Al Rajhi Bank
Investment Update

Record breaking results in Q2-24; performance to continue going forward driven by NIMs expansion ; upgrading to "Overweight"

Al Rajhi exceeded market's expectations with a record breaking financial result in Q2-24, where net income grew by 13.2% Y/Y to SAR 4.69bn. The outperformance was driven by above expected growth in balance sheet and higher other operating income. We forecast Alrajhi to exhibit a notable increase in ROE over the next three years as interest rates come down. We see a strong decline in funding costs in 2025, unlike what bank underwent in the previous rate down cycle, due to higher time deposits and bank borrowings, while we expect yields on earning assets to come down at a much slower rate, due to high long-dated mortgage and fixed rate sukuk exposure. We see NIMs expanding by 8/23bps in 2024/25, respectively, because of the asset liability duration mismatch (only 35.6% of assets reprice within one year, as compared to 83.2% of liabilities). We estimate cost to income to decline by 329bps, and cost of risk to average around 31bps from 2023-27. Due to the slowdown in demand for retail loans, focus would remain on corporate lending (2023-27E CAGR 13.9%); and the retail-corporate mix would move to 62/38% by 2027 from 71/29% in Q2-24. We forecast AlRajhi to deliver medium term (2023-27) earnings CAGR of 12.0% and best in class average ROE of 20.0%. We upgrade our recommendation to "Overweight", with revised up TP of SAR 102.0/share.

Al Rajhi exceeded market's expectations with a record breaking set of financial result in Q2-24: Al Rajhi bank posted historic high net income of SAR 4.69bn in Q2-24, up 13.2% Y/Y (+6.7% sequentially), the result was above our and consensus estimate of SAR4.41bn and SAR4.46bn, respectively. The outperformance was driven by above expected growth in balance sheet and higher other operating income. Net Special Commission Income grew by 12.8% Y/Y in Q2-24 (+2.6% deviation from AJC estimate), due to 11.0% Y/Y growth in earnings assets and 9bps Y/Y improvement in NIMs. Non-Commission Income improved by 8.9% Y/Y (+14.1% deviation from AJC estimate). Operating expenses (excluding debt provisions) totaled at SAR 1,956mn, up 6.3% Y/Y (+3.3% on Q/Q basis), in line with our estimates (+0.4% deviation). A relatively smaller increase in opex as compared to operating income, caused the cost to income ratio to drop by 134bps Y/Y to 25.6% in Q2-24. Provision expenses grew by 26.2% Y/Y to SAR 455mn (+8.0% on a Q/Q basis), 13.7% above our estimate of SAR 400mn. NPL ratio saw a 9bps Y/Y increase to 0.78% in Q2-24, while coverage declined by 41.6ppts to 168.1%. Loan book expanded by 7.4% Y/Y & 2.1% Q/Q to SAR 621.8bn in Q2-24; retail loans grew by 2.3% Y/Y while corporate loans increased by 21.9% Y/Y. ADR ratio dropped to 99.9% in Q2-24 from 101.5% in Q2-23 (100.8% in Q1-24), as deposit growth outpaced loan growth. Moreover, the bank expanded its investments book by 26.9% Y/Y (7.7% on a Q/Q basis) to SAR 153.0bn. The rapid expansion in risk weighted assets resulted in a 50/61bps decline in Tier-1/total CAR ratios to 20.02/21.05%, respectively.

Funding costs to experience stronger decline in the impending rate down cycle, as compared to 2019 rate cuts, due to higher share of rate sensitive deposits and borrowings: Al Rajhi has accumulated sizable rate sensitive time deposits and increased reliance on interbank borrowings, to fund the robust loan book expansion of the last four years (2019-23 CAGR 24.2%) that was primarily driven by intensified demand for mortgage financing. The share of rate sensitive liabilities as percentage of total liabilities has increased to 45.8% in 2023 (42.8% in 2022) from 7.2% in 2019. Time deposits constitute 29.9% of total deposits in Q2-24 vs 7.1% in 2019, and bank borrowings have grown to 14.1% of total deposits in Q2-24 as compared to just 0.7% of deposits in 2019. The aforementioned changes in liabilities mix has made funding costs considerably more sensitive to interest rate changes, hence a stronger decline in cost of funds is expected in current rate down cycle as compared to 2019 rate cuts. We estimate a 100bps cut in interest rate to result in a 33bps decline in cost of funds, as compared to 3bps decline in 2019 easing cycle.

