Results Flash Note | 2020A

Alinma Bank

ITQAN CAPITAL

Strong Balance Sheet Growth, but Earnings Remain at Risk.

9 March 2021

Alinma bank reported strong balance sheet growth in FY2020, yet its net earnings fell by 22.4% amid a significant rise in provisions. Alinma's Cost of Risk and Non-Performing Loans (NPL) ratios reached a historic high, mainly due to the bank's high exposure to corporate loans. Despite the surge in provisions during the year, we do not expect lower provisions in return during FY2021e yet recovering financing income and investment income should support earnings recovery during FY2021e. We maintain our Neutral recommendation for Alinma with a target price of SAR17.0/share.

Alinma's gross financing income dropped by 2.7% Y-o-Y during Q4 2020 amid lower SAIBOR and deferral of SMEs payments. Yield on financing and investments contracted to a four-year low of 4.3% vs 5.0% during FY2019. Return on time investments, in return, fell by 45.0% Y-o-Y (despite the rise in time deposits by 16.5%) thanks to lower profit rate paid on the customers' time investments which account for 42.0% of the bank's deposits. Net income from financing and investments grew by 8.3% Y-o-Y and 6.0% Q-o-Q. Net interest margin, however, tightened by 30bps to 3.6% vs 3.9% during FY2019.

Non-financing income grew by 5.5% Y-o-Y and 22.5% Q-o-Q during Q4 2020, mainly on account of higher fees from banking services. Total operating income increased by 7.6% Y-o-Y and 9.5% Q-o-Q during Q4 2020. Cost to Income ratio improved to 33.4% vs 36.9% in Q4 2019. Net operating income before provisions increased by 13.6% Y-o-Y and 15.3% Q-o-Q during Q4 2020.

On the other hand, Loan loss provisions surged by 69.0% Y-o-Y and 178.3% Q-o-Q to SAR651mn during Q4 2020 amid the bank's high exposure to corporate loans (79% of the financing portfolio), which are currently underperforming retail loans amid business disruptions. Cost of Risk (CoR) increased to a historic high of 1.3% in FY2020 vs 0.8% in FY2019 and 0.6% in FY2018. As a result of the hike in provisions, net income dropped by 22.5% Y-o-Y and 37.4% Q-o-Q during Q4 2020.

On the other hand, Alinma's assets growth remains healthy; financing portfolio grew by 17.3% Y-o-Y while investments grew by 25.8% Y-o-Y. Customers deposits grew by 17.0% Y-o-Y and 7.3% Q-o-Q. Loans to customers deposits ratio stood at 95.8% vs 95.4% in FY2019.

However, the rise in Alinma's non-performing loans (NPL) is concerning which increased to 2.5% of gross loans (above the sector's NPL of 2.2%) vs 1.9% in FY2019. Non-performing loans coverage dropped to a historic low of 116% vs 140% in FY2019, indicating lower reserves to absorb future losses and potential rise in impairments during FY2021e.

Alinma declared a cash dividend of SAR0.30/share for FY2020, which represents a dividend yield of around 1.8% and a payout ratio of 30%. It is worth mentioning that Alinma granted bonus shares during FY2019 instead of distributing cash dividends.

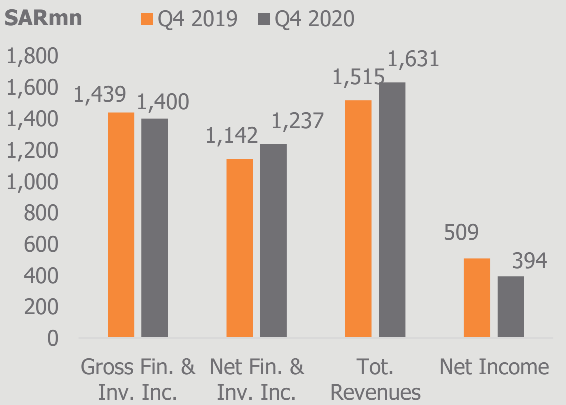
Alinma's stock price is currently trading at 16.9x FY2020 earnings and 1.3x its book value, which is in-line with the banking sector's median.

Recommendation	Neutral
Previous Recommendation	Neutral
Current Price (08-03-2021)	SAR16.48
Target Price (52 weeks)	SAR17.0
Upside/ (Downside)	3.0%
Shariah Compliance	Pass

