Samba Financial Group

August 2010

Tadawul/Reuters Code: 1090.SE | Bloomberg Code: SAMBA AB|
Current Market Price: SAR 59.00 (As of 15 August 10)
Initial Coverage: May 2008

Stock Volatility		Expected Return (August 2009)		
		Low	Medium	High
	Low			
	Medium			
	High			

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		Low	Medium	High
	Low	▪		
	Medium			
	High	▪		

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- Samba Financial Group (Samba) has significantly outperformed the TASI on YTD basis. While Samba increased 20.3% on YTD basis, TASI expanded 0.8% during the same period. However, the bank’s stock rose 3% in 2009 compared to an index gain of 27%.
- Samba’s current P/E stands at 11.8x; the bank’s PE gained nearly 3% in 2009, and a further 20.3% on YTD 2010. We would place fair value PE at 10x.
- In 1H10, Samba’s net profit declined 3.4% YoY to USD 648 Mn. This was primarily ascribed to a 9.2% YoY fall in net interest income, during the same period. In 2Q10, the bank’s interest income declined 16.2% YoY to USD 363 Mn and a steeper 50.5% YoY fall in interest expenses; NII decline of 7.8% YoY to USD 321 Mn.
- Samba’s Net interest income was USD 1.35 Bn in 2009, a 0.2% YoY increase almost in line with our earlier estimate of 1.38 Bn. The bank managed to hold its 2008 income levels mainly through a substantial decline in the interest expense. Net profit of the bank increased 2.4% YoY to USD 1.22 Bn during the year against our estimates of USD 1.04 Bn.
- Loans declined 13.5% YoY to USD 23.3 Bn in 2009, as a result of slowdown in credit off-take in Saudi, while deposits grew 9.7% YoY USD 39.2 Bn in the same year. We had earlier estimated Samba’s loans to decline to USD 22.9 Bn while deposits matched our estimate. In 1H10, the bank’s loan book contracted 5.9% YoY to USD 22 Bn, while deposits posted a 1.5% YoY fall to USD 36.3 Bn.
- As one of the leading market players, we believe Samba stands to benefit from a pick up in demand for credit, leveraging its economies of scale. However, following the impact of the credit crisis, the bank is expected to tread cautiously while expanding its loan portfolio. We expect Samba to post a 2% growth in net profit to USD 1.24 Bn in 2010.

USD Mn	2004	2005	2006	2007	2008	2009	2010F
Net interest income	787	935	1,147	1,319	1,349	1,352	1,323
Net income	668	1,071	1,389	1,287	1,188	1,216	1,240
P/E (LFY)	21.46	13.38	10.32	11.14	12.07	11.79	12.02
P/B (LFI)	5.31	4.17	3.51	3.01	2.71	2.41	2.20
M. Cap	17,066	31,121	20,801	28,860	12,295	12,119	14,426
Stock Returns		86%	-27%	32%	-56%	3%	20%

2010 figures - P/E, P/B on 2Q-2010 ending results and M.Cap. as on 14th August 2010
Source: Reuters Knowledge, Zawya

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Discussion Note

Looking Back

2009

Net profit rose 2.4% YoY to USD 1.22 Bn in FY 2009, while earlier estimates projected a 3.7% decline

Net Income: In FY2009, the bank's net profit stood at USD 1.22 Bn, an increase of 2.4% YoY. It differed from our earlier estimate of about USD 1.04 Bn mainly due to robust investment income of USD 124 Mn in 2009 as against a loss in the previous year and lower-than-expected rise in loan loss provisions. Samba's operating expenses contracted 7.6% YoY to USD 520 Mn in 2009. Though the loan loss provision was lower than our earlier estimate of USD 236 Mn, it still more than doubled in 2009. Non-operating expenses fell 7.6% YoY to USD 520 Mn during the same period.

