Bank Alinma

TASI Code: 1150 | Reuters Code: 1150.SE | Bloomberg Code: ALINMA AB|
Current Market Price: SAR 11.50 (As of May 22, 2010)
Initial Coverage: May 2010

May 2010

Stock Volatility	Expected Return (May 2010) Low	Medium	High
Low			
Medium			
High			

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- Bank Alinma's share price has fallen 9.8% YTD, while the TASI index has risen 4.5% during the same period. In 2009, the index gained 27.5%, while Alinma's share price increased 14.4%.
- Alinma currently trades at a P/B of 1.1x. The company's P/B fell 9% YTD and trades lower than the industry average of 2x. We place fair value P/B at 1.2x indicating limited upside potential. We have used P/B for valuation purposes rather than P/E due to the instability of the latter given the newness of the bank's operations.
- In 1Q10, Alinma's net income from investing and financing activities fell 62.2% YoY to USD 18 mn, while on a QoQ basis it declined 51.3%. The company's non interest income increased to USD 4 mn in 1Q10 from USD 0.1 mn in Q1 2009, led by rise in banking fees, which amounted to USD 3.0 mn in Q1 2010. The company reported a net loss of USD 20 mn in 1Q10 versus a net profit of USD 29.2 mn in 1Q09. This was on account of a sharp rise in non-interest expenses, which increased 128% YoY to USD 42 mn in 1Q10.
- The company's loan and deposit book increased remarkably; loans increased to USD 958.8 mn in Q1 2010 from USD 80.2 mn in Q1 2009 and USD 300 mn in Q4 2009, while customer deposits rose to USD 793.1 mn in Q1 2010 from USD 155mn in Q1 2009 and USD 400 mn in Q4 2009.
- Bank Alinma reported net income from investing and financing activities of USD 162 mn in 2009, 4.5% higher than the annualized figure of USD 155 mn in 2008. The company reported a net profit of USD 57.4 mn in 2009, a decline of 67.8% from the annualized net profit of USD 178.2 mn in 2008; however, 2008 net profit included a pre-operating gain of USD 73 mn.
- We expect Bank Alinma to generate revenue (including interest income and non-interest income) of USD 186.5 mn in 2010, an increase of 13% YoY, while net profit is expected at USD 61.2 mn, an increase of 7% YoY.

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USD Mn	2008*	2009	2010f
Revenue	90	165	186
Net profit	104	57	61
P/E (LTM)	NA	85.8x	NA
P/B (LFI)	NA	1.2x	1.1x
Market Cap	4,439	5,079	4,580
Stock Returns	NA	14.4%	-9.8%

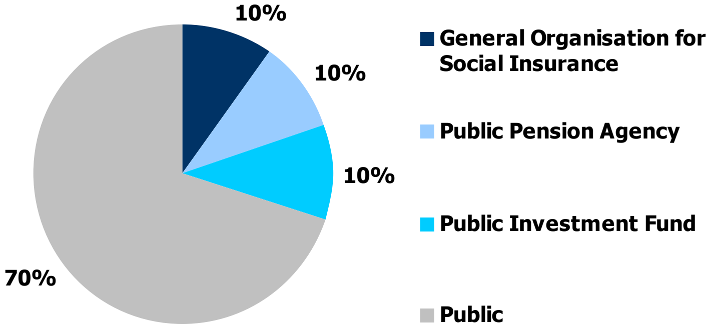
Note: 2010 figures - M.Cap., Stock Returns as on May 18, 2010, * represents 7 months fig
Source: Financial Reports, Bloomberg, Reuters

Company Overview

Second largest Islamic bank in Saudi Arabia in terms of market capitalization

Established in 2006, Alinma Bank is a Saudi-based listed financial institution engaged in providing banking and investment services in accordance with the Islamic Shariah principles. The bank currently has 13 branches and 82 ATMs across Saudi Arabia. With a market cap of USD 4.6 bn, Bank Alinma is the second largest Islamic bank in Saudi Arabia. The company was listed on the Saudi Exchange in June 2008. The government of Saudi Arabia through its various units holds a 30% stake, while the remaining 70% stake is held by general public.

