21.3%, down from 26.7% in 2006.

• We re-initiate coverage on Riyad bank with a ST / LT Neutral recommendation. Our LTFV of SAR57.2 per share implies 18% upside potential. Riyad bank currently trades on PEs of 12.8x 2007 and 11.7x 2008 and adjusted P/BVs of 2.4x 2007 and 2.3x 2008.

• We assign a ST neutral Recommendation on Riyad bank as we expect the share price to perform weakly over the short term as a result of slow forecast growth in the loan portfolio, affecting growth in earnings. Furthermore, we believe the stock lacks the catalyst of a positive surprise.

December year end	*2006a*	*2007e*	*2008e*	*2009e*
Net Special Commission Inc. (mn)	*2,926*	*3,025*	*3,191*	*3,404*
Inc.before Provisions (IBP)(mn)	*3,281*	*2,750*	*2,959*	*3,228*
Net Income	*2,909*	*2,377*	*2,588*	*2,770*
ROAE	*26.7%*	*20.9%*	*21.3%*	*21.6%*
Net Commission Spread (NIS)	*3.21%*	*2.98%*	*2.87%*	*2.75%*
EPS	*4.65*	*3.80*	*4.14*	*4.43*
EPS Growth	*2.5%*	*-18.3%*	*8.9%*	*7.0%*
P/E	*10.4*	*12.8*	*11.7*	*10.9*
DPS (Gross)	*3.32*	*2.50*	*3.00*	*3.50*
Dividend Yield	*6.8%*	*5.2%*	*6.2%*	*7.2%*
BVPS	*17.47*	*18.87*	*20.01*	*20.94*
P/BV	*2.78*	*2.57*	*2.42*	*2.32*
Market Cap. / Deposits	*43.8%*	*36.9%*	*32.4%*	*28.8%*
Net Loans / Deposits	*75.4%*	*70.6%*	*70.1%*	*72.2%*
NPLs / Gross Loans	*1.56%*	*1.70%*	*1.60%*	*1.50%*
Provisions / NPLs	*176.8%*	*165.0%*	*160.0%*	*150.0%*
CAR	*18.0%*	*16.9%*	*16.0%*	*14.8%*

Fig in SAR unless otherwise stated

Estimate Changes

(SAR mn)	*2006a*	*2007e Old*	*2007e New*	*2008e Old*	*2008e New*
Net Special Comm. Inc. (mn)	*2,926*	*N/R*	*3,025*	*N/R*	*3,191*
Net Banking Income	*4,886*	*N/R*	*4,550*	*N/R*	*4,971*
IBP	*3,281*	*N/R*	*2,750*	*N/R*	*2,959*
Net Attributable Income	*2,909*	*N/R*	*2,377*	*N/R*	*2,588*

Stock Data:

Last Ex-Div Date	*SAR1.6 on 27 Feb 2007*
Mkt. Val. (Local mn)	*SAR30,313*
Shares (mn)	*625*
Av. Mthly Liqd. (mn)	*SAR245.0*
52-Week High / Low	*SAR114.0 / 45.50*
Bloomberg / Reuters	*RIBL AB / 1010.SE*
Est. Free Float	*71%*

