

# The Saudi British Bank(SABB)

**STRONG BUY**

TP SAR27.3

41.7%

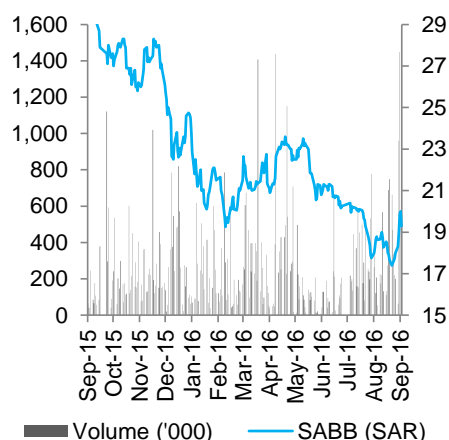
## Market Data

Bloomberg Code:	SABB AB
Reuters Code:	1060.SE
CMP (7 Sep, 2016):	SAR 19.3
O/S (mn)	1,500
Market Cap (SAR mn):	28,951.5
Market Cap (USD mn):	7,721.6
52 Week High (SAR)	30.6
52 Week Low (SAR)	17.4
3m ADVT (USD mn)	1.5

## Price Performance

	1m	3m	12m
Absolute (%)	-9.4	-13.1	-36.5
Relative (%)	-2.3	-8.5	-17.5

## Price Volume Performance



Source: Bloomberg

- Earnings growth to resume in 2017e
- Rise in provisions remains our short term dampener
- Stock at enticing levels post correction

**We have upgraded the stock to STRONG BUY from HOLD on enticing valuations.** Our fair value for SABB comes at SAR27.3/share, which is 41.7% above the bank's current market price of SAR19.3/share as on September 07, 2016. SABB is one of the cheapest banks in Saudi Arabia; the stock trades at 2016e P/BV of 0.9x which is at a discount to the KSA sector average of 1.0x. The stock has jumped 10% in the last 10 days but still trades at a discount of 37% as compared to the stock price a year ago thereby offering a favorable risk reward scenario if an entry is made at current levels.

**Due to its sizeable exposure to corporate loans** (more than 79% of total loans) the bank's yield on corporate assets is likely to get re-priced faster in an increasing interest rate scenario. Furthermore, advantage will be reaped by the bank from its favorable deposit base, which boasts a 54% demand deposit bucket. The bank is therefore in a position to expand its NIMs with the financing assets yield outstripping the cost of funds once the benchmark rates head north. Also, we expect that the non-financing income which has been facing heat in the near term will likely gather momentum over our forecast horizon. In addition to this, the bank has one of the lowest cost-to-income ratios among our KSA coverage.

**The banking stock has taken a severe beating over the past 12 months.** However, we believe that the correction has been overdone and the stock will see increased attention on the earnings growth that we see ensuing from 2017e. We remain upbeat about the stock considering its low P/BV with respect to its RoE, compelling valuation, decent bottom-line expectations, stable asset quality ratio and favorable loan & deposit mix. Currently, the stock trades at a 2016e P/BV multiple of 0.9x which is at a 10% discount to the KSA average and also well below the stocks' 5-year average and offers an attractive entry point. We have derived a fair value of SAR27.3/share for SABB reflecting a 41.7% upside from current levels.

## Investment Indicators

(SAR mn)	2014	2015	2016e	2017e	2018e
NII	4,063	4,254	4,426	4,805	5,272
NFI	2,440	2,377	2,324	2,477	2,632
Net Income	4,266	4,331	4,192	4,619	5,048
PE	13.7x	8.6x	6.9x	6.3x	5.7x
P/B	2.3x	1.3x	0.9x	0.9x	0.8x
RoE	18.3%	16.5%	14.4%	14.3%	14.1%

Source: Global Research

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### Provisioning pains might not pan out as bad as we have penciled in...

In light of the current low oil price scenario and tighter growth in the economy, we remain cautious on the bank's asset quality. We expect the NPL ratio to inch upwards to 1.7% by 2017e but we do not see further deterioration in the same, expecting it to stabilize and improve slightly to 1.6% by 2019e. Also, we expect the coverage ratio to taper off until 2017e and then start moving upwards with the cost of risk averaging at 40bps over the next 4 years. Noteworthy, our stance on NPLs remains conservative and so do our estimates on the cost of risk despite the fact that the bank's exposure to the troubled construction and building sector is limited to 8% of the loan book.

