

# Al Rajhi Bank (RJHI)

**HOLD**  
TP SAR53.5  
-7%

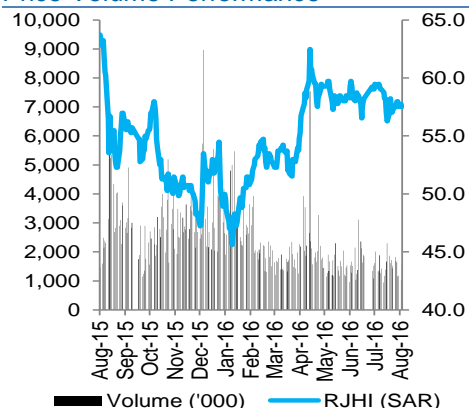
## Market Data

Bloomberg Code:	RJHI AB
Reuters Code:	1120.SE
CMP (15 Aug, 2016):	SAR 57.6
O/S (mn)	1,625.0
Market Cap (SAR mn):	93,435.0
Market Cap (USD mn):	24,916.7
52 Week High (SAR)	63.3
52 Week Low (SAR)	44.7
3m ADVT (USD mn)	2,460

## Price Performance

	1m	3m	12m
Absolute (%)	-3.0	-3.8	-9.8
Relative (%)	1.6	1.9	17.0

## Price Volume Performance



Source: Bloomberg

**Naveed Ahmed, CFA**  
Assistant Vice President  
nahmed@global.com.kw  
Tel.: (965) 22951280

Please see penultimate page for additional important disclosures. Global Investment House (K.P.S.C.) ("Global") is a foreign broker-dealer unregistered in the USA. Global research is prepared by research analysts who are not registered in the USA. Global research is distributed in the USA pursuant to Rule 15a-6 of the Securities Exchange Act of 1934 solely by Rosenblatt Securities Inc, an SEC registered and FINRA-member broker-dealer.

[www.globalinv.net](http://www.globalinv.net)

- Satisfactory 2Q16 result with moderate profit growth
- Current dividend payout levels to sustain
- Downgrade to HOLD from BUY on higher valuations

**We have downgraded the stock to HOLD from BUY on higher valuations.** Our fair value for RJHI comes at SAR53.5/share, which is 7% below the bank's current market price of SAR57.6/share as on August 15, 2016. Also, RJHI is one of the most expensive banks in Saudi Arabia and in the GCC; the stock trades at a significant upside to the market 2016e P/BV of 1.9x vs the sector's 1.2x indicate a potential downside rather than an attractive investment opportunity.

**RJHI's loan book is worst placed to take advantage of the rise in interest rates from amongst our coverage.** With 80% of its book skewed towards the retail segment, RJHI's yield on assets will be slowest to respond to rising interest rates given that retail loans are mostly fixed. RJHI can however overcome this by shifting its book to the corporate side. We have already observed RJHI's corporate book jumping by a massive 20%YTD in 2Q16 whereas overall loan book grew by a lower 7%YTD, translating into a 220bps change in the loan mix over the last 2 quarters.

**Cost of funds is increasing and reducing the cushion it normally offers NIMs.** RJHI's cost of fund is the lowest among its Saudi peers and also the lowest within our banking universe. This is primarily ascribed to the large zero-cost demand deposit base (more than 91% of total deposit). In 2Q16, the cost of fund was at 0.20%, up from just 12bps for full year 2015; we expect it to increase to 0.33% in 2018e.

**We have revised downwards our 2016e estimates for the bank;** owing it to slower loans growth expectations and tighter NIMs, we have trimmed our net financing income estimate by 8%. Resultantly, our net income estimates have been reduced by 12%. We have also decreased our financing and deposit estimates by 7.4% and 9.9%, respectively.

## Investment Indicators

	2014	2015	2016e	2017e	2018e
NII	9,817	9,959	10,712	11,641	12,767
NFI	3,850	3,787	4,163	4,413	4,635
Net Income	6,836	7,130	7,644	8,321	9,010
PE	16.3x	11.9x	12.2x	11.3x	10.4x
P/B	2.8x	1.9x	1.9x	1.8x	1.6x
RoE	17.9%	17.0%	16.5%	16.4%	16.2%

Source: Global Research

### Valuation update – Downgrade to HOLD from BUY

We have reduced our fair value estimate for RJHI from SAR61.7/share to SAR53.5/share, thereby prompting us to downgrade the stock to HOLD from BUY with a downside potential of 7% from the bank's current market price of SAR57.6/share as on 15 August, 2016. We assumed the risk-free rate (US 10-year Treasury yield) at 1.6% and risk premium at 9.1%, including the country- and stock-specific risk.

