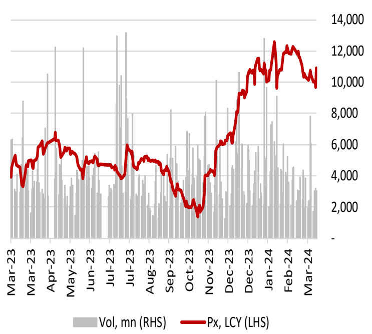
Al-Rajhi Bank (RJHI)

Target Price: SAR 96
Upside/ (Downside): 15%

Recommendation	Accumulate
Bloomberg Ticker	RJHI AB
Current Market Price (SAR)	83.3
52wk High / Low (SAR)	92.50/63.10
12m Average Vol. (000)	4,121.5
Mkt. Cap. (USD/SAR bn)	88/333
Shares Outstanding (mn)	4,000.0
Free Float (%)	98%
3m Avg Daily Turnover (SAR mn)	370.0
6m Avg Daily Turnover (SAR mn)	315.0
PE 2024e (x)	17.3
PBv 2024e (x)	3.3
Dividend Yield '24e (%)	1.8%

Price Performance:	
1 month (%)	-3.4%
3 month (%)	-3.6%
12 month (%)	8.8%

Price-Volume Performance



Source: Bloomberg

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- **Al Rajhi is the #1 Islamic bank globally and has the fastest-growing balance sheet among peers**
- **Robust net financing growth (about 5%YoY in FY23) on the back of mortgage lending growth as well as commercial segment**
- **Superior asset quality (NPA Ratio at 0.71%, NPA coverage ratio at 203%) on low-default retail-loan profile**
- **Most cost-efficient in the Saudi banking space; however, Cost-to-Income Ratio rose by 90bps in FY23**

We assign "**Accumulate**" rating to Al Rajhi Bank (RJHI) with a target price of **SAR 96 per share**. Our TP **implies** a P/E'24e of 17.3x, and a P/B'24e of 3.3x. We believe that this TP is justified because of the bank' strengths as compared to its peers as well as a firmer growth trajectory amid a mega-project pipeline.

Investment Thesis

- RJHI's fundamentals are superior to local peers in almost all aspects:
  - Lowest non-performing asset (NPA) ratio a 0.71%.
  - Strong NPA provision coverage ratio at about 203% at end-FY23
  - CASA stock has weakened but still remains high at 64% to support low-cost funding.
  - Best cost efficiency ratio, 27.2% during FY23
  - Regulatory Loan-to-deposit (LTD) ratio at 82.9% at end-FY23
  - Well-positioned as a mortgage lender to benefit from Saudi's Vision 2030 Housing Program, with the country's mortgage penetration being low as compared to other Emerging Market countries.
- Al Rajhi heavily relies on Retail funding; however, the company has fastened its product diversification program which has resulted in 2x corporate market share to ~13% against ~6.5% in FY20.
- Al Rajhi's deposit profile faded a little with CASA share declining from 91% in 2018 to ~65% in 4Q23 due to rising interest rates, making time deposits more appealing. Higher percentage of mortgage loans with fixed rate (~40%), squeezing net interest margins from loans and investments from 4.9% in 2018 to ~3% in 2023. However, as interest rates soften, gradual improvement is anticipated in FY24e and beyond.
- We forecast a compound annual growth rate of approximately 10% for the gross loan book from FY23 to FY28e.

