

4th Quarter Preview: Rates Power Higher

In our sector initiation report 'Marhaba to Rising Rates' we predicted that 2016 would be a watershed year for the KSA banking sector with: lower deposit and credit growth, lower opportunities for generating fee income, cost of risk bottoming-out and mostly from higher rates on tighter liquidity and US Fed monetary policy tightening. Due to lower than expected oil prices, these changes are manifesting earlier than expected in 4Q2015. Over the quarter (to date, 22nd December, 2015), 3m and 12m SAIBOR have risen by 57bps and 63bps respectively. Historically, market declines in KSA have been the result of demand-deficiency induced falls in oil prices as the global economy struggles, and thus KSA banks contend with dual challenges of contracting NIM and higher cost of risk. However, with NIM likely to expand for the sector over the next few years, we believe that the market is under-valuing the sector. We continue to prefer Samba, SABB and ARNB.

US Fed raises FFR for first time in almost a decade: The US Fed delivered a 25 bps hike to the Fed Funds Rate (FFR) in its December meeting. This is the first hike delivered by the US Fed in almost a decade. The accompanying message was that the future path of monetary tightening was very much to be gradual and 'data-dependent.' As a result of government bond issuance, lower oil prices and the Fed rate hike, over the quarter (to date, 22nd December, 2015) 3m and 12m SAIBOR have risen by 57bps and 63bps respectively. Average 3m SAIBOR for the QTD stands at 1.06%, versus 0.865% YTD and 0.889% in 4Q2014.

Deposit growth likely to have slowed further in 4Q2015: While asset yield should be bolstered by the c. 20 bps average increase in SAIBOR, the NIM outlook is complicated by liquidity tightening in the sector as well as seasonal factors. According to SAMA monthly monetary data up to Oct 2015, there has been a sharp uptick in time deposits as 1) banks compete for deposits for the year end, and 2) attempt to lock in funds at current rates with the expectation that rates will rise further in the future. At the end of 3Q2015, time deposits made up 24.6% of total deposits (against low of 22.2% made in April 2015), which ticked up to 25.2% in Oct 2015. Furthermore, weekly money supply data (typically quite volatile) up to Dec 10th suggests that time deposits have ticked even higher, as narrow money (M1) falls at a faster pace than broad money (M2). Our estimate based upon the weekly data stands at above 27%.

Lending growth also trending lower: Lending by the sector has slowed appreciably this year, and according to SAMA data loan growth slowed to 3.9% Y/Y in Oct 2015, decelerating sharply from 11% and 11.9% in 2013 and 2014 respectively. Generally across listed sectors we are not seeing such a sharp decline in demand for loans, thus this decline may primarily be driven by a reduction in the banking sector's appetite for credit in the current economic environment.

Oil prices have plummeted below our forecasts, credit risk has risen: This quarter has seen oil prices plummet and anecdotally government restrain spending. The fall has been greater than forecast in our initial model. We are maintaining our below trend forecasts for growth in all key drivers, but are raising on our forecasts for credit provisioning by the sector in 4Q 2015.

Sector has underperformed TASI over the last 3 months and Y/Y: The KSA banking sector has typically underperformed the index when the broad market has been weak. This trend has continued in the current quarter, where SASEBNK has underperformed the market by 3 ppt QTD, with BJAZ, ARNB and SIBC as the 3 biggest decliners. On a Y/Y basis, declines are led by BJAZ (losing almost half its value) and SABB, Alinma and ALBI (all losing a third of their value). The underperformance is driven by investors' concerns regarding bank liquidity and credit quality.

