الجزيرة كابيتال
ALJAZIRA CAPITAL الجزيرة للأسواق المالية

Saudi Banking Sector

Better positioned for downtrend in interest rates

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The robust credit growth of past three years (14.2% CAGR between 2019-22) is expected to moderate (2022-25E CAGR 9.8%) over the medium term; while liquidity pressure would improve. We anticipate the US Fed to raise interest rates higher than markets expectations and pivot towards rate cuts in Q1-24. In this backdrop, we foresee NIMs for Saudi banks to see continuous improvement and peak in Q2-24. NIMs contraction will most likely begin in the H2-24, albeit at a much softer pace as compared to 2018-20 rate cycle, as banks are better positioned for a downtrend in interest rates. Overall, we forecast banks under our coverage to deliver double-digit earnings CAGR of 12.6% between 2022-25. Within our universe, Alinma is expected to lead in terms of NIM expansion and earnings growth in 2023, while AlRajhi, after facing headwinds this year, will see earnings growth return to double digits in 2024/25. We upgrade our recommendation to "Overweight" on AlRajhi with TP at SAR 85.7/share as its long-term fixed-rate mortgage loans better place it for the decline in interest rates, we maintain "Overweight" on Alinma with TP of SAR 41.70/share due to its better exposure to key drivers of credit growth (project financing), while we remain "Neutral" on AlBilad with TP of SAR 41.50/share.

The robust credit growth of past three years (14.2% CAGR between 2019-22) is expected to moderate to 9.8% (2022-25E CAGR) over the medium term, lifting some pressure off system liquidity: Moderation in fresh mortgage issuances (monthly run rate for mortgages in H1-23 is at SAR 6.6bn, down 34.0% Y/Y, compared to SAR 10.0bn in FY22) due to high interest rate, changes in housing subsidy rules and market saturation will taper total loan growth, and improve banking sector liquidity pressure in 2023. Demand for rate sensitive non-mortgage retail loans, that have contracted by 1.7% YTD in H1-23, is likely to remain subdued. However, strong non-oil GDP growth and government initiatives to support development of SMEs would keep demand for corporate and MSME loans intact (MSME loans are up 10.2% Q/Q and 15.5% Y/Y in Q1-23). We expect total deposit growth for the sector (+8.7% Y/Y in 2023E) to lag credit growth (+9.8% Y/Y in 2023E) by 117bps in 2023 (as compared to 402bps lag seen 2022) and improve the liquidity pressure in the banking system in 2023. Regulatory LDR is already at 23-month low of 78.7 in Jun-23.

Fed might raise rates higher than market's expectation and pivot towards cut in Q1-24, in this backdrop NIMs would peak in Q2-24 and begin reversal in 1H-24, albeit at a softer pace: Market expects US interest rates (midpoint) to stay at current level (5.4%) through the end of the year. On the other hand, FOMC appears less enthusiastic with median projection for appropriate exit rate at 5.6% for 2023. It is important to note that, although core PCE inflation (Jun-23: 4.1%) in US is at its lowest since Sept-21, it still exceeds the 2% target by more than double. Hence, we expect Fed to raise rates by another quarter percentage points in H2-23, and pivot towards rate cut in Q1-24. In this backdrop, we expect NIMs to see continuous improvement and peak in Q2-24. We forecast NIM reversal to begin in the 2H-24, but at a milder pace as compared to 2018-20 rate cycle, as banks are better positioned for downtrend in interest rates. Our view is supported by several factors. Firstly, there is an increase in share of time and savings deposits (31.6% of total deposits in Jun-23 compared to 26.5% in 2018). Secondly, interbank borrowing has also risen (3.9% of total deposits in Q2-23 compared to 2.3% in 2018). Additionally, loan maturities have gotten longer (48.6% of total loans mature in more than 3 years as of Jun-23 vs 34.6% in 2018). Lastly, banks have much larger exposure in long-maturity fixed-rate investments.

Banks under our coverage offer double-digit medium term earnings growth; on margins front, we expect Alinma to lead in 2023, whereas AlRajhi would outperform in 2024 and beyond: Within our universe, Alinma is expected to lead with 23bps Y/Y NIM expansion in 2023 (due to higher exposure to faster repricing corporate loans), margins for AlBilad are expected to decline by 15bps Y/Y, and AlRajhi's NIMs are projected to contract by 55bps Y/Y, due to substantial fixed-rate mortgage exposure. AlRajhi will outperform peers on margins front in 2024 and beyond, as interest rates start to come down. Overall, we forecast banks under our coverage to deliver double digit medium term earnings CAGR of 12.6% between 2022-25. Banks wise, Alinma is expected to lead in the near term with 2023/24E earnings growth of 30.9/12.7% Y/Y, respectively. AlRajhi, after a slow 2023 (EPS down 0.1% Y/Y), will see earnings growth turn double digits in 2024/25 (+11.3/23.7% Y/Y). In the medium term, most of the improvement in AlRajhi's NII would come by way of margin improvement, whereas Alinma's NSCI growth would be driven by balance sheet expansion. Credit risk for banks under our coverage is likely to remain under control. We expect, corporate and MSME segment to see some pick up in NPLs due to aging of loans and higher interest rates. However, the high proportion of salary-linked fixed-rate mortgages are likely to keep retail bad loans under control. With a coverage ratio of 189% we expect cost of risk for banks under our coverage to average at 43bps over 2023-25.

Figure 1: Valuation Summary

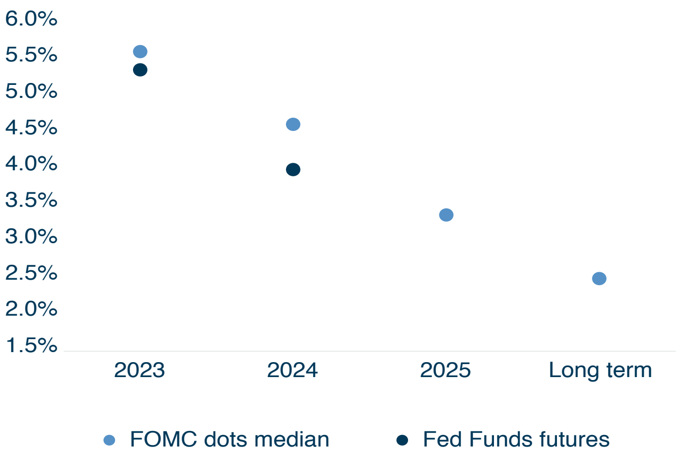
Company	Net profit (FY23E)	Net profit (FY24E)	ROE (2023)	ROA (2023)	P/B(x)	TP (per share)	Recommendation
AlRajhi	SAR 17.1bn	SAR 19.1bn	18.7%	2.1%	3.2x	85.7	**Overweight**
Alinma	SAR 4.7bn	SAR 5.3bn	16.1%	2.0%	2.5x	41.7	**Overweight**
AlBilad	SAR 2.4bn	SAR 2.7bn	16.6%	1.8%	2.7x	41.5	**Neutral**

Source: Bloomberg, Aljazira Capital Research, Price as on 16th August 2023

US Fed will likely raise interest rates higher than market's expectation: The US Fed, in a bid to speed up disinflation, raised federal funds rate range by 25bps to 5.25-5.5% in July-23 meeting, emulating this increase SAMA raised repo and reverse repo rate to 6.0% and 5.5%, respectively.

Fed fund futures imply that interest rates will stay at current level through the end of the year, and come down to 4.0% by the year-end 2024. On the other hand, FOMC participants appear less enthusiastic with median projection for appropriate exit rate at 5.6% and 4.6% for 2023 and 2024, respectively, implying another 25bps hike in 2023, and 100bps cut in 2024.

Fig 2: Rate expectations FOMC and market



Source: CME, AlJazira Capital Research

We believe Fed will raise rates by 25bps in H2-23, followed by a cumulative 125bps cut in rates in 2024. We expect SAMA to mirror these changes; our exit repo rate estimates for 2023 and 2024 are 6.25% and 5.0%, respectively. It is important to note, however, that while US core PCE inflation (Jun-23: 4.1%) is at its lowest since Sept-21, it is more than double the 2% target, and a good portion of the slowdown in inflation is owed to easing off of supply chain disruptions, food and energy prices. However, energy prices are on the rise again, and housing and labor costs are also increasing. US Producer Price Index rose 0.8% Y/Y in July-23, more than analyst expectation of 0.7% Y/Y. Recent upward revisions to FOMC's inflation, GDP and employment expectations strengthen our view on interest rates.

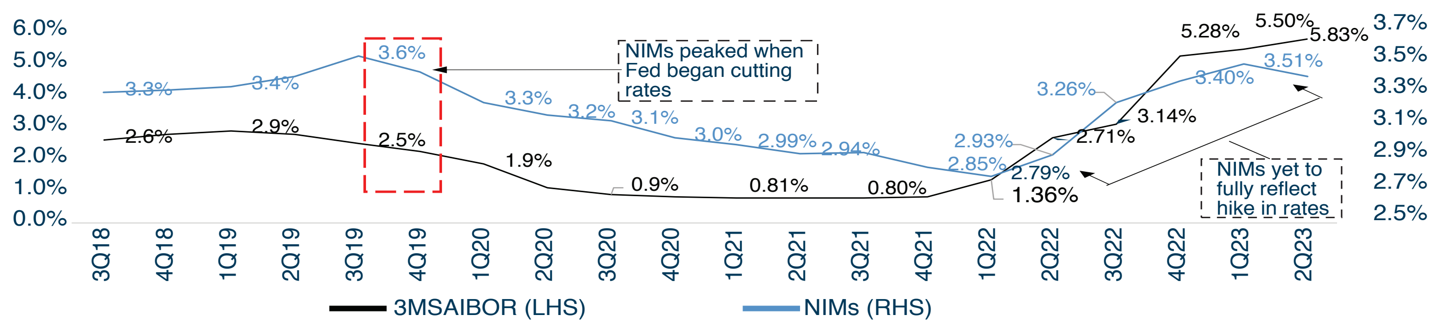
Fig 3: FOMC raising 2023 end median projections for PCE inflation, real GDP, employment and Fed funds rate

	Core PCE inflation		Change in real GDP		Unemployment rate		Fed funds rate	
	2023	2024	2023	2024	2023	2024	2023	2024
Dec-2022	3.5%	2.5%	0.5%	1.6%	4.6%	4.6%	5.1%	4.1%
Mar-2023	3.6%	2.6%	0.4%	1.2%	4.5%	4.6%	5.1%	4.3%
Jun-2023	3.9%	2.6%	1.0%	1.1%	4.1%	4.5%	5.6%	4.6%

Source: Federal reserve, AlJazira Capital

Net interest margins to peak in Q2-24: On a cumulative basis, SAMA has raised repo rates by 500bps since the start of rate upcycle in Mar-22, while banks (excluding AlRajhi and SNB) have seen their NIMs grow by 64bps. In our view, the increase in interest rates has not yet fully reflected into margins, as deposits got repriced upfront while asset prices reset with a lag. We expect NIMs to expand further and peak in Q2-24, when Fed pivots towards rate cuts. This phenomenon was seen during the 2018-20 rate cycle, where NIMs peaked in Q3-19 during the initial stage of policy loosening

