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# Saudi Arabia Banking Pulse

## Quarter 2, 2020

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# FOREWORD

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Alvarez & Marsal Middle East Limited (A&M) is delighted to publish the 2<sup>nd</sup> edition of the Kingdom of Saudi Arabia (KSA) Banking Pulse (“The Pulse”). In this quarterly series, we share results from our research examining the top ten largest listed KSA banks by assets, and highlight key performance indicators of the KSA banking industry. The Pulse aims to help banking executives and board members stay current on industry trends.

All the data used in this report has been obtained from publicly available sources and the methodology for the calculations is discussed in the glossary. Calculation of several metrics will be subject to change based on available information.

Following the outbreak of COVID-19, the KSA government and central bank have announced a series of stimulus measures worth ~SAR 170bn, to support the economy. However, it also imposed some austerity measures in the form of tripling VAT rate, reducing budget spending and suspending cost of living allowance for the citizens.

The planned merger between NCB and SAMBA reinstated the consolidation wave in the domestic banking sector, after SABB acquired Alawwal Bank in 2019.

The performance in Q2’20 may not be entirely comparable with that of the previous quarters, as we are comparing the sector’s performance during COVID and pre-COVID periods. Post the outbreak of COVID sector-wide loan growth, profitability and interest rates reached multi-period low levels. However, the COVID-19 related impact on the industry is expected to continue for FY’20.

We hope that you will find our second edition of the KSA Banking Pulse useful and informative.

*Disclaimer:*

*The information contained in this document is of a general nature and has been obtained from publicly available information plus market insights. The information is not intended to address the specific circumstances of an individual or institution. There is no guarantee that the information is accurate at the date received by the recipient or that it will be accurate in the future. All parties should seek appropriate professional advice to analyze their particular situation before acting on any of the information contained herein*



## Co-Authors

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Co-Author, Managing Director  
Head of Middle East

- 18+ years of international experience in management consulting and industry
- Focuses on strategic and performance-related matters in financial institutions, sovereign wealth funds, family businesses, real estate, private equity and private investments
- Emirati National, frequent speaker and moderator in Banking & Finance events



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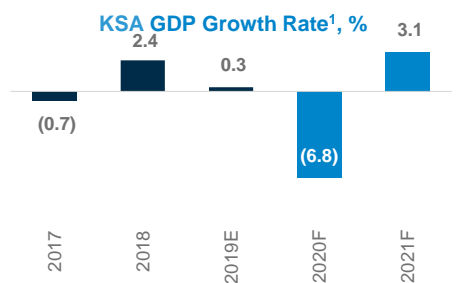
- 30+ years of experience in banking
- Focuses on performance improvement, turn-around, credit management, and formulating and managing strategic and operational changes in financial institutions
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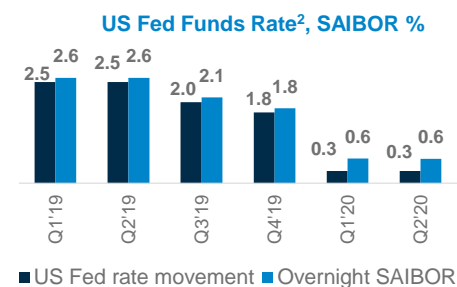
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# Saudi Arabia Macro & Sector Overview

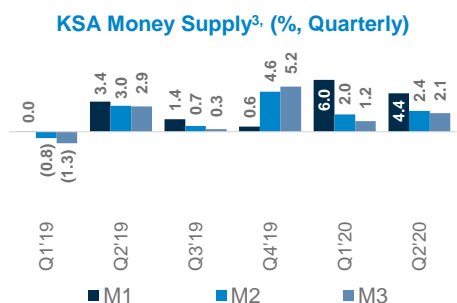
## Macro overview



- The Q1'20 GDP growth of KSA decreased by 1.0% YoY, due to subdued performance in the oil sector. The economy is expected to have contracted further in Q2'20
- In Q2'20, the average PMI reading fell to 46.7 from 49.9 in Q1'20, as cautious business and consumer spending caused holding back of new order intakes
- In June'20, the IMF reduced KSA's GDP estimate further to -6.8% for FY'20, compared to -2.3% in April'20 estimate
- Unusually high level of uncertainty due to COVID-19 and low oil prices led to the reduction in the growth estimate



