Saudi Banking Sector *-resilient and powering strong…*

December 16, 2021

Bank	Rating
Al Rajhi Bank (RJHI)	**Accumulate**
Saudi National Bank (SNB)	**Accumulate**
Saudi British Bank (SABB)	**Accumulate**

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- **Credit growth to remain resilient over 2022-25e on faster GDP growth**
- **Deposit growth likely to remain robust on Government's higher oil & gas revenues**
- **Net interest/finance margins expected to improve on rising interest rates**
- **Cost of risk to remain largely under control on better macroeconomic outlook**

We initiate coverage on the Saudi Banking Sector with three names in focus: Saudi National Bank (SNB), Al Rajhi Bank (RJHI) and Saudi British Bank (SABB). While our valuations are based on Excess Returns Methodology (80% weight) & relevant price-to-book multiples for each bank for 22e (20% weight), our positive stance on credit growth outlook for the country drives our forecasts. In our view, out-performance of Saudi banks on YTD basis should not be a cause for concern as some names still have some steam left. We will be expanding our coverage to include more Saudi banks with time.

- **Saudi banks are set to see further credit growth.** Our credit growth estimates are based on IMF's real GDP growth outlook for Saudi Arabia, whereby the Fund expects the real GDP to grow at 4.8% in FY22e, followed by an average growth rate of 2.8% over FY23-26e. Saudi banks have clocked in a Private & Government (including Quasi) credit growth of 11.5% on year-to-date (YTD) basis (at end-9M21) as compared to a simple average growth rate of 10% over 2010-2020.
- **Saudi banking sector sports exceptional credit quality.** Most banks within the sector boast exceptional credit quality. Saudi Central Bank data shows that while the sector's non-performing asset (NPA) ratio ticked up at end-1H20 to 2.3% from 1.9% at end-FY20, it has since then come down to 2.1% at end-1H21. This compares quite favorably with other GCC countries, with Saudi banks' NPA ratio being the lowest as compared to others, with UAE being as high as 6.6%[1].
- **Cost of risk to remain largely under control as regulatory forbearance measures unwind progressively**. We believe that cost of risk will remain under control for most banks as Saudi banks sport high NPA provision coverage ratios, with average at 170% (second highest after Kuwait).
- **Superior capital adequacy of the Saudi banking sector expected to maintain.** The total regulatory capital to risk-weighted assets (RWAs) stood at 19.8% at end-1H21 vs. 20.3% at end-FY20 and 19.4% at end-FY19. Regulatory Tier 1 capital to RWAs stood at a solid 18.1% at end-1H21 vs. 18.7% at end-FY20 and 18.1% at end-FY19.
- **Momentum in non-funded income of banks to remain robust.** Saudi banks' fee income has been positively impacted by improved domestic economic & trading environment as well as stock exchange activity. Fee-based income has collectively shot up by 28.4%YoY during 9M21 alone. We expect fee income growth to remain strong throughout our forecast period.

We prefer banks that have sound capital management policies, better credit supervision, and stronger liquidity profiles and stand to benefit from rising interest rates. The **US Fed** has indicated as many as **<u>three rate hikes</u>** in 2022 alone. We have assumed credit growth in Saudi to remain upbeat and spreads to improve given ample liquidity amid the prospect of rising interest rates. Any development on the contrary is likely to provide a downside to our valuations.

Name	Last Px (OMR)	Target Price (OMR)	Upside / (Downside) (%)	Current P/B	P/B'22e, (x)	P/E'22e, (x)	ROE'22e, (%)	Cash Div Yield, %
THE SAUDI NATIONAL BANK	61.90	**68.50**	11%	1.9	1.8	16.0	11.7%	2.9%
AL RAJHI BANK	139.00	**157.00**	13%	5.5	4.8	19.8	26.5%	2.3%
SAUDI BRITISH BANK	28.85	**32.40**	12%	1.1	1.1	14.8	7.6%	4.0%
Average				**2.8**	**2.6**	**16.9**	**15.3%**	**3.1%**

Source: Bloomberg, U Capital Research

[1] *Source: S&P Global, Top 45 banks of GCC*

Saudi Banking Sector

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Valuation

We have used Excess Returns Methodology (80% weightage) and Peer-Group Price-to-Book'22e multiple based valuation (20% weightage) to arrive at our target price for each bank. We find present value of the excess returns (net profit minus the cost of equity) for each year over the forecast period (2021-2025e). 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.

Valuation

	SNB	RJHI	SABB
Excess Returns Methodology (80% weightage)			
Current value of equity invested (A)	147.5	63.6	52.6
PV of Excess Returns (SAR bn)			
Year 1	4.6	7.5	(3.1)
Year 2	(0.4)	9.2	(2.4)
Year 3	0.4	9.2	(1.4)
Year 4	1.1	8.4	(0.5)
Year 5	1.7	8.5	(0.2)
Terminal	149.5	289.8	24.6
Total PV of Excess Returns (B)	156.9	332.5	16.9
Assumptions			
Risk Free Rate, % (Saudi 10Yr Bond Yield)	2.3%	2.3%	2.3%
Risk Premium, % (US Country Risk Premium: Bloomberg)	9.5%	9.5%	9.5%
Beta (2Yr Daily), x	1.05	1.03	1.16
Cost of Equity (COE), %	12.3%	12.1%	13.3%
Growth Rate, %	7.2%	9.8%	7.2%
Retention Ratio in stable period, %	40%	45%	40%
ROE in stable period, %	18%	22%	18%
Fair Value of Equity, SAR bn (A + B)	304.4	396.1	69.5
Outstanding Shares, bn	4.4	2.5	2.1
Target Price, SAR	***68.60***	***158.46***	***33.80***
P/B'22e Average Multiple (20% weightage)*	2.0	5.1	1.3
BVPS'22e, SAR	33.96	29.20	20.69
Target Price, SAR	***67.90***	***150.04***	***26.90***
Weighted Average Target Price, SAR	**68.50**	**157.00**	**32.40**
Current Market Price, SAR	*61.90*	*139.00*	*28.85*
Upside/(Downside), %	11%	13%	12%
Recommendation	Accumulate	Accumulate	Accumulate

**For Rajhi, it is justified P/B multiple, derived using the Gordon Growth Model.*

**For SNB, quasi-retail banks' average P/B'22e has been used for valuation, while for SABB, corporate banks' average P/B'22e has been used.*

Source: Company Financials, Bloomberg, U Capital Research

Risks to Valuation

Key downside risks to our valuations include:

- A slower-than-expected credit growth.
- Deterioration in asset quality.

Key upside risks to our valuation include:

- Any movement bans / lockdowns due to coronavirus-variants that could negatively affect global growth forecasts and hence the oil and gas prices, which in turn would negatively affect Saudi Arabia’s finances.

Sensitivity Analysis

Our TP for **SNB** is not sensitive to +/- 0.1% changes to stable period ROE assumption or +/-0.1x changes in P/B per-group multiple assumption. Our TP is sensitive to +/-0.25% changes in cost of equity, affecting our TP by +/-4% with every change.

SNB

Cost of Equity	Stable Period ROE				
	17.8%	**17.9%**	**18.0%**	**18.1%**	**18.2%**
11.8%	73.40	74.20	75.10	76.00	76.90
12.0%	70.10	70.90	71.60	72.40	73.20
12.3%	67.10	67.70	**68.50**	69.20	69.90
12.5%	64.30	64.90	65.60	66.30	66.90
12.8%	61.80	62.50	63.00	63.70	64.20

Cost of Equity	Peer-Group P/B Multiple				
	1.80	**1.90**	**2.0**	**2.1**	**2.2**
11.8%	73.70	74.40	75.10	75.80	76.50
12.0%	70.20	70.90	71.60	72.30	72.90
12.3%	67.10	67.80	**68.50**	69.10	69.80
12.5%	64.20	64.90	65.60	66.30	66.90
12.8%	61.70	62.30	63.00	63.70	64.40

Our TP for **RJHI** is not sensitive to +/- 0.1% changes to stable period ROE assumption (changes about 2%-3%) or +/-0.1x changes in P/B per-group multiple assumption. Our TP is quite sensitive to +/-0.25% changes in cost of equity, affecting our TP by +/-11% with every change.

RJHI

Cost of Equity	Stable Period ROE				
	21.4%	**21.5%**	**21.6%**	**21.7%**	**21.8%**
11.6%	189.00	194.00	200.00	206.00	212.00
11.8%	167.00	171.00	176.00	180.00	185.00
12.1%	150.00	153.00	**157.00**	160.00	164.00
12.3%	136.00	139.00	141.00	144.00	148.00
12.6%	124.00	126.00	129.00	131.00	134.00

Cost of Equity	Peer-Group P/B Multiple				
	4.9	**5.0**	**5.1**	**5.2**	**5.3**
11.1%	252.00	252.00	253.00	254.00	254.00
11.6%	190.00	191.00	192.00	192.00	193.00
12.1%	156.00	156.00	**157.00**	157.00	158.00
12.6%	133.00	134.00	134.00	135.00	136.00
13.1%	117.00	118.00	119.00	119.00	120.00

Our TP for **SABB** is not sensitive to +/- 0.1% changes to stable period ROE assumption or +/-0.1x changes in P/B per-group multiple assumption. Our TP is sensitive to +/-0.25% changes in cost of equity, affecting our TP by +/-4% with every change.

SABB

Cost of Equity	Stable Period ROE				
	17.8%	**17.9%**	**18.0%**	**18.1%**	**18.2%**
12.8%	34.40	34.70	35.10	35.40	35.70
13.0%	33.10	33.40	33.70	33.90	34.30
13.3%	31.90	32.20	**32.40**	32.70	33.00
13.5%	30.80	31.10	31.30	31.50	31.80
13.8%	29.80	30.00	30.30	30.50	30.70

Cost of Equity	Peer-Group P/B Multiple				
	1.10	**1.20**	**1.3**	**1.4**	**1.5**
12.3%	37.30	37.70	38.10	38.50	38.90
12.8%	34.20	34.60	35.10	35.50	35.90
13.3%	31.60	32.00	**32.40**	32.80	33.20
13.8%	29.40	29.80	30.30	30.70	31.10
14.3%	27.50	27.90	28.30	28.80	29.20

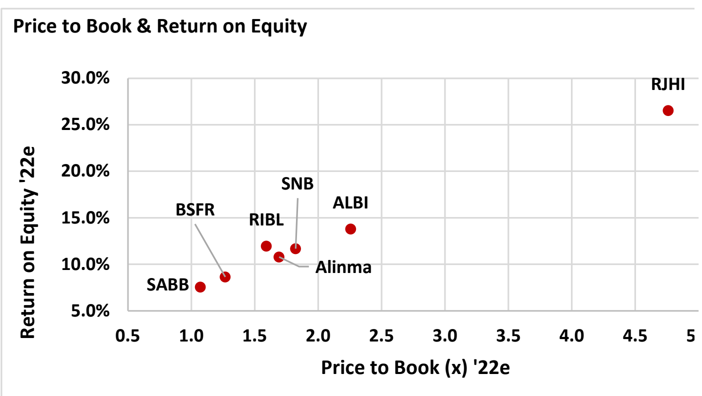
Peer Group Valuation

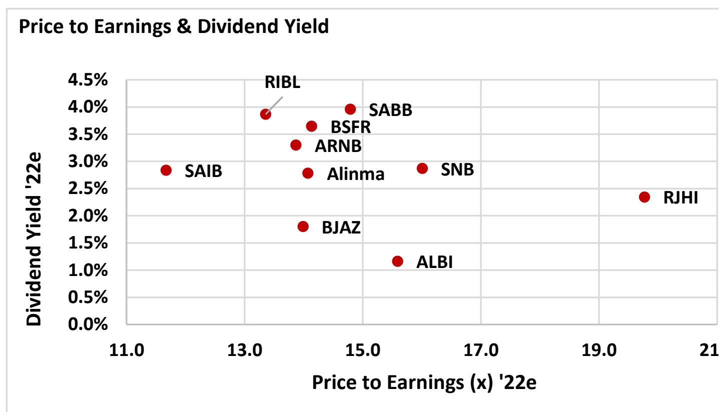
Name	Mkt Cap (SAR mn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current P/B	P/B'22e, (x)	P/E'22e, (x)	ROE'22e, (%)	Div Yield' 21e, (%)	Retail Financing as % of Total
Retail & Quasi-Retail Banks											
AL RAJHI BANK	347,500.0	139.00	-6	13	89	5.5	4.8	19.8	26.5%	2.3%	79%
THE SAUDI NATIONAL BANK	277,188.2	61.90	-10	1	43	1.9	1.8	16.0	11.7%	2.9%	49%
BANK ALBILAD	32,325.0	43.10	-6	4	52	2.7	2.3	15.6	13.8%	1.2%	49%
BANK AL-JAZIRA	15,940.8	19.44	-3	6	42	1.4	na	14.0	11.1%	1.8%	49%
Average						**3.3**	**2.9**	**17.1**	**17.3%**	**2.1%**	**59%**
Median						**2.7**	**2.3**	**16.0**	**13.8%**	**2.3%**	**49%**
Corporate-oriented Banks											
RIYAD BANK	79,800.0	26.60	-11	-1	32	1.7	1.6	13.4	12.0%	3.9%	33%
SAUDI BRITISH BANK	59,280.8	28.85	-15	-13	17	1.1	1.1	14.8	7.6%	4.0%	23%
BANQUE SAUDI FRANSI	50,142.9	41.60	-15	2	32	1.5	1.3	14.1	8.6%	3.6%	17%
ARAB NATIONAL BANK	32,970.0	21.98	-8	-6	9	1.1	1.0	13.9	na	3.3%	25%
ALINMA BANK	46,600.0	23.30	-9	-3	44	1.9	1.7	14.1	10.8%	2.8%	21%
SAUDI INVESTMENT BANK/THE	13,524.0	17.62	-2	4	13	0.9	na	11.7	na	2.8%	20%
Average						**1.4**	**1.3**	**13.6**	**9.7%**	**3.4%**	**23%**
Median						**1.3**	**1.3**	**14.0**	**9.7%**	**3.5%**	**22%**

Note: For banks outside of our coverage, the forward multiples are consensus mean extracted from Bloomberg

na = not available

Source: Company Financials, Bloomberg, U Capital Research



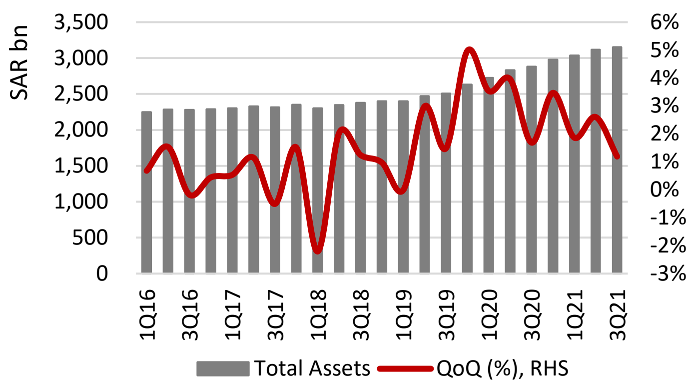


Source: Company Financials, Bloomberg, U Capital Research

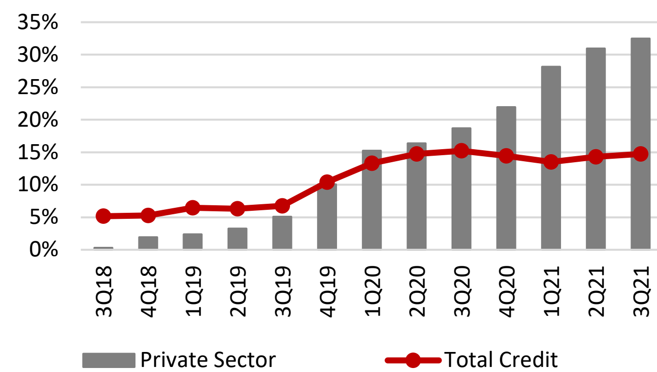
Local Peer Group Analysis

Saudi banks' operating environment has been driving significant growth, both in terms of balance sheets as well as income growth. While covid-19 pandemic affected banks' profitability in 2020 due to a high cost of risk, most banks have seen improvements in provision expenses during 2021. Further, the Government's conducive policies towards business have supported banks' loan & Islamic Financing growth, especially to the private sector while public sector credit growth is on a downtrend. Credit to the private sector is growing strongly (up about 13%YTD at end-3Q21), boosted by lending for housing (mostly under subsidized government home ownership programs) and to SMEs (helped by the expansion of the Kafala loan guarantee program) where bank's share of MSME credit has grown to 8.1% as a percentage of total banks' credit facilities at end-2Q21 as compared to 5.1% at end-1Q18.