Fig 4: NIMs trend during current and last rate cycle

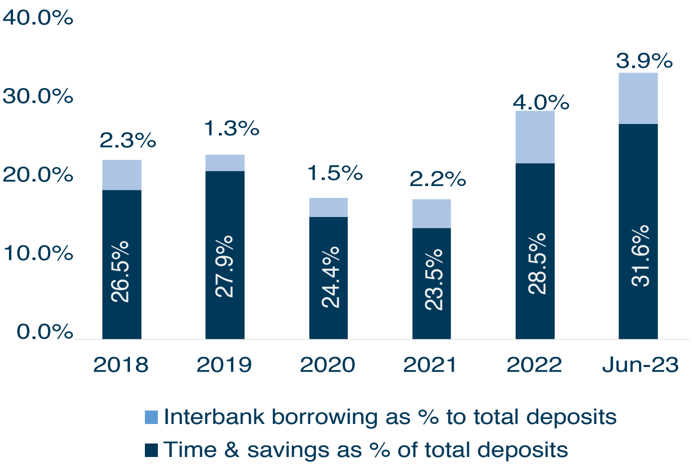


Source: Company reports, AlJazira Capital Research

Expect softer reversal in NIMs in H2-24, due to better positioning: We forecast margin reversal to begin in the H2-24, but at a much softer pace as compared to 2018-20 rate cycle, as banks are better positioned for downtrend in interest rates. Our view is supported by the increase in share of (1) time and savings deposits – 31.6% of total deposits as of Q2-23 vs 26.5% in 2018, (2) interbank borrowing – 3.9% of total deposits as of Q2-23 vs 2.3% in 2018, (3) long-term loans - 48.6% of total loans as of Jun-23 vs 34.6% in 2018, and (4) long-maturity fixed-rate investments.

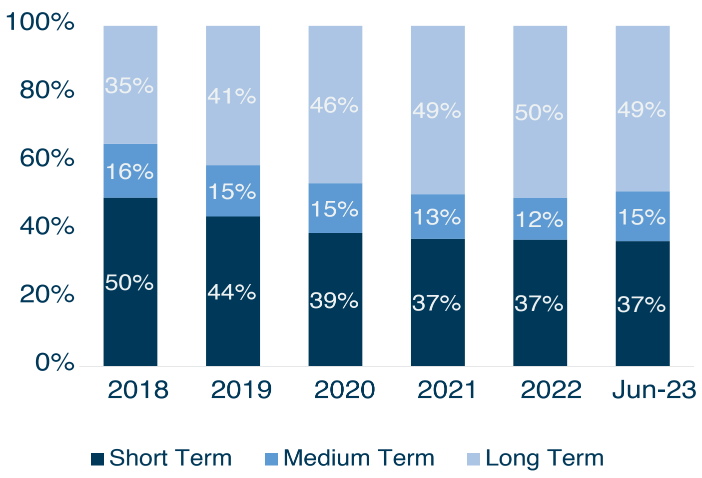
Higher weight of remunerative deposits and interbank borrowings would result in a larger downwards adjustment in cost of funds, when rates start coming down; at the same time increased exposure to long-term loans and investments will cushion the decline in asset yields.

Fig 5: Higher reliance on remunerative funding



Source: SAMA Monthly Bulletin, AlJazira Capital Research

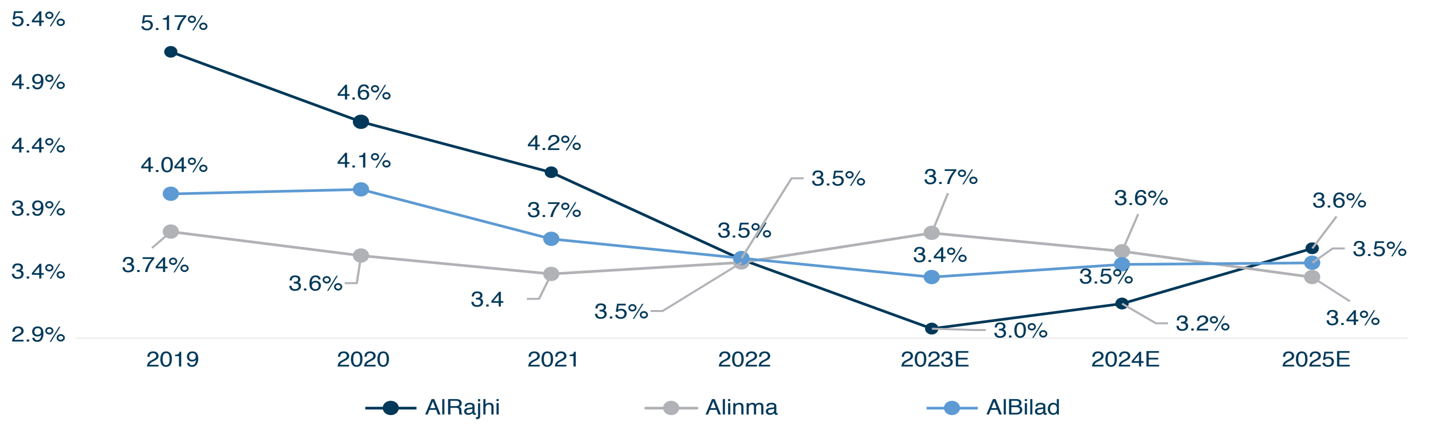
Fig 6: Banks have more exposure to LT-loans



Source: SAMA Monthly Bulletin, AlJazira Capital Research

Alinma to lead in 2023, AlRajhi to outperform in 2024 and beyond: Within our coverage universe, in 2023, Alinma is expected to lead with 23bps Y/Y expansion in NIMs, margins for AlBilad are expected to decline by 15bps Y/Y, and, AlRajhi's NIMs are projected to contract by 55bps Y/Y, due to substantial fixed-rate mortgage exposure. Alinma's relative outperformance in the ongoing year is owed to higher exposure to faster repricing corporate loans which constitute 74.9% of bank's loan book as compared to 48.6/25.9% for AlBilad/AlRajhi, respectively. Due to its retail orientation (retail loans are mostly long-term fixed-rate mortgages) AlRajhi will outshine peers on margins front in 2024 (up 20bps Y/Y vs -15/+10bps for Alinma/AlBilad) and beyond, as interest rates start to come down.

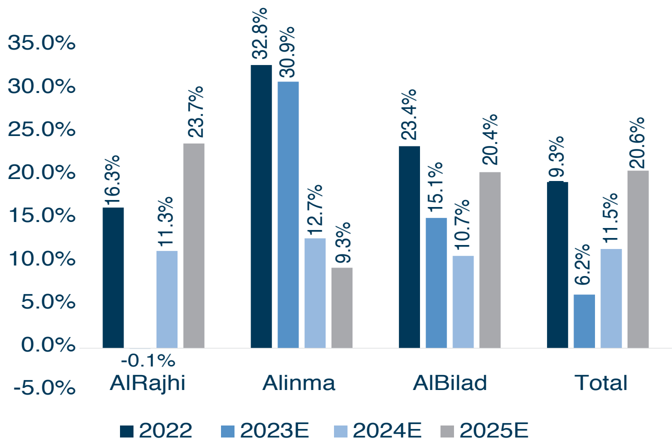
Fig 7: On NIMs front, Alinma will lead in 2023, Alrajhi will outperform in 2024 and beyond



Source: Company Reports, AlJazira Capital Research

Banks under our coverage to post double digit earnings growth: We forecast banks under our coverage to deliver double digit earnings CAGR of 12.6% between 2022-25 (+19.3% Y/Y in 2023), led by funded income CAGR of 11.6%, 263bps reduction in C/I ratio and 6bps decline in CoR. Alinma and Albilad are expected to post earnings growth of 30.9% and 15.1% Y/Y, respectively, in 2023, while AlRajhi is forecasted to record a 0.1% Y/Y decline in net income. Alinma and Albilad's strong performance in 2023 is owed to higher exposure to faster repricing corporate loans (74.9% and 48.6% of Alinma and Albilad's loan book) and 20.9% and 10.5% Y/Y increase in total assets. Due to higher weight of long-term fixed-rate mortgages, AlRajhi's earnings growth is expected to turn double digit when rates start coming down in 2024/25.

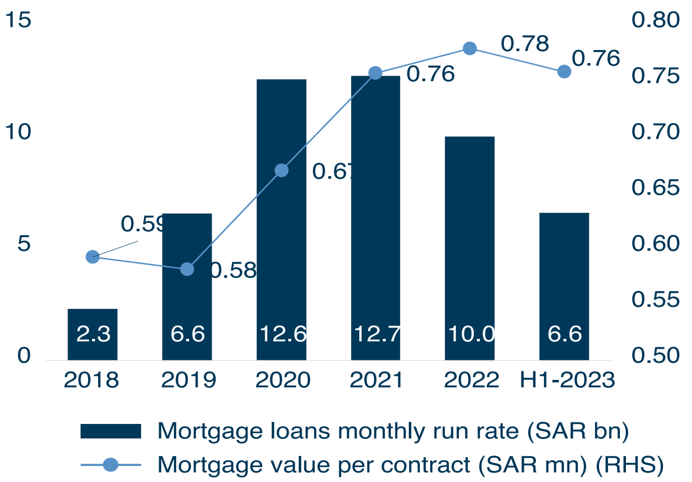
Fig 8: Earnings growth profile



Source: Company Reports, AlJazira Capital Research

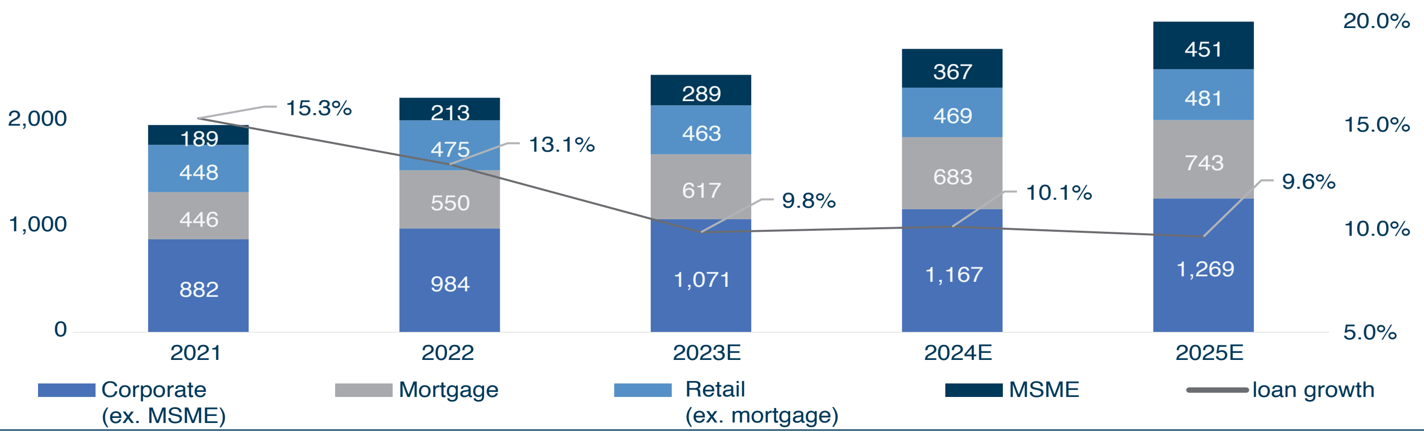
Credit demand growth is moderating: The robust credit growth of past three years (14.2% CAGR between 2019-22) is expected to moderate over the medium term; we forecast private sector credit to grow at a CAGR of 9.8% over 2022-25. Mortgages, which have been the main drivers of credit growth over 2019-22, are already experiencing a slowdown in new originations. Monthly run rate for mortgages in H1-23 is at SAR 6.6bn (down 34.0% Y/Y) compared to SAR 10.0bn in FY22. Total loan growth has decelerated to 5.3% YTD in Jun-23, compared to 8.9% YTD in Jun-22. With home ownership at around 64% (47% in 2017) housing market is beginning to saturate. Moreover, there is demand attrition due to changes is housing subsidy rules, higher interest rates and rising property prices (reflected by 21.2% increase in loan value per mortgage in last three years). Rate-sensitive, non-mortgage retail loans are expected to contract 2.5% Y/Y in 2023 (-1.7% YTD in H1-23). However, the USD521bn infrastructure projects pipeline under Vision 2030 and Shareek program is likely to keep demand for corporate and MSME credit intact, we forecast CAGR of 12.8% and 28.4% for corporate and MSME loans over 2022-25 respectively.