Figure 1: Shareholding (as of December 2009)

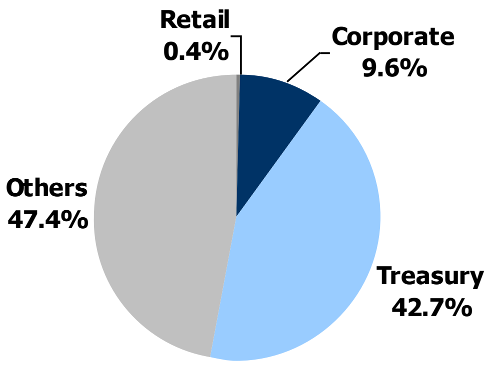


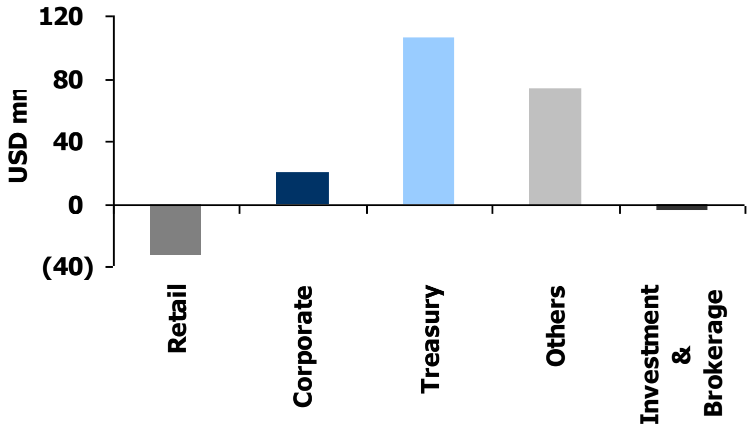
Source: Zawya

Corporate and Treasury segment being the main profitable segment

Bank Alinma operates in four business segments – Retail, Corporate, Treasury and Investment & Brokerage. Corporate and Treasury are the major revenue generating segments for the company. From May 2008 till Dec 2009; Corporate and Treasury segments have remained profitable business segments, while Retail and Investment & Brokerage segments have incurred losses. Bank Alinma has maximum credit exposure in the Treasury segment, of around 86%, followed by the Corporate segment with around 12%.

Figure 2: Segment-wise revenue and net profit break up[1]





Source: Company's Financial

[1] Period: May 26, 2008-Dec 31, 2009

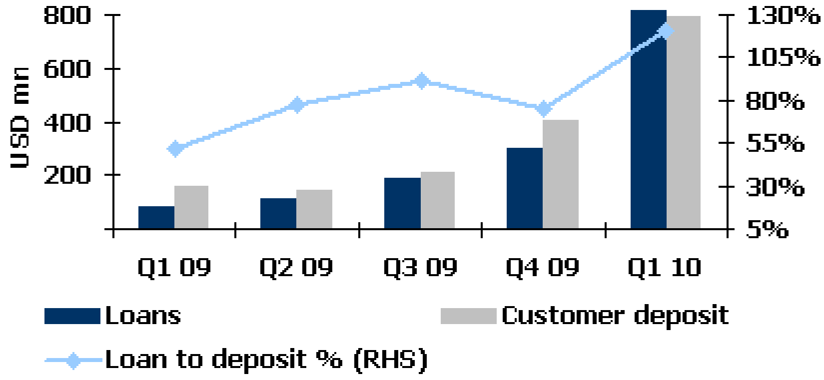
Investment Highlights

Impressive growth in deposit and financing book

Loans and customer deposits rose at a CAGR of 86% and 50% over the period Q1 2009 – Q1 2010

Over the last four quarters, Bank Alinma witnessed impressive growth in its loans and customer deposits. The bank's loans rose at a CAGR of 86% over the period Q1 2009-Q1 2010 to reach USD 958.8 mn, while its customer deposit increased at a CAGR of 50% over the same period to reach USD 793.1 mn.

Figure 3: Loan and deposit trend



Source: Reuters, Company Report

Loan to deposit rising 120.9% in Q1 2010 from 51.7% in Q1 2009

The bank's loan to deposit ratio increased from 51.7% in Q1 2009 to 120.9% in Q1 2010. In Q1 2010, on a YoY basis, Bank Alinma's customer deposit and financing book rose more than four and ten times, respectively, while the industry witnessed a 1% decline in both deposit and loan book during the same period.