NII grew 0.2% YoY to USD 1.35 Bn in 2009

Operating Income: Growth in net interest income (NII) was stagnant in 2009; it inched up 0.2% YoY to USD 1.35 Bn, lower than our forecast of USD 1.38 Bn. Sluggish growth in NII could be ascribed to a 25% YoY decrease in interest income to USD 1.7 Bn, compounded by a steep 62% YoY fall in interest expense to USD 342 Mn in 2009. However, operating income rose due to robust investment income, which stood at USD 124 Mn in 2009 as against a loss of USD 82 Mn in 2008. This increase was partly offset by a 24% YoY drop in other operating income (bank fees, forex income and other bank income) to USD 419 Mn during the same period. As a result, Samba's total operating income grew 4.3% YoY to USD 1.9 Bn in 2009.

Provisions: In 2009, the bank's provisions increased 127% YoY to USD 161 Mn due to deteriorating credit market conditions and higher risk of defaults. Although this rise was lower-than-expected, it was still substantial. In fact, provisions made amid the financial crisis proved to be the highest in the past six years.

In 2009, loans declined 13.5% YoY to USD 23 Bn amid slowing economic activity and elevated credit risks

Loans & Deposits: The loan book dipped 13.5% YoY to USD 23.3 Bn in 2009 amid slowing economic activity in the Kingdom and elevated credit risks. Earlier, we had estimated the bank's loan portfolio to fall 15%. On the other hand, deposits reported a healthy growth of 9.7% YoY to USD 39.22 Bn, just USD 20 Mn higher than our prediction. As of 31 December 2009, the loan to deposit ratio stood at 59%.

2Q10

Samba's net income marginally increased 0.8% QoQ to USD 325 Mn. The bank's operating income contracted 3.8% QoQ to USD 472 Mn in 2Q10, while operating expenses rose 5.0% QoQ to USD 132 Mn, resulting in a 6.8% QoQ decline in net operating income before provisions.

In 2Q10, NII dropped 8% to USD 321 Mn, partially offset by a 10.5% YoY rise in non-interest income to USD 152 Mn

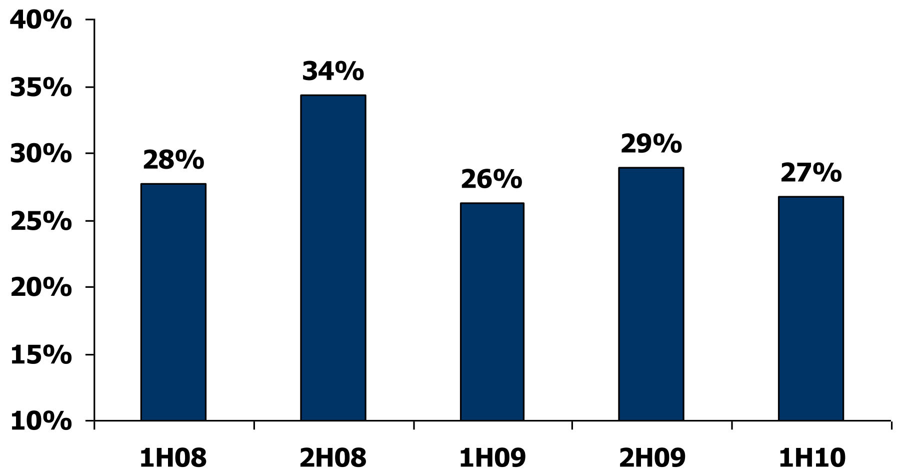
During the quarter, interest income increased 0.8% QoQ to USD 363 Mn, while interest expenses reported a fall of 11.4% QoQ. As a result, NII rose 2.6% QoQ to USD 321 Mn. The bank's non-interest income dipped 14.9% QoQ to USD 152 Mn. During the same period, Samba's profitability was aided by lower provisions, which decreased 64.1% QoQ to USD 15 Mn.

Interest income decreased 21% YoY to USD 722 Mn, while interest expenses fell 59% YoY to USD 89 Mn in 1H10

1H10

Net profit dipped 3.4% YoY to USD 648 Mn in 1H10. This was due to the 9.2% YoY decline in NII, partially offset by a 3.7% YoY rise in non-interest income (USD 330 Mn) and a 3.3% YoY fall in operating expenses (USD 256 Mn). The bank's cost-to-income ratio improved from 28.9% in 2H09 to 26.7% in 1H10. However, on a YoY basis, it marginally rose 50 bps from 26.2% to the current level.

