

June 08, 2021

AL RAJHI BANK

Company Update

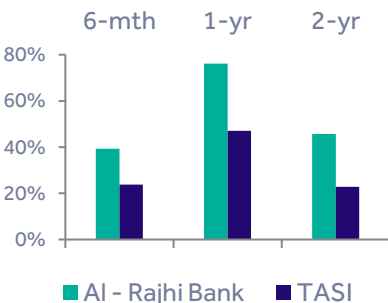
Rating Buy
12- Month Target Price SAR 120.0

Price as on Jun-07, 2021 SAR 103.40
Upside to Target Price 16.1%
Expected Dividend Yield 2.9%
Expected Total Return 19.0%

Market Data

52 Week H/L SAR 104.6/56.5
Market Capitalization SAR 258.5 bln
Shares Outstanding 2,500 mln
Free Float 94.09%
12-Month ADTV 4,158,570
Bloomberg Code RJHI AB

1-Year Price Performance



Source: Bloomberg

Leading Retail Bank in the Middle East

Upgrade to Buy

Using justified price-to-book ratio method, we arrive at a fair value of SAR 119.80 for Al Rajhi Bank. Thus, we raise our target price from SAR 90.00 to SAR 120.00 and upgrade our recommendation to Buy. Al Rajhi has the best RoE amongst peers at 19.9% while we expect dividends to come back to SAR3/share in 2021.

Third of the GCC's total banking assets are in KSA

Almost 35% of the GCC's total banking assets are within Saudi Arabia. The Kingdom achieving its 2030 vision through a number of ongoing mega projects will require financing from strong banks. Consequently, it indicates more prosperity and growth opportunities for the banking sector in Saudi Arabia.

3M SAIBOR increased continuously in 2018, hitting its highest level in the past 10 years at 2.975% in Dec 2018. Thereafter, it started to decline from 2019, due to number of factors, ending 1Q2021 at 0.80%.

Industry Loan and Deposits Rising

Total Loans increased by +15% Y/Y in 1Q2021 to reach SAR 1,943 billion while Total Deposits improved by +10% Y/Y in 1Q2021 to reach SAR 1,980 billion. We believe that part of this growth is driven by the ongoing impact of the Saudi Central Bank's decision to enhance the liquidity of the banking sector by SAR 50 billion.

Ambitious strategy

Al Rajhi Bank is implementing a new strategy that is designed to spotlight two significant areas, maintaining the bank's leadership in retail banking services and shifting from the public sector to the private sector while continuing to build on its market-leading digital capabilities.

Mortgages lead financing growth

Total financing increased by +36% Y/Y to reach SAR 356.1 bln in 1Q2021, as most of the growth was driven by the increase in mortgage financing. At the same time, total deposits grew by +33% Y/Y to reach SAR 421 bln. As a result of these two factors, Loans to Deposits Ratio (LDR) reached 81%, which gives Al Rajhi Bank more room to grow its financing portfolio.

Highest quarterly net income in 1Q2021

Net financing and investment income increased by +16% Y/Y to reach SAR 4.8 bln in 1Q2021. Thus, Al Rajhi Bank achieved the highest quarterly earnings of SAR 3.3 bln (+7% Q/Q, +40% Y/Y). We expect continued bottom line growth going forward.

Table 1: Financial Summary (2019-2023)

	2019	2020	2021E	2022E	2023E
Income Statement Items (SAR mln)					
Net financing income	16,428	16,913	19,223	21,609	23,890
Total operating income	19,484	20,721	23,236	25,791	28,248
Net Income	10,159	10,596	11,969	13,755	15,440
NIM	5.22%	4.71%	4.33%	4.19%	4.23%
Balance Sheet Items (SAR mln)					
Net Financing	249,683	315,712	403,998	446,171	492,560
Deposits	312,406	382,631	451,505	519,230	571,153

Source: Riyad Capital, Company's Financial Reports

■ Macro Overview

Almost 35% of the GCC's total banking assets are within Saudi Arabia, and it is the biggest in terms of market capitalization. The Kingdom achieving its 2030 vision will provide a path and opportunities for the development of financial services in the country and a range of lending opportunities in significant sectors. Also, a number of ongoing mega projects will require financing from strong banks. Apart from this, in March 2021 the Crown Prince furthermore launched an initiative of USD 3.2 trillion to enhance the private sector. Therefore, it will require financial institutions to finance and refinance some of private sector entities.