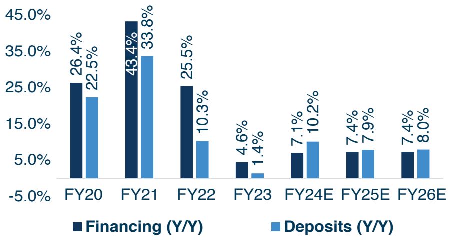
Recommendation	Overweight
Target Price (SAR)	102.0
Upside / (Downside)*	27.3%

Source: Tadawul *prices as of 6th of October 2024

Key Financials

in SAR mn, (unless specified)	FY22	FY23	FY24E	FY25E
Net financing & investment income	22,173	21,269	23,686	27,749
Growth %	8.7%	-4.1%	11.4%	17.2%
Net Profit	16,954	15,800	17,649	21,017
Growth %	15.0%	-6.8%	11.7%	19.1%
EPS	4.24	3.95	4.41	5.25
DPS	1.25	2.25	2.50	3.00

Fig 1: Loans and Deposit Growth



Source: AlJazira Capital, Company reports, *LDR Is unweighted
Source: Company reports, Aljazira Capital

Key Ratios

	FY22	FY23	FY24E	FY25E
NIMs	3.52%	2.97%	3.05%	3.29%
P/E (x)	17.7	21.9	18.2	15.2
P/B (x)	3.0	3.2	3.3	2.9
Dividend Yield	1.5%	2.7%	3.1%	3.7%
ROA	2.4%	2.0%	2.1%	2.3%
ROE	22.5%	18.2%	18.7%	20.3%
Net loan growth	25.5%	4.6%	7.1%	7.4%
Deposit growth	10.3%	1.4%	10.2%	7.9%

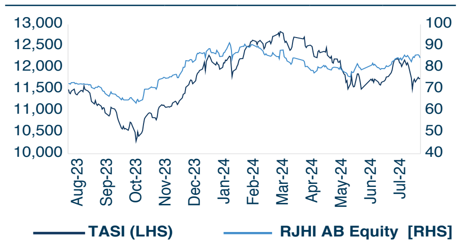
Source: AlJazira Capital, Company accounts

Key Market Data

Market Cap (SAR bn)	334.4
YTD%	-7.4%
52 week (High)/(Low)	92.5/63.1
Share Outstanding (mn)	4,000.0

Source: Company reports, Bloomberg, Aljazira Capital

Price Performance



Source: Tadawul, Aljazira Capital

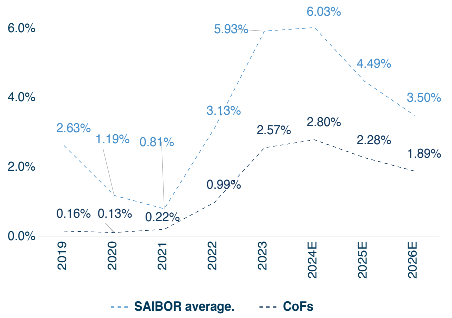
Fahad Qureshi, CFA
+966 11 2256315
f.irfan@aljaziracapital.com.sa

Favorable asset-liability duration mismatch to turnaround the decline in NIMs; we expect 100bps cuts in 2024 and four 25bps cuts in 2025: The above expected increase in unemployment rate and slowing inflationary pressures prompted US Fed to begin easing of interest rates with 50bps cut in Sept-24. According to CME FedWatch, there is 93.1% probability that FED will cut interest rates by 25bps in Nov-24. We expect two 25bps cuts in remaining 2024 and four quarter point cuts in 2025. In this backdrop, due to favorable assets/liabilities duration mismatch (only 35.6% of assets reprice within one year, as compared to 83.2% of liabilities) we expect Al Rajhi to see a notable turnaround in NIMs, +8/23bps to 3.05/3.29% in 2024/25E respectively. Overall, we forecast Return on Earning Assets to decline by 26bps Y/Y in 2025, while we forecast 102bps Y/Y drop in the cost of remunerative liabilities (-52bps Y/Y cost of funds). The decline in asset returns would be smaller than previous down cycle since 35.6% of assets reprice within one year (as of 2023) as compared to 48.1% in 2019. The aforementioned increase in assets duration emanated on account of the increase in long dated mortgage loans and fixed rate sukuk investments.