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**As at 16 May 2007*

Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	2,949	5,842	5,174	5,656	5,214	5,934	6,682
Due from Banks	1,735	1,924	5,713	5,515	6,015	6,331	6,663
Loans and Advances, Net	45,606	49,041	52,183	52,707	57,928	65,538	75,926
Investment Securities, Net	27,240	27,202	27,502	27,069	28,822	30,670	32,598
Fixed Assets, Net	1,329	1,369	1,654	1,761	1,819	1,964	2,063
Other Assets	1,220	1,571	1,790	1,469	2,059	2,367	2,604
Total Assets	**80,079**	**86,949**	**94,016**	**94,178**	**101,855**	**112,805**	**126,535**
Customer Deposits	52,929	60,874	69,192	71,349	82,103	93,444	105,222
Due to Banks	12,963	11,282	9,239	6,603	3,265	2,104	3,386
Term Loan (Debt)	0.0	0.0	1,871	1,871	1,871	1,871	1,871
Other Liabilities	3,295	3,838	2,794	2,785	2,822	2,879	2,965
Total Liabilities	**69,187**	**75,994**	**83,096**	**82,609**	**90,061**	**100,297**	**113,445**
Shareholders' Equity	**10,891**	**10,955**	**10,920**	**11,570**	**11,794**	**12,508**	**13,090**
Total Labilities & Shareholders' Equity	**80,079**	**86,949**	**94,016**	**94,178**	**101,855**	**112,805**	**126,535**
Income Statement							
Special Commission Income	4,050	1,288	5,509	1,453	6,078	6,558	7,187
Special Commission Expense	(1,379)	(562.8)	(2,582)	(683.0)	(3,053)	(3,367)	(3,783)
Net Special Commission Income	**2,672**	**725.4**	**2,926**	**770.4**	**3,025**	**3,191**	**3,404**
Exchange Income	91.5	26.6	141.8	56.2	146.9	166.5	192.6
Fees from Banking Services, Net	1,098	461.7	1,317	247.4	942.5	1,078	1,250
Investments Income, Net	296.8	127.1	377.1	129.4	413.1	510.9	571.1
Other Operating Income	37.3	3.1	123.8	3.5	22.7	24.9	27.6
Total Non Special Commission Income	**1,523**	**618.5**	**1,960**	**436.6**	**1,525**	**1,780**	**2,041**
Total Banking Income	**4,195**	**1,344**	**4,886**	**1,207**	**4,550**	**4,971**	**5,444**
SG&A, Rent and Depreciation Expense	(622.2)	(175.9)	(715.4)	(211.0)	(857.1)	(937.0)	(1,026)
Salaries and Other employees Expense	(792.9)	(222.9)	(875.4)	(242.9)	(912.4)	(1,042)	(1,153)
Other Operating Expenses	(26.4)	(5.2)	(14.3)	(8.6)	(30.4)	(33.4)	(36.9)
Total Operating Expenses	**(1,441)**	**(404.0)**	**(1,605)**	**(462.5)**	**(1,800)**	**(2,013)**	**(2,217)**
Income before Provisions	**2,754**	**939.9**	**3,281**	**744.5**	**2,750**	**2,959**	**3,228**
Provisions for Possible Credit Losses	(212.1)	(67.5)	(372.5)	(89.4)	(373.4)	(370.1)	(457.5)
Net Income*	**2,837**	**872.4**	**2,909**	**655.1**	**2,377**	**2,588**	**2,770**
Dividends (Gross)	1,600		2,072		1,563	1,875	2,188
Ratios							
Growth in Loans	34.4%	35.9%	14.4%	7.5%	11.0%	13.1%	15.8%
Growth in Deposits	6.4%	6.6%	30.7%	17.2%	18.7%	13.8%	12.6%
Net Loans / Deposits	86.2%	80.6%	75.4%	73.9%	70.6%	70.1%	72.2%
Net Interbank Borrowing / Total Assets	-14.0%	-10.8%	-3.7%	-1.2%	2.7%	3.7%	2.6%
NPL / Gross Loans	1.08%	N/A	1.56%	N/A	1.70%	1.60%	1.50%
Write-Offs / Gross Loans	0.61%	N/A	0.67%	N/A	0.30%	0.48%	0.56%
Loan Provisions / NPLs	269.5%	N/A	176.8%	N/A	165.0%	160.0%	150.0%
(Loan Provisions-NPLs) / Equity	7.9%	N/A	5.9%	N/A	5.6%	5.2%	4.5%
Net Commission Spread	3.42%	3.73%	3.21%	3.43%	2.98%	2.87%	2.75%
Net Commission Margin	3.68%	4.03%	3.58%	3.62%	3.30%	3.17%	3.03%
Growth in Net Commission Income	11.0%	16.7%	9.5%	6.2%	3.4%	5.5%	6.7%
Growth in Non Commission Income	45.0%	164.8%	28.7%	-46.4%	-22.2%	16.7%	14.7%
Growth in Expenses	6.3%	33.5%	11.4%	14.5%	12.1%	11.8%	10.1%
Growth in Provisions Made	119.0%	56.3%	75.7%	32.5%	0.3%	-0.9%	23.6%
Growth in Net Profit	41.5%	67.3%	2.5%	-24.9%	-18.3%	8.9%	7.0%
Cost / Income	34.4%	30.1%	32.9%	38.3%	39.6%	40.5%	40.7%
ROAE	28.1%	34.0%	26.7%	23.3%	20.9%	21.3%	21.6%
ROAA	3.6%	4.2%	3.3%	2.9%	2.5%	2.4%	2.3%
EPS Reported	4.54	1.40	4.65	1.05	3.80	4.14	4.43
BVPS	17.43	17.53	17.47	18.51	18.87	20.01	20.94
DPS (Gross)	2.56	N/A	3.32	N/A	2.50	3.00	3.50