Bank	Rating	CMP	Target	
			Price	Upside
ALBI	HOLD	24.30	26.00	7%
Alinma	HOLD	14.30	16.50	15%
BJAZ	SELL	16.40	18.00	10%
RJHI	HOLD	52.00	60.00	15%
ARNB	BUY	22.60	38.00	68%
NCB	HOLD	50.75	55.00	8%
Riyad	SELL	12.05	13.00	8%
SABB	BUY	23.60	35.00	48%
SAMBA	BUY	22.80	31.00	36%
SHB	HOLD	28.20	34.00	21%
SIBC	SELL	17.05	16.00	-6%

Source: Bloomberg, SFC

Bank	P/B	P/E	RoAA	RoAE
	2016e	2016e	2016e	2016e
ALBI	1.8	14.7	1.6	12.4
Alinma	1.2	12.4	2.0	9.5
BJAZ	0.9	11.4	0.8	7.8
RJHI	1.7	11.9	2.1	15.0
ARNB	0.9	6.4	1.9	15.3
NCB	1.7	9.4	2.2	19.4
Riyad	0.9	8.2	1.9	11.5
SABB	1.1	7.8	2.2	15.0
SAMBA	1.1	8.2	2.4	13.3
SHB	1.2	7.0	2.0	18.1
SIBC	0.8	8.8	1.3	9.6
Sector	1.2	9.7	1.9	13.4

Source: SFC

Bank Index movement vs. TASI



Source: Bloomberg

Aqib E Mehboob
amehboob@fransicapital.com.sa
+966 11 282 6840

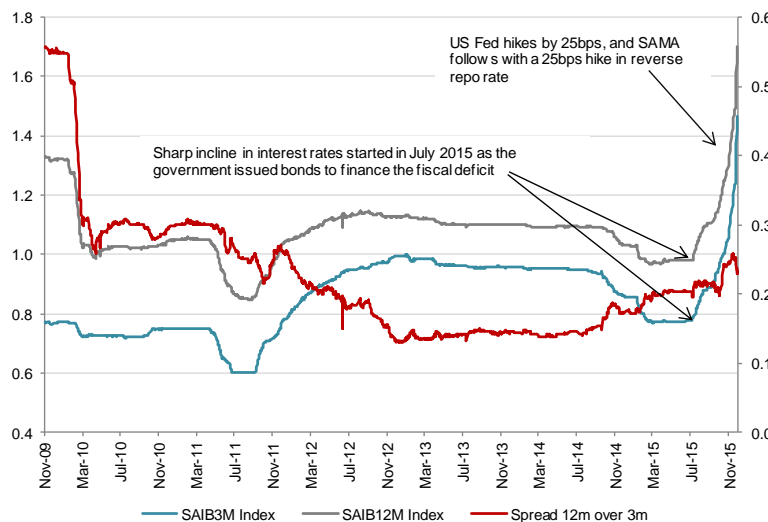


Interest rates powered higher, SAIBOR +57bps

In our sector initiation report 'Marhaba to Rising Rates' we predicted that 2016 would be a watershed year for the KSA banking sector account of lower deposit and credit growth, lower opportunities for generating fee income, cost of risk bottoming-out and mostly from higher rates on account of tighter liquidity conditions and US Fed monetary policy tightening.

Due to lower than expected oil prices, these changes are manifesting earlier than expected in 4Q2015. Over the quarter (to date, 22nd December, 2015), 3m and 12m SAIBOR have risen by 57bps and 63bps respectively. Average 3m SAIBOR for the quarter to date stands at 1.06%, versus 0.865% YTD and 0.889% in 4Q2014.

Chart 1: Interest rates have powered higher in 4Q2015, 3m-12m spread has continued to widen



Source: Bloomberg

The KSA banking sector is positively geared to higher rates, with a high proportion of zero interest cost deposits. Since 2008, ZIRP and 3 rounds of QE, have depressed the sector's NIM by 116 bps to 2015E (96 bps to 2014A).