Fig 9: Mortgage issuances have slowed down



Source: SAMA Monthly Bulletin, Aljazira Capital Research

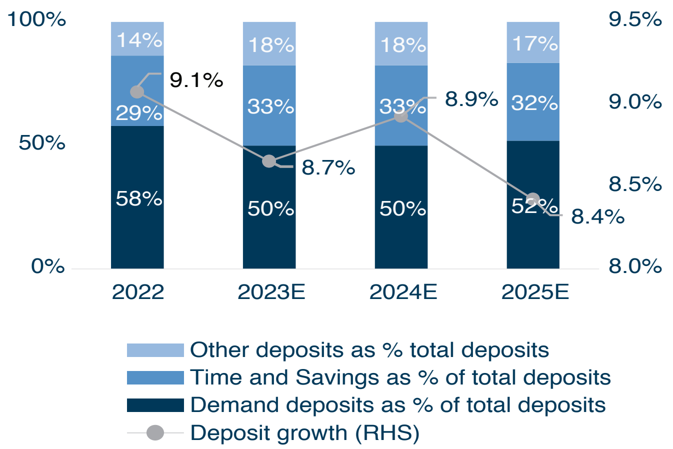
Fig 10: loans segment breakup and growth



Source: SAMA Monthly Bulletin, Aljazira Capital Research

System liquidity pressures are improving: Deposit growth (+6.3% YTD) exceeded loan growth (+5.3% YTD) by 94bps YTD in Jun-23, as compared to a 286bps lag in the same period last year. Moreover, the share of demand deposits contracted by 350bps to 54.4% YTD in Jun-23. Overall, regulatory LDR improved by 281bps to 23-month low of 78.74 in YTD Jun-23; regulatory LDR hit the high of 82.98 in Feb-23. 3MSAIBOR after averaging 41bps above the Repo rate since the start of rate upcycle in Mar-22, is now priced just 10bps above Repo rate. Normal LDR peaked at 101.12 in Jan-23 due massive increase in loan growth, however, it is down 206bps to 99.07 in Jun-23. We expect LDR to stay around this level in the medium term.

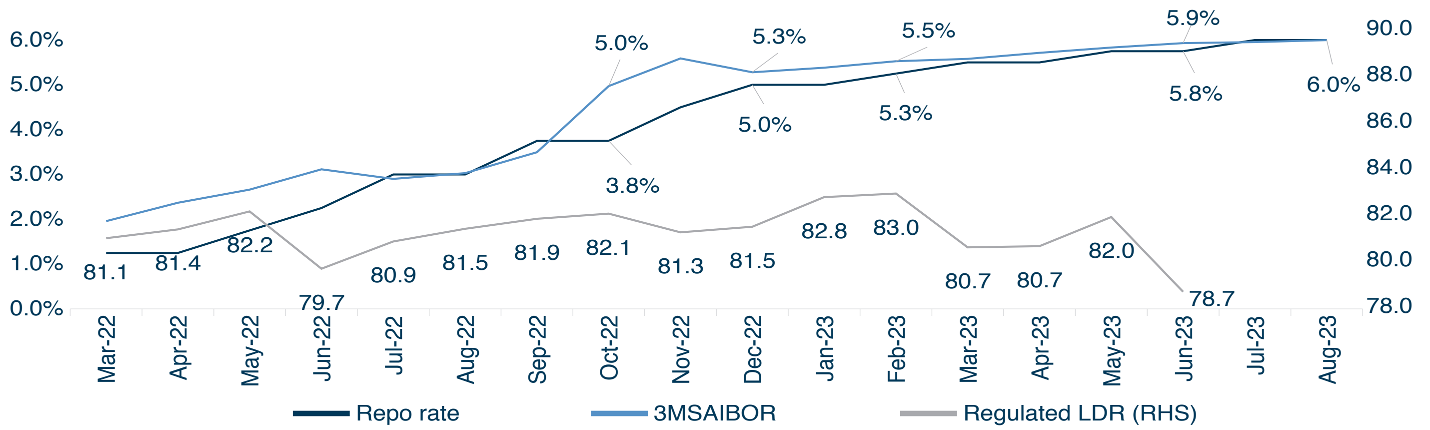
Fig 11: Deposit mix and growth



Source: SAMA Monthly Bulletin, Aljazira Capital Research

We expect total deposit growth for the sector (+8.7% Y/Y in 2023E) to lag credit growth (+9.8% Y/Y in 2023E) by 117bps in 2023, as compared to 402bps lag seen 2022. Moreover, we anticipate further diversification of funding towards Sukuks and time deposits. In this backdrop, we see further improvement in liquidity pressure in the banking system in 2023.

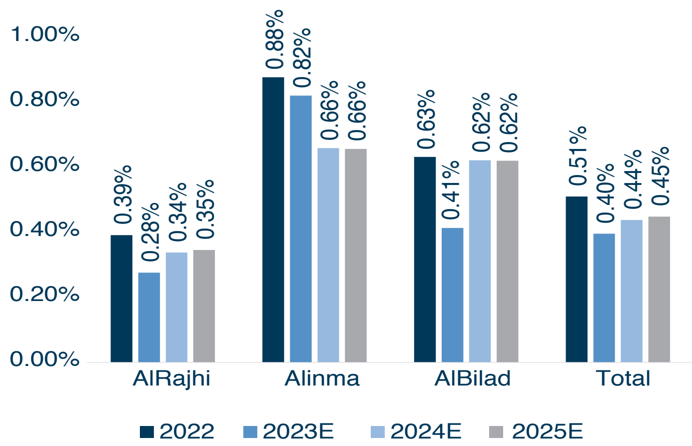
Fig 12: Regulated LDR at 23 month low, 3MSAIBOR's premium over Repo rate down to 10bps



Source: SAMA Monthly Bulletin, Aljazira Capital Research

Credit risk to remain largely muted: The massive loan book expansion of last three years has improved gross NPL ratio for the sector to 1.72% (down by 46bps since 2020). Going forward, we expect, corporate and MSME segment to see some pick up in NPLs due to aging of loans and higher interest rates. However, the high proportion of salary-linked fixed-rate mortgages are likely to keep retail bad loans under control. With a coverage ratio of 189% we expect 2023-25 average cost of risk for banks under our coverage to stay under control at 43bps, compared to 2020-22 average of 73bps.

Fig 13: Cost of risk to remain undercontrol



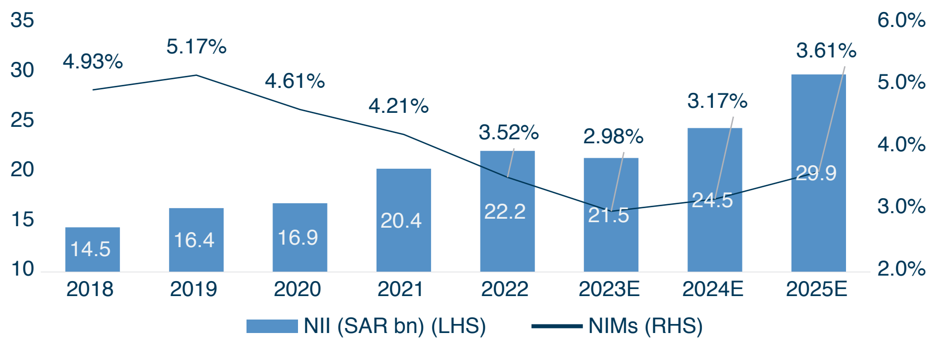
Source: Company reports, Aljazira Capital Research

Al Rajhi Bank: Ideally positioned to benefit from rate cuts in 2024, after a subdued 2023.

Upcoming expected interest rate hike and late cuts would keep AlRajhi's NIMs under pressure in H2-23, however, due to substantial long-term fixed-rate mortgage exposure, bank's margins would post sizable recovery when rates start coming down in 2024-25. We estimate bank's NIMs to expand by 67bps to reach 3.61% in 2025 from 2.94% in Q2-23, cost-to-income ratio to improve by 223bps to 23.8% and cost of risk to average around 32bps over 2023-25. In this backdrop, we forecast AlRajhi to deliver medium term (2023-25) earnings CAGR of 11.2% and best in class average ROE of 19.8%. We upgrade our recommendation to "Overweight" with TP of SAR 85.7/share.

Forthcoming expected rate hike and delayed cuts to keep NIMs under pressure in 2H-23, margins would recover in 2024-25: Due to the stronger consumer prices and strength in the job market (in the US) we expect another 25bps hike in interest rates in 2023, moreover, we have pushed back on our rate cut projections to the end of Q1-24. In this backdrop, since only 37.9% of bank's profit-bearing assets reprice in less than one year (due to higher fixed rate long term mortgage exposure) compared to 85.5% of interest-bearing liabilities, we foresee a six-month sluggish period for AlRajhi's margins that would be followed by a recovery in 2024, when rates start coming down. Overall, we forecast AlRajhi to see a 55bps Y/Y decline in NIMs, in 2023. However, we expect the bank to lead on margins front in 2024 and beyond, with 20/44bps expansion in NIMs in 2024/2025, respectively.