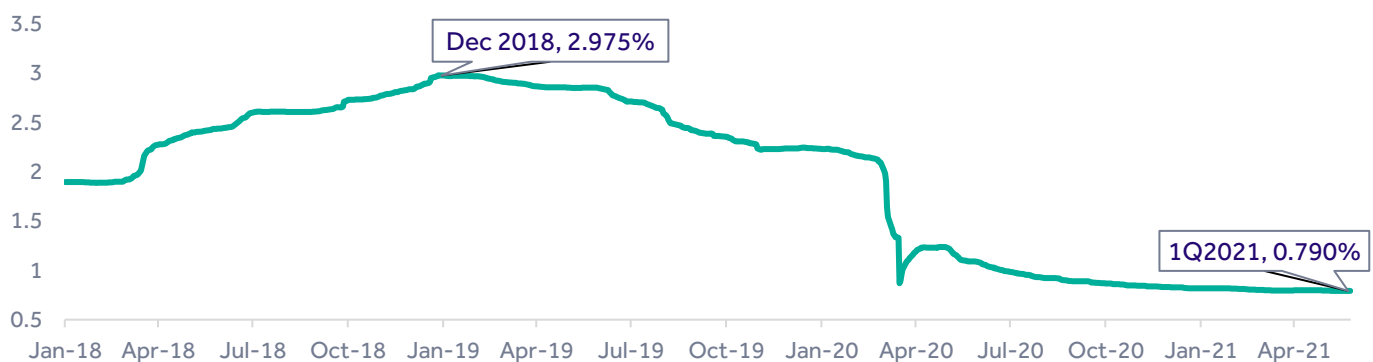
Consequently, those factors indicate more prosperity and growth opportunities for the banking sector in Saudi Arabia.

From a more macro perspective, the Covid-19 pandemic led to a decline in oil prices in 2020, which made it a challenging year for the banking sector. Furthermore, the banking industry was suffering from lower lending revenue due to the economic downturn caused by the pandemic, lower interest rates and higher costs related to higher cost of risk.

On the other hand, at the beginning of 2020, the full negative economic impact was not yet clear, but the government was quick to react by announcing a series of measures to mitigate the possible negative effects, including a SAR 50 billion stimulus package in the banking sector. In addition, SAMA also provided support for bank customers by restructuring loans without additional fees, removing any charges for accounts that are below minimum balance limits, changes to interest rates, and credit card fees.

3M SAIBOR increased continuously in 2018, hitting its highest level in the past 10 years at 2.975% in Dec 2018. Thereafter, it started to decline in 2019, due to SAMA's decision to decrease the reverse repo rate 3 times through the year. In early 2020, the US Federal Reserve cut interest rates as a move intended to protect U.S economy from the impact of Covid-19. Subsequently, Saudi Central Bank has decided to cut Repo rate by -75 bps to 1.00% and Reverse Repo rate by -75 bps to 0.50%, to preserve monetary stability given evolving global developments. 3M SAIBOR adopted a steady downtrend to end the 1Q2021 at 0.80%.

Exhibit 1: 3M SAIBOR changes from January 2018



Source: Riyad Capital, Bloomberg

Positive macroeconomic outlook

- Roll-out of the vaccine is likely to help avoid further lockdowns.
- We remain optimistic about the possibility of a decrease in the value-added tax (VAT) from its current level at 15% in the future. This is likely to positively affected consumer buying and encourage people towards mortgages, automobiles and luxury goods, which all require financing from the banks.

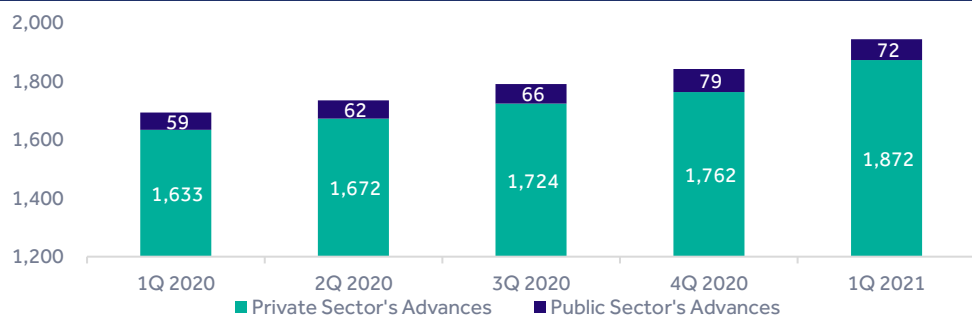
■ Sector Overview

Retail Mortgage Leads Loan growth

Total Loans increased by +15% Y/Y in 1Q2021 to reach SAR 1,943 billion, Private Sector's Advances followed a similar trend to rise also by +15% Y/Y to reach SAR 1,872 billion, while Public Sector's Advances improved by +26% Y/Y to reach SAR 71.65 billion, according to SAMA's Monthly Bulletin March 2021.

Total Real Estate loans increased by +44% Y/Y to reach about SAR 475 billion in 1Q2021. The value of Retail Loans, which represents 75% of total real estate loans, increased by +59% Y/Y during the quarter, to reach SAR 358 billion, due to increased activities in the housing sector.