*2005 net income included a one-off gain from sale of land of SAR295.7 million
Sources: Riyad and EFG-Hermes estimates

EFG - Hermes

Samba Financial Group (Samba)

Awaiting a Good Acquisition

20 May 2007

Saudi Arabia | Banking

ST Rec. : Accumulate **Current Price*: SAR 132.3**
LT Rec. : Neutral **LT Fair Value : SAR 148.5**

• Samba Financial Group is the largest bank in our peer group in terms of total assets and shareholders' equity. Samba became the second largest bank in Saudi Arabia in 1999 following the merger with United Saudi Bank (USB), and in 2004 Citigroup sold its 20.0% stake in the bank.

• Management recently announced an expansion strategy that involves acquisitions in neighboring countries. In 2006, the bank concluded its first cross border transaction with the acquisition of Crescent Bank of Pakistan for USD100 million. Samba is also considering opportunities in the GCC and Egypt. We have opted to exclude the impact of possible acquisitions on our assumptions for Samba till acquisitions materialize and since the acquisition of Crescent bank is negligible relative to the size of Samba.

• Similarly to most banks in Saudi Arabia, Samba saw an 11.0% Y-o-Y decline in net income in 1Q2007, impacted largely by a 41% drop in net banking fees on the back of slowing brokerage activity.

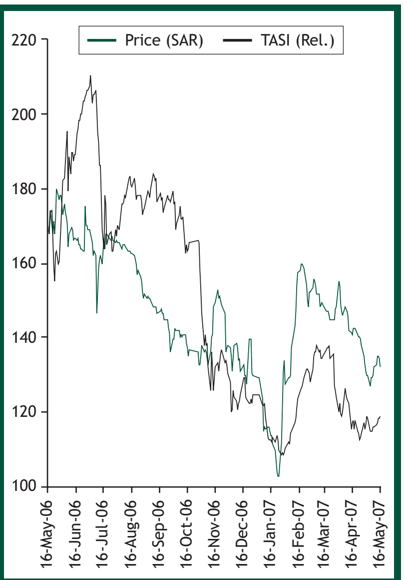
• We forecast Samba's net loans will grow at a 2006-09 CAGR of 12.9%, while deposits will grow at a rate of 11.3% over the same period. We expect growth in net income to slow dramatically to 5.7% over the same period compared to a 2003-06 CAGR of 53.6%. Additionally, with its NPLs/Gross Loans ratio having dropped to 1.9% in 2009, down from 3.4% in 2005, we expect the bank to continue to clean up its loan portfolio.

• We re-initiate coverage on Samba Financial Group with a ST Accumulate / LT Neutral recommendation. Our LTFV of SAR148.5 per share implies 12% upside potential. Samba is currently the most expensive bank in the peer group, with PEs of 16.4x 2007 and 14.6x 2008 and adjusted P/BVs of 4.4x 2007 and 3.8x 2008.

• We assign a ST Accumulate recommendation to Samba as we expect the share price to show some positive short term momentum based on acquisition news and the consolidation of Crescent bank, with the bank's cross border expansion strategy allowing the bank to sustain a valuation premium in the short term. This, we believe, is because Samba is currently viewed as the only Saudi Bank that is likely to carry out significant expansions outside of Saudi Arabia.

December year end	2006a	2007e	2008e	2009e
Net Special Commission Inc. (mn)	4,301	4,595	4,996	5,558
Inc.before Provisions (IBP)(mn)	5,474	5,092	5,644	6,356
Net Income	5,210	4,845	5,423	6,157
ROAE	38.4%	29.7%	28.3%	27.9%
Net Commission Spread (NIS)	3.64%	3.53%	3.51%	3.50%
EPS	8.68	8.07	9.04	10.26
EPS Growth	29.7%	-7.0%	11.9%	13.5%
P/E	15.2	16.4	14.6	12.9
DPS (Gross)	3.40	3.50	4.00	5.00
Dividend Yield	2.6%	2.6%	3.0%	3.8%
BVPS	23.66	28.02	32.61	37.36
P/BV	5.59	4.72	4.06	3.54
Market Cap. / Deposits	83.7%	76.2%	68.2%	60.7%
Net Loans / Deposits	70.7%	70.7%	71.9%	73.9%
NPLs / Gross Loans	2.19%	2.10%	2.00%	1.90%
Provisions / NPLs	182.4%	185.0%	180.0%	170.0%
CAR	17.7%	17.2%	17.9%	18.2%

