

## Arab National Bank (ARNB)

Higher non-funded income boosted profitability

**Rating : ACCUMULATE**

### First Look Note – 1Q23

**Sector: Banking**

#### 1Q23 Net Profit exceeded our estimate

Arab National Bank (ARNB/the Bank) recorded a strong 2464.41% growth in net profit to SAR 1,068 Mn in 1Q23, higher than our estimate of SAR 858 Mn. The increase in net profit was mainly attributed to growth in net funded and non-funded income and operating income partially offset by the an increase in the impairment charge for expected credit losses and increasing operating expenses.

#### P&L highlights

ARNB's funded income more than doubled grew significantly from SAR 1,334 Mn in 1Q22 to SAR 2,826 Mn in 1Q23 attributable to a 5.84.4% YOY increase in net advances and higher interest rates asset yield. Funded expenses increased majorly from SAR 150 Mn in 1Q22 to SAR 1,641 093 Mn in 1Q23 due to a 64.8% YOY growth in deposits and amid a rising interest rate scenario. Thus, the net funded income remained stable at SAR 1,185 733 Mn in 1Q23. Non-funded income also grew 65.5% YOY SAR 447 Mn in 1Q23 due to higher gain on sale of investments, higher fee income, exchange income and dividend income. The operating income inclined 49.9% YOY to SAR 2,180 Mn in 1Q23. Although operating expenses rose 14.7% YOY to SAR 659 Mn in 1Q23, the cost-to-income ratio declined 928 bps YOY and 693 bps QOQ to 30.2% in 1Q23 implying improved efficiency of the bank. The rise in operating expense is owing to an increase in G&A expenses, employee, and D&A expenses partially offset by a decline in rent and related expenses. Net impairments increased 91.7% YOY to SAR 298 Mn in 1Q23 charged on the expected credit losses and other provisions. Furthermore, profit before tax expenses rose 59.5% YOY to SAR 1,233 Mn in 1Q23 owing to an increase in the net fees and commission income, net exchange income, gain on sale of investments and dividend income, as well as a decrease in rent and premises-related expenses offset by the rising net impairments and general expenses, and salaries and employee-related expense.

#### Balance Sheet highlights

ARNB's net advances further increased 4.4% YOY and 0.6% QOQ to SAR 144.7 Bn in 1Q23. Total assets rose 4.6% YOY and 0.7% QOQ to SAR 214.0 Bn in 1Q23. Similarly, customer deposits rose 4.8% YOY to SAR 155.3 Bn in 1Q23 with a cost-to-deposit ratio of 93.2% in 1Q23. Consequently, total equity increased marginally 1.9% YOY to SAR 32.6 Bn in 1Q23.

#### Target price and rating

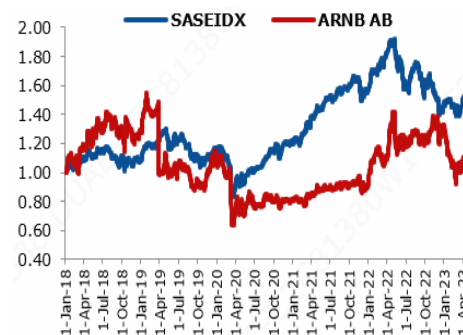
We maintain our ACCUMULATE rating on Arab National Bank with a target price of SAR 30.00. The Bank reported strong growth in net profit in 1Q23 owing to a healthy growth in funded and non-funded income. Also, ARNB recorded a subdued growth in advances and deposits which rose 0.6% and 0.2% QOQ, respectively in 1Q23. The lower growth in deposits lead to a marginal increase in loan-to-deposit ratio from 92.9% in 4Q22 to 93.2% in 1Q23. Despite this, ARNB managed to expand its NIM based on our calculation. The Bank's wholesale banking business, which includes lending to corporate, commercial, and SMEs, is anticipated to benefit from the KSA's Vision 2030, which will offer significant opportunity for the Bank to fund a number of large projects over the medium term. While for the treasury banking segment, the Bank is seeking to expand its in-

#### Recommendation

Current Price (15-May-23)	26.90
Target Price (SAR)	30.00
Upside/Downside (%)	+12%

#### Stock Information

Market Cap (mm)	42,075.00
Paid Up Capital (mm)	15,000.00
52 Week High	35.00
52 Week Low	23.00
3M Avg. daily value (SAR)	26,506,770