Figure 1: Cost-to-Income Ratio Trend



Source: Company Filings, Markaz Research

Interest income decreased 21% YoY to USD 722 Mn mainly due to declining loan book, while interest expenses fell at a faster pace of 59% YoY to USD 89 Mn. Lower interest expenses coupled with a 3.7% increase in non-interest income buffered the decline in total operating income. Loan loss provisions fell 27.6% YoY to USD 58 Mn in 1H10.

Loans & advances continued to decline in 1H10. The bank's loan book contracted 5.9% YoY to USD 22 Bn. Deposits posted a 1.5% YoY fall to USD 36.28 Bn. In 1H10, the bank's loan to deposit ratio declined to 60.8% compared to 63.7% in 1H09. Samba is facing headwinds from slow credit growth in KSA. According to figures released by the Saudi Arabian Monetary Agency (SAMA), bank credit (bank claims) in the Kingdom grew at a sluggish annual rate of 1.8% to USD 256 Bn in 1Q10. On the brighter side, this was in contrast to the negative annual growth witnessed in the previous quarter.

Looking forward – 2010

As a result of the tepid economic activity, credit growth was adversely affected. Consequently, Samba's loan book contracted and provisioning increased. However, going forward, the economy is expected to gather momentum. According to the International Monetary Fund (IMF), the Kingdom's real GDP is expected to grow 3.7% and 4% in 2010 and 2011, respectively. We anticipate a pick-up in credit growth to support the increase in economic activity backed by high government spending.

In June 2010, Standard and Poor's (S&P) upgraded Samba's rating from A to A+. Earlier, in February 2010 Moody's had also raised its ratings from A1 to Aa3 citing strong capitalization, resilient funding and liquidity indicators and a balanced risk profile.

Operating income

NII is forecasted to decline 2.1% YoY to USD 1.3 Bn, operating income by 3% YoY to USD 1.8 Bn, in 2010

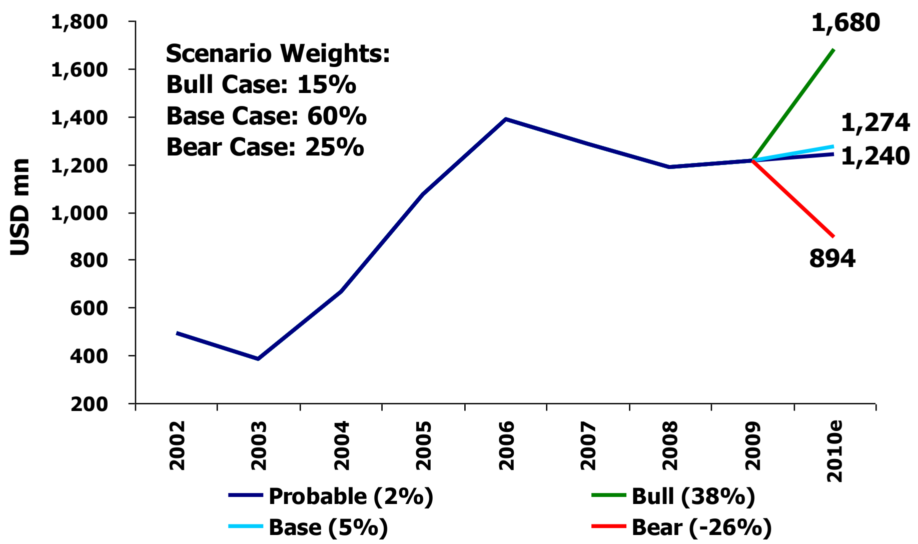
In 2010, interest income is likely to decline 10.0% YoY to USD 1.5 Bn as the bank is expected to maintain its conservative lending policy, while interest expense is projected to fall 41.4% YoY to USD 200 Mn as it benefits from the lower cost of its deposit base. NII is forecasted to decline 2.1% YoY to USD 1.3 Bn in 2010. As a result, operating income is expected to decrease 3% YoY to USD 1.8 Bn during the same period.