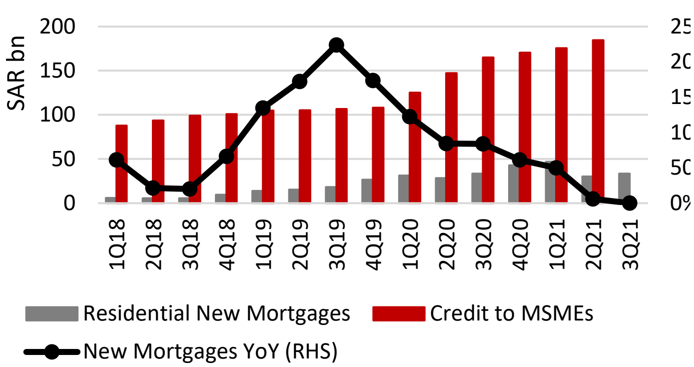
Saudi Banking Sector: Asset Growth



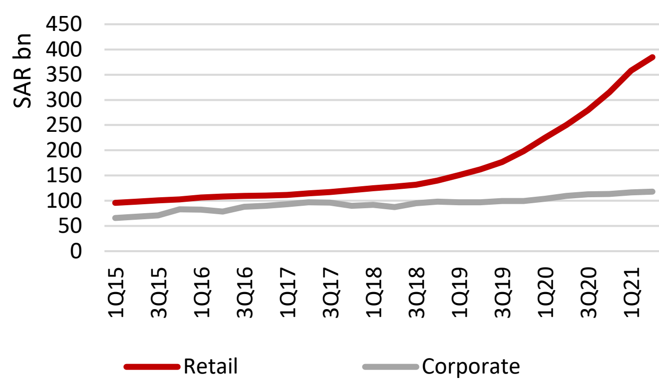
Saudi Banking Sector: Credit Growth, YoY



Saudi Banking Sector: Financing Growth in Mortgages & MSMEs



Saudi Banking Sector: Real Estate Credit

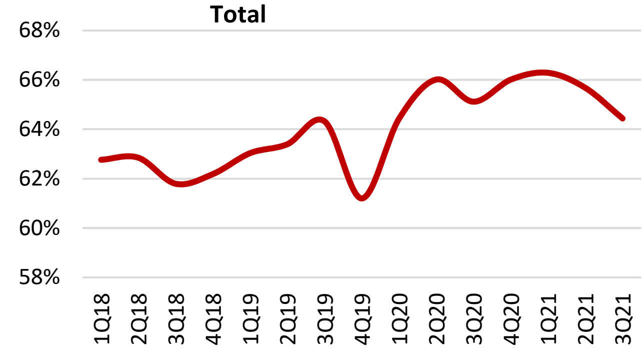


Source: Saudi Central Bank

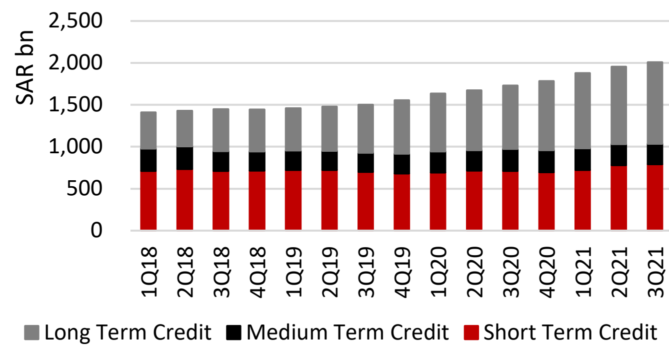
Most Saudi banks are highly liquid, with large share of demand or CASA deposits

Most of Saudi banks are sitting on large liquid funds in terms of demand deposits. Given the fact that interest rates are expected to increase from 2022e onwards, with the US Fed having indicated as many as **three** rate hikes in 2022 alone, most banks are expected to see expansion in NIMs. Further, banks have increased the share of longer-term credit (at 48% at end-9M21 vs. 31% at end-1Q18), with likely provision of annual interest rate revisions supporting re-pricing to higher rates.

Saudi Banking Sector: Demand Deposits as % of Total



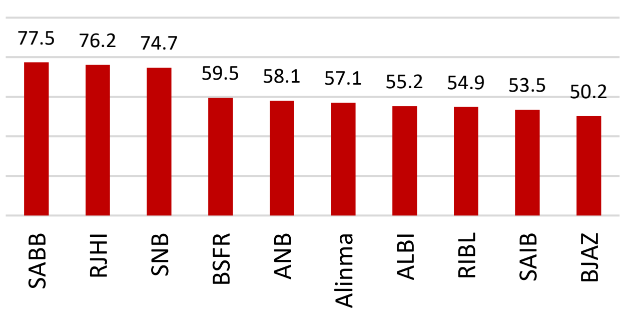
Saudi Banking Sector: Credit by Maturity



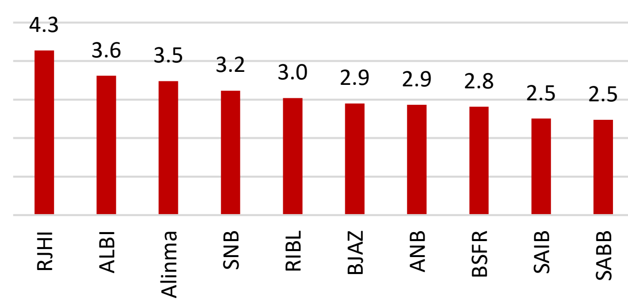
Source: Saudi Central Bank

SABB, SNB and RJHI stand out as having the largest share of demand deposits, whereas Riyad Bank (RIBL), Saudi Investment Bank (SAIB) and Bank Al Jazira (BJAZ) sport the lowest within the peer-group. In anticipation of rising interest rates, a lower dependence on low-cost deposits might negatively affect cost of funding for banks.

Saudi Banks: Demand Deposits to Total Deposits (%)



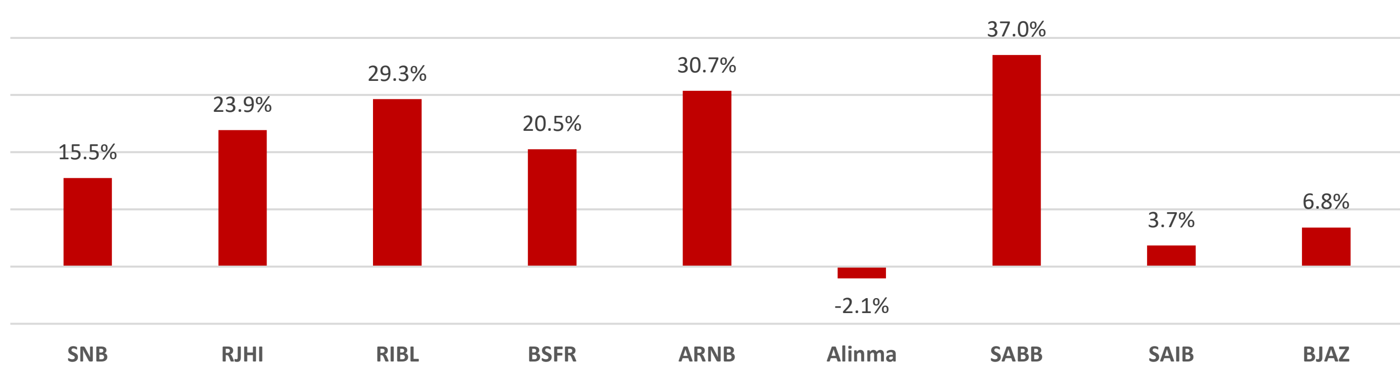
Saudi Banks' TTM Net Interest / Financing Margin



Source: Bank Financials, Bloomberg, Argaam, U Capital ---TTM = trailing 12 months --- Al Rajhi Bank (RJHI), Bank Al Bilad (ALBI), Alinma Bank (ALINMA), The Saudi National Bank (SNB), Riyad Bank (RIBL), Bank Al Jazira (BJAZ) Arab National Bank (ANB), Banque Saudi Fransi (BSFR), The Saudi Investment Bank (SAIB), Saudi British Bank (SABB)

Within the sector, an analysis of the interest rate risk of the balance sheet reveals that SABB, ARNB, and RIBL have significant assets becoming due for re-pricing during the first 12 months (as at end-FY20, recent data unavailable). We believe that given the anticipation of interest rate increases, these banks are **best positioned** to benefit from the rising interest rate environment due to faster re-pricing of their assets as compared to their liabilities. **RJHI and SNB** are distant next two banks to benefit from rising interest rates.

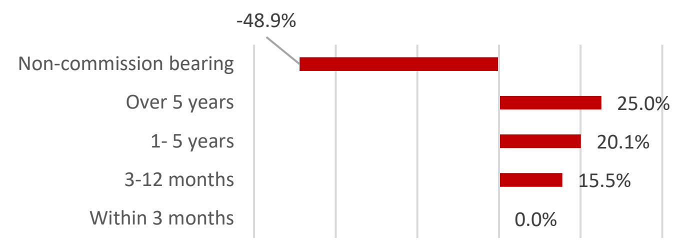
Position Gap (Assets - Liabilities) for 0-12 Months as % of Total Assets -FY20



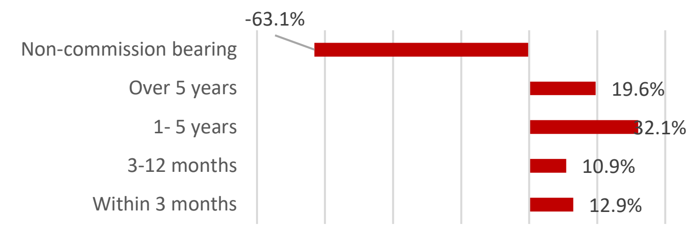
Source: FY20 Financials, U Capital Research

Position Gap (Assets - Liabilities) as a % of Total Assets -FY20

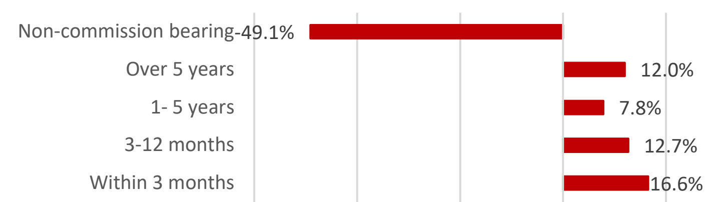
SNB



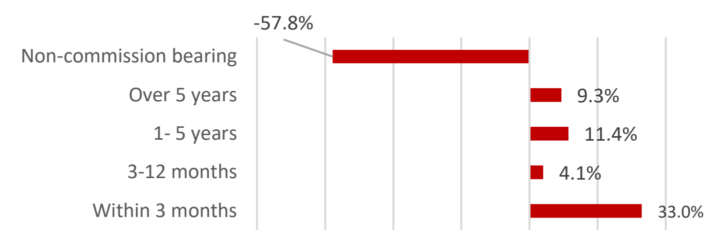
RJHI



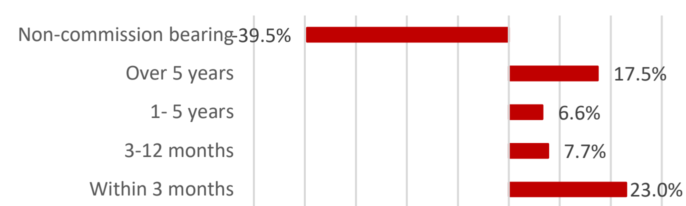
RIBL



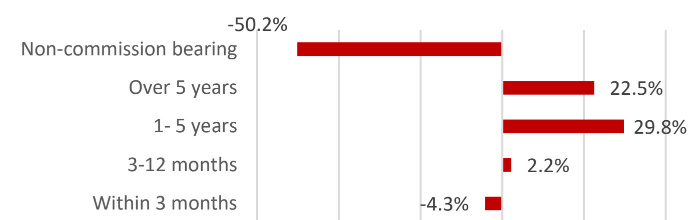
SABB



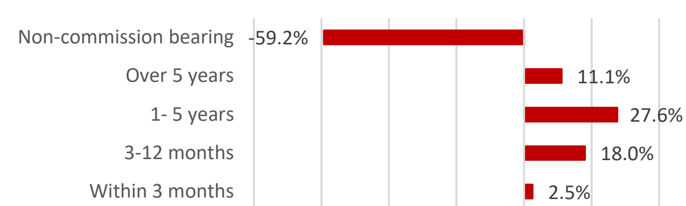
ARNB



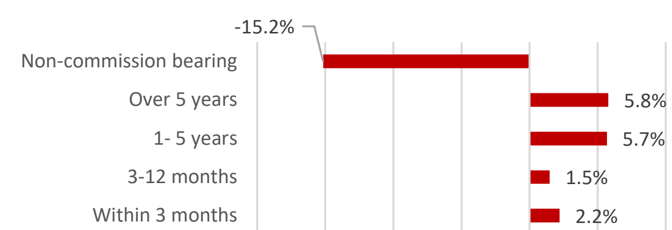
Alinma



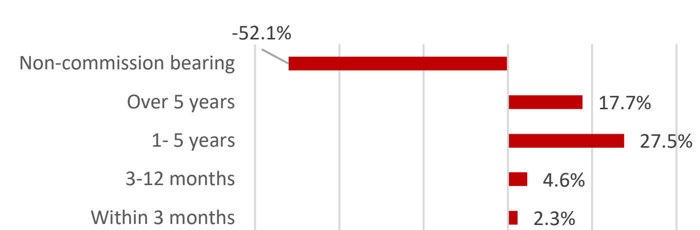
BSFR



SAIB



BJAZ



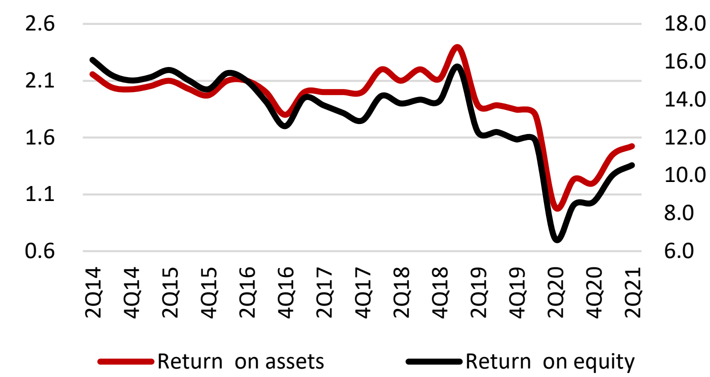
Al Bilad data is unavailable.

Source: Bank Financials, U Capital Research

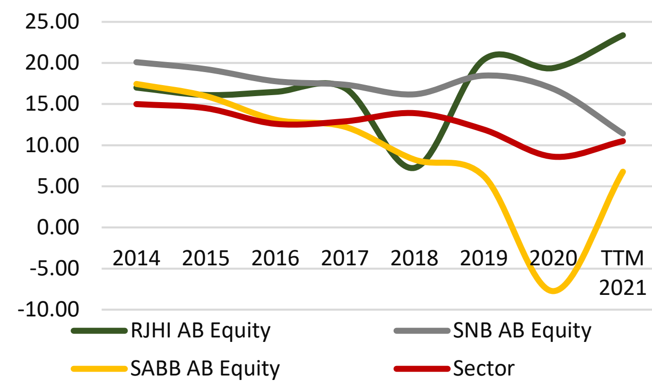
Sector profitability ratios have recovered and are nearing pre-pandemic levels

While requirement to meet Basel and regulatory capital adequacy ratios has led many banks to increase capital, thereby negatively affecting their profitability (RoEs) over the last few years, the largest hit on profitability came in FY20 as many banks front-loaded provisions in order to remain defensive in the pandemic-ridden times. However, ROEs and ROAs have since recovered, nearing pre-pandemic sector profitability at end-1H21. For the banks under over our coverage, profitability is close to pre-pandemic level for SABB, while RJHI has already overshot on stellar loan growth (see later section on RJHI). For SNB, as merger-related expenses continue to weigh, ROE is still below pre-pandemic levels.

Saudi Banking Sector: Profitability Metrics



Coverage Universe ROEs vs. Sector

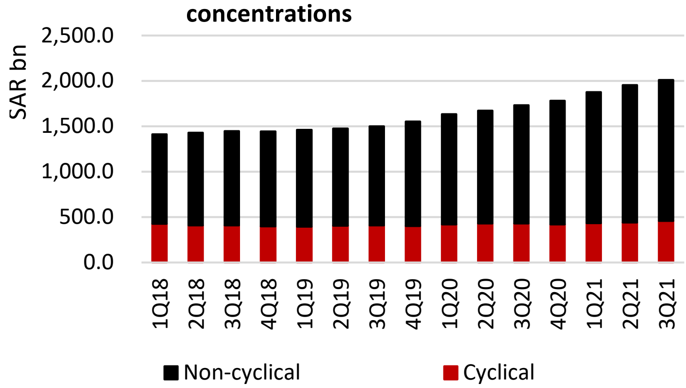


Source: Saudi Central Bank, Bloomberg

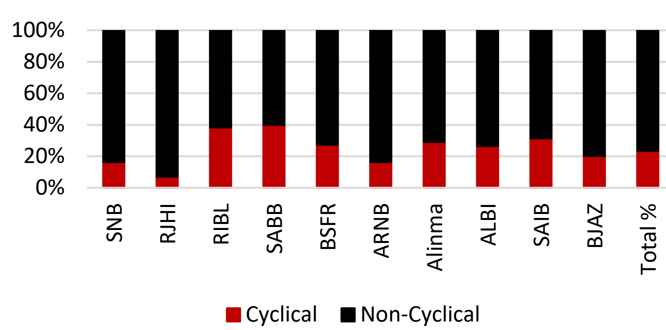
Economic sector concentration has improved over the last few quarters

Saudi banking sector's credit concentration has improved, with relatively more expansion seen in non-cyclical sectors of the economy since en-FY19.

Saudi Banking Sector: Economic Sector Credit concentrations



Saudi Banks Economic Sector Concentrations, FY20



Source: Saudi Central Bank, Bank Financials

At end-FY20, RJHI had the lowest exposure to cyclical sectors, however, the bank's retail exposure includes residential mortgages (at SAR 153.2bn or about 44% of retail book and 36% of total book at end-9M21), which is a sector that is prone to boom-and-bust cycles. However, we believe a **structural shift is taking place within the housing sector of Saudi Arabia**, as described under the Vision 2030 Housing Program. In 2018, our calculations show that Saudi Arabia had a low mortgage penetration level (**mortgage loans ratio of a mere 8% of its real GDP**), which rapidly increased to 16% at end-FY20 under the Housing Program. The Government is targeting a ratio of outstanding **mortgage loans to GDP of 18%** by

2025e, with total outstanding residential mortgage lending reaching SAR 640bn from SAR 420bn in 2020. Mortgage debt makes up the bulk of household debt in advanced economies, but less so in emerging market economies. It accounts for more than 50% of total household debt in most advanced economies, whereas among emerging market economies it captures one-third or less of total household debt.[2]

ARNB and SNB have relatively lower exposures to cyclical sectors as compared to the rest of the sector. End-9M21 data is not available for the banks for the comparison to be more recent.