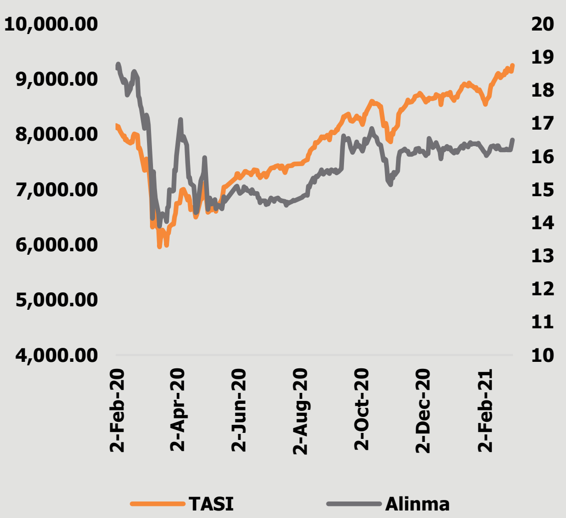
Key Financial Ratios

Ratio	Q4 2020	Q3 2020	Q4 2019
Gross Fin. & Inv.	4.7%	0.0%	-0.3%
Net Fin. Margin	88.4%	87.3%	79.4%
Net Inc. Margin	28.1%	47.1%	35.3%

Key Financial Results (Q4 2020)



Share Price Performance



Financial Overview

2020A Overview & Outlook

High exposure to corporate loans adversely impacted Alinma's profitability and asset quality during FY2020. Alinma reported 60bps rise in NPL ratio to 2.5% vs 1.9% in FY2019. NPL ratio in the retail segment fell to 1.1% vs 1.7% in FY2019 (but mainly due to loans write offs) while corporate segment's NPL ratio increased by 100bps to 2.9% vs 1.9% in FY2019. The NPL ratio didn't show much improvement in H2 2020 despite improving business conditions in the second half of the year.

Stage 1 loans, stage 2 loans, and stage 3 loans accounted for around 91.7%, 5.9%, and 2.5% of Alinma's total loans vs 91.3%, 6.8%, and 1.9% in FY2019. The former numbers reflect migration of stage 2 loans (underperforming loans) to stage 3 loans (non-performing loans).

As a result, Alinma's impairment charges increased by 103% during FY2020 to SAR1,419mn vs SAR700mn during FY2019. Alinma's net income dropped to a 3-year low (-22.4% Y-o-Y) during FY2020 recording SAR1,966mn.

Further rise in provisions is possible during FY2021 as NPL coverage is at record low and continued SMEs payment deferral may be delaying recognition of non-performing loans from SMEs. Alinma's NPL coverage reached 116% vs 140% in FY2019 and a historic average of 180%. Stage 3 coverage dropped to 52.8% vs 61.5% in FY2019. This reflects lower provisions buffer to absorb future expected losses from non-performing loans, which risks recognition of higher impairment charges during FY2021e.

On a similar note, the continued extension of SAMA's Deferred Payment Program for SMEs may be delaying the recognition of underperforming and non-performing loans from SME loans as the payments are not due yet. SAMA recently announced further extension of the SMEs deferral program until the end of June 2021, thus any underperformance from the SMEs portfolio may not materialize until H2 2021. Alinma has exposure to the SMEs portfolio of SAR4.4bn (around 4% of the financing portfolio).

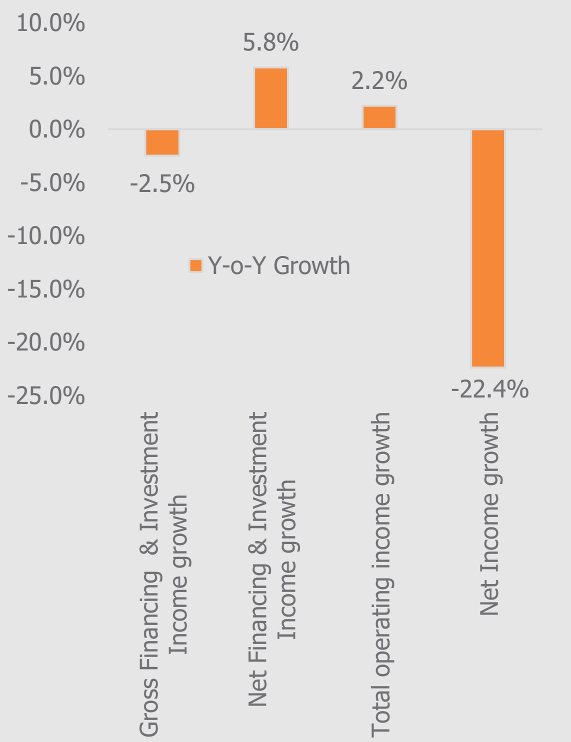
Strong balance sheet growth, supporting net financing income growth and offsetting the impact of lower lending rates. Alinma's financing portfolio grew by 17.3% Y-o-Y in FY2020 while investments grew by 25.8%. Customers deposits similarly increased by 17.0% Y-o-Y. Loans to customer deposits ratio remained high, however, at 95.8%. Strong assets growth as well as deposits growth supported Alinma's financing income during FY2020, mitigating the impact of lower lending rates on financing income. Gross income from financing and investing fell by only 2.5% during FY2020, while net financing income grew by 5.8% thanks to lower profit rate paid on time deposits.

