المجموعة المالية - هيرميس
EFG HERMES

# SAUDI INVESTMENT BANK

## Strong Growth in Core Banking Income

10 AUGUST 2008

SAUDI | BANKING

| | |
|---|---|
| ST Rec. : Neutral | Current Price*: SAR 30.5 |
| LT Rec. : Neutral | LT Fair Value : SAR 36.2 |

• **2Q2008 Earnings Ahead of Estimates:** Saudi Investment Bank's 2Q2008 net profit rose 26.3% Y-o-Y and 4.5% Q-o-Q to SAR285 million (EPS: SAR0.63). The announced earnings were almost 9% higher than our estimate of SAR257 million, primarily on account of lower-than-expected operating and provisioning costs. Total net income for 1H2008 stood at SAR538 million (EPS: SAR1.20), 1.2% Y-o-Y higher.

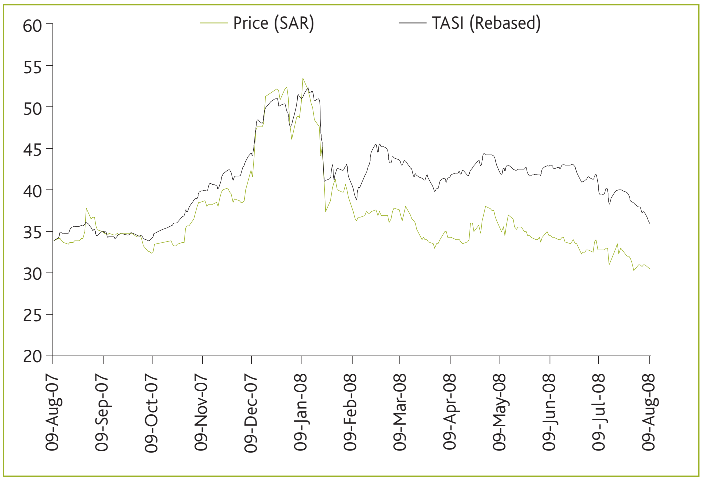
• **Core Banking Income Surges:** SAIB's renewed focus on growing its core banking operations has paid off, with net special commission income rising 40.8% Y-o-Y and 37.2% Q-o-Q to SAR350 million. The strong growth was supported by: i) strong growth in loans, which rose 42.6% Y-o-Y and 14.6% Q-o-Q to SAR28.1 billion, and ii) a 20 bps Q-o-Q improvement in spreads to 2.09%. The improvement in spreads, in our opinion, has primarily been driven by efficient asset allocation. Historically, SAIB had a higher proportion of assets tied up in the investment book (34% of total assets in 2007), which is now gradually changing as the bank deploys more of its liquidity for growing its investment book. Net loans as percentage of total assets stood at 54.1% in 4Q2007, up from 49.7% in 2Q2008. Net investments on the other hand remained largely stable at SAR15.2 billion, 0.1% Y-o-Y lower.

• **Investment Losses Continue to Depress Revenue Growth**: Despite the strong improvement in net special commission income, total income grew by 16.2% Y-o-Y and by a modest 1.0% Q-o-Q as investment losses continued to depress overall revenue growth. The loss on the trading and non-trading portfolio of the bank widened to SAR74 million in 2Q2008 from SAR29 million in 1Q2008. This led to a 45.5% Y-o-Y and 62.8% Q-o-Q decline in non-special commission income. However, other reserves of the bank, which primarily represents mark to market movements in available-for-sale securities, improved by SAR42 million, signifying an improvement in the carrying value of the investment securities.

• **Strong Cost Controls:** SAIB's total operating cost declined 2.4% Y-o-Y but rose 1.5% Q-o-Q to SAR114 million. We were expecting costs to increase to SAR120 million on account of higher salary and rent-related expenses. We believe that this is due to streamlining of the broking operations as the bank shifted its focus towards expanding its core banking operations. The cost-to-income ratio remained stable Q-o-Q at 28.3% but declined by over 500 bps from 33.7% in 2Q2007. Provisions against credit losses were reported at SAR5 million, flat Y-o-Y but 67% lower Q-o-Q and lower than our estimate of SAR20 million.

• **Maintain Neutral Stance:** We maintain our ST/LT Neutral recommendation on SAIB with a LT Fair Value of SAR36.2/share. While core banking operations and their contribution to revenues is improving, the lower investment returns will continue to depress profitability in the short term. Additionally, we believe that SAIB's historically high ROE (36% in 2006) was driven by exceptionally high investment returns and high broking income, both of which continue to remain under pressure. Sustainable core banking driven ROE is much lower (2008e ROE of 13.6) and hence justifies lower multiples.