Fig in SAR unless otherwise stated



Estimate Changes

(SAR mn)	2006a	2007e Old	2007e New	2008e Old	2008e New
Net Special Comm. Inc. (mn)	4,301	N/R	4,595	N/R	4,996
Total Banking Income	7,273	N/R	7,023	N/R	7,787
IBP	5,474	N/R	5,092	N/R	5,644
Net Attributable Income	5,210	N/R	4,845	N/R	5,423

Stock Data:

Last Ex-Div Date	SAR1.7 on 10 Mar 2007
Mkt. Val. (Local mn)	SAR79,350
Shares (mn)	600
Av. Mthly Liqd. (mn)	SAR859.0
52-Week High / Low	SAR187.0 / 99.25
Bloomberg / Reuters	SAMBA AB / 1090.SE
Est. Free Float	48%

*As at 16 May 2007

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Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	4,139	7,827	10,257	13,312	11,770	13,025	14,112
Due from Banks	2,791	2,927	5,145	5,775	5,917	6,212	6,523
Loans and Advances, Net	62,386	64,650	67,028	67,971	73,688	83,616	96,546
Investment Securities, Net	36,357	35,592	37,682	38,893	38,481	41,165	44,339
Fixed Assets, Net	674	684	713	770	820	943	1,085
Other Assets	1,960	2,844	3,190	2,936	3,509	3,860	4,246
Total Assets	**108,306**	**114,525**	**124,015**	**129,657**	**134,185**	**148,821**	**166,851**
Customer Deposits	85,240	93,344	94,856	97,645	104,160	116,296	130,664
Due to Banks	4,399	3,383	6,887	9,874	7,311	6,982	7,716
Term Loan (Debt)	2,250	2,250	4,275	2,025	2,025	2,025	2,025
Other Liabilities	3,511	3,129	3,799	4,432	3,875	3,952	4,031
Total Liabilities	**95,400**	**102,106**	**109,817**	**113,976**	**117,371**	**129,256**	**144,436**
Shareholders' Equity	**12,906**	**12,418**	**14,198**	**15,680**	**16,813**	**19,566**	**22,415**
Total Liabilities & Shareholders' Equity	**108,306**	**114,525**	**124,015**	**129,657**	**134,185**	**148,821**	**166,851**
Income Statement							
Special Commission Income	5,322	1,642	6,991	1,943	7,571	8,204	9,135
Special Commission Expense	(1,814)	(628)	(2,690)	(781)	(2,976)	(3,209)	(3,577)
Net Special Commission Income	**3,508**	**1,014**	**4,301**	**1,163**	**4,595**	**4,996**	**5,558**
Exchange Income	216	54	276	94	310	351	411
Fees from Banking Services, Net	1,906	737	2,420	434	1,822	2,135	2,407
Investments Income, Net	187	117	265	137	286	294	347
Other Operating Income	10	0	12	11	10	11	12
Total Non Special Commission Income	**2,320**	**908**	**2,972**	**675**	**2,428**	**2,791**	**3,177**
Total Banking Income	**5,828**	**1,922**	**7,273**	**1,837**	**7,023**	**7,787**	**8,735**
SG&A, Rent and Depreciation expense	(591)	(134)	(613)	(155)	(731)	(801)	(901)
Salaries and Other Employees Expense	(910)	(265)	(1,186)	(295)	(1,200)	(1,341)	(1,477)
Other Operating Expenses	(10)	0	0	0	0	0	0
Total Operating Expenses	**(1,511)**	**(399)**	**(1,799)**	**(450)**	**(1,931)**	**(2,143)**	**(2,379)**
Income before Provisions	**4,316**	**1,523**	**5,474**	**1,388**	**5,092**	**5,644**	**6,356**
Provisions for Possible Credit Losses	(298)	(96)	(264)	(118)	(247)	(221)	(200)
Net Income	**4,018**	**1,428**	**5,210**	**1,270**	**4,845**	**5,423**	**6,157**
Dividends	1,680		2,040		2,100	2,400	3,000
Ratios							
Growth in Loans	29.5%	20.6%	7.4%	5.1%	9.9%	13.5%	15.5%
Growth in Deposits	27.1%	31.5%	11.3%	4.6%	9.8%	11.7%	12.4%
Net Loans / Deposits	73.2%	69.3%	70.7%	69.6%	70.7%	71.9%	73.9%
Net Interbank Borrowing / Total Assets	-1.5%	-0.4%	-1.4%	-3.2%	-1.0%	-0.5%	-0.7%
NPL / Gross Loans	3.40%	N/A	2.19%	N/A	2.10%	2.00%	1.90%
Write-Offs / Gross Loans	0.05%	N/A	0.04%	N/A	0.07%	0.09%	0.10%
Loan Provisions / NPLs	124.4%	N/A	182.4%	N/A	185.0%	180.0%	170.0%
(Loan Provisions-NPLs) / Equity	4.2%	N/A	8.9%	N/A	8.1%	7.1%	5.9%
Net Commission Spread	3.42%	3.94%	3.64%	3.96%	3.53%	3.51%	3.50%
Net Commission Margin	3.63%	4.12%	3.91%	4.13%	3.79%	3.77%	3.77%
Growth in Net Commission Income	18.9%	19.6%	22.6%	14.6%	6.8%	8.7%	11.3%
Growth in Non Commission Income	122.1%	151.0%	28.1%	-25.6%	-18.3%	14.9%	13.8%
Growth in Expenses	15.6%	18.7%	19.0%	12.8%	7.4%	11.0%	11.0%
Growth in Provisions Made	62.9%	64.4%	-11.5%	22.9%	-6.2%	-10.8%	-9.5%
Growth in Net Profit	60.4%	75.0%	29.7%	-11.0%	-7.0%	11.9%	13.5%
Cost / Income	25.9%	20.7%	24.7%	24.5%	27.5%	27.5%	27.2%
ROAE	34.9%	51.6%	38.4%	36.2%	29.7%	28.3%	27.9%
ROAA	4.0%	5.2%	4.5%	4.2%	3.6%	3.6%	3.7%
EPS	6.70	2.38	8.68	2.12	8.07	9.04	10.26
BVPS	21.51	20.70	23.66	26.13	28.02	32.61	37.36
DPS (Gross)	2.80	N/A	3.40	N/A	3.50	4.00	5.00