Fig 14 : NIMs to recover in 2024/25, as rates start coming down



Source: Company reports, Aljazira Capital

Best in class ROE and double-digit earnings growth: We forecast AlRajhi to deliver 2023-25 average ROE of 19.8% vs 16.8% and 16.7% for Alinma and Albilad, respectively. Banks superior ROE is owed to: 1) higher proportion of demand deposits (64.5% vs 43.3/41.4% for Alinma/Albilad), 2) lower cost to income ratio (26.3% vs 31.1/42.8% for Alinma/Albilad) and 3) lower Cost of Risk (2023-25 average CoRs 32bps vs 71/55bps for Alinma/Albilad). We estimate earnings (adjusted for sukuk) to decline by 4.2% to SAR 16,254mn in 2023, and post a 12.4/25.9% recovery in 2024/2025, respectively, as rates start coming down. Overall, we expect AlRajhi to post 2022-25 earnings CAGR of 11.2%.

Pristine asset quality and strong capitalization: AlRajhi's asset quality is unmatched with NPL ratio of 0.61% (vs 1.5/1.9% for Alinma/Albilad) and coverage ratio of 225% (vs 130/191% for Alinma/Albilad). The salary linked nature of mortgage loans are likely to keep NPL risk of retail portfolio in check. However, we do see increase in NPLs from corporates segment due to higher interest rates and aging of loans. Overall, we expect 7bps increase in bank's NPL ratio over 2023-25, and cost of risk to average at 32bps over the same period as compared to 59bps between 2019-2022. With 2023E Tier-1 ratio of 20.3%, bank remains in a comfortable position to maintain payout at 55%, which implies a 2023/24E dividend yield of 3.1/3.5% respectively.

Recommendation	**Overweight**
Target Price (SAR)	**85.7**
Upside/(Downside)	**18.5%**

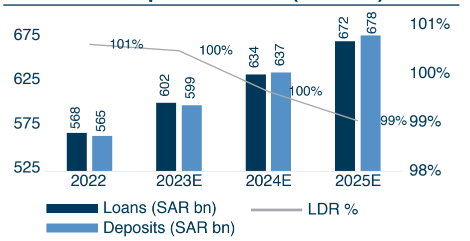
Source: Tadawul *prices as of 16th of August 2023

Key Financials

SARmn	FY22	FY23E	FY24E	FY25E
NSCI	22,173	21,444	24,480	29,874
Growth %	8.7%	-3.3%	14.2%	22.0%
Net Profit	17,151	17,142	19,076	23,606
Growth %	16.3%	-0.1%	11.3%	23.7%
EPS	4.29	4.29	4.77	5.90

Source: AlJazira Capital, Company reports

Loans and Deposit Growth (SAR bn)



Source: AlJazira Capital, Company reports, *LDR Is unweighted

Key Ratios

	FY22	FY23E	FY24E	FY25E
NIMs	3.52%	2.97%	3.17%	3.61%
P/E	17.5	17.7	15.8	12.5
P/B	3.0	3.2	2.9	2.6
DPS	1.25	2.25	2.50	3.25
Dividend Yield	1.7%	3.1%	3.5%	4.5%
C/I	26.1%	26.3%	26.5%	23.8%
ROA	2.4%	2.1%	2.2%	2.5%
ROE	22.5%	18.7%	19.2%	21.6%
Loan growth	25.5%	6.0%	5.3%	5.9%
Deposit growth	10.3%	6.1%	6.2%	6.6%

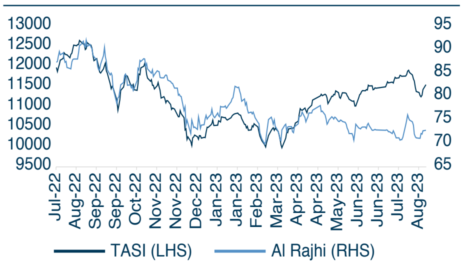
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	288.4
YTD%	-4.12%
52 week (High)/(Low)	69.0/92.8
Share Outstanding (mn)	4,000.0

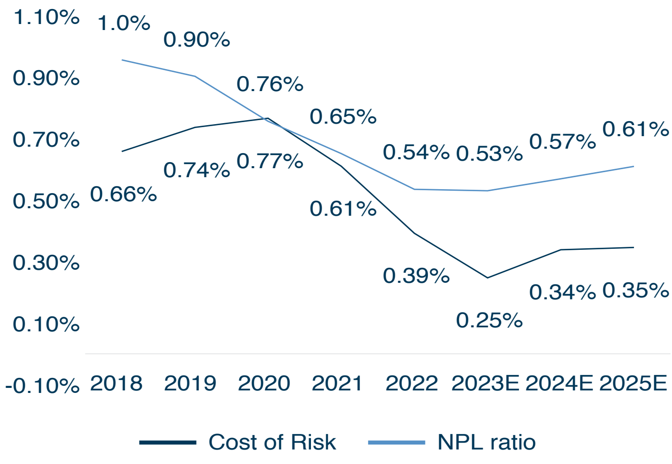
Source: Company reports, Bloomberg, Aljazira Capital

Price Performance



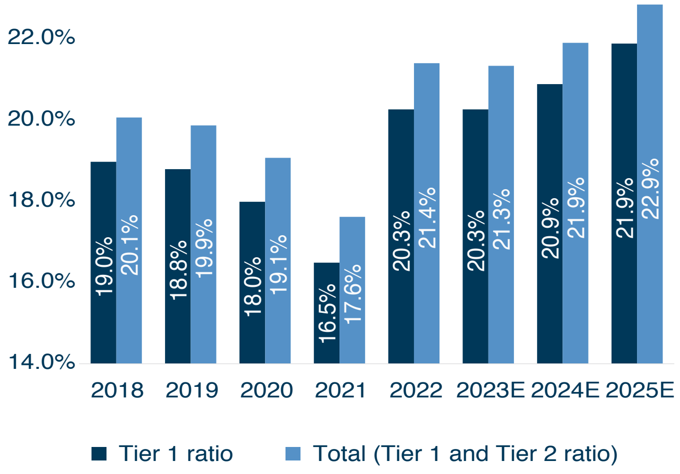
Source: Tadawul, Aljazira Capital

Fig 15: Best in class asset quality



Source: Company reports, Aljazira Capital

Fig 16 : Tier 1 and CAR above 20%

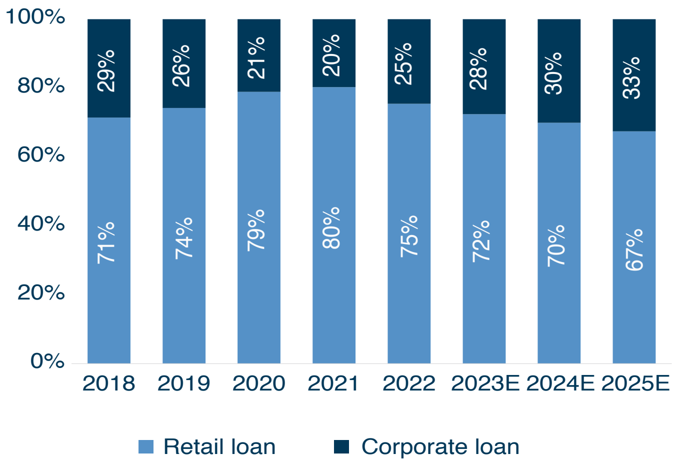


Source: Company reports, Aljazira Capital

Focus shifts to corporate amidst a slowdown in demand for mortgages: AlRajhi's retail loan growth turned negative -14bps YTD in Q2-23, thanks to hike in interest rates, high base effect, change in mortgage subsidy rules and saturation in housing market. We expect retail loan growth to slow down to 1.4% Y/Y in 2023 from 17.6% Y/Y in 2022. We have built in 2022-25E retail loan CAGR of 1.9% in our working, as compared to 2019-22 CAGR of 32.1%. Bank is concentrating on corporate business, where it logged in growth of 8.6% YTD in Q2-23; we forecast this segment to grow by 19.1% Y/Y in 2023 (58.8% Y/Y in 2022), and post a 16.3% growth between 2022-25 (2019-22 CAGR 30.0%). There is special focus on SME segment, loans to this segment are up 25.7% Y/Y in Q2-23.

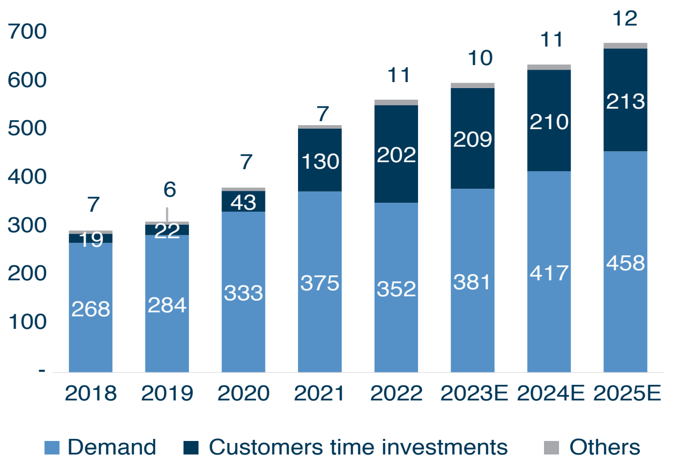
Funding mix to improve over the medium term, as focus shifts on quality: On funding side, bank is now prioritizing mobilizing low cost deposits instead of growth. This is reflected by 4.5% YTD decline in time deposits in Q2-23, and a concurrent 4.8% increase in demand deposits. We forecast deposit growth to slow down to 6.1% in 2023 vs 10.3% in 2022. Our estimate for 2022-25 deposit CAGR stands at 6.3% vs 21.8% CAGR between 2019-22. We foresee share of demand deposits to improve from 64.5% in Q2-23 to 67.5% in 2025. Interbank borrowings, after expanding from 0.7% of deposits in 2019 to 14.3% of deposits in Q2-23 are expected to decline to 12.1% of deposits in 2025.

Fig 17: Corporate gaining share in total loans



Source: Company reports, Aljazira Capital

Fig 18: Break up of deposit franchise



Source: Company reports, Aljazira Capital

Investment thesis: AlRajhi has seen major compression in NIMs (-98bps), since the beginning of the policy tightening cycle in early 2022, thanks to its sizable exposure to fixed rate mortgage loans. A reversal in interest rates, beginning most likely in Q1-24, means bank's margin will start to recover in back half of 2024, at a time when the sector by in large will see margin trending downwards. We expect NIMs to expand by 20/44bps Y/Y in 2024/25, respectively; after constricting by 55bps in 2023. We see earnings growth turning double digits in 2024/25 and ROE scaling to 21.6% in 2025. Bank's cost of risk is forecasted to remain under control due to superior bad loan coverage and salary linked nature of mortgage. We believe balance sheet expansion will mainly come from corporate and SME segment going forward. Bank is currently trading on 2023/24E PB of 3.2/2.9x, whereas, based on fundamental valuations (residual income and two stage Gordon growth model) bank deserves a PB multiple of 3.9x. hence there is ample room for rerating for the stock.

Valuation: We value the stock based on equal weight to Residual Income and Two staged Gordon growth. Our residual income-based TP assumes the cost of equity of 10.12% and terminal growth rate of 2.5%, whereas; through the Two staged Gordon growth model, based on FY24E ROE of 19.2%, we arrive at a justified P/B multiple of 3.9x. Hence, the equal weight TP stands at **SAR 85.7/share** which translates to an upside of **18.5%** and upgrades our recommendation to "**Overweight**".

