

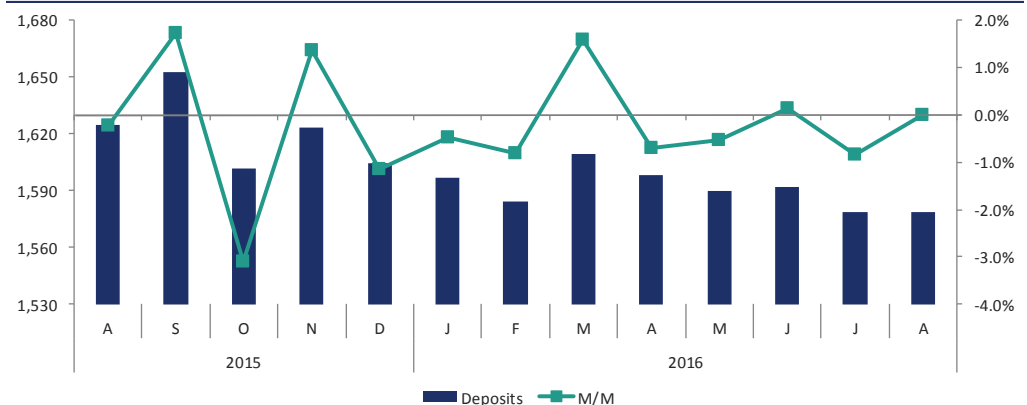
October 03, 2016

## SAUDI ARABIAN BANKS 3Q2016 Preview

### Shift in Deposits' Composition

Liquidity concerns continue to loom in the banking industry. Towards the end of the last quarter LDR climbed to 85% from 83% a quarter earlier and during the same period the 3-month SAIBOR jumped 42 bps. Recently, SAMA announced that it has taken measures to ease the situation by injecting SAR 20 billion in demand deposits, in addition to introducing longer maturities for repurchase agreements. This indicates a commitment to support financial stability in the banking system during a time of tight liquidity. By August 2016 deposits have declined by SAR 26.2 billion from the beginning of the year as the government has withdrawn SAR 23.8 billion. On the other hand, 3-month SAIBOR reached 2.35% in September but has stabilized now. The situation has not changed much in 3Q2016 although there is some relief from stabilizing SAIBOR rates.

**Exhibit 1: Banking Sector's Deposits (SAR bln) & M/M Growth (%)**

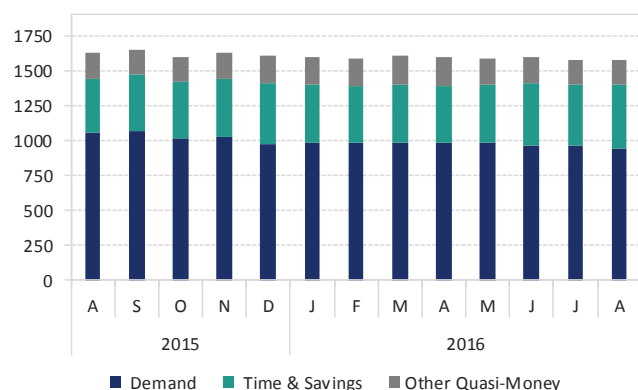


Source: SAMA

Deposits have been on the downtrend, recording a -1.6% drop year to date at SAR 1.58 trillion while declining -2.8% Y/Y in August. Government entities' net withdrawals reached SAR 23.8 billion this year, while on the other hand businesses and individuals deposited net SAR 2.8 billion. The impact of increasing interest rates is clear on businesses and individuals' (B&I) deposits. Demand deposits for B&I, which represents the majority, declined by SAR 44.6 billion YTD, while time and savings deposits increased by SAR 44.2 billion. It is worth mentioning that in line with liquidity pressures, banks have resorted to attracting more deposits through offering higher rates, raising funding costs in the process. In light of such figures, SAMA's deposit of SAR 20 billion is significant and would support liquidity in the banking system.

