April 4, 2017

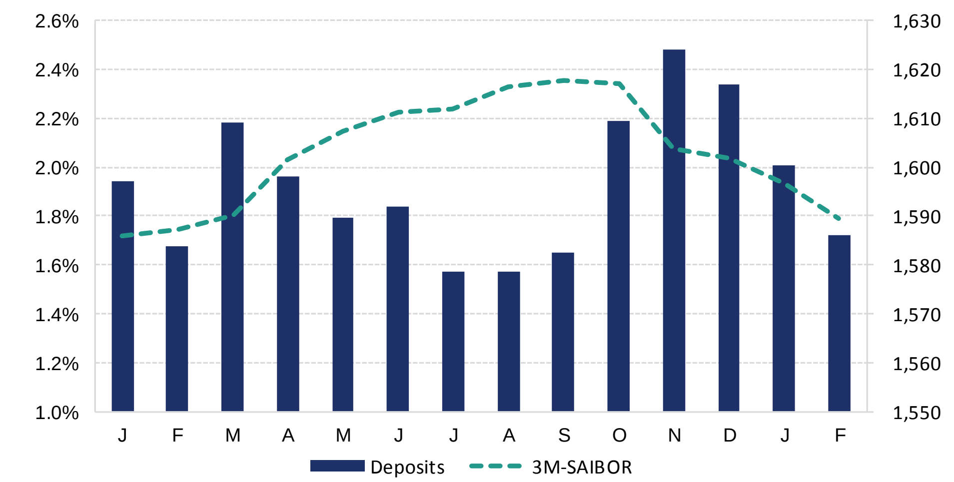
SAUDI ARABIAN BANKS

1Q2017 Preview

Contradicting Signs

The banking sector ended 2016 with a decline in SAIBOR and a slight increase in deposits and loans. By year-end, 3-month SAIBOR reached 2.04% falling from 2.38% in September. LDR remains stable at 81% for the sector, with SAMBA at the lowest (73%). The NPL portfolio for the banks has increased as expected while write-offs did not witness a spike. At the same time, provisions growth outpaced that of NPL's leading to an increase in the coverage ratio from 173% in 2015 to 178% in 2016, thus relieving some of the major concerns about the quality of the assets. 2016 ended with signs of improving liquidity, however, the first two months of 2017 provided mixed signals. Since the beginning of the year and up to February, 3-month SAIBOR has declined by 25 bps, indicating a continuous improvement in liquidity. However, deposits have witnessed a massive decline, suggesting the opposite. Moving into 2017, we believe banks face a different challenge than 2016, loan growth given a subdued loan demand outlook and banks' more cautious approach.

Exhibit 1: 3-Month SAIBOR & Banking Sector Deposits



Source: Bloomberg

3-month SAIBOR has continued its downtrend in 2017, declining by 30 bps to 1.74%, clearly indicating that pressure on liquidity continued to ease off. However, deposit levels have another story to tell. They have declined by SAR 31 bln YTD in February, a significant amount given that the largest drop in 2016 was at SAR 26 bln. It seems that banks are pricing in a better outlook for liquidity going forward. The recent interest rate hike by the Fed, and the subsequent rise of the reverse repo rate by SAMA, has supported SAIBOR in the face of its declining trend but to a limited extent. Further, US Fed hikes are likely to provide another boost to interest rates.

Sector's NPLs have grown by SAR 1.9 bln in 2016 (+12% Y/Y) while provisions grew by SAR 4.2 bln (+15% Y/Y), pushing the coverage ratio to 178% from 173% in 2015. The NPL ratio has edged up slightly to 1.2% compared with 1.1% in 2015. Provisions are likely to continue their rise but at a slower pace than 2016.

