

Al-Rajhi Bank (RJHI)

Target Price: SAR 91
Upside/ (Downside): 26%

Recommendation	BUY
Bloomberg Ticker	RJHI AB
Current Market Price (SAR)	72.10
52wk High / Low (SAR)	117.40/71.80
12m Average Vol. (000)	6,020.1
Mkt. Cap. (USD/SAR bn)	78/288
Shares Outstanding (mn)	4,000.0
Free Float (%)	98%
3m Avg Daily Turnover (SAR mn)	385.4
6m Avg Daily Turnover (SAR mn)	425.0
PE 2023e (x)	14.2
PBv 2023e (x)	3.0
Dividend Yield '23e (%)	2.9%

Price Performance:

1 month (%)	(14)
3 month (%)	(20)
12 month (%)	(15)

Source: Bloomberg

Price-Volume Performance



Source: Bloomberg

- **Al Rajhi is the #1 Islamic bank globally and has the fastest-growing balance sheet among peers**
- **Stellar Islamic financing growth (about 32%YoY at end-9M22) on the back of mortgage lending growth as well as other segments.**
- **Superior asset quality (NPA Ratio at 0.55%, NPA coverage ratio at 272%) on low-default retail-loan profile.**
- **Most cost-efficient in the Saudi banking space (Cost-to-Income Ratio at a superior 25.8% during 3Q22 vs. 26.7% in 3Q21).**

We revise our 12-month target price (TP) for Al Rajhi Bank (RJHI) down from SAR 98.1 to **SAR 91 per share**. We upgrade the rating on the stock to **BUY**. The TP reduction comes on the back of a lower median price-to-book multiple for the local peer group (de-rated amid reduced oil prices clouding KSA's macroeconomic outlook while global outlook remains subdued) as well as adjustments to our forecasts. Our TP **implies** a P/E'23e of 18x, and a P/B'23e of 3.8x. We believe that this TP is justified because of the bank's strengths as compared to its peers as well as a firmer growth trajectory amid a mega-project pipeline. Furthermore, (1) recent completion of Tier 1 Sukuk issuance will be a drag on return for the equity shareholders but will provide the necessary capital boost for growth (2) financial soundness indicators of the bank remain resilient (3) margin expansion to kick in by the end of 2023.

Investment Thesis

Valuation & Risks: Our target price is based on a weighted average of Excess Returns Methodology & a justified P/B multiple for 2023e for the bank. Key downside risks to our valuation include slower-than-expected financing offtake and asset quality deterioration. Key upside risks to our valuation include faster-than-expected improvement in net financing margin (NFM) and better-than-expected financing growth resulting in higher net finance income.

Superior fundamentals: RJHI's fundamentals are superior to local peers in almost all aspects: (i) Lowest non-performing asset (NPA) ratio a 0.55%; (iii) highest NPA provision coverage ratio at about 272% at end-9M22 (ii) CASA stock has weakened but still remains high at 68% to support low-cost funding; iv) Best cost efficiency ratio, 25.6% during 9M22 (v) Regulatory Loan-to-deposit (LTD) ratio at 88.4% at end-9M22 (vi) fastest-growing bank in terms of assets (+27%YoY), deposits (+16%YoY) and profit before taxes and provisions (+19%YoY) within the peer-group. (v) Well-positioned as a mortgage lender to benefit from Saudi's Vision 2030 Housing Program, with the country's **mortgage penetration being low** as compared to other Emerging Market (EM) countries).

The bank has improved its capital adequacy metrics through lower payouts (skipped 1H22 dividend) and higher income generation. Further, it has issued capital and has recently completed issuance of Tier 1 Capital Securities worth SAR 10bn (about 13% of shareholders' equity at end-9M22), which is expected to have boosted its capital adequacy metrics further, which continue to remain higher than the regulatory prescribed minima. Additionally, a relatively lower payout ratio as compared to peers ensures that adequate capital is shored up over the forecast period, in addition to a conservative financing growth estimate over 2022-2026e. A significant portion of the bank's fixed-rate financing exposure could potentially reprice in the second half of 2023, supporting margin expansion. Al Rajhi is heavily focused on mortgages, but a successful product diversification is expected to enhance the revenue mix.

Key Indicators

Year	FY19	FY20	FY21	FY22e	FY23e	FY24e
Net Financing (SAR mn)	249,683	315,712	452,831	587,496	682,281	750,509
Customer Deposits (SAR mn)	312,406	382,631	512,072	571,523	670,252	740,916
Operating Income (SAR mn)	19,460	20,668	25,637	29,078	34,858	38,751
Net Profit (SAR mn)	10,159	10,596	14,746	17,127	20,306	22,295
Diluted EPS (SAR)	4.06	4.24	5.90	4.28	5.08	5.57
Tangible BVPS (SAR)	20.48	23.25	26.92	19.98	23.72	27.72
P/E (x)	16.1	17.4	15.0	16.8	14.2	12.9
P/BVPS (x)	3.2	3.2	3.3	3.6	3.0	2.6
Dividend Yield (%)	4.6%	2.0%	2.7%	2.4%	2.9%	3.1%