Deposit growth likely to have slowed further in 4Q2015

While asset yield should be bolstered by the c. 20 bps average increase in SAIBOR, the NIM outlook is complicated by liquidity tightening in the sector as well as seasonal factors. According to SAMA monthly monetary data up to Oct 2015, there has been a sharp uptick in time deposits as 1) banks compete for deposits for the year end, and 2) attempt to lock in funds at current rates with the expectation that rates will rise further in the future. At the end of 3Q2015, time deposits made up 24.6% of total deposits (against low of 22.2% made in April 2015), which ticked up to 25.2% in Oct 2015. Furthermore, weekly money supply data (typically quite volatile) up to Dec 10th suggests that time deposits have ticked even higher, as narrow money (M1) falls at a faster pace than broad money (M2). Our estimate based upon the weekly data stands at above 27%.

In the 3Q results of the sector, substantial government and quasi-government inflows supported deposits (which were subsequently withdrawn in October), while this may be the case in the year-end numbers as

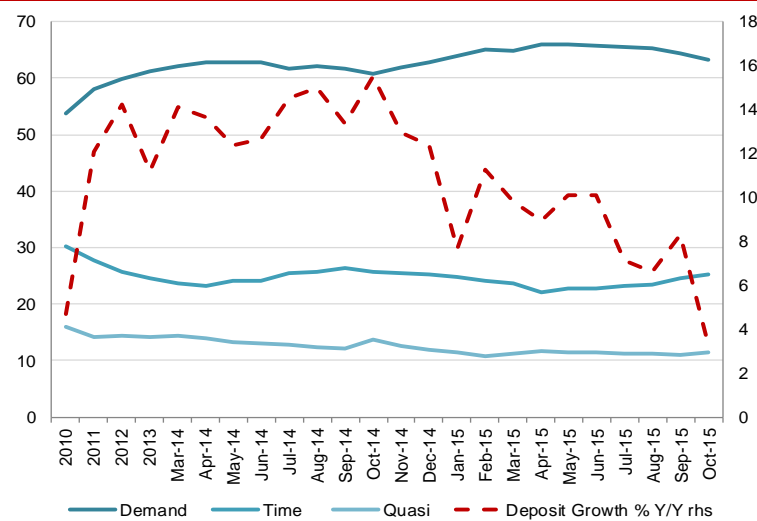
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well, public sector deposits are gradually trending lower, which may spell trouble for banks more reliant on public sector deposits for their funding needs, such as RIBL and Alinma.

At the same time, overall deposit growth has slowed considerably to 3.3% Y/Y in Oct 2015, where deposits fell a significant c.SAR 50 bn in October alone. However, according on our estimate based on weekly SAMA money supply data (10th Dec) Y/Y deposit growth may tick higher to 4.4% for CY2015. This is significantly below the 12.4% growth in deposits in 2014, and similar average annual growth since 2011.

Chart 2: Share of demand deposits has fallen in last 3 months, overall deposit growth is also slowing