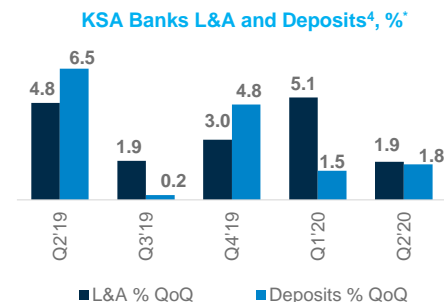
- The US Fed lowered lending rates twice, bringing it close to 0% mark, amid the COVID-19 situation. In August'20, Fed Chair also hinted that rates could remain low for longer period
- In line with the US Fed, the Saudi central bank also lowered its interest rates, with the overnight **SAIBOR declining to 0.59% at the end of Q2'20**
- Saudi central bank's efforts to stabilize the economy from the current economic headwinds will keep **interest rates at low levels in the foreseeable future**



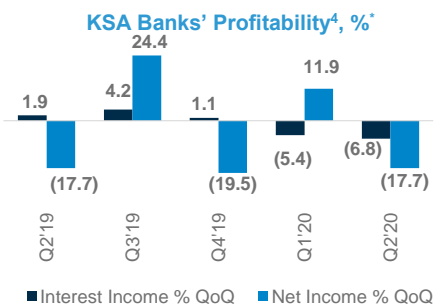
- In Q2'20, M2 money supply growth stood at 2.4% QoQ and 9.9% YoY to reach SAR 1.9tn
- M2 money supply increased primarily driven by **4.3% QoQ increase in demand deposits to SAR 1.2tn**
- M1 increased by 4.4% QoQ in Q2'20 to SAR 1.4tn, while M3 money supply grew 2.1% QoQ to SAR 2.1tn

<sup>1</sup> IMF forecast, <sup>2</sup> US Board of Federal Reserve, <sup>3</sup> KSA Central Bank, <sup>4</sup> Company Financials, \* Data for top ten KSA banks by asset size as of June 30<sup>th</sup> 2020, QoQ stands for quarter over quarter, net income excludes the one-off impairment charge reported by Saudi British Bank in Q2'20

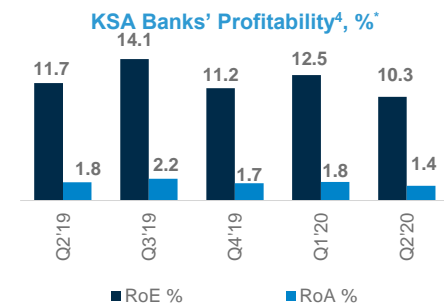
## Banking overview Q2'20



- Loans & Advances (L&A) growth of top ten KSA banks slowed to 1.9% QoQ in Q2'20, compared to 5.1% QoQ in Q1'20
- Deposit growth improved slightly to 1.8% QoQ, compared to 1.5% QoQ in the preceding quarter
- The profitability of the banking sector was impacted substantially, as most sections of the economy was under the lockdown during the period**



- Interest income of top ten banks declined by 6.8% QoQ, due to lower interest rates
- Net income declined by 17.7% QoQ, as lockdowns impacted most of the income streams for the banks
- Outlook for profitability for KSA banks remains subdued, as low oil prices and after effects of COVID-19 might impact credit demand and asset quality



- The return ratios deteriorated during the quarter primarily driven by decrease in net income
- Return on Equity (RoE – Q2'20 annualized) declined by 2.15% points to reach 10.3%
- Similarly, return on asset (RoA – Q2'20 annualized) declined from 1.8% in Q1'20 to 1.4% in Q2'20
- Aggregate RoE and RoA remained at multi-period low levels