Retail lending, after growing at healthy a CAGR of 23.0% over 2019-23, is expected to remain slow; focus to remain on corporate lending: Al Rajhi's lending book saw an increase of 7.4% Y/Y to reach SAR 621.8bn in Q2-24, as compared to industry loan growth of 10.8% Y/Y. This underperformance is owed to slow down in mortgage lending, monthly new mortgage issuance averaged at SAR 6.1bn in Q2-24 vs SAR 6.5bn in 2023. We expect retail lending to slow to 3.5/3.7/5.2% in 2024/25/26, CAGR of 4.3% expected from 2023-2027 as compared to 2019-23 CAGR of 23.0%. The slowdown in retail lending is mainly owed to high interest rates and high home ownership level, which stood at 63.74% at the end of 2023 as compared to 47/60% in 2016/2022. Focus has shifted to corporate lending, where bank expanded its loan book by 21.9% Y/Y in Q2-24. We forecast corporate loans to grow at a CAGR of 13.9% over 2023-27, lower interest rates and demand from mega projects are key drivers for the corporate book. We project total loan growth to slow down to 7.1% Y/Y in 2024 (CAGR of 7.3% over 2023-27E), and the retail-corporate mix to move to 62/38% by 2027 from 71/29% in Q2-24.

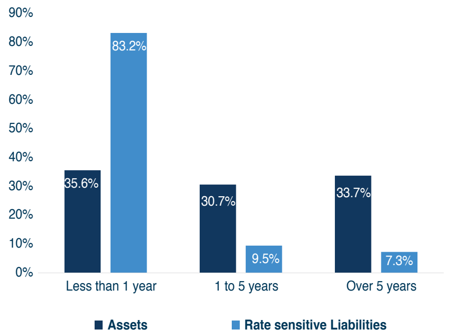
ROE to post small increase in 2024 (+54bps Y/Y) and notable improvement in 2025, on the back of margin improvement, we forecast net income to grow by 11.7/19.1% in 2024/25: ROE is estimated to post small increase in 2024 (+54bps Y/Y), following a 436bps Y/Y decline in 2023, thanks to 544bps increase in interest rates over 2021 and 2022, that resulted in a 55bps decline in NIMs. However, a notable improvement in ROE is expected in 2025 (+157bps Y/Y to 20.3%) mainly on the back of margin expansion (NIMs up 23bps Y/Y in 2025E) that would be driven by 52bps decline in funding costs amidst a 26bps decline in return on earning assets. In this backdrop, we forecast net special commission income to grow by 14.8/17.2% Y/Y in 2024/25 respectively (as compared to a 4.1% Y/Y decline in 2023). Non-funded income following a decline of 2.2% Y/Y in 2023 (due to regulatory changes that disallowed booking certain fee income) is forecasted to grow by 6.5/4.0% in 2024/25 and deliver a medium term CAGR of 5.1% over 2023-2027. Overall after receding by 6.8% in 2023, we forecast net income to grow by 11.7/19.1% in 2024/25.

Fig 2: CoFs to exhibit a much stronger decline in impending rate downcycle



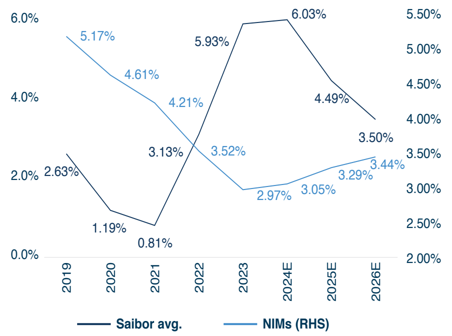
Source: Aljazira capital Research, Company accounts

Fig 3: Favorable duration gap



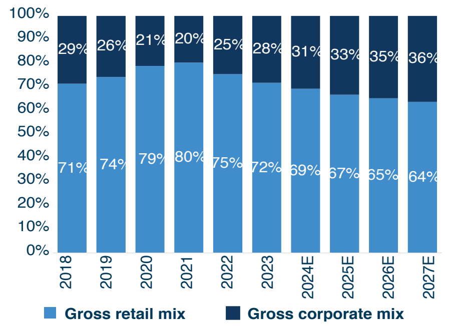
Source: Aljazira capital Research, Company accounts