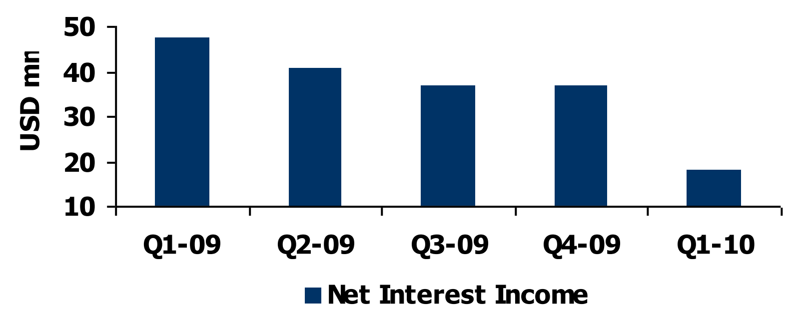
With the remarkable increase in Alinma's customer deposits and financing book in Q1 2010, the bank has been able to increase its share in the industry's deposit book to 0.4% in Q1 2010 from 0.1% in Q1 2009, while in the loan book its share increased to 0.6% from mere 0.05%.

Declining net income from investing and financing activities

Declining net income from investing and financing, although expanding loan book

Bank Alinma's net income from investing and financing activities has declined at a CAGR of 21.6% over the period Q1 2009-Q1 2010, when its loan book has increased at a CAGR of 86% during the same period.

Figure 5: Net Interest Income trend



Source: Bloomberg, Company Report

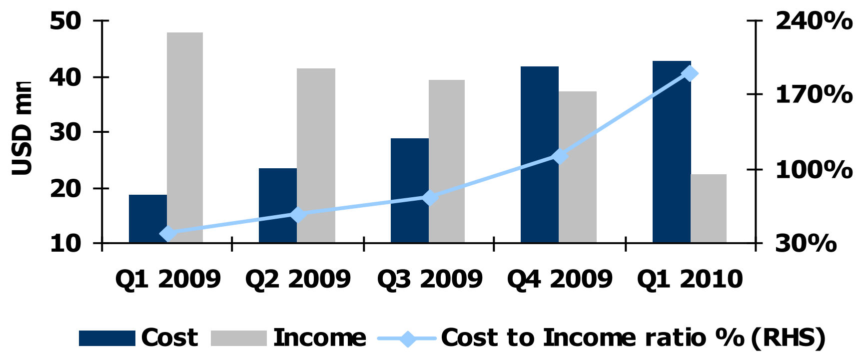
While most of the players in the industry witnessed decline in income from financing activities during the same period, the quantum was not as steep as Alinma's. Overall, the industry witnessed an average increase of 11.2% YoY in net interest income led by Al Rajhi, which gained 191% YoY in Q1 2010.

Increasing efficiency ratio affecting bottom-line

Cost to income ratio increasing to 190% in Q1 2010 from 39% in Q1 2009

Bank Alinma's rising cost to income ratio poses a threat to its bottom-line. The company's ratio increased to 190% in Q1 -2010 from 39% in Q1 2009, much higher than the industry's average ratio at around 39% in Q1 2010.

Figure 6: cost and income trend over the year



Source: Bloomberg, Company Report

Staff expenses is the major contributor to the rising cost to income ratio

The company's cost increased at a CAGR of 23.1% over the period Q1 2009 – Q1 2010, while its income fell at a CAGR 17.2% during the same period. The increase in cost was on account of rising general administrative expenses, staff expenses and depreciation. Staff expenses, which contrbuted around 58% to the total expenses in Q1 2010, increased at a CAGR of 24% over the period Q1 2009 – Q1 2010, while general administrative expenses and depreciation rose at a CAGR of 29% and 25% respectively over the same period. Thus, with the increasing cost to income ratio, Bank Alinma reported a net loss of USD 20 mn in Q1 2010 compared with a profit of USD 29.2 mn in Q1 2009.

Absence of non-performing loans in total financing

No provisioning for impairment

Bank Alinma hasn't reported any non-performing loans out of its total loan book. Further, as of Dec 2009, around 46% of the loans represented very good credit quality, while the remaining 54% represented good credit quality, hence the company didn't report provisioning. Corporate financing comprised 95% of the total loan portfolio in 2009, while the remaining 5% comprised of retail financing. Further classifying the loan portfolio, 82% of the total loan was directed towards building and construction, while 13% was towards commercial segment.