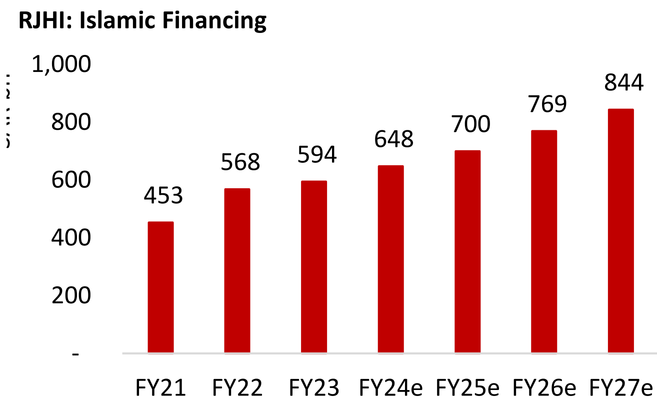
Key Indicators

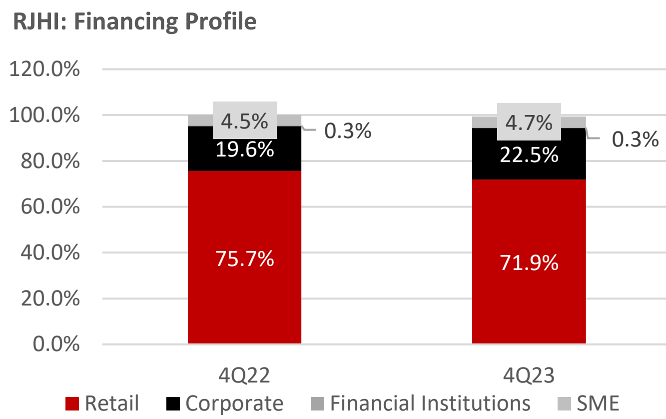
Year	FY20	FY21	FY22	FY23	FY24e	FY25e	FY26e	FY27e
Net Financing (SAR mn)	315,712	452,831	568,338	594,205	647,695	699,538	768,830	843,535
Customer Deposits (SAR mn)	382,631	512,072	564,925	573,101	627,718	681,264	752,409	829,578
Operating Income (SAR mn)	20,668	25,637	28,562	27,453	31,104	33,439	36,205	39,457
Net Profit (SAR mn)	10,596	14,746	17,151	15,800	19,225	20,666	22,539	24,654
Diluted EPS (SAR)	4.24	5.90	4.29	3.95	4.81	5.17	5.63	6.16
Tangible BVPS (SAR)	23.25	26.71	20.63	22.19	25.43	27.88	30.70	33.73
P/E (x)	17.4	15.0	24.2	21.1	17.3	16.1	14.8	13.5
P/BVPS (x)	3.2	3.3	5.0	3.7	3.3	3.0	2.7	2.5
Dividend Yield (%)	1.4%	1.6%	1.2%	1.5%	1.8%	2.0%	2.1%	2.6%

Source: Company Financials, U Capital Research

Financing growth to remain strong over the forecast period

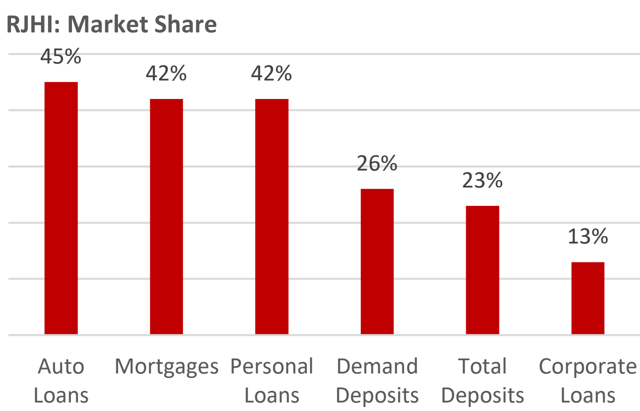
Given the positive outlook on Saudi's real GDP growth, we believe that credit growth will remain strong for RJHI. According to Knight Frank report, the Kingdom has witnessed an influx of real estate and infrastructure ventures surpassing USD 1.25tn since 2016, with the current active projects valued at ~USD 250bn. Specifically, Riyadh accounts for 18% of this expenditure, totaling USD 229bn, encompassing initiatives like constructing 241k residential units by 2030 and introducing 3.6mn square meters of new office spaces. Additionally, Saudi Arabia will be hosting the Expo 2030 in Riyadh attracting investments worth SAR 29bn. As these projects unfold, there is a foreseen need for additional capital injections into the real estate sector in the upcoming years.

