

Banking sector posts another strong quarter; Al Rajhi leads the charge

The Saudi banking sector had a strong quarter as the economy started to recover from the pandemic. Credit growth continues in at a double-digit rate, driven by the government's expansionary policy and surging retail demand. Oil prices have recovered strongly and are at pre-COVID-19 levels. This should provide the much-needed support to the government's finances. The Saudi Central Bank's SAR50bn liquidity support program and private sector financial support program continues to drive credit growth in the near term.

Al Rajhi was the top performer during the quarter. The bank's market share (loans) increased by 190 bps to 18.5% as its loan book registered a staggering increase of 25.9% Y/Y. It also posted the highest operating income (SAR 5.79bn), contributing 22.2% to the sector's overall earnings in Q4-20. With the outlook for the sector being positive, the bank seems to be in a good position to enhance its market share.

Demand deposits drive deposit growth: Total banking deposits grew 8.2% Y/Y to SAR 1.94tn in Q4-20. The growth was mainly due to demand deposits which rose 16.7%, while time and savings deposits fell 5.5% Y/Y.

Continued growth in real estate sector boosts loan growth: Loan growth remained robust, increasing 14.8% Y/Y to SAR 1.78tn in Q4-20, led by a 59% Y/Y increase in real estate loans. All sectors registered positive Y/Y loan growth during the quarter. The miscellaneous sector was the standout, posting a 48.2% Y/Y growth in Q4-20.

Increase in provisions and higher NPLs impact net income: Most banks witnessed a significant increase in provisions during the quarter, as the government continued to extend the loan deferral program for MSME up-to 1H-2021. The low interest rate scenario, driven by the US Fed's decision, is expected to continue into 2021 and to impact NIM. This coupled with the higher NPL ratio (2.2% in Q4-20) continues to pressurize the bottom line.

Saudi central bank extends deferred payments program to June 30, 2021: Saudi Central Bank extended the deferred payments program for MSMEs up to June 30, 2021. It also extended the Guaranteed Financing Program until March 14, 2022. The extension has been provided to support business continuity in the private sector, which in turn would aid economic growth and development. The deferred payments program was launched on March 14, 2020 and has benefitted 99,000 contracts amounting to SAR 124bn in deferred payments, exceeding the initial allocated amount of SAR 30bn. With the extension, provisions could remain low in H1-21 and increase significantly in H2-21 once this support is withdrawn.

NCB, SAMBA shareholders approve merger: Shareholders of NCB and Samba Financial Group approved the merger during their respective EGMs on March 1, 2021. Each SAMBA share would garner 0.739 NCB shares. NCB shareholders also approved increasing the company's capital from SAR 30bn to SAR 44.78bn, as per the merger agreement. The merger is expected to be completed in H1-21 and could pave the way for further consolidation in the Saudi banking industry.

S&P states Saudi PIF Investments to spur corporate credit growth: S&P stated investments by Saudi Arabia's sovereign wealth fund is likely to boost corporate credit growth in the kingdom in 2021. Domestic private-sector credit in Saudi Arabia is expected to exceed 80% of its GDP in 2021 as the PIF's investment in construction-related sectors offsets the easing of government support provided in the pandemic. It expects credit growth to remain at 10% in 2021-22. The government's efforts to meet the 2030 Vision targets is expected to boost the demand for housing, resulting in strong growth in mortgage and retail loans.

Fitch expects retail sector to drive banking growth in Saudi Arabia: The retail lending segment has been growing rapidly in Saudi Arabia in recent years; it is the key driver of growth of the Saudi banking sector. Fitch expects the growth momentum to continue due to high appetite among banks. Returns on retail portfolios have low funding costs, as retail loans are largely funded by retail non-interest-bearing deposits (NIBs). As there are no caps on retail loans, their pricing contributes to high margins. Hence, banks with a larger proportion of retail lending in their portfolios display higher profitability than their peers. This has led to banks actively chasing retail lending and accordingly adjusting their strategy and appetite for this segment.

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Valuation

Al Rajhi Bank: Stellar growth in loans driven by retail sector led to strong earnings growth in Q4-20; double-digit earnings growth expected in FY21, while loans growth rate could taper marginally

Al Rajhi Bank's net profit increased 34.7% Y/Y to SAR 3,121mn, driven by an 8.9% Y/Y rise in net financing and investment income. Fee from banking services surged 89.6% Y/Y, resulting in a 15.8% increase in total operating income. The loan growth (up 26.5% Y/Y) was staggering and was driven largely by the retail sector (up 34.2% Y/Y). The strong retail sector performance can be attributed to mortgage financing (up 90% Y/Y). With this strong performance, Al Rajhi narrowed the gap between the top two players (NCB leads). The retail sector accounted for 79.5% of the bank's total loan book in Q4-20. We expect the contribution of retail sector to decline in FY21 and tread close to the historical levels. The challenge for Al Rajhi would be to maintain the growth momentum witnessed in FY20 without the bottom line being affected.