Sources: Samba and EFG-Hermes estimates

EFG - Hermes

Saudi Investment Bank

Islamic Banking Could Be The Way

20 May 2007

Saudi Arabia | Banking

ST Rec. : Neutral **Current Price*: SAR 37.5**
LT Rec. : Neutral **LT Fair Value : SAR 41.3**

- SAIB was established in 1976. The Saudi Government is the largest shareholder in the bank; holding a combined stake of 39.2%. SAIB is the smallest bank in our peer group as measured by assets, with a market share of 4.7% at the end of 2006.

- Management has announced its intention to convert the bank's operations to being fully Shariaa compliant by the end of 2008, which entails the offering of a wide range of new Islamic products. The bank recently announced a cooperation agreement with BNP Paribas; setting up a new asset management firm.

- SAIB holds 50% stake in AMEX (Saudi Arabia) and 28% of Saudi ORIX Leasing Company. The bank leverages on these stakes to serve both the credit card and leasing markets in Saudi Arabia.

- We expect SAIB to be towards the end of our peer group in terms of balance sheet growth and earnings growth going forward. We estimate the bank's loan book will grow at a 2006-09 CAGR of 7.0%, and deposits at a 2006-09 CAGR of 7.5%, while we forecast the bottom line will grow at a 2006-09 CAGR of -12.9%.

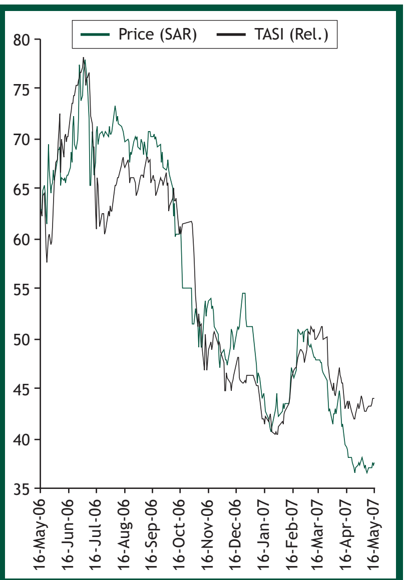
- We initiate coverage on SAIB with a ST / LT Neutral recommendation. Our LTFV of SAR41.3 per share implies 10% upside potential. SAIB currently trades on PEs of 12.2x 2007 and 11.2x 2008, and adjusted P/BVs of 2.0x 2007 and 1.9x 2008.