### Valuation update – Upgraded to STRONG BUY

We have reduced our fair value estimate for SABB from SAR37.9/share to SAR27.3/share, due to a change in the economic backdrop and the operating environment as well as lower bottom-line expectations and a drop in expected ROE. We expect the bank's RoE to average at 14.3% over our forecast horizon.

However, after the huge 37% decline in the stock price over the past 12 months, the bank is currently trading at a 2016 P/E of 6.9x and P/BV of 0.9x against 5 year historical average of 10.9x and 1.8x. Also, the stock is trading at a discount as compared to the sector average of 7.9x and 1.0x. We believe that the stock has been overly penalized and offers an excellent entry point at current levels. We have assumed the risk-free rate (US 10-year Treasury yield) at 1.6% and risk premium at 10.1%, including the country as well as stock-specific risk.

### Risks to valuation

- **Loans growth:** While we have been 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 a stable NPL ratio post 2017; the cost of risk also stabilizes from then onwards. Any major delinquency over and above our expectations or change in provisioning rules/policy will lead to even higher provisions and lower profits, prompting us to revisit our estimates with negative bias.

### 2016e estimates have been trimmed

We have revisited most of the line items in the balance sheet and the income statement for 2016e post recent 2Q16 results. Realizing that our previous loan growth estimates were a tad on the higher end and perhaps not realistic in the prevailing environment, we have cut down our loan and deposit estimates by 5.8% and 6.5%, respectively. We have reduced our net interest income forecast by 12% as a result. We have increased our provision expectations by a massive 72.5% as we assume higher build-up of provisions due to slowdown in the economy. All these revisions have led to a reduction in our bottom-line estimates by 21.8% for 2016e.

#### Estimates Revision - 2016e

(SAR mn)	Earlier Estimates	Revised Estimates	% Change
Gross Loans	146,660	138,144	-5.8%
Deposits	165,448	154,682	-6.5%
Net Interest Income	5,023	4,426	-11.9%
Operating Income	7,723	6,750	-12.6%
Provision for loan losses	347	599	72.5%
Net Profit	5,364	4,192	-21.8%