#### Financial Ratios

Dividend Yield (12m)	3.92
Dividend Pay-out (%)	53.74
Price-Earnings Ratio (x)	12.10
Price-to-Book Ratio (x)	1.29
Book Value (SAR)	21.76
Return-on Equity (%)	10.78
Earning Per Share (SAR)	2.32
Beta	1.05

#### Stock Performance

5 Days	1.08%
1 Months	5.45%
3 Months	6.25%
6 Months	-16.02%
1 Year	-7.12%
Month to Date (MTD)	1.45%
Quarter to Date (QTD)	8.72%
Year to Date (YTD)	-12.48%

come streams by expanding product offerings and enhancing cross-selling with the Wholesale and Private banking clients. The stock is trading at attractive dividend of 4.8% compared to peer average of 3.5% based on FY2023 financials. Thus, based on our analysis, we assign an ACCUMULATE rating to the stock.

**ARNB - Relative valuation**

(at CMP)	2018	2019	2020	2021	2022	2023F
P/E (x)	10.2	13.3	19.5	18.6	13.2	10.2
P/B (x)	1.6	1.5	1.4	1.3	1.3	1.2
Dividend Yield (%)	3.7%	3.7%	1.5%	3.0%	4.1%	4.8%

FABS Estimates & Co Data

**ARNB - P&L**

SAR mm	1Q22	4Q22	1Q23	1Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Funded income	1,334	2,521	2,826	2,694	4.9%	111.8%	12.1%	7,657	11,683	52.6%
Funded expense	-150	-876	-1,093	-942	16.0%	630.2%	24.8%	-2,020	-4,537	124.6%
<b>Net funded income</b>	<b>1,185</b>	<b>1,645</b>	<b>1,733</b>	<b>1,752</b>	<b>-1.1%</b>	<b>46.3%</b>	<b>5.3%</b>	<b>5,636</b>	<b>7,146</b>	<b>26.8%</b>
<b>Operating income</b>	<b>270</b>	<b>273</b>	<b>447</b>	<b>249</b>	<b>79.2%</b>	<b>65.5%</b>	<b>63.5%</b>	<b>1,226</b>	<b>1,276</b>	<b>4.1%</b>
Operating expenses	1,455	1,919	2,180	2,001	8.9%	49.9%	13.6%	6,862	8,422	22.7%
<b>Pre-provision profit</b>	<b>-575</b>	<b>-713</b>	<b>-659</b>	<b>-701</b>	<b>-6.0%</b>	<b>14.7%</b>	<b>-7.6%</b>	<b>-2,458</b>	<b>-2,687</b>	<b>9.3%</b>
Impairment	880	1,206	1,521	1,301	16.9%	72.9%	26.2%	4,405	5,736	30.2%
<b>PBT</b>	<b>-155</b>	<b>-270</b>	<b>-298</b>	<b>-283</b>	<b>5.5%</b>	<b>91.7%</b>	<b>10.5%</b>	<b>-880</b>	<b>-1,085</b>	<b>23.4%</b>
<b>Profit after tax</b>	<b>773</b>	<b>953</b>	<b>1,233</b>	<b>1,035</b>	<b>19.1%</b>	<b>59.5%</b>	<b>29.3%</b>	<b>3,633</b>	<b>4,722</b>	<b>30.0%</b>
Non-controlling int.	651	792	1,057	859	23.0%	62.4%	33.5%	3,067	3,943	28.6%
<b>Net profit attributable</b>	<b>651</b>	<b>791</b>	<b>1,068</b>	<b>858</b>	<b>24.4%</b>	<b>64.1%</b>	<b>35.1%</b>	<b>3,070</b>	<b>3,948</b>	<b>28.6%</b>

FABS Estimates & Co Data

**ARNB - Margins**

	1Q22	4Q22	1Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Net FI/OI	81.4%	85.8%	79.5%	-194	-626	82.1%	84.9%	271
Fees & comms/OI	8.8%	6.7%	6.3%	-250	-45	8.0%	7.1%	-83
Impairment/PPP	17.7%	22.4%	19.6%	192	-277	20.0%	18.9%	-105
Cost to income	39.5%	37.2%	30.2%	-928	-693	35.8%	31.9%	-392
Impairment/PPP	17.7%	22.4%	19.6%	192	-277	20.0%	18.9%	-105
NP/OI	44.8%	41.2%	49.0%	424	778	44.7%	46.9%	213
ROAE	7.3%	9.7%	12.7%	548	303	9.9%	12.1%	223
ROAA	1.13%	1.5%	1.9%	81	48	1.5%	1.7%	23