Source: SAMA

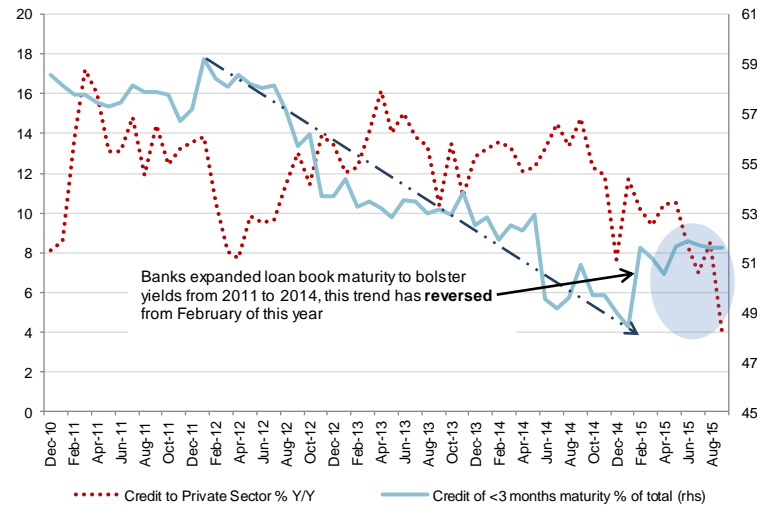
Lending growth also trending lower

Lending by the sector has slowed appreciably this year, and according to SAMA data loan growth slowed to 3.9% Y/Y in Oct 2015, decelerating sharply from 11% and 11.9% in 2013 and 2014 respectively. Generally across listed sectors we are not seeing such a sharp decline in demand for loans, thus this decline may primarily be driven by a reduction in the banking sector's appetite for credit in the current economic environment.

Fears of government bond issuance crowding out credit to the private sector have not been borne out thus far as per SAMA data, where in line with our expectations, banks appear to be reluctant to invest in these bonds with the prospect of higher interest rates ahead. In fact, there has also been a sharp decrease in investment in SAMA bills, down SAR 67.4 bn from April and c. SAR 8 bn in the month of October.



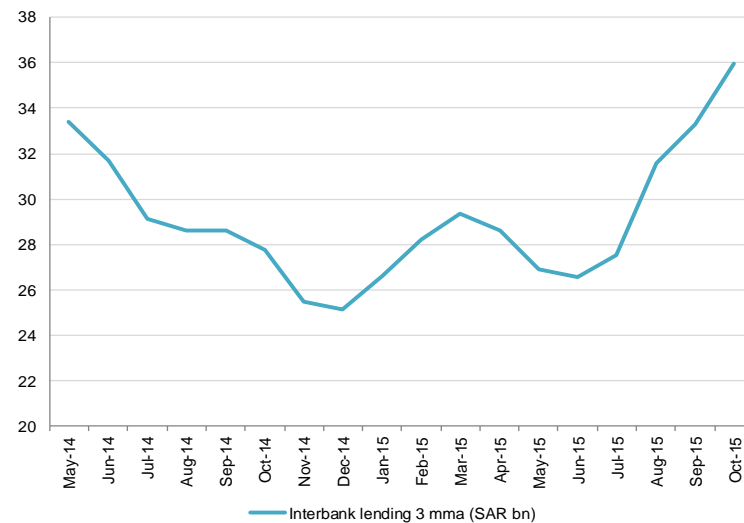
Chart 3: Lending growth has slowed and banks have reduced loan book maturity this year



Source: SAMA

On the asset side, the remaining notable trend is a pick-up in interbank lending, suggesting some banks are facing funding pressures.

Chart 4: Interbank lending has picked up sharply in 2H2015



Source: SAMA

LDR at 4-year high, exceeding previous seasonal peak of 83%

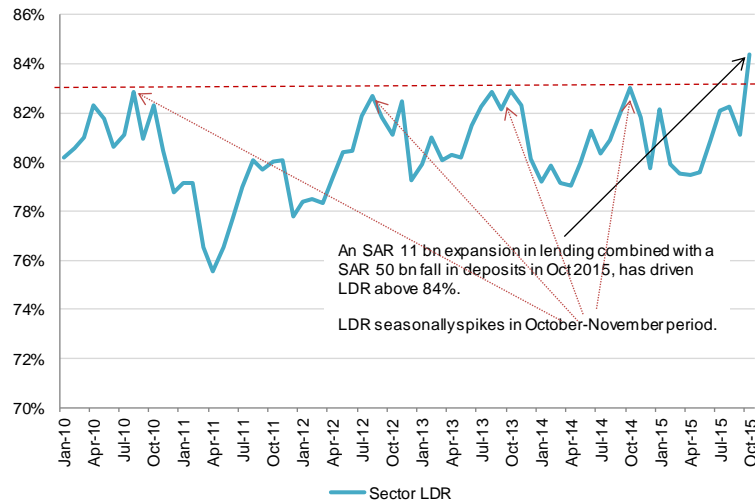
The sector typically sees an uptick in its loan-to-deposit ratio (LDR) in the Oct-Nov period, in the previous 4 years, the LDR peaked during this period at or below 83%. In Oct 2015, the LDR exceeded 84% which may indicate that the slowdown in deposits may intensify year-end competition for funds. We had highlighted in our initiation report that many banks would see cost of funds rise before asset yields kicked in significantly, and we may see this play out in the sector in 4th quarter.