Net profit

We expect Samba's operating expenses to decline 5.8% YoY to USD 490 Mn in 2010. Furthermore, we expect the bank's provisioning requirements to be lower, going forward. As a result, we anticipate a loan loss provision of USD 108 Mn, a decline of 33% YoY in 2010. Consequently, we expect Samba's net profit to rise 2% YoY to USD 1.24 Bn in 2010.

In the bull case and base case scenarios, we have assumed net interest income to increase 20% YoY and decrease 20% YoY, respectively in 2010. Again, under bull case, we expect a 43% YoY decline in Samba's interest expenses as well as its loan loss provisioning. Under the bear case scenario, we expect interest expenses to decline 40% YoY while its loan loss provisions are expected to decline only 17% YoY. The effect of these assumptions causes a wide divergence in net profit under the two scenarios.

Figure 2: Net Profit



Source: Company Filings, Markaz Research

Loans and Deposits

Following the credit crisis, loan growth is estimated to remain relatively low.

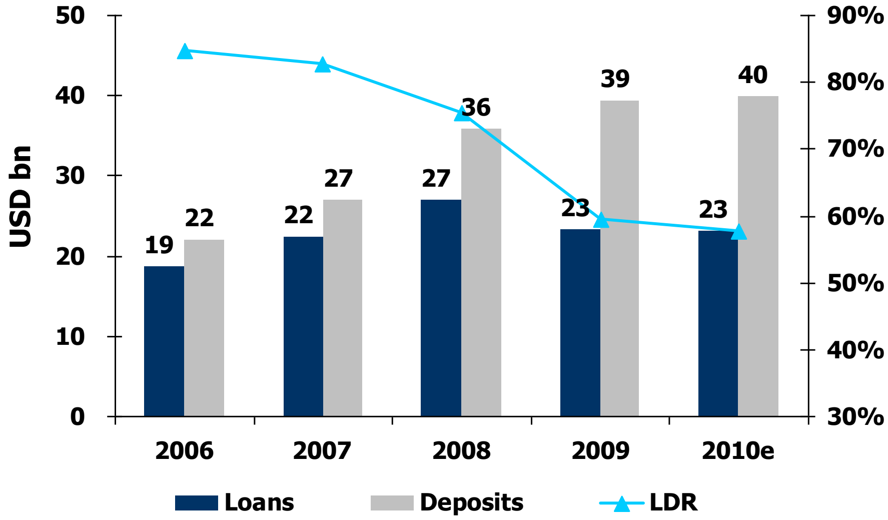
Over the short term, Samba is expected to tread cautiously as economic activity gradually gathers momentum in Saudi Arabia. Following the credit crisis, loan growth is estimated to remain tepid. In fact, we expect the bank's loan book to likely decline 1.2% YoY to USD 23 Bn in 2010.

Samba is expected to register a moderate growth in its deposit base. The bank's strategy is to lower interest expenses. In 2010, we expect deposits to rise 1.8% to USD 39.9 Bn. Hence; the Loan/Deposit ratio is expected to stay in the 58%

range, well below the SAMA cap of 85%. The Saudi banking industry average in 1Q10 was at 81%. Compared to its peers, Samba has maintained relatively higher levels of liquidity.

Deposits are expected to remain around the same level as that in 2009

Figure 3: Loan – Deposit Trend



Source: Company Filings, Markaz Research

Broker Estimates

Brokerage houses expect Samba to generate USD 1.81–1.95 Bn in revenues in 2010, providing for a moderately flat growth

We expect ROA to marginally decline from 2.5% in 2009 to 2.4% in 2010 due to decline in operating income, partly offset by a rise in profitability. Samba's ROE is expected to decline from 20.4% in 2009 to 18.8% in 2010. However, the bank's net profit is projected to grow 2.0% YoY to USD 1.2 Bn, mainly due to declining interest expense as it benefits from the lower cost of deposits and reduced loan loss provisions.