Gross Loan/ Financing Concentration*	SNB	RJHI	RIBL	SABB	BSFR	ARNB	Alinma	ALBI	SAIB	BJAZ	Total % (From SAMA)
Government and quasi Government	2%	0%	0%	0%	5%	0%	9%	0%	1%	6%	**4%**
Banks and other financial institutions	3%	0%	5%	2%	2%	3%	0%	0%	15%	3%	**3%**
Agriculture and fishing	0%	0%	1%	0%	2%	1%	3%	2%	0%	0%	**1%**
Manufacturing	9%	0%	12%	22%	15%	9%	11%	0%	5%	8%	**9%**
Building and construction	4%	0%	8%	19%	9%	6%	6%	2%	12%	1%	**5%**
Commerce	10%	7%	24%	20%	18%	10%	9%	5%	19%	19%	**17%**
Transportation and communication	3%	0%	3%	1%	4%	7%	4%	3%	2%	0%	**3%**
Services	10%	4%	5%	2%	11%	3%	12%	3%	4%	3%	**5%**
Consumer loans and credit cards	50%	79%	34%	22%	17%	26%	21%	51%	20%	50%	
Industrial	0%	9%	0%	0%	0%	0%	0%	9%	0%	2%	
Others	0%	1%	0%	7%	9%	31%	6%	5%	21%	7%	**48%**
Real estate business	0%	0%	0%	0%	0%	0%	13%	16%	0%	0%	
Mining	2%	0%	6%	0%	1%	0%	2%	3%	0%	0%	**1%**
Electricity, water, gas & health services	6%	0%	3%	4%	8%	5%	3%	2%	0%	0%	**4%**
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

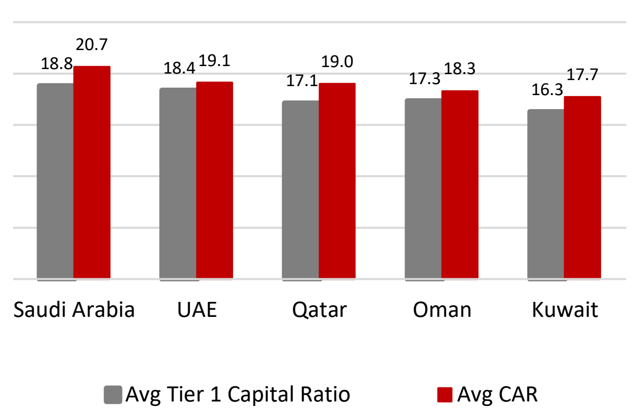
**Includes non-performing exposures*

Source: Bank Financials, Saudi Central Bank

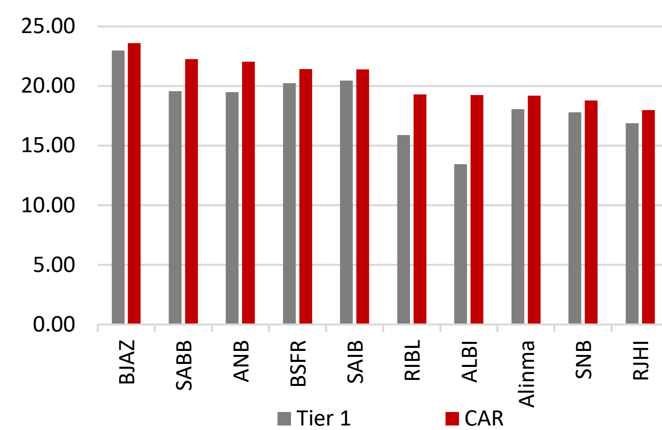
Saudi banks boast robust capital adequacy, superior to all GCC countries

Most Saudi banks boast superior capital adequacy levels as at end-9M21. SAMA requires Banks to hold the minimum level of the regulatory capital and maintain a ratio of total eligible capital to the risk-weighted asset at or above the agreed minimum of 8%. Within the listed banks, RJHI and SNB are on the lower end of the spectrum, but still quite comfortably above the regulatory requirement.

Select GCC banks' average Capital Adequacy Ratios



Saudi Banks' Capital Adequacy metrics



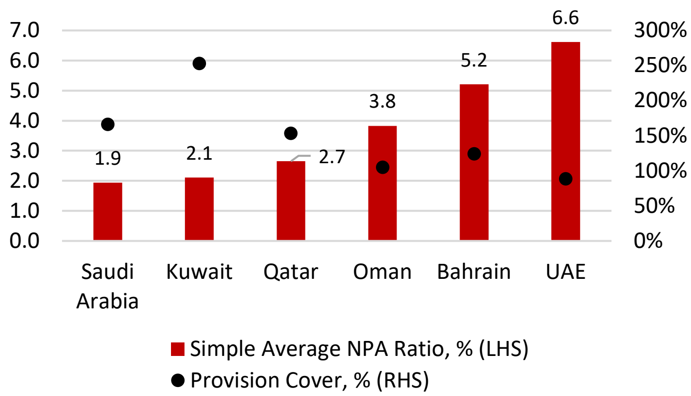
Source: Saudi Central Bank; All data as at end-9M21

[2] Global Financial Stability Report October 2017 Chapter Two: Household Debt and Financial Stability

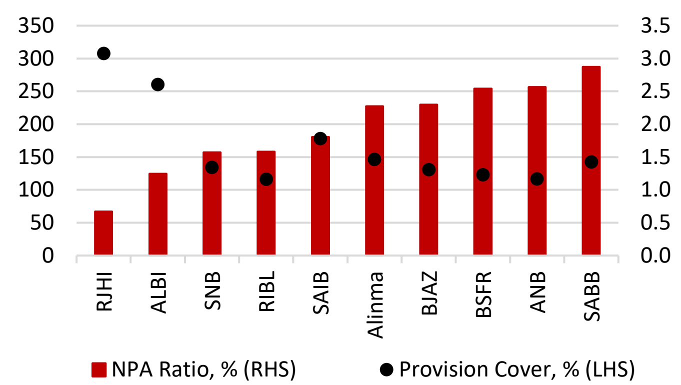
Saudi banks' asset quality is superior to its GCC counterparts (other than Kuwait)

Saudi's listed bank 9M-21 data indicates that over RJHI has a superior asset quality, with NPA Ratio lowest at 0.67%. Its provision cover is also superior to the sector at 307% (likely on account of exposure to the high growth/highly cyclical mortgage sector; its boom-bust cycle has prompted the bank to maintain a high provision coverage). SNB ranks third with NPA ratio at 1.58% and provision cover about a 100% (including Purchased or Originated Impaired (POCI) exposure due to merger). SABB has the weakest asset quality amongst its local peers, with NPA ratio at 2.7% but NPAs well covered with provisions, at about 140%.

Select GCC banks' asset quality



Saudi Banks' Asset Quality Metrics



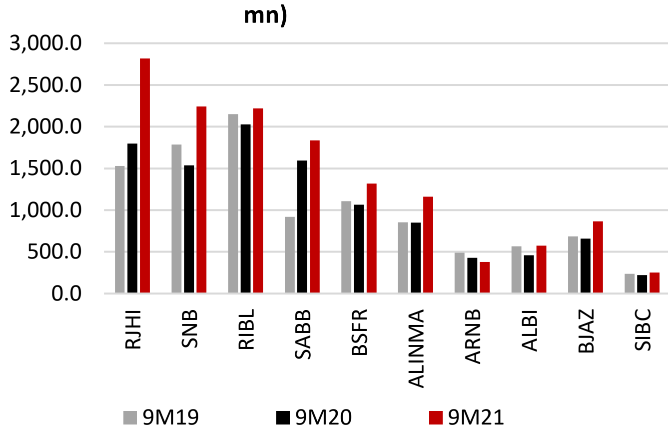
Source: Saudi Central Bank, Bloomberg, Banks' financials for end-9M21 data. (Excluding Purchased or Originated Credit Impaired (POCI)

Overall, NPA ratio (non-performing loans &/or Islamic financing to gross loans &/or Islamic financing) is very low for the Saudi banking sector (as compared to its GCC counterparts), although it has climbed up over the last few years. We believe that we might see a slight upward pressure on NPAs as regulatory forbearance measures pertaining to MSMEs (under the Private Sector Financing Support Program (PSFP)) unwind at the end of the year (the deadline to end payments deferral has been extended). However, it must be noted that banks have been unwinding modification losses that have arisen under this Programme.

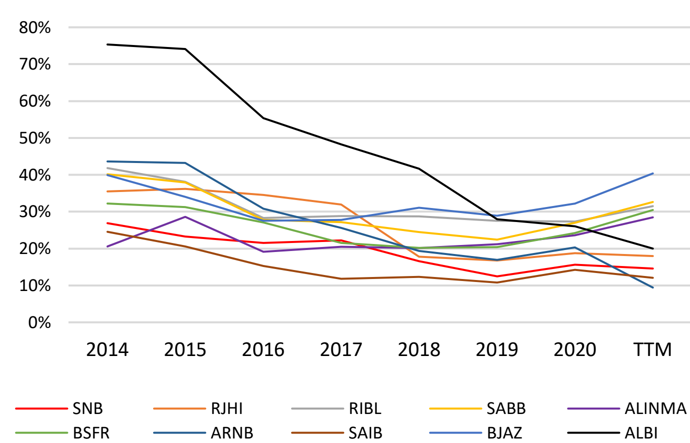
Net fee income growth has been notable across almost all large banks

Net fee income growth (YoY% during 9M21) has been notable foremost banks, especially RJHI, SNB and SABB. Further, we expect this momentum to continue on the bank of demand for new loan originations and ancillary services.

Saudi banks commission and fee income (SAR mn)



Fee-based income to funded income



Source: Saudi Central Bank, Bloomberg

Fee-based Income to Fund-based Income

	2014	2015	2016	2017	2018	2019	2020	TTM
SNB	27%	23%	22%	22%	17%	12%	16%	15%
RJHI	36%	36%	35%	32%	18%	17%	19%	18%
RIBL	42%	38%	28%	29%	29%	28%	27%	31%
SABB	40%	38%	28%	27%	24%	22%	27%	33%
ALINMA	21%	29%	19%	20%	20%	21%	24%	29%
BSFR	32%	31%	27%	22%	20%	20%	24%	30%
ARNB	44%	43%	31%	26%	19%	17%	20%	9%
SAIB	25%	21%	15%	12%	12%	11%	14%	12%
BJAZ	40%	34%	28%	28%	31%	29%	32%	40%
ALBI	75%	74%	55%	48%	42%	28%	26%	20%

Source: Bloomberg

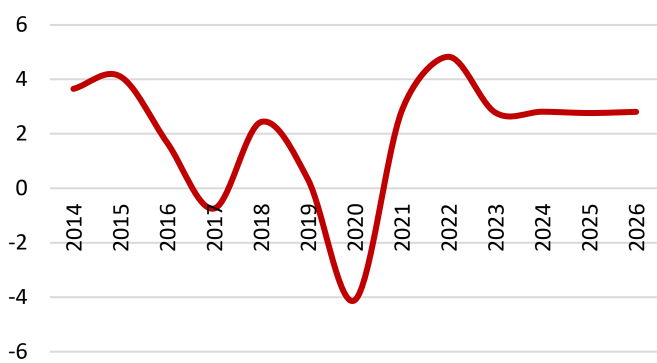
For many corporate-oriented banks, we are already seeing a recovery in the fee-based to fund-based income to historical levels.

Macroeconomic Outlook

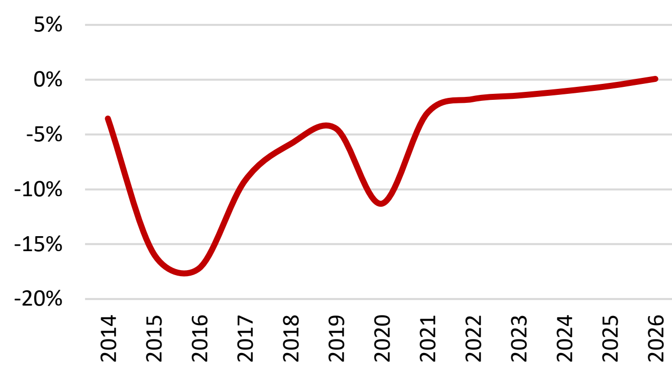
Overall macroeconomic recovery to continue

Saudi Arabia's real GDP is expected to grow by 4.8%YoY in 2022e[3]. Furthermore, the IMF expects the country's fiscal deficit to turn into a surplus by 2026. We believe that with sustained elevated oil prices, the country might witness an accelerated turn to a fiscal surplus.

Saudi Arabia: Real GDP Growth, YoY (%)



Saudi Arabia: Fiscal Surplus / (Deficit) as % of GDP



Source: World Bank Economic Outlook, October 2021

As per the Ministry of Finance (MoF), Saudi has already posted a fiscal surplus of SAR6.68bn[4] in 3Q21, its first since 1Q19, on account of higher oil prices and higher oil production. This surplus has reduced the year-to-date (YTD) deficit to SAR5.37bn. We believe this may indicate a potential to record a surplus in 2021e and/or providing more room to spend toward capex in Q4 21.

Non-oil GDP growth is expected to remain robust

The IMF expects Saudi Arabia's non-oil GDP growth at 4.3% in 2021 and 3.6% in 2022. As per the IMF, Central government fiscal consolidation will be a drag on growth in 2021 but is expected to be offset by higher PIF investment and strong private demand as credit growth remains robust and household savings accumulated during the crisis are rundown. Mortgage lending is expected to continue to grow robustly as well.

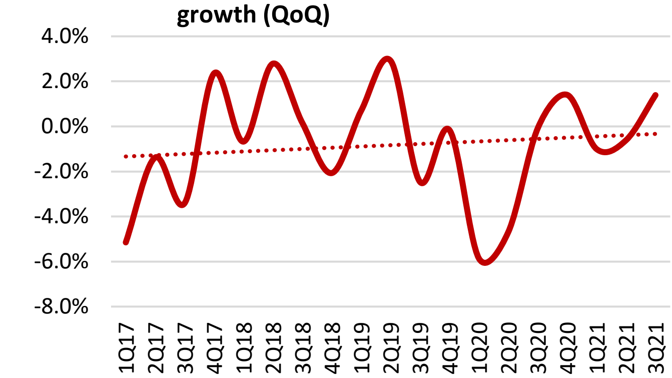
Central Bank's net foreign assets are burgeoning

Saudi Central Bank (SCB)'s foreign assets at end-3Q21 stood at SAR 1.68 trillion, up 1.4%YoY and 1.2%QoQ. The central bank's reserve assets stood at SAR 1.75 trillion at end-3Q21, up 4%YoY, on expansion in Special Drawing Rights (SDR), Reserve Position in the IMF and Investment in Foreign Securities, despite a fall in foreign currency and deposits abroad.

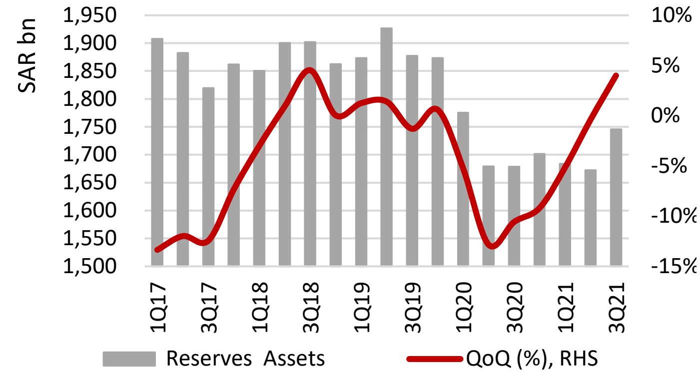
[3] IMF's World Economic Outlook, October 2021

[4] Quarterly Budget Performance Report, 3Q21

Saudi Banking Sector: SCB Net Foreign Assets growth (QoQ)



Saudi Central Bank: Reserve Assets



Source: Saudi Central Bank, Bulletin Sept'21

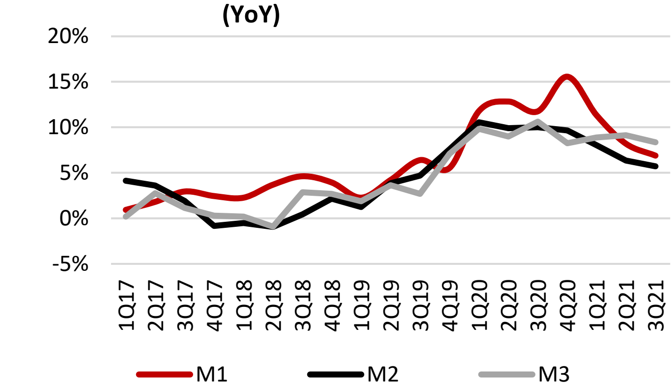
Inflation expected to remain range-bound

The IMF expects Saudi Arabia's Inflation to average 3.2% in 2021. Following the VAT rate increase in July 2020 (from 5% to 15%), CPI inflation jumped higher, but then settled around zero. Over the medium-term, inflation is projected to settle around 2%, broadly in line with the US.

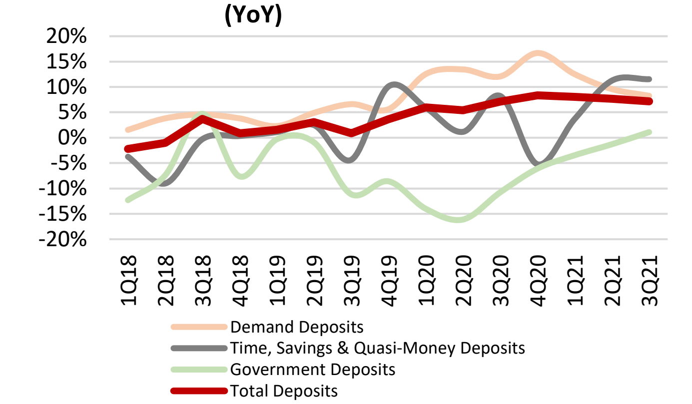
Money supply is growing amid strong deposit growth

Deposits into banks from the central bank (liquidity injection in lieu of the pandemic) and reduced consumption opportunities during lockdowns have driven strong M3 growth. Saudi Arabia's money supply has grown on a 7%YoY growth in its M1 (includes currency outside banks and demand deposits), which formed 68% of the total money supply (M3) at end-3Q21. Further, time & savings deposits (about 20% of M3) and other quasi-money deposits (about 12% of M3) supported the growth of M2 & M3 respectively.