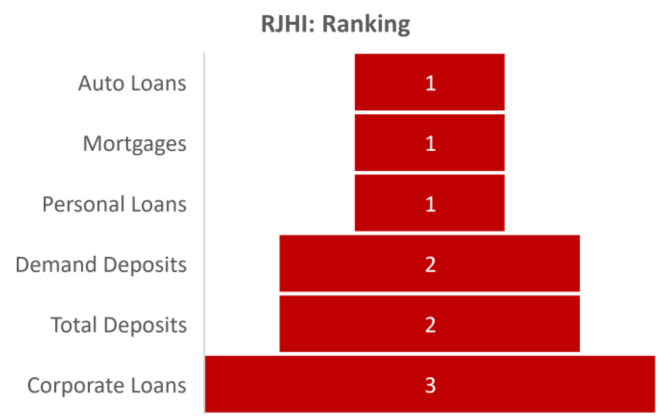




Source: Company Financials, U Capital Research

For RJHI, mortgage lending growth (45% CAGR over the last five years) will continue to remain strong supporting overall financing growth for the bank. The surge in growth can be attributed primarily to an increase in residential mortgages, spurred by government endeavors to enhance housing conditions in the Kingdom.





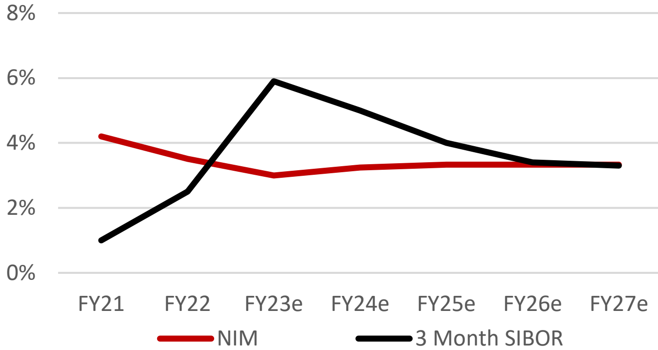
Source: Company Financials, U Capital Research

Also, the bank has had a higher exposure to retail but in recent years, it has made notable progress in diversifying its financing mix. RJHI has nearly doubled its market share in corporate loans from 6.7% in 2019 to ~13% by 2023, solidifying its position as the third-largest player in this sector. The outlook for corporate loan demand remains robust, driven by anticipated investments in the economy across infrastructure, real estate, hotels, and other key sectors over the next five years.

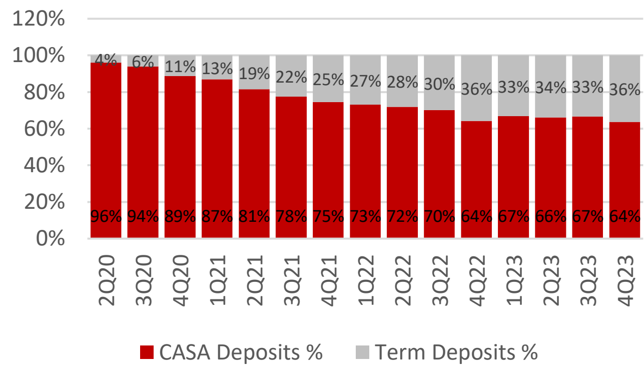
Altering the funding mix presents challenges to Net Interest Margin (NIM), the overall outlook is optimistic

Despite RJHI's profitability growth driven by a loan book expansion, its Net Interest Margin (NIM) has faced pressure in recent years, particularly in 2023 as growth slows. Rising inflation and increased US policy rates have elevated funding costs in the Kingdom, with the average 3M-SIBOR climbing from 1% in 2021 to 5.9% in 2023. Also, the proportion of term deposits to total deposits has risen from 7% in 4Q20 to 36% in 4Q23. This, combined with the inflexibility in pricing part of the asset book, has resulted in RJHI's NIM declining from ~4% in FY21 to ~3% in FY23. Nevertheless, with the deceleration of inflation and a plateau in US growth, we anticipate that interest rates have peaked, and we project a gradual easing of pressure over the next 3 to 4 years. This is likely to lead to a corresponding decline in SIBOR rates as well.