Table 2: Broker Estimates

Consensus Estimate Table (2010 f)					
Annual (USD Mn)	**EFG Hermes**	**Global Investment House**	**NBK Capital**	**TAIB Securities**	**Markaz**
Date of Estimates	**Jul-10**	**May-10**	**Apr-10**	**Jul-10**	**Aug-10**
ROA:	NA	2.5%	2.5%	2.4%	2.4%
ROE:	20.4%	20.2%	19.4%	19.2%	18.8%
Revenue:	1,950	1,813	1,918	1,807	1,838
Net Profit:	1,271	1,267	1,257	1,228	1,240
Growth (%)	5%	4%	3%	1%	2%
Recommendation	Buy	Hold	Hold	Buy	

Source: Zawya, Reuters Knowledge, Markaz Research

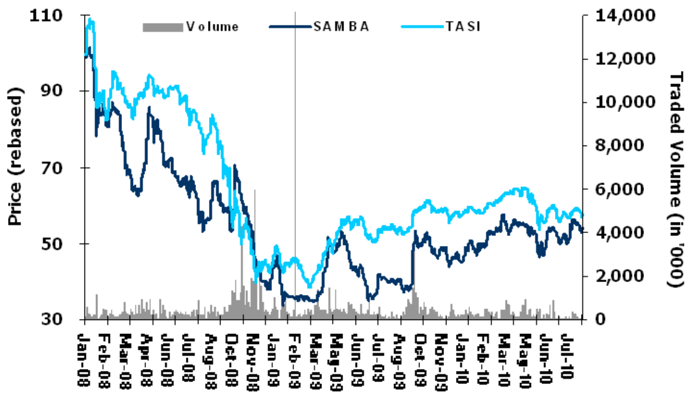
Brokerage houses expect Samba to generate USD 1.81–1.95 Bn in revenues in 2010, providing for a flat growth. The analysts' consensus net profit estimates provides for a 3.6% YoY rise to USD 1.26 Bn during the same period.

Valuation

On YTD basis, Samba Financial Group's share price has increased 20.3%, a significant gain compared to the TASI benchmark, which is up 0.8% since the beginning of the year (Figure 4). In 2009, the turnover velocity of Samba stood at 13% compared to 11% in 2008. The company's current PE stands at 11.8x; 14.6% higher than its 2 year average of 10.3x. Given the historical range in which the company's valuation has ranged and the current financial projections, we would place fair value PE for the group at 10x.

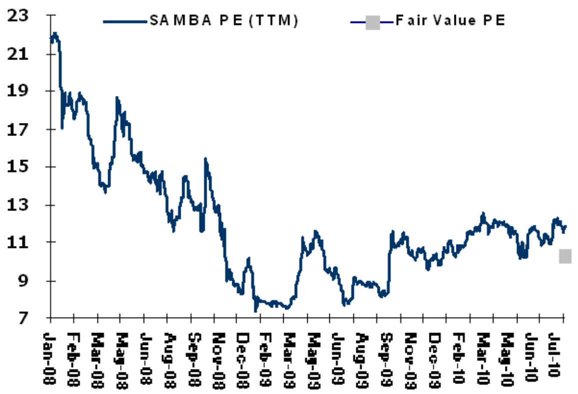
S&P's and Moody's upgrading of Samba's ratings from A to A+ and A1 to Aa3, respectively, confirms its strong capitalization, resilient funding and liquidity indicators and a balanced risk profile contribute to a stable outlook for the bank. However, in the short term, growth in credit off-take could be slower than expected which could adversely affect growth in Samba's loan portfolio. As a result, we expect the stock to provide low return coupled with medium risk going forward as the stock is currently trading in the middle of its MVX band (Figure 6).