Saudi Banking Sector: Money Supply Growth (YoY)



Saudi Banking Sector: Deposit Growth Trends (YoY)



Source: Saudi Central Bank, Bulletin Sept'21

Saudi National Bank (SNB)

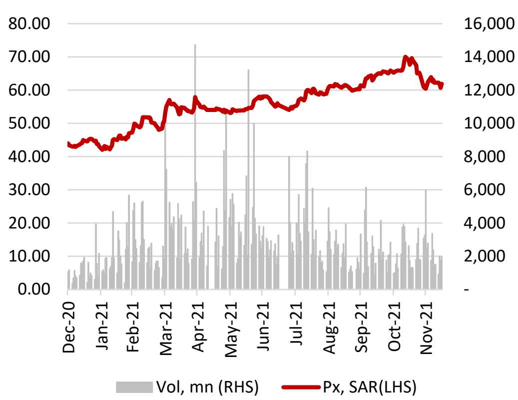
Target Price: SAR 68.5

Upside: 11%

Recommendation	**Accumulate**
Bloomberg Ticker	SNB AB
Current Market Price (SAR)	61.90
52wk High / Low (SAR)	70.00/42.00
12m Average Vol. (mn)	2,819.0
Mkt. Cap. (USD/SAR bn)	75/277
Shares Outstanding (mn)	4,478.0
Free Float (%)	50%
3m Avg Daily Turnover (SAR mn)	144.4
6m Avg Daily Turnover (SAR mn)	172.2
PE 2022e (x)	16.0
PBv 2022e (x)	1.8
Dividend Yield '21e (%)	2.9%
Price Performance:	
1 month (%)	(10)
3 month (%)	1
12 month (%)	44

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **SNB is Saudi Arabia's largest bank with a well-diversified business model and international presence.**
- **The Saudi Arabian government via PIF and other funds is the largest shareholder with more than 50% stake.**
- **Its merger integration is on track for completion ahead of schedule, by the end of 2021**
- **Showing an accelerated digital transformation and operational efficiency improvements.**
- **Credit quality metrics to remain under pressure due to the ongoing crisis.**

We initiate coverage on Saudi National Bank (SNB) with an **Accumulate** rating and a target price of SAR 68.5 per share, implying an upside of 11% to the last closing price. Our target price **implies** a P/E'22e of 17.7x, and P/B'22e of 2.0x. We expect the bank to post a reasonable financing growth (at about 5% CAGR over 2021-2025e) as Saudi Arabia's macroeconomic indicators are expected to remain strong over the forecast period as real GDP growth continues amid elevated oil and gas prices. Further, we expect the bank's capital ratios to remain firm and above some of the regional peers, even though there will be an upward pressure on non-performing assets (NPAs) in the short to medium term as regulatory measures unwind.

Investment Thesis

Valuation & Risks: Our target price is based on a weighted average of Excess Returns Methodology & Quasi-Retail Local Banks' average P/B multiple for 2022e. Key downside risks to our valuation include slower-than-expected credit offtake and more-than-anticipated asset quality deterioration. Key upside risks to our valuation include better-than-expected financing growth resulting in higher net finance income, and improvements in asset quality and provision coverage levels.

Strong fundamentals: SNB's fundamentals are superior in some respects as compared to its Saudi banking peers: (i) second-lowest loan-to-deposit (LTD) ratio at 85.5% at end-9M21; (ii) better NIM growth prospects on third-highest CASA stock; (iii) cost efficiency ratio, 32% during 9M21, second lowest to Al Rajhi, which is the best in the space.

Caveats: The bank has a high capital adequacy ratio at 19.1% but it is low as compared to its local peers. Its NPA coverage ratio has also fallen recently to about 100% (including Purchased or originated credit impaired (POCI)), which in our view, warrants higher cost of risk for 2022e in order to build the buffer to previous levels. Its NPA ratio is strong at 1.58% excluding POCI, while including POCI it is 2.12% which is near the sector median.

Key Indicators

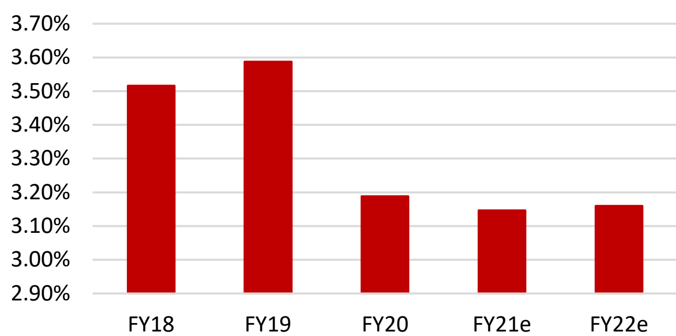
Year	FY18	FY19	FY20	FY21e	FY22e	FY23e
Net Financing (SAR mn)	265,062	281,843	346,708	511,472	538,186	559,714
Customer Deposits (SAR mn)	318,701	353,389	416,419	603,089	635,338	661,532
Operating Income (SAR mn)	18,844	20,575	21,458	29,126	34,755	36,663
Net Profit (SAR mn)	9,594	11,401	11,440	13,126	17,156	19,021
Diluted EPS (SAR)	3.21	3.81	3.83	2.96	3.87	4.29
Tangible BVPS (SAR)	19.31	20.54	23.14	32.34	33.96	35.73
P/E (x)	14.9	12.9	11.3	20.9	16.0	14.4
P/BVPS (x)	2.5	2.4	1.9	1.9	1.8	1.7
Dividend Yield (%)	4.4%	4.7%	0.0%	2.9%	3.7%	4.2%

Source: Company Financials, U Capital Research

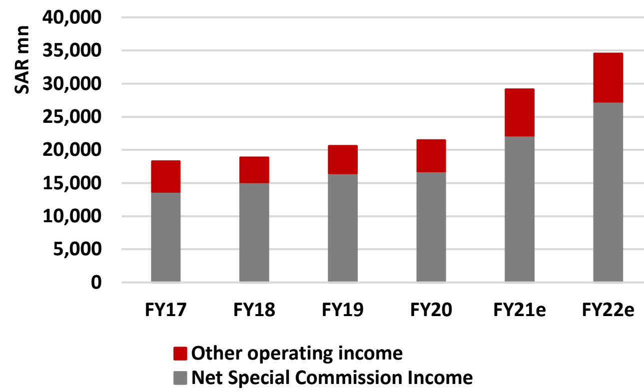
SNB's topline performance to remain strong as interest rates rise given the favorable funding profile

SNB's 9M21 total operating income rose 34%YoY to SAR 21.1bn (including the impact of the merger). Its net financing income grew only 2%YoY due to a fall in its Net Financing Margin from 3.1% during 9M20 to 2.9% during 9M21. Margin fell due to the low prevailing rates, with financing yield having fallen from 3.79% during 9M20 to 3.39% during 9M21, and despite funding cost having fallen from 0.76% during 9M20 to 0.53% during 9M21. Margin has expanded in retail (as retail portfolio has posted a strong growth of +19%YTD), but all other assets have yielded lower on YTD basis.

SNB: Net Financing Income Margin



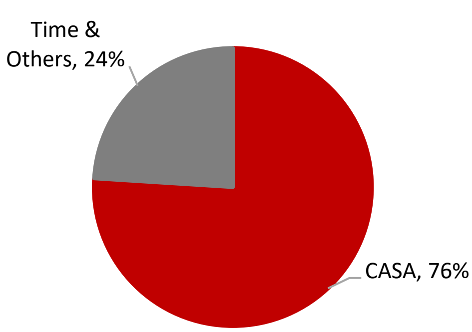
SNB: Operating Income Constituents



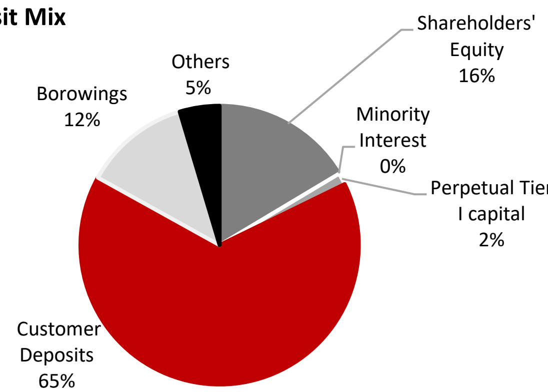
Source: Company Financials, U Capital Research

We believe that the bank is well-positioned to benefit from the rise in interest rates, as the US Fed begins to hike interest rates from 2022e, since the bank has a large stock of CASA deposits at 76% of total customer deposits.

SNB: Deposit Mix



SNB: Deposit Mix



Source: Company Financials, U Capital Research

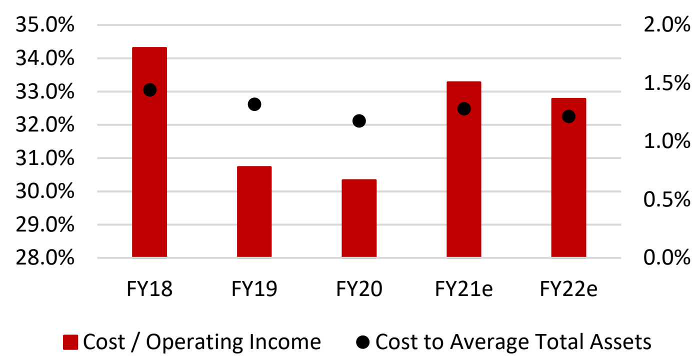
Furthermore, we expect that SNB's other operating income will also grow, albeit more slowly than net financing income, on faster finance asset growth and optimization of other investments. During 9M21, SNB's fee and other income decreased 3% YoY from lower other operating income (expenses) that was partially offset by higher brokerage & investment management fees and investment related income.

SNB management is expecting a better-than-previously estimated post-merger cost synergy

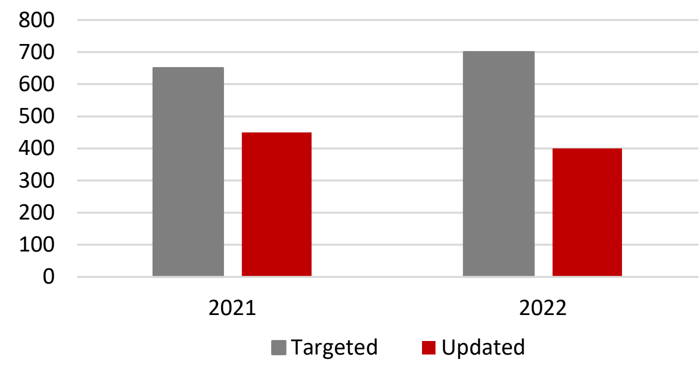
At end-3Q21, the bank has already realized 39% of cost synergies (SAR 315mn) vs. the targeted cost synergies of SAR 800+. The various sources of synergies are (1) Benefit from the combined talent of the two banks and natural FTE Attrition, (2) Optimization of technology stack, (3) Operational efficiencies from control and support functions, and (4) Revenue synergies being assessed.

The bank has allocated maximum integration costs SAR 1,100mn. Integration costs on track to be at or below originally targeted levels, on a cash-spend basis (P&L impact significantly lower due to capitalization and amortization of depreciation expenses). Integration cash spend is expected on IT stack optimization spend, Data migration, Rebranding & marketing, and Advisory.

SNB: Efficiency metrics



SNB: Planned Integration Cost Spend, SAR mn



Source: Bank Financials, U Capital Research

During 9M21, SNB saw 4%YoY higher operating expenses attributable to 10% higher VAT rate and IT related costs, which were partially offset by realized synergy savings to date.

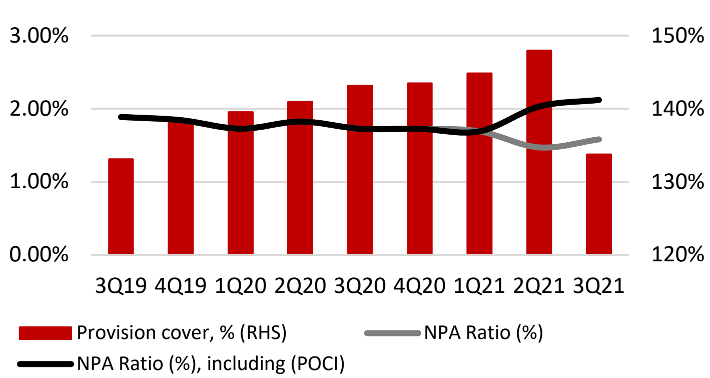
We expect cost-to-income ratio of the bank to remain on the downtrend as integration costs unwind and cost synergies are realized. We believe that our stance is justified as the bank has already invested heavily in technological infrastructure, with digital user penetration a high 78% of its retail base, and a ratio of 99% digital financial transactions as opposed to branch transactions. The bank's cost-to-income at local level is 31.2% as compared to 32.4% including international operations.

Asset quality to remain firm over the forecast period

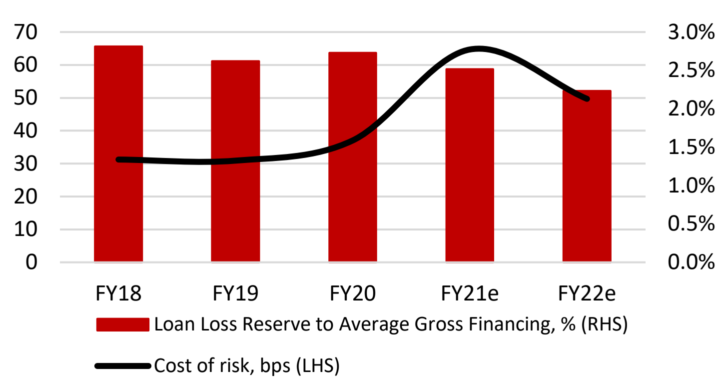
The bank is expected to see a normalization of cost of risk over the forecast period. Further, its asset quality metrics are expected to remain firm, despite an anticipation of slight rise in non-performing assets on unwinding of regulatory forbearance measures.

During 9M21, the bank saw a rise in cost of risk for corporate exposures of 353bps, while retail's fell by 91bps. Cost of risk for financial institutions (FIs) and international operations fell by 26bps and 279bps, respectively. Overall, cost of risk fell from 73bps to 65bps on proforma basis, while it rose to 106bps due to merger related items.

SNB: Asset Quality Metrics



SNB: Cost of risk & Provsion to Gross Financing

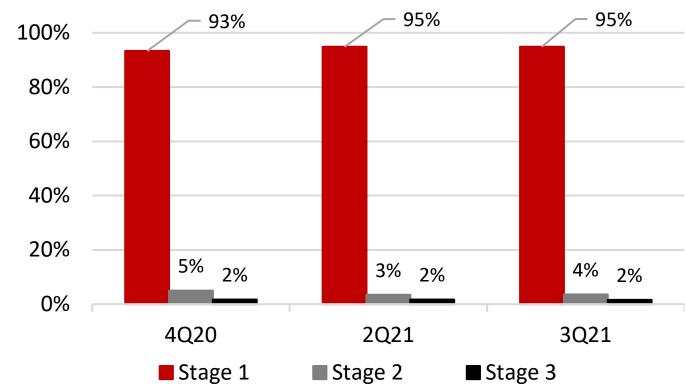


Source: Bank Financials, U Capital Research; Provision cover is excluding POCI in the left chart.

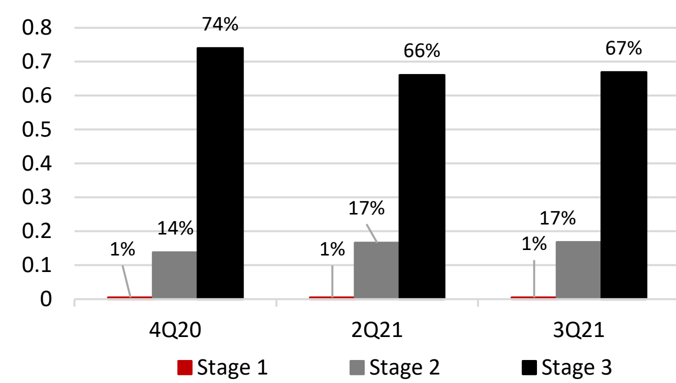
Stage-wise provision coverage is healthy but slightly lower than RJHI

SNB has robust asset quality management, with an NPA provision coverage ratio that is mediocre as compared to most local peers (low when POCI is included), but quite a low NPA ratio (excluding POCI). At end-9M21, about 95% of its gross exposure is sitting in Stage 1, with a provision cover for Stage 3 loans at a high 67%, lower than RJHI's at 81%. We believe that the bank will see elevated levels of cost of risk for 2021-2022e in order to build the provision buffer to previous levels.

SNB: Gross Exposure by Stage



SNB: ECL Coverage* (%)

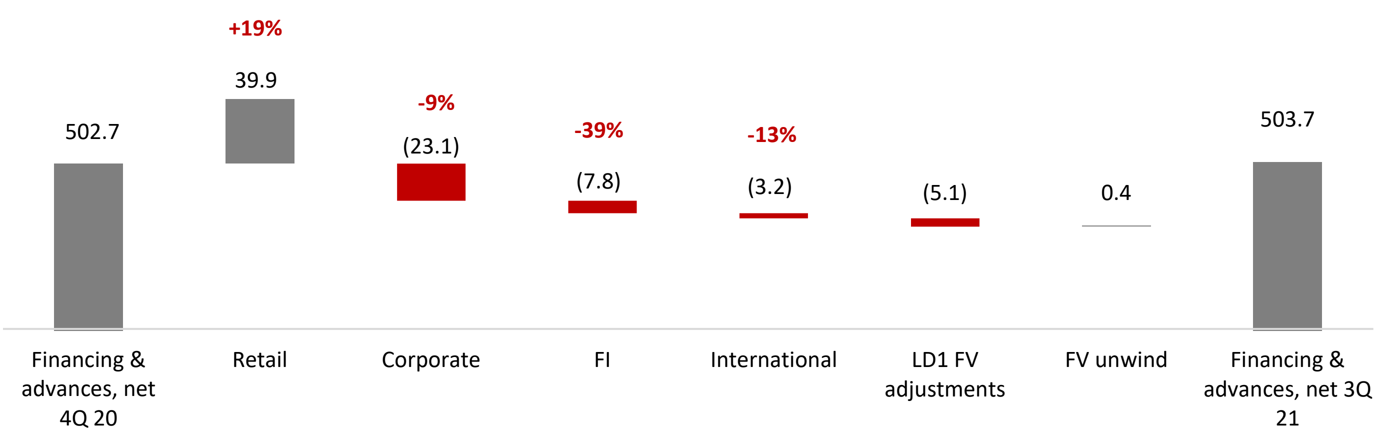


Source: Company Financials, U Capital Research

Financing growth to remain strong supported by conducive Government policies

For SNB, a strong Retail financing growth more than offset corporate repayments and FI maturities during 9M21. *Total financing & advances grew 1% on year-to-date (YTD) basis, while retail financing grew 19%YTD.*

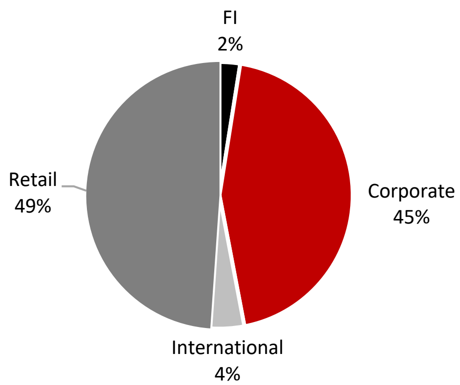
SNB: Financing & Advances, net movement YTD (SAR bn)



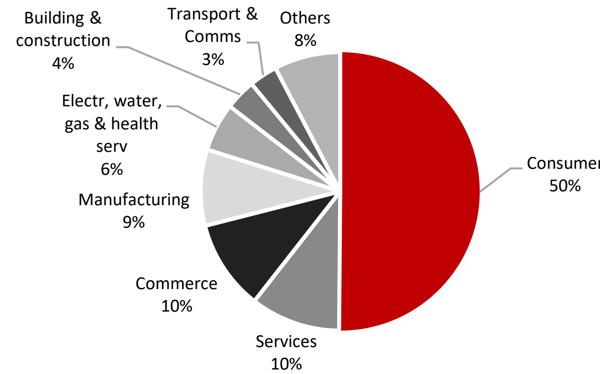
Source: Company Financials, U Capital Research

We believe that retail growth will likely remain strong while corporate financing growth will also recover as the wider macroeconomic recovery continues. We expect financing to grow at a CAGR of about 5% over the forecast period (2021e-2025e) on conducive Government policies that support credit growth. Further, we believe that since SNB has a well-diversified financing & advances mix, it stands to benefit from growth in all sectors.