- While SAIB trades on relatively attractive P/BV ratios, we believe this partly reflects the "excess" equity relative to the peer group. This excess equity is reflected in a CAR that was 25% at the end of 2006 compared to an average of 18% for the peer group.

- We asign a short-term Neutral recommendation to SAIB as we don't see a catalyst for the bank to outperform in the short term. Furthermore, we believe the high earnings growth rates that were achieved historically are not repeatable over the medium term and, historically, were the result of a smaller earnings base.

December year end	2006a	2007e	2008e	2009e
Net Special Commission Inc. (mn)	1,030	1,097	1,114	1,152
Inc.before Provisions (IBP)(mn)	2,103	1,227	1,332	1,422
Net Income	2,006	1,198	1,307	1,326
ROAE	35.5%	18.0%	17.9%	16.8%
Net Commission Spread (NIS)	2.32%	2.32%	2.20%	2.08%
EPS	5.13	3.06	3.34	3.39
EPS Growth	88.5%	-40.3%	9.1%	1.5%
P/E	7.3	12.2	11.2	11.1
DPS (Gross)	0.00	1.00	1.50	2.00
Dividend Yield	0.0%	2.7%	4.0%	5.3%
BVPS	15.35	16.91	18.58	19.81
P/BV	2.44	2.22	2.02	1.89
Market Cap. / Deposits	52.5%	51.0%	46.5%	42.3%
Net Loans / Deposits	74.1%	72.0%	71.5%	73.0%
NPLs / Gross Loans	1.01%	1.01%	1.05%	1.20%
Provisions / NPLs	357.7%	370.0%	300.0%	225.0%
CAR	25.0%	26.1%	26.2%	25.8%

Fig in SAR unless otherwise stated



Estimate Changes

(SAR mn)	2006a	2007e Old	2007e New	2008e Old	2008e New
Net Special Comm. Inc. (mn)	1,030	N/R	1,097	N/R	1,114
Net Banking Income	2,556	N/R	1,741	N/R	1,884
IBP	2,103	N/R	1,227	N/R	1,332
Net Attributable Income	2,006	N/R	1,198	N/R	1,307

Stock Data:

Last Ex-Div Date	SAR3.0 on 7 Mar 2006
Mkt. Val. (Local mn)	SAR14,663
Shares (mn)	391
Av. Mthly Liqd. (mn)	SAR276.9
52-Week High / Low	SAR83.08 / 36.00
Bloomberg / Reuters	SIBC AB / 1030.SE
Est. Free Float	35%

*As at 16 May 2007

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Financial Statments (December year end)