We expect the bank's ROE to average at 16.4% over our forecast horizon which is a major reduction from 21.6% in 2013. This emanates from our expectations of a slower growth in the bank's top-line and our cautious assessment of its asset quality. On a positive note, the bank is somewhat shielded from delinquencies in the corporate segment since its loan book is skewed towards retail loans, however it is about time when delinquencies in the retail segment also follow suit. We therefore expect a rise in provisions over the forecast horizon which would offset the operating income gains. Presently, the bank is trading at a 2016 P/E of 12.2x and P/BV of 1.9x, as compared to sector average of 9.2x and 1.2x which shows that the stock is trading at a significant premium to its peers.

### 2016e estimates have been revised downward

We have revised our estimates for most of the line items from the balance sheet and income statement after the release of the bank's 2Q16 results. We have reduced our 2016e gross loans estimate by 7.4% and deposits estimate by 9.9%, as we believe, due to the falling oil and tighter growth in the economy, lending and deposits growth would be slower. We have reduced our net interest income forecast by 8% due to moderate lending growth and tighter NIMs. Operating income projection was revised down by 6%.

We have raised our provision expectations by 4.1% as we assume higher build-up of provisions due to slowdown in the economy; all these lead to a 12.5% reduction in the bank's bottom-line for 2016e.

#### Estimates Revision - 2016e

(SAR mn)	Earlier Estimates	Revised Estimates	% Change
Gross Loans	259,043	239,750	-7.4%
Deposits	308,538	278,070	-9.9%
NII	11,641	10,712	-8.0%
Operating Income	15,827	14,875	-6.0%
Provision for loan losses	2,072	2,158	4.1%
Net Profit	8,734	7,644	-12.5%

Source: Global Research

### Risks to valuation

- Liquidity shortage: Liquidity shortage in the Kingdom may jack up interbank rates further driving up the cost of funds of the bank while competitive pressures require the bank to maintain its yield on assets/financings. This would lead to shrinkage in NIMs and therefore profitability and valuations.
- Loans growth: While we have been fairly conservative in our estimates for loans growth, any major deviation from our estimates is likely to shift our views negatively if the deviation is on the lower side and vice versa.
- Asset deterioration/cost of risk: Our model assumes lower cost of risk over the forecast horizon as compared to the recent past (average of 93bps vs 129bps). Any buildup in

provisions higher than what we expect will erode the bank's profitability and ROE; this will prompt us to revise our valuation downwards.

### 2Q16 net profit recorded a 5.7%YoY rise

RJHI reported a 5.7%YoY growth in net profit in 2Q16, primarily due to the rise in the total operating income of the bank. The bank's net and non-interest income both rose during the quarter, which partially offset the rise in provisions and operating expenses.

Notably, the bank's net financing and investment in 2Q16 rose 9.6%YoY, while non-interest income grew 12%YoY. Fee income was up by a massive 28.7%YoY. Strong growth in net-interest income was driven by a stable loan growth of 6.6%YoY; furthermore, the bank's NIM improved by 24bps YoY during the quarter. The bank's yield grew 33bps YoY, while cost of fund grew 9bps YoY leading to an overall rise in NIM's by 24bps on a YoY basis. The bank's provisions grew 26.6%YoY in 2Q16 while other operating expenses saw an addition of 11.5%.

Balance sheet growth of the bank was mixed during the quarter. Net loans growth was stable during the quarter which rose 6.6%YoY. However, deposits growth was subdued at 0.6%YoY. Slow growth in deposits can be attributed to a tougher operating environment as persistently low oil prices and tight fiscal measures weigh on the economy. Notably, lending growth was driven by the corporate segment (+20%YTD) while retail loans grew just 4%YTD.