SNB: Financing & Advances Mix -9M21



SNB: Economic Concentration of Financing (end-FY20)

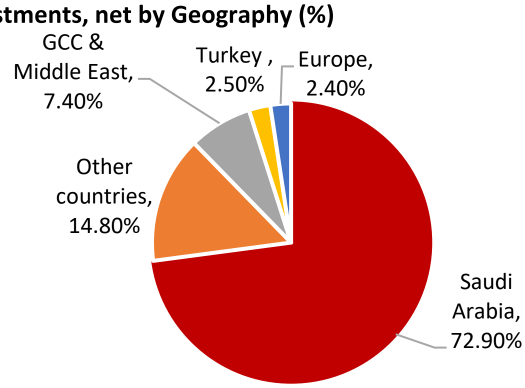


Source: Company Financials, U Capital Research

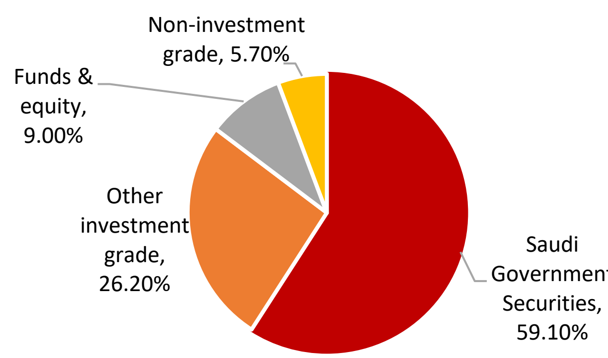
Optimization of investment portfolio to improve yields

A significant portion of the bank's assets are investment securities (at about 25% of FY21e). During 9M21, the bank reduced its investments by 4% owing to sale of securities to realize capital gains, while holdings in funds & equity was increased to enhance yields. At end-9M21, about 73% of its investment securities were in Saudi Arabia, while 59% were in Saudi Government Securities.

Investments, net by Geography (%)



Investments, net by Geography (%)

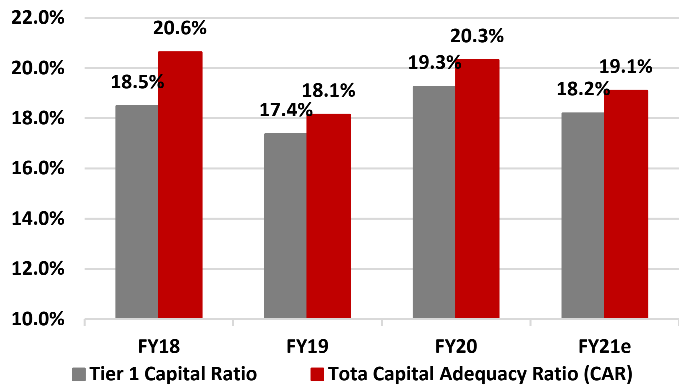


Source: Company Financials, U Capital Research

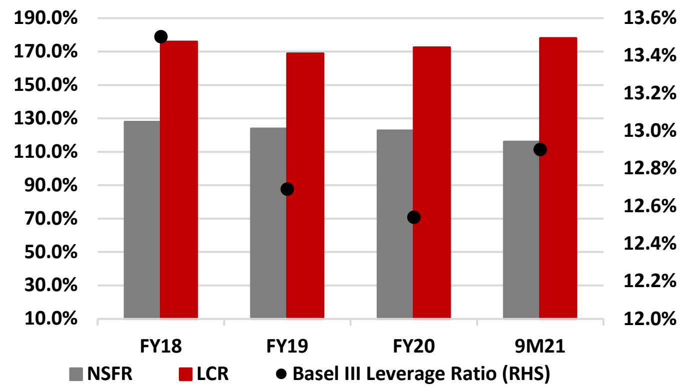
Robust capitalization and strong liquidity profile ensure ability to weather the current downturn

SNB boasts the highest level of capitalization amongst its local peers with the total capital adequacy ratio at 18.2% as at the end of 9M21. The bank's capital adequacy ratios are comfortably above regulatory minima. Further, the bank's Loan-to-Deposit (LTD Ratio) at 85.5% at end-9M21 is well below the regulatory ceiling of 90%, providing ample room for growth.

SNB: Capital Adequacy Ratios



SNB: Basel III Ratios



Source: Company Financials, U Capital Research; NSFR = Net Stable Funding Ratio, LCR = Liquidity Coverage Ratio

About Saudi National Bank

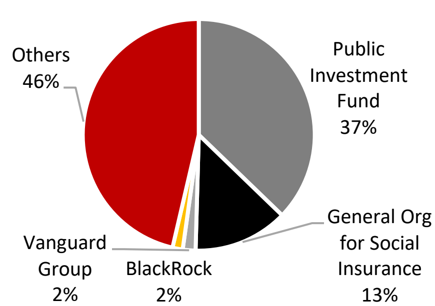
SNB has been formed after the merger of two big banks: the National Commercial Bank and Samba Financial Group. The National Commercial Bank (NCB) has been considered the largest and the first bank to officially be licensed and operate in Saudi Arabia, following the Royal Decree of the 26th of December 1953. On 11 October 2020, NCB entered into a merger agreement with Samba. The merger was completed on 1 April 2021. The transaction perimeter included Samba's assets and liabilities in exchange for 1.478bn of NCB shares. The purchase consideration was determined based on the exchange ratio (0.739) and NCB's 31 March 2021 share price. The final purchase consideration was SAR 78.5 bn vs, Samba's net assets of SAR 45.8bn book value.

Bank Profile

Saudi National Bank is headquartered in Riyadh, with 502 branches, 3,111 ATMs, 131 Remittance centers and 10,197 Employees at end-9M21. It has a Digital-to-Branch ratio of 99%: 1%, while digital user penetration is high at 78% of total base. Its digital retail sales are at 61% while retail digital account opening stood at 86% of total. It has two banking subsidiaries: (Turkiye Finans katilim Bankasi) TFKB (owns 67.03%) in Turkey and Samba Bank Ltd. In Pakistan. The Saudi National Bank is a leader in treasury and capital markets, and it owns both NCB Capital and Samba Capital & Investment Management, which together form the biggest asset manager, brokerage, and investment bank in Saudi Arabia.

Both Turkey and Pakistan have seen their currencies depreciate meaningfully over the last 4 months and it is possible that SNB might witness some temporary headwinds on its net interest margins.

SNB: Shareholding Structure



Source: Bloomberg, 8th Dec 2021

Key Financials

(SAR bn)	FY18	FY19	FY20	FY21e	FY22e	FY23e
Income Statement						
Interest/Financing Income	19.1	21.2	19.5	25.4	31.7	33.9
Interest Expense/Payment to Depositors	(3.9)	(4.7)	(2.8)	(3.3)	(4.3)	(4.9)
Net Interest/Financing Income	**15.2**	**16.5**	**16.8**	**22.2**	**27.4**	**29.0**
Fee & Commission Income	2.5	1.9	2.3	3.1	3.3	3.5
Other Income	1.2	2.2	2.4	3.8	4.0	4.2
Total Non-Interest/Financing Income	**3.7**	**4.1**	**4.7**	**6.9**	**7.4**	**7.7**
Total Operating Income	**18.8**	**20.6**	**21.5**	**29.1**	**34.8**	**36.7**
Provisions expense	(1.3)	(1.4)	(2.0)	(4.6)	(3.9)	(3.2)
Operating Expenses	(6.5)	(6.3)	(6.5)	(9.6)	(11.3)	(11.8)
Other non-operating losses / (income)	(0.2)	0.1	(0.1)	(0.1)	(0.2)	(0.2)
Profit Before Taxation	**10.8**	**12.9**	**12.9**	**14.9**	**19.4**	**21.5**
Taxation & Minority Interest	(1.2)	(1.5)	(1.5)	(1.7)	(2.2)	(2.5)
Net Profit Attributable to Parent	**9.6**	**11.4**	**11.4**	**13.1**	**17.2**	**19.0**
Balance Sheet						
Cash Balances	32.5	45.4	56.8	57.4	74.0	75.3
Deposits with other banks & FIs	16.0	16.6	13.6	24.6	25.9	26.9
Gross Financing	272.5	289.2	355.5	522.5	538.2	559.7
Loan Loss Reserve	(7.4)	(7.4)	(8.8)	(11.0)	(11.9)	(12.9)
Net Financing	265.1	281.8	346.7	511.5	526.3	546.8
Other Assets	138.6	163.0	182.3	321.0	329.1	346.6
Total Assets	**452.2**	**506.8**	**599.4**	**914.5**	**955.3**	**995.6**
Deposits from Banks & FIs	-	-	-	-	-	-
Deposits from Customers	318.7	353.4	416.4	603.1	635.3	661.5
Other Borrowings	59.7	72.3	89.7	124.1	135.9	141.0
Other Liabilities	8.1	11.8	13.1	30.9	20.4	21.5
Paid-up Capital	30.0	30.0	30.0	44.8	44.8	44.8
Retained Earnings	6.8	6.2	14.4	12.8	18.9	25.7
Other Reserves	20.9	25.3	24.8	85.9	87.0	88.0
Shareholders' Equity	**57.7**	**61.4**	**69.2**	**143.5**	**150.7**	**158.5**
Minority Interest	0.9	0.9	0.8	0.8	0.8	0.9
Tier 1 Perpetual Notes	7.0	7.0	10.2	12.2	12.2	12.2
Total Equity & Liability	**452.2**	**506.8**	**599.4**	**914.5**	**955.3**	**995.6**
Cash Flow Statement						
Cash from operations	12.7	43.1	28.2	42.7	28.1	37.9
Cash from investing activities	10.6	25.5	20.1	107.5	4.2	25.6
Cash from financing	(7.5)	(4.8)	3.3	65.4	(7.2)	(11.0)
Net changes in cash	(5.5)	12.9	11.4	0.6	16.6	1.3
Cash at the end of period	32.5	45.4	56.8	57.4	74.0	75.3
Key Ratios						
Return on Average Assets	2.1%	2.4%	2.1%	1.7%	1.8%	1.9%
Return on Average Equity	16.9%	19.1%	17.5%	12.3%	11.7%	12.3%
Return on Tangible Average Common Equity (ROTCE)	16.9%	19.1%	17.5%	12.3%	11.7%	12.3%
Recurring Income/Operating Income	93.9%	89.4%	88.8%	86.9%	88.4%	88.5%
Yield on Interest Earning & Islamic Finance Assets	4.4%	4.6%	3.7%	3.6%	3.7%	3.7%
Cost of Funds	-1.0%	-1.2%	-0.6%	-0.5%	-0.6%	-0.6%
Net Spread	5.5%	5.8%	4.3%	4.1%	4.2%	4.3%
Net Interest Margin (NIM)	3.5%	3.6%	3.2%	3.1%	3.2%	3.2%
Cost to Income Ratio	34.3%	30.7%	30.3%	32.8%	32.5%	32.2%
Net Financing to Customer Deposits	83.2%	79.8%	83.3%	84.8%	84.7%	84.6%
NPAs to Gross Financing	2.3%	1.8%	1.7%	1.7%	1.7%	1.8%
NPA Coverage (%)	116	138	143	126	127	132
Cost of Risk (bps)	31.2	30.9	37.1	64.7	44.7	34.7
Equity to Total Assets	12.8%	12.1%	11.5%	15.7%	15.8%	15.9%
Cash Dividend Payout Ratio	65.4%	60.3%	0.0%	60.0%	60.0%	60.0%
Adjusted EPS (SAR)	3.08	3.68	3.68	2.83	3.70	4.10
Adjusted BVPS (SAR)	19.31	20.54	23.14	32.34	33.96	35.73
TangBVPS, LCY	19.31	20.54	23.14	32.34	33.96	35.73
Market Price (SAR) *	47.85	49.25	43.35	61.90	61.90	61.90
Dividend Yield	4.4%	4.7%	0.0%	2.9%	3.7%	4.2%
P/E Ratio (x)	14.9	12.9	11.3	20.9	16.0	14.4
P/BV Ratio (x)	2.5	2.4	1.9	1.9	1.8	1.7
P/TangBVPS	2.5	2.4	1.9	1.9	1.8	1.7

* Market price for the current and subsequent years as per the closing price of 15-Dec-2021

Source: Company Financials, U Capital Research

NPA coverage is excluding Purchased or Originated Impaired (POCI) here.

Al-Rajhi Bank (RJHI)

Target Price: SAR 157

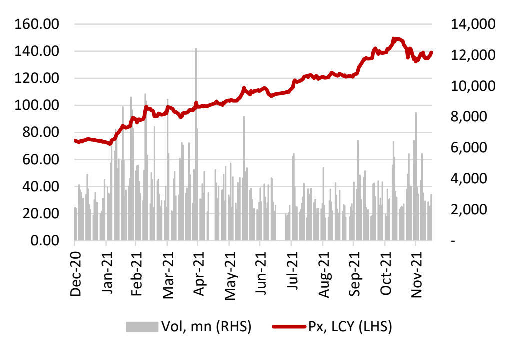
Upside/ (Downside): 13%

Recommendation	**Accumulate**
Bloomberg Ticker	RJHI AB
Current Market Price (SAR)	139.00
52wk High / Low (SAR)	151.00/71.40
12m Average Vol. (000)	3,461.9
Mkt. Cap. (USD/SAR bn)	94/348
Shares Outstanding (mn)	2,500.0
Free Float (%)	90%
3m Avg Daily Turnover (SAR mn)	436.6
6m Avg Daily Turnover (SAR mn)	375.5
PE 2022e (x)	19.8
PBv 2022e (x)	4.8
Dividend Yield '21e (%)	2.3%

Price Performance:	
1 month (%)	(6)
3 month (%)	13
12 month (%)	88

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Al Rajhi is the #1 Islamic bank globally.**
- **Second largest bank of Saudi Arabia.**
- **Stellar loan growth (about 45%YoY at end-9M21) on the back of mortgages.**
- **Superior asset quality (NPA Ratio at 0.69%, NPA coverage ratio at 307.5%).**
- **Most cost-efficient in the Saudi banking space (Cost-to-Income Ratio at 28% during 9M21).**

We initiate coverage on Al-Rajhi Bank (RJHI) with a **Accumulate** rating and a target price of SAR 157 per share. Our target price (TP) **implies** a P/E'22e of 22x, and a P/B'22e of 5.4x. We believe that this TP is justified because of excellence in almost all financial soundness indicators of the bank, with the bank being well-positioned to benefit from the growing Saudi banking credit, especially mortgages under the Vision 2030 Housing Program in lieu of real GDP growth prospects.

Investment Thesis

Valuation & Risks: Our target price is based on a weighted average of Excess Returns Methodology & a justified P/B multiple for 2022e for the bank. Key downside risks to our valuation include slower-than-expected credit offtake and asset quality deterioration. Key upside risks to our valuation include better-than-expected credit growth resulting in higher net finance income, and improvements in asset quality and loan-loss coverage levels.

Superior fundamentals: RJHI's fundamentals are superior to local peers in almost all aspects: (i) Lowest non-performing asset (NPA) ratio a 0.69%; (iii) highest NPA provision coverage ratio at about 308% at end-9M21 iii) Second-highest CASA stock to support low-cost funding; iv) Best cost efficiency ratio, 28% during 9M21 (v) Third-lowest loan-to-deposit (LTD) ratio at 88% at end-9M21. (vi) fastest-growing bank in terms of assets, deposits and profit before taxes and provisions within the peer-group. (v) Well-positioned as a Mortgage lender to benefit from Saudi's Vision 2030 Housing Program, whereby the country's **mortgage penetration (that is currently quite low** as compared to other Emerging Market (EM) countries) is expected to rise.

Risks: The bank has the lowest capital adequacy ratio at 17.9% as compared to its local peers. Its Tier 1 Capital Adequacy Ratio is also third lowest at 16.81% due to lack of Tier 1 funding. Nevertheless, its capital adequacy metrics are much higher than the regulatory prescribed minima. Further, we believe that with a superior asset quality as the bank's, it is acceptable to be on the lower end of the spectrum in terms of capital adequacy ratios. Additionally, a relatively lower payout ratio as compared to peers ensures that adequate capital is shored up over the forecast period, in addition to a conservative financing growth estimate over 2021-2025e.