Al Rajhi Bank's TTM PE stood at 17.4x vis-à-vis the estimated forward PE of 18.3x. Retail loans have a lower probability of being repriced, whereas the low interest rate on Murabaha deposits would further pare the returns on customer deposits. We estimate an EPS of SAR 4.91 in FY21, driven by a double-digit increase in loan growth and higher fee from banking services, offset by an increase in impairment charges. We maintain our "Neutral" recommendation for Al Rajhi Bank with a TP of SAR 87/share.

Alinma Bank: Higher impairment charges dent net profit in Q4-20; higher percentage of corporate loans could increase provisions in FY21

Alinma Bank's earnings declined 22.5% Y/Y to SAR 394mn, driven by a significant jump (up 69%) in impairment charges. This was partially offset by a 41.6% increase in fees from banking services. The bank's loan portfolio grew by 16.9% Y/Y, driven by corporate loans. Once the deferred payments program is complete, we expect the bank to post higher impairment charges.

Alinma Bank's loan book contains 79% corporate loans and 42% of its deposits are Murabaha deposits. A higher concentration of corporate loans leaves the bank susceptible to higher NPLs, which increased to 2.6% in FY20 from 1.9% in FY19. Additionally, more corporate exposure could result in the re-pricing of loans, consequently impacting NIMs. We expect the bank to post earnings of SAR 2.1bn, an increase of 9.8% Y/Y. We maintain a cautious "Overweight" rating on Alinma Bank with a TP of SAR 19.0/share.

Bank Albilad: Double-digit earnings posted despite increase in provision; withdrawal of loan deferral program expected to hike provisions in FY21

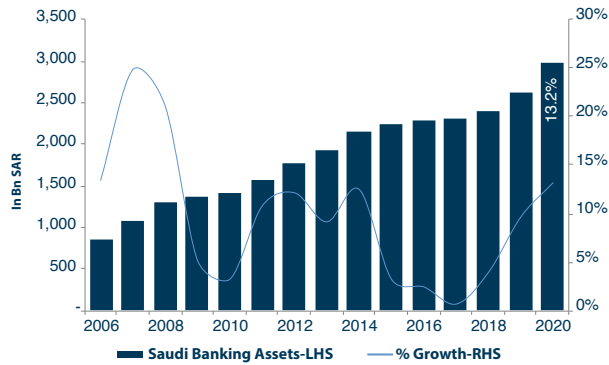
Bank Albilad's net income rose 15.5% Y/Y to SAR 377.8mn, driven by an 6.9% Y/Y increase in income from investing and financing assets. Loans grew 18.3% Y/Y to SAR 70.1bn. We expect loan growth in mid-single digits in FY20.

Bank Albilad has an even mix of corporate and retail loans, while almost 56% of its deposits are NIB. Its NPL ratio in FY20 stood at 1.2%, unchanged from the rate in FY19. As corporate loans account for close to 50% of loans, we expect higher provisioning once the loan deferral program is completed. We estimate an EPS of SAR 1.86 for FY21, an increase of 2.7% on expectations of higher provisions. We maintain our "Neutral" rating on Bank Albilad with a TP of SAR 28.0/share.

Company	EPS (FY-21)	ROE (TTM)	ROA (TTM)	TTM P/E(x)	P/B(x)	TP(Price/share)	Recommendation
Al-Rajhi	4.91	19.4%	2.5%	17.4	3.2	87.0	Neutral
Alinma	1.09	8.4%	1.4%	16.5	1.3	19.0	Overweight
Al-Bilad	1.86	13.4%	1.5%	15.8	2.0	28.0	Neutral



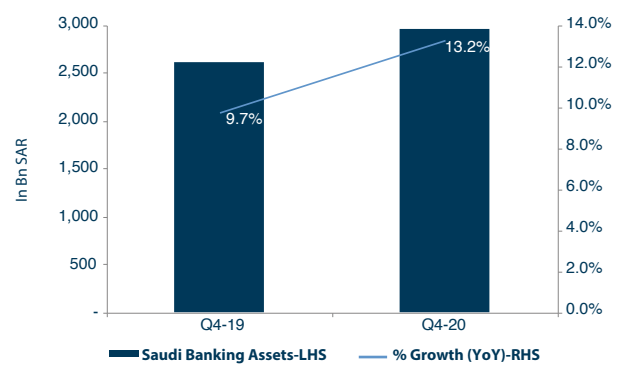
Saudi Banking Sector Balance Sheet Growth – Q4-20



Source: SAMA, Argaam, Aljazira Research

KSA's banking sector registered a CAGR of 7.7% during 2010-20.

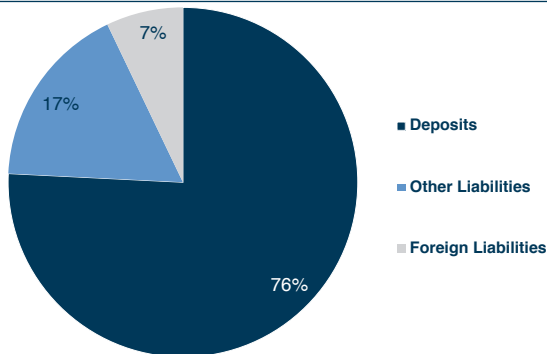
Saudi Banking Sector Balance Sheet Growth – Q4-20



Source: SAMA, Argaam, Aljazira Research

In Q4-20, the banking sector grew 13.2% Y/Y, while it advanced 3.5% Q/Q to SAR 2,980bn.