Fig 4: NIMs to turnaround as rates come down



Source: Aljazira capital Research, Company accounts

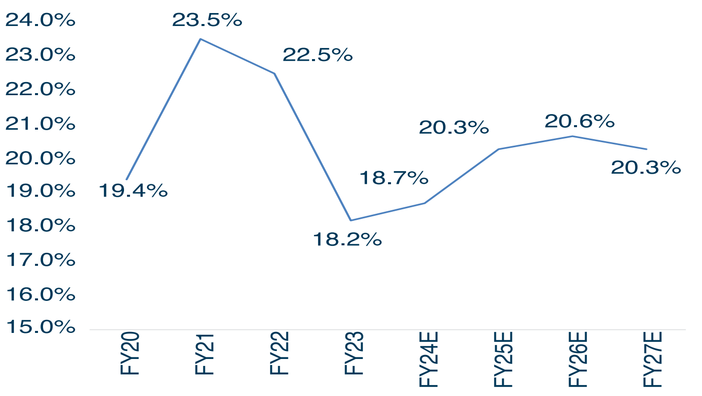
Fig 5: Share of corporate loans to further increase



Source: Aljazira capital Research, Company accounts

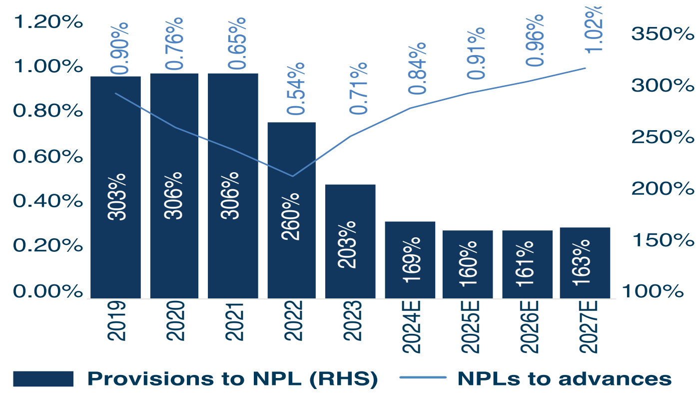
Unmatched asset quality and strong capitalization: AlRajhi's asset quality remains unmatched with NPL ratio of 0.78% and coverage ratio of 168% in Q2-24. The salary linked nature of mortgage loans are likely to keep NPL risk of retail portfolio in check. However, we see increase in NPLs from corporates segment due to higher interest rates and aging of loans. Overall, we expect 21bps increase in bank's NPL ratio over 2023-27, and cost of risk to average at 31bps over the same period (as compared to 55bps between 2019-23). With a Tier-1 ratio of 20.02%, bank remains in a comfortable position to maintain payout at 55%, which implies a 2024/25E dividend yield of 3.1/3.7% respectively.

Fig 6: ROE to recover as rates come down



Source: Aljazira capital Research, Company accounts

Fig 7: Top class asset quality



Source: Aljazira capital Research, Company accounts

Investment thesis and valuation:

Alrajhi has experienced a 124bps and 541bps decline in NIMs and ROE since the beginning of interest rate increases in 2022, thanks to the large fixed rate mortgage exposure. Due to favorable asset liability duration mismatch we see a notable improvement in margins and ROE in the medium term as rates start coming down from peak levels. We forecast AlRajhi to deliver medium term (2023-27) earnings CAGR of 12.0% and best in class average ROE of 20.0%. We forecast EPS to grow by 11.7/19.1% to SAR 4.41/5.25 per share, and DPS to stand at SAR 2.5/3.0 per share (DY 3.1/3.7%) in 2024/25, respectively. At 2024/25E PB of 3.3/2.9x we see sizable room for re-rating of the stock.

We value the stock based on equal weight to Residual Income and Two staged Gordon growth. Our residual income-based TP assuming the cost of equity of 10.5% is SAR 99.4 per share whereas; through the Two staged Gordon growth model, based on ROE of 20.2%, we arrive at a justified P/B multiple of 3.8x. Hence, the equal weight revised up TP stands at **SAR 102.0 per share** which translates to an upside of 27.3% from the CMP of SAR 80.1 per share, hence we upgrade our recommendation to "**Overweight**".