Source: Global Research

(SAR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
<b>Income Statement</b>							
Special commission income	4,386	4,626	4,813	5,415	5,923	6,502	7,354
Special commission expenses	(667)	(563)	(560)	(989)	(1,119)	(1,230)	(1,473)
<b>Financing and Investment Income, Net</b>	<b>3,719</b>	<b>4,063</b>	<b>4,254</b>	<b>4,426</b>	<b>4,805</b>	<b>5,272</b>	<b>5,881</b>
Fee & Commission Income	1,433	1,645	1,550	1,503	1,596	1,681	1,805
Investment Income	180	285	323	279	293	308	323
Other Income	482	510	504	542	588	643	705
<b>Total Non-Commission Income</b>	<b>2,096</b>	<b>2,440</b>	<b>2,377</b>	<b>2,324</b>	<b>2,477</b>	<b>2,632</b>	<b>2,833</b>
<b>Total Operating Income</b>	<b>5,815</b>	<b>6,502</b>	<b>6,631</b>	<b>6,750</b>	<b>7,281</b>	<b>7,904</b>	<b>8,713</b>
Provisions expense	(442)	(450)	(420)	(599)	(571)	(608)	(569)
Operating Expenses	(1,723)	(1,896)	(2,010)	(2,066)	(2,202)	(2,362)	(2,571)
<b>Profit Before Taxation</b>	<b>3,651</b>	<b>4,157</b>	<b>4,200</b>	<b>4,085</b>	<b>4,508</b>	<b>4,934</b>	<b>5,573</b>
Sale of associate (net)	123	109	130	107	110	114	117
Taxation & Minority Interest	-	-	-	-	-	-	-
<b>Net Profit Attributable to Parent</b>	<b>3,774</b>	<b>4,266</b>	<b>4,331</b>	<b>4,192</b>	<b>4,619</b>	<b>5,048</b>	<b>5,690</b>
<b>Balance Sheet</b>							
Cash Balances	26,124	19,314	10,942	11,691	11,926	12,701	13,578
Deposits with Banks & FIs	3,286	2,469	11,452	14,888	15,632	17,196	20,119
Investment Securities	37,400	45,281	35,426	32,007	31,409	34,464	37,823
Gross Loans & Financings	108,374	117,623	127,911	138,144	147,537	156,390	168,901
Loan Loss Reserve	(2,259)	(2,403)	(2,487)	(3,085)	(3,657)	(4,264)	(4,834)
Net Loans & Financings	106,115	115,221	125,424	135,059	143,881	152,125	164,067
Investment in Associates	647	652	693	714	735	758	780
Investment Properties	-	-	-	-	-	-	-
Net Fixed Assets	604	663	991	983	976	969	962
Other Assets	3,127	4,010	2,821	2,905	2,992	3,082	3,175
<b>Total Assets</b>	<b>177,302</b>	<b>187,609</b>	<b>187,750</b>	<b>198,247</b>	<b>207,553</b>	<b>221,296</b>	<b>240,504</b>
Deposits from Banks & FIs	3,770	4,086	1,827	1,973	2,131	2,301	2,485
Deposits from Customers	138,961	145,870	148,639	154,682	160,064	169,560	183,968
Other Borrowings	5,392	5,343	4,547	4,547	4,547	4,547	4,547
Other Liabilities	6,346	6,239	4,564	5,248	5,511	5,786	6,075
Paid-up Capital	10,000	10,000	15,000	15,000	15,000	15,000	15,000
Retained Earnings	3,809	5,859	5,361	7,391	9,608	12,030	14,762
Other Reserves	9,024	10,213	7,813	9,406	10,693	12,071	13,667
Shareholders' Equity	22,833	26,071	28,175	31,797	35,300	39,101	43,428
Minority Interest	-	-	-	-	-	-	-
<b>Total Equity &amp; Liability</b>	<b>177,302</b>	<b>187,609</b>	<b>187,750</b>	<b>198,247</b>	<b>207,553</b>	<b>221,296</b>	<b>240,504</b>
<b>Ratio Analysis</b>							
Return on Average Assets	2.3%	2.3%	2.3%	2.2%	2.3%	2.4%	2.5%
Return on Average Equity	18.5%	18.3%	16.5%	14.4%	14.3%	14.1%	14.3%
Recurring Income/Operating Income	88.6%	87.8%	87.5%	87.8%	87.9%	88.0%	88.2%
Interest Earning/Financing Assets Yield	3.1%	2.96%	2.85%	3.03%	3.14%	3.25%	3.40%
Cost of Funds	0.5%	0.37%	0.36%	0.63%	0.68%	0.72%	0.80%
Net Spread	2.6%	2.59%	2.49%	2.40%	2.46%	2.53%	2.60%
Cost to Income Ratio	29.6%	29.2%	30.3%	30.6%	30.2%	29.9%	29.5%
Net Loans to Customer Deposits	76.4%	79.0%	84.4%	87.3%	89.9%	89.7%	89.2%
Non Performing Loans	1,525.3	1,494.9	1,517.3	2,072.2	2,508.1	2,658.6	2,702.4
Loan Loss Reserve	2,258.7	2,402.5	2,486.5	3,085.2	3,656.5	4,264.4	4,833.6
NPLs to Gross Loans	1.4%	1.27%	1.19%	1.50%	1.70%	1.70%	1.60%
NPL Coverage	148.1%	160.7%	163.9%	148.9%	145.8%	160.4%	178.9%
Provisions/Total Income	7.6%	6.9%	6.3%	8.9%	7.8%	7.7%	6.5%
Cost of Risk (bps)	42.7	39.8	34.2	45.0	40.0	40.0	35.0
Equity to Gross Loans	21.1%	22.2%	22.0%	23.0%	23.9%	25.0%	25.7%
Equity to Total Assets	12.9%	13.9%	15.0%	16.0%	17.0%	17.7%	18.1%
DPS	1.05	1.10	0.79	0.71	0.79	0.87	0.98
Dividend Yield	2.4%	1.9%	3.2%	3.7%	4.1%	4.5%	5.1%
Dividend Payout Ratio	29.1%	27.0%	28.7%	26.6%	27.0%	27.0%	27.0%
Adjusted EPS (SAR)	2.5	2.8	2.9	2.8	3.1	3.4	3.8
Adjusted BVPS (SAR)	14.5	16.6	18.4	20.5	22.7	25.2	27.9
Market Price (SAR)*	44.0	58.4	24.8	19.3	19.3	19.3	19.3
P/E Ratio (x)	11.7	13.7	8.6	6.9	6.3	5.7	5.1
P/BV Ratio (x)	2.0	2.3	1.3	0.9	0.9	0.8	0.7

Source: Company Reports & Global Research\*

\* Market price for 2016 and subsequent years as per closing prices on September 07, 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
The Saudi British Bank	STRONG BUY	SABB AB	1060.SE	SAR 19.3	1,10

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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

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