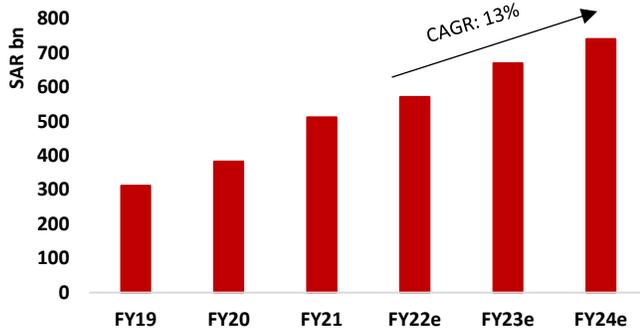
Source: Company Financials, U Capital Research

Ayisha Zia
 Head of Research
a.zia@u-capital.net
 Tel: +968 24 94 90 36

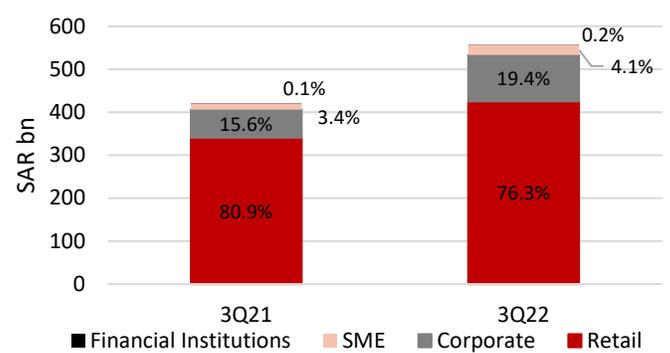
Financing growth to remain strong over the forecast period

Given the positive outlook on Saudi's real GDP growth, we believe that credit growth will remain strong for RJHI. For RJHI, while mortgage lending growth (at 39.9%YoY at end-9M22) will be front-loaded at the start of the forecast period, it will continue to remain strong supporting overall financing growth for the bank. Further, as indicated by the management, the bank is focusing on increasing its corporate exposure as well, which is already up 65% on YoY basis.

RJHI: Financing Asset



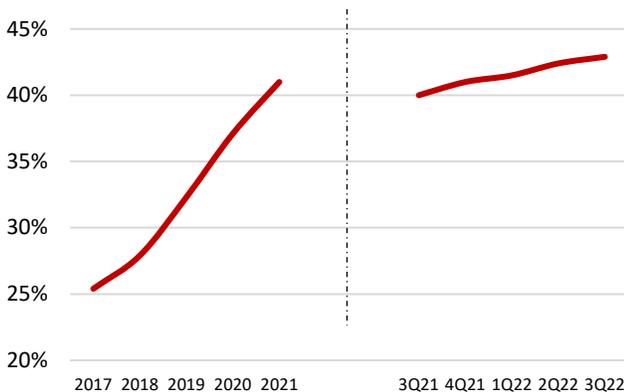
RJHI: Financing mix



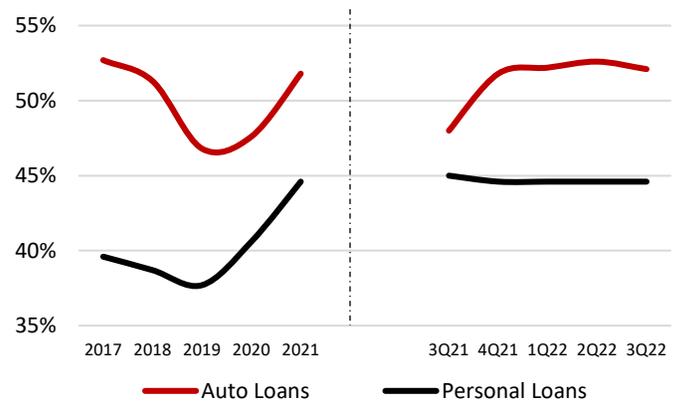
Source: Company Financials, U Capital Research

RJHI has consistently gained mortgage lending market share over the last few quarters and years. The bank characteristically has had a higher exposure to retail as compared to corporate but has made notable progress in diversifying its financing mix.