High capital adequacy ratio

Capital adequacy ratio as high as 151% in Q1 2010

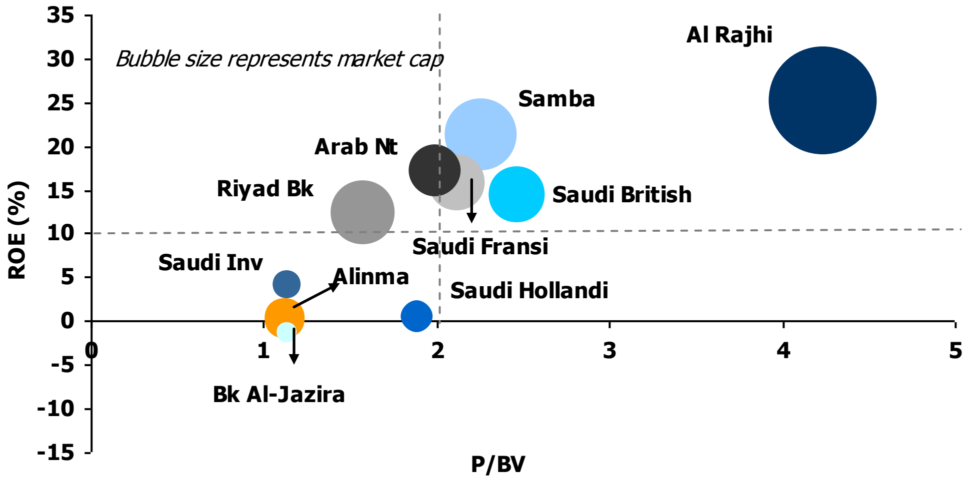
Bank Alinma maintains a high capital adequacy ratio. The company's Tier 1 Capital ratio and Total Capital ratio stood at 151%[2] each at end of Q1 2010. The high capital adequacy ratio gives the company scope to further increase its financing.

Comparative valuations

Company's ROE (TTM) of 0.2% far behind the industry average of 9.3%

Bank Alinma trades at P/BV of 1.11x, while the industry averages at around 2.0x, however in terms of ROE, Bank Alinma generated a ROE (TTM) of 0.2% as of Q1 2010, while industry averaged at around 10.2%.

Figure 7: Industry P/BV vs. ROE[3]



Source: Bloomberg

With limited history, the company's performance metrics may not be comparable currently but it appears that the company's returns may increase in line with the industry average once its expansion is complete.

Discussion Notes

Looking back – 2009 results

Revenue of USD 165 mn and net profit of USD 57.4 mn reported for the period 2009

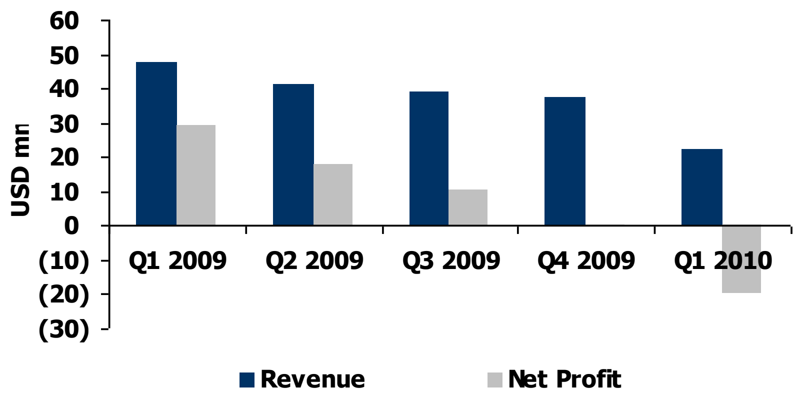
Bank Alinma generated revenue of USD 165 mn for the period 2009, an increase of 6.6% from the annualized revenue of USD 155 mn in 2008. The bank generated a non-interest revenue of USD 2.3 mn in 2009, of which USD 1.9 mn is generated through banking fees, while the company did not generated any non-interest revenue in 2008. The bank reported non-interest expenses of USD 110.7 mn in 2009, an increase of 8.6% from the annualized expense of USD 102 mn in 2008. Non-interest expenses in 2009 comprised 62% (USD 68.3 mn) staff expenses, 16% (USD 18 mn) general and administrative expenses and 14% (USD 15.6 mn) depreciation & amortization. The company reported a net profit of USD 57.4 mn in 2009 a decline of 68% from the annualized net profit of USD 178.2 mn in 2008. However, 2008 net profit included a pre-operating income of USD 73.2 mn. Customer deposits came in at USD 400 mn in 2009 and the financing book was USD 300 mn in 2009, while the company did not have any customer deposits or financing book at the end of 2008.