# Pulse: Performance of Top Ten Banks was Impacted Substantially by COVID-19 Lockdowns

➔ Improved
 ↔ Stable
 ➔ Worsened

	Metric	Q1'20	Q2'20	Q2'19	Q3'19	Q4'19	Q1'20	Q2'20	Key Trends of Q2'20
Size	L&A Growth (QoQ)	5.1%	➔ 1.9%						1 L&A growth stood at 1.9%, the slowest in last five quarters. Deposit growth increased marginally by 1.8%
	Deposits Growth (QoQ)	1.5%	➔ 1.8%						
Liquidity	Loan-to-Deposit Ratio (LDR)	86.0%	➔ 86.1%						2 LDR increased marginally to 86.1%, as L&A growth outpaced deposit growth
Income & Operating Efficiency	Operating Income Growth (QoQ)	-2.0%	➔ -3.8%						3 Operating income decreased ~4% QoQ, as major income streams witnessed negative growth
	Operating Income / Assets	4.0%	➔ 3.7%						
	Non-Interest Income (NII) / Operating Income	23.2%	➔ 21.9%						4 NIM compressed further by 18 bps due to low interest rate environment
	Yield on Credit (YoC)	6.1%	➔ 5.5%						
	Cost of Funds (CoF)	0.9%	➔ 0.7%						5 Banks continued to improve their efficiency, as C/I ratio improved for the second consecutive quarter to reach 34.9%
	Net Interest Margin (NIM)	3.2%	➔ 3.0%						
	Cost-to-Income Ratio (C/I)	35.1%	➔ 34.9%						6 CoR increased substantially (+48 bps QoQ), as impairment charges spiked. On the other hand, coverage ratio fell to 146.2%
Risk	Coverage Ratio	147.8%	➔ 146.2%						
	Cost of Risk (CoR)	0.8%	➔ 1.3%						7 RoE and RoA dropped to their multi-period low levels, as net income dropped 17.7%
Profitability	Return on Equity (RoE)	12.5%	➔ 10.3%						
	Return on Assets (RoA)	1.8%	➔ 1.4%						8 RoRWA tracked RoE and RoA lower to 1.7%. On the other hand, CAR improved to 19.0%
	Return on Risk-Weighted Assets (RoRWA)	2.2%	➔ 1.7%						
Capital	Capital Adequacy Ratio (CAR)	18.5%	➔ 19.0%						

Note 1: Growth in loans & advances and deposits were presented QoQ instead of YoY

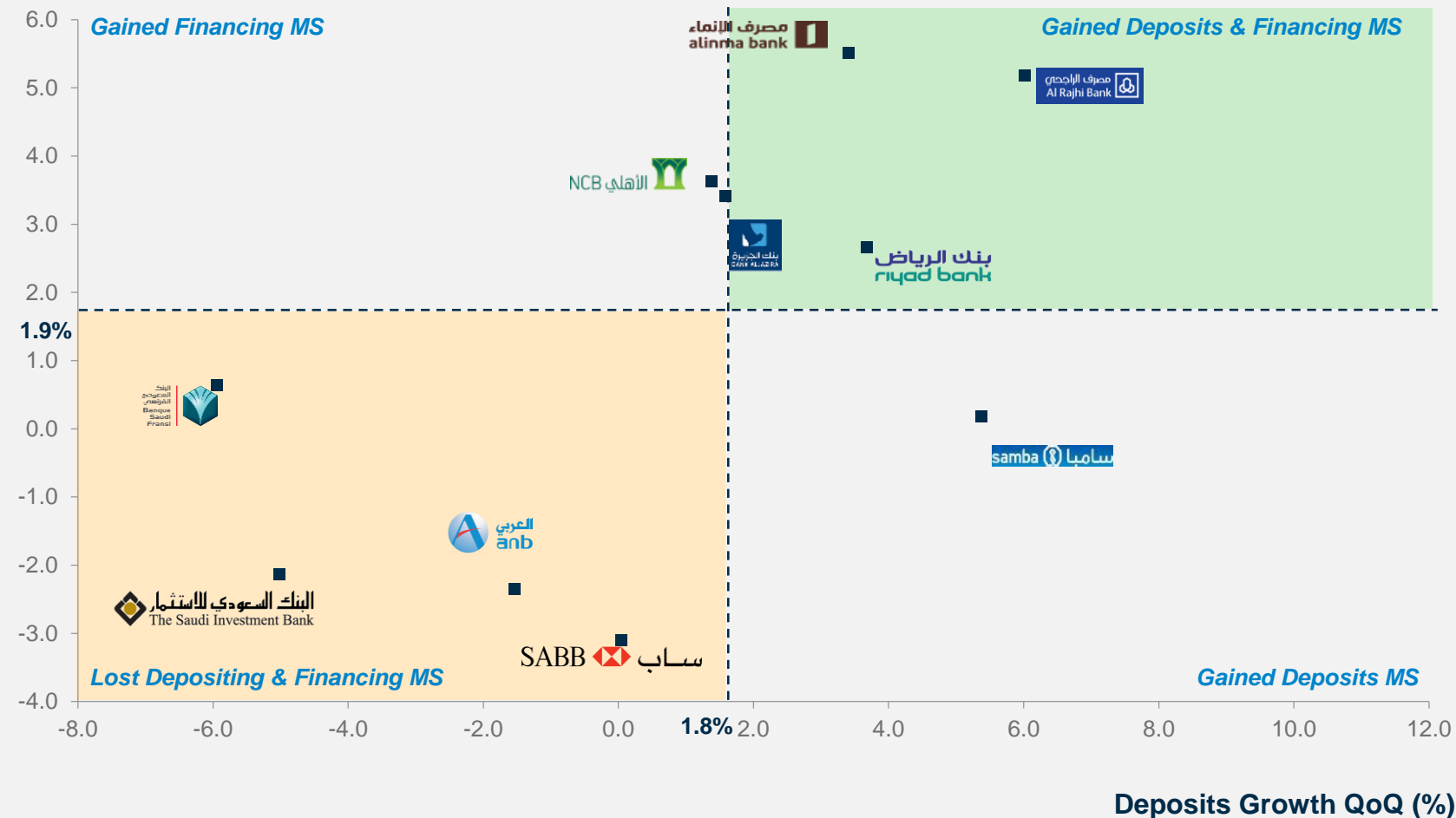
Note 2: Quarterly income was used in the calculation of operating income growth