RJHI: Mortgage Market Share



RJHI: Auto Loans & Personal Loans Market Share

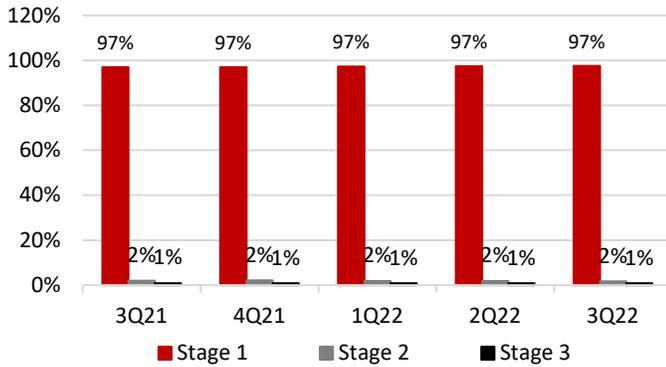


Source: Company Financials, U Capital Research

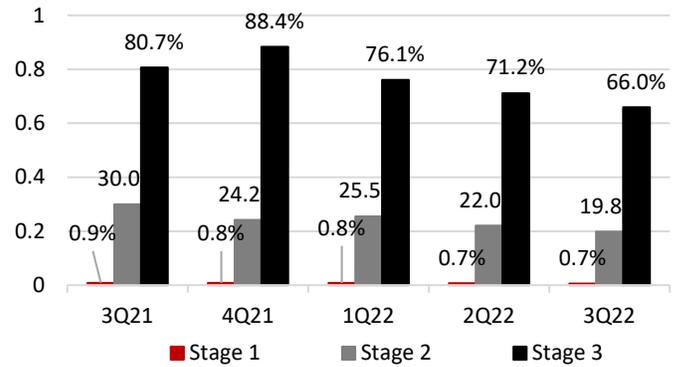
Healthy stage coverage reflects prudent risk management

RJHI has exceptional asset quality management, with a superior NPA provision coverage ratio as compared to local peers, and a low NPA ratio. Further, about 97% of its gross exposure is sitting in Stage 1 at end-9M22, with a provision cover for Stage 3 loans at 66%. Due to a 45%YoY jump in the bank's gross financing exposure, stage 3 exposure has declined from 0.9% at end-9M21 to 0.7% at end-9M22. Furthermore, its net provision charges have dropped 18%YoY while the bank maintains a superior provision coverage ratio.

RJHI: Gross Exposure by Stage



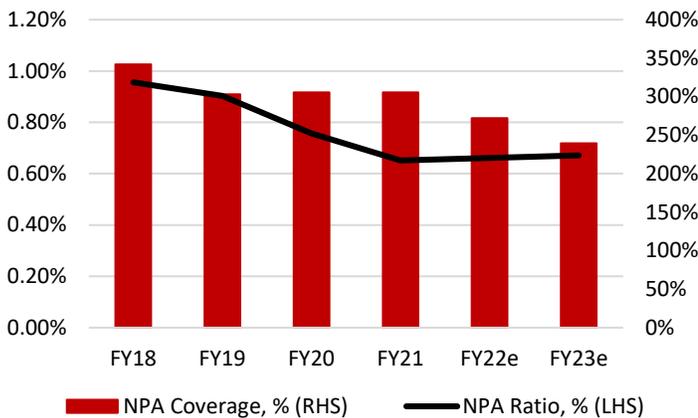
RJHI: ECL Coverage (%)



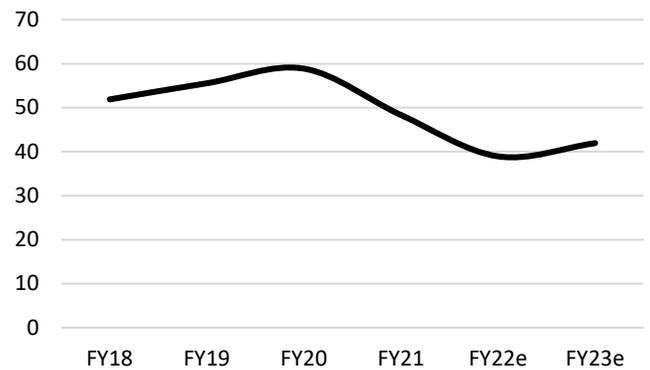
Source: Company Financials, U Capital Research

RJHI’s cost of risk on Profit Earning Assets (PEAs) is small on a relatively lower-default retail-loan profile, recoveries, and strong economic growth of KSA. However, we have penciled in a gradual increase in cost of risk due to a planned change in the financing mix and possible pressure on mid- to small-sized business cash flows in a high interest rate environment. The coverage ratio fell on more write-offs this year but is above peers.

RJHI: Asset Quality Metrics



RJHI: Cost of Risk on PEAs (bps)