[2] According to company reports
[3] ROE – TTM including Q1 2010., Market Cap and P/BV as on 17th May 2010

Revenue declined 53% YoY in Q1 2010, while net loss of USD 20 mn was reported in Q1 2010 compared with profit of USD 29.2 mn in Q1 2009

For the period 1Q 2010, Bank Alinma's net income from investing activities declined 62.2% YoY to USD 18.0 mn, while on a QoQ basis it fell 51%. In Q1 2010, the company witnessed a sharp rise in non-interest revenue led by revenue from banking fees. The company's non-interest revenue increased to USD 4 mn in Q1 2010 from USD 0.1 mn in Q1 2009, of which USD 3.0 mn was generated through banking fees. The company reported a net loss of USD 20.0 mn in Q1 2010 compared with a profit of USD 29.2 mn in Q1 2009, owing to sharp increase in non-interest expenses, which rose 128% to USD 42 mn in Q1 2010 from USD 18.4 mn in Q1 2009.

Figure 8: Revenue and net profit trend

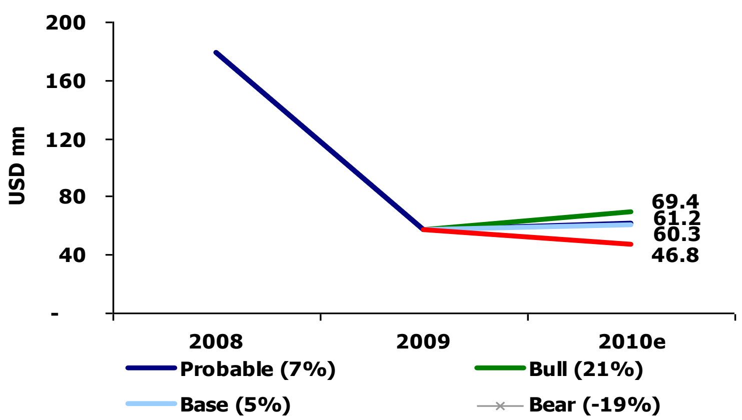


Source: Reuters, Company Report

Looking forward – 2010

We expect 2010 revenue to increase 13.0% YoY to USD 186 mn, led by 10% growth in net income from investing and financing activities. We expect non-interest revenue to increase to USD 7.3 mn in 2010 from USD 2.3 mn in 2009. The company is expected to report a net profit of USD 61.2 mn in 2010, an increase of 7% YoY. Our call on 2010 net profit is a weighted product of three scenarios - the Bull Case (with 21% rise in net earnings and a 25% probability of occurring), a Base Case (with a 5% increase in net earnings and a 65% probability of occurring), and finally, a Bear Case (with a 19% decline in net earnings and a 10% probability of occurring).

Figure 9: Net income



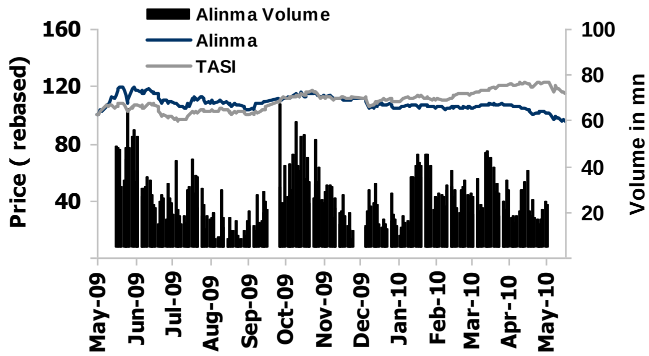
Source: Reuters Knowledge, Markaz Research

Valuation

In 2009, Bank Alinma's share price increased 14.4%, while the TASI surged 27.5%. On a YTD basis, Bank Alinma's share price declined 8.3%, while TASI increased 7.1%. We believe that with the increasing expenditure by the Saudi government, Bank Alinma, which has recently started operations, is likely to further increase its financing book. Its high capital adequacy ratio gives it scope to enhance financing further. We expect Bank Alinma to generate net profit of USD 61.2 mn in 2010, an increase of 7% YoY, backed by 13% rise in total revenue. We place a fair value P/B of 1.2x for Bank Alinma indicating upside potential as the company is only at a nascent stage and going forward, with the expanding loan book, the bank is expected to increase its market presence. We have used P/B for valuation due to the instability of P/E at this juncture.

