

Arab National Bank (ARNB)

Strong loan growth and growth in core non-funded income supported profit

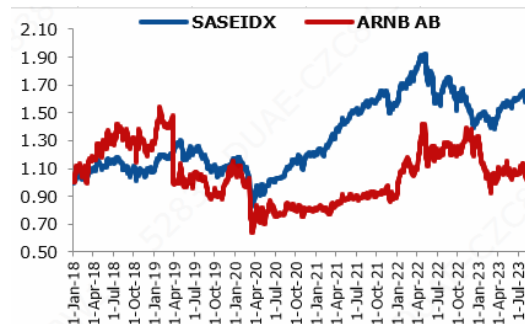
Current Price
SAR 25.45

Target Price
SAR 30.00

Upside/Downside (%)
+18%

Rating
BUY

- Loan growth exceeded deposits pressurizing the liquidity of the bank. The loan-to-deposit ratio rose from 92.9% in 4Q22 to 94.0% in 2Q23
- Loan growth is on account of growth in commercial and consumer loans
- CASA deposits made up 48.2% of total deposits in 2Q23 as compared to 47.9% in 1Q23
- Bank recorded strong funded income growth of 77.5%, despite global uncertainties and inflationary pressure.



2Q23 Net Profit below our estimate

Arab National Bank ("ARNB", "the Bank") recorded a strong 39.3% YOY growth in net profit to SAR 986 Mn in 2Q23, slightly lower than our estimate of SAR 1,020 Mn. The increase in net profit is mainly attributed to growth in net funded income and a decline in impairments partially offset by a decline in non-funded income and an increase in operating expenses.

P&L Highlights

ARNB's funded income grew 77.5% YOY to SAR 3,039 Mn in 2Q23 attributable to a 4.1% YOY increase in net advances and expansion in asset yield. Funded expenses increased significantly from SAR 402 Mn in 2Q22 to SAR 1,309 Mn in 2Q23 due to an increase in the cost of funds owing to higher benchmark rates. Thus, net funded income grew 32.1% YOY to SAR 1,730 Mn in 2Q23. Fees and commission income rose 46.7% YOY to SAR 185 Mn in 2Q23 while exchange income grew 1.6% YOY to SAR 77 Mn. However, other non-funded income declined 27.4% YOY to SAR 173 Mn in 2Q23 while dividend income fell 50.4% YOY to SAR 40 Mn. Thus, total non-funded income reduced by 1.8% YOY to SAR 357 Mn in 2Q23. As a result, total operating income inclined 24.7% YOY to SAR 2,088 Mn in 2Q23. Operating expenses rose 17.3% YOY to SAR 674 Mn in 2Q23, while the cost-to-income ratio declined 206 bps YOY to 32.3% in 2Q23 due to an increase in the operating income base. However, the cost-to-income ratio increased on a QOQ basis by 203 bps. The rise in operating expenses is owing to an increase in G&A expenses, salaries and employee-related expenses, D&A expenses, and rent and premise-related expenses. Net impairments declined 5.0% YOY to SAR 268 Mn in 2Q23.

Stock Information

| | |
|--------------------------|------------|
| Market Cap (SAR, mm) | 38,175.00 |
| Paid Up Capital (mm) | 15,000.00 |
| 52 Week High | 35.00 |
| 52 Week Low | 23.00 |
| 3M Avg. daily value(SAR) | 32,307,080 |

2Q23 Result Review (SAR, mm)

| | |
|-------------------|---------|
| Total Assets | 215,984 |
| Total Liabilities | 182,248 |
| Total Equity | 33,710 |
| Total Deposits | 158,378 |
| Net Profit | 986 |

Financial Ratios

| | |
|-------------------------|-------|
| Dividend Yield (12m) | 4.91 |
| Dividend Pay-out (%) | 53.74 |
| Price-Earnings Ratio(x) | 10.24 |
| Price-to-Book Ratio (x) | 1.13 |
| Book Value (SAR) | 22.47 |
| Return-on Equity (%) | 11.63 |