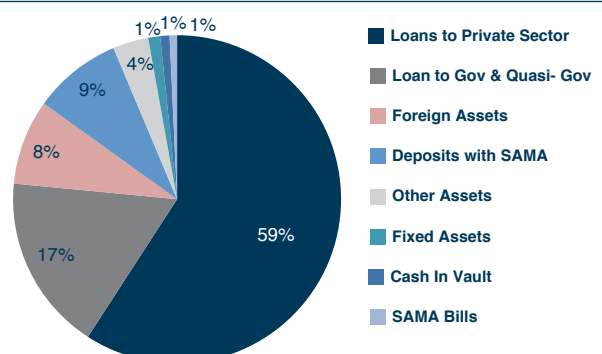
Saudi Banking Sector Liabilities Composition (Q4-20)



Source: SAMA, Argaam, Aljazira Research

The share of deposits (as a percentage of balance sheet liabilities) declined to 75.8% in Q4-20 from 76.0% in Q3-20.

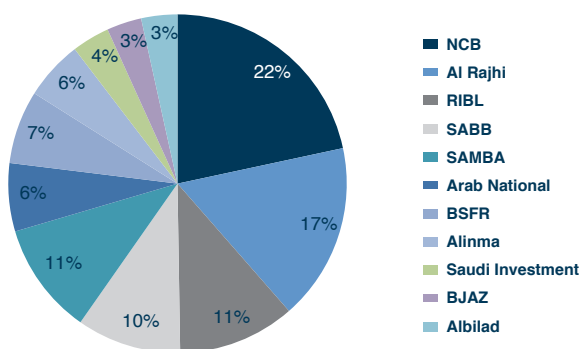
Banking Sector – Assets Breakdown (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Loans to private sector decreased to 59.2% in Q4-20 as compared to 59.9% in Q3-20.

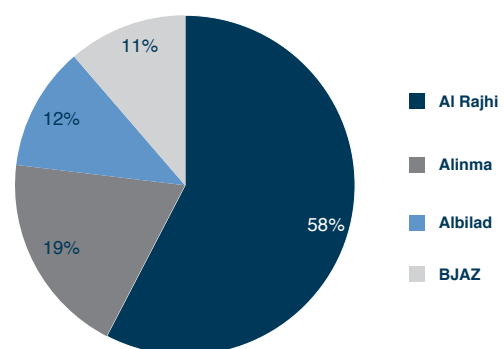
Distribution of Total Banking Assets (Q4-20)



Source: SAMA, Argaam, Aljazira Research

NCB (assets over SAR 599bn) led the market with a share of 21.6% in Q4-20, an increase of 0.1% from 21.5% in Q3-20.

Asset Market Share of Shariah-Compliant Banks (Q4-20)

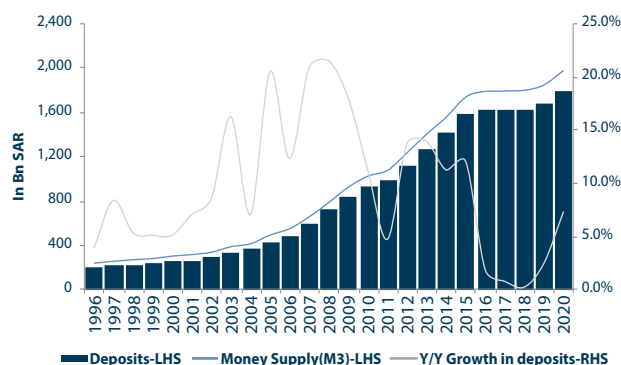


Source: SAMA, Argaam, Aljazira Research

Al Rajhi is the largest Shariah-compliant bank in KSA. The bank holds 57.6% of the total market share in Q4-20, an increase of 0.6% from the previous quarter.



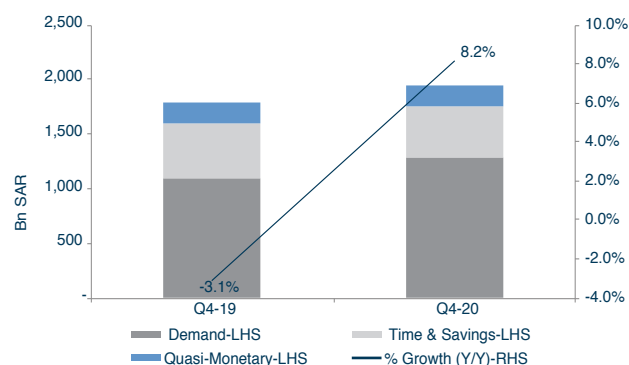
Deposits Growth (Historical) (1996–2020)



Source: SAMA, Argaam, Aljazira Research

Deposits and money supply in KSA rose steadily at CAGRs of 7.0% and 7.1% over 10 years, respectively.