Exhibit 2: Total loan growth 1Q2020 – 1Q2021 (SAR billion)



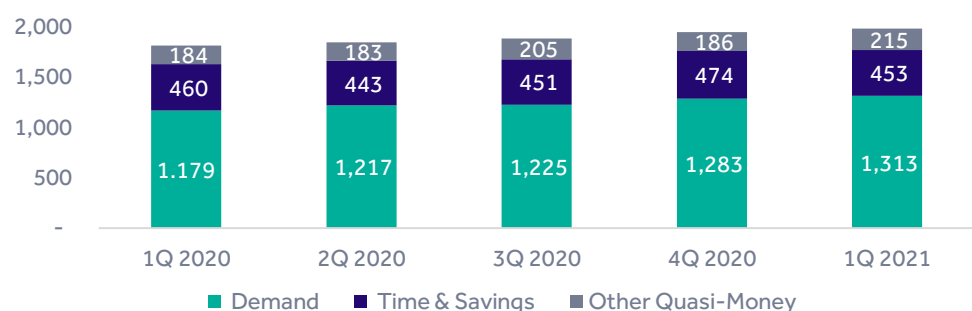
Source: Riyad Capital, SAMA

Rising Deposits

Total Deposits improved by +9% Y/Y in 1Q2021 to reach SAR 1,980 billion while Time & Savings deposits, still decreasing on a yearly basis, dropped by -2% Y/Y. Demand deposits are improving on a yearly basis and went up by +13% Y/Y. We believe that part of this growth is driven by the ongoing impact of the Saudi Central Bank's decision to enhance the liquidity of the banking sector by SAR 50 billion, as an activation of its monetary policy and to enhance the financial stability of the sector to face the challenges related to Covid-19.

As a result, Loan to Deposit Ratio (LDR) for the sector declined from 80% in March 2020 to 78% in March 2021.

Exhibit 3: Total Deposits growth 1Q2020 – 1Q2021 (SAR billion)



Source: Riyad Capital, SAMA

Continued support from SAMA

- The Saudi Central Bank announced the extension of the Deferred Payment Program, for three additional months to end on June 30, 2021.
- SAMA also announced the extension of the Guaranteed Financing Program for one year to end on March 14, 2022, as another support lever for MSMEs to help overcome challenges that arise from the COVID-19 preventive measures.

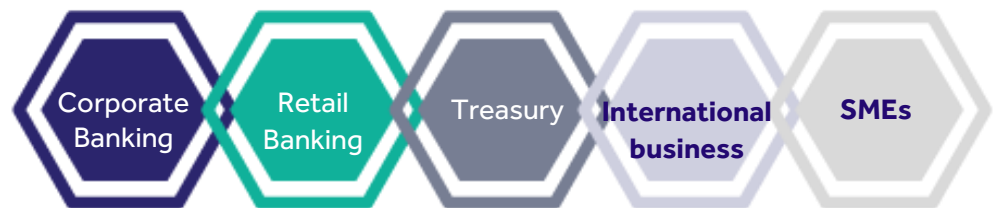
■ Company Overview

Al Rajhi Bank was established in 1957 and has grown to become the largest Islamic bank, the No.1 retail bank in the Middle East and Saudi Arabia's second largest bank, with total assets of SAR 512.2 bln as of 1Q2021, representing 20% of total Saudi banking assets. Al Rajhi Bank is the leading bank in the sharia-compliant industry which also includes Alinma Bank, Bank Albilad, and Bank AlJazira. In addition, it has an international presence in Malaysia (16 branches), Jordan (10 branches), and Kuwait (2 branches).

Business Model

The Bank's business is diversified across the following:

Exhibit 4: Al Rajhi Bank Business Model



Source: Riyad Capital, Company's Board Report 2020

Key Figures

Exhibit 5: Al Rajhi Bank's Key Figures



Source: Riyad Capital, Company's Board Report 2020

Future strategy and the new focus

Al Rajhi Bank is implementing a new strategy with a planning duration between 2021-2023. The new strategy is designed to spotlight two significant areas, maintaining the bank's leadership in retail banking services and shifting from the public sector to the private sector while continuing to build on its market-leading digital capabilities.

The bank continues to maintain its leadership in retail banking along with focusing on client needs. They have launched a finance company (Emkan), its purpose is to focus on the part that is not covered by the bank or micro-financing. Hence, they are the first in terms of personal and consumer financing through Emkan Co. with a portfolio of SAR 3.4 billion. Besides, they continue to focus more in improving customer experience, maintain payment and digital leadership.