High Capital Adequacy provides adequate capital buffers to withstand any unforeseen losses. Alinma's capital adequacy reached around 19.3%, in line with the banking sector's ratio of 19.6%, yet it fell slightly from 20.3% in FY2019. Adequate Capital should enable the bank to withstand potential worsening of asset quality. Accordingly, while Alinma's earnings are at risk of higher impairment charges, its capital is sufficient to absorb any possible deterioration in asset quality.

Key Financial Ratios

Ratio	FY 2020	FY 2019
Gross Fin. & Inv. growth	-2.5%	14.6%
Net Financing Margin	85.0%	78.3%
Net Income Margin	35.9%	45.2%
Net Interest Margin	3.6%	3.9%
Return on Equity	8.4%	11.6%
Cost to Income	36.9%	37.0%
NPL Ratio	2.5%	1.9%
Cost of Risk	1.3%	0.8%
NPL Coverage	115.7%	140.3%
LDR Ratio	95.8%	95.4%
Capital Adequacy Ratio	19.3%	20.3%

Key Financial Results (2020A)



Financial Projection

Residual Income Valuation

	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Net Income	2,245	2,391	2,532	2,658	2,794	2,926
Excess Return for Excess Capital	167	174	189	206	225	246
Adjusted Net Income	2,078	2,218	2,342	2,452	2,569	2,680
Equity Charge	1,592	1,691	1,769	1,853	1,941	2,035
Economic Value Added (EVA)	486	527	573	599	628	645
Discount Factor	0.92	0.85	0.78	0.71	0.66	0.60
NPV of EVA	447	445	445	428	412	389

EVA Forecast period	2,567
Perpetual Growth Rate	3.0%
Terminal Value	11,512
Terminal Value Discounted	6,952
Required Equity	16,602
Surplus Capital	7,231
Dividends	596
Total Fair Value	33,949
Number of shares	2,000
Target price per share (52 Weeks)	17.0
Current share price (08-03-2021)	16.48
Upside/(downside)	3.0%

We have valued Alinma Bank using Residual Income approach, considering a Cost of Equity equal to 8.8% (based on a risk-free rate of 2.7%, market risk premium 7.0%, Beta of 0.87).

Based on the Residual Income valuation, the fair price of Bank Alinma share is SAR17.0, which is higher than the traded value by 3.0%.

Financial Ratios

Financial Ratios	2020 A	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Net Income Margin	35.9%	38.2%	37.4%	36.6%	35.9%	35.2%	34.3%
Net Spread	3.6%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Total Finances / Total Deposits	95.8%	95.0%	95.0%	95.0%	95.0%	95.0%	95.0%
Investments/Total Deposits	24.7%	24.5%	24.5%	25.0%	25.4%	25.9%	26.4%
Net Interest Margin	3.6%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Return on Average Equity	8.4%	8.9%	8.9%	9.0%	8.9%	8.8%	8.7%
CASA Ratio	58.0%	54.1%	55.6%	58.5%	61.5%	64.7%	68.0%

Income Statement

Income Statement	2020 A	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Gross financing and investment income	5,470	5,882	6,402	6,914	7,412	7,947	8,522
Net financing and investment income	4,648	4,923	5,236	5,537	5,819	6,122	6,448
Non-financing related income	1,086	1,341	1,405	1,472	1,542	1,616	1,694
Total Revenues	**5,734**	**6,264**	**6,641**	**7,009**	**7,361**	**7,738**	**8,142**
Operating income	3,616	3,979	4,182	4,362	4,510	4,665	4,828
Net Income	**1,966**	**2,245**	**2,391**	**2,532**	**2,658**	**2,794**	**2,926**

Balance Sheet

Balance Sheet	2020 A	2021 F	2022 F	2023 F	2024 F	2025 F	2026 F
Total Investments	29,526	31,593	33,804	36,170	38,702	41,411	44,310
Total Financing	111,196	117,913	125,164	130,380	135,927	141,825	148,081
Total assets	**156,877**	**168,308**	**178,527**	**186,591**	**195,070**	**203,986**	**213,343**
Customers Deposits	119,454	128,959	137,986	144,886	152,130	159,736	167,723
Total Liabilities	132,448	142,230	151,051	157,577	164,392	171,507	178,931
Total equity	**24,429**	**26,078**	**27,476**	**29,014**	**30,678**	**32,479**	**34,412**
Total liabilities and equity	**156,877**	**168,308**	**178,527**	**186,591**	**195,070**	**203,986**	**213,343**

Guide to Ratings and Disclaimer

Guide to Ratings

Buy	An upside potential of more than 20% in 52-week period
Overweight	An upside Potential of more than 10% in 52-week period
Neutral	Will stay in the range of it value (up/down 10%) in a 52-week period
Underweight	A downside potential of more than 10% in 52-week period
Sell	A downside potential of more than 20% in 52-week period

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