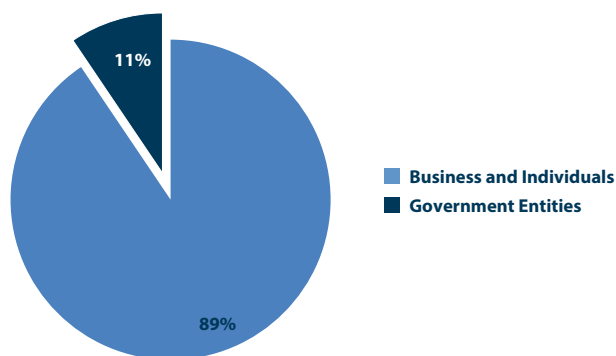
Deposits Breakup and Growth (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Total deposits increased 8.2% Y/Y to SAR 1.94tn in Q4-20 from SAR 1.80tn compared to Y/Y deposit growth of 10.7% in Q3-20.

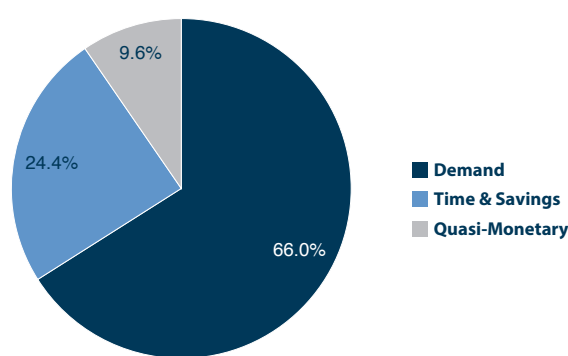
Demand Deposits Breakdown (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Businesses and individuals held 88.7% of demand deposits in Q4-20 compared to 88.3% in Q3-20.

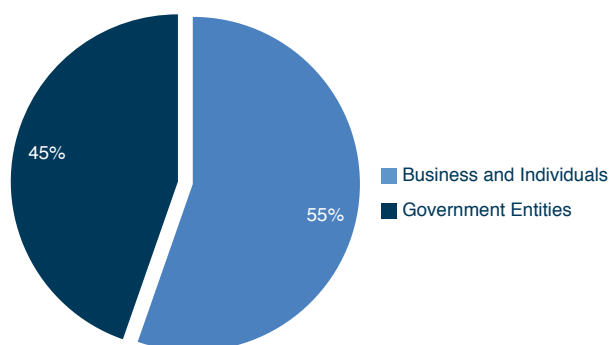
Deposits Breakdown (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Of the total deposits, demand deposits accounted for 66.0% in Q4-20 compared to 65.1% in Q3-20.

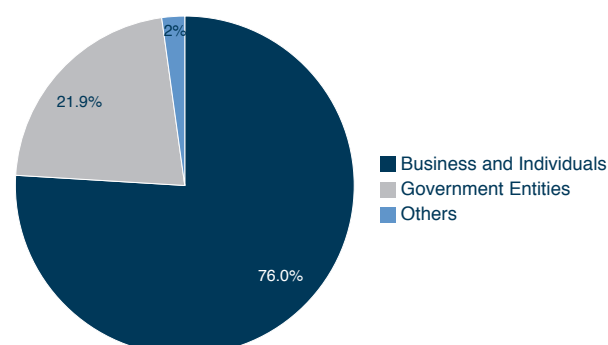
Time & Savings Deposit Breakdown (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Businesses and individuals held 55.3% of time and saving deposits in Q4-20 compared to 56.0% in Q3-20.

Sector-Wise Deposits (Q4-20)

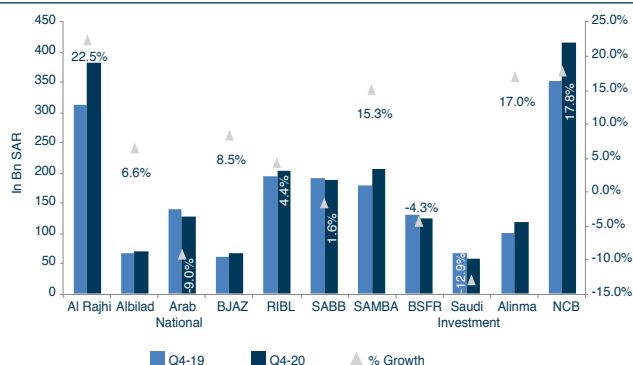


Source: SAMA, Argaam, Aljazira Research

Business and individuals held 76.0% of total deposits in Q4-20, a decline of 0.2% from 76.2% in Q3-20.



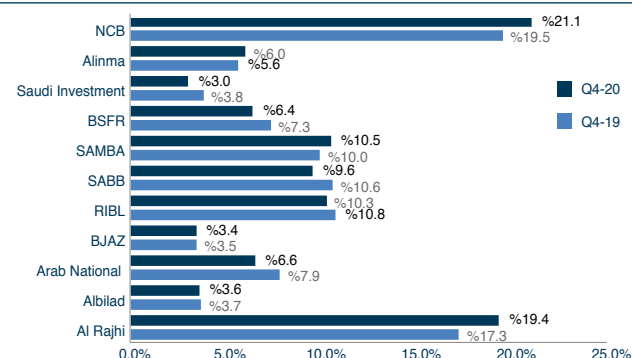
Bank-Wise Deposits Growth (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

Al Rajhi recorded the highest growth (22.5% Y/Y) in deposits, while NCB stood second, increasing the deposit base by 17.8% Y/Y.