Source: Financial statements, Investor presentations, A&M analysis



# ALINMA's L&A Growth Outperformed its Peers; ALRAJHI Reported the Highest Deposit Growth

## L&A Growth QoQ (%)



## KEY TAKEAWAYS

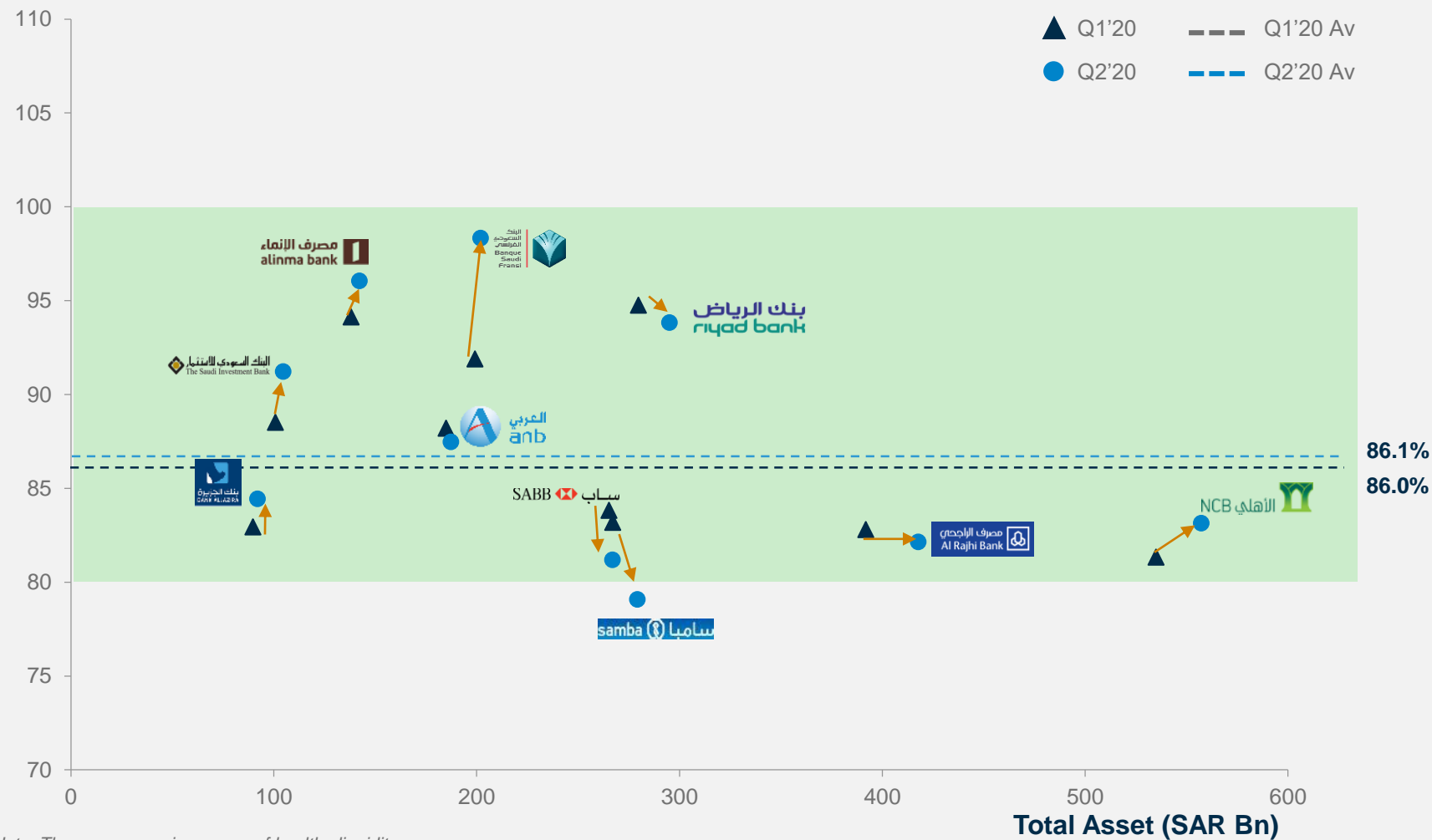
- L&A and deposits of top ten banks increased by 1.9% and 1.8%, respectively
- L&A growth of ALINMA (+5.5%) was the highest among all peers
  - The growth resulted from increased financing in both retail and corporate segments
- ALRAJHI reported the strongest deposit growth (+6.0%), driven by considerable increase in demand deposits