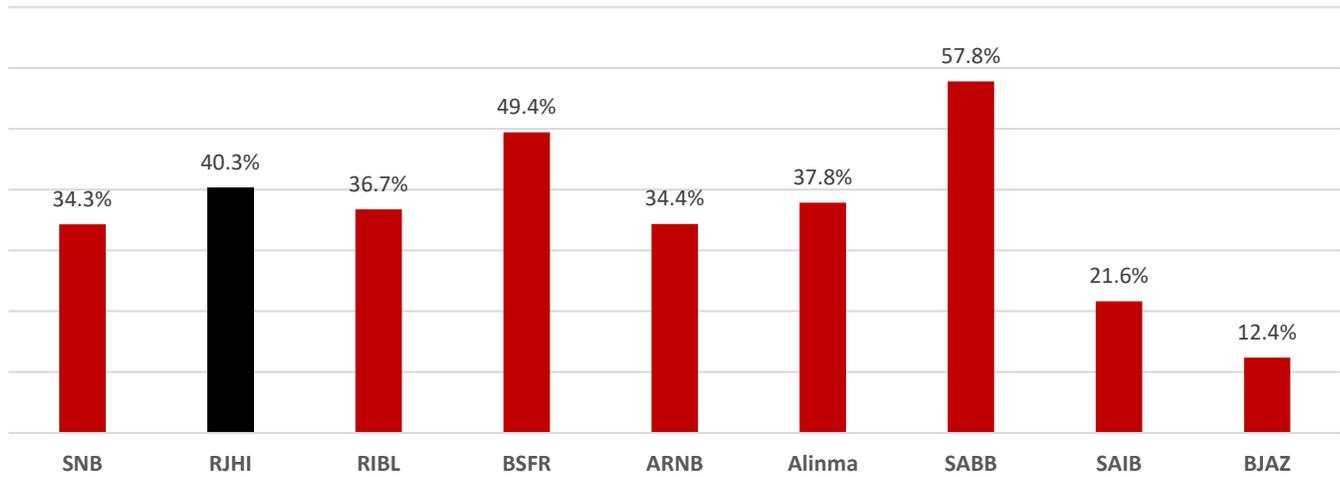


Source: Company Financials, U Capital Research; PEAs = Profit Earning Assets

Large share of CASA deposits to support margins; NIM to expand by the end of 2023

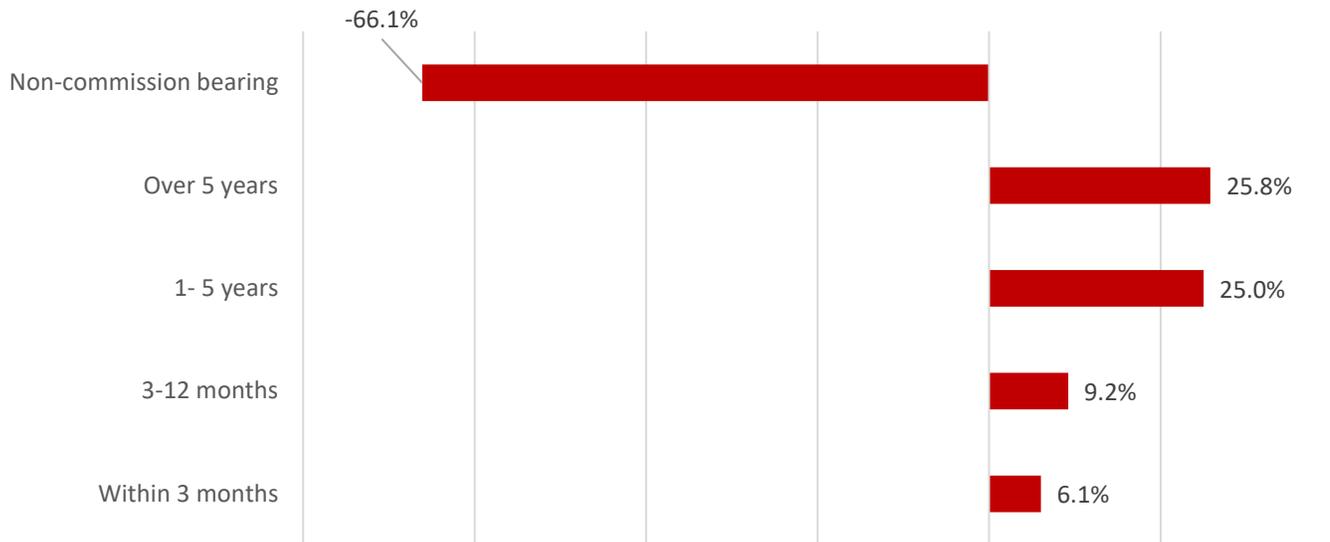
RJHI has relatively lower wholesale funding and relies heavily on customer deposits (85%) to fund its balance sheet. This has supported its margin historically. However, as interest rates have risen, we have seen margin contraction during 9M22. 68% of RJHI’s total customer deposits are CASA, and this ratio has been on a decline since 2Q20. However, a significant portion of the bank’s fixed-rate financing exposure could potentially reprice in the second half of 2023, supporting margin expansion. Margin will further besupported by finacing diversification to a higher share of the coporate segment.

Position Gap (Assets - Liabilities) for 0-5 Years as % of Total Assets (end-FY21)



Source: Company Financials, U Capital Research

RJHI: Commission Rate Sensitivity Gap as % of Assets, FY21



Source: Company Financials, U Capital Research

Valuation

We have used Excess Returns Methodology (80% weightage) and Peer-Group Price-to-Book'23e multiple based valuation (20% weightage) to arrive at our target price for the bank. We find the present value of the excess returns (net profit minus the cost of equity) for each year over the forecast period. This present value is then added to the equity value invested currently and the terminal value. For terminal value calculation, we use the relationship between an estimated long-term ROE and retention ratio as proxy for terminal growth rate for each entity. **Key assumptions: risk-free rate of 4.29% (Saudi's 10 Yr current bond yield), 2 year weekly average Beta (Source: Bloomberg) of 1.187, US risk premium of 5.174% to arrive at a cost of equity of 10.4%.**