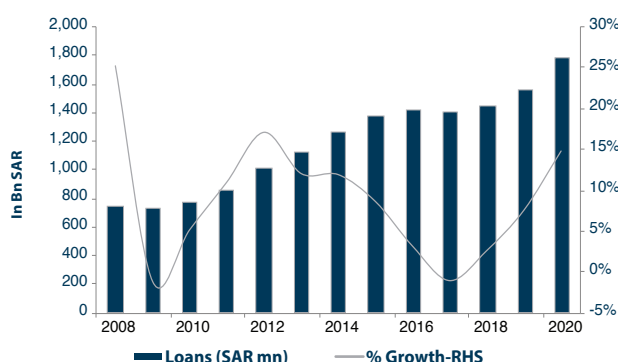
Deposits Market Share Comparison (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

NCB (deposit base of SAR 416bn) is the largest bank in Saudi Arabia, followed by Al Rajhi Bank (deposit base of SAR 383bn).

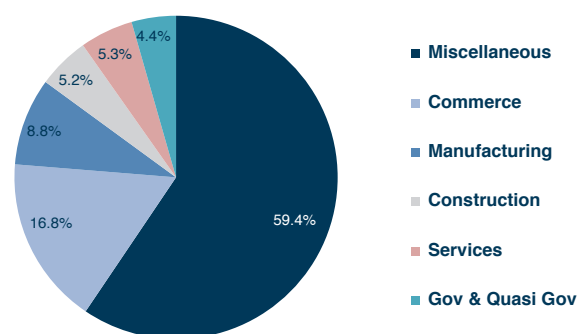
Loan Growth Historicals (2007–20)



Source: SAMA, Argaam, Aljazira Research

Total loan book of the banking sector increased 14.8% Y/Y to SAR 1.78tn in Q4-20, clocking a 10-year CAGR of 8.7%.

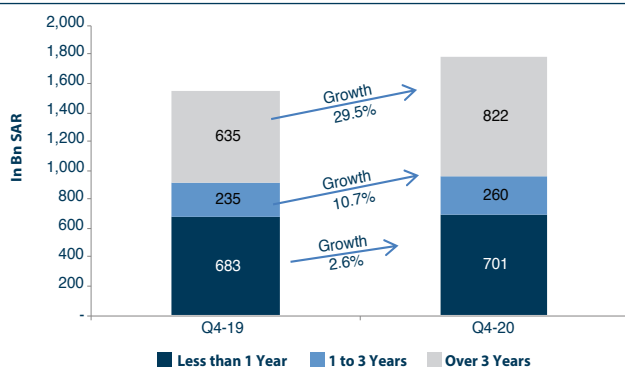
Sector-Wise Loan Distribution (Q4-20)



Source: SAMA, Argaam, Aljazira Research

The commerce sector accounted for 16.8% of total loans, a decrease of 1.1% from the prior quarter.

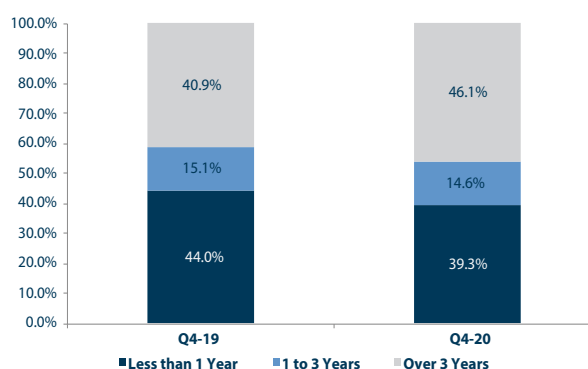
Loan Maturity – Growth (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

Loans with maturity of over three years grew 29.5% Y/Y, while those with maturity of less than one year rose 2.6%.

Loan Share According to Maturity Profile (Q4-20 vs Q4-19)

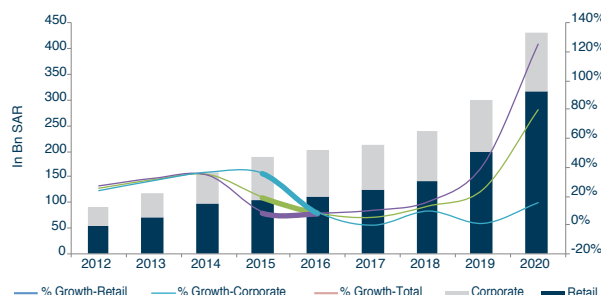


Source: SAMA, Argaam, Aljazira Research

The share of loans with maturity of more than three years rose to 46.1% in Q4-20 from 40.9% in Q4-19.



