

Al Rajhi Bank

Rising cost of funds pressurized overall margins and profit

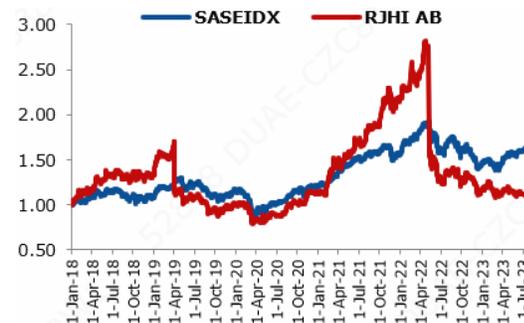
Current Price
SAR 71.40

Target Price
SAR 82.00

Upside/Downside (%)
+14.8%

Rating
ACCUMULATE

- Net financing rose marginally 0.4% QOQ to SAR 579 Bn due to additional financing to mortgages, corporate and SME sector
- Customer deposit rose 2.6% QOQ to SAR 571 Bn with a CASA ratio of 66%. The strong growth also led to a decline in the regulatory loan-to-deposit ratio from 87.8% in 1Q23 to 81.9% in 2Q23
- NIMs stood flat at 2.76% in 2Q23 as compared to 1Q23 growth in asset yield offset rise in cost of funds
- The Bank revised its 2023 expectation lower and expects NIMs to decline 40-50 bps in 2023 as compared to 2022, the cost-to-income amount below 27.5%, generate an ROE below 19% with cost of risk of 0.20-30% in 2023



Stock Information

Market Cap (SAR, mm)	284,800.00
Paid Up Capital (mm)	40,000.00
52 Week High	92.80
52 Week Low	69.00
3M Avg. daily value(SAR)	337,943,800

2Q23 Net Profit in line with our estimates

Al Rajhi Bank's ("ALRAJHI", "The Bank") net profit declined 2.5% YOY to SAR 4,150 Mn in 2Q23, in line with our estimate of SAR 4,193 Mn. The decline in net profit is attributable to a fall in net-funded income and a marginal rise in operating expenses partially offset by an increase in non-funded income and a decline in impairments.

P&L Highlights

ALRAJHI's financing and investing income increased 43.5% YOY to SAR 9,296 Mn in 2Q23 driven by an increase in interest-earning assets and rise in asset yield. On the other hand, financing and investment expense rose significantly from SAR 913 Mn in 2Q22 to SAR 4,102 Mn in 2Q23 due to an increase in the cost of funds owing to higher benchmark rates. Thus, net funded income declined 6.7% YOY to SAR 5,194 Mn in 2Q23. The rising cost of fund's pressurized ALRAJHI's NIMs YOY in 2Q23. Fee and banking services income declined 2.9% YOY to SAR 1,129 Mn in 2Q23 whereas exchange income fell 5.4% YOY to SAR 291 Mn. Moreover, Other operating income almost doubled to SAR 214 Mn in 2Q23, up from SAR 111 Mn in 2Q22. Thus, the Bank's total non-funded income rose 3.3% YOY to SAR 1,634 Mn in 2Q23. As a result, total operating income declined 4.5% YOY to SAR 6,827 Mn in 2Q23. Moreover, operating expenses grew 1.1% YOY to SAR 1,840 Mn in 2Q23 due to an increase in salary and employee-related expenses and depreciation expenses partially offset by a decline in G&A expenses. Thus, the cost-to-income ratio increased 149 bps YOY to 27.0% in 2Q23. Furthermore, impairment charges declined 37.9% YOY to SAR 360 Mn in 2Q23. Likewise, zakat expenses declined 2.4% YOY to SAR 477 Mn in 2Q23.

2Q23 Result Review (SAR, mm)

Total Assets	784,520
Total Liabilities	681,333
Total Equity	103,187
Total Deposits	570,665
Net Profit	4,150

Financial Ratios

Dividend Yield (12m)	3.23
Dividend Pay-out (%)	29.15
Price-Earnings Ratio(x)	17.19
Price-to-Book Ratio (x)	3.29
Book Value (SAR)	21.67
Return-on Equity (%)	20.51

Stock Performance

5 Days	-5.07%
1 Months	-1.79%
3 Months	-5.07%
6 Months	-8.95%
1 Year	-17.40%
Month to Date (MTD%)	-4.56%
Quarter to Date (QTD%)	-2.47%
Year to Date (YTD%)	-5.32%

Balance Sheet Highlights

ALRAJHI's net advances recorded a strong growth of 11.4% YOY and 0.4% QOQ to SAR 579.1 Bn in 2Q23. Net financing growth was mainly driven by 13.6% YOY growth in mortgage and 36.7% YOY growth in non-retail financing. The loan-to-deposit ratio of 101.5% in 2Q23 as compared to 103.7% in 1Q23. Total assets increased 10.6% YOY and 1.1% QOQ to SAR 784.5 Bn in 2Q23. Moreover, customer deposits rose 3.2% YOY and 2.6% QOQ to SAR 570.7 Bn in 2Q23. Demand deposits witnessed a decline in 2Q23 while time and other deposits increased. Total equity rose 26.0% YOY and 4.0% QOQ to SAR 103.2 Bn in 2Q23.

Target Price and Rating

We maintain our ACCUMULATE rating on AL Rajhi with a target price of SAR 82.00. The Bank recorded a healthy growth in deposits which rose 2.6% QOQ to SAR 571 Bn in 2Q23. This led to a decline steep decline in regulatory advances' loan-to-deposit ratio from 87.8% in 1Q23 to 81.9% in 2Q23. The decline provides enough headroom to grow advances going forward. ALRAJHI NIM continued to fall since 2021 however it remained flat in 2Q23 as compared to 1Q23 supported by healthy growth in CASA deposits. Al Rajhi's asset quality remained stable with an NPL ratio of 0.6% as compared to the previous quarter. However, the coverage ratio moderated to 225.0% in 2Q23 as compared to 230.4% in 1Q23. The bank is expected to incur a cost of risk of 0.20-0.30% in 2023 as compared to the previous expectation of 0.30-0.40%. The Bank maintained a healthy capitalization with a CET 1 ratio of 20.5% and a total CAR of 21.7% in 2Q23. However, we remained concerned about loan growth as the loan growth slowed down in the last two quarters. The Bank expects loan to grow in mid-single digit in 2023. The mortgage growth is expected to slow down due to the introduction of new mechanism and higher interest rates too will have a negative impact on loan growth. Thus, considering the above-mentioned factors, we assign a ACCUMULATE rating on the stock.

Al Rajhi Bank - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	30.6	28.1	27.0	19.4	16.8	16.8
PB	6.4	6.0	4.9	4.2	3.6	3.1
Dividend yield	2.4%	2.6%	0.9%	1.2%	1.8%	3.2%

FABS Estimates & Co Data

Al Rajhi Bank - P&L

SAR mm	2Q22	1Q23	2Q23	2Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Financing and Invst. Income	6,480	8,768	9,296	9,064	2.6%	43.5%	6.0%	28,202	36,974	31.1%
Financing and Invst. Expense	-913	-3,643	-4,102	-3,735	9.8%	349.2%	12.6%	-6,029	-15,115	150.7%
Net Financing and Inv. Inc.	5,567	5,125	5,194	5,329	-2.5%	-6.7%	1.3%	22,173	21,859	-1.4%
Fees fr. Banking service, net	1,163	1,210	1,129	1,246	-9.4%	-2.9%	-6.7%	4,624	5,318	15.0%
Exchange income, net	308	298	291	313	-7.0%	-5.4%	-2.4%	1,162	1,278	10.0%
Other operating income	111	148	214	153	39.7%	93.5%	45.3%	616	665	8.0%
Total non-funded income	1,581	1,655	1,634	1,712	-4.6%	3.3%	-1.3%	6,402	7,261	13.4%
Net operating income	7,148	6,781	6,827	7,042	-3.0%	-4.5%	0.7%	28,575	29,121	1.9%
Salaries & emp. related exp.	-804	-872	-885	-900	-1.6%	10.1%	1.5%	-3,395	-3,667	8.0%
Other G&A expenses	-674	-565	-573	-593	-3.5%	-15.0%	1.4%	-2,726	-2,508	-8.0%
D&A expenses	-342	-363	-382	-283	34.9%	11.6%	5.2%	-1,330	-1,330	0.0%
Total ope. exp. Before credit impairment	-1,820	-1,800	-1,840	-1,776	3.6%	1.1%	2.2%	-7,451	-7,505	0.7%
Profit before provision	5,328	4,980	4,988	5,266	-5.3%	-6.4%	0.1%	21,124	21,616	2.3%
Impairment charge	-580	-359	-360	-591	-39.0%	-37.9%	0.4%	-2,001	-2,398	19.8%
Total operating expenses	-2,401	-2,159	-2,200	-2,367	-7.1%	-8.3%	1.9%	-9,452	-9,902	4.8%
Net income before zakat	4,747	4,622	4,627	4,675	-1.0%	-2.5%	0.1%	19,123	19,218	0.5%
Zakat	-489	-477	-477	-481	-0.9%	-2.4%	0.1%	-1,972	-1,979	0.4%
Net profit for the year	4,258	4,145	4,150	4,193	-1.0%	-2.5%	-5.9%	17,151	17,239	0.5%