- On the other hand, SABB's L&A decreased the most (-3.1%)
- BSF reported the highest decline in deposits (-5.9%), as the bank witnessed outflow (SAR 9.5bn) in demand and time deposits

Note: MS stands for market share

Source: Financial statements, Investor presentations, A&M analysis

# Five of the Top Ten Banks Reported an Increase in LDR

Loans to Deposits Ratio (%)



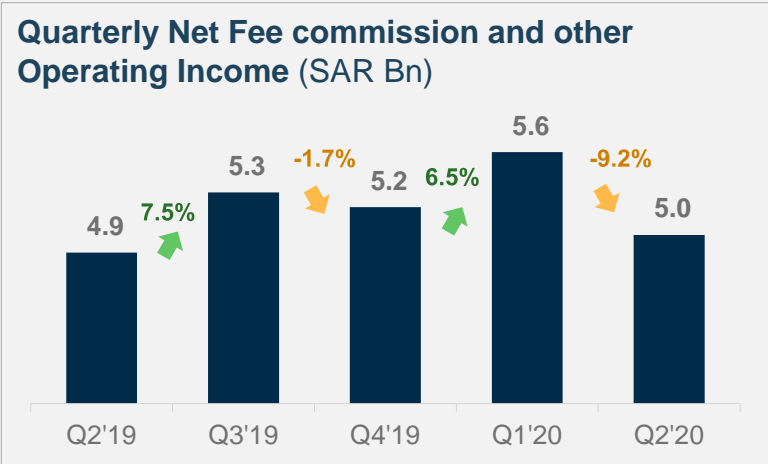
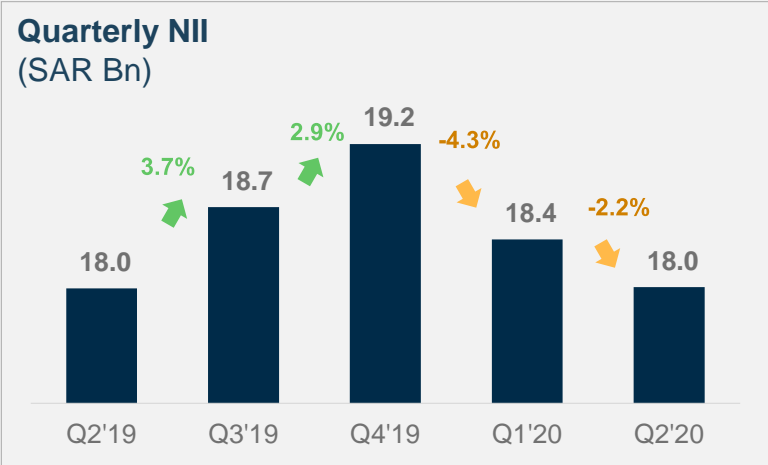
Note: The green zone is an area of healthy liquidity  
Source: Financial statements, A&M analysis