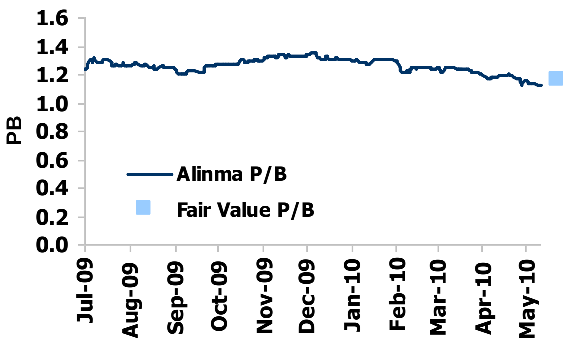
Bank Alinma has a very high turnover velocity of around 500%. In 2009, the company had a turnover velocity of 510%, while in 2008 it was 508%. High turnover velocity is on account of high annual traded value, which amounted to USD 25.5 bn in 2009 and USD 30.1 bn in 2008. Given that the bank is a relatively new listing, it exhibits low risk as per our volatility index, with a lower current MVX and a narrower band than that of the index.

Figure 10: Price & volume trend



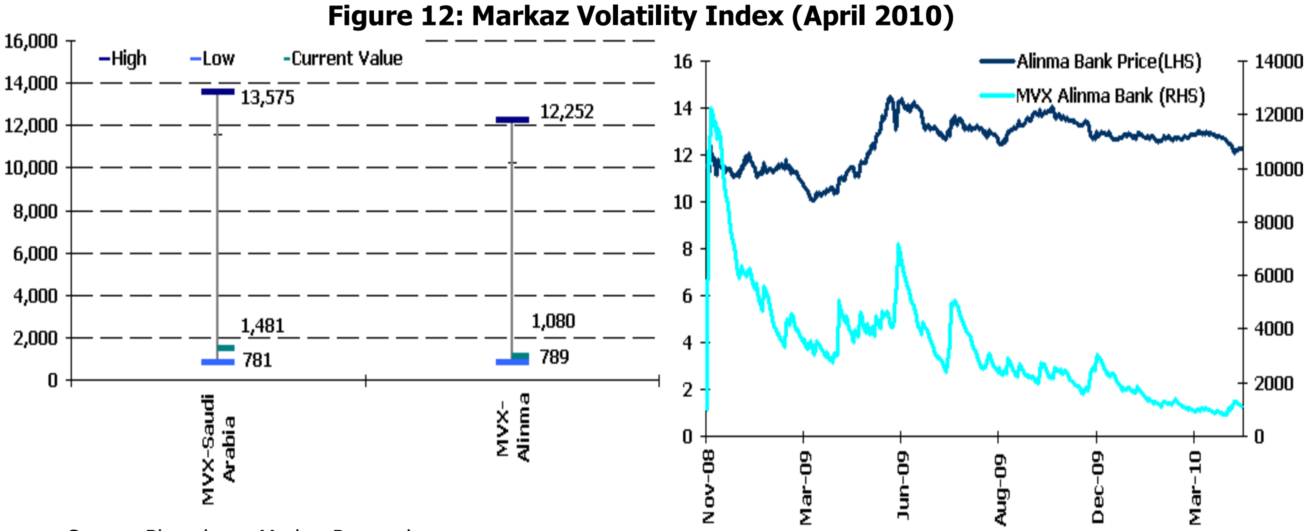
Source: Bloomberg

Figure 11: PB trend & fair value



Source: Bloomberg, Markaz Research

Figure 12: Markaz Volatility Index (April 2010)