## FLASH NOTE




| | 2008e | 2009e | 2010e |
|---|---|---|---|
| EPS | 2.17 | 2.52 | 2.95 |
| P/E* (x) | 14.08 | 12.11 | 10.33 |
| DPS | 0.43 | 0.50 | 0.59 |
| Div. Yield* | 1.4% | 1.7% | 1.9% |
| BVPS | 16.90 | 18.91 | 21.27 |
| P/BV* (x) | 1.81 | 1.61 | 1.43 |

Figures in SAR unless otherwise stated

| *Stock Data* | |
|---|---|
| *Last Ex-Div Date* | *N/A* |
| *Mkt. Val. (mn)* | *SAR 13,725* |
| *Shares (mn)* | *450.0* |
| *Av. Mthly Liqd. (mn)* | *SAR 211.9* |
| *52-Week High / Low* | *53.44 / 30.25* |
| *Bloomberg / Reuters* | *SIBC AB / 1030.SE* |
| *Est. Free Float* | *43.61%* |

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**prices as of 09 August 2008*

Table 1: Income Statement

| (SAR mn) | 2Q2007 | 1Q2008 | 2Q2008 | Y-o-Y | Q-o-Q |
|---|---|---|---|---|---|
| Special Commission Income | 598 | 592 | 624 | 4.3% | 5.5% |
| Special Commission Expense | 350 | 337 | 274 | -21.6% | -18.6% |
| **Net Special Commission Income** | **249** | **255** | **350** | **40.8%** | **37.2%** |
| | | | | | |
| **Non-Special Commission Income** | | | | | |
| Fees from Banking Services | 83 | 161 | 128 | 54.5% | -20.2% |
| Exchange Income | 7 | 13 | (0) | -102.8% | -101.7% |
| Investment Income | 8 | (29) | (74) | -988.6% | 160.1% |
| **Total Non-Special Commission Income** | **99** | **145** | **54** | **-45.5%** | **-62.8%** |
| | | | | | |
| **Total Income** | **347** | **400** | **404** | **16.2%** | **1.0%** |
| | | | | | |
| **Operating Expenses** | | | | | |
| Salaries & Related Expenses | 70 | 73 | 75 | 7.7% | 3.2% |
| Rent & Premises | 10 | 13 | 13 | 31.1% | 3.7% |
| Other Operating Expenses | 37 | 27 | 26 | -30.2% | -4.2% |
| **Total Operating Expenses** | **117** | **113** | **114** | **-2.4%** | **1.5%** |
| | | | | | |
| **Operating Profit** | **230** | **287** | **290** | **25.7%** | **0.8%** |
| Provision for Credit Losses | 5 | 15 | 5 | 0.0% | -66.7% |
| | 225 | 272 | 285 | 26.3% | 4.5% |
| Minority Interest | | | | | |
| **Net Income** | **225** | **272** | **280** | **24.2%** | **2.9%** |
| EPS (SAR) | 0.50 | 0.60 | 0.62 | | |
| | | | | | |
| **Ratios** | | | | | |
| Net Interest Spreads | 2.26% | 1.89% | 2.09% | | |
| Non Special Commission Inc/Total Income | 28.4% | 36.2% | 13.3% | | |
| Cost-to-Income | 33.7% | 28.2% | 28.3% | 5.39% | |

Source: Saudi Investment Bank, EFG-Hermes

Table 2: Balance Sheet

| (SAR mn) | 2Q2007 | 1Q2008 | 2Q2008 | Y-o-Y | Q-o-Q |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and Balances with SAMA | 815 | 1,232 | 1,861 | 128.2% | 51.0% |
| Due from Banks & Fis | 3,461 | 3,693 | 5,190 | 50.0% | 40.6% |
| Investments | 15,167 | 15,106 | 15,159 | -0.1% | 0.4% |
| Loans & Advances | 19,728 | 24,563 | 28,140 | 42.6% | 14.6% |
| Fixed Assets | 366 | 442 | 469 | 27.9% | 5.9% |
| Other Assets | 903 | 1,086 | 1,116 | 23.6% | 2.8% |
| **Total Assets** | **40,441** | **46,123** | **51,934** | **28.4%** | **12.6%** |
| | | | | | |
| **Liabilities** | | | | | |
| Customer Deposits | 27,695 | 33,079 | 36,863 | 33.1% | 11.4% |
| Due to Banks & Fis | 3,874 | 3,924 | 5,635 | 45.4% | 43.6% |
| Debt Securities Issued | 999 | 889 | 878 | -12.1% | -1.2% |
| Other liabilities | 1,425 | 1,425 | 1,425 | 0.0% | 0.0% |
| **Total Liabilities** | **33,993** | **39,316** | **44,801** | **31.8%** | **14.0%** |
| | | | | | |
| **Shareholders' Equity** | | | | | |
| Share Capital | 3,910 | 4,500 | 4,500 | 15.1% | 0.0% |
| Reserves | 2,538 | 2,292 | 2,615 | 3.0% | 14.1% |
| **Total Equity** | **6,448** | **6,792** | **7,115** | **10.3%** | **4.7%** |
| | | | | | |
| **Total Equity & Liabilities** | **40,441** | **46,109** | **51,916** | **28.4%** | **12.6%** |

Source: Saudi Investment Bank, EFG-Hermes

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