## KEY TAKEAWAYS

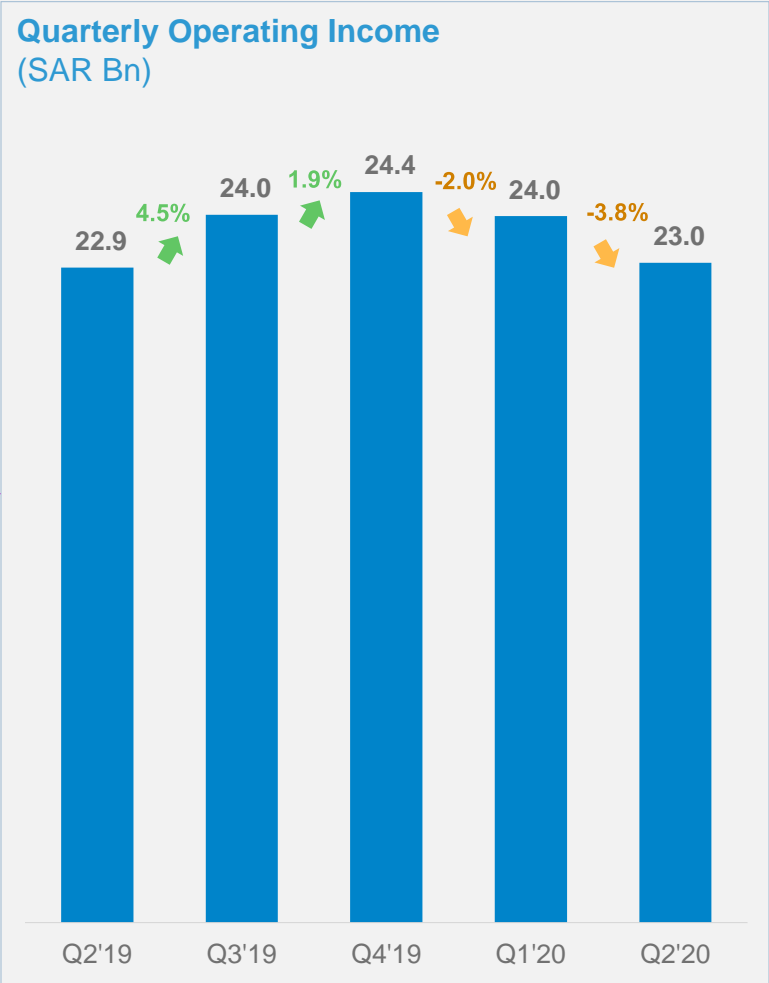
- Aggregate LDR increased from 86.0% in Q1'20 to 86.1% in Q2'20
- BSF (+6.4% points) reported the highest increase in LDR, while SAMBA (-4.1% points) reported the highest decline in LDR during the period