(SAR mn)	2005a	1Q2006	2006a	1Q2007	2007e	2008e	2009e
Balance Sheet							
Cash in Hand and SAMA	971.7	838.3	861.2	1,019	948.6	1,040	1,144
Due from Banks	6,798	9,195	6,299	5,087	6,942	7,983	9,181
Loans and Advances, Net	19,794	19,752	20,691	17,815	20,703	22,525	25,318
Investment Securities, Net	11,276	11,119	11,777	14,940	11,345	12,419	11,950
Fixed Assets, Net	204.6	173.0	340.4	368.1	408.5	469.7	526.1
Other Assets	536.8	702.5	875.7	656.3	963.3	1,060	1,166
Total Assets	**39,581**	**41,781**	**40,845**	**39,885**	**41,310**	**45,497**	**49,285**
Customer Deposits	27,858	29,332	27,931	27,601	28,746	31,524	34,681
Due to Banks	3,991	4,397	4,447	3,739	3,477	4,221	3,294
Term Loan (Debt)	1,425	1,425	1,425	1,425	1,425	1,425	2,494
Other Liabilities	1,000	1,006	1,040	819.2	1,051	1,061	1,072
Total Liabilities	**34,274**	**36,159**	**34,843**	**33,584**	**34,699**	**38,231**	**41,541**
Shareholders' Equity	**5,307**	**5,621**	**6,001**	**6,302**	**6,611**	**7,266**	**7,744**
Total Liabilities & Shareholders' Equity	**39,581**	**41,781**	**40,845**	**39,885**	**41,310**	**45,497**	**49,285**
Income Statement							
Special Commission Income	1,746	634.6	2,505	646.7	2,542	2,605	2,786
Special Commission Expense	(960.2)	(409.8)	(1,475)	(362.5)	(1,445)	(1,492)	(1,634)
Net Special Commission Income	**785.7**	**224.8**	**1,030**	**284.3**	**1,097**	**1,114**	**1,152**
Exchange Income	27.4	10.4	34.8	6.5	31.6	35.7	41.7
Fees from Banking Services, Net	655.7	265.9	783.9	120.1	527.3	644.2	720.1
Investments Income, Net	47.1	168.6	707.0	14.6	84.7	90.4	113.0
Other Operating Income	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Non Special Commission Income	**730.3**	**444.9**	**1,526**	**141.2**	**643.6**	**770.3**	**874.7**
Total Banking Income	**1,516**	**669.7**	**2,556**	**425.5**	**1,741**	**1,884**	**2,027**
SG&A, Rent and Depreciation Expense	(127.8)	(35.8)	(194.2)	(35.2)	(195.6)	(215.0)	(238.9)
Salaries and Other Employees Expense	(224.0)	(53.6)	(259.3)	(69.2)	(318.6)	(337.6)	(366.1)
Other Operating Expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Operating Expenses	**(351.8)**	**(89.4)**	**(453.5)**	**(104.4)**	**(514.2)**	**(552.6)**	**(604.9)**
Income before Provisions	**1,164**	**580.3**	**2,103**	**321.1**	**1,227**	**1,332**	**1,422**
Provisions for Possible Credit Losses	(100.0)	(40.0)	(96.5)	(15.0)	(29.1)	(24.5)	(95.3)
Net Income	**1,064**	**540.3**	**2,006**	**306.1**	**1,198**	**1,307**	**1,326**
Dividends (Gross)	103.2		0.0		391.0	586.5	782.0
Ratios							
Growth in Loans	51.9%	30.1%	4.5%	-9.8%	0.1%	8.8%	12.4%
Growth in Deposits	37.3%	36.5%	0.3%	-5.9%	2.9%	9.7%	10.0%
Net Loans / Deposits	71.1%	67.3%	74.1%	64.5%	72.0%	71.5%	73.0%
Net Interbank Borrowing / Total Assets	7.1%	11.5%	4.5%	3.4%	8.4%	8.3%	11.9%
NPL / Gross Loans	0.92%	N/A	1.01%	N/A	1.01%	1.05%	1.20%
Write-Offs / Gross Loans	0.04%	N/A	0.03%	N/A	0.01%	0.41%	0.48%
Loan Provisions / NPLs	364.0%	N/A	357.7%	N/A	370.0%	300.0%	225.0%
(Loan Provisions-NPLs) / Equity	9.4%	N/A	9.3%	N/A	8.9%	6.7%	5.0%
Net Commission Spread	2.18%	2.01%	2.32%	2.65%	2.32%	2.20%	2.08%
Net Commission Margin	2.48%	2.46%	2.76%	3.05%	2.85%	2.74%	2.60%
Growth in Net Commission Income	33.7%	31.2%	31.1%	26.5%	6.5%	1.5%	3.4%
Growth in Non Commission Income	71.6%	238.1%	108.9%	-68.3%	-57.8%	19.7%	13.6%
Growth in Expenses	18.7%	24.4%	28.9%	16.7%	13.4%	7.5%	9.5%
Growth in Provisions Made	-23.1%	100.0%	-3.5%	-62.5%	-69.8%	-15.8%	288.5%
Growth in Net Profit	81.3%	156.0%	88.5%	-43.3%	-40.3%	9.1%	1.5%
Cost / Income	23.2%	13.3%	17.7%	24.5%	29.5%	29.3%	29.9%
ROAE	24.7%	45.0%	35.5%	20.5%	18.0%	17.9%	16.8%
ROAA	3.2%	5.8%	4.9%	3.0%	2.9%	3.0%	2.8%
EPS	2.72	1.38	5.13	0.78	3.06	3.34	3.39
BVPS	13.57	14.38	15.35	16.12	16.91	18.58	19.81
DPS (Gross)	0.26	N/A	0.00	N/A	1.00	1.50	2.00

Sources: SAIB and EFG-Hermes estimates

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