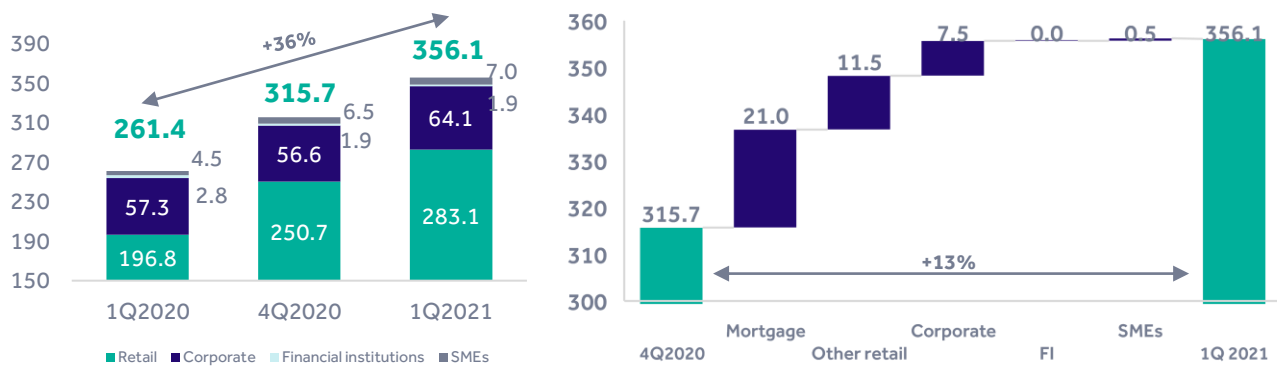
Strong Balance Sheet

Mortgage drives financing growth

Since one of the key objectives for the Housing Program, is to increase the homeownership percentage among Saudis from 47% in 2016 to 70% by 2030, key retail banks are working along with the Ministry of Housing and the real estate sector to meet this target. Thus, we witnessed a substantial growth in mortgage financing in the meantime in the sector, and we believe it will continue to grow through 2021-2022. Al Rajhi bank was one of the biggest beneficiaries of the growth in mortgage financing, their mortgage financing portfolio increased by +20% Q/Q in 1Q2021 to reach nearly SAR 121 bln, representing almost 34% of the total book and 43% of the retail book.

Total financing increased by +13% Q/Q and +36% Y/Y to reach SAR 356.1 bln in 1Q2021, as most of the growth was driven by the increase in mortgage financing.

Exhibit 6: Movement in Financing (SAR billion)

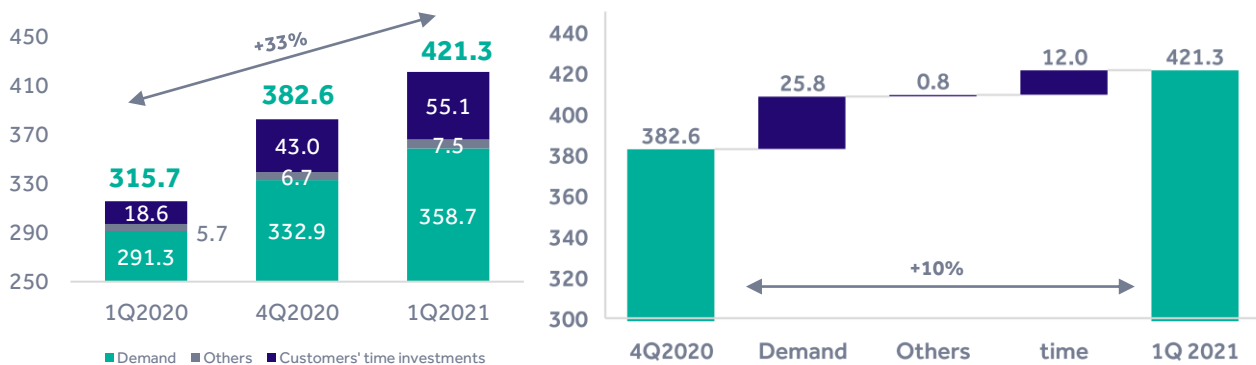


Source: Riyad Capital, 1Q2021 Results Presentation

Deposits reach SAR 421 bln

In 1Q2021, total deposits grew by +10% Q/Q and +33% Y/Y to reach SAR 421 bln. Demand deposits have always been the banks focus, which increased by +8% Q/Q and +23% Y/Y to reach SAR 359 bln, representing nearly 85% of Al Rajhi's total customer deposits and 27% of the total demand deposits in the banking sector, according to SAMA's Monthly Bulletin March 2021.

Exhibit 7: Movement in Deposits (SAR billion)



Source: Riyad Capital, 1Q2021 Results Presentation

As a result of these two factors, Loans to Deposits Ratio (LDR) reached 81%, which gives Al Rajhi Bank more room to grow its financing portfolio.

Cash levels allow ample room for dividends

As of 1Q2021, cash remains at a comfortable position reaching almost SAR 39 bln (up by +6% Y/Y, but lower by -19% Q/Q), hence, we believe these levels allow ample room for dividends in the future. We expect dividend will come back to 2019's level of SAR 3 per share in 2021, compared to SAR 1 per share in 2020 as its statutory reserves are in a comfortable position (SAR 25 bln which equals the paid-up capital).