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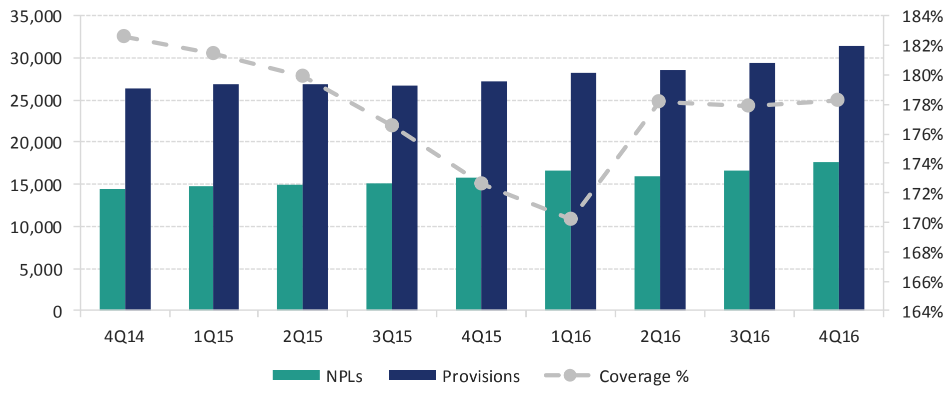
Exhibit 2: Banking Sector's NPLs, Provisions (SAR mln) and NPL Coverage (%)



Source: company filings

1Q2017 Expectations

Our 1Q2017 forecasts for banking names under coverage are detailed in Table 1 below. We forecast net special commission income (NSCI) to rise by an average of +10% Y/Y for the seven stocks we cover. With the rise in SAIBOR, NIMs have expanded over the last few quarters. Thus, Y/Y comparison looks good but Q/Q NIMs are likely to have shrunk with 3-month SAIBOR trading close to 1.73%, down from its peak of 2.36% in September 2016. However, net income comparison is less attractive with an average -3% Y/Y decline for our coverage. Non-interest income, in particular fee-based and exchange income, are no longer what they used to be. We have seen a steady decline commencing from 2Q2016 to a new normal, much below earlier. Resultantly, Y/Y decline in other income is likely to be the main culprit pushing down bottom-line.

After recording elevated provisions in 4Q2016, particularly by Alawwal, BSF and SABB; 1Q2017 is unlikely to be a huge negative surprise. Banks generally become more aggressive on provisioning towards year-end. While Alawwal recorded provisions of over SAR 1 billion in 2H2016, we expect SAR 95 million in 1Q2017, in line with SAR 101 million in 1Q2016. BSF had to accrue SAR 636 million in the preceding quarter to clean up. We expect slightly higher Y/Y provisions of SAR 51 million versus SAR 42 million last year. ANB has been relatively safe so far with no extraordinary provisions last year, which we do not expect to change at least in 1Q.

Deposits are expected to grow by +2% Y/Y led by Alinma with a +20% Y/Y rise. Alinma has grown deposits impressively last year, despite difficult conditions, but this has come at a significant cost. BSF has also managed to augment deposits in 4Q and we expect a +10% Y/Y increase to a total of SAR 156 billion. Al Rajhi is also growing deposits despite commanding a large base. On the other hand, SABB has been bleeding money with total deposits forecasted to stand at SAR 138 billion at 1Q2017 versus SAR 152 billion last year.

Net advances are expected to grow marginally with an average rise of +1% Y/Y for our coverage. Alinma will also be a leader in loan growth with an expected increase of +18% Y/Y followed by Al Rajhi at +6%. Loan demand has slowed down after liquidity improved from 4Q last year as delayed payments were made to companies. We forecast others to contract their loan portfolio led by SABB with a decline of -12% Y/Y.