# Low Interest Rate Environment and Lockdown Measures Impacted Operating Income

➔ Improved
 ↔ Stable
 ➔ Worsened



+



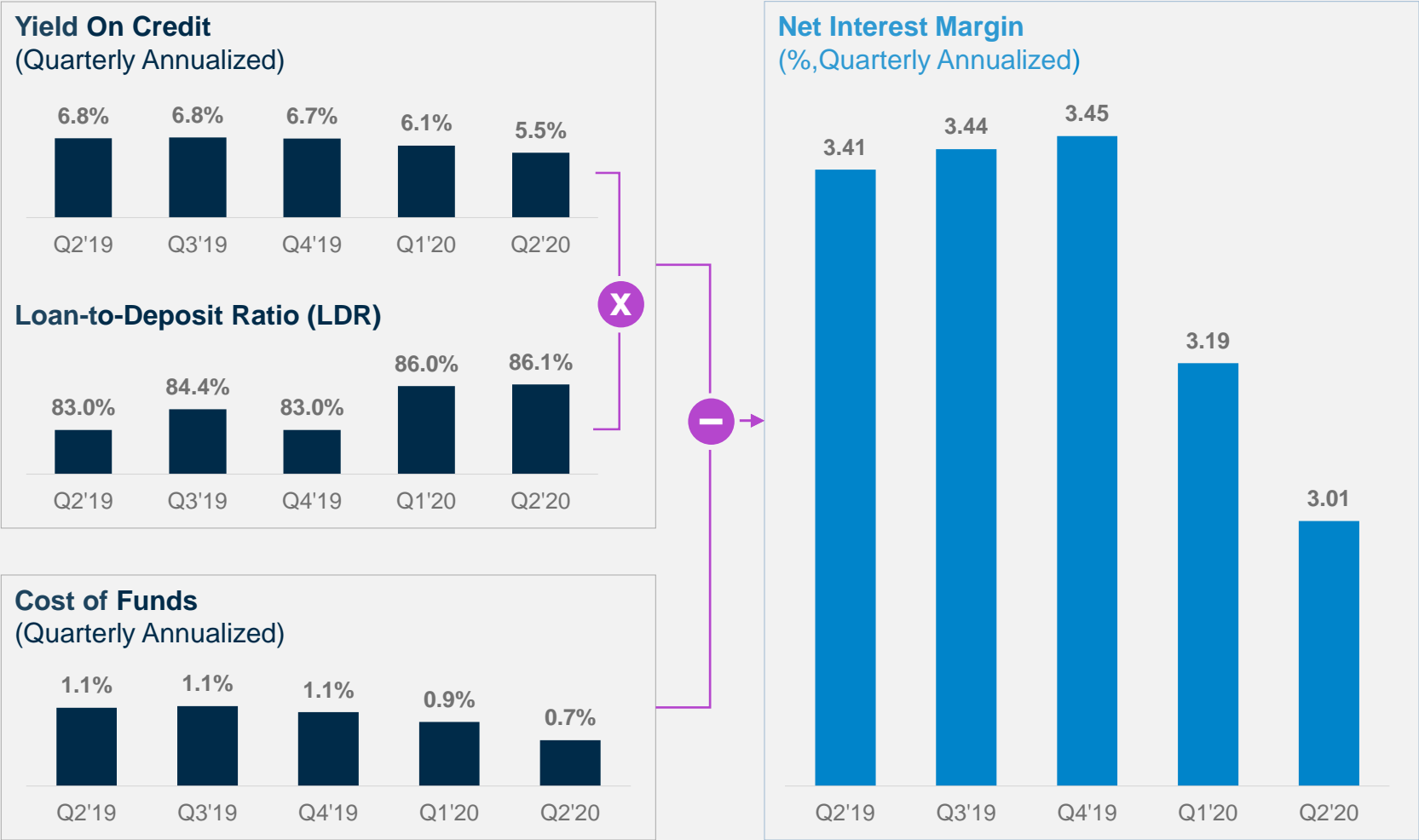
## KEY TAKEAWAYS

- Total operating income declined for the second consecutive quarter by 3.8% QoQ. Decline in NII (-2.2%) and non-interest income (-9.2%) impacted operating income
- Non-interest income declined, as lockdown measures weighed on the fee income arising from cards
- Among the individual banks, NCB (-10.2%) reported the biggest decline in operating income, on the back of a sharp decline in trading income\*
- On the other hand, ALINMA's operating income increased 6.2%, as the bank reported gains under other operating income compared to losses in Q1'20

Note: Some numbers might not add up due to rounding  
 Source: Financial statements, investor presentations, A&M analysis  
 \*Income from Fair Value through Income Statement (FVIS) securities like fixed and floating rate securities and equities