Beginning book value of Equity invested currently **79,601,238**

SAR'000 unless otherwise stated **31-Dec-22** **31-Dec-23** **31-Dec-24** **31-Dec-25** **31-Dec-26**

Net Income	17,127,425	20,306,038	22,295,433	24,069,300	26,004,622
Less: Equity Cost	7,021,348	8,334,942	9,897,027	11,566,969	13,294,557
Excess Equity Return	10,106,076	11,971,096	12,398,406	12,502,331	12,710,065
Present value of Excess Equity Return	10,056,062	10,786,639	10,116,376	9,237,554	8,503,949
Sum of present value of Excess Return	48,700,579				

Terminal value projections

Book value of equity at start of year 6	127,445,801
Net income in Stable period	24,214,702
Less equity cost	13,294,557
Excess return	10,920,145
Terminal Value	388,190,642
PV of Terminal Value	259,727,493
Total Equity value	388,029,309
Total shares out, '000	4,000,000
Target Price, SAR	97.00

Peer-Group Multiples Based Approach

Median Peer-Group P/B (x) '23e	2.9
Bank's BVPS'23e	23.72
Target Price, SAR	69.00

Weighted-average Target Price, SAR **91.00**

Current Price, SAR 72.10

Upside / (Downside), % 26%

Sensitivity Analysis

Our TP is sensitive to changes in our cost of equity assumption of +/-0.25% where our TP moves +/-7% with each change in cost of equity, ceteris paribus. Our TP is not sensitive to +/-0.1% changes to our stable period assumption. It is neither sensitive to +/- 0.1x changes to our P/B'23e assumption nor to +/- 5bps changes to cost risk assumption for 2023.

RJHI

		Stable Period ROE				
		18.8%	18.9%	19.0%	19.1%	19.2%
Cost of Equity	9.9%	103.00	105.00	107.00	109.00	111.00
	10.2%	95.00	97.00	99.00	100.00	102.00
	10.4%	89.00	90.00	91.00	93.00	94.00
	10.7%	83.00	84.00	85.00	87.00	87.00
	10.9%	79.00	79.00	80.00	81.00	83.00

		Peer-Group P/B Multiple				
		2.7	2.8	2.9	3.0	3.1
Cost of risk '23e	32	91.00	92.00	92.00	93.00	93.00
	37	91.00	92.00	92.00	93.00	93.00
	42	90.00	91.00	91.00	92.00	92.00
	47	90.00	90.00	91.00	91.00	91.00
	52	90.00	90.00	91.00	91.00	91.00

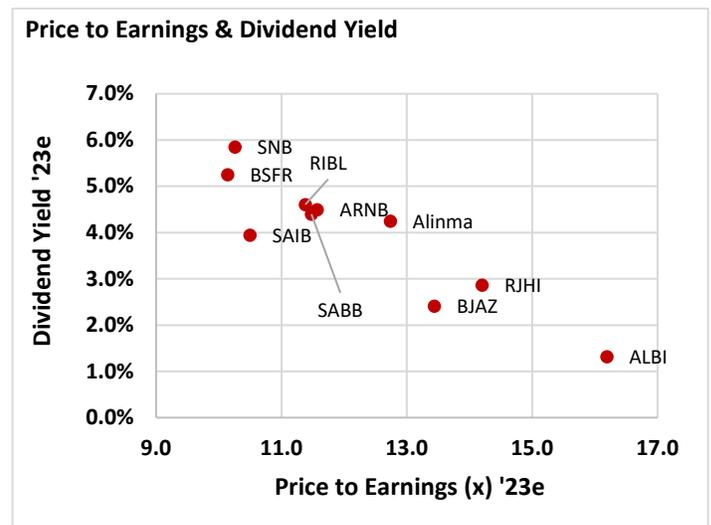
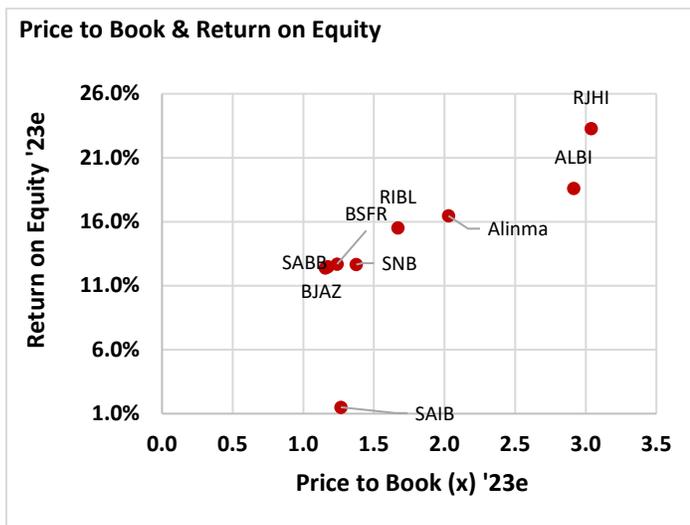
Source: U Capital Research