Weighted Average TP

Method	Value	Weight	W.Value
RI	99.40	50%	49.7
Justified P/B	104.43	50%	52.2
Target Price			**102.00**
CMP			80.10
Upside/Downside			27.3%

Key Financials

Amount in USD mn, unless otherwise specified	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E
Income statement									
Net financing and investments income	**16,913**	**20,392**	**22,173**	**21,269**	**23,686**	**27,749**	**31,094**	**33,800**	**36,156**
Fee from banking services, net	2,660	3,933	4,624	4,226	4,435	4,652	4,883	5,128	5,386
Exchange income, net	784	788	1,162	1,246	1,308	1,372	1,440	1,513	1,589
Other operating income	365	603	616	790	929	916	961	1,010	1,060
Total operating income	**20,721**	**25,716**	**28,575**	**27,531**	**30,359**	**34,690**	**38,378**	**41,450**	**44,191**
Impairment charge for financing	(2,166)	(2,345)	(2,001)	(1,504)	(1,779)	(2,039)	(2,336)	(2,533)	(2,712)
Other operating expenses	(6,742)	(6,927)	(7,451)	(7,498)	(7,926)	(8,556)	(9,243)	(9,992)	(10,755)
Operating Profit	**11,814**	**16,445**	**19,123**	**18,529**	**20,654**	**24,094**	**26,798**	**28,926**	**30,723**
Y/Y	**4.3%**	**39.2%**	**16.3%**	**-3.1%**	**11.5%**	**16.7%**	**11.2%**	**7.9%**	**6.2%**
Zakat	(1,218)	(1,699)	(1,972)	(1,908)	(2,127)	(2,481)	(2,760)	(2,979)	(3,164)
Net income	**10,596**	**14,746**	**17,151**	**16,621**	**18,527**	**21,613**	**24,039**	**25,947**	**27,560**
Y/Y	**4.3%**	**39.2%**	**16.3%**	**-3.1%**	**11.5%**	**16.7%**	**11.2%**	**7.9%**	**6.2%**
Net income (adjusted for Tier-1)	**10,596**	**14,746**	**16,954**	**15,800**	**17,649**	**21,017**	**23,618**	**25,568**	**27,180**
Y/Y	**4.3%**	**39.2%**	**15.0%**	**-6.8%**	**11.7%**	**19.1%**	**12.4%**	**8.3%**	**6.3%**
EPS	**4.24**	**5.90**	**4.29**	**4.16**	**4.63**	**5.40**	**6.01**	**6.49**	**6.89**
EPS (adjusted for Tier-1)	**4.24**	**5.90**	**4.24**	**3.95**	**4.41**	**5.25**	**5.90**	**6.39**	**6.80**
DPS	**1.00**	**1.50**	**1.25**	**2.25**	**2.50**	**3.00**	**3.25**	**3.50**	**3.75**
Balance sheet									
Assets									
Cash and balances with SAMA	47,363	40,363	42,052	41,768	46,019	49,664	53,632	57,937	62,587
Due from banks and other financial institutions	28,655	26,065	25,656	9,507	10,474	11,304	12,207	13,187	14,245
Financing, net	315,712	452,831	568,338	594,205	636,216	683,042	733,278	787,276	845,111
Investments, net	60,285	84,433	101,325	133,376	159,578	179,036	193,338	208,857	225,622
Property and equipment, net	10,235	10,666	11,339	12,853	13,114	13,376	13,644	13,917	14,195
Other assets, net	5,034	7,902	12,835	15,028	15,334	15,640	15,953	16,272	16,598
Total assets	**468,825**	**623,672**	**762,366**	**808,098**	**882,126**	**953,481**	**1,023,498**	**1,098,921**	**1,179,864**
Liabilities & owners' equity									
Due to banks and other financial institutions	10,764	17,952	70,839	97,247	104,198	114,590	118,260	121,994	125,862
Customers' deposits	382,631	512,072	564,925	573,101	631,428	681,453	735,891	794,961	858,772
Other liabilities	17,311	26,339	26,377	27,202	27,755	28,310	28,877	29,454	30,043
