

Al Rajhi Bank

Higher cost of funds continues to impact profitability

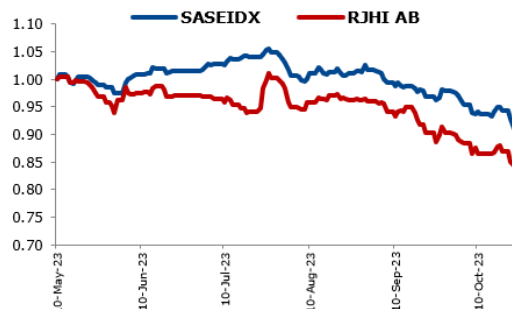
Current Price
SAR 65.60

Target Price
SAR 82.00

Upside/Downside (%)
+25%

Rating
BUY

- Al Rajhi's NIMs rose for the second consecutive quarter as it was declining under pressure from 2Q23. NIMs rose 6 bps QOQ basis to 2.8% in 3Q23
- Al Rajhi witnessed a solid loan growth of 6.0% YOY and 2.0% QOQ to c. SAR 591 Bn in 3Q23 driven by a strong growth in non-retail financing and mortgages
- Al Rajhi's CASA deposits accounted for 67% of total deposits in 3Q23
- Deposits declined 0.9% QOQ to c. SAR 566 Bn in 3Q23 pressurizing liquidity. Thus, loan to deposit ratio rose to 104.0% in 3Q23 from 101.5% in 2Q23



Stock Information

Market Cap (SAR, mm)	262,400.00
Paid Up Capital (mm)	40,000.00
52 Week High	87.50
52 Week Low	63.10
3M Avg. daily value(SAR)	254,409,700

3Q23 Net Profit in line with our estimates

Al Rajhi Bank's ("ALRAJHI", "The Bank") net profit declined 4.6% YOY to SAR 4,155 Mn in 3Q23, in line with our estimate of SAR 4,171 Mn. The decline in net profit is attributable to a fall in net-funded and non-funded income partially offset by a decline in operating expenses, impairment charges, and zakat expenses.

P&L Highlights

ALRAJHI's funded income rose 36.6% YOY to SAR 9,970 Mn in 3Q23 mainly driven by an increase in net advances and expansion in asset yield. On the other hand, funded expense rose significantly from SAR 1,610 Mn in 3Q22 to SAR 4,569 Mn in 3Q23 owing to rise in cost of funds due to higher benchmark rates. Thus, net funded income declined 5.0% YOY to SAR 5,401 Mn in 3Q23. The Bank's NIMs declined 44 bps YOY but rose 6 bps QOQ to 2.8% in 3Q23. ALRAJHI's total non-funded income fell 3.1% YOY to SAR 1,472 Mn in 3Q23 owing to a 3.1% decline in fee and other income to SAR 1,472 Mn in 3Q23 and a decrease in investment income partially offset by an increase in exchange income and other operating income. As a result, total operating income declined 4.6% YOY to SAR 6,873 Mn in 3Q23. Furthermore, the Company's total operating expenses declined 4.8% YOY to SAR 2,239 Mn in 3Q23 due to a 22.6% decline in impairment charges to SAR 379 Mn attributable to improved economic activities, decrease in salary and employee-related expenses, and other G&A expenses partially offset by increase in depreciation expense. In addition, Zakat expense declined 4.6% YOY to SAR 478 Mn in 3Q23 in line with a decline in profitability.

3Q23 Result Review (SAR, mm)

Total Assets	801,483
Total Liabilities	699,204
Total Equity	102,280
Total Deposits	556,719
Net Profit	4,155

Financial Ratios

Dividend Yield (12m)	3.51
Dividend Pay-out (%)	29.15
Price-Earnings Ratio(x)	15.96
Price-to-Book Ratio (x)	3.03
Book Value (SAR)	21.67
Return-on Equity (%)	20.51

Stock Performance

5 Days	3.31%
1 Months	-3.39%
3 Months	-12.53%
6 Months	-14.69%
1 Year	-23.63%
Month to Date (MTD%)	-3.53%
Quarter to Date (QTD%)	-3.53%
Year to Date (YTD%)	-12.90%