NIM to imrpove graduallly with expected downward trend in interest rates

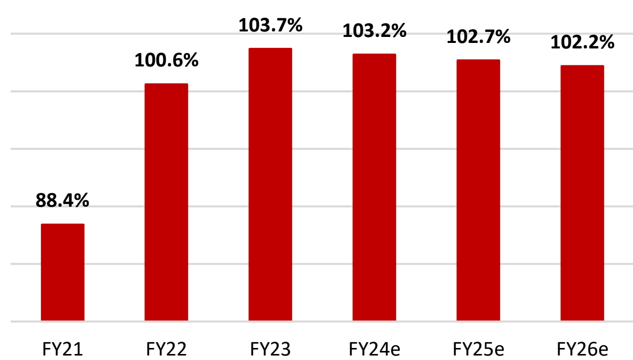


RJHI: Deposits Profile

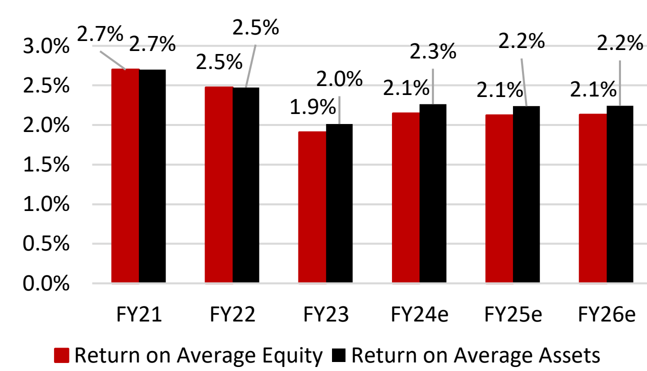


RJHI has relatively lower wholesale funding and relies heavily on customer deposits to fund its balance sheet. This has supported its margin historically. As of Dec 2023, ~67% of RJHI's total customer deposits are CASA, and this ratio has been on a decline since the start of 2020. From 2024 onwards, we expect an improvement in the deposit profile, with the anticipated decline in time deposits with a relatively lower interest rate in the next 3-4 years. On the other hand, a significant portion of the bank's fixed-rate financing exposure could potentially decrease in 2024 and thereafter, supporting margin expansion. Overall, we project a gradual enhancement in NIMs from the current levels of ~3% to 3.3% in 2027. However, it's important to note that RJHI's NIM is unlikely to reach the 2018 and 2019 levels of ~5%, given the prolonged expectation that interest rates will not return to those levels in the foreseeable future.

RJHI: Loan-to-Deposit Ratio



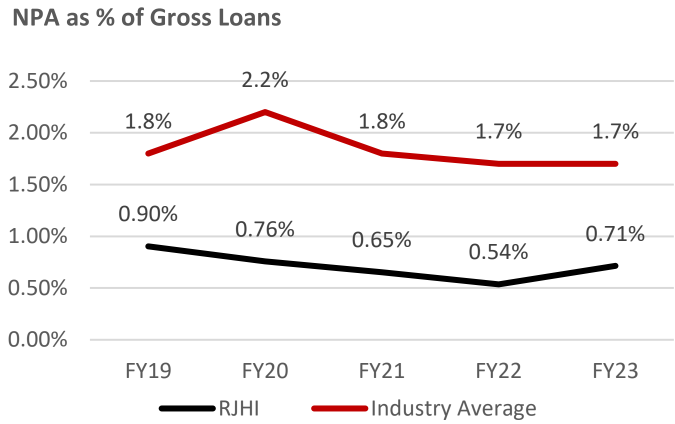
RJHI: Profitability Ratios

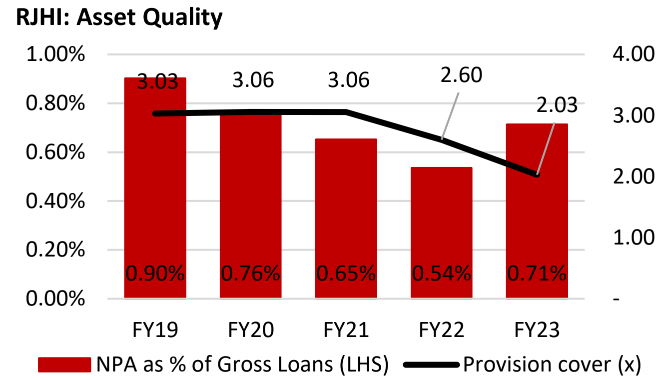


Source: Company Financials, U Capital Research

Low non-performing loans coupled with robust coverage enhances the overall quality of assets

RJHI has exceptional asset quality management, with a superior NPA provision coverage ratio as compared to local peers.