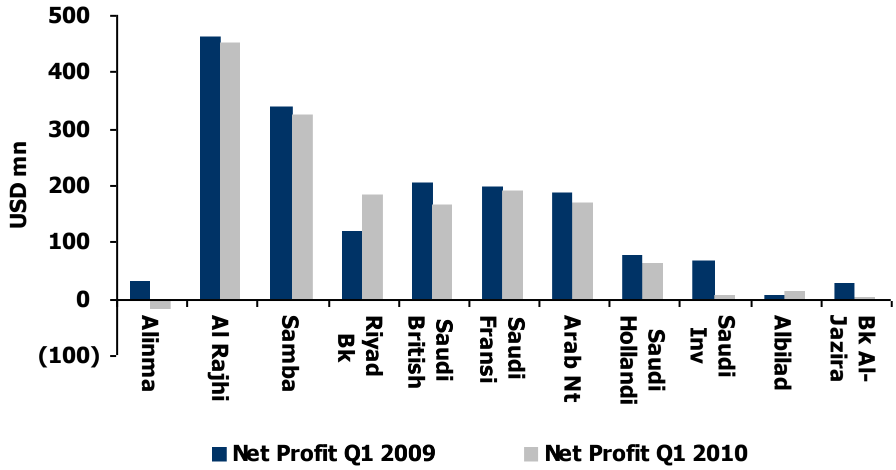
Source: Bloomberg, Markaz Research

Appendix 1: Industry Overview

Sector's net earnings declined 9.5% YoY in Q1 2010.

The Saudi banking sector is characterized with the presence of eleven listed companies. The sector witnessed a decline in net earnings by 9.5% YoY in Q1 2010 to USD 1.5 bn. Most of the banks witnessed a decline in their net earnings in Q1 2010. Saudi Investment Bank and Bank Al-Jazira witnessed the highest decline of 91% and 88% YoY in their Q1 2010 net earnings. Riyad Bank and Bank Albilad reported the highest rise of 55% and 135% YoY respectively in their net earnings in Q1 2010.

Figure 13: Revenue and net profit trend (based on listed banks)

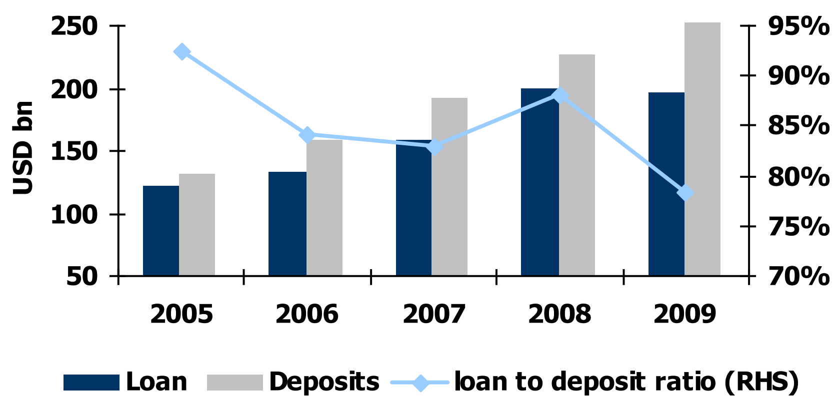


Source: Bloomberg

Increase in deposits, leading to fall in loan to deposit ratio

The sector's lending fell 1% YoY to USD 196.2 bn, while its deposits rose 11% YoY to USD 250.5 bn in 2009. This has led to sharp fall in loan to deposit ratio to 78.35% in 2009 from 88% in 2008.

Figure 14: loan and deposit trend



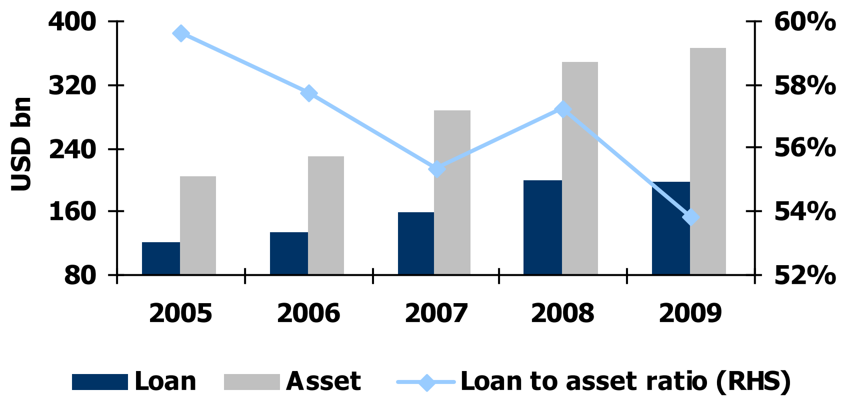
Source: SAMA

In 2009, a YoY growth of 26.5% was witnessed in demand deposit, while time & saving deposit declined 12% owing to low interest rates and weak lending growth, which led to banks increasing the share of non-interest bearing deposits in total deposits and decreasing the share of high interest bearing fixed-deposit to improving their margins.