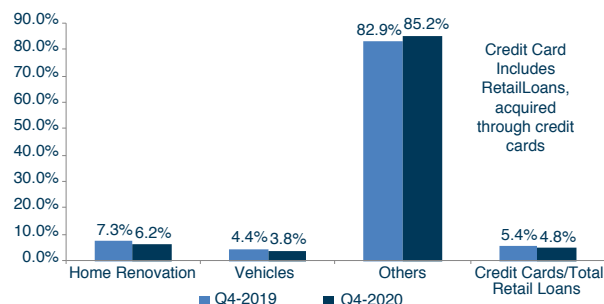
Real Estate Loan Historicals



Source: SAMA, Argaam, Aljazira Research

In Q4-20, the retail sector accounted for 73.6% of loans, an increase of 2.4% from the previous quarter.

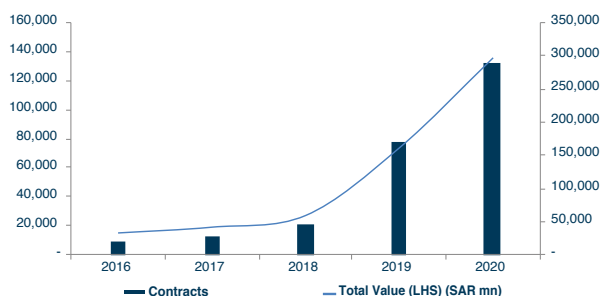
Retail Loans Breakdown (Q4-20 Vs. Q4-19)



Source: SAMA, Argaam, Aljazira Research

Loans for home renovation financing accounted for 6.2% in Q4-20. Retail loans acquired through credit cards constituted 4.8% in Q4-20, a decline of 0.7% from Q3-20.

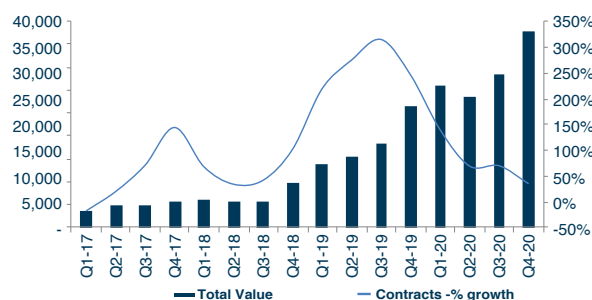
Mortgage (Contracts and Total Value) Historicals



Source: SAMA, Argaam, Aljazira Research

Mortgage contracts increased 70% Y/Y to 289.3k, while the total value rose 84% Y/Y to SAR 136.2bn.

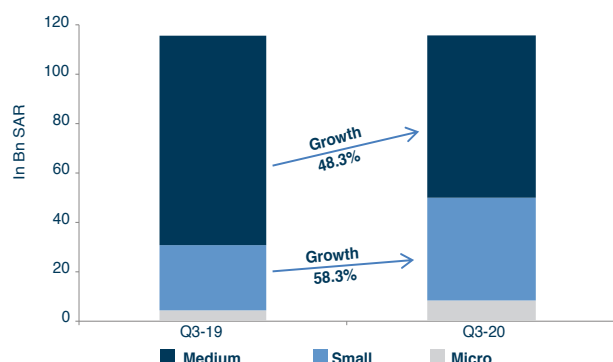
Contract Value and Growth (Quarterly)



Source: SAMA, Argaam, Aljazira Research

New contracts in Q4-20 stood at 85.5k with a value of SAR 42.9bn, an increase of 61.3% Y/Y.

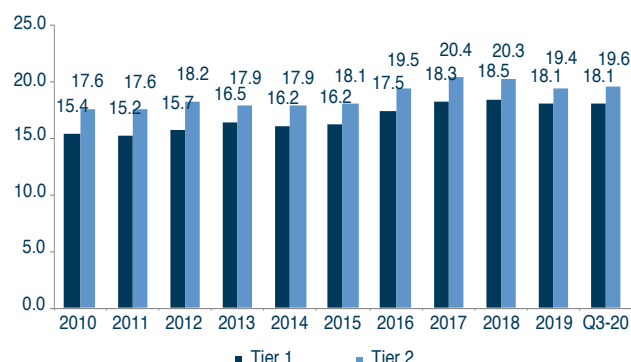
Credit Facilities to SMEs (SAR Mn) (Q3-20 vs Q3-19)



Source: SAMA, Argaam, Aljazira Research

Total credit facilities to SMEs increased 52.0% Y/Y to SAR 175.7bn, while those to medium enterprises rose 48.3% Y/Y to SAR 125.3bn in Q3-20.

