

Samba Financial Group (SAMBA)

STRONG BUY

TP SAR27.5

52%

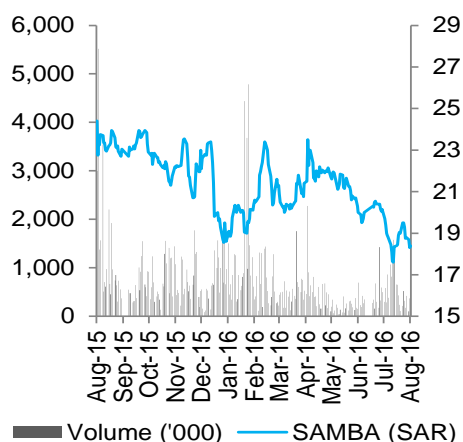
Market Data

Bloomberg Code:	SAMBA AB
Reuters Code:	1090.SE
CMP (24 Aug, 2016):	SAR 18.0
O/S (mn)	2,000
Market Cap (SAR mn):	36,080.0
Market Cap (USD mn):	9,621.3
52 Week High (SAR)	24.4
52 Week Low (SAR)	17.1
3m ADVT (USD mn)	2.1

Price Performance

	1m	3m	12m
Absolute (%)	-8.4	-17.6	-20.7
Relative (%)	-0.8	-10.7	-6.5

Price Volume Performance



Source: Bloomberg

- Best choice amongst Saudi banks
- Ideal combination of low retail loans & high retail deposits
- Trading below BV, recommendation upgraded

We have upgraded the stock to STRONG BUY from BUY on appealing valuations, given that the stock has slid by 21% over the past 12 months. Our fair value for SAMBA comes at SAR27.5/share, which is 52.4% above the bank's current market price of SAR18.0/share as on August 24, 2016. SAMBA is one of the cheapest banks in Saudi Arabia; the stock trades at 2016e P/BV of 0.9x vs the sector's 1.1x. Also, the stock is trading near its 7-year low which provides an excellent opportunity for investors to enter into a position in the stock at appealing valuations.

The bank is favourably positioned to expand its NIMs with the yield on assets outperforming the cost of funds once the benchmark rates begin to move upwards. Due to its sizeable exposure to corporate loans (~85%), the bank's yield on assets is more likely to get re-priced faster in an increasing interest rate scenario. With demand deposits composing 61% of the deposit base, it will be easier for the bank to shed some pressure on its cost of funds.

SAMBA is relatively shielded from the risky building/construction sector despite a corporate heavy book; the troubled sector forms slightly less than 12% of SAMBA's loan book. Driven by a conservative mindset, the bank has shown strong resilience which is well reflected in its asset quality ratios; the NPL ratio was well contained at 0.93% in 2Q16 while NPL coverage is at a very comfortable 165%.

We remain upbeat about the stock considering its stable ROE (4-yr average: 13.0%), handsome dividend yield (4-yr average: 7.3%), favorable loan and deposit mix and low LDR. Currently, the stock trades at a 2016e P/BV multiple of 0.9x which is at 18% discount to the KSA average and offers an attractive entry point. Despite our conservative stance on loans growth and provision buildup, we have arrived at a price target of SAR27.5/share reflecting a 52.4% upside from the bank's closing price as on August 24, 2016.

Investment Indicators

SAR mn	2014	2015	2016e	2017e	2018e
NII	4,593	4,663	5,252	5,684	6,290
NFI	2,791	3,092	2,771	2,887	3,085
Net Income	5,005	5,212	5,171	5,548	6,163
PE	15.4x	9.0x	7.0x	6.5x	5.9x
P/B	2.0x	1.2x	0.9x	0.8x	0.7x
RoE	14.0%	13.5%	12.7%	12.7%	13.2%

Source: Global Research

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Valuation update – Upgraded to **STRONG BUY**

We have kept our fair value estimate for SAMBA relatively unchanged at SAR27.5/share due to slower pace of loan growth and lower net income being offset by higher ROE expectations. Our recommendation on the stock however gets upgraded to **STRONG BUY** from **BUY** mainly due to a massive decline in the bank's stock price led by weak sentiments in the region.