RJHI continued to improve its asset quality ratios on a QoQ basis with a decline in the NPL ratio which dropped to 1.43% in 2Q16 from 1.65% in 1Q16; the figure is still higher as compared to 1.24% in 2Q15. Similarly, NPL coverage has improved on a QoQ basis (195% in 2Q16 from 163% in 1Q16) but declined on a YoY basis (195% in 2Q16 from 197% in 2Q15).

#### Income Statement

(SAR mn)	2Q16	2Q15	YoY%	1Q16	QoQ%
Interest Income	2,891	2,587	11.8%	2,700	7.1%
Interest Expense	134	73	84.9%	126	6.9%
<b>Net Interest Income</b>	<b>2,757</b>	<b>2,514</b>	<b>9.6%</b>	<b>2,574</b>	<b>7.1%</b>
Fee & Commission Income	847	658	28.7%	830	2.0%
Exchange Income	248	240	3.3%	244	1.9%
Other Income	48	122	-60.6%	47	3.0%
Non-Interest Income	1,143	1,021	12.0%	1,121	2.0%
<b>Total Operating Income</b>	<b>3,900</b>	<b>3,535</b>	<b>10.3%</b>	<b>3,695</b>	<b>5.5%</b>
Provisions Expense	592	467	26.6%	537	10.1%
Operating Expenses	1,256	1,126	11.5%	1,140	10.1%
<b>Net Profit</b>	<b>2,052</b>	<b>1,941</b>	<b>5.7%</b>	<b>2,017</b>	<b>1.7%</b>