Capital Adequacy Ratio (Historicals)

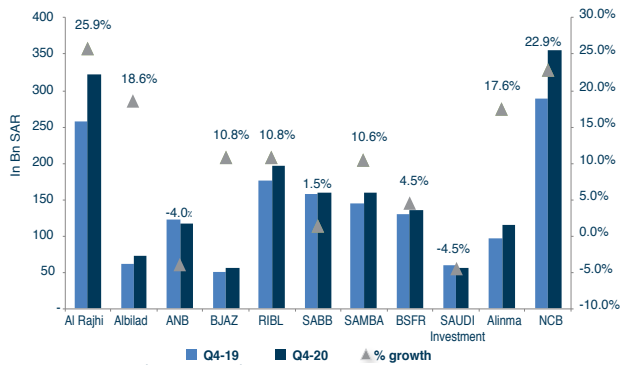


Source: SAMA, Argaam, Aljazira Research

The Tier 1 capital stood unchanged at 18.1% in Q3-20, compared to that a year ago, while the Tier 2 ratio increased to 19.6% in Q3-20 from 19.4% in Q3-19.



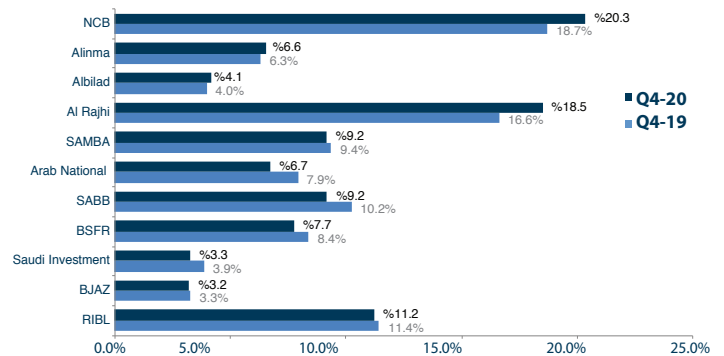
Bank-Wise Loan Distribution (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

Of the 11 banks in the sector, 9 registered Y/Y increase in gross loans. Al Rajhi's loan book registered the highest increase of 25.9% Y/Y in Q4-20, further strengthening its market share.

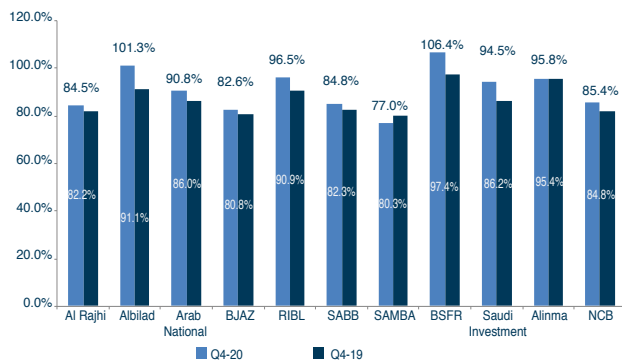
Bank-Wise Market Share (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

Al Rajhi was the biggest gainer in the market share, witnessing a significant jump to 18.5% in Q4-20 from 16.6% in Q4-19. NCB's market share rose to 20.3% in Q4-20.

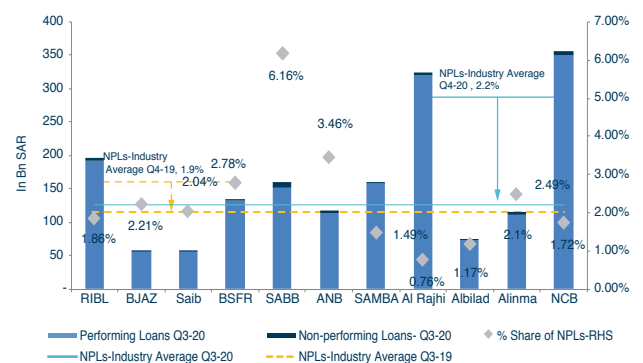
Bank-Wise ADR ratio (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

The industry ADR ratio stood at 88.5% in Q4-20 compared to 85.5% in Q4-19. BSFR posted the highest ADR ratio of 106.4%, followed by Bank Albilad with a ratio of 101.3% in Q4-20.

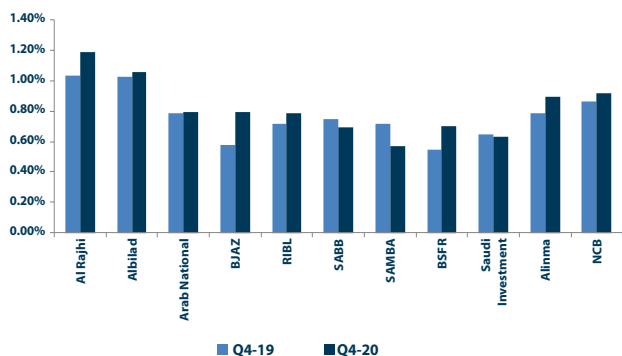
Performing Loans to NPLs



Source: SAMA, Argaam, Aljazira Research

The sector's NPL ratio jumped to 2.2% in Q4-20 from 2.07% in Q4-19. The NPL coverage ratio increased to 131% in Q4-20 from 129% in Q4-19.