We expect the bank's ROE to average at 13.0% over our forecast horizon which is a minor reduction from 13.5% in 2015 but higher than our previous average ROE forecast of ~12.7% for 2016 & 2017. Moreover, unlike most of its counterparts, the bank offers substantial liquidity at current levels (76%) against SAMA's regulatory limit of 90% (increased from 85% in Feb-2016). This provides the bank with a substantial cushion to disburse loans without the need to collate deposits aggressively, thereby keeping its cost of deposits in check as well. Additionally, we have been overly conservative regarding the bank's provisions, raising our cost of risk from 11bps in 2015 to ~26bps over our forecast horizon. A lower than expected deterioration in asset quality and therefore provisioning needs, will be seen as a positive development by investors.

After the huge 21% decline in the stock price over the past 12 months, the bank is currently trading at a 2016 P/E of 7.0x and P/BV of 0.9x, as compared to sector average of 7.5x and 1.1x which leaves enough room for the stock to scale upwards. The stock offers an upside potential of 52.4% from the bank's current market price of SAR18.0/share as on August 24, 2016. We have assumed the risk-free rate (US 10-year Treasury yield) at 1.6% and risk premium at 9.6%, including the country as well as stock-specific risk.

Risks to valuation

- **Advances growth:** While we have been fairly conservative in our estimates for loans growth, any major deviation from our estimates is likely to shift our views negatively if the deviation is on the lower side and vice versa.
- **Direction and magnitude of NIMs:** We have assumed moderate improvement in NIMs over the forecast horizon once the benchmark rates begin to scale-up. Any unexpected event which leads to prolonged period of unchanged Federal Reserve rates will likely have a negative impact on our projections.
- **Asset deterioration/cost of risk:** Our model assumes a stable NPL ratio post 2016; the cost of risk also stabilizes from then onwards. Any major delinquency or announcement from the Central Bank will lead to higher provisions and lower profits, prompting us to revisit our estimates negatively.

2016e estimates have been trimmed

We have revisited most of the line items for 2016e post recent 2Q16 results. Realizing that our previous loan growth estimates were slightly bullish and non-conforming to the prevalent environment, we have reduced our loan and deposit estimates by 3% and 6.6%, respectively. We have reduced our net interest income forecast by 7% as we believe, in a low oil price scenario and tighter growth in the economy, lending growth would be impacted and that NIMs will not expand as we had estimated earlier. Operating income projection was revised down by 5.2% due to higher salaries and other expenses coupled with lower financing income. Also, we have increased our provision expectations by 68.2%; all these revisions lead to an 8.7% reduction in the bank's bottom-line for 2016e.

Estimates Revision - 2016e

(SAR mn)	Earlier Estimates	Revised Estimates	% Change
Gross Loans	142,772	138,428	-3.0%
Deposits	190,760	178,145	-6.6%
NII	5,645	5,252	-7.0%
Operating Income	8,460	8,024	-5.2%
Provision for loan losses	214	360	68.2%
Net Profit	5,661	5,171	-8.7%

Source: Global Research

2Q16 net profit recorded a 1.4%YoY fall

SAMBA reported a 1.4%YoY decline in the reported net profit in 2Q16, due to an increase in the provision expenses as well as other operating expenses thereby paring the operating income gains.

Notably, the bank's total interest income surged 27.5%YoY while interest expense surged 162.1%YoY thereby pushing the net financing income up by 15.1%YoY. Net interest income growth could be attributed to a 23bps YoY surge in the NIMs. The bank's yield on assets improved 57bps YoY whereas the cost of funds rose by 36bps YoY which took the company's NIM's to 2.66% in 2Q16 from 2.43% in 2Q15.

A decline in the fee income by 13.5%YoY along with decline in gains from investment had an impact on the total non-interest income which fell 19.8%YoY. This led to a cumulative jump of only 1.1%YoY in the total operating income. The bank's provision expenses saw a rise of 40.5%YoY while other operating expenses saw an addition of 4.9% as a result of increase in salaries and related expenses.