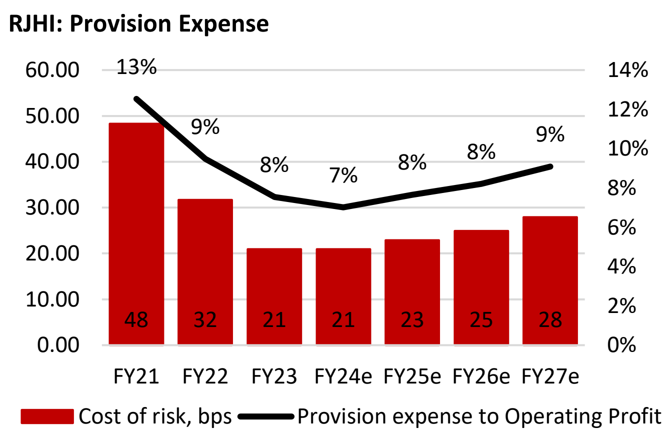


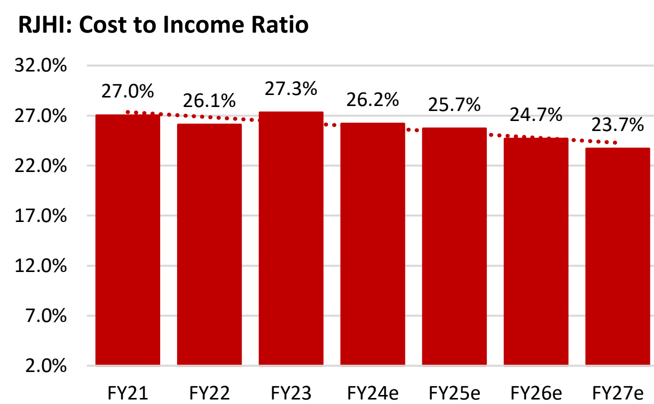


Source: Company Financials, U Capital Research

The NPL to gross loans ratio has improved consistently in the last 4 years and it has been steadily below 1%, outperforming the industry average of approximately 1.7%. The company attributes its robust asset quality to a significant portion of financing from retail operations, especially in the mortgage sector, where ~40% of loans have a maturity exceeding 5 years. Despite the typical 5-year test for mortgage loans, the company is confident in overall credit quality, backed by government-backed mortgage schemes that mitigate default risks. Untapped growth opportunities, including increased private sector participation, SME growth, and tourism potential, provide additional comfort against systemic risks. NPL coverage ratio of ~203% and expected adequacy going forward reinforce a positive outlook for ARB's asset quality.

RJHI's cost of risk on Profit Earning Assets (PEAs) is small on a relatively lower-default retail-loan profile, recoveries, and strong economic growth of KSA. However, we have penciled in a gradual increase in cost of risk due to a planned change in the financing mix and possible pressure on mid- to small-sized business cash flows in a high interest rate environment. On the other hand, the company's cost to income ratio is expected to improve in the forecasted years on the back of profitability growth.





Source: Company Financials, U Capital Research

Valuation

We have used Excess Returns Methodology (80% weightage) and Peer-Group Price-to-Book'24e multiple based valuation (20% weightage) to arrive at our target price for the bank. We find the present value of the excess returns (net profit minus the cost of equity) for each year over the forecast period. This present value is then added to the equity value invested currently and the terminal value. For terminal value calculation, we use the relationship between an estimated long-term ROE and retention ratio as proxy for terminal growth rate for each entity. **Key assumptions: risk-free rate of 4.14% (Saudi's 10 Yr current bond yield), 2 year weekly average Beta (Source: Bloomberg) of 1.250, US risk premium of 5.70% to arrive at a cost of equity of 11.3%.**

Beginning book value of Equity invested currently	**90,259,431**				
SAR'000 unless otherwise stated	**31-Dec-24**	**31-Dec-25**	**31-Dec-26**	**31-Dec-27**	**31-Dec-28**
	0.71	**1.71**	**2.71**	**3.71**	**4.71**
Net Income	**19,224,772**	**20,665,837**	**22,539,415**	**24,654,056**	**27,137,626**
Less: Equity Cost	11,460,463	12,562,730	13,835,118	15,197,909	16,757,841
Excess Equity Return	**7,764,309**	**8,103,107**	**8,704,297**	**9,456,147**	**10,379,786**
Present value of Excess Equity Return	7,196,755	6,750,360	6,517,041	6,363,154	6,277,519
Sum of present value of Excess Return	**33,104,828**				
Equity Cost					
Opening book value	**101,735,136**	**111,520,019**	**122,815,075**	**134,912,642**	**148,760,236**
Cost of Equity	11.3%	11.3%	11.3%	11.3%	11.3%
Equity Cost	11,460,463	12,562,730	13,835,118	15,197,909	16,757,841
Terminal value projections					
Book value of equity at start of year 6	**148,760,236**				
Net income in Stable period	29,752,047				
Less equity cost	16,757,841				
Excess return	12,994,207				
Terminal Value	429,823,680				
PV of Terminal Value	259,950,079				
Total Equity value	383,314,338				
Total shares out, '000	4,000,000				
Target Price, SAR	***96.00***				