Stock Performance

| | |
|------------------------|---------|
| 5 Days | -4.50% |
| 1 Months | -5.04% |
| 3 Months | -8.29% |
| 6 Months | -5.91% |
| 1 Year | -19.08% |
| Month to Date (MTD%) | -4.50% |
| Quarter to Date (QTD%) | -3.42% |
| Year to Date (YTD%) | -20.59% |

Balance Sheet Highlights

ARNB's net advances further increased 4.1% YOY and 2.9% QOQ to SAR 148.9 Bn in 2Q23. Total assets rose 2.9% YOY and 0.9% QOQ to SAR 216.0 Bn in 1Q23. Similarly, customer deposits rose 7.9% YOY and 2.0% QOQ to SAR 158.4 Bn in 2Q23. The loan-to-deposit ratio stood at 94.0% in 2Q23 as compared to 93.2% in 1Q23. Consequently, total equity increased 8.6% YOY and 3.3% QOQ to SAR 33.7 Bn in 2Q23.

Target Price and Rating

We revise our rating from ACCUMULATE to BUY on Arab National Bank with an unchanged target price of SAR 30.00. ARNB reported significant growth in profitability of 39.3% YOY in 2Q23 mainly driven by a healthy growth in net advances. The Bank's NIMs declined marginally 3 bps QOQ to 3.4% in 2Q23 owing to higher benchmark rates in the economy. The CASA deposit rose marginally from 47.9% in 1Q23 to 48.2% in 2Q23. The rise in CASA deposits will lend support to margins going forward. ARNB's net advances grew 4.1% YOY and 2.9% QOQ to SAR 148.8 Bn in 2Q23 while customer deposits grew 7.9% YOY to SAR 158.4 Bn in 2Q23. Thus, the loan-to-deposit ratio slightly increased to 94.0% in 2Q23 as compared to 93.2% in 1Q23. Moreover, the asset quality of the Bank moderated as the NPL ratio increased from 1.9% in 1Q23 to 2.3% in 2Q23. Additionally, provision coverage stood at 120.8% in 2Q23 but still provides a strong buffer against loan losses. The stock is trading at an attractive dividend yield of 5.4% based on 2023 financials compared to the peer average of 3.3%. ARNB declared an interim dividend of SAR 0.65 per share during 1H23. Thus, based on our analysis, we assign a BUY rating on the stock.

ARNB - Relative valuation

| (at CMP) | 2018 | 2019 | 2020 | 2021 | 2022 | 2023F |
|----------------|------|------|------|------|------|-------|
| PE | 9.8 | 12.8 | 18.7 | 17.8 | 12.6 | 9.2 |
| PB | 1.5 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 |
| Dividend yield | 3.9% | 3.9% | 1.6% | 3.1% | 4.3% | 5.5% |