# NIM Compressed Further, as System-Wide Rates Touched Multi-Year Lows



## KEY TAKEAWAYS

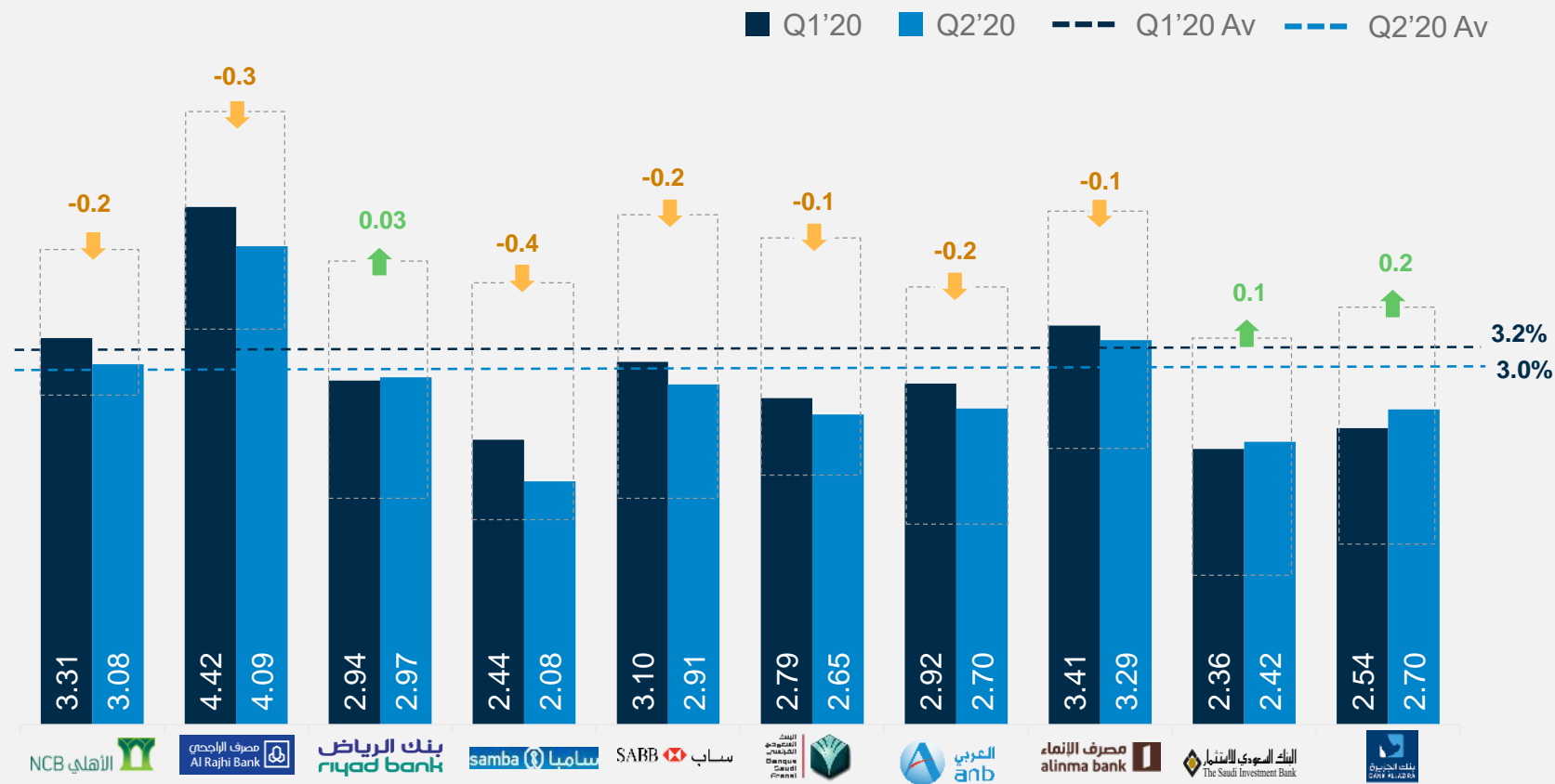
- NIM fell by 18 bps to reach 