Peer-Group Multiples Based Approach	
Median Peer-Group P/B (x) '24e	3.8
Bank's BVPS'24e	25.43
Target Price, SAR	***95.00***

Weighted-average Target Price, SAR	**96.00**
Current Price, SAR	83.3
Upside / (Downside), %	15%

Sensitivity Analysis

Our TP is sensitive to changes in our cost of equity assumption of +/-0.25% where our TP moves +/-7% with each change in cost of equity, ceteris paribus. Our TP is not sensitive to +/-0.1% changes to our stable period assumption. It is neither sensitive to +/- 0.1x changes to our P/B'23e assumption nor to +/- 5bps changes to cost risk assumption for 2023.

RJHI

Cost of Equity	Stable Period ROE: 19.8%	19.9%	20.0%	20.1%	20.2%
10.8%	107.00	109.00	110.00	113.00	114.00
11.0%	100.00	101.00	102.00	104.00	105.00
11.3%	93.00	94.00	**96.00**	97.00	98.00
11.5%	88.00	89.00	90.00	91.00	92.00
11.8%	83.00	84.00	85.00	85.00	87.00

Cost of risk	Peer-Group P/B Multiple: 3.6	3.7	3.8	3.9	4.0
32	95.00	95.00	96.00	96.00	97.00
37	95.00	95.00	96.00	96.00	97.00
42	95.00	95.00	**96.00**	96.00	97.00
47	95.00	95.00	96.00	96.00	97.00
52	95.00	95.00	96.00	96.00	97.00