FABS Estimates & Co Data

ARNB – P&L

| SAR mm | 2Q22 | 1Q23 | 2Q23 | 2Q23F | Var. | YOY Ch | QOQ Ch | 2022 | 2023F | Change |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|--------------|--------------|--------------|
| Funded income | 1,712 | 2,826 | 3,039 | 3,009 | 1.0% | 77.5% | 7.5% | 7,657 | 12,486 | 63.1% |
| Funded expense | -402 | -1,093 | -1,309 | -1,164 | 12.4% | 225.5% | 19.7% | -2,020 | -4,938 | 144.4% |
| Net funded income | 1,310 | 1,733 | 1,730 | 1,844 | -6.2% | 32.1% | -0.1% | 5,636 | 7,548 | 33.9% |
| Fees and commissions | 126 | 151 | 185 | 163 | 13.1% | 46.7% | 22.1% | 546 | 666 | 22.0% |
| Exchange income, net | 75 | 85 | 77 | 94 | -18.4% | 1.6% | -10.2% | 354 | 389 | 9.9% |
| Trading Income | 14 | 19 | 8 | 21 | -60.3% | -40.4% | -56.3% | 39 | 89 | 125.0% |
| Dividend income | 80 | 24 | 40 | 24 | 65.4% | -50.4% | 68.7% | 160 | 96 | -40.0% |
| other operating income | 13 | 21 | 27 | 25 | 8.6% | NM | 24.8% | 74 | 111 | 50.0% |
| Other non-funded income | 238 | 297 | 173 | 164 | 5.7% | -27.4% | -41.7% | 680 | 854 | 25.6% |
| Non-funded income | 364 | 448 | 357 | 327 | 9.4% | -1.8% | -20.2% | 1,226 | 1,520 | 24.0% |
| Operating income | 1,674 | 2,180 | 2,088 | 2,171 | -3.8% | 24.7% | -4.3% | 6,862 | 9,067 | 32.1% |
| Operating expenses | -574 | -659 | -674 | -720 | -6.5% | 17.3% | 2.2% | -2,458 | -2,956 | 20.3% |
| Pre-provision profit | 1,099 | 1,521 | 1,414 | 1,451 | -2.5% | 28.7% | -7.0% | 4,405 | 6,111 | 38.7% |
| Impairment | -282 | -298 | -268 | -263 | 1.8% | -5.0% | -10.2% | -880 | -1,219 | 38.5% |
| PBT | 839 | 1,233 | 1,163 | 1,198 | -2.9% | 38.7% | -5.7% | 3,633 | 4,964 | 36.6% |
| Tax | -133 | -174 | -174 | -186 | -6.2% | 30.5% | 0.3% | -566 | -746 | 31.8% |
| Reversal of deferred tax | -2 | -9 | 2 | -9 | NM | NM | NM | 0 | 0 | NM |
| Profit after tax | 707 | 1,068 | 987 | 1,021 | -3.3% | 39.6% | -7.6% | 3,067 | 4,218 | 37.5% |
| Non-controlling interest | 0 | -1 | -1 | -1 | NM | NM | NM | 3 | 5 | 49.3% |
| Net Profit attributable | 708 | 1,067 | 986 | 1,020 | -3.3% | 39.3% | -7.6% | 3,070 | 4,223 | 37.6% |

FABS estimate & Co Data
ARNB - KPI

| | 2Q22 | 1Q23 | 2Q23 | YOY Ch | QOQ Ch | 2022 | 2023F | Change |
|-----------------|-------|-------|-------|--------|--------|-------|-------|--------|
| Net FI/OI | 78.3% | 79.5% | 82.9% | 462 | 342 | 82.1% | 83.2% | 110 |
| NIM | 2.6% | 3.4% | 3.4% | 72 | -3 | 2.9% | 3.5% | 57 |
| NIS | 2.5% | 3.0% | 2.8% | 29 | -19 | 2.7% | 3.5% | 78 |
| Fees & comms/OI | 7.5% | 6.9% | 8.8% | 132 | 191 | 8.0% | 7.3% | -61 |
| Impairment/PPP | 25.6% | 19.6% | 18.9% | -672 | -67 | 20.0% | 19.9% | -3 |
| Cost to income | 34.3% | 30.2% | 32.3% | -206 | 203 | 35.8% | 32.6% | -321 |
| NP/OI | 42.3% | 49.0% | 47.2% | 494 | -173 | 44.7% | 46.6% | 184 |
| ROAE | 7.9% | 10.9% | 11.3% | 340 | 48 | 9.9% | 12.9% | 303 |
| ROAA | 1.20% | 1.63% | 1.75% | 55 | 12 | 1.5% | 1.9% | 35 |