Saudi banking assets increased at a CAGR of 16% over the period 2005 - 2009

Saudi banking assets rose 5.2% YoY in 2009 to reach USD 364 bn. The country's banking asset has increased at a CAGR of 16% over the period 2005 – 2009. The sector witnessed a drop in its loan to asset ratio to 53.8% from 57.2% in 2008.

Figure 15: loan and asset trend



Source: SAMA

Saudi Banking sector witnessed an increase of 250% YoY in the amount of provisioning to reach USD 2.78 bn in 2009; owing to weakening economies and debt repayment defaults by the two major Saudi conglomerates namely Saad and Algosaibi Groups amounting to USD 22 bn. In addition, Dubai World crisis in late 2009 further questioned the asset quality in banks balance sheet. The Kingdom's provision to loan increased to 1.42% in 2009 from 0.4% in 2008.

Banking Sector 2010 outlook

Lending activity in the Kingdom to increase more than deposits in 2010

In our January report on banks, we estimated banks' net profit to grow 20% in 2010. Interest income was expected to increase 22% YoY, while interest expense was likely to grow 38%, resulting in 16% growth in net interest. However, we also anticipate provisions would reach their peak in 2010. Furthermore, in terms of deposits and loans, we expect lending activity in the Kingdom to record higher growth than deposits, therefore loan to deposit ratio increasing in 2010.

Appendix 2: Key Statistics

Income statement (USD mn)	2008*	2009	2010f
Net Income from investment and Financing	90	162	177
Non-Interest Income	-	2.3	7.3
Provision	-	-	-
Net profit	104	57.4	61.2
Balance Sheet (USD mn)			
Cash	1	96	
Financing	-	300	1,345
Total Assets	4,147	4,614	
Customer Deposit	-	400	1,033
Total Liabilities	44	453	
Total Shareholders' Equity	4,103	4,160	
Key Ratios			
Financing growth (%)	NA	NM	348%
Deposit growth (%)	NA	NM	158%
loan/deposit (%)	NA	75.0%	130.2%
Return on Assets (%)	NA	1.2%	1.2%
Return on Equity (%)	NA	1.4%	1.5%
Earnings growth	NA	NM	7%
Revenue growth	NA	NM	12.9%
Cost-to-Income (%)	66%	68%	67%
P/E	NA	85.8x	NM
P/B	NA	1.2x	1.1x
Market Price (SR)	11.1	12.7	
EPS (USD)	0.1	0.04	
Asset Growth (%)	NA	11%	
Equity Growth (%)	NA	1%	
Annual Trading Volume (mn)	8	8	
Annual Trading Value (USD mn)	30,113	25,532	
Turnover Velocity	508%	510%	
M Cap (USD mn)	4,439	5,079	

Source: Zawya, Reuters, Company Financials, *represents 7 months figures

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- Union National Bank (Aug-08)
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- Qatar Insurance Co. (Nov-08)
- Qatar Gas Transport Co. (Oct-08)
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- QEWC (July-08)
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- Ithmaar Bank (July-08)
- Tameer (July-08)
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Saudi Arabia	55%	53%	76%
Kuwait	70%	68%	43%
Qatar	92%	90%	95%
UAE	79%	25%	58%
Bahrain	58%	74%	23%
Oman	63%	100%	50%
Egypt	60%	85%	40%
Jordan	39%	0%	32%
Morocco	50%	70%	24%
MENA	**75%**	**83%**	**60%**

Analyst Certification

Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of this research report hereby certifies that, with respect to each issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) strategist(s) or research associate(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst, strategist or research associate in this research report.

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Definitions - Return

Low	Where the potential return is less than 10%
Medium	Where the potential return is between 10% and 25%
High	Where the potential return is greater than 25%

Definitions – Volatility (Risk)

High	Where the Current MVX and band width of stock is more than the respective country benchmark
Medium	Where the current MVX is lower than benchmark and band width higher than or lower than benchmark
Low	Where the current MVX is lower than the benchmark and the band width lower than the benchmark

MVX refers to Markaz Volatility Index calculated by Markaz based on in-house proprietary model

Disclaimer