Peer Group Valuation

Name	Mkt Cap (SAR bn)	Last Px (SAR)	Px Change 1M, %	Px Change 3M, %	Px Change YTD, %	Current P/B	P/B '23e (x)	P/E '23e (x)	ROE '23e (%)	Div Yield '23e (%)	Retail Financing as % Total	
Retail & Quasi-Retail Banks												
AL RAJHI BANK	288.4	72.10	-14	-20	-19	3.6	3.0	14.2	23.3%	2.9%	80%	
THE SAUDI NATIONAL BANK	215.8	48.20	-15	-28	-25	1.5	1.4	10.3	12.7%	5.8%	52%	
BANK ALBILAD	45.5	45.50	-13	-13	31	3.5	2.9	16.2	18.6%	1.3%	48%	
BANK AL-JAZIRA	15.3	18.68	-19	-19	-3	1.3	1.2	13.4	12.4%	2.4%	44%	
Average						2.9	2.4	13.6	18.2%	3.3%	59.9%	
Median						3.5	2.9	14.2	18.6%	2.9%	51.7%	
Corporate-oriented Banks												
RIYAD BANK	92.0	30.65	-17	-10	13	2.0	1.7	11.4	15.5%	4.6%	34%	
SAUDI BRITISH BANK	75.0	36.50	-12	-9	11	1.4	1.2	11.5	12.5%	4.4%	23%	
BANQUE SAUDI FRANSI	44.8	37.20	-12	-25	-21	1.4	1.2	10.1	12.7%	5.3%	18%	
ARAB NATIONAL BANK	44.7	29.80	-11	-5	30	1.4	1.3	11.6	na	4.5%	26%	
ALINMA BANK	61.1	30.55	-20	-18	28	2.3	2.0	12.7	16.5%	4.2%	21%	
SAUDI INVESTMENT BANK/THE	17.7	17.74	-3	-9	21	1.3	1.3	10.5	1.5%	3.9%	17%	
Average						1.6	1.4	11.3	258.9%	4.5%	23.2%	
Median						1.4	1.3	11.4	15.5%	4.4%	22.0%	

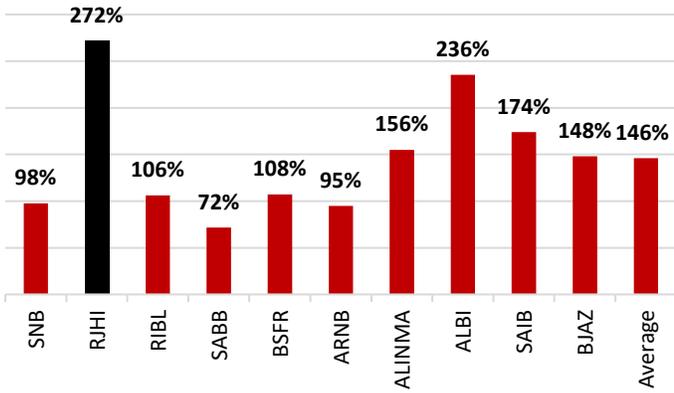
Source: Bloomberg, U Capital Research

The highlighted rows indicate banks under our coverage.