Table 1: 1Q2017 Estimates (SAR mln)

Company	Net Comm Income			Net Income			Net Advances			Deposits		
	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E	Y/Y Chg	1Q2016	1Q2017E	Y/Y Chg
ALAWWAL	597	675	13%	512	491	-4%	78,370	77,085	-2%	85,549	85,976	0%
BSF	1,049	1,080	3%	1,078	990	-8%	124,976	131,468	5%	141,819	156,001	10%
SABB	1,117	1,224	10%	1,142	1,009	-12%	129,983	121,701	-6%	151,528	138,496	-9%
ANB	962	1,019	6%	752	690	-8%	116,040	115,698	0%	132,032	135,992	3%
SAMBA	1,252	1,296	4%	1,260	1,203	-5%	132,359	124,891	-6%	178,326	169,410	-5%
ALRAJHI	2,574	2,953	15%	2,017	2,130	6%	216,394	228,324	6%	264,783	272,726	3%
ALINMA	589	701	19%	391	424	8%	60,250	71,110	18%	68,785	82,542	20%
Group Total	8,141	8,948	10%	7,152	6,937	-3%	858,372	870,277	1%	1,022,821	1,041,144	2%

Source: Riyad Capital, Company Reports

We maintain our target prices and recommendations for now. Valuations are mixed as names such as BSF and ANB trade below book values and offer decent dividend yields, prompting us to continue a Buy stance. Al Rajhi and Alinma are trading at rich valuations as compared to peers.

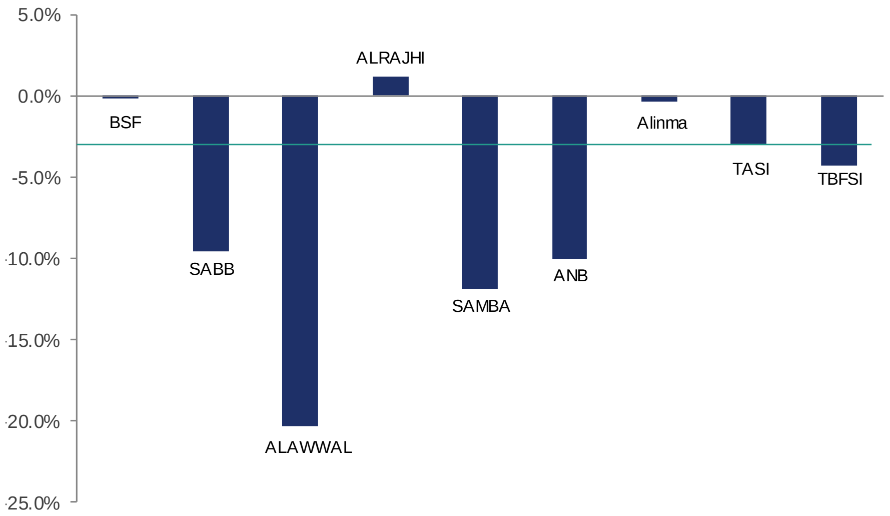
Table 2: Ratings and Valuations (SAR mln)

Company	TASI Code	Current Price	Market Cap	Target Price	Rating	Dividend Yield	P / E		P/B	
							2016	2017E	2016	2017E
ALAWWAL	1040	11.15	12,745	14.00	Neutral	4.5%	12.0x	6.9x	1.0x	0.9x
BSF	1050	25.80	31,099	33.00	Buy	4.1%	8.9x	7.9x	1.0x	0.9x
SABB	1060	22.05	33,075	27.00	Neutral	3.6%	8.5x	8.1x	1.1x	1.0x
ANB	1080	19.55	19,550	25.00	Buy	5.6%	7.7x	7.1x	0.9x	0.8x
SAMBA	1090	21.00	42,000	25.00	Neutral	4.5%	8.4x	8.6x	1.0x	0.9x
ALRAJHI	1120	63.50	103,188	62.00	Neutral	3.1%	12.7x	12.4x	2.0x	1.9x
ALINMA	1150	14.95	22,425	14.00	Neutral	3.7%	15.0x	13.7x	1.2x	1.1x
Group Average							10.4x	9.3x	1.2x	1.1x

Source: Riyad Capital

The banking index underperformed the broader market this quarter on the back of disappointing 4Q announcements by some banks during January and have been unable to recover since. ANB, Samba, Alawwal and SABB have underperformed both the market and peers. ANB underperformance of the market in 1Q makes it attractive on valuations (0.8x 2017E P/B and 7.1x forward P/E) and offers around 5.6% dividend yield.

Exhibit 3: 1Q 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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