FABS estimate & Co Data
ARNB - Key B/S items

| SAR mm | 2Q22 | 3Q22 | 4Q22 | 1Q23 | 2Q23 | YOY Ch |
|-------------------|---------|---------|---------|---------|---------|--------|
| Net advances | 143,055 | 145,475 | 143,829 | 144,727 | 148,852 | 4.1% |
| QOQ ch | 3.2% | 1.7% | -1.1% | 0.6% | 2.9% | |
| Total assets | 209,828 | 207,266 | 212,628 | 214,042 | 215,984 | 2.9% |
| QOQ ch | 2.5% | -1.2% | 2.6% | 0.7% | 0.9% | |
| Customer deposits | 146,791 | 147,806 | 154,871 | 155,247 | 158,378 | 7.9% |
| QOQ ch | -0.9% | 0.7% | 4.8% | 0.2% | 2.0% | |
| Total equity | 31,028 | 31,749 | 32,334 | 32,644 | 33,710 | 8.6% |
| QOQ ch | -3.1% | 2.3% | 1.8% | 1.0% | 3.3% | |

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 | 30.08 | 70.0% | 21.06 |
| Relative Valuation (RV) | 29.80 | 30.0% | 8.94 |
| Weighted Average Valuation (SAR) | | | 30.00 |
| Current market price (SAR) | | | 25.45 |
| Upside/Downside (%) | | | +18% |

1) Residual Income Method:

We have discounted the economic profit/excess equity using the cost of equity of 8.5%. Cost of equity is calculated by using 10-year government bond yield of 4.7%, beta of 1.0 and equity risk premium of 3.7%. Government bond yield is calculated after adding KSA 10-year CDS spread over a 10-year US risk-free rate. Also, assumed a terminal growth rate of 2.0%.

| | |
|--|---------------|
| Sum of PV (SAR, Mn) | 3,535 |
| Terminal value (SAR, Mn) | 7,877 |
| Book Value of Equity (as of March 2023) | 33,710 |
| FV to Common shareholders (SAR, Mn) | 45,123 |
| No. of share (Mn) | 1,500 |
| Current Market Price (SAR) | 25.45 |
| Fair Value per share (SAR) | 30.08 |

Residual Income Method

| (All Figures in SAR Mn) | FY 2023E | FY 2024E | FY 2025E | FY 2026E | FY 2027E |
|---------------------------------------|------------|--------------|--------------|------------|------------|
| Net Profit | 4,223 | 4,131 | 4,208 | 4,265 | 4,154 |
| (-) Equity Charge | -2,855 | -3,013 | -3,166 | -3,311 | -3,446 |
| Excess Equity | 456 | 1,117 | 1,042 | 954 | 708 |
| Discounting Factor | 0.97 | 0.90 | 0.83 | 0.76 | 0.70 |
| Present Value of Excess Equity | 444 | 1,003 | 862 | 728 | 498 |

Source: FAB Securities

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 assets returns as compared to its peers. It is valued at PB multiple of 1.3x.

| Company | Market (USD Mn) | P/B (x) | | P/E (x) | | Dividend Yield (%) | |
|---------------------|--------------------|-------------|-------------|--------------|--------------|--------------------|-------------|
| | | 2023F | 2024F | 2023F | 2024F | 2023F | 2024F |
| Alinma Bank | 19,446 | 2.5 | 2.3 | 16.4 | 14.8 | 3.4 | 3.8 |
| Al Rajhi Bank | 75,542 | 3.0 | 2.7 | 16.5 | 14.7 | 2.5 | 3.4 |
| Saudi National Bank | 64,126 | 1.5 | 1.4 | 12.5 | 11.1 | 4.1 | 4.5 |
| Banque Saudi Fransi | 14,126 | 1.5 | 1.4 | 12.3 | 11.4 | 4.5 | 4.6 |
| Riyad Bank | 11,303 | 1.9 | 1.8 | 12.8 | 12.1 | 4.0 | 4.2 |
| Bank Albilad | 11,563 | 2.8 | 2.5 | 18.3 | 15.9 | 1.4 | 1.8 |
| Average | | 2.2x | 2.0x | 14.8x | 13.3x | 3.3% | 3.7% |
| Median | | 2.2x | 2.0x | 14.6x | 13.4x | 3.7% | 4.0% |
| Max | | 2.8x | 2.4x | 16.5x | 14.8x | 4.0% | 4.4% |
| Min | | 1.6x | 1.5x | 12.6x | 11.6x | 2.7% | 3.5% |

Source: FAB Securities

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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