Source: U Capital Research

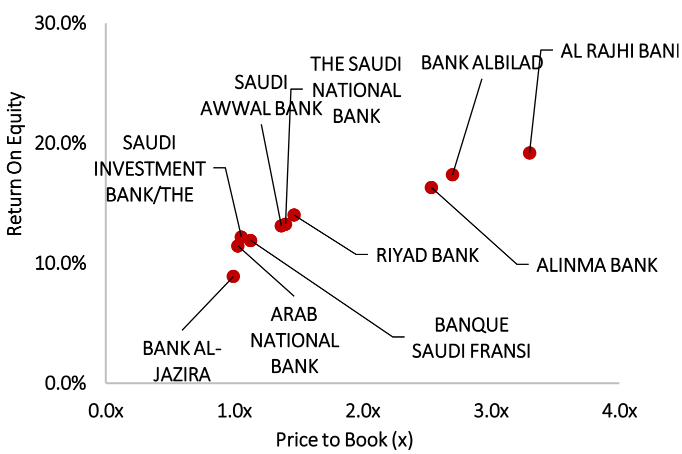
Peer Group Valuation

Name	Mkt Cap (SAR bn)	Shares out (mn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current P/B	P/B'24e, (x)	P/E'24e, (x)	ROE'24e, (%)	Div Yield' 24e, (%)	Retail Financing as % Total
Retail & Quasi-Retail Banks												
AL RAJHI BANK	348.4	4.0	87.10	-4	6	1	3.9	3.1	17.0	19.6%	3.5%	71%
THE SAUDI NATIONAL BANK	240.0	6.0	40.00	-6	5	3	1.5	1.3	10.9	13.7%	4.9%	53%
BANK ALBILAD	50.1		50.10	0	20	10	3.3	2.5	16.6	16.5%	1.3%	48%
BANK AL-JAZIRA	16.8		20.52	4	9	10	1.3	na	12.4	10.1%	3.4%	36%
Average							**2.5**	**2.3**	**14.2**	**14.9%**	**3.3%**	**51.8%**
Median							**2.4**	**2.5**	**14.5**	**15.1%**	**3.5%**	**50.3%**
Corporate-oriented Banks												
RIYAD BANK	91.5		30.50	0	8	7	1.7	1.4	10.6	14.4%	5.0%	34%
SAUDI AWWAL BANK	85.4	2.1	41.55	7	16	10	1.5	1.5	11.0	13.4%	4.9%	24%
BANQUE SAUDI FRANSI	46.9	1.2	38.90	1	-1	-3	1.3	1.1	10.2	11.7%	5.6%	18%
ARAB NATIONAL BANK	44.3	1.5	29.50	13	17	17	1.3	1.1	10.0	11.1%	5.3%	26%
ALINMA BANK	87.7	2.0	43.85	-1	18	13	3.0	2.4	14.7	17.5%	3.0%	24%
SAUDI INVESTMENT BANK/THE	17.0		17.00	0	7	7	1.2	1.0	8.6	12.1%	5.4%	13%
Average							**1.6**	**1.4**	**10.8**	**13.4%**	**4.9%**	**23.2%**
Median							**1.4**	**1.3**	**10.4**	**12.7%**	**5.1%**	**24.1%**

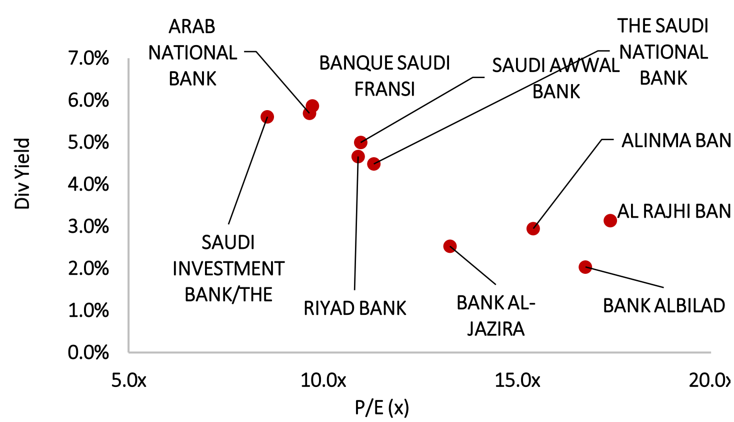
Source: Bloomberg, U Capital Research

The highlighted rows indicate banks under our coverage.