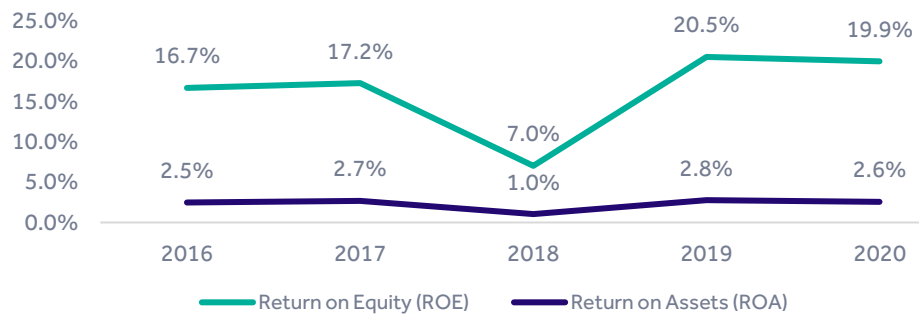
Highest RoE among peers

Al Rajhi Bank has the highest ROE for 2020 at 19.9% among its peers and compared to the sector's median ROE of 7.8% led by the good financial performance with a 5-year CAGR of 8% in net income.

Return on Assets at 2.6%

Similarly, Al Rajhi Bank has the highest ROA for 2020 at 2.6% among its peers and compared to the sector's median ROA of 1.3%. Higher ROA implies how good Al Rajhi is at using its assets efficiently. The bank is focused on improving its digital channels.

Exhibit 8: ROE and ROA movement through 2016-2020



Source: Riyad Capital, Company's Financial Reports

Current Accounts and Savings Accounts (CASA)

Al Rajhi Bank has one of the highest CASA ratios in the sector at nearly 86% in 2020. A higher CASA ratio indicates a lower cost of funds (banks don't regularly give any interests on current account deposits). Therefore, Al Rajhi Bank gets a large portion of their funds at a relatively lower cost vs peers, eventually, this leads to a higher net interest margin.

To sum up, all of these strong balance sheet metrics, will allow Al Rajhi Bank to retain more risk thus more allow for more financing (even on the corporate finance side) and result in growth opportunities.

■ Solid Income Statement

Net Financing and Investment Income

Net financing and investment income increased by +3% Q/Q and +16% Y/Y to reach SAR 4.8 bln in 1Q2021, due to the increasing activity in the lending, especially the retail sector (mortgages) along with the expansion of its market share, recording the highest yearly growth rate since the beginning of 2019, which we believe is a good start for 2021 financials.

Non-Core income

Non-core income improved by +2% Q/Q and +39% Y/Y to reach SAR 1.2 bln in 1Q2021, largely due to increasing income from Al Rajhi Capital's brokerage fees.

As a result, total operating income enhanced by +3% Q/Q and +20% Y/Y to reach SAR 5.9 bln last quarter.

Provisions

On a yearly basis, provisions declined by -17% to reach SAR 577 mln in 1Q2021. The decrease in provisions came as a result of a reduction of -94% Y/Y in the corporate segment's provisions reaching SAR 24 mln in 1Q2021, compared to SAR 418 mln in 1Q2020 while retail segment's provisions increased to reach SAR 544 mln during 1Q2021, compared to SAR 273.2 mln in the same period last year.

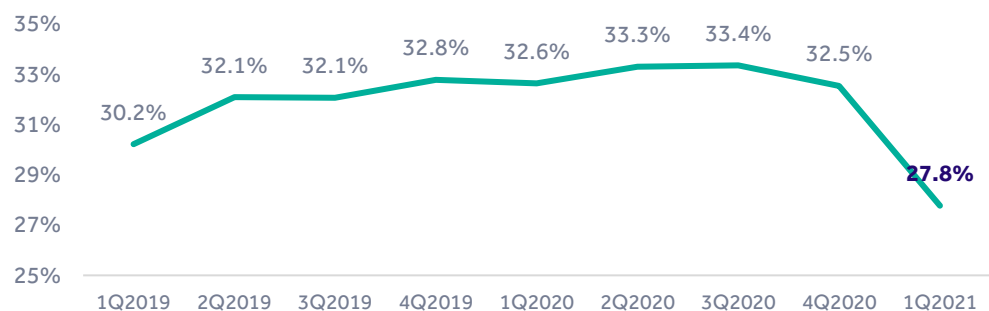
Total Operating Expenses

Total operating expenses decreased by -4% on both Q/Q and Y/Y to reach SAR 2.2 bln in 1Q2021. Although, salaries increased by +3% Y/Y but they remained almost flat Q/Q. Salaries comprise an average of 34% of total Opex in the past two years.

Cost to Income Ratio

Al Rajhi bank managed to reduce the Cost to Income ratio from 32.6% last year to 27.8% in the 1Q2021 (one of the lowest ratios in the sector), we believe this reflects the management approach in improving digital banking and the bank intends to maintain the ratio below 30% during this year, which we assume it can be applied through optimizing the cost and generating higher income (revised down from below 31%).

Exhibit 9: C/I movement from 1Q2019



Source: Riyad Capital, Company's Financial Reports

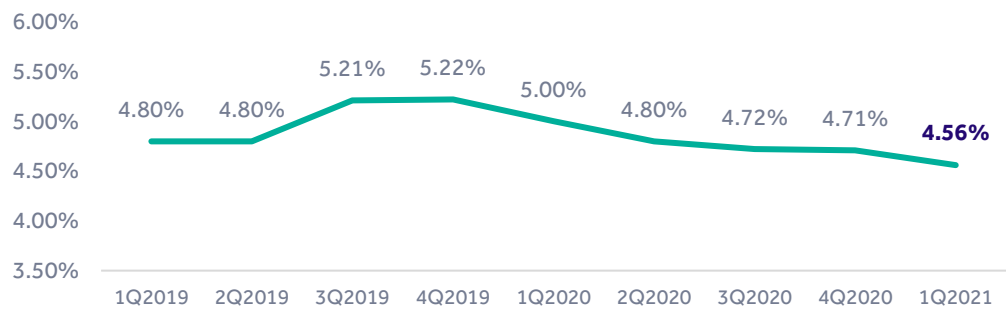
Net Income

Al Rajhi Bank achieved the highest quarterly earnings of SAR 3.3 bln (+7% Q/Q, +40% Y/Y). Therefore, its share increased from 24% last year to 28% of the Saudi banking sector's net income this quarter (the second largest bank after Saudi National Bank). This was driven from both net-yield income and non-core income.

Net Interest Margin (NIM)

Net Interest Margin witnessed a downtrend from 4Q2019, as a result of slow rate-cut repricing by SAMA. Meanwhile, we assume NIM will resumed its downtrend, since Saudi Real Estate Refinance Company (SRC) has reduced the mortgage reference rate, which was effective on 1st of April coupled with lower SAIBOR rate environment. Yet, we believe that Al Rajhi has a chance in mitigating NIM shrinkage in the future by increasing the weight of non-profit bearing deposits in total deposits, as well as improving their retail financing portfolio especially the fixed-rate one.

Exhibit 10: NIM movement from 1Q2019



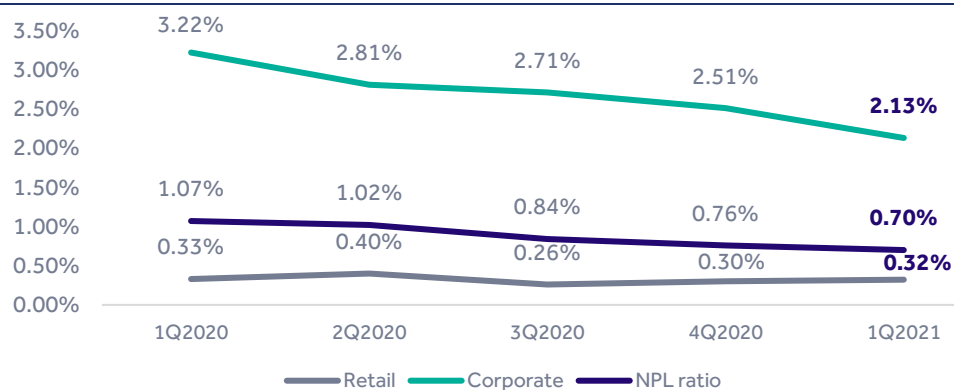
Source: Riyad Capital, Company's Financial Reports

■ Asset Quality and Liquidity

Non-performing loan ratio (NPL)

NPL ratio witnessed some improvement, decreasing to 0.70% in 1Q2021, compared to 1.07% in 1Q2020 and 0.76% in 4Q2020 (lowest NPL ratio in the sector), making this the second consecutive year that the Bank has recorded an improvement in ratio. Corporate NPL followed a similar trend as well to reach 2.13% in 1Q2021, while Retail NPL was lower Y/Y but higher Q/Q reaching 0.32%. We believe this can be justified due to the growth in retail loans (increased by +13% Q/Q). Thus, the quality of their loan portfolios among banks is considered strong.

Exhibit 11: NPL ratio movement from 1Q2020

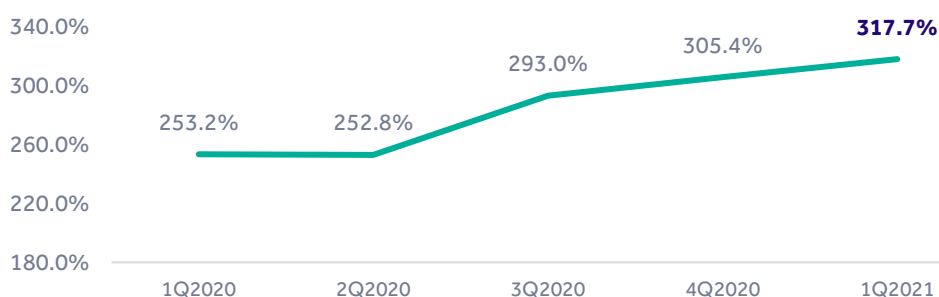


Source: Riyad Capital, Company's 1Q 2021 Results Presentation

Non-performing loan Coverage (NPL)

Al Rajhi has a very strong coverage ratio of almost 318% in 1Q2021, compared to 253% in 1Q2020 and 305% in 4Q2020 (best-in-class in the banking sector), which offers a strong capacity for Al Rajhi to absorb any unexpected loan losses.

Exhibit 12: NPL coverage movement from 1Q2020



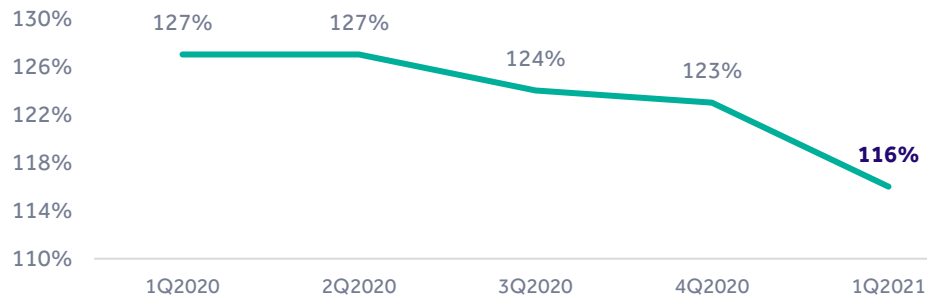
Source: Riyad Capital, Company's 1Q 2021 Results Presentation

To conclude, we believe that Al Rajhi has managed to maintain a good asset-quality in their financials.

Net stable funding ratio (NSFR)

NSFR it's a long-term liquidity risk management measure to ensure a stable funding structure within banks, Rajhi`s NSFR in 1Q2021 is at 116%, it's lower than 127% in 1Q2020 and 123% in 4Q2020, yet higher than 100% (the minimum requirement under Basel III).

Exhibit 13: NSFR movement from 1Q2020

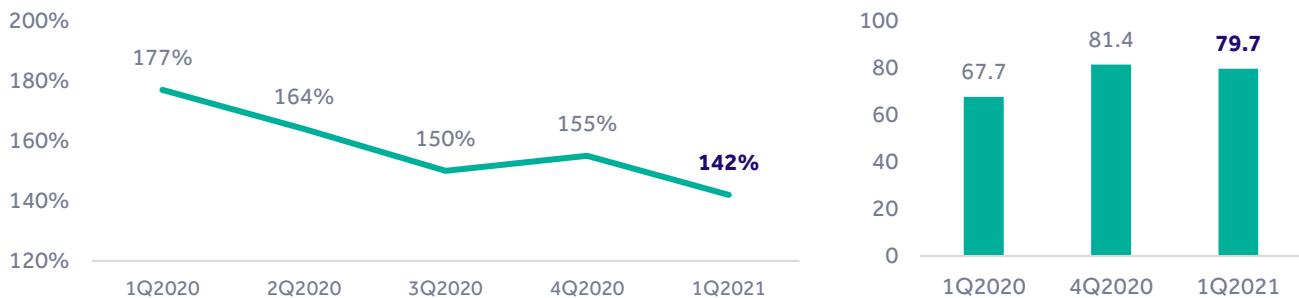


Source: Riyad Capital, Company's 1Q 2021 Results Presentation

Liquidity coverage ratio (LCR) and High-quality liquid assets (HQLA)

LCR took a downtrend from 177% in 1Q2020 to 142% in 1Q2021 but until now it is still in a healthy position. While HQLA improved by +18% Y/Y, to rise from SAR 67.7 bln 1Q2020 to SAR 79.7 bln in 1Q2021, but declined compared to SAR 81.4 bln in 4Q2020.

Exhibit 14: LCR and HQLA movement from 1Q2020 (% / SAR billion)



Source: Riyad Capital, Company's 1Q 2021 Results Presentation

All the liquidity ratios mentioned above for Al Rajhi Bank, are higher than 100% and remain securely within regulatory requirements.