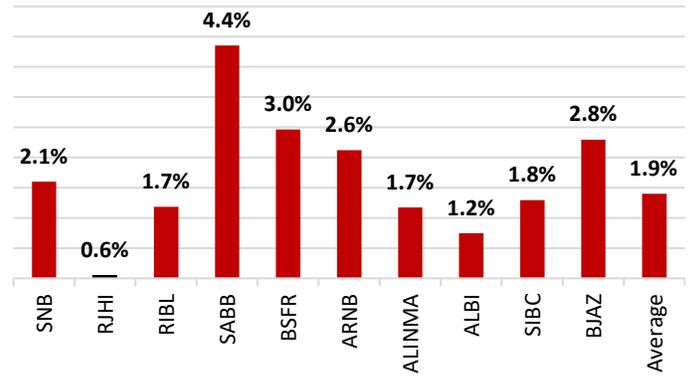


Source: Company Financials, U Capital Research

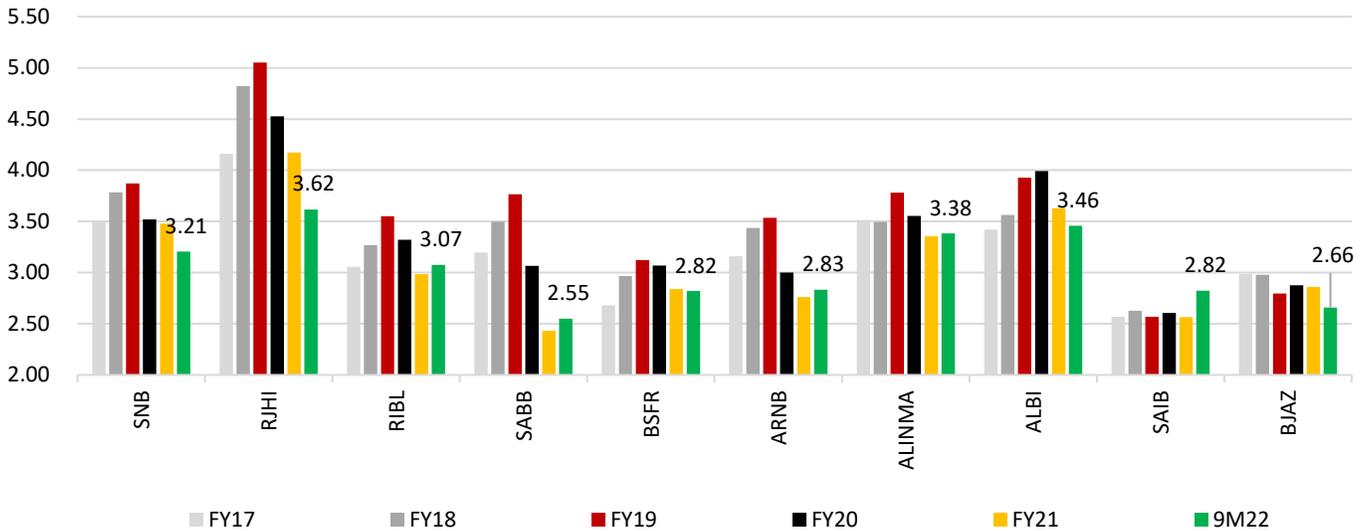
Saudi Banks: Provision Cover (x)



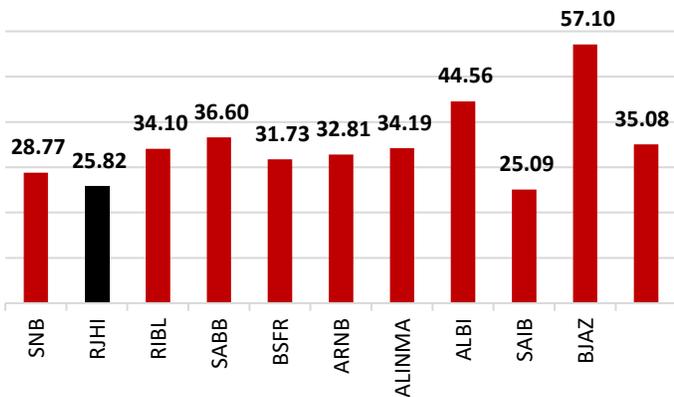
Saudi Banks: Non-performing loans (asset) Ratio



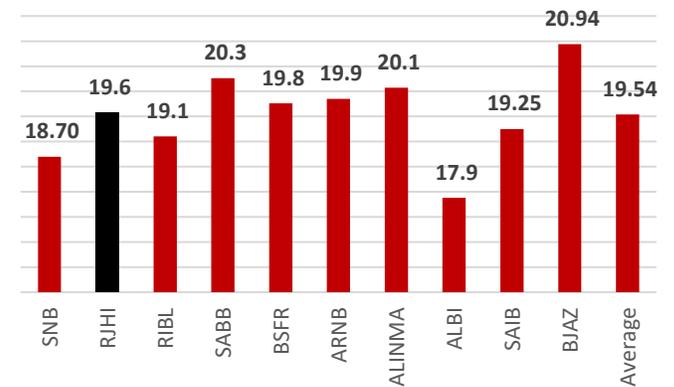
T12 month Net Interest Margin (%)



Saudi Banks: Cost-to-Income Ratio



Capital Adequacy Ratio



Source: Bloomberg, U Capital Research, all data as of 9M22, unless stated otherwise.