Key Indicators

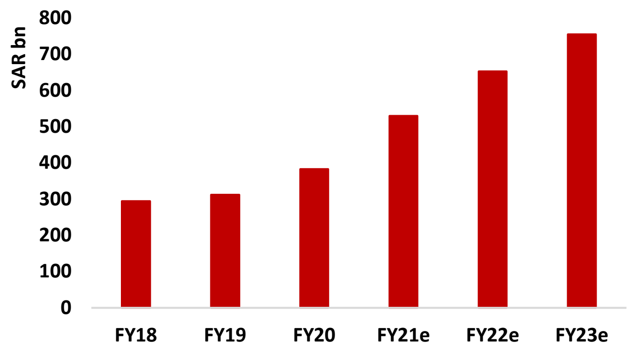
Year	FY18	FY19	FY20	FY21e	FY22e	FY23e
Net Financing (SAR mn)	231,758	249,683	315,712	446,332	546,904	628,939
Customer Deposits (SAR mn)	293,909	312,406	382,631	529,302	652,438	754,806
Operating Income (SAR mn)	17,272	19,460	20,668	26,025	33,272	39,058
Net Profit (SAR mn)	3,768	10,159	10,596	14,535	17,580	20,411
Diluted EPS (SAR)	1.51	4.06	4.24	5.81	7.03	8.16
Tangible BVPS (SAR)	19.32	20.48	23.25	23.78	29.20	34.85
P/E (x)	37.7	16.1	17.4	23.9	19.8	17.0
P/BVPS (x)	2.9	3.2	3.2	5.8	4.8	4.0
Dividend Yield (%)	4.9%	4.6%	1.4%	2.3%	2.8%	3.2%

Source: Company Financials, U Capital Research

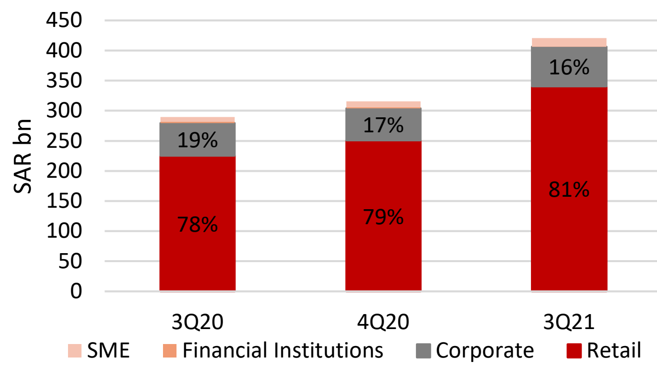
Financing growth to remain strong over the forecast period

Given the positive outlook on Saudi's real GDP growth, we believe that credit growth will remain strong for most banks within the space, including RJHI. For RJHI, while mortgage lending growth (at 36%YTD at end-9M21) will be front-loaded at the start of the forecast period (as indicated by the management in its recent investor & analyst call) but will continue to remain strong supporting overall financing growth for the bank. Further, as indicated by the management, the bank is focusing on increasing its corporate exposure as well, which is already up 23% on year-to-date (YTD) basis.

RJHI: Islamic Financing



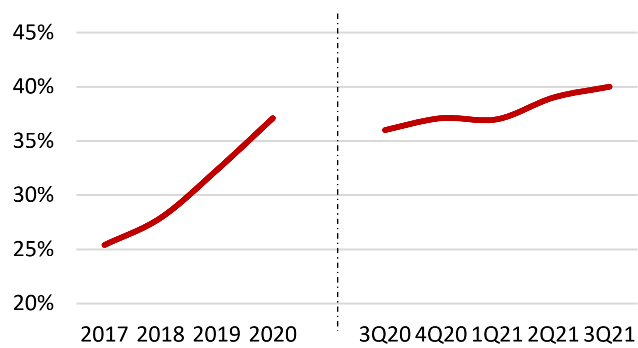
RJHI: Financing mix



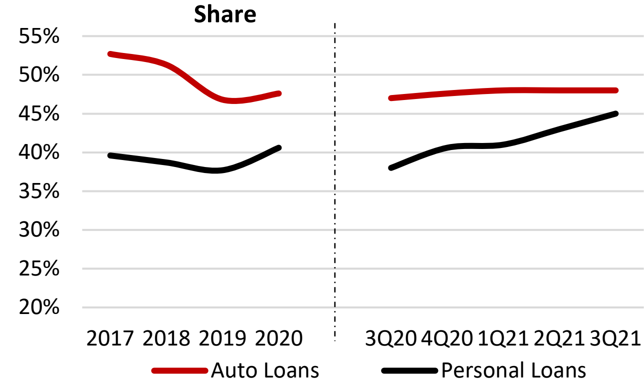
Source: Company Financials, U Capital Research

RJHI has consistently gained mortgage lending market share over the last few quarters and years. The bank characteristically has a higher exposure to retail (about 80%) as compared to corporate.

RJHI: Mortgage Market Share



RJHI: Auto Loans & Personal Loans Market Share

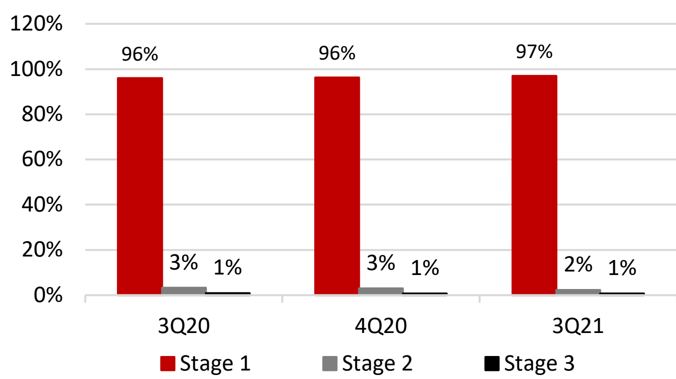


Source: Company Financials, U Capital Research

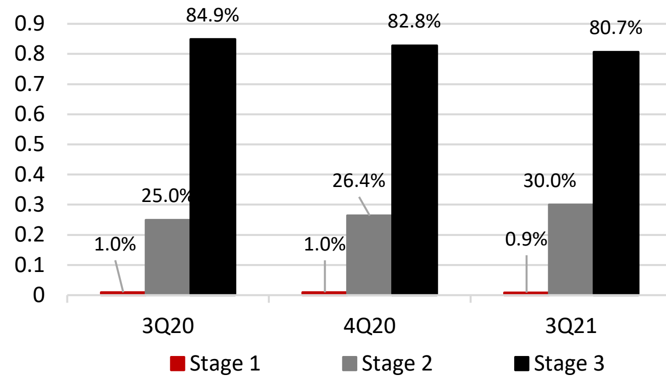
Healthy stage coverage reflects prudent risk management

RJHI has exceptional asset quality management, with a superior NPA provision coverage ratio as compared to local peers, and a low NPA ratio. Further, about 97% of its gross exposure is sitting in Stage 1 at end-9M21, with a provision cover for Stage 3 loans at a high 81%. Due to a 45%YoY jump in the bank's gross financing exposure, stage 3 exposure has declined from 0.8% at end-9M20 to 0.7% at end-9M21. Furthermore, its provision charges have also climbed 28%YoY, indicating a prudent approach to provisioning, where the bank maintains a superior provision coverage ratio.

RJHI: Gross Exposure by Stage



RJHI: ECL Coverage* (%)

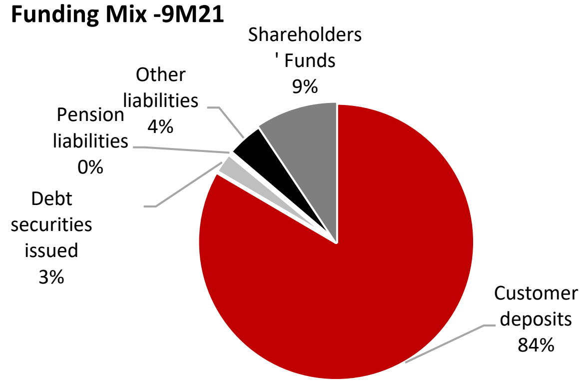


Source: Company Financials, U Capital Research

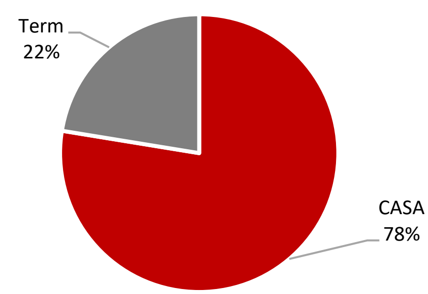
No wholesale funding and a large share of CASA deposits to support margins; ST cyclical headwinds to be seen

RJHI has no wholesale funding an relies heavily on customer deposits (84%) to fund its balance sheet. This has supported its margin historically. Further, 78% of its total customer deposits are CASA, while over 90% of its deposits are non-profit bearing (Customers' time investments, at about 22% of total deposits, are subject to Murabaha contracts and therefore are non-profit.)

Funding Mix -9M21



Deposit Mix -9M21



Source: Company Financials, U Capital Research

We are forecasting that the bank's non-profit-bearing deposits will continue to decline, albeit slowly, as observed since 4Q20, as the bank increases its corporate exposures for sourcing deposits together with the bank's requirement to extend its balance sheet funding maturities as asset maturities increase fast on strong mortgage growth. Therefore, we expect some upward pressure on the bank's cost of funding as interest rates begin to rise. On the other hand, its assets may not be as sensitive to interest rate rise as some of the other banks, like SABB and SNB, on higher retail exposure, especially mortgages. Nonetheless, we expect the bank's funding mix to continue to support its margins in times of rising interest rates, although **short-term (ST) cyclical headwinds are inevitable**.

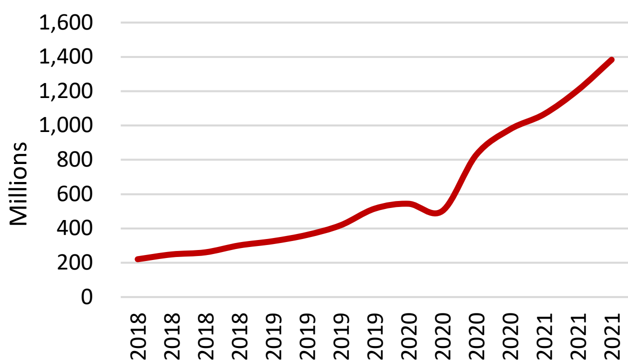
Operating income growth to be supported by Financing growth as well as fee income

The bank's operating income is expected to grow at a CAGR of 17% over the forecast period, largely on account of a CAGR of 14% in its financing asset. However, other operating income growth is also expected to remain strong, as the bank's revenue diversification efforts continue. Also, RJHI recently introduced its payments subsidiary, **neoleap**, in its 9M21 results.

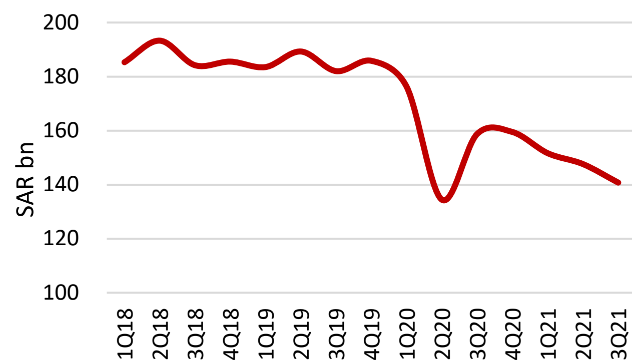
The bank is already at the top position in terms of merchant acquisition (32% POS terminals market share). Saudi digital payments sector has been seeing healthy volume growth (POS transactions at 1.38 trillion (+67%YoY) worth SAR 120mn during 3Q21 and E-commerce transactions at SAR 90.9mn for 3Q21 (+96%YoY) while cash usage has reduced. Saudi Arabia is prioritizing digital banking, with the Govt. & Saudi Central Bank having launched a series of successful initiatives to digitize payments, where new Fintech licenses & other new entrants have increased competition & innovation.

It must be noted that Saudi Arabis is the largest payments market in the region with the biggest growth potential. Management believes that **neoleap** is in a favorable position to win the payment market given RJHI's leading market share with the largest customer base. Centralizing payments expertise would allow the bank to provide a full range of solutions as well as the ability to respond to rapidly changing technology & competition.

Saudi Arabia: Number of POS Transactions



Saudi Arabia: Cash Withdrawals from ATMs

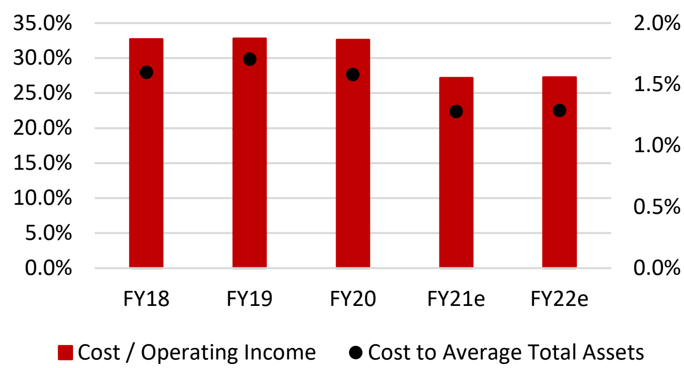


Source: Company Financials, U Capital Research

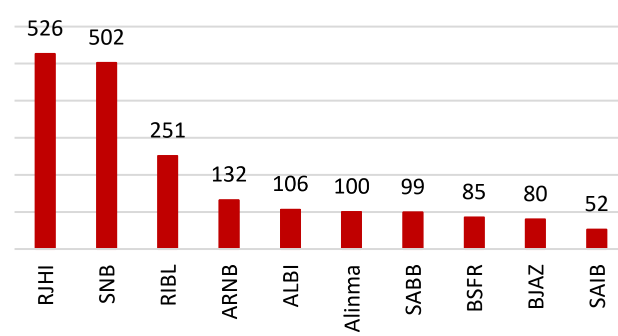
Boasts superior cost efficiencies with higher positive jaws

During 3Q21, the bank's operating expenses rose 1.8%YoY while for 9M21, its operating expenses rose 3.2%YoY, largely driven by higher salaries and benefits and other G&A expenses. However, a significant rise in operating income resulted in its cost-to-income ratio to drop down to 27.2% for 9M21 as compared to 9M20. We are expecting the bank to maintain its cost efficiency over the forecast period, given the operating income growth outlook on the back of increasing financing asset. RJHI is able to leverage its large retail presence in terms of number of branches operating in Saudi Arabia to generate income, and yet maintain low operating costs.

RJHI: Efficiency metrics



Saudi Banks: Number of branches operating in Saudi Arabia

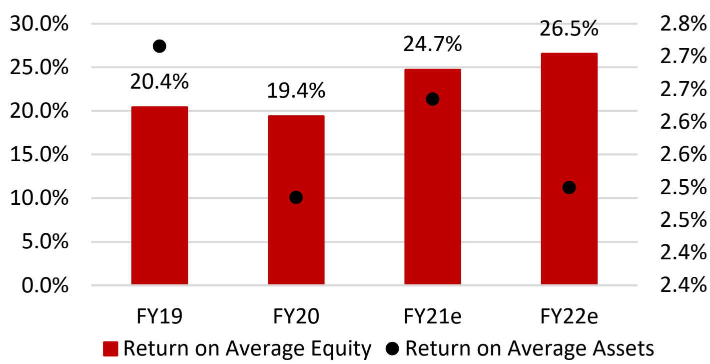


Source: Company Financials, U Capital Research

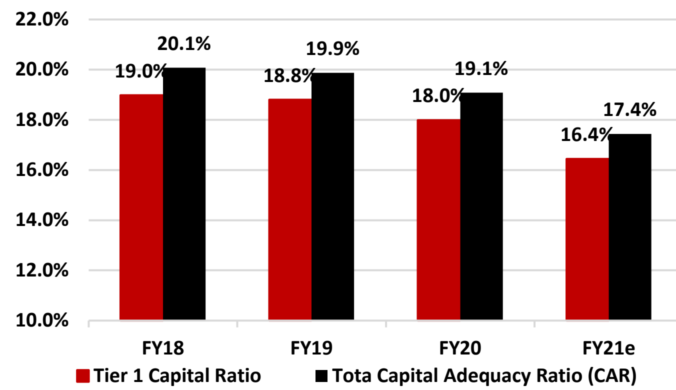
Superior profitability metrics supported by a large retail network

RJHI has superior profitability ratios as compared to its local peer-group. We believe that its profitability will be maintained as it remains best positioned to benefit from the strong mortgage lending growth. It is also key a beneficiary of the ongoing shift to e-banking and card usage for e-commerce as well as POS transactions.

RJHI: Profitability Ratios



RJHI: Capital Adequacy Ratios



Source: Company Financials, U Capital Research

Strong capital adequacy given the nature of the loan book

The bank had a CAR of 17.9% as at end-9m21. We believe that even though RJHI's capital adequacy metrics are lower as compared to other names in the Saudi banking space, they are still strong when the quality of loan book is taken into account and the fact that the bank as about an 80% exposure to retail lending, which is characteristically less risky due to salary backing.

About Al Rajhi Bank

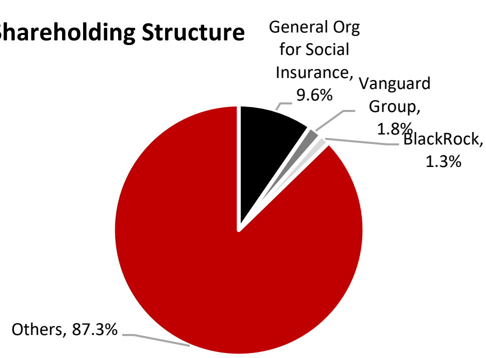
Bank Profile

Founded in 1957, Al Rajhi Bank today is the world's largest Islamic bank with assets of +SR 583 billion (+USD 155 billion) and the largest retail bank in the Middle East serving more than 11.6 million customers with 13,996 employees. Al Rajhi Bank has the largest distribution network in Saudi Arabia with 526 branches, 4,910 ATMs, 290,302 POS terminals and 215 remittance centers. The bank also operates 16 branches in Malaysia, 10 in Jordan and 2 in Kuwait.