Source: Company Accounts

	(SAR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement	Gross Financing & Investment Income	10,115	10,213	10,258	11,295	12,294	13,576	14,961
	Income paid	(466)	(395)	(299)	(584)	(653)	(809)	(924)
	<b>Financing and Investment income, net</b>	<b>9,649</b>	<b>9,817</b>	<b>9,959</b>	<b>10,712</b>	<b>11,641</b>	<b>12,767</b>	<b>14,037</b>
	Fees from banking services, net	2,937	2,738	2,704	2,996	3,167	3,301	3,489
	Other Investment Income (Sale of vehicles)	-	-	-	-	-	-	-
	Dividend, Other and Forex Income	1,259	1,111	1,083	1,167	1,246	1,333	1,400
	<b>Total Non-Commission Income</b>	<b>4,196</b>	<b>3,850</b>	<b>3,787</b>	<b>4,163</b>	<b>4,413</b>	<b>4,635</b>	<b>4,889</b>
	<b>Total Operating Income</b>	<b>13,845</b>	<b>13,667</b>	<b>13,746</b>	<b>14,875</b>	<b>16,054</b>	<b>17,401</b>	<b>18,926</b>
	Total Operating Expenses	(4,057)	(4,519)	(4,658)	(5,073)	(5,468)	(5,899)	(6,365)
	Impairment charge for financing & other, net	(2,350)	(2,312)	(1,958)	(2,158)	(2,266)	(2,492)	(2,617)
<b>Profit Before Taxation</b>	<b>7,438</b>	<b>6,836</b>	<b>7,130</b>	<b>7,644</b>	<b>8,321</b>	<b>9,010</b>	<b>9,945</b>	
Sale of associate (net)	-	-	-	-	-	-	-	
Minority interest	-	-	-	-	-	-	-	
<b>Net Profit Attributable to Parent</b>	<b>7,438</b>	<b>6,836</b>	<b>7,130</b>	<b>7,644</b>	<b>8,321</b>	<b>9,010</b>	<b>9,945</b>	
Balance Sheet	Cash & balances with SAMA	29,970	33,585	27,054	32,068	38,092	40,117	45,292
	Due from banks & other FIs	15,463	16,516	26,911	28,257	31,647	26,900	32,280
	Investments	39,573	42,550	39,877	35,861	38,083	40,494	42,619
	Gross Loans & Financings	191,132	211,134	215,991	239,750	251,738	276,912	290,757
	Loan Loss Reserve	(4,319)	(5,194)	(5,773)	(7,931)	(10,197)	(12,689)	(15,306)
	Financing, net	186,813	205,940	210,218	231,819	241,541	264,223	275,451
	Investment in Associates	-	-	-	-	-	-	-
	Investments Properties	-	-	-	-	-	-	-
	Property & equipment, net	4,320	4,814	6,929	7,806	8,789	9,890	11,123
	Other Assets, net	3,731	4,306	4,631	4,909	5,204	5,516	5,847
	<b>Total Assets</b>	<b>279,871</b>	<b>307,712</b>	<b>315,620</b>	<b>340,720</b>	<b>363,357</b>	<b>387,140</b>	<b>412,613</b>
	Due to banks & other FIs	3,640	2,135	4,558	3,012	3,162	3,321	3,487
	Customer Deposits (inc. other customer acc)	231,589	256,077	256,228	278,070	295,466	313,684	333,047
	Other Borrowings	-	-	-	-	-	-	-
	Other Liabilities	6,144	7,603	8,195	8,604	9,035	9,486	9,961
	Share capital	15,000	16,250	16,250	16,250	16,250	16,250	16,250
	Retained earnings	4,086	4,829	8,666	12,297	16,125	20,179	24,655
	Other Reserve	19,411	20,817	21,723	22,487	23,319	24,220	25,215
	Total Shareholders' Equity	38,498	41,896	46,639	51,034	55,694	60,650	66,119
Minority Interest	-	-	-	-	-	-	-	
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>279,871</b>	<b>307,712</b>	<b>315,620</b>	<b>340,720</b>	<b>363,357</b>	<b>387,140</b>	<b>412,613</b>	
Ratio Analysis	Return on Average Assets	2.7%	2.3%	2.3%	2.3%	2.4%	2.4%	2.5%
	Return on Average Equity	21.6%	17.9%	17.0%	16.5%	16.4%	16.2%	16.3%
	Recurring Income/Operating Income	90.9%	91.9%	92.1%	92.2%	92.2%	92.3%	92.6%
	Interest Earning/Financing Assets Yield	4.3%	4.0%	3.8%	4.0%	4.1%	4.3%	4.4%
	Cost of Funds	0.2%	0.2%	0.1%	0.2%	0.2%	0.3%	0.3%
	Net Spread	4.1%	3.9%	3.7%	3.8%	3.9%	4.0%	4.1%
	Cost to Income Ratio	29.3%	33.1%	33.9%	34.1%	34.1%	33.9%	33.6%
	Net Loans to Customer Deposits	80.7%	80.4%	82.0%	83.4%	81.7%	84.2%	82.7%
	Non Performing Loans	3,008	2,656	3,267	3,836	4,280	4,707	4,943
	Loan Loss Reserve	4,319	5,194	5,773	7,931	10,197	12,689	15,306
	NPLs to Gross Loans	1.6%	1.3%	1.5%	1.6%	1.7%	1.7%	1.7%
	NPL Coverage	143.6%	195.6%	176.7%	206.8%	238.3%	269.5%	309.7%
	Provisions/Total Income	17.0%	16.9%	14.2%	14.5%	14.1%	14.3%	13.8%
	Cost of Risk (bps)	142.4	132.6	112.7	94.7	92.2	94.3	92.2
	Equity to Gross Loans	20.1%	19.8%	21.6%	21.3%	22.1%	21.9%	22.7%
	Equity to Total Assets	13.8%	13.6%	14.8%	15.0%	15.3%	15.7%	16.0%
	DPS	2.8	2.2	2.0	2.0	2.3	2.5	2.8
	Dividend Yield	4.1%	3.2%	3.9%	3.5%	3.9%	4.3%	4.8%
	Dividend Payout Ratio	60.5%	52.6%	46.1%	42.5%	44.0%	45.0%	45.0%
Adjusted EPS (SAR)	4.6	4.2	4.4	4.7	5.1	5.5	6.1	
Adjusted BVPS (SAR)	22.3	24.6	27.2	29.9	32.8	35.8	39.2	
Market Price (SAR)*	67.4	68.4	52.1	57.6	57.6	57.6	57.6	
P/E Ratio (x)	14.7	16.3	11.9	12.2	11.3	10.4	9.4	
P/BV Ratio (x)	3.0	2.8	1.9	1.9	1.8	1.6	1.5	

Source: Company Reports & Global Investment House

\* Market price for 2016 and subsequent years as per closing prices on 15 August, 2016