Weighted Average TP			
Method	**Value**	**Weight**	**W.Value**
RI	73.7	50%	36.8
Justified P/B	97.7	50%	48.9
Price Target			**85.7**
Upside/Downside			**18.5%**

Source: AlJazira capital, Company reports. Closing market price as of 16th August 2023

Upside Risk: Lower than expected increase and/or faster decrease in interest rates. Larger increase deposit size and improvement in deposit mix. Lower than anticipated cost of risk and larger payout. Stronger oil prices. Improvement in system liquidity.

Downside risk: Higher than anticipated increase and/or slower cuts in interest rates. Weaker deposit growth and worsening of deposit mix. Deterioration of loan book, which can lead to higher cost of risk. Lower payout. Decrease in oil prices. Further tightness in system liquidity.

Figure 19: Key Financial Data

Amount in SARmn, unless otherwise specified	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
Income statement							
Net financing and investments income	16,913	20,392	22,173	21,444	24,480	29,874	35,415
Fee from banking services, net	2,660	3,933	4,624	4,646	5,140	5,391	5,658
Exchange income, net	784	788	1,162	1,184	1,242	1,303	1,368
Other operating income	365	603	616	800	917	962	1,009
Total operating income	20,721	25,716	28,575	28,073	31,779	37,530	43,450
Impairment charge for financing	(2,166)	(2,345)	(2,001)	(1,619)	(2,090)	(2,259)	(2,409)
Other operating expenses	(6,742)	(6,927)	(7,451)	(7,375)	(8,419)	(8,951)	(9,564)
Operating Profit	11,814	16,445	19,123	19,079	21,269	26,320	31,477
Y/Y	**4.3%**	**39.2%**	**16.3%**	**-0.2%**	**11.5%**	**23.7%**	**19.6%**
Zakat	(1,218)	(1,699)	(1,972)	(1,937)	(2,193)	(2,714)	(3,246)
Net income	10,596	14,746	17,151	17,142	19,076	23,606	28,231
Y/Y	**4.3%**	**39.2%**	**16.3%**	**-0.1%**	**11.3%**	**23.7%**	**19.6%**
Net income (adjusted for Tier-1)	10,596	14,746	16,960	16,254	18,268	23,004	27,835
Y/Y	**4.3%**	**39.2%**	**15.0%**	**-4.2%**	**12.4%**	**25.9%**	**21.0%**
EPS	4.24	5.90	4.29	4.29	4.77	5.90	7.06
EPS (adjusted for Tier-1)	4.24	5.90	4.24	4.06	4.57	5.75	6.96
Balance sheet							
Assets							
Cash and balances with SAMA	47,363	40,363	42,052	47,958	47,385	50,493	54,526
Due from banks and other financial institutions	28,655	26,065	25,656	11,446	9,548	10,175	10,987
Financing, net	315,712	452,831	568,338	602,321	634,250	671,763	721,037
Investments, net	60,285	84,433	101,325	132,629	152,776	176,360	190,449
Investment Property	1,541	1,411	821	1,389	1,417	1,445	1,474
Property and equipment, net	10,235	10,666	11,339	12,008	12,252	12,497	12,747
Other assets, net	5,034	7,902	12,835	15,052	15,358	15,665	15,978
Total assets	468,825	623,672	762,366	822,802	872,987	938,397	1,007,199
Liabilities & owners' equity							
Due to banks and other financial institutions	10,764	17,952	70,839	86,765	90,006	100,193	99,087
Customers' deposits	382,631	512,072	564,925	599,476	636,567	678,308	732,494
Other liabilities	17,311	26,339	26,377	25,795	26,319	26,845	27,382
Sukuk	-	-	-	3,790	3,790	3,790	3,790
Share capital	25,000	25,000	40,000	40,000	40,000	40,000	40,000
Statutory reserve	25,000	25,000	29,288	31,385	35,952	41,703	48,662
Other reserves	(135)	309	(428)	(332)	(332)	(332)	(332)
Retained earnings (incl. proposed dividend)	8,253	16,999	14,865	19,424	24,186	31,391	39,615
Total shareholders' equity	58,119	67,309	83,725	90,477	99,806	112,762	127,945
Tier-1 Sukuk	-	-	16,500	16,500	16,500	16,500	16,500
Total equity & liabilities	468,825	623,672	762,366	822,802	872,987	938,397	1,007,199
Key fundamental ratios							
Capital Ratios							
Equity/ Total Assets	12%	11%	11%	11%	11%	12%	13%
Tier-1 ratio	18.0%	16.5%	20.3%	20.2%	20.9%	21.9%	22.8%
CAR	19.1%	17.6%	21.4%	21.3%	21.9%	22.8%	23.7%
Profitability Ratios							
NIMs	4.61%	4.21%	3.52%	2.97%	3.17%	3.61%	3.98%
Return On Assets (ROA)	2.5%	2.7%	2.4%	2.1%	2.2%	2.5%	2.9%
Return On Equity (ROE)	19.4%	23.5%	22.5%	18.7%	19.2%	21.6%	23.1%
ROE/ROA (Leverage Ratio) (X)	7.8	8.7	9.2	9.1	8.9	8.5	8.1
Asset Quality Ratios							
NPL ratio	0.8%	0.7%	0.5%	0.5%	0.6%	0.6%	0.7%
NPL Coverage	306%	306%	260%	240%	237%	239%	240%
Funding Ratios							
Loans/ Customer Deposits	82.5%	88.4%	100.6%	100.5%	99.6%	99.0%	98.4%
Liquid Assets / Total Assets	96.4%	96.8%	96.7%	96.5%	96.7%	96.8%	97.0%
Net Loans / Tot Assets	67.3%	72.6%	74.5%	73.2%	72.7%	71.6%	71.6%
Market/valuation ratios							
DPS	1.00	1.50	1.25	2.25	2.50	3.25	3.75
Dividend Yield	0.9%	1.2%	1.7%	3.1%	3.5%	4.5%	5.2%
Book Value Per Share (BVPS)	23.2	26.9	25.1	26.7	29.1	32.3	36.1
Market price	46.01	88.64	75.20	72.10	72.10	72.10	72.10
PE (x)	10.9	15.0	17.5	17.7	15.8	12.5	10.4
PB (x)	2.0	3.3	3.0	3.2	2.9	2.6	2.3
Growth rates							
Investments (Y/Y)	28.7%	40.1%	20.0%	30.9%	15.2%	15.4%	8.0%
Financing (Y/Y)	26.4%	43.4%	25.5%	6.0%	5.3%	5.9%	7.3%
Deposits (Y/Y)	22.5%	33.8%	10.3%	6.1%	6.2%	6.6%	8.0%

Source: Company reports, Aljazira Capital Research

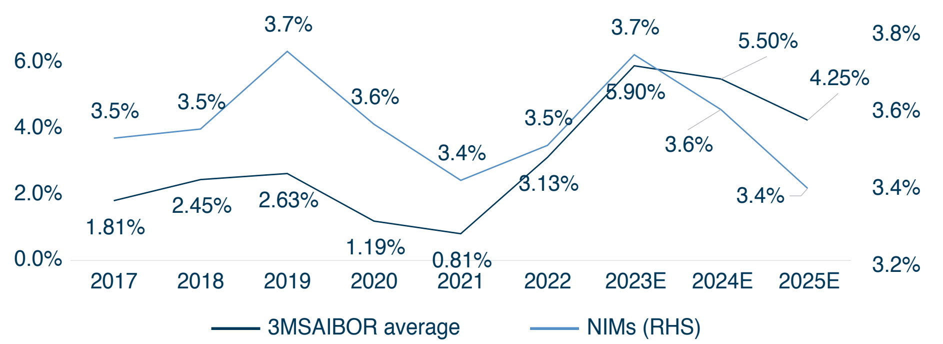
Bank Alinma: Robust asset growth to make up for margin contraction

Bank Alinma is expected to lead our coverage with earnings growth of 30.9% Y/Y in 2023, supported by 23bps Y/Y expansion in NIMs and 20.9% Y/Y increase in total assets. Beyond 2023, earnings growth would be driven by balance sheet expansion (supported by banks strong project financing franchise and mega investments under Vision 2030), improvement in cost-to-income ratio (as bank exits investment cycle) and fee income growth (owing to fast growing digital product portfolio). In this backdrop, despite the expected decline in interest rates, we forecast Alinma to deliver double digit earnings CAGR of 17.3% and high teen ROE in the medium term (2022-25). We reiterate our "Overweight" recommendation on the stock, with a TP of SAR 41.70/share.

Alinma to post medium term credit growth of 16.7%, driven by Giga projects: The Kingdom, through PIF (Public Investment Fund), plans on investing more than USD500bn on Giga projects under Vision 2030. These projects are expected to spur demand for corporate and MSME loans. Alinma's track record in project financing and its strong corporate lending franchise (corporate loans make up 74.8% of total loan book; highest amongst Islamic banks) ideally place it to benefit from these mega investments. We estimate total financing to grow at CAGR of 16.7% between 2022-2025. Bank overwhelmed the market by posting 10.4% YTD loan growth in Q2-23, management has guided high-teen loan growth in 2023.

ROE to remain in high teens in the medium term, despite decline in margins: Alinma is expected to deliver 2022-25 earnings CAGR of 17.3% (23/24/25E net income up 30.9/12.7/9.3% Y/Y), highest amongst our coverage banks, led by: (1) 14.8% NII CAGR, underpinned by Kingdom's National Investment Strategy and bank's renewed focus on mid-corporate and SME business, (2) 12.3% fee income CAGR, driven by fast growing digital product portfolio, (3) 366bps reduction in cost-to-income ratio – as bank exits its investment cycle, and (4) lower cost of risk of 71bps as compared to 1.1% for last three years. In this backdrop, we forecast ROE to average around 16.8% between 2023-25, significantly above 2020-22 average of 10.6%, despite a 225bps expected reduction in interest rates. We expect the bank to maintain payout ratio at 56%, which implies 2023/24e dividend yield of 3.5/4.2%, respectively.

Fig 20: NIM trend



Source: Company reports, Aljazira Capital

Recommendation	Overweight
Target Price (SAR)	41.70
Upside/(Downside)	18.3%

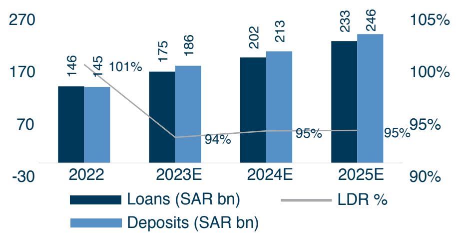
Source: Tadawul *prices as of 16th of August 2023

Key Financials

SARmn	FY22	FY23E	FY24E	FY25E
NSCI	6,066	7,587	8,466	9,176
Growth %	18.1%	25.1%	11.6%	8.4%
Net Profit	3,599	4,712	5,313	5,809
Growth %	32.8%	30.9%	12.7%	9.3%
EPS	1.80	2.36	2.66	2.90

Source: AlJazira Capital, Company reports,

Loans and Deposit Growth (SAR bn)



Source: AlJazira Capital, Company reports, *LDR Is unweighted

Key Ratios

	FY22	FY23E	FY24E	FY25E
NIMs	3.50%	3.73%	3.59%	3.38%
P/E	18.1	15.9	14.0	12.8
P/B	2.4	2.5	2.3	2.1
DPS	1.00	1.25	1.50	1.50
Dividend Yield	3.1%	3.5%	4.2%	4.2%
C/I	34.6%	31.9%	31.7%	31.0%
ROA	1.8%	2.0%	2.0%	1.9%
ROE	12.9%	16.1%	17.0%	17.4%
Loan growth	16.0%	19.1%	15.5%	15.4%
Deposit growth	19.9%	28.0%	14.8%	15.3%

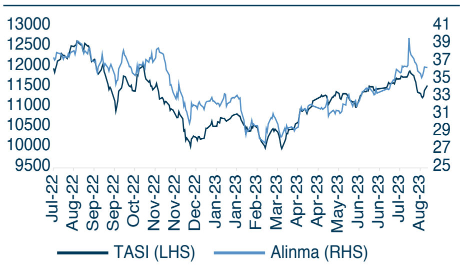
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	72.2
YTD%	10.3%
52 week (High)/(Low)	39.8/27.4
Share Outstanding (mn)	2,000.0

Source: Company reports, Bloomberg, Aljazira Capital

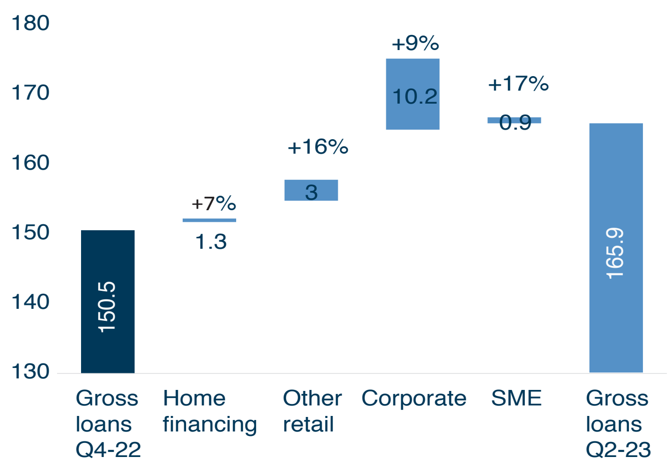
Price Performance



Source: Tadawul, Aljazira Capital

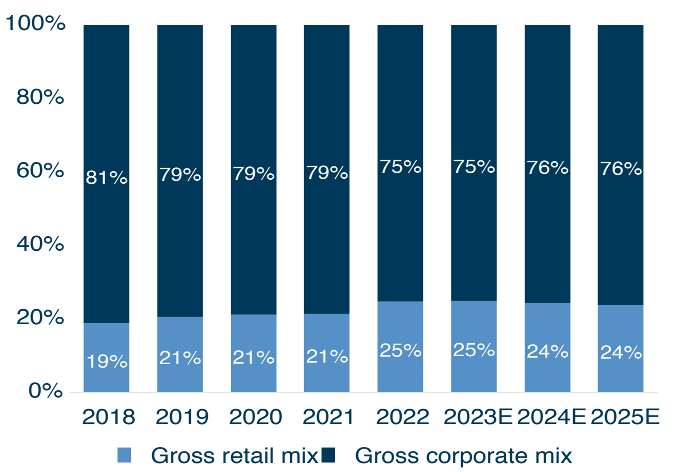
Renewed focus on high yielding mid-corporate and MSME segment: Alinma is paying special attention to high margin mid-corporate and SME segment, which is reflected by the 72% and 17% YTD growth in respective segments loans in Q2-23. Management launched 6 new SME segment product offerings in 2022, that have less requirements and are more flexible. Overall, SME customers and transaction grew by 102.2% Y/Y and 37.7% Y/Y, respectively, in 2022. Management is improving cooperation with Monshaat and expanding SME book through Kafalah program; Kafalah program financing grew by 20% YTD in Q2-23, and total loans and transactions guaranteed by Kafalah program were up 40.7% Y/Y and 65.3% Y/Y, respectively, in 2022.

Fig 21: SME book posting 17% growth YTD



Source: Company reports, Aljazira Capital

Fig 22: Retail and corporate mix

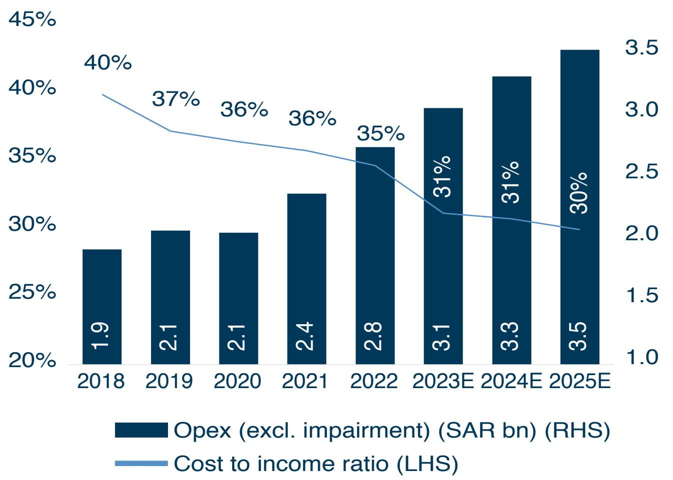


Source: Company reports, Aljazira Capital

Better positioned for decline in rates as compared to 2018-20 rate cycle: Higher share of remunerative deposits (up 10.5ppts to 51.0% since end of 2019), larger reliance on interbank borrowings (4.4% of total assets in Q2-23 vs 2.5% at 2019 end), and increased exposure to retail loans (25.2% of total loans book in Q2-23 vs 20.6% in 2019) and long-term fixed-rate investments during higher interest rates (investments that reprice/mature in more than 5 years increased by 60.9% Y/Y in 2022), better position Alinma for a downtrend in interest rates (as compared to 2018-20 rate cycle). There would be larger decline in CoFs, when rates start coming down. Whereas, higher long-term fixed-rate investments and retail loans (that are mostly long term fixed yielding mortgages) will cushion the contraction in asset yields during declining interest rates.

Normalization of business development costs to improve C/I by 366bps: Alinma's operating expenses grew at a 15.5% CAGR between 2020-22; the bank increased its work force by 49% to 3,676 employees and upgraded its digital infrastructure (Chat bot service, new mobile app, Anti-fraud AI, Digital factory) as it made hefty investments to implement its ambitious 'growth plan 2021-2025'. With 75% of initiatives already achieved, we expect operating cost growth to rationalize to 8.7% (2022-25 CAGR), and cost to income to steadily improve from 34.6% in 2022 to 31.0% in 2025. The 12.6% Y/Y increase in operating expenses in Q2-23, primarily reflects higher salaries, software maintenance costs, and higher marketing costs.

Fig 23: Cost to income to improve



Source: Company reports, Aljazira Capital

Investment thesis: The 500bps hike in interest rates made since the start of tightening cycle in Mar-22, has expanded interest margins for Alinma by 39bps, owing to the large floating rate mortgage exposure. With declining interest rates Alinma is expected to see reversal in NIMs, however, we expect limited impact on the bottom-line due to robust asset growth (bank's strong project finance franchise places it well to benefit from uptick in credit demand from Vision 2030 investments) and better balance sheet mix (higher weight of term deposits and increase in fixed rate investments). At 2023/24E PB of 2.3/2.5x and medium term (2022-25) earnings CAGR of 17.3% and average ROE of 16.8% Alinma is a good investment proposition.

Valuation: We value the stock based on Residual Income and Two Stage Gordon Growth Model. Our residual income-based TP assumes the cost of equity of 10.3% and terminal growth rate of 2.5%, whereas; through the Gordon Growth model, based on FY24E ROE of 17.0%, we arrive at a justified P/B multiple of 3.2x for the stock. Hence, a 50% and 50% weighted RI and P/B based TP stands at **SAR 41.70/share** which translates to an upside of **18.3%** and "**Overweight**" recommendation on the stock.

Weighted Average TP			
Method	**Value**	**Weight**	**W.Value**
RI	33.16	50%	16.6
Justified P/B	50.25	50%	25.1
Price Target			**41.70**
Upside/Downside			**18.3%**

Source: Company reports, Aljazira capital, Closing market price as of 16th August 2023

Upside Risk: Higher than expected increase in interest rates, lower than forecasted cost of risk, above expected increase in lending, and better than estimated cost to income ratio.

Downside side risk: larger and/or faster than expected decline in interest rates in 2024, larger than estimated NPL pile up, slower loan growth, and less than expected improvement in operating costs.

Figure 24. Key Financial Data

Amount in SARmn, unless otherwise specified	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
Income statement							
Net financing and investments income	**4,648**	**5,137**	**6,066**	**7,587**	**8,466**	**9,176**	**9,674**
Fees from banking services, net	936	1,085	1,209	1,414	1,484	1,712	1,981
Exchange income, net	220	215	291	376	323	339	356
Dividend and other operating income	(122)	230	397	255	213	218	223
Total operating income	**5,682**	**6,667**	**7,963**	**9,632**	**10,486**	**11,445**	**12,234**
Impairment charge for financing	(1,419)	(1,252)	(1,198)	(1,319)	(1,241)	(1,428)	(1,393)
Other operating expenses	(2,065)	(2,380)	(2,756)	(3,071)	(3,325)	(3,542)	(3,770)
Operating Profit	**2,197**	**3,036**	**4,010**	**5,242**	**5,921**	**6,474**	**7,071**
Y/Y	**-22.3%**	**38.2%**	**32.1%**	**30.7%**	**13.0%**	**9.3%**	**9.2%**
Share of loss from associate	5	(14)	4	2	2	2	2
Zakat	(236)	(312)	(414)	(532)	(611)	(668)	(729)
Net income	**1,966**	**2,709**	**3,599**	**4,712**	**5,313**	**5,809**	**6,344**
Y/Y	**-22.4%**	**37.8%**	**32.8%**	**30.9%**	**12.7%**	**9.3%**	**9.2%**
Net income (adjusted for Tier-1)	**1,966**	**2,659**	**2,604**	**3,399**	**4,512**	**5,113**	**5,609**
EPS	**0.98**	**1.35**	**1.80**	**2.36**	**2.66**	**2.90**	**3.17**
EPS (adujusted for Tier-1)	**0.98**	**1.33**	**1.70**	**2.26**	**2.56**	**2.80**	**3.07**
Balance sheet							
Assets							
Cash and balances with SAMA	12,208	9,177	9,723	17,488	14,283	16,475	19,072
Due from banks and other financial institutions	443	738	1,454	3,628	2,136	2,464	2,853
Investments, net	29,526	33,278	38,529	41,896	48,093	55,474	64,221
Financing, net	111,196	126,271	146,492	174,522	201,649	232,711	269,775
Property and equipment, net	2,365	2,383	2,633	2,696	2,966	3,262	3,589
Other assets, net	1,139	1,629	1,605	2,192	2,301	2,416	2,537
Total assets	**156,877**	**173,476**	**200,436**	**242,421**	**271,429**	**312,803**	**362,046**
Liabilities & owners' equity							
Due to banks and other financial institutions	7,312	15,240	16,483	16,239	15,098	20,096	26,461
Customers' deposits	119,454	121,061	145,168	185,763	213,242	245,967	284,750
Amount due to Mutual Funds' unitholders	110	496	137	-	-	-	-
Other liabilities	5,571	5,969	6,772	6,213	7,132	8,227	9,524
Share capital	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Statutory reserve	591	1,269	2,169	2,773	4,051	5,453	6,989
Net change in fair value of 'available for sale' investments	-	-	-	-	-	-	-
Other reserves	177	155	(507)	(167)	(167)	(167)	(167)
Retained earnings	3,760	3,586	4,285	6,600	7,073	8,227	9,489
Proposed issue of bonus shares	-	-	-	-	-	-	-
Proposed gross dividend	-	795	996	-	-	-	-
Treasury shares	(100)	(94)	(66)	-	-	-	-
Tier 1 Sukuk	-	5,000	5,000	5,000	5,000	5,000	5,000
Total shareholders' equity	24,429	30,711	31,876	34,206	35,957	38,513	41,311
Total equity & liabilities	**156,877**	**173,476**	**200,436**	**242,421**	**271,429**	**312,803**	**362,046**
Key fundamental ratios							
Capital Ratios							
Equity/ Total Assets	16%	18%	16%	14%	13%	12%	11%
Tier 1 ratio	18%	22%	19%	17%	15%	14%	13%
Total (Tier 1 and Tier 2 ratio)	19%	23%	20%	17%	16%	15%	14%
Profitability Ratios							
NIMs	3.55%	3.41%	3.50%	3.73%	3.59%	3.38%	3.08%
Return On Assets (ROA)	1.4%	1.6%	1.8%	2.0%	2.0%	1.9%	1.8%
Return On Equity (ROE)	8.4%	10.4%	12.9%	16.1%	17.0%	17.4%	17.6%
ROE/ROA (Leverage Ratio) (X)	6.2	6.6	7.1	7.9	8.5	9.1	9.7
Asset Quality Ratios							
NPL ratio	2.5%	1.8%	1.9%	1.9%	1.8%	1.8%	1.7%
NPL Coverage	114%	177%	136%	138%	139%	140%	137%
Funding Ratios							
Loans/ Customer Deposits	93.1%	104.3%	100.9%	93.9%	94.6%	94.6%	94.7%
Liquid Assets / Total Assets	97.8%	97.7%	97.9%	98.0%	98.1%	98.2%	98.3%
Net Loans / Total Assets	70.9%	72.8%	73.1%	72.0%	74.3%	74.4%	74.5%
Market/valuation ratios							
DPS	0.30	0.75	1.00	1.25	1.50	1.50	1.75
Dividend Yield	1.8%	3.1%	3.1%	3.5%	4.2%	4.2%	4.9%
Book Value Per Share (BVPS)	12.2	12.9	13.4	14.6	15.5	16.8	18.2
Market price	16.3	24.0	32.6	35.8	35.8	35.8	35.8
PE (x)	16.5	17.7	18.1	15.9	14.0	12.8	11.7
PB (x)	1.3	1.9	2.4	2.5	2.3	2.1	2.0
Growth rates							
Investments (Y/Y)	25.8%	12.7%	15.8%	8.7%	14.8%	15.3%	15.8%
Financing (Y/Y)	17.3%	13.6%	16.0%	19.1%	15.5%	15.4%	15.9%
Deposits (Y/Y)	17.0%	1.3%	19.9%	28.0%	14.8%	15.3%	15.8%

Source: Company reports, Aljazira Capital Research

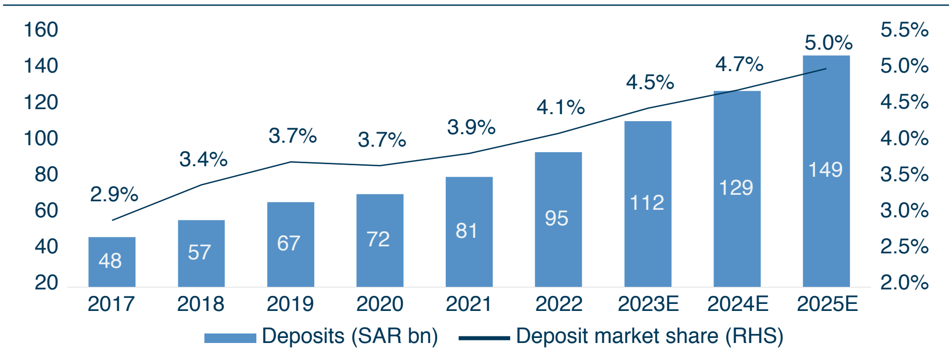
Bank AlBilad: Diversified loan portfolio to mitigate impact of rate cuts, however positives are priced in

We forecast Bank Albilad to post 2022-25 earnings CAGR of 15.3%. With limited NIM movement, earnings are expected to closely follow deposit growth. We estimate cost of risk to average at 55bps in 2023-25 as compared to 82bps for the last three years, owing to a healthy NPL coverage ratio of 190.8%. Cost to income ratio is projected improve by 457bps to 40.1% over 2022-25. Bank Albilad trades at 2024E P/B of 2.4x on ROE of 16.2%, whereas our Gordon growth and residual income based target price implies a target P/B of 2.5x, implying that the script is fairly valued. We maintain our "Neutral" recommendation on Albilad, with a TP of SAR 41.50/share. Improvement in fundamentals is in the price.

NIMs to remain stable amidst decline in interest rates: Since the beginning of policy tightening cycle in Q1-22, interest rates are up 500bps, whereas Albilad's NIMs have contracted by 33bps as compared to 51/74bps increase/decrease for Alinma/AlRajhi, respectively. An almost equal mix of mostly fixed-rate long maturity retail loans (48.6% of outstanding lending) and floating rate commercial loans (51.4% of outstanding lending), and large proportion of low-cost savings deposits (38.2% of remunerative deposits) make Albilad's NIMs less sensitive to changes in interest rates, as compared to peer banks. Overall, we expect NIMs to edge down by 15bps Y/Y in 2023, and improve by 10bps Y/Y in 2024, when interest rates start coming down.

Consistently gaining deposit market share: AlBilad has a strong deposit mobilization track record, with deposit CAGR of 17.9% for the last three years (Q2-20 to Q2-23) as compared to 9.8% for the total industry. After posting a phenomenal 12.1% YTD increase in deposits in Q2-23, Albilad's deposit market share has expanded to 4.4% (deposit market share stood at 3.8% in Q1-20). Share of time deposits in total deposits has expanded by 13.9ppts to 55.7% in Q2-23 from 41.8% in Q1-20. We expect deposits to grow at a CAGR of 14.0% between 2023-25, and mix of non-profit bearing demand deposits to decline from 41.4% in Q2-23 to 41.1% in 2025.

Fig 25: Robust deposit mobilisation track record



Source: Company reports, Aljazira Capital Research

Recommendation	Neutral
Target Price (SAR)	41.50
Upside/(Downside)	0.6%

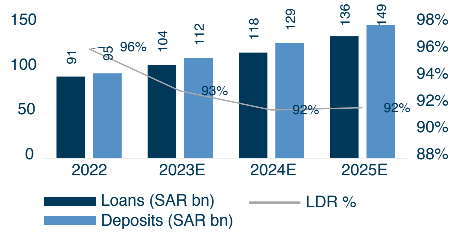
Source: Tadawul *prices as of 16th of August 2023

Key Financials

SARmn	FY22	FY23E	FY24E	FY25E
NSCI	3,887	4,222	4,903	5,639
Growth %	11.4%	8.6%	16.1%	15.0%
Net Profit	2,082	2,396	2,653	3,195
Growth %	23.4%	15.1%	10.7%	20.4%
EPS	2.08	2.40	2.65	3.19

Source: AlJazira Capital, Company reports,

Loans and Deposit Growth (SAR bn)



Source: AlJazira Capital, Company reports

Key Ratios

	FY22	FY23E	FY24E	FY25E
NIMs	3.53%	3.38%	3.48%	3.50%
P/E	19.9	17.3	15.6	13.0
P/B	3.3	2.7	2.4	2.1
DPS	0.50	0.75	0.75	1.25
Dividend Yield	1.1%	1.7%	2.0%	2.8%
C/I	44.7%	42.8%	42.6%	40.1%
ROA	1.7%	1.8%	1.7%	1.8%
ROE	16.4%	16.6%	16.2%	17.4%
Loan growth	9.9%	14.3%	13.3%	15.5%
Deposit growth	16.9%	18.1%	15.0%	15.3%

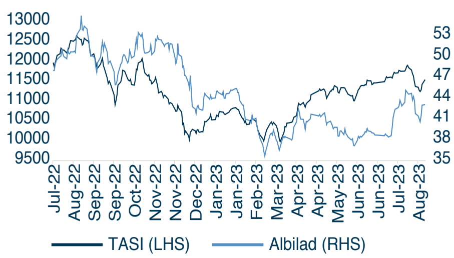
Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (SAR bn)	40.6
YTD%	-6.64%
52 week (High)/(Low)	35.3/56
Share Outstanding (mn)	1,000.0