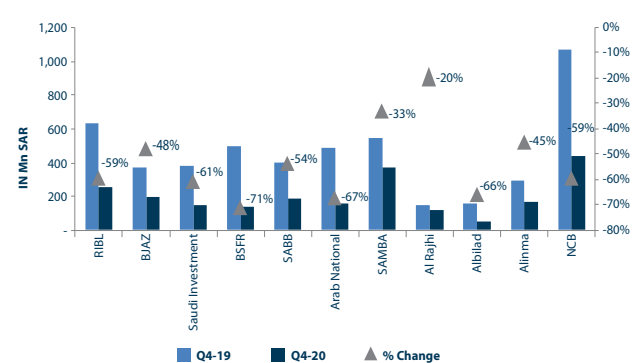
Bank-Wise NIM (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

The sector's average NIMs rose to 0.82% in Q4-20 from 0.77% in Q4-19. Al Rajhi registered the highest quarterly NIM of 1.19% in Q4-20, an increase from 1.03% in Q4-19.

Absolute Return on Savings and Time Deposits

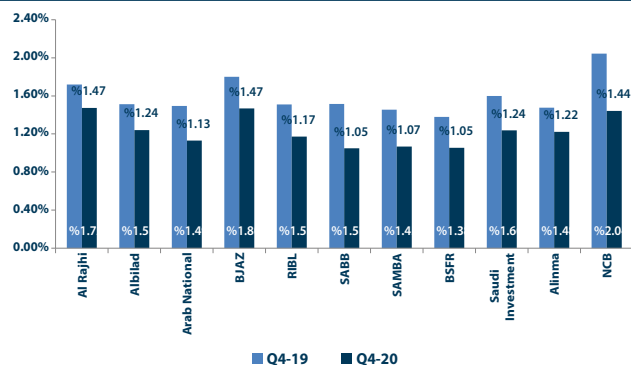


Source: SAMA, Argaam, Aljazira Research

The sector's quarterly return on savings and time deposits decreased 55.3% Y/Y in Q4-20. Bank Aljazira recorded the highest return on time and savings deposit expense at 0.68%.



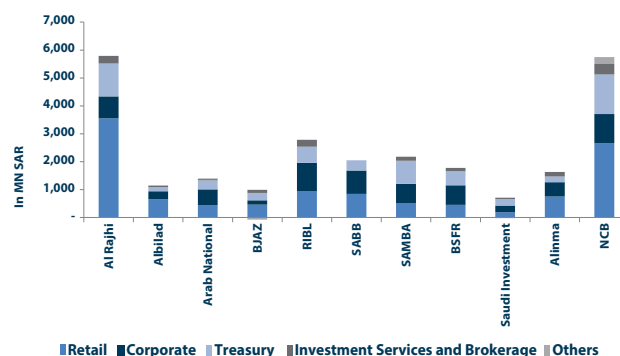
Bank-Wise Lending Rates (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

The average lending rate stood at 1.23% in Q4-20 compared to 1.59% in Q4-19. Al Rajhi and Bank Aljazira had the joint highest lending rate of 1.47%.

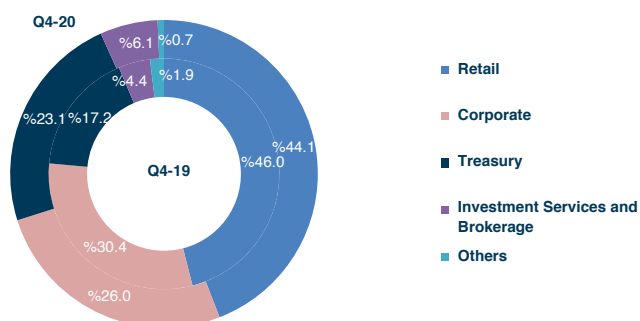
Company-Wise Operating Income (Q4-20)



Source: SAMA, Argaam, Aljazira Research

Al Rajhi, with an operating income of SAR 5.79bn, contributed 22.2% to total sector earnings in Q4-20, followed by NCB (22.0%) with earnings of SAR 5.75bn.

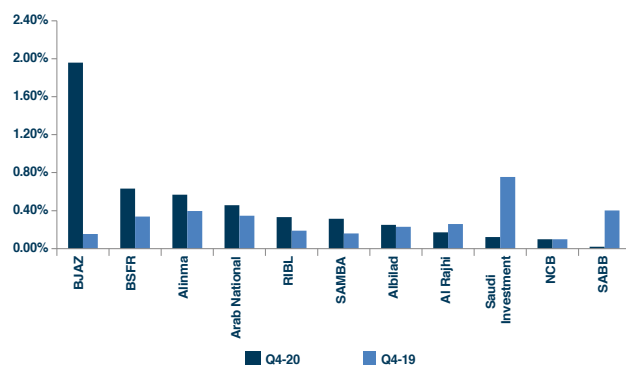
Operating Income Breakdown (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

The sector's operating income increased 2.9% Y/Y to SAR 26.1bn in Q4-20, with the retail sector accounting for 44.1%. On a Q/Q basis, operating income rose 2.2%.

Company-Wise Cost of Risk (Q4-20 vs Q4-19)



Source: SAMA, Argaam, Aljazira Research

The average cost of risk increased to 0.45% in Q4-20 from 0.30% in Q4-19. Bank Aljazira posted the highest cost of risk of 1.96% in Q4-20, a significant increase from 0.15% in Q4-19.



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RATING TERMINOLOGY

1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer

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