FABS estimate & Co Data

**ARNB- B/S Key Items**

SAR mm	1Q22	2Q22	3Q22	4Q22	1Q23	YOY Ch
<b>Net advances</b>	138,642	143,055	145,475	143,829	144,727	4.4%
QOQ change	9.4%	3.2%	1.7%	-1.1%	0.6%	
<b>Total assets</b>	204,620	209,828	207,266	212,628	214,042	4.6%
QOQ change	6.3%	2.5%	-1.2%	2.6%	0.7%	
<b>Customer deposits</b>	148,138	146,791	147,806	154,871	155,247	4.8%
QOQ change	9.2%	-0.9%	0.7%	4.8%	0.2%	
<b>Total equity</b>	32,035	31,028	31,749	32,334	32,644	1.9%
QOQ change	3.0%	-3.1%	2.3%	1.8%	1.0%	

FABS estimate & Co Data

## Valuation:

We use Residual Income and Relative Valuation (RV) method to value ARNB. We have assigned 70% weight to Residual Income, and 30% to RV method.

Valuation Method	Target	Weight	Weighted Value
Residual Income	32	70.0%	22.14
Relative	26	30.0%	7.90
<b>Weighted Average Valuation (SAR)</b>			<b>30.00</b>
<b>Current market price (SAR)</b>			<b>26.90</b>
<b>Upside/Downside (%)</b>			<b>+11.5%</b>

### 1) Residual Income Method:

We have discounted the economic profit/excess equity using the cost of equity of 8.6%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 1.1 and equity risk premium of 3.7%. Government bond yield is calculated after adding KSA 10-year CDS spread over 10-year US risk free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (SAR, Mn)	4,403
Terminal value (SAR, Mn)	11,538
Book Value of equity (as of March 2023)	31,508
<b>FV to Common shareholders (SAR, Mn)</b>	<b>47,449</b>
No. of share (Mn)	1,500
Current Market Price (SAR)	26.95
<b>Fair Value per share (SAR)</b>	<b>31.63</b>

### Residual Income Method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Net Profit	3,948	4,381	4,636	4,747	4,693
(-) Equity charge	-2,879	-3,063	-3,255	-3,443	-3,627
<b>Excess Equity</b>	<b>356</b>	<b>1,318</b>	<b>1,381</b>	<b>1,304</b>	<b>1,066</b>
Discounting Factor	0.97	0.90	0.82	0.76	0.70
<b>Present Value of Excess Equity</b>	<b>347</b>	<b>1,181</b>	<b>1,139</b>	<b>991</b>	<b>746</b>

## 2) Relative Valuation:

We have used local peers to value ARNB and it is valued using the PB multiple. We applied a discount to peer valuation since it generates lower asset returns as compared to its peers. It is valued at PB multiple of 1.2x.

Company	Market (USD Mn)	P/B (x)		PE (x)		Dividend Yield (%)	
		2023	2024	2023	2024	2023	2024
Alinma Bank	16,736	2.2	2.1	14.1	12.9	3.9	4.4
Al Rajhi Bank	79,892	3.3	2.8	17.1	15.1	2.2	3.0
Saudi National Bank	58,925	1.3	1.3	12.0	10.9	4.1	4.7
Banque Saudi Fransi	12,399	1.2	1.1	10.5	10.3	4.9	5.3
Riyad Bank	24,203	1.7	1.6	11.7	11.0	4.2	4.5
Bank Albilad	10,887	2.7	2.4	15.4	13.3	1.4	1.7
<b>Average</b>		2.1x	1.9x	13.4x	12.3x	3.5%	3.9%
<b>Median</b>		2.0x	1.8x	13.0x	12.0x	4.0%	4.4%
<b>Max</b>		2.6x	2.3x	15.1x	13.2x	4.2%	4.6%
<b>Min</b>		1.4x	1.3x	11.7x	11.0x	2.6%	3.3%

### Research Rating Methodology:

Rating	Upside/Downside potential
BUY	Higher than +15%
ACCUMULATE	Between +10% to +15%
HOLD	Lower than +10% to -5%
REDUCE	Between -5% to -15%
SELL	Lower than -15%

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