Key Financials

(SAR bn)	FY19	FY20	FY21	FY22e	FY23e	FY24e
Income Statement						
Interest/Financing Income	17.0	17.5	21.6	27.3	32.8	36.7
Interest Expense/Payment to Depositors	(0.5)	(0.5)	(1.0)	(4.7)	(5.5)	(6.2)
Net Interest/Financing Income	16.5	17.0	20.5	22.6	27.3	30.4
Fee & Commission Income	2.0	2.7	3.9	1.1	1.3	1.4
Other Income	1.0	1.0	1.2	5.4	6.2	6.9
Total Non-Interest/Financing Income	3.0	3.6	5.1	6.5	7.6	8.3
Total Operating Income	19.5	20.7	25.6	29.1	34.9	38.8
Provisions expense	(1.8)	(2.2)	(2.3)	(2.5)	(3.2)	(3.8)
Operating Expenses	(6.4)	(6.7)	(6.9)	(7.4)	(9.0)	(10.0)
Other non-operating losses / (income)	0.0	0.1	0.1	(0.1)	(0.1)	(0.1)
Profit Before Taxation	11.3	11.8	16.4	19.1	22.6	24.9
Sale of associate (net)	1.0	2.0	3.0	4.0	5.0	6.0
Taxation & Minority Interest	(1.2)	(1.2)	(1.7)	(2.0)	(2.3)	(2.6)
Net Profit Attributable to Parent	10.2	10.6	14.7	17.1	20.3	22.3
Net Profit Attributable to Parent after Tier 1 Interest Expense	10.2	10.6	14.7	16.1	19.1	20.9
Balance Sheet						
Cash Balances	39.3	47.4	40.4	32.8	31.4	61.4
Deposits with other banks & FIs	32.1	28.7	26.1	15.5	18.0	19.8
Gross Financing	256.7	323.2	462.0	593.3	682.3	750.5
Loan Loss Reserve	(7.0)	(7.5)	(9.2)	(8.9)	(11.0)	(12.8)
Net Financing	249.7	315.7	452.8	584.3	671.3	737.7
Other Assets	63.1	77.1	104.4	129.4	147.8	156.5
Total Assets	384.1	468.8	623.7	762.1	868.5	975.5
Deposits from Banks & FIs	-	-	-	-	-	-
Deposits from Customers	312.4	382.6	512.1	571.5	670.3	740.9
Other Borrowings	4.5	13.1	20.1	58.3	48.4	63.4
Other Liabilities	16.0	15.0	24.2	35.9	38.5	43.8
Paid-up Capital	25.0	25.0	25.0	40.0	40.0	40.0
Retained Earnings	0.9	8.3	17.0	9.6	20.4	32.3
Other Reserves	25.3	24.9	25.3	30.3	34.4	38.6
Shareholders' Equity	51.2	58.1	67.3	79.9	94.9	110.9
Minority Interest	-	-	-	-	-	-
Tier 1 Perpetual Notes	-	-	-	16.5	16.5	16.5
Total Equity & Liability	384.1	468.8	623.7	762.1	868.5	975.5
Cash Flow Statement						
Cash from operations	16.5	30.4	29.9	8.3	21.2	52.3
Cash from investing activities	13.3	18.9	31.4	28.1	17.5	16.1
Cash from financing	(7.2)	(3.5)	(5.5)	12.1	(5.0)	(6.2)
Net changes in cash	(4.0)	8.1	(7.0)	(7.6)	(1.4)	30.0
Cash at the end of period	39.3	47.4	40.4	32.8	31.4	61.4
Key Ratios						
Return on Average Assets	2.7%	2.5%	2.7%	2.5%	2.5%	2.4%
Return on Average Equity	20.4%	19.4%	23.5%	23.3%	23.2%	21.7%
Return on Tangible Average Common Equity (ROTCE)	20.4%	19.4%	23.5%	23.3%	23.2%	21.7%
Yield on Islamic Finance Assets	5.34%	4.76%	4.45%	4.29%	4.32%	4.32%
Cost of Funds	-0.17%	-0.13%	-0.23%	-0.81%	-0.82%	-0.82%
Net Spread	5.5%	4.9%	4.7%	5.1%	5.1%	5.1%
Net Interest Margin (NIM)	5.2%	4.6%	4.2%	3.5%	3.6%	3.6%
Cost to Income Ratio	32.8%	32.6%	27.0%	25.6%	25.7%	25.8%
NPAs to Gross Financing	0.9%	0.8%	0.7%	0.6%	0.6%	0.6%
NPA Coverage (x)	3.0	3.1	3.1	2.7	2.9	3.0
Cost of Risk (bps)	55.5	58.9	48.3	38.9	41.9	44.9
Equity to Total Assets	13.3%	12.4%	10.8%	10.5%	10.9%	11.4%
Capital Adequacy Ratio (CAR)	19.9%	19.1%	17.6%	20.7%	20.7%	21.6%
Cash Dividend Payout Ratio	73.8%	35.4%	40.7%	40.7%	40.7%	40.7%
Adjusted EPS (LCY)	4.06	4.24	5.90	4.02	4.77	5.24
Adjusted BVPS (LCY)	20.48	23.25	26.92	19.98	23.72	27.72
TangBVPS, LCY	20.48	23.25	26.92	19.98	23.72	27.72
Market Price (LCY) *	65.40	73.60	88.63	72.10	72.10	72.10
Dividend Yield	4.6%	2.0%	2.7%	2.4%	2.9%	3.1%
P/E Ratio (x)	16.1	17.4	15.0	16.8	14.2	12.9
P/BV Ratio (x)	3.2	3.2	3.3	3.6	3.0	2.6
P/TangBVPS	3.2	3.2	3.3	3.6	3.0	2.6

* Market price for the current and subsequent years as per the closing price of 12-Dec-2022

Source: Company Financials, U Capital Research

Disclaimer

Recommendation

BUY	Greater than 20%
ACCUMULATE	Between +10% and +20%
HOLD	Between +10% and -10%
REDUCE	Between -10% and -20%
SELL	Lower than -20%



Ubhar Capital SAOC (U Capital)

Website: www.u-capital.net

PO Box 1137

PC 111, Sultanate of Oman

Tel: +968 2494 9000

Fax: +968 2494 9099

Email: research@u-capital.net

Disclaimer: This report has been prepared by Ubhar Capital (U Capital) Research and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell or solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained therein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no responsibility whatsoever for any direct or indirect consequential loss arising from any use of this report or its contents. All opinions and estimates included in this document constitute the U Capital Research team's judgment as at the date of production of this report and are subject to change without notice. This report may not be reproduced, distributed, or published by any recipient for any other purpose.