In light of the above analysis, we are forecasting a relatively weaker NIM versus previous quarters. While yield on earning assets may inch higher by approximately 13 bps, we expect NIM to contract by 12 bps.

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Chart 5: The sector's Loan-to-Deposit Ratio exceeded 84% in Oct 2015

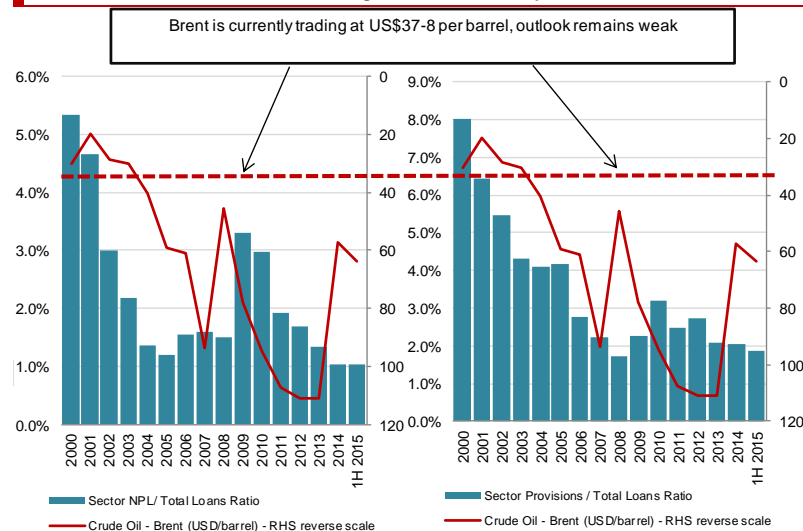


Source: SAMA

Oil prices have plummeted below our forecasts, credit risk has risen

This quarter has seen oil prices plummet with Brent crude falling below US\$38 per barrel. The fall has been greater than forecast in our initial model. We are maintaining our below trend forecasts for growth in all the above earnings drivers, but are raising our forecasts for credit provisioning by the sector in 4Q 2015. As can be seen in the charts below, there is a positive relationship between oil prices and NPLs in the KSA banking sector, and whilst the sector may not have seen a significant rise in NPLs thus far, it may raise its collective provisioning to reflect higher credit risk.

Chart 5: NPL and cost of risk react with a lag of c.12 months to oil prices



Source: Bloomberg, SAMA, Company Reports, Tadawul

We have significantly raised forecasts for provisioning against credit losses for RIBL, ARNB, SHB, NCB and RJHI.

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Table 1: Change in Provisioning Forecast

SAR mln	2015 Previous Estimate	2015 New Estimate	% change
RIBL	782	1202	54
ARNB	405	636	57
SHB	402	515	28
NCB	978	1782	82
RJHI	1734	1845	6