FABS estimate & Co Data

Riyad Bank - KPI

	2Q22	1Q23	2Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Net FI/OI	77.9%	75.6%	76.1%	-181	48	77.6%	75.1%	-253
NIM	3.4%	2.8%	2.8%	-64	0	3.3%	2.9%	-43
NIS	3.3%	2.4%	2.4%	-91	-3	3.2%	2.6%	-57
Fees & comms/OI	16.3%	17.8%	16.5%	26	-131	16.2%	18.3%	208
Exchange Income/OI	4.3%	4.4%	4.3%	-4	-13	4.1%	4.4%	32
Cost to income	25.5%	26.5%	26.9%	148	40	26.1%	25.8%	-30
Impairment/PPP	-10.9%	-7.2%	-7.2%	367	-2	-9.5%	-11.1%	-162
NP/OI	59.6%	61.1%	60.8%	121	-35	60.0%	59.2%	-82
ROAA	2.4%	2.2%	2.2%	-18	-5	2.5%	2.2%	-28
ROAE	22.0%	21.3%	20.1%	-186	-113	23.5%	20.3%	-318

FABS estimate & Co Data

Riyad Bank - Key B/S items

SAR mm	2Q22	3Q22	4Q22	1Q23	2Q23	
Net advances	519,701	557,498	568,338	577,011	579,080	11.4%
QOQ ch	7.3%	7.3%	1.9%	1.5%	0.4%	
Total assets	709,278	740,627	761,649	776,196	784,520	10.6%
QOQ ch	7.9%	4.4%	2.8%	1.9%	1.1%	
Customer deposits	552,957	555,767	564,925	556,197	570,665	3.2%
QOQ ch	8.9%	0.5%	1.6%	-1.5%	2.6%	
Total equity	81,913	86,101	100,225	99,227	103,187	26.0%
QOQ ch	4.5%	5.1%	16.4%	-1.0%	4.0%	

FABS estimate & Co Data

Valuation:

We use Residual Income and Relative Valuation (RV) method to value Al Rajhi. We have assigned 70% weight to Residual Income, and 30% to RV method.

Valuation Method	Target	Weight	Weighted Value
Residual Income	83.91	70.0%	58.74
Relative Valuation (RV)	77.55	30.0%	23.26
Weighted Average Valuation (SAR)			82.00
Current market price (SAR)			71.40
Upside/Downside (%)			+14.8%

1) Residual Income Method:

We have discounted the economic profit/excess equity using the cost of equity of 8.12%. Cost of equity is calculated by using 10-year government bond yield of 4.7%, beta of 1.0 and equity risk premium of 3.4%. Government bond yield is calculated after adding KSA 10-year CDS spread over 10-year US risk-free rate. Also, assumed a terminal growth rate of 2.0%.

Sum of PV (SAR, Mn)	49,202
Terminal value (SAR, Mn)	199,769
Book Value of Equity (as of March 2023)	86,687
FV to Common shareholders (SAR, Mn)	335,659
No. of share (Mn)	4,000
Current Market Price (SAR)	72.00
Fair Value per share (SAR)	83.91

Residual Income Method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Net Profit	17,048	18,829	22,178	25,263	28,685
(-) Equity Charge	-7,405	-8,205	-9,212	-10,307	-11,355
Excess Equity	6,428	10,625	12,966	14,956	17,330
Discounting Factor	0.95	0.88	0.81	0.75	0.69
Present Value of Excess Equity	6,102	9,325	10,524	11,225	12,027

Source: FAB Securities

2) Relative Valuation:

We have used local peers to value Al Rajhi and it is valued using the PB multiple. We have applied a premium and valued at a PB multiple of 3.4x.

Company	Market (USD Mn)	P/B (x)		P/E (x)		Dividend Yield (x)	
		2023F	2024F	2023F	2024F	2023F	2024F
Alinma Bank	16,736	2.3	2.2	17.6	14.1	3.1	3.9
Bank Albilad	10,887	3.0	2.7	19.5	15.4	1.2	1.4
Riyad Bank	11,303	1.9	1.8	12.8	12.1	4.0	4.2
Banque Saudi Fransi	12,399	1.4	1.2	13.6	10.5	4.1	4.9
Arab National Bank	10,613	1.3	1.2	12.8	11.0	4.1	4.8
Saudi National Bank	58,925	1.5	1.3	12.4	12.0	4.5	4.1
Average		1.9x	1.7x	14.8x	12.5x	3.5%	3.9%
Median		1.7x	1.6x	13.2x	12.0x	4.0%	4.2%
Max		2.2x	2.1x	16.6x	13.6x	4.1%	4.7%
Min		1.4x	1.2x	12.8x	11.2x	3.3%	3.9%

Source: FAB Securities