Balance sheet growth was tepid during the quarter. Gross advances saw a marginal decline of 0.5%YoY whereas deposits advanced 0.7%YoY.

On the asset quality front, we saw a marginal uptick in the NPL ratio which rose to 0.93% in 2Q16 from 0.83% in 1Q16; the figure is however significantly lower as compared to 1.23% in 2Q15. Non-performing loans coverage has dipped to 165% from 183% in the 1Q16 while it is stable as compared to 162% in 2Q15.

Income Statement

(SAR mn)	2Q16	2Q15	YoY%	1Q16	QoQ%
Special Commission Income	1,620	1,270	27.5%	1,494	8.4%
Special Commission Expenses	281	107	162.1%	242	15.9%
Net Interest Income	1,339	1,163	15.1%	1,252	6.9%
Fee from Services	392	453	-13.5%	439	-10.8%
Exchange Income	129	105	23.0%	178	-27.4%
Trading Income	38	18	110.4%	-46	-181.3%
Realized Gains on Investments	29	121	-75.9%	50	-41.2%
Other Operating Income	43	90	-51.8%	51	-15.7%
Total Non-Interest Income	631	786	-19.8%	671	-6.0%
Total Operating Income	1,970	1,949	1.1%	1,923	2.4%
Provisions Expense	38	27	40.5%	45	-14.9%
Operating Expenses	618	589	4.9%	619	-0.2%
Net Profit	1,314	1,333	-1.4%	1,260	4.3%