Source: SFC

Sector has underperformed TASI over the last 3 months and Y/Y

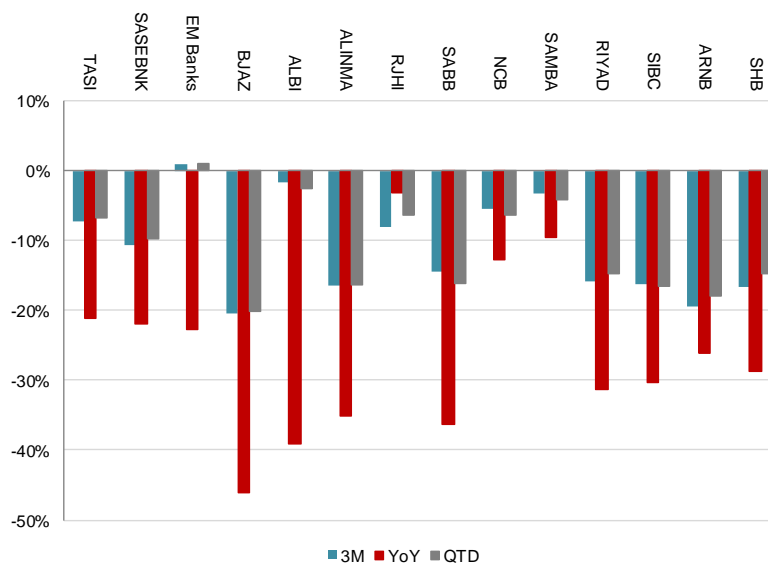
Historically, the KSA banking sector has typically underperformed the index when the broad market has been weak. This trend has continued in the current quarter, where SASEBNK has underperformed the market by 3 ppt QTD, with BIAZ, ARNB and SIBC as the 3 biggest decliners. On a Y/Y basis, declines are led by BIAZ (losing almost half its value) and SABB, Alinma and ALBI (all losing a third of their value). The underperformance is driven by investors' concerns regarding bank liquidity and credit quality.

Price Performance	TASI	SASEBNK	EM Banks	BIAZ	ALBI	ALINMA	RJHI	SABB	NCB	SAMBA	RIYAD	SIBC	ARNB	SHB
3M	-7%	-11%	1%	-21%	-2%	-16%	-8%	-15%	-5%	-3%	-16%	-16%	-20%	-17%
YoY	-21%	-22%	-23%	-46%	-39%	-35%	-3%	-36%	-13%	-10%	-31%	-30%	-26%	-29%
QTD	-7%	-10%	1%	-20%	-3%	-16%	-6%	-16%	-6%	-4%	-15%	-17%	-18%	-15%

Source: Bloomberg

We continue to believe that the dynamics for the sector are different in this case. In previous market sell-offs, driven by weaker oil prices, the US interest rates (and via the peg, KSA interest rates) have subsequently declined. Thus leaving banks to contend with tighter NIMs and expanding NPLs. However, those previous bouts of low oil prices were driven by poor outlook for oil demand, as opposed to supply-concerns today. Thus, with the global economy gradually improving, US and KSA interest rates are now likely to trend higher. We believe the expansion in NIMs will more than offset higher provisioning charges.

Chart 6: KSA banking sector has underperformed the TASI and EM Banks in this quarter



Source: Bloomberg

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4Q Forecasts

Sector 4Q Summary	4Q 2015e	% QoQ	3Q 2015	% YoY	4Q 2014
<i>SAR mIn</i>					
Net Interest Income	12,595	1	12,523	4	12,127
Total Income	19,326	9	17,810	13	17,159
Total Costs	7,408	14	6,480	10	6,716
Net Profit	9,617	1	9,476	9	8,792

Source: SFC

Bank AlBilad	SFC	Consensus					
<i>SAR mIn</i>	4Q 2015e	4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	277	na	na	294	-6%	269	3%
Total Income	584	na	na	566	3%	535	9%
Net Profit	216	na	na	203	6%	249	-13%
EPS	0.43	na	na	0.41	6%	0.50	-13%

Source: SFC , Bloomberg

Alinma Bank	SFC	Consensus					
<i>SAR mIn</i>	4Q 2015e	4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	587	na	na	548	7%	531	11%
Total Income	807	747	8%	708	14%	721	12%
Net Profit	345	330	5%	375	-8%	333	4%
EPS	0.23	0.22	5%	0.25	-8%	0.22	4%