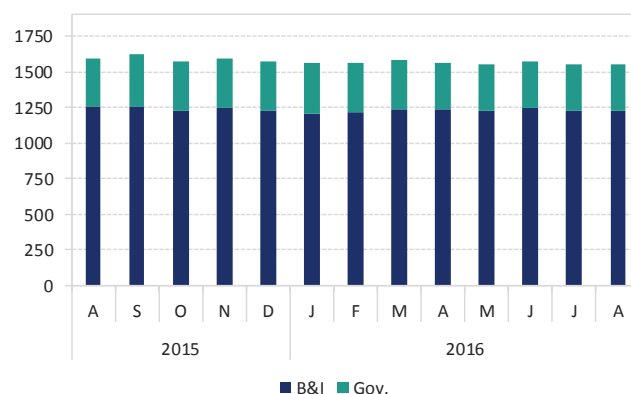
During the first two months of 3Q2016, deposits declined by SAR 13.2 billion, or -0.8% Q/Q. However the fall came as a result of a decline by -1.4% Q/Q in B&I's deposits, both demand and time & savings, while government entities' deposits grew slightly by 0.1%. 3-month SAIBOR has also stabilized around 2.34% recently, increasing by only 13 bps in 3Q2016 compared to a jump of 42bps and 25bps during 2Q and 1Q respectively. Taken as an indicator for liquidity, this is positive.

**Exhibit 2: Deposits' Breakdown by Type (SAR bln)**



Source: SAMA

**Exhibit 3: Deposits' Breakdown by Source (SAR bln)**



Source: SAMA

Demand deposits comprise the majority of banking deposits, providing a solid base for non-interest bearing funds that Saudi banks benefit from. At August-end, demand deposits have fallen to 60% of total deposits from 65% a year earlier when 3-month SAIBOR was at 0.86% (last year). Rising interest rate environment and the tight liquidity situation have combined to lead banks to compete for funds by offering higher rates on deposits, thus reducing the demand portion. During the same period, time and saving deposits' portion jumped to 29% of total deposits compared to 23% a year earlier. As of latest numbers available for end of August, nearly 78% of total deposits came from businesses and individuals (SAR 1,226 billion) while 21% came from government entities (SAR 325 billion). The breakdown has been fairly stable at these levels as seen in Exhibit 3.

### 3Q2016 Expectations

Table 1 below details our 3Q2016 forecasts for banking stocks under coverage. We expect an average +10% Y/Y increase in net special commission income (NSCI). Expansion in NIMs (due to higher Interest rates) coupled with growing advances should benefit banks topline. While the rise in SAIBOR has been slower in 3Q (13 bps) as compared to 2Q (42bps), it trades above 2.3%. Slowing rise in SAIBOR signals a somewhat better liquidity position in 3Q. On the back of rising expenses and a neutral to negative impact on non-core income, we expect the +10% increase in NSCI to have a muted impact in net income to the extent of +6% Y/Y. We have modeled in a higher provisioning charge for the quarter in line with market conditions. Despite having average provisions for 1H2016, we are modeling in higher provisioning in 3Q, a prelude to a possible jump in 4Q. For Al Rajhi, we forecast provisions of SAR 589 million in 3Q versus SAR 555 million in the preceding quarter and SAR 420 million last year while we believe SAR 100 million is reasonable for Saudi Hollandi as compared to SAR 87 million in 2Q. Similarly, expect a rise to SAR 110 million at SABB in 3Q versus SAR 103 million in the preceding quarter.

We expect overall deposits of our coverage universe to remain flat. It is likely that only Hollandi and Al Rajhi will post a Y/Y rise in deposits of +4% and +3% respectively. Offering better rates on its interest bearing time deposits, Hollandi has been able to attract money of late. We expect a -3% Y/Y decline in deposits at Saudi Fransi and SAMBA as competition intensifies in the sector.

Loan demand continues to be strong due to higher financing requirements in the face of limited liquidity in the system. We forecast an overall +4% Y/Y growth in advances. Al Rajhi is expected to lead at +9% Y/Y, followed by +6% Y/Y at Saudi Hollandi and Arab National Bank. Saudi Fransi may post a -6% Y/Y decline in advances.