Source: Company Accounts

	(SAR mn)	2013	2014	2015	2016e	2017e	2018e	2019e
Income Statement	Special commission income	4,997	5,041	5,164	6,174	6,710	7,556	8,348
	Special commission expense	(469)	(448)	(501)	(922)	(1,026)	(1,266)	(1,457)
	Special Commission Income, Net	4,528	4,593	4,663	5,252	5,684	6,290	6,890
	Fee & Commission Income	1,600	1,775	1,683	1,776	1,863	1,975	2,093
	Investment Income	320	382	533	195	194	225	258
	Other Income	552	634	876	800	829	885	945
	Total Non-Commission Income	2,472	2,791	3,092	2,771	2,887	3,085	3,297
	Total Operating Income	7,001	7,385	7,755	8,024	8,571	9,376	10,187
	Provisions expense	(353)	(141)	(142)	(360)	(363)	(385)	(408)
	Operating Expenses	(2,137)	(2,233)	(2,398)	(2,491)	(2,656)	(2,822)	(2,997)
	Profit Before Taxation	4,510	5,010	5,214	5,173	5,552	6,168	6,782
	Sale of associate (net)	-	-	-	-	-	-	-
	Taxation & Minority Interest	0	(5)	(2)	(2)	(4)	(5)	(7)
Net Profit Attributable to Parent	4,510	5,005	5,212	5,171	5,548	6,163	6,775	
Balance Sheet	Cash Balances	20,383	14,679	15,300	17,711	19,175	19,348	19,379
	Deposits with Banks & FIs	4,858	7,406	14,397	12,237	12,849	14,134	15,547
	Investment Securities	60,341	64,516	69,705	67,296	71,180	75,209	78,966
	Gross Loans & Financings	116,382	126,747	131,837	138,428	145,350	154,071	163,315
	Loan Loss Reserve	(2,927)	(2,668)	(2,018)	(2,378)	(2,741)	(3,126)	(3,535)
	Net Loans & Financings	113,455	124,079	129,819	136,051	142,609	150,945	159,781
	Investment in Associates	-	-	-	-	-	-	-
	Investment Properties	-	-	-	-	-	-	-
	Net Fixed Assets	1,824	2,067	2,267	2,583	2,931	3,314	3,734
	Other Assets	4,176	4,652	3,755	3,943	4,140	4,347	4,564
	Total Assets	205,037	217,399	235,243	239,822	252,884	267,296	281,972
	Deposits from Banks & FIs	7,473	9,385	19,191	12,733	13,370	14,038	14,740
	Deposits from Customers	158,337	163,795	171,396	178,145	187,052	196,919	206,635
	Other Borrowings	-	-	-	-	-	-	-
	Other Liabilities	4,296	5,307	4,296	4,511	4,736	4,973	5,222
	Paid-up Capital	9,000	12,000	20,000	20,000	20,000	20,000	20,000
	Retained Earnings	16,141	4,926	6,524	9,398	12,377	15,723	19,416
	Other Reserves	9,661	21,858	13,727	14,924	15,233	15,522	15,833
	Shareholders' Equity	34,803	38,784	40,251	44,321	47,610	51,245	55,248
	Minority Interest	128	128	109	111	115	120	127
Total Equity & Liability	205,037	217,399	235,243	239,822	252,884	267,296	281,972	
Ratio Analysis	Return on Average Assets	2.2%	2.4%	2.3%	2.2%	2.3%	2.4%	2.5%
	Return on Average Equity	13.9%	14.0%	13.5%	12.7%	12.7%	13.2%	13.4%
	Recurring Income/Operating Income	87.5%	86.2%	81.8%	87.6%	88.1%	88.2%	88.2%
	Interest Earning/Financing Assets Yield	3.0%	2.79%	2.59%	2.95%	3.12%	3.33%	3.48%
	Cost of Funds	0.3%	0.26%	0.28%	0.48%	0.52%	0.62%	0.67%
	Net Spread	2.8%	2.52%	2.32%	2.47%	2.60%	2.72%	2.80%
	Cost to Income Ratio	30.5%	30.2%	30.9%	31.0%	31.0%	30.1%	29.4%
	Net Loans to Customer Deposits	73.5%	77.4%	76.9%	77.7%	77.7%	78.2%	79.0%
	Non Performing Loans	2,011.6	1,659.7	1,113.8	1,799.6	2,034.9	2,157.0	2,286.4
	Loan Loss Reserve	2,926.5	2,667.6	2,017.8	2,377.7	2,741.0	3,126.2	3,534.5
	NPLs to Gross Loans	1.8%	1.33%	0.85%	1.32%	1.42%	1.42%	1.42%
	NPL Coverage	145.5%	160.7%	181.2%	132.1%	134.7%	144.9%	154.6%
	Provisions/Total Income	5.0%	1.9%	1.8%	4.5%	4.2%	4.1%	4.0%
	Cost of Risk (bps)	31.5	11.6	11.0	26.6	25.6	25.7	25.7
	Equity to Gross Loans	30.0%	30.7%	30.6%	32.1%	32.8%	33.3%	33.9%
	Equity to Total Assets	17.0%	17.9%	17.2%	18.5%	18.9%	19.2%	19.6%
	DPS	0.98	1.12	1.17	1.15	1.28	1.41	1.54
	Dividend Yield	2.0%	2.9%	5.0%	6.4%	7.1%	7.8%	8.5%
	Dividend Payout Ratio	43.4%	44.8%	44.8%	44.4%	46.3%	45.7%	45.5%
	Adjusted EPS (SAR)	2.3	2.5	2.6	2.6	2.8	3.1	3.4
Adjusted BVPS (SAR)	17.0	18.9	19.6	21.1	22.6	24.3	26.1	
Market Price (SAR)*	50.0	38.6	23.3	18.0	18.0	18.0	18.0	
P/E Ratio (x)	22.2	15.4	9.0	7.0	6.5	5.9	5.3	
P/BV Ratio (x)	2.9	2.0	1.2	0.9	0.8	0.7	0.7	

Source: Company Reports & Global Research*

* Market price for 2016 and subsequent years as per closing prices on August 24, 2016

Disclosure

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist					
Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Samba Financial Group	STRONG BUY	SAMBA AB	1090.SE	SAR 18.04	1,10

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Global Research: Equity Ratings Definitions	
Global Rating	Definition
STRONG BUY	Fair value of the stock is >20% from the current market price
BUY	Fair value of the stock is between +10% and +20% from the current market price
HOLD	Fair value of the stock is between +10% and -10% from the current market price
SELL	Fair value of the stock is < -10% from the current market price

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