Source: Company reports, Bloomberg, Aljazira Capital

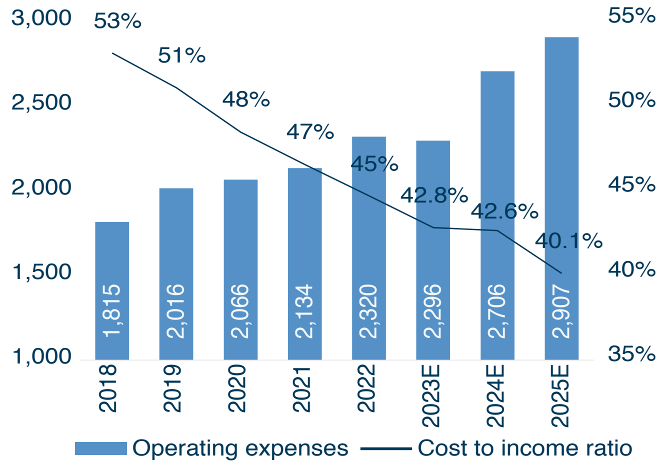
Price Performance



Source: Tadawul, Aljazira Capital

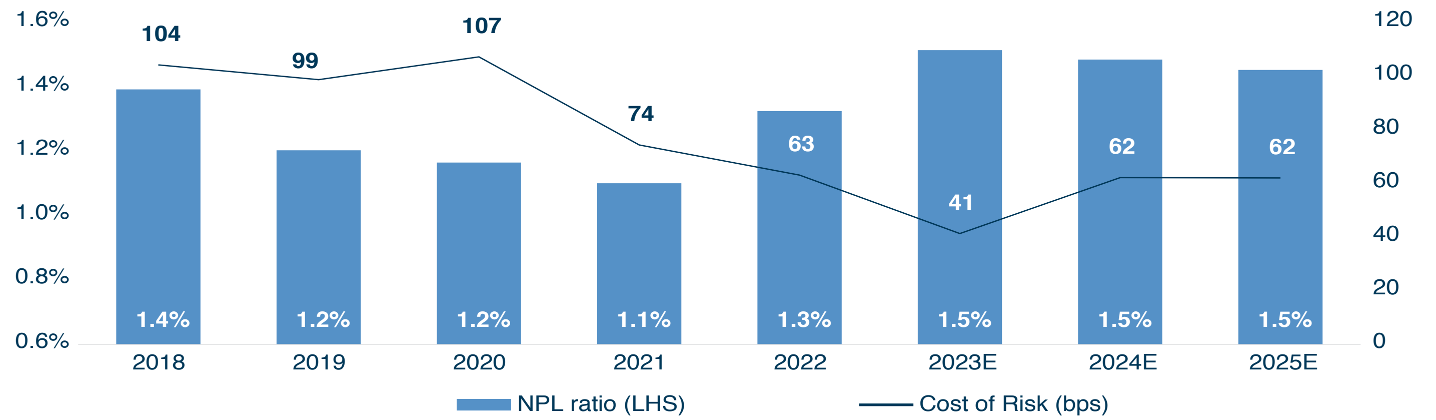
Earnings to closely follow balance sheet growth: We forecast Albilad to post 2022-25 earnings CAGR of 15.3% on the underlying expectation that NIMs will contract by 15bps in 2023, and improve by 11bps in 2024, assets will grow at a double digit CAGR of 13.2% (2019-22 CAGR 14.6%), cost of risk would average at 55bps (coverage ratio 190.8%), and cost to income ratio would improve by 457bps to 40.1%, over 2022-25. We expect digitization initiatives such as, end to end digital process for credit card and personal finance, faster opening of savings account through Albilad App and Albilad Net would improve process efficiency.

Fig 26: Cost efficiencies will further improve



Source: Company reports, Aljazira Capital Research

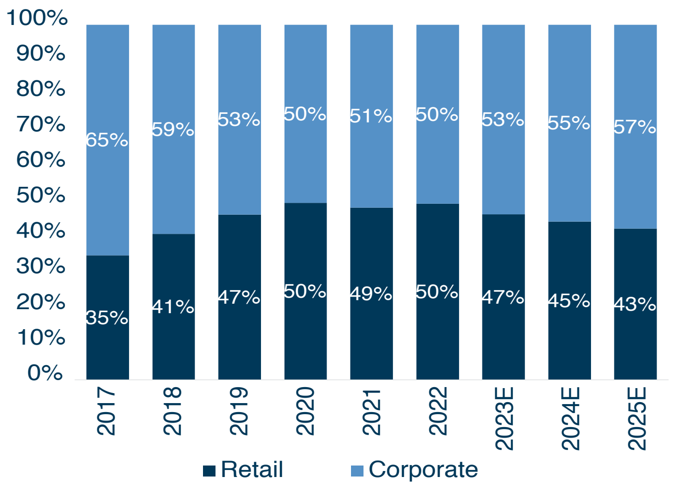
Fig 27: Cost of risk to stay under control



Source: Company reports, Aljazira Capital Research

Attention on commercial business amidst a slowdown in mortgage: Albilad posted a 12.6% YTD increase in commercial loans in Q2-23, whereas retail loans grew by 4.1% over the same period. Going forward, due to the slowdown in mortgage market, and bank's renewed focus on Corporate (trade finance, syndicated loans and global transaction service) and MSME (real estate, manufacturing and hospitality), we expect corporate loans to grow at of CAGR of 19.7% over 2023-25. As a result, we forecast weight of commercial loans to move up to 56.8%, and retail's share in total loans to decline to 43.2% by 2025. Note that, commercial loans had a share of 58.9% in total loans, before the mortgage boom in 2018.

Fig 28: Pick up in share of corporate loans



Source: Company reports, Aljazira Capital Research

Investment thesis: Bank Albilad trades at 2024E P/B of 2.4x on ROE of 16.2%, whereas our Gordon growth and residual income based target price implies a target P/B of 2.5x, implying that the script is fairly valued. Key drivers for the stock are: 1) a stable balance sheet mix that is expected to keeps interest margins fairly stable in a declining interest rate environment, 2) track record of robust deposit mobilization (deposit CAGR of 17.9% for the last three years (Q2-20 to Q2-23) as compared to 9.8% for the total industry), 3) focus on commercial and high yielding SME business and 4) double digit medium term earnings growth (2022-25E earnings CAGR of 15.3%). Moreover, there is ample room for the bank to improve its cost to income ratio, which can result in valuation upgrade.

Valuation: We value the stock based on equal weight to Residual Income and Two Stage Gordon growth Model. Our residual income-based TP assuming the cost of equity of 10.36% and terminal growth rate of 2.5%, whereas; through the Two Staged Gordon growth model, based on FY24E ROE of 16.2%, we arrive at a justified P/B multiple of 2.5x for the stock. Thus, the equal-weighted TP stands at **SAR 41.50/share** which translates to an upside of **0.6%** and a "**Neutral**" rating on the stock.

Weighted Average TP			
Method	**Value**	**Weight**	**W.Value**
RI	40.07	50%	20.0
Justified P/B	42.95	50%	21.5
Price Target			**41.50**
Upside/Downside			**0.6%**

Source: AlJazira research, Company reports, Closing market price as of 16th August 2023

Upside Risk: Higher than expected cut interest rate in 2023/2024 respectively, lower than forecasted cost of risk, above expected increase in lending, and better than estimated improvement in cost efficiencies.

Downside side risk: Larger than anticipated hike in interest rate, larger than estimated bad loan accumulation, slower loan growth, and less than expected improvement in operating costs.

Figure 29. Key Financial Data

Amount in SARmn, unless otherwise specified	FY20	FY21	FY22	FY23E	FY24E	FY25E	FY26E
Income statement							
Net financing and investments income	**3,293**	**3,489**	**3,887**	**4,222**	**4,903**	**5,639**	**6,620**
Fee and commission income, net	627	731	669	655	867	980	1,098
Exchange income, net	362	313	398	283	442	464	487
Dividend and other operating income	(20)	50	238	202	134	163	137
Total operating income	**4,262**	**4,584**	**5,191**	**5,363**	**6,346**	**7,246**	**8,342**
Impairment charge for financing	(695)	(570)	(551)	(404)	(692)	(789)	(958)
Other operating expenses	(2,066)	(2,134)	(2,320)	(2,296)	(2,706)	(2,907)	(3,118)
Operating Profit	**1,502**	**1,880**	**2,321**	**2,662**	**2,948**	**3,550**	**4,266**
Y/Y	**8.3%**	**25.2%**	**23.4%**	**14.7%**	**10.7%**	**20.4%**	**20.2%**
Zakat	(153)	(194)	(239)	(266)	(295)	(355)	(427)
Net income	**1,349**	**1,687**	**2,082**	**2,396**	**2,653**	**3,195**	**3,839**
Y/Y	**8.4%**	**25.1%**	**23.4%**	**15.1%**	**10.7%**	**20.4%**	**20.2%**
EPS	1.35	1.69	2.08	2.40	2.65	3.19	3.84
Balance sheet							
Assets							
Cash and balances with SAMA	5,745	6,097	8,711	8,159	9,662	11,140	12,747
Due from banks and other financial institutions	2,179	2,137	6,067	3,388	3,896	4,492	5,140
Investments, net	14,884	17,092	20,600	24,188	27,818	32,074	36,702
Financing, net	70,115	82,933	91,179	104,179	117,991	136,282	156,092
Property and equipment, net	1,896	1,925	2,105	2,167	2,383	2,622	2,884
Other assets, net	935	669	881	1,071	1,124	1,180	1,239
Total assets	**95,754**	**110,854**	**129,543**	**143,152**	**162,875**	**187,790**	**214,806**
Liabilities & owners' equity							
Due to SAMA, banks and other financial institutions	5,403	8,777	10,621	5,867	5,878	7,708	9,548
Customers' deposits	71,553	81,110	94,843	112,013	128,822	148,531	169,963
Sukuk	2,005	3,015	3,040	3,046	3,046	3,046	3,046
Other liabilities	6,053	5,970	7,639	6,809	7,830	9,028	10,331
Share capital	7,500	7,500	10,000	10,000	10,000	10,000	10,000
Statutory reserve	648	1,070	1,590	1,902	2,565	3,364	4,323
Other reserves	897	440	(239)	(140)	(140)	(140)	(140)
Retained earnings	1,756	522	1,590	3,656	4,873	6,253	7,734
Total shareholders' equity	10,741	11,980	13,399	15,417	17,298	19,477	21,918
Total equity & liabilities	**95,754**	**110,854**	**129,543**	**143,152**	**162,875**	**187,790**	**214,806**
Key fundamental ratios							
Capital Ratios							
Equity/ Total Assets	11%	11%	10%	11%	11%	10%	10%
Tier-1 ratio	14%	14%	14%	14%	14%	13%	13%
CAR	18%	19%	18%	17%	17%	16%	15%
Profitability Ratios							
NIMs	4.08%	3.69%	3.53%	3.38%	3.48%	3.50%	3.57%
Return On Assets (ROA)	1.5%	1.6%	1.7%	1.8%	1.7%	1.8%	1.9%
Return On Equity (ROE)	13.4%	14.8%	16.4%	16.6%	16.2%	17.4%	18.5%
ROE/ROA (Leverage Ratio) (X)	9.0	9.1	9.5	9.5	9.4	9.5	9.7
Asset Quality Ratios							
NPL ratio	1.2%	1.1%	1.3%	1.5%	1.5%	1.5%	1.4%
NPL Coverage	280%	280%	228%	191%	182%	174%	175%
Funding Ratios							
Loans/ Customer Deposits	98.0%	102.2%	96.1%	93.0%	91.6%	91.8%	91.8%
Liquid Assets / Total Assets	97.0%	97.7%	97.7%	97.7%	97.8%	98.0%	98.1%
Net Loans / Tot Assets	73.2%	74.8%	75.6%	75.7%	75.1%	74.2%	73.7%
Market/valuation ratios							
DPS	-	-	0.50	0.75	0.75	1.25	1.50
Dividend Yield	0.0%	0.0%	1.1%	1.7%	2.0%	2.8%	3.9%
Book Value Per Share (BVPS)	10.7	12.0	13.4	15.4	17.3	19.5	21.9
Market Price	21.28	34.79	44.45	41.50	41.50	41.50	41.50
PE (x)	30.8	24.6	19.9	17.3	15.6	13.0	10.8
PB (x)	2.0	2.9	3.3	2.7	2.4	2.1	1.9
Growth							
Investments (Y/Y)	35.5%	14.8%	20.5%	17.4%	15.0%	15.3%	14.4%
Financing (Y/Y)	18.3%	18.3%	9.9%	14.3%	13.3%	15.5%	14.5%
Deposits (Y/Y)	6.6%	13.4%	16.9%	18.1%	15.0%	15.3%	14.4%

Source: Company reports, Aljazira Capital Research

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RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

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