Share capital	25,000	25,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
Statutory reserve	25,000	25,000	29,288	33,443	37,855	43,109	49,014	55,406	62,201
Retained earnings (incl. proposed dividend)	8,253	16,999	14,865	16,913	20,696	25,826	31,265	36,914	42,794
Total shareholders' equity	58,119	67,309	83,725	90,259	98,455	108,838	120,182	132,224	144,898
Total equity & liabilities	**468,825**	**623,672**	**762,366**	**808,098**	**882,126**	**953,481**	**1,023,498**	**1,098,921**	**1,179,864**
Key fundamental ratios									
Capital Ratios									
Equity/ Total Assets	12%	11%	11%	11%	11%	11%	12%	12%	12%
Tier-1 ratio	18.0%	16.5%	20.3%	20.5%	20.6%	20.9%	21.2%	21.5%	21.7%
CAR	19.1%	17.6%	21.4%	21.6%	21.6%	21.8%	22.1%	22.3%	22.5%
Profitability Ratios									
NIMs	4.6%	4.2%	3.5%	3.0%	3.1%	3.3%	3.4%	3.5%	3.5%
Return On Assets (ROA)	2.5%	2.7%	2.4%	2.0%	2.1%	2.3%	2.4%	2.4%	2.4%
Return On Equity (ROE)	19.4%	23.5%	22.5%	18.2%	18.7%	20.3%	20.6%	20.3%	19.6%
ROE/ROA (Leverage Ratio) (X)	7.8	8.7	9.2	9.0	9.0	8.9	8.6	8.4	8.2
Asset Quality Ratios									
NPL ratio	0.8%	0.7%	0.5%	0.7%	0.8%	0.9%	1.0%	1.0%	1.1%
NPL Coverage	306%	306%	260%	203%	169%	160%	161%	163%	167%
Funding Ratios									
Loans/ Customer Deposits	82.5%	88.4%	100.6%	103.7%	100.8%	100.2%	99.6%	99.0%	98.4%
Liquid Assets / Total Assets	96.4%	96.8%	96.7%	96.4%	96.6%	96.8%	97.0%	97.1%	97.3%
Net Loans / Tot Assets	67.3%	72.6%	74.5%	73.5%	72.1%	71.6%	71.6%	71.6%	71.6%
Market/valuation ratios									
Dividend Yield	0.8%	1.1%	1.6%	2.8%	3.1%	3.7%	4.1%	4.4%	4.7%
Book Value Per Share (BVPS)	23.2	26.9	25.1	26.7	28.7	31.3	34.2	37.2	40.3
Market price	46.01	88.64	75.20	86.50	80.10	80.10	80.10	80.10	80.10
PE (x)	10.9	15.0	17.7	21.9	18.2	15.2	13.6	12.5	11.8
PB (x)	2.0	3.3	3.0	3.2	3.3	2.9	2.7	2.4	2.2
Growth rates									
Investments (Y/Y)	28.7%	40.1%	20.0%	31.6%	19.6%	12.2%	8.0%	8.0%	8.0%
Financing (Y/Y)	26.4%	43.4%	25.5%	4.6%	7.1%	7.4%	7.4%	7.4%	7.3%
Deposits (Y/Y)	22.5%	33.8%	10.3%	1.4%	10.2%	7.9%	8.0%	8.0%	8.0%

Sources: AlJazira Capital, Company accounts

RESEARCH DIVISION

Head of Sell-Side Research - AGM
Jassim Al-Jubran
+966 11 2256248
j.aljabran@aljaziracapital.com.sa

RESEARCH DIVISION

AlJazira Capital, the investment arm of Bank AlJazira, is a Shariaa Compliant Saudi Closed Joint Stock company and operating under the regulatory supervision of the Capital Market Authority. AlJazira Capital is licensed to conduct securities business in all securities business as authorized by CMA, including dealing, managing, arranging, advisory, and custody. AlJazira Capital is the continuation of a long success story in the Saudi Tadawul market, having occupied the market leadership position for several years. With an objective to maintain its market leadership position, AlJazira Capital is expanding its brokerage capabilities to offer further value-added services, brokerage across MENA and International markets, as well as offering a full suite of securities business.

RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer