

Initiation Coverage

February 22, 2018

Recommendation	Underweight
Current Price (SAR)	20.2
Target Price (SAR)	17.5
Upside/Downside (%)	(13.4%)

As of February 21, 2018

Key Data (Source: Bloomberg)

Market Cap (SAR bn)	30.4
52 Wk High (SAR)	20.9
52 Wk Low (SAR)	14.0
Total Outstanding shares (in mn)	1,490.0
Free Float (%)	73.8%

Alinma Vs TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	(1.6%)	(1.5%)
6m	23.2%	18.4%
12m	37.7%	28.3%

Major Shareholders (%)

General Retirement Organization	10.71
Public Investment Fund	10.00
General Organization for Social Insurance	5.10

Net investment and financing income (SAR mn) and NIM (annualized)



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 22nd February 2018

In FY 2017, Alinma Bank (Alinma)'s net financing and investment income grew 31.7% YoY to SAR3.5mn, led by 23.6% YoY and 200.8% YoY growth in financing income and income from sukuk, respectively. The bank's net income came in 33.9% YoY higher at SAR 2.0mn in FY 2017, vis-à-vis SAR 1.5mn in FY16, despite a considerable rise in impairment charges. This was ascribed to significant growth in all the operating segments.

In spite of substantial growth in net profit, Alinma's RoE is at 10.1%, much lower than the peer median of 13% in FY17. Moreover, considering the bank's risky asset concentration, challenges in the IFRS 9 implementation, additional zakat liability, and current run-up in stock price (+15.5% over last three months), we recommend a sell rating with a target price of SAR 17.5 per share.

Decline in credit and deposit growth amid economic uncertainty:

Oil price volatility led to a muted deposit growth in the country, thereby raising liquidity concerns in the banking sector. Alinma's deposit growth moderated to 10.5% YoY to SAR 89.1bn in 2017, vis-à-vis 22.7% YoY a year ago. Additionally, the credit growth of the bank declined 12.4% YoY to SAR 79.1bn in FY 2017 (FY 2016: 23.3% YoY), weighed by weak industrial activity. Although the outlook for the Saudi banking sector remains stable, given strong capital buffers and increased capital spending, we believe loan and deposit growth is expected to drop further in 2018, dragged down by economic uncertainty. Furthermore, the Saudi government is expected to issue additional sukuk bonds in FY 2018 to finance its fiscal deficit, likely to impact growth in customer deposits.

Adapting to IFRS 9 standards remains a challenge:

IFRS 9, scheduled to be implemented from January 2018, mandates banks adopt a more proactive approach to provisioning based on future expected loss. This may reduce banks' retained earnings as they are likely to resort to higher provisioning on the expectation of future loss. Alinma projects its Tier 1 ratio to decline due to strict financial standards, with the net impact of the capital adequacy ratio to be less than 1%. Despite a low impact on capital adequacy ratios, adapting and successfully implementing the IFRS 9 standard remains a challenge.

Additional zakat levy may hurt bottom line:

Saudi General Authority of Zakat & Tax (GAZT) recently applied a new accounting method on long-term bank investments. Accordingly, the authority has mandated banks to pay an additional zakat levy for prior periods. Alinma Bank has been advised to pay an additional zakat of SAR 1.65bn for the period of 2009–15. The bank has not allocated any provisions to meet the requirement and is yet to announce its stance on whether to abide by the authority or contest its decision before the Appeal Committee. However, in the event of payment of an additional levy, the bank's bottom line and net profit margin are expected to be negatively impacted.

Asset concentration remains challenge; low NPLs a key positive:

Although Alinma's asset quality remains high with an NPL ratio of 1.0%, we believe the bank's asset concentration in comparatively risky sectors, such as real estate, contracting, and commercial (37.4% of the bank's financing assets as of FY 2017), may expose it to unexpected shocks in the event of economic downturn.

Valuation: We valued Alinma using the weighted average approach (Residual Income and P/B) to arrive at a fair value of SAR 17.5 per share. We considered the cost of equity at 10.7%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E
Net financing and investment income (SAR bn)	3.5	4.2	4.4	4.8
Operating income (SAR bn)	4.4	5.2	5.5	6.1
EPS (SAR)	1.3	1.6	1.9	2.1
Net Interest Margin (%)	3.5%	3.8%	3.7%	3.8%
Cost to income (%)	39.9%	41.9%	42.0%	42.0%
RoE (%)	10.1%	11.5%	12.8%	13.1%
P/B (x)	1.5	1.4	1.3	1.2
NPL (%)	1.0%	1.0%	1.1%	1.2%
Provision coverage (%)	184.7%	189.7%	189.7%	189.7%

Source: Company Financials, FALCOM Research

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Valuation Summary

Explanation of valuation methodology and assumptions

We valued Alinma using the weighted average method, with equal weightage given to RI and P/B approach to arrive at a fair value of SAR 17.5 per share. We considered cost of equity at 10.7% with a terminal growth rate of 2.0%. In relative terms, Alinma is trading at 1yr forward P/B of 1.5x, at a discount of 0.7% to its sector peers and discount of 5.2% to the Tadawul All Share Index.

Residual Income valuation

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E	
Net income for the year	2,011	2,443	2,899	3,194	3,329	
Beginning book value	19,178	20,597	21,776	23,412	25,341	
Cost of equity	10.7%	10.7%	10.7%	10.7%	10.7%	
Equity charge	(2,059)	(2,211)	(2,337)	(2,513)	(2,720)	
Excess equity return	(47)	232	562	681	609	
Ending book value	20,597	21,776	23,412	25,341	27,406	
Discount Factor		0.9	0.8	0.7	0.7	
Discounted returns (including terminal value)		213	465	508	4,196	
PV of cash flows (A)					5,382	
Beginning book value (B)					20,597	
Assumed Terminal Growth Rate					2.0%	
Equity Value (A+B)	25,979	Cost of Equity Assumptions				
Number of shares in mn	1,490	Risk free rate				2.6%
Target Price in SAR per share	17.44	Beta				0.875
CMP in SAR as on February 21st, 2018	20.24	Country risk premium (US)				2.0%
Upside/(Downside) to current market price	-13.9%	Saudi spread				7.3%
		Cost of equity				10.7%

P/B Valuation		Weighted average Valuation	Weighted average price
Exit Year	2018	RI Valuation	8.72
Normalized ROE	12.5%	P/B valuation	8.80
Cost of Equity	10.73%	Weighted average fair price	17.52
Terminal growth rate	2.00%	Upside/(Downside) %	-13.4%
Justified P/B	1.20		
BVPS	14.61		
Target Price	17.61		
Upside/downside	-13.0%		

Risks

Upside Risks:

- Sharp uptick in economic growth will result in greater than expected increase in top line.
- Easing of geopolitical tension will lead to higher money inflow within the banking sector.

Downside Risks

- Any downward movement in oil prices would hurt economic growth which in turn will have a negative impact on credit growth.
- Customer deposits might face competition from government issued sukuk bonds.
- Loan quality may deteriorate due to weaker than expected economic growth.

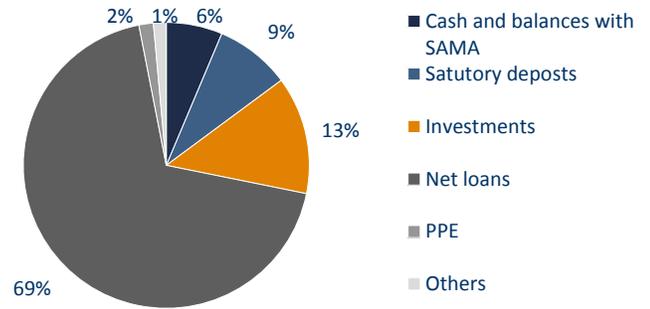


Key Charts

Net Financing and Investment Income (SAR bn) and NIM



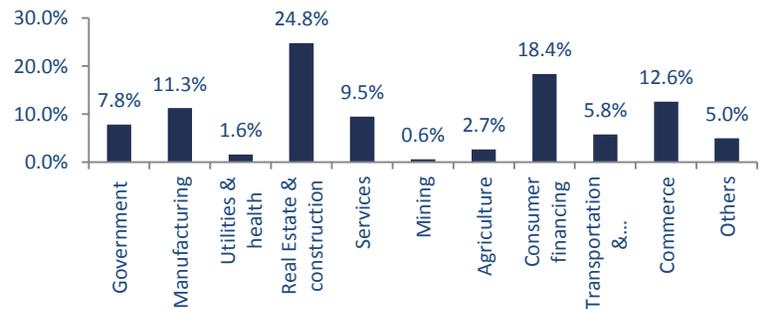
Asset break-up (2017)



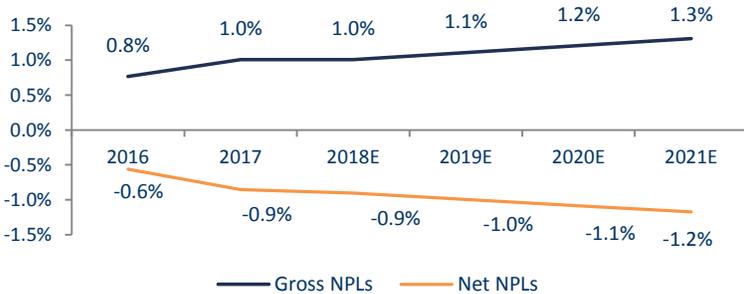
Investment Yield



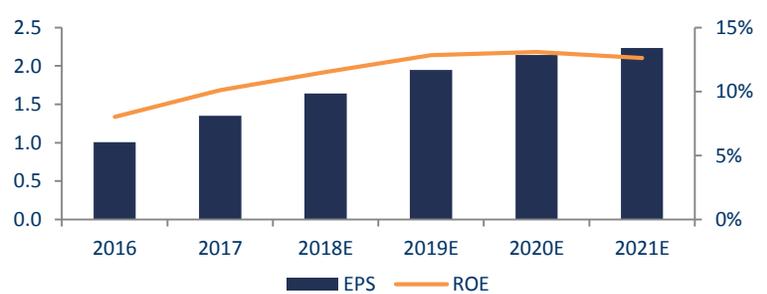
Asset concentration by sectors (2017)



Gross and Net NPLs



EPS and ROE



P/B



Dividend Yield



Source: FALCOM Research Estimates



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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Net financing and investment income	3,493	4,188	4,404	4,837
Fee income	676	739	802	863
Total operating income	4,373	5,179	5,518	6,086
Total operating expenses	(1,745)	(2,170)	(2,319)	(2,556)
Pre-provision profit	2,628	3,009	3,199	3,531
Impairment charge for financing, net	(558)	(503)	(228)	(257)
Net Income	2,011	2,443	2,899	3,194
EPS	1.3	1.6	1.9	2.1
DPS	0.8	0.8	0.8	0.8

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	7,299	7,612	7,189	6,733
Due from banks	9,789	9,985	10,184	10,388
Investments	15,320	17,618	20,260	23,299
Financing, net	79,063	85,976	92,419	99,542
Total assets	115,005	124,927	133,995	144,134
Due to banks	1,353	1,421	1,492	1,566
Customer deposits	89,065	97,700	105,022	113,116
Total liabilities	94,408	103,151	110,584	118,793
Shareholder equity	20,597	21,776	23,412	25,341
Total liabilities and equity	115,005	124,927	133,995	144,134

Solvency	2017	2018E	2019E	2020E
Credit risk weighted assets	95,891	104,163	111,725	120,178
Operational risk weighted assets	6,727	7,308	7,838	8,431
Market risk weighted assets	870	945	1,014	1,091
Total risk weighted assets	103,488	112,416	120,577	129,700
Tier I capital	20,597	21,776	23,412	25,341
Tier II capital	884	960	1,030	1,108
Total tier I and tier II	21,481	22,737	24,442	26,449

Valuation	2017	2018E	2019E	2020E
PE	15.0x	12.3x	10.4x	9.4x
PB	1.5x	1.4x	1.3x	1.2x
Dividend Yield	4.0%	3.9%	3.9%	3.8%

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Operating income	31.4%	18.4%	6.5%	10.3%
Pre-provision profit	43.8%	14.5%	6.3%	10.4%
Net income	33.9%	21.5%	18.7%	10.1%
Loan growth	12.4%	8.7%	7.5%	7.7%
Deposit growth	10.5%	9.7%	7.5%	7.7%

Ratios (%)	2017	2018E	2019E	2020E
Yield on earning assets	4.3%	4.6%	4.6%	4.7%
Cost of funds	0.9%	0.9%	1.1%	1.1%
Spread (Yield-Costs)	3.4%	3.7%	3.6%	3.6%
Net Interest Margin	3.5%	3.8%	3.7%	3.8%
Cost/Income (%)	39.9%	41.9%	42.0%	42.0%
ROE	10.1%	11.5%	12.8%	13.1%
ROA	1.8%	2.0%	2.2%	2.3%
Loans/ Customer Deposits	88.8%	88.0%	88.0%	88.0%
Loans/Total Assets	68.7%	68.8%	69.0%	69.1%
Customer Deposits/Total Funding	94.3%	94.7%	95.0%	95.2%
RWA/Total Assets	90.0%	90.0%	90.0%	90.0%
Tier I ratio	19.9%	19.4%	19.4%	19.5%
Capital adequacy ratio	20.8%	20.2%	20.3%	20.4%
Gross NPLs	1.0%	1.0%	1.1%	1.2%
Net NPLs	-0.9%	-0.9%	-1.0%	-1.1%
Provision coverage	184.7%	189.7%	189.7%	189.7%

Peer Valuations	12M Fwd PB	12m Fwd PE
Al Rajhi Bank	2.0x	12.3x
Bank Al-Jazira	NA	8.4x
Bank Albilad	NA	11.2x
Sharjah Islamic Bank	0.6x	8.9x
Abu Dhabi Islamic Bank	1.2x	11.4x
Dubai Islamic Bank	1.6x	7.9x
Qatar Islamic Bank	1.5x	11.2x
Kuwait Finance House	1.7x	14.4x
Alinma Bank	1.46	13.75
Sector Median	1.47	10.76
TASI	1.54	13.57

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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