Strategy

The Bank of the Future (BOTF) strategy is designed to ensure that it remains future-ready in terms of its business and stakeholder groups, as it continues to focus on providing market leading customer experience. The bank is building the "Bank of the Future": **B - Build on core, O - Outperform competition, T - Transform technology, F - Focus on new clients' needs.**

RJHI: Shareholding Structure



Source: Bloomberg, 8th Dec 2021

Key Financials

(SAR bn)	FY18	FY19	FY20	FY21e	FY22e	FY23e
Income Statement						
Interest/Financing Income	15.0	17.0	17.5	21.7	28.0	33.1
Interest Expense/Payment to Depositors	(0.5)	(0.5)	(0.5)	(1.0)	(1.3)	(1.6)
Net Interest/Financing Income	**14.5**	**16.5**	**17.0**	**20.7**	**26.7**	**31.5**
Fee & Commission Income	1.9	2.0	2.7	3.8	4.7	5.4
Other Income	0.9	1.0	1.0	1.5	1.9	2.1
Total Non-Interest/Financing Income	**2.7**	**3.0**	**3.6**	**5.4**	**6.6**	**7.5**
Total Operating Income	**17.3**	**19.5**	**20.7**	**26.0**	**33.3**	**39.1**
Provisions expense	(1.5)	(1.8)	(2.2)	(2.6)	(3.1)	(3.3)
Operating Expenses	(5.7)	(6.4)	(6.7)	(7.1)	(9.1)	(10.7)
Other non-operating losses / (income)	0.0	0.0	0.1	(0.1)	(0.1)	(0.1)
Profit Before Taxation	**10.1**	**11.3**	**11.8**	**16.2**	**21.0**	**24.9**
Taxation & Minority Interest	(6.4)	(1.2)	(1.2)	(1.7)	(3.4)	(4.5)
Net Profit Attributable to Parent	**3.8**	**10.2**	**10.6**	**14.5**	**17.6**	**20.4**
Balance Sheet						
Cash Balances	43.2	39.3	47.4	49.1	53.0	67.6
Deposits with other banks & FIs	32.4	32.1	28.7	33.0	40.4	46.5
Gross Financing	239.6	256.7	323.2	455.8	546.9	628.9
Loan Loss Reserve	(7.8)	(7.0)	(7.5)	(9.4)	(11.9)	(14.3)
Net Financing	231.8	249.7	315.7	446.3	535.1	614.7
Other Assets	56.6	63.1	77.1	105.9	143.6	166.3
Total Assets	**364.0**	**384.1**	**468.8**	**634.3**	**772.1**	**895.0**
Deposits from Banks & FIs	-	-	-	-	-	-
Deposits from Customers	293.9	312.4	382.6	529.3	652.4	754.8
Other Borrowings	8.2	4.5	13.1	17.6	19.0	20.1
Other Liabilities	13.6	16.0	15.0	28.0	27.6	33.0
Paid-up Capital	16.3	25.0	25.0	25.0	25.0	25.0
Retained Earnings	12.5	0.9	8.3	8.6	16.6	25.8
Other Reserves	19.6	25.3	24.9	25.8	31.4	36.3
Shareholders' Equity	**48.3**	**51.2**	**58.1**	**59.5**	**73.0**	**87.1**
Minority Interest	-	-	-	-	-	-
Tier 1 Perpetual Notes	-	-	-	-	-	-
Total Equity & Liability	**364.0**	**384.1**	**468.8**	**634.3**	**772.1**	**895.0**
Cash Flow Statement						
Cash from operations	19.2	16.5	30.4	48.7	41.1	50.5
Cash from investing activities	13.1	13.3	18.9	34.3	33.5	30.0
Cash from financing	(11.2)	(7.2)	(3.5)	(12.7)	(3.7)	(6.0)
Net changes in cash	(5.0)	(4.0)	8.1	1.7	3.9	14.6
Cash at the end of period	43.2	39.3	47.4	49.1	53.0	67.6
Key Ratios						
Return on Average Assets	1.1%	2.7%	2.5%	2.6%	2.5%	2.4%
Return on Average Equity	7.2%	20.4%	19.4%	24.7%	26.5%	25.5%
Return on Tangible Average Common Equity (ROTCE)	7.2%	20.4%	19.4%	24.7%	26.5%	25.5%
Recurring Income/Operating Income	95.0%	95.0%	95.3%	94.2%	94.4%	94.5%
Yield on Interest Earning & Islamic Finance Assets	5.1%	5.3%	4.8%	4.5%	4.5%	4.5%
Cost of Funds	-0.2%	-0.2%	-0.1%	-0.2%	-0.2%	-0.2%
Net Spread	5.3%	5.5%	4.9%	4.7%	4.7%	4.7%
Net Interest Margin (NIM)	4.9%	5.2%	4.6%	4.2%	4.2%	4.2%
Cost to Income Ratio	32.7%	32.8%	32.6%	27.2%	27.3%	27.4%
Net Financing to Customer Deposits	78.9%	79.9%	82.5%	84.3%	83.8%	83.3%
NPAs to Gross Financing	1.0%	0.9%	0.8%	0.8%	0.8%	0.8%
NPA Coverage (x)	3.4	3.0	3.1	3.0	2.9	3.0
Cost of Risk (bps)	51.9	55.5	58.9	54.4	49.4	44.4
Equity to Total Assets	13.3%	13.3%	12.4%	9.4%	9.5%	9.7%
Cash Dividend Payout Ratio	183.1%	73.8%	23.6%	56.1%	54.7%	54.7%
Adjusted EPS (LCY)	1.51	4.06	4.24	5.81	7.03	8.16
Adjusted BVPS (LCY)	19.32	20.48	23.25	23.78	29.20	34.85
TangBVPS, LCY	19.32	20.48	23.25	23.78	29.20	34.85
Market Price (LCY) *	56.87	65.40	73.60	139.00	139.00	139.00
Dividend Yield	4.9%	4.6%	1.4%	2.3%	2.8%	3.2%
P/E Ratio (x)	37.7	16.1	17.4	23.9	19.8	17.0
P/BV Ratio (x)	2.9	3.2	3.2	5.8	4.8	4.0
P/TangBVPS	2.9	3.2	3.2	5.8	4.8	4.0

* Market price for the current and subsequent years as per the closing price of 15-Dec-2021

Source: Company Financials, U Capital Research

Saudi British Bank (SABB)

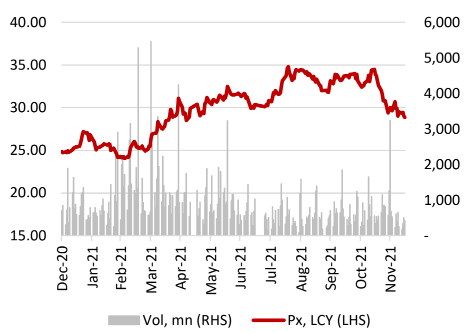
Target Price: SAR 32.4

Upside: 12%

Recommendation	**Accumulate**
Bloomberg Ticker	SABB AB
Current Market Price (SAR)	28.85
52wk High / Low (SAR)	34.80/24.02
12m Average Vol. (000)	930.9
Mkt. Cap. (USD/SAR bn)	196/59
Shares Outstanding (mn)	2,054.8
Free Float (%)	42%
3m Avg Daily Turnover (SAR mn)	22.2
6m Avg Daily Turnover (SAR mn)	22.1
PE 2022e (x)	14.8
PBv 2022e (x)	1.1
Dividend Yield '21e (%)	4.0%
Price Performance:	
1 month (%)	(14.52)
3 month (%)	(13.49)
12 month (%)	15.40

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Fourth-largest bank of Saudi Arabia in terms of total assets; Loans and deposit market share of about 9% each with Demand Deposit market share of 10%.**
- **Highest demand deposits to total deposits amongst peer-group at 77.5% at end-9M21.**
- **One of the weakest cost efficiencies within the sector.**
- **Highest non-performing asset ratio at 5.46% at end-9M21 on POCI loans as compared to peers; sequentially coming down since 3Q20.**

We initiate coverage on The Saudi British Bank (SABB) with an **Accumulate** rating and a weighted average target price (TP) of SAR 32.4 per share. Our TP **implies** a P/E'22e of 16.6x, and a P/B'22e of 1.2x, which we believe is justified given the weak asset quality metrics and a return on equity (ROE) that is currently lower than peers. However, we believe that the bank is well-positioned to benefit from the rising interest rate environment given its large corporate exposure (inherently more interest rate sensitive as compared to retail) amid a high ratio of zero-cost deposits that support its low cost of funding. We see an expanding net interest margin (NIM) as the key driver for the bank's improving performance over the forecast period.

Investment Thesis

Valuation & Risks: Our target price is based on a weighted average of Excess Returns Methodology & a justified P/B multiple for 2022e for the bank. Key downside risks to our valuation include slower-than-expected credit offtake and asset quality deterioration that could be a repercussion of any new coronavirus variants and resultant issues like low oil demand negatively affecting oil prices. Key upside risks to our valuation include better-than-expected credit growth resulting in higher net finance income, and improvements in asset quality and loan-loss coverage levels.

SABB's fundamentals are resilient, albeit weaker than its larger peers: (i) highest non-performing asset (NPA) ratio at 5.5%, including POCI (Purchased or Originated Credit-impaired upon merger with NCB); (ii) lowest NPA provision coverage ratio at about 75% at end-9M21, including POCI. iii) Weak cost efficiency ratio, 45% during 9M21.

Room for NIM expansion and efficiency improvement: Its **key strengths** are (i) the highest demand deposit stock that is likely to support low-cost funding during times of rising interest rates; (ii) high corporate exposure (@77% of gross loans & financing), which is relatively more sensitive to interest rate changes than retail. Furthermore, the bank has one of the highest capital adequacy ratios within its peer group, at about 22%. Its Tier 1 Capital Adequacy Ratio is also solid at 19.3%, which gives ample to absorb any asset quality deterioration. Additionally, the bank is also targeting efficiency improvements with a targeted Cost-to-Income ratio of less than 32% by 2025e (as per its 5-Year Strategic Plan that kicked off in 2021), as compared to 45% during 9M21.

Key Indicators

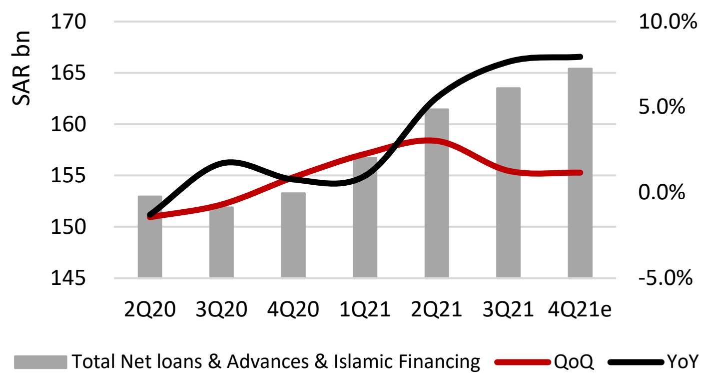
Year	FY18	FY19	FY20	FY21e	FY22e	FY23e
Total Net Loans (SAR mn)	110,326	152,075	153,243	165,407	186,263	203,027
Total Customer Deposits (SAR mn)	130,507	192,167	189,110	180,904	204,835	224,504
Operating Income (SAR mn)	7,323	9,213	8,878	7,897	8,908	11,866
Net Profit (SAR mn)	2,715	2,754	(4,132)	3,612	4,009	5,567
Diluted EPS (SAR)	1.81	1.34	-2.01	1.76	1.95	2.71
Tangible BVPS (SAR)	21.60	18.27	19.33	19.42	20.69	22.37
P/E (x)	18.0	25.9	-12.3	16.4	14.8	10.6
P/BVPS (x)	1.5	1.3	1.0	1.2	1.1	1.0
Dividend Yield (%)	6.0%	1.7%	0.0%	4.0%	4.4%	6.1%

Source: Company Financials, U Capital Research

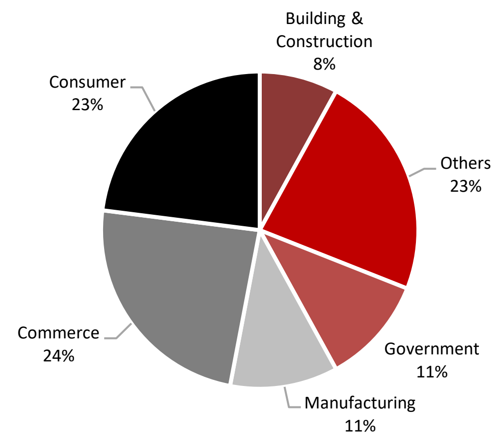
Growing net loans & Islamic financing

At end-9M21, the bank's gross loans & financing increased by 1% in the quarter and 7% year-on-year. The net growth in 3Q21 was across both businesses with 1% growth in corporate and 2% growth in retail. Further, continued strong mortgage originations were seen although partly offset by repayments. SABB has been actively focusing on the fast-growing mid-corporate business segment as well as mortgages, while its digital SME focus is also strong. The bank is focused on diversifying its loan and financing mix, while at the same time, maximizing its yields. As compared to 9M20, its loan mix has become more diversified, with slight reduction in building & construction sector (from 9% at end-9M20 to 8% at end 9M21) and consumer sector (from 24% at end-9M20 to 23% at end-9M21). There is a notable reduction in exposure to the manufacturing sector (from 14% at end-9M20 to 11% at end-9M21) while a notable increase has been seen in the diversified group classified as others, and commerce (which rose from 21% to 24% of total).

Net Loans & Islamic Financing growth



Economic concentration in Loans & Financing - 9M21



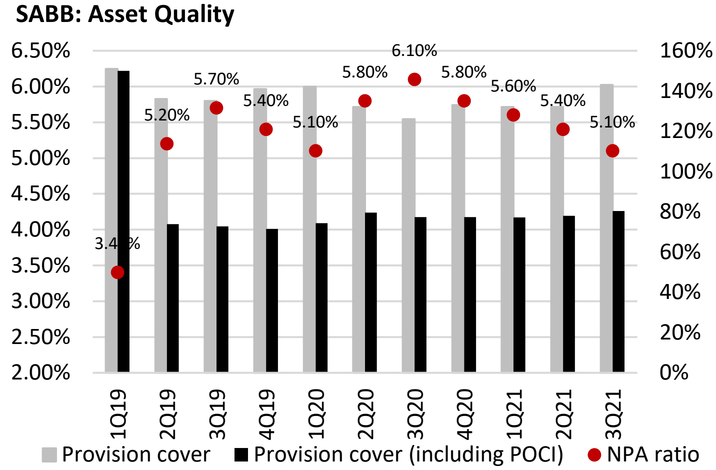
Source: Company Financials, U Capital Research

SABB has seen a sequential growth in its net loans & financing roughly since 2Q20 on YoY as well as QoQ basis. We believe this trend to continue over the forecast period, with a CAGR of about 11% over 2021e-2025e.

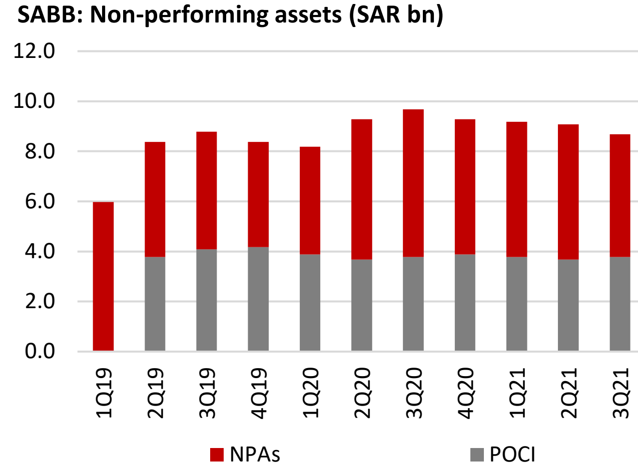
Improving asset quality metrics

SABB has been able to sequentially improve its asset quality since 3Q20, with total non-performing asset (NPA), including POCI, ratio down from 6.1% at end-9M20 to 5.1% at end-9M21. Further, the bank has been building provision cover in order to increase its provision coverage to almost about 143% at end-9M21, excluding purchased or originated credit impaired (POCI). When POCI is included, then provision coverage level is relatively lower as compared to the bank's peer group at about 80%.

SABB: Asset Quality



SABB: Non-performing assets (SAR bn)



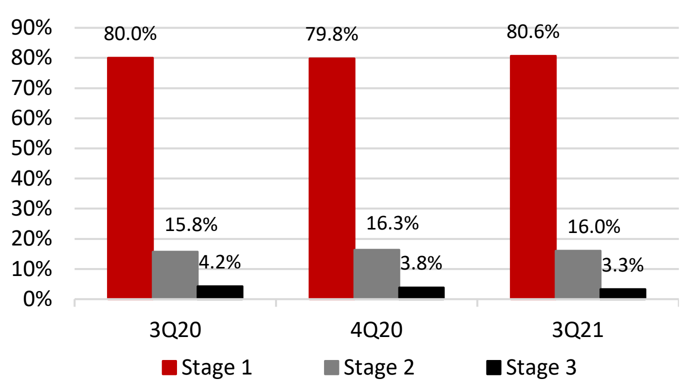
Source: Company Financials, U Capital Research

It must be noted that at end-9M21, gross loans & financing included about SAR5.5bn (about 3% of total) of lifetime ECL credit impaired of which SAR4.9bn is non-performing. It also includes exposures that are performing but have yet to complete a period of 12 months of performance (curing period) to be eligible to be upgraded to a not-impaired category.

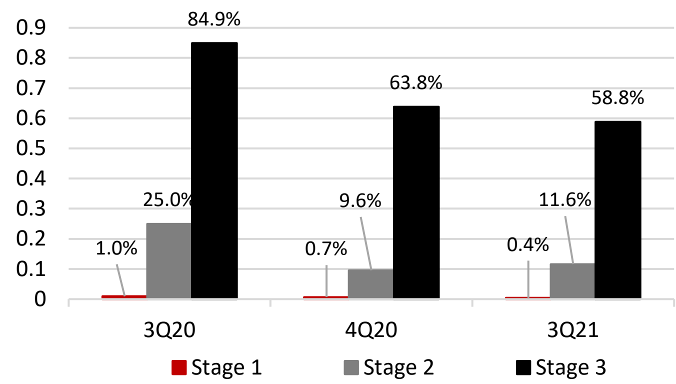
Fair stage coverage reflects adequate risk management

About 81% of SABB's gross exposure is sitting in Stage 1 at end-9M21, with a provision cover for Stage 3 loans at a mediocre 59%. It must be noted that as the bank carries out lending book clean-up exercise, it has been able to reduce its Stage 3 loans & financing from 3.8% of total gross loans & financing at end-FY20 to 3.3% at end-9M21, excluding POCI, which forms about 40% of total Stage 3 exposures. Furthermore, its provision cover of Stage 3 loans is relatively weaker than peers at about 59%.

SABB: Gross Exposure by Stage



SABB: ECL Coverage* (%)

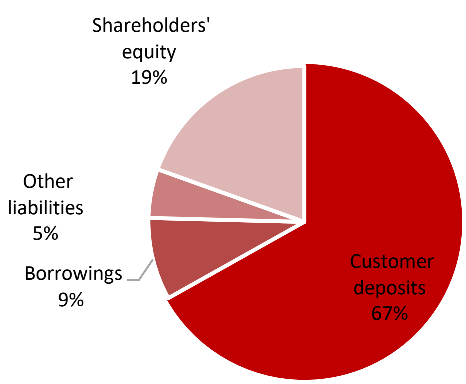


Source: Company Financials, U Capital Research

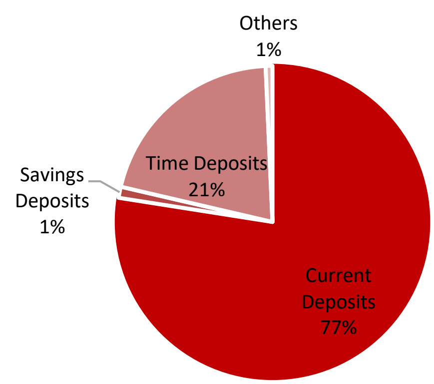
Liquidity and funding remain strong

The bank's customer deposit base remains strong. It saw a decline of SAR7bn during 3Q21 from a reduction in time deposits. At end-9M21, the bank had SAR180bn of customer deposits with 77% demand deposit, with both corporate and retail businesses contributing to this strong position.