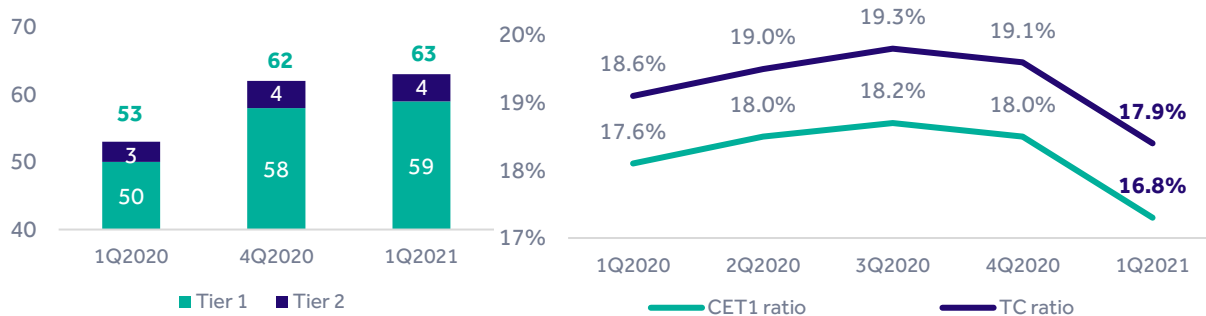
Capital Adequacy

Total Capital

The capital adequacy ratio (CAR) of Saudi banks are one of the highest in the world, exceeding the 8% requirement under Basel III and the threshold of the Saudi Central Bank (SAMA). For 1Q2021, the Saudi banks' CAR increased to 20.4%, according to Argaam.

For Al Rajhi, total capital increased by +2% Q/Q and +19% Y/Y to reach SAR 63 Bln in 1Q2021, consisting of SAR 59 bln as Tier 1 capital and SAR 4 bln as Tier 2 capital. Therefore, the bank had a strong CET1 ratio at 16.8% and CAR at 17.9%. In addition, capital is in a comfortable position beside an easier statutory reserving requirement suggesting higher dividend capacity in the future.

Exhibit 15: Capital Breakdown (SAR billion/%)



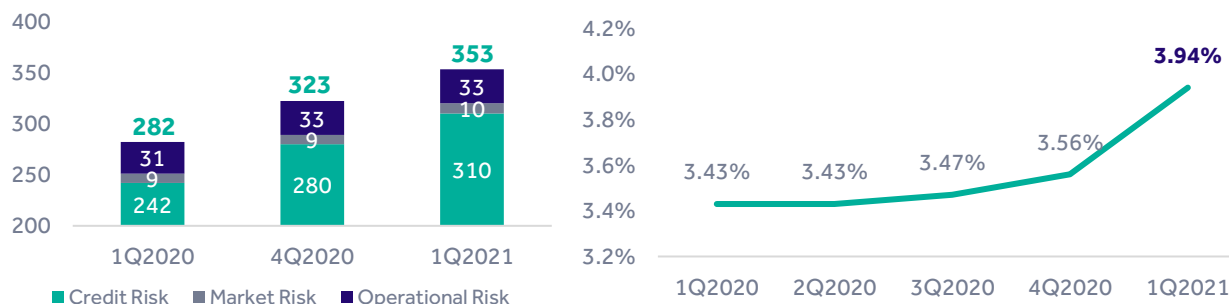
Source: Riyad Capital, Company's Financial Reports

Risk weighted assets (RWA) and return on RWA (RORWA)

Total RWA has increased by +10% Q/Q and +25% Y/Y to reach SAR 353 bln in 1Q2021, mainly driven by the increase in the credit risk while Market and Operational risks remain almost flat both Q/Q and Y/Y.

However, in terms of return, return on RWA kept improving over the quarters reaching 3.94% in 1Q2021 which is considered healthy, given that mortgage lending represents a good portion of the overall financing book.

Exhibit 16: RWA Breakdown and RORWA (SAR billion/%)



Source: Riyad Capital, Company's 1Q 2021 Results Presentation

■ Valuation

We have valued Al Rajhi Bank on the basis of justified price-to-book ratio (P/B). We used 0.96 as a raw beta obtained from Bloomberg and a Cost of Equity of 9.2%. We arrived at long-term growth at 5.9%, by using Return on Equity at 21.8% and a retention ratio of 27.1%. Our justified P/B come in at 4.88x. Our assumptions are illustrated below:

Table 2: Justified Price to Book Valuation

Cost of Equity	
Risk free rate	2.7%
Risk Prem	6.8%
Beta	0.96
CoE	9.2%
P/B	
Justified P/B	4.88x
Avg. BVPS	24.55
Fair value per share	119.85

Source: Riyad Capital

Investment Thesis

- Largest Islamic bank globally and Saudi's second largest bank
- Roll-out of the vaccine is likely to spur economic growth
- Possible decrease in VAT from current level is expected to positively impact financing growth within banks

Investment Risks

- Negative developments on the economic front, decline in interest rates or adverse regulatory requirements
- Lower than expected Financing growth or unfavorable shift in the deposit mix

Using our preferred valuation method, we arrive at a fair value of SAR 119.85 for Al Rajhi Bank. Thus, we raise our target price from SAR 90.00 to SAR 120.00 and upgrade our recommendation to Buy.

■ Stock Rating

Buy	Neutral	Sell	Not Rated
Expected Total Return Greater than +15%	Expected Total Return between -15% and +15%	Expected Total Return less than -15%	Under Review/ Restricted

* The expected percentage returns are indicative, stock recommendations also incorporate relevant qualitative factors

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