Balance Sheet Highlights

ALRAJHI's net advances recorded a strong growth of 6.0% YOY and 2.0% QOQ to SAR 590.8 Bn in 3Q23. Net financing growth was mainly driven by 6.6% YOY growth in mortgage and 25.1% YOY growth in non-retail financing while the growth in retail financing remained flat. The loan-to-deposit ratio increased to 104.4% in 3Q23 as compared to 101.5% in 2Q23. Total assets increased 8.3% YOY and 2.2% QOQ to SAR 801.5 Bn in 3Q23. Moreover, customer deposits rose 1.8% YOY but declined 0.9% QOQ to SAR 565.7 Bn in 3Q23. In addition, CASA deposits represented 67% of total deposits in 3Q23. The Bank's total equity rose 18.8% YOY but declined 0.9% QOQ to SAR 102.3 Bn in 3Q23.

Target Price and Rating

We maintain our BUY rating on Al Rajhi with an unchanged target price of SAR 82.00. ALRAJHI witnessed a 4.6% YOY decline in net profit attributable to a rise in the cost of funds leading to high funding cost pressurizing margins. The Bank recorded strong growth in advances, which rose 6.0% YOY to SAR 590.8 Bn in 3Q23. ALRAJHI's retail financing remained flat while non-retail financing witnessed a strong growth of 25.1% YOY in 3Q23 mainly driven by 23.9% YOY growth in corporate and 27.2% YOY growth in SME loans. Al Rajhi is expected to benefit from an improving product mix as the Bank is diversifying its financing portfolio in the non-retail segment. The Bank's NIMs rose for the second consecutive time after a long period by 6 bps QOQ to 3.0% in 3Q23 while CASA deposits accounted for 67% of total deposits which helps in quick repricing of loans. Al Rajhi's asset quality improved as NPLs declined 9 bps QOQ to 0.6% in 3Q23 whereas the Bank's coverage further strengthened to 239.9% in 3Q23 as compared to 209.6% in 2Q23. Furthermore, Al Rajhi's capitalization stood strong with a Tier 1 ratio of 19.6% and CAR of 20.8% in 3Q23. Thus, considering the above-mentioned factors, we assign a BUY rating on the stock.

Al Rajhi Bank - Relative valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE	27.5	25.3	24.2	17.4	15.1	16.3
PB	5.7	5.4	4.4	3.8	3.3	2.8
Dividend yield	2.7%	2.9%	1.0%	1.4%	1.9%	3.6%

FABS Estimates & Co Data

Al Rajhi Bank - P&L

SAR mm	3Q22	2Q23	3Q23	3Q23F	Var.	YOY Ch	QOQ Ch	2022	2023F	Change
Funded Income	7,297	9,296	9,970	9,597	3.9%	36.6%	7.3%	28,202	37,634	33.4%
Funded Expense	-1,610	-4,102	-4,569	-4,340	5.3%	183.7%	11.4%	-6,029	-16,836	179.3%
Net Funded Income	5,687	5,194	5,401	5,256	2.8%	-5.0%	4.0%	22,173	20,797	-6.2%
Total non-funded Income	1,519	1,634	1,472	1,682	-12.5%	-3.1%	-9.9%	6,402	6,668	4.2%
Net Operating Income	7,206	6,827	6,873	6,938	-0.9%	-4.6%	0.7%	28,575	27,466	-3.9%
Op. exp. before provisions	-1,861	-1,840	-1,860	-1,873	-0.7%	-0.1%	1.1%	-7,451	-7,406	-0.6%
Profit before provisions	5,345	4,988	5,013	5,065	-1.0%	-6.2%	0.5%	21,124	20,060	-5.0%
Impairment charge	-490	-360	-379	-415	-8.7%	-22.6%	5.2%	-2,001	-1,544	-22.9%
Total Operating Expenses	-2,351	-2,200	-2,239	-2,288	-2.2%	-4.8%	1.8%	-9,452	-8,949	-5.3%
Net income before zakat	4,855	4,627	4,633	4,649	-0.4%	-4.6%	0.1%	19,123	18,516	-3.2%
Zakat	-501	-477	-478	-479	-0.2%	-4.6%	0.2%	-1,972	-1,907	-3.3%
Net profit for the year	4,355	4,150	4,155	4,171	-0.4%	-4.6%	0.1%	17,151	16,609	-3.2%