## Disclosure

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

### Disclosure Checklist

Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Al Rajhi Bank	HOLD	RJHI AB	1120.SE	SAR 57.62	1,10

1. Global Investment House did not receive and will not receive any compensation from the company or anyone else for the preparation of this report.
2. The company being researched holds more than 5% stake in Global Investment House.
3. Global Investment House makes a market in securities issued by this company.
4. Global Investment House acts as a corporate broker or sponsor to this company.
5. The author of or an individual who assisted in the preparation of this report (or a member of his/her household) has a direct ownership position in securities issued by this company.
6. An employee of Global Investment House serves on the board of directors of this company.
7. Within the past year, Global Investment House has managed or co-managed a public offering for this company, for which it received fees.
8. Global Investment House has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
9. Global Investment House expects to receive or intends to seek compensation for investment banking services from this company in the next three month.
10. Please see special footnote below for other relevant disclosures.

### Global Research: Equity Ratings Definitions

Global Rating	Definition
STRONG BUY	Fair value of the stock is >20% from the current market price
BUY	Fair value of the stock is between +10% and +20% from the current market price
HOLD	Fair value of the stock is between +10% and -10% from the current market price
SELL	Fair value of the stock is < -10% from the current market price

## Disclaimer

*This material was produced by Global Investment House KPSC ('Global'), a firm regulated by the Central Bank of Kuwait and the Capital Markets Authority (Kuwait). This document is not to be used or considered as an offer to sell or a solicitation of an offer to buy any securities. Global may, from time to time to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities ('securities'), perform services for or solicit business from such issuer, and/or have a position or effect transactions in the securities or options thereof. Global may, to the extent permitted by applicable Kuwaiti law or other applicable laws or regulations, effect transactions in the securities before this material is published to recipients. Information and opinions contained herein have been compiled or arrived by Global from sources believed to be reliable, but Global has not independently verified the contents of this document. Accordingly, no representation or warranty, express or implied, is made as to and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. Global accepts no liability for any loss arising from the use of this document or its contents or otherwise arising in connection therewith. This document is not to be relied upon or used in substitution for the exercise of independent judgment. Global shall have no responsibility or liability whatsoever in respect of any inaccuracy in or omission from this or any other document prepared by Global for, or sent by Global to any person and any such person shall be responsible for conducting his own investigation and analysis of the information contained or referred to in this document and of evaluating the merits and risks involved in the securities forming the subject matter of this or other such document. Opinions and estimates constitute our judgment and are subject to change without prior notice. Past performance is not indicative of future results. This document does not constitute an offer or invitation to subscribe for or purchase any securities, and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. Neither this report nor any copy hereof may be distributed in any jurisdiction outside Kuwait where its distribution may be restricted by law. Persons who receive this report should make themselves aware of and adhere to any such restrictions. By accepting this report you agree to be bound by the foregoing limitations.*



**Global Investment House**  
Website: [www.globalinv.net](http://www.globalinv.net)  
Global Tower  
Sharq, Al-Shuhada Str.  
Tel. + (965) 2 295 1000  
P.O. Box: 28807 Safat, 13149 Kuwait

**Research**

Naveed Ahmed, CFA  
(965) 2295-1280  
[nahmed@global.com.kw](mailto:nahmed@global.com.kw)

**Wealth Management**

Rasha Al-Qenaei  
(965) 2295-1380  
[alqenaei@global.com.kw](mailto:alqenaei@global.com.kw)

**Global Kuwait**

Tel: (965) 2 295 1000  
P.O.Box 28807 Safat, 13149  
Kuwait

**Global Bahrain**

Tel: (973) 17 210011  
P.O.Box 855 Manama, Bahrain

**Global UAE**

Tel: (971) 4 4477066  
P.O.Box 121227 Dubai,  
UAE

**Global Egypt**

Tel: (202) 24189705/06  
24 Cleopatra St., Heliopolis,  
Cairo

**Global Saudi Arabia**

Tel: (966) 1 2994100  
P.O. Box 66930 Riyadh 11586,  
Kingdom of Saudi Arabia

**Global Jordan**

Tel: (962) 6 5005060  
P.O.Box 3268 Amman  
11180,  
Jordan

**Global Wealth Manager**

E-mail: [global@global.com.kw](mailto:global@global.com.kw)