Funding Profile -9M21



Deposit Mix-9M21



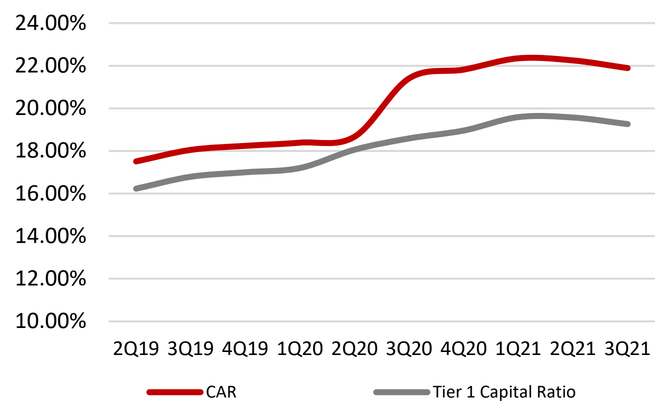
Source: Company Financials, U Capital Research

Further, the bank has robust levels of liquidity as evident from its liquidity coverage ratio (LCR) of 189% at end-9M21 and a strong net stable funding ratio (NSFR) of 132%.

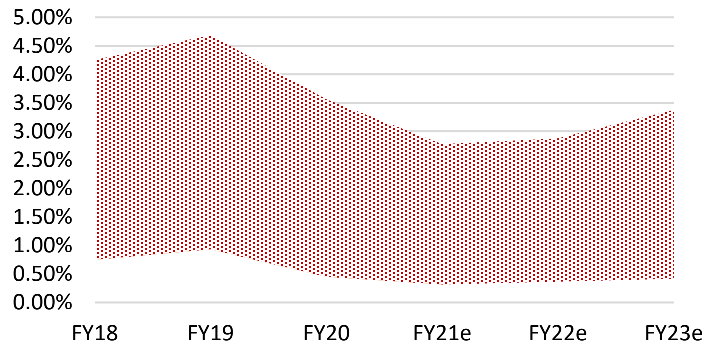
Solid capital adequacy metrics

SABB sports robust levels of capital with CET1 ratio of 19.3%, and a total capital adequacy ratio of about 22%.

SABB: Capital Adequacy Metrics



SABB: Net Spread



Source: Company Financials, U Capital Research

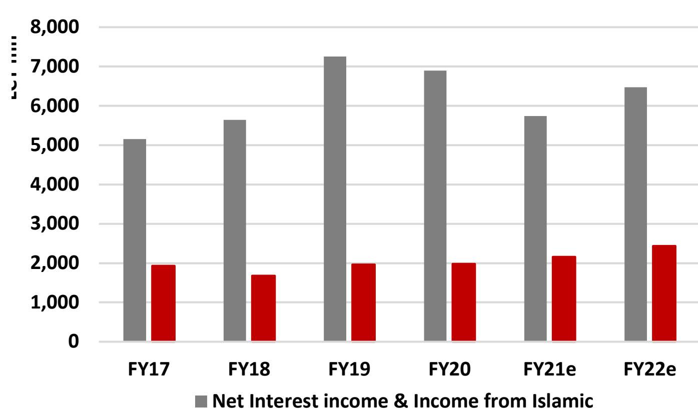
Low-cost funding base to support net interest and finance margin

SABB has one of the lowest costs of funding, given that it has no wholesale funding as well as a large share of demand deposits. We believe that given the nature of the funding mix of the bank, it is quite well-positioned to benefit from interest rate increase expected to start from as early as FY22e. As discussed in the Local Peer Group Section above, about 37% of the SABB's assets become due for re-pricing within 12 months (data as at end-FY20), positioning the bank to benefit from rising interest rates faster than most of its peers. As outlined before, **key risk** is delay in US Fed's rate hikes due to any unforeseen circumstances like emergence of new coronavirus variants that could negatively affect global growth outlook.

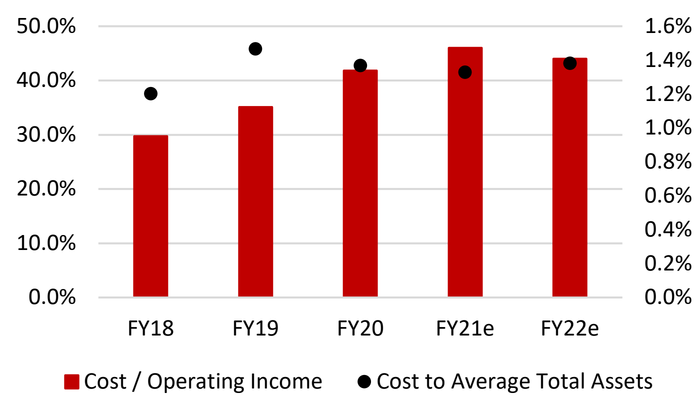
Interest and finance income to grow; efficiency improvements expected to support profitability

Given the expectation of an accelerated growth in net loans & financing of the bank, as well as improvements expected in its spreads, we are forecasting a CAGR of about 15% in the operating income growth of the bank over 2021e-2025e. Further, the bank is targeting to reduce its cost-to-income ratio from greater than 40% to sub-32% by FY25e.

SABB: Operating Income Components



SABB: Efficiency metrics



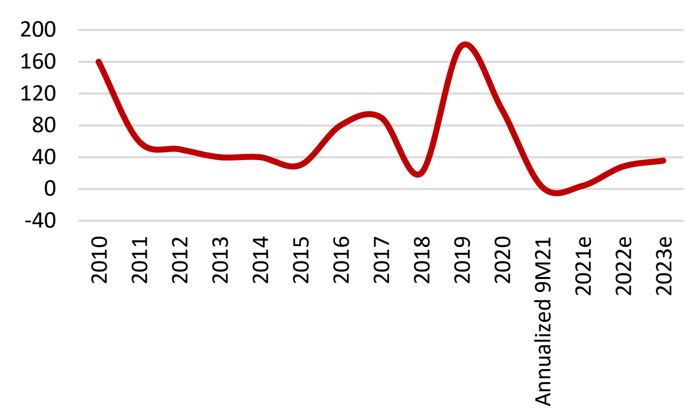
Source: Company Financials, U Capital Research

While the bank has aggressive efficiency improvements on the cards, we have factored in moderate improvement in its cost-to-income ratio by 2025e, with any further improvements captured in its terminal return on equity (ROE) for the bank's valuation.

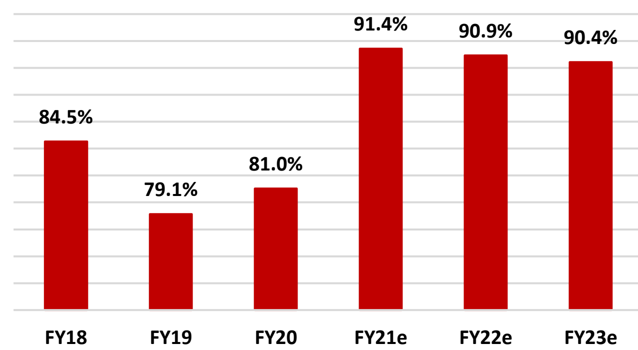
Cost of risk is benign but expected to normalize over the forecast period; LTD has risen

So far during the year, SABB's cost of risk has remained benign. However, we expect provision expenses to normalize over the forecast period and settle close to historical averages as covid-related delinquencies unwind.

SABB: Cost of risk (bps)



SABB: Loan-to-Deposit Ratio



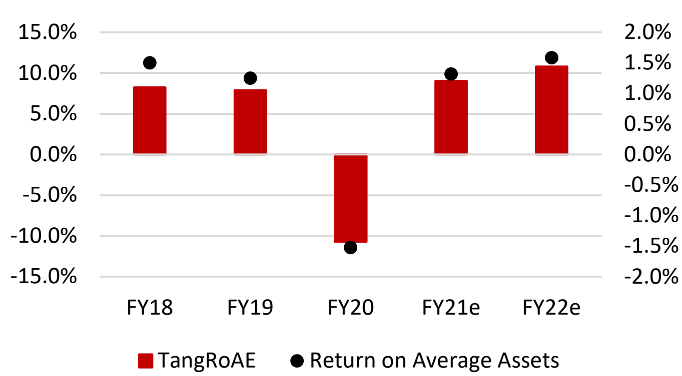
Source: Company Financials, U Capital Research

SABB has let go of some of its high-cost deposits, which has resulted in a material rise in its loan-to-deposit (LTD) ratio to 91% as compared to 81% at end-FY20. However, it must be noted that SABB's LTD is still quite low as compared to the rest of its local peers and is the fourth highest after BJAZ, SNB and RJHI.

Profitability ratios expected to improve

As outlined above, with operating income supported by a rising interest rate environment and loan & financing growth, we expect the bank's profitability ratios to show improvement. This is expected to be further compounded by improvements in efficiency as the bank has embarked on a 5-year strategic plan under which it is aiming to bring its cost-to-income ratio down to sub 32% levels. While we have not incorporated such an aggressive efficiency improvement, we have factored in some improvements in efficiencies that will support the bank's profitability ratios.

SABB: Profitability Metrics



Source: Company Financials, U Capital Research

Name of Subsidiary	SABB Ownership	Pricipal Activity
SABB Insurance Agency Limited ("SIAL")	100%	Exclusive insurance agent for SABB Takaful Company ("SABB Takaful")
Arabian Real Estate Company Limited ("ARECO")	100%	Purchase, sale and lease of land and real estate for investment purposes
SABB Real Estate Company Limited ("SRECO")	100%	Registration of real estate and to hold and manage collateral on behalf of SABB.
SABB Markets Limited ("SABB Markets")	100%	Derivatives trading and repo activities.
SABB Takaful*	65%	**Listed on Tadawul**. Engage in Shariah compliant insurance activities and to offer family and general Takaful products to individuals and corporates in Saudi Arabia.
Alawwal Invest ("AI")	100%	Investment services and asset management activities
Alawwal Real Estate Company ("AREC")	100%	Hold and manage collateral on behalf of SABB.
Alawwal Insurance Agency Company ("AIAC")	100%	Insurance agent for Wataniya Insurance Company (WIC) (under liquidation), an associate of SABB, to sell its insurance products.

**SABB Takaful announced the signing of a non-binding Memorandum of Understanding with Walaa Cooperative Insurance Company on 14 July 2021 corresponding to 04/12/1442H to evaluate a potential merger between the two companies. SABB Takaful will continue to announce any material developments regarding the proposed merger in accordance with the relevant laws and regulations.*

About SABB

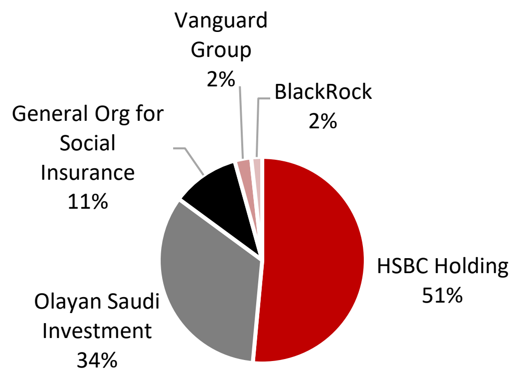
SABB is a Saudi Joint Stock Company and was established on 21st January 1978. It formally commenced activities on 1st July 1978 when it took over the operations of The British Bank of the Middle East in the Kingdom of Saudi Arabia.

SABB provides Shariah approved products, which are approved and supervised by an independent Shariah board. SABB also provides the option of a set of conventional banking products and services to its corporate and institutional customers, which include current accounts, savings, time deposits, corporate credit facilities, trade finance, cash and payments management, and treasury risk management solutions.

SABB is a leading international bank in the Kingdom due to its partnership with HSBC Group. It has recently increased scale and has a diversified business mix, reinforced by the merger with Alawwal Bank (integration completed in 1H21).

SABB owns 49% (2020: 49%) of the shares of HSBC Saudi Arabia, an associate. HSBC Asia Holdings B.V. a related party and shareholder in SABB, owns the remaining shares of HSBC Saudi Arabia. The main activities of HSBC Saudi Arabia are to provide a full range of investment banking services.

SABB: Shareholding Structure



Source: Bloomberg, 8th Dec 2021

Key Financials

(SAR bn)	FY18	FY19	FY20	FY21e	FY22e	FY23e
Income Statement						
Interest/Financing Income	6.7	8.8	7.8	6.4	7.3	10.2
Interest Expense/Payment to Depositors	(1.1)	(1.6)	(0.9)	(0.7)	(0.8)	(1.0)
Net Interest/Financing Income	**5.6**	**7.3**	**6.9**	**5.7**	**6.5**	**9.2**
Fee & Commission Income	1.1	1.3	1.3	1.3	1.4	1.5
Other Income	0.6	0.7	0.7	0.9	1.0	1.1
Total Non-Interest/Financing Income	**1.7**	**2.0**	**2.0**	**2.2**	**2.4**	**2.7**
Total Operating Income	**7.3**	**9.2**	**8.9**	**7.9**	**8.9**	**11.9**
Provisions expense	(0.3)	(2.5)	(1.6)	(0.1)	(0.5)	(0.7)
Operating Expenses	(2.2)	(3.2)	(3.7)	(3.6)	(3.9)	(5.0)
Other non-operating losses / (income)	0.0	(0.3)	(7.8)	0.1	0.1	0.2
Profit Before Taxation	**4.9**	**3.2**	**(4.3)**	**4.3**	**4.6**	**6.3**
Taxation & Minority Interest	(2.2)	(0.4)	0.2	(0.7)	(0.6)	(0.8)
Net Profit Attributable to Parent	**2.7**	**2.8**	**(4.1)**	**3.6**	**4.0**	**5.6**
Balance Sheet						
Cash Balances	14.1	21.3	36.4	12.1	9.8	8.8
Deposits with other banks & FIs	12.0	5.0	5.1	5.8	6.5	7.1
Gross Financing	118.9	158.1	160.4	172.5	186.3	203.0
Loan Loss Reserve	(8.6)	(6.0)	(7.2)	(7.1)	(7.8)	(8.7)
Net Financing	110.3	152.1	153.2	165.4	178.5	194.3
Other Assets	38.2	87.7	81.7	87.0	102.6	111.8
Total Assets	**174.7**	**266.0**	**276.5**	**270.3**	**297.4**	**322.0**
Deposits from Customers	130.5	192.2	189.1	180.9	204.8	224.5
Other Borrowings	5.2	8.3	27.2	26.3	26.2	25.6
Other Liabilities	6.4	9.4	9.4	12.2	10.9	11.9
Paid-up Capital	15.0	20.5	20.5	20.5	20.5	20.5
Retained Earnings	5.3	4.9	0.8	1.4	2.8	4.7
Other Reserves	12.2	30.5	29.4	28.9	31.9	34.6
Shareholders' Equity	**32.5**	**56.0**	**50.7**	**50.9**	**55.3**	**59.9**
Minority Interest	0.1	0.1	0.1	0.1	0.1	0.1
Tier 1 Perpetual Notes	-	-	-	-	-	-
Total Equity & Liability	**174.7**	**266.0**	**276.5**	**270.3**	**297.4**	**322.0**
Cash Flow Statement						
Cash from operations	2.7	30.2	(8.9)	(14.5)	4.4	8.5
Cash from investing activities	7.8	46.9	(6.3)	5.4	7.1	7.9
Cash from financing	(7.7)	23.9	17.7	(4.3)	0.4	(1.6)
Net changes in cash	(12.8)	7.2	15.2	(24.3)	(2.4)	(1.0)
Cash at the end of period	14.1	21.3	36.4	12.1	9.8	8.8
Key Ratios						
Return on Average Assets	1.5%	1.3%	-1.5%	1.3%	1.4%	1.8%
Return on Average Equity	8.3%	6.2%	-7.7%	7.1%	7.6%	9.7%
Return on Tangible Average Common Equity (ROTCE)	8.3%	7.9%	-10.7%	9.1%	9.7%	12.6%
Recurring Income/Operating Income	92.5%	92.8%	92.2%	88.6%	88.6%	90.7%
Yield on Interest Earning & Islamic Finance Assets	4.3%	4.7%	3.6%	2.8%	2.9%	3.7%
Cost of Funds	-0.7%	-0.9%	-0.5%	-0.3%	-0.4%	-0.4%
Net Spread	5.0%	5.6%	4.0%	3.1%	3.2%	4.1%
Net Interest Margin (NIM)	3.6%	3.9%	3.1%	2.5%	2.6%	3.3%
Cost to Income Ratio	29.7%	35.1%	41.8%	46.0%	44.0%	42.0%
Net Financing to Customer Deposits	84.5%	79.1%	81.0%	91.4%	90.9%	90.4%
NPAs to Gross Financing	4.9%	2.7%	3.4%	3.4%	3.4%	3.4%
NPA Coverage (%)	148	143	133	121	124	126
Cost of Risk (bps)	16.4	133.0	74.2	2.9	20.0	25.0
Equity to Total Assets	18.6%	21.1%	18.3%	18.8%	18.6%	18.6%
Cash Dividend Payout Ratio	108.3%	44.8%	0.0%	65.0%	65.0%	65.0%
Adjusted EPS (SAR)	1.81	1.34	(2.01)	1.76	1.95	2.71
Adjusted BVPS (SAR)	21.64	27.25	24.68	24.77	26.91	29.15
TangBVPS, SAR	21.60	18.27	19.33	19.42	20.69	22.37
Market Price (SAR) *	32.65	34.70	24.72	28.85	28.85	28.85
Dividend Yield	6.0%	1.7%	0.0%	4.0%	4.4%	6.1%
P/E Ratio (x)	18.0	25.9	(12.3)	16.4	14.8	10.6
P/BV Ratio (x)	1.5	1.3	1.0	1.2	1.1	1.0
P/TangBVPS	1.5	1.9	1.3	1.5	1.4	1.3

* Market price for the current and subsequent years as per the closing price of 15-Dec-2021

Source: Company Financials, U Capital Research

Provision cover excludes POCI.

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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