Price to Book and Return on Equity



Price to EPS and Dividend Yield



Source: Company Financials, U Capital Research

Key Financials

(SAR bn)	FY21	FY22	FY23	FY24e	FY25e	FY26e
Income Statement						
Interest/Financing Income	21.4	28.2	38.7	43.0	46.4	50.2
Interest Expense/Payment to Depositors	(1.0)	(6.0)	(17.5)	(18.6)	(20.2)	(22.0)
Net Interest/Financing Income	**20.4**	**22.2**	**21.3**	**24.4**	**26.2**	**28.2**
Fee & Commission Income	3.9	4.6	4.2	4.6	5.0	5.5
Other Income	1.3	1.8	2.0	2.1	2.3	2.5
Total Non-Interest/Financing Income	**5.2**	**6.4**	**6.2**	**6.7**	**7.3**	**8.0**
Total Operating Income	**25.6**	**28.6**	**27.5**	**31.1**	**33.4**	**36.2**
Provisions expense	(2.3)	(2.0)	(1.5)	(1.6)	(1.9)	(2.2)
Operating Expenses	(6.9)	(7.5)	(7.5)	(8.1)	(8.6)	(8.9)
Other non-operating losses / (income)	0.1	0.0	0.1	0.1	0.1	0.1
Profit Before Taxation	**16.4**	**19.1**	**18.5**	**21.4**	**23.0**	**25.1**
Sale of associate (net)	3.0	4.0	5.0	6.0	6.0	6.0
Taxation & Minority Interest	(1.7)	(2.0)	(2.7)	(2.2)	(2.4)	(2.6)
Net Profit Attributable to Parent	**14.7**	**17.2**	**15.8**	**19.2**	**20.7**	**22.5**
Net Profit Attributable to Parent after Tier 1 Interest Expe	14.7	17.2	15.0	18.2	19.6	21.4
Balance Sheet						
Cash Balances	40.4	42.1	41.8	75.5	82.8	96.3
Deposits with other banks & FIs	26.1	25.7	9.5	10.4	11.2	12.3
Gross Financing	462.0	576.4	602.9	647.7	699.5	768.8
Loan Loss Reserve	(9.2)	(8.0)	(8.7)	(10.0)	(11.5)	(13.4)
Net Financing	452.8	568.3	594.2	637.7	688.0	755.4
Other Assets	104.4	126.3	162.6	165.7	175.7	186.4
Total Assets	**623.6**	**762.4**	**808.1**	**889.3**	**957.7**	**1,050.4**
Deposits from Banks & FIs	-	-	-	-	-	-
Deposits from Customers	512.1	564.9	573.1	627.7	681.3	752.4
Other Borrowings	20.4	74.4	103.6	105.1	113.6	116.9
Other Liabilities	23.9	22.8	24.6	38.3	34.9	41.8
Paid-up Capital	25.0	40.0	40.0	40.0	40.0	40.0
Retained Earnings	17.0	9.9	16.9	29.1	42.1	56.3
Other Reserves	25.3	33.9	33.3	32.7	29.4	26.5
Shareholders' Equity	**67.3**	**83.7**	**90.3**	**101.7**	**111.5**	**122.8**
Minority Interest	-	-	-	-	-	-
Tier 1 Perpetual Notes	-	16.5	16.5	16.5	16.5	16.5
Total Equity & Liability	**623.6**	**762.4**	**808.1**	**889.3**	**957.7**	**1,050.4**
Cash Flow Statement						
Cash from operations	30.0	12.9	50.5	54.1	34.9	42.4
Cash from investing activities	30.7	25.9	37.6	12.9	17.1	17.7
Cash from financing	(6.3)	14.7	(13.2)	(7.3)	(10.5)	(11.2)
Net changes in cash	(7.0)	1.7	(0.3)	33.8	7.3	13.5
Cash at the end of period	40.4	42.1	41.8	75.5	82.8	96.3
Key Ratios						
Return on Average Assets	2.7%	2.5%	2.0%	2.3%	2.2%	2.2%
Return on Average Equity	23.5%	22.7%	18.2%	20.0%	19.4%	19.2%
Return on Tangible Average Common Equity (ROTCE)	23.6%	23.0%	18.5%	20.2%	19.4%	19.2%
Yield on Islamic Finance Assets	4.42%	4.47%	5.39%	5.59%	5.59%	5.59%
Cost of Funds	-0.23%	-1.03%	-2.65%	-2.64%	-2.65%	-2.65%
Net Spread	4.6%	5.5%	8.0%	8.2%	8.2%	8.2%
Net Interest Margin (NIM)	4.2%	3.5%	3.0%	3.2%	3.2%	3.1%
Cost to Income Ratio	27.0%	26.1%	27.3%	26.2%	25.7%	24.7%
NPAs to Gross Financing	0.7%	0.5%	0.7%	0.7%	0.7%	0.7%
NPA Coverage (x)	3.1	2.6	2.0	2.1	2.2	2.4
Cost of Risk (bps)	48.3	31.7	20.9	20.9	22.9	24.9
Equity to Total Assets	10.8%	11.0%	11.2%	11.4%	11.6%	11.7%
Capital Adequacy Ratio (CAR)	17.5%	21.4%	21.5%	21.7%	22.1%	22.2%
Cash Dividend Payout Ratio	23.7%	29.2%	31.6%	31.6%	31.6%	31.6%
Adjusted EPS (LCY)	5.90	4.29	3.74	4.56	4.90	5.34
Adjusted BVPS (LCY)	26.91	20.93	22.56	25.43	27.88	30.70
TangBVPS, LCY	26.71	20.63	22.19	25.43	27.88	30.70
Market Price (LCY) *	88.63	103.66	83.25	83.25	83.25	83.25
Dividend Yield	1.6%	1.2%	1.5%	1.8%	2.0%	2.1%
P/E Ratio (x)	15.0	24.2	21.1	17.3	16.1	14.8
P/BV Ratio (x)	3.3	5.0	3.7	3.3	3.0	2.7
P/TangBVPS	3.3	5.0	3.8	3.3	3.0	2.7

* Market price for the current and subsequent years as per the closing price of 15-Apr-2024

Source: Company Financials, U Capital Research

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%

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