Table 1: 3Q2016 Estimates (SAR mln)

Company	Net Comm Income			Net Income			Net Advances			Deposits		
	3Q2015	3Q2016E	Y/Y Chg	3Q2015	3Q2016E	Y/Y Chg	3Q2015	3Q2016E	Y/Y Chg	3Q2015	3Q2016E	Y/Y Chg
SHB	606	609	0%	493	498	1%	73,191	77,900	6%	82,697	86,414	4%
BSF	1,044	1,050	1%	1,020	1,032	1%	132,230	123,972	-6%	143,876	140,198	-3%
SABB	1,079	1,197	11%	1,140	1,158	2%	128,884	133,723	4%	155,586	151,771	-2%
ANB	995	1,081	9%	764	791	3%	112,747	119,056	6%	132,522	131,097	-1%
SAMBA	1,184	1,335	13%	1,371	1,310	-4%	127,149	131,474	3%	174,576	169,539	-3%
ALRAJHI	2,495	2,894	16%	1,721	2,138	24%	209,910	227,891	9%	265,480	273,667	3%
Group Total	7,403	8,166	10%	6,509	6,926	6%	784,110	814,016	4%	954,736	952,686	0%

Source: Riyad Capital, Company Reports

We have revised our target price for banks under coverage by between 15-20% after accounting for higher sector level risk. However, our recommendations remain the same with a Neutral stance on Al Rajhi and a Buy on the remaining five names. Most banks are now trading under book value as investors perceive stress on banks' earnings and book values towards the end of this year and next year on account of slowing economic growth.

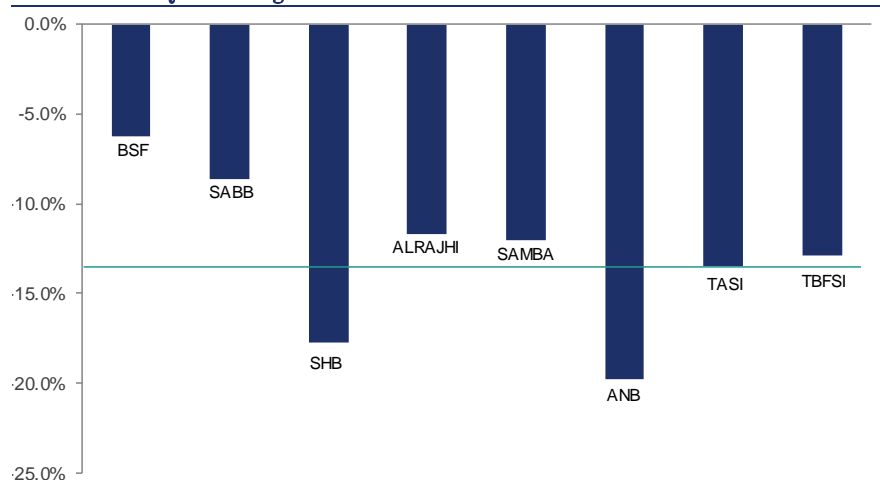
Table 2: Ratings and Valuations (SAR mln)

Company	TASI Code	Current Price	Market Cap	Target Price	Rating	Dividend Yield	P / E		P/B	
							2015	2016E	2015	2016E
SHB	1040	9.65	11,031	14.00	Buy	5.2%	5.5x	5.4x	0.9x	0.8x
BSF	1050	19.80	23,867	27.00	Buy	5.1%	5.9x	6.1x	0.9x	0.8x
SABB	1060	18.00	27,000	26.00	Buy	4.2%	6.2x	6.1x	1.0x	0.9x
ANB	1080	15.00	15,000	22.00	Buy	6.7%	6.1x	6.4x	0.7x	0.7x
SAMBA	1090	16.40	32,800	25.00	Buy	5.5%	6.3x	6.0x	0.8x	0.8x
ALRAJHI	1130	50.75	82,469	51.00	Neutral	3.0%	11.6x	11.3x	1.8x	1.7x
Group Average							6.9x	6.9x	1.0x	0.9x

Source: Riyad Capital

The Tadawul has had a tough 3Q with the TASI falling -13.5%. Besides ANB and SHB, other names on our list have outperformed, Valuations are increasingly attractive but market is waiting for some positive catalyst for upward movement. BSF and SABB have done well falling only -6.2% and -8.7% respectively versus a fall in the banking index (TBFSI) of -12.9%.

Exhibit 4: 3Q Banking Sector vs. TASI Performance



Source: Tadawul

## Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than 15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

*\* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors*

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