Source: SFC , Bloomberg

Bank AlJazira	SFC	Consensus					
<i>SAR mIn</i>	4Q 2015e	4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	387	na	na	411	-6%	390	-1%
Total Income	653	na	na	532	23%	557	17%
Net Profit	100	na	na	166	-40%	199	-50%
EPS	0.25	na	na	0.41	-40%	0.50	-50%

Source: SFC , Bloomberg



AlRajhi Bank <i>SAR mln</i>	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from Financing & Investing	2,481	na	na	2,495	-1%	2,469	0%
Total Income	3,623	3,472	4%	3,195	13%	3,036	19%
Net Profit	1,738	1,723	1%	1,721	1%	1,520	14%
EPS	1.07	1.06	1%	1.06	1%	0.94	14%

Source: SFC , Bloomberg

Arab National Bank <i>SAR mln</i>	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from Financing & Investing	1,020	na	na	995	3%	942	8%
Total Income	1,597	1,494	7%	1,470	9%	1,448	10%
Net Profit	726	660	10%	764	-5%	629	16%
EPS	0.73	0.66	10%	0.76	-5%	0.63	16%

Source: SFC , Bloomberg

NCB <i>SAR mln</i>	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from Financing & Investing	3,254	na	na	3,210	1%	3,007	8%
Total Income	4,550	4,497	1%	4,313	6%	4,035	13%
Net Profit	2,245	2,160	4%	1,994	13%	1,825	23%
EPS	1.12	1.08	4%	1.00	13%	0.91	23%

Source: SFC , Bloomberg

Riyad Bank <i>SAR mln</i>	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	% QoQ	4Q 2014A	YoY
Net Income from Financing & Investing	1,305	na	na	1,262	3%	1,329	-2%
Total Income	2,096	1,996	5%	1,863	12%	1,995	5%
Net Profit	925	930	-1%	899	3%	1,060	-13%
EPS	0.31	0.31	-1%	0.30	3%	0.35	-13%

Source: SFC , Bloomberg



SABB SAR mIn	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	%QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	1,069	na	na	1,079	-1%	1,064	0%
Total Income	1,748	1,608	9%	1,689	3%	1,563	12%
Net Profit	1,055	1,035	2%	1,140	-7%	969	9%
EPS	0.70	0.69	2%	0.76	-7%	0.65	9%

Source: SFC , Bloomberg

SAMBA SAR mIn	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	%QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	1,193	na	na	1,184	1%	1,174	2%
Total Income	2,025	1,907	6%	1,990	2%	1,817	11%
Net Profit	1,328	1,231	8%	1,370	-3%	1,232	8%
EPS	0.66	0.62	8%	0.69	-3%	0.62	8%

Source: SFC , Bloomberg

Hollandi Bank SAR mIn	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	%QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	612	na	na	606	1%	529	16%
Total Income	975	882	11%	880	11%	805	21%
Net Profit	496	na	na	493	1%	462	7%
EPS	0.87	na	na	0.86	1%	0.81	7%

Source: SFC , Bloomberg

SIBC SAR mIn	SFC 4Q 2015e	Consensus 4Q 2015e	Deviation	3Q 2015A	%QoQ	4Q 2014A	YoY
Net Income from							
Financing & Investing	410	na	na	442	-7%	425	-3%
Total Income	668	na	na	603	11%	647	3%
Net Profit	403	na	na	351	15%	375	8%
EPS	0.62	na	na	0.54	15%	0.58	8%

Source: SFC , Bloomberg



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BUY

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

HOLD

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

SELL

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

Saudi Fransi Capital

Call Center | 800 125 9999

www.sfc.sa

Commercial Registration | 1010231217

Research and Advisory

P.O. Box 23454

Riyadh 11426

Saudi Arabia

Head Office | Riyadh

research&advisory@fransicapital.com.sa

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Saudi Fransi Capital LLC

C.R. 1010231217

P.O Box 23454

Riyadh 11426

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Head Office | Riyadh