Figure 4: Price & Volume Trend



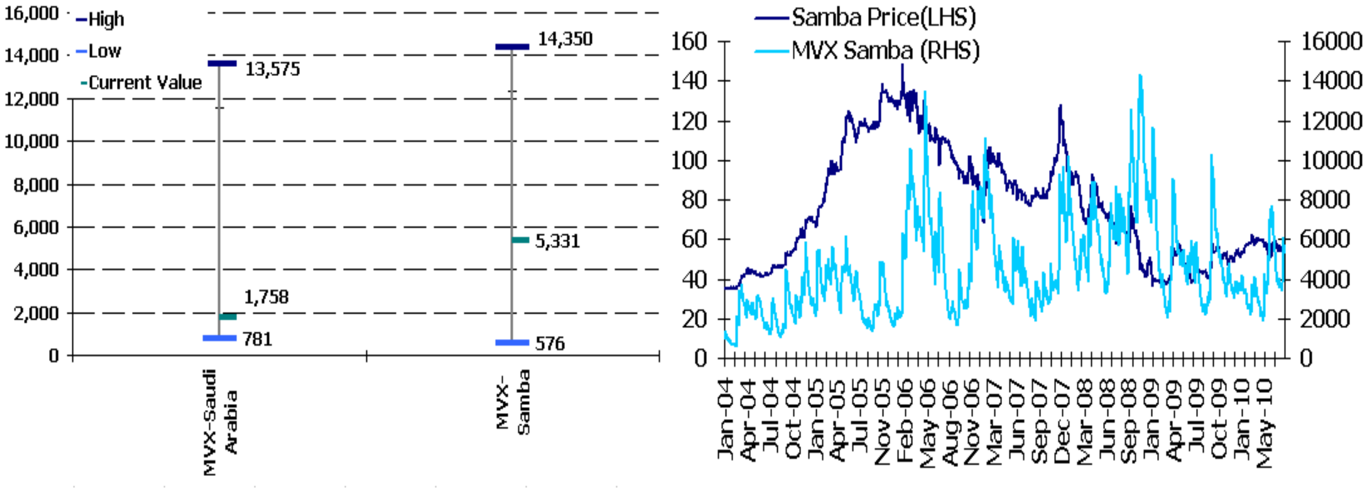
Source: Bloomberg

Figure 5: PE Trend & Fair Value



Source: Bloomberg, Markaz Research

Figure 6: Markaz Volatility Index (July 2010)



Source: Bloomberg, Markaz Research

Appendix 1: Key Statistics

Income statement (USD Mn)	2004	2005	2006	2007	2008	2009	2010e
Net interest income	787	935	1,147	1,319	1,349	1,352	1,323
Provisions	48	79	70	83	71	161	108
Net Profit	**668**	**1,071**	**1,389**	**1,287**	**1,188**	**1,216**	**1,240**
Balance Sheet(USD Mn)	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010e**
Loans	13,532	17,368	18,614	22,278	26,988	23,333	23,053
Deposits	16,271	19,733	21,967	26,946	35,768	39,224	39,930
Equity	2,702	3,442	4,080	4,760	5,289	5,948	
Assets	**25,250**	**28,882**	**33,071**	**41,188**	**47,679**	**49,458**	
Key Ratios	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010e**
Return on Assets (%)	3%	4%	4%	3%	2%	2%	2%
Return on Equity (%)	25%	31%	34%	27%	22%	20%	19%
Earnings Growth (%)	74%	60%	30%	-7%	-8%	2%	2%
Revenues Growth (%)	20%	46%	25%	-3%	-4%	4%	-3%
P/E	21.46	13.38	10.32	11.14	12.07	11.79	
Price/Book	5.31	4.17	3.51	3.01	2.71	2.41	
Market Price (SAR)	60.88	113.31	83.26	109.93	47.82	49.05	
EPS (SAR)	8.35	8.93	2.32	2.15	1.32	1.35	
Assets Growth	20%	14%	15%	25%	16%	4%	
Equity Growth	14%	27%	19%	17%	11%	12%	
Annual Trading Volume (Mn)	211	265	182	69	114	132	
Annual Trading Value (USD Mn)	2,767	7,581	5,886	1,686	2,173	1,603	
Turnover Velocity (%)	22%	5%	4%	7%	11%	13%	
M Cap (USD Mn)	17,066	31,121	20,801	28,860	12,295	12,119	

Source: Bloomberg, Zawya, Reuters, Company Financials

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UAE	79%	25%	58%
Bahrain	79%	100%	21%
Oman	63%	100%	50%
Egypt	62%	100%	45%
Jordan	39%	0%	32%
Morocco	50%	70%	24%
MENA	**79%**	**93%**	**63%**

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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

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