FABS estimate & Co Data

Riyad Bank - KPI

	3Q22	2Q23	3Q23	YOY Ch	QOQ Ch	2022	2023F	Change
Net FI/OI	78.9%	76.1%	78.6%	-33	251	77.6%	75.7%	-187
NIM	3.3%	2.8%	2.8%	-44	6	3.3%	2.7%	-59
NIS	3.1%	2.4%	2.4%	-70	3	3.2%	2.4%	-80
Cost to income	25.8%	26.9%	27.1%	124	11	26.1%	27.0%	89
Impairment/PPP	-9.2%	-7.2%	-7.6%	161	-33	-9.5%	-7.7%	178
NP/OI	60.4%	60.8%	60.5%	3	-33	60.0%	60.5%	45
ROAA	2.3%	2.2%	2.1%	-19	-6	2.5%	2.1%	-37
ROAE	21.6%	19.6%	18.8%	-284	-85	23.5%	19.6%	-384

FABS estimate & Co Data

Riyad Bank - Key B/S items

SAR mm	3Q22	4Q22	1Q23	2Q23	3Q23	Change
Net advances	557,498	568,338	577,011	579,080	590,826	6.0%
QOQ ch	7.3%	1.9%	1.5%	0.4%	2.0%	
Total assets	739,962	761,649	776,196	784,520	801,483	8.3%
QOQ ch	4.3%	2.9%	1.9%	1.1%	2.2%	
Customer deposits	555,767	564,925	556,197	570,665	565,719	1.8%
QOQ ch	0.5%	1.6%	-1.5%	2.6%	-0.9%	
Total equity	86,101	100,225	99,227	103,187	102,280	18.8%
QOQ ch	5.1%	16.4%	-1.0%	4.0%	-0.9%	

FABS estimate & Co Data

Valuation:

We use the 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	79.88	70.0%	55.92
Relative Valuation (RV)	86.95	30.0%	26.08
Weighted Average Valuation (SAR)			82.00
Current market price (SAR)			65.60
Upside/Downside (%)			+25%

1) Residual Income Method:

We have discounted the economic profit/excess equity using the cost of equity of 8.7%. Cost of equity is calculated by using 10-year government bond yield of 4.5%, beta of 1.0 and equity risk premium of 4.2%. 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)	43,773
Terminal value (SAR, Mn)	189,963
Book Value of Equity (as of June 2023)	85,780
FV to Common shareholders (SAR, Mn)	319,517
No. of share (Mn)	4,000
Current Market Price (SAR)	65.60
Fair Value per share (SAR)	79.88

Residual Income Method

(All Figures in SAR Mn)	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E
Net Profit	15,718	17,712	21,880	26,339	30,152
(-) Equity Charge	-7,889	-8,703	-9,794	-11,093	-12,376
Excess Equity	1,305	9,009	12,086	15,246	17,776
Discounting Factor	0.99	0.91	0.83	0.77	0.71
Present Value of Excess Equity	1,287	8,171	10,080	11,695	12,540

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 as ALRAJHI trades at a premium to its peers and is valued at a PB multiple of 3.5x. The premium in valuation stems from high composition of retail loan book and generates superior return on assets as compared to its peers.

Company	Market (USD Mn)	P/B (x)		P/E (x)		Dividend Yield (x)	
		2023F	2024F	2023F	2024F	2023F	2024F
Riyad Bank	4,283	1.4	1.3	9.8	9.0	5.2	5.5
Alinma Bank	2,568	2.1	2.0	13.5	12.1	3.9	4.3
Al Rajhi Bank	7,330	2.7	2.5	15.7	14.2	3.4	3.8
Banque Saudi Fransi	2,526	1.1	1.1	9.2	8.5	5.8	6.0
Arab National Bank	2,240	1.0	1.0	5.9	6.2	5.9	6.2
Bank Albilad	1,443	2.4	2.1	15.6	13.5	1.8	2.1
Average		1.8x	1.6x	11.6x	10.6x	4.3%	4.7%
Median		1.7x	1.7x	11.6x	10.5x	4.5%	4.9%
Max		2.3x	2.1x	15.1x	13.2x	5.6%	5.9%
Min		1.2x	1.1x	9.3x	8.6x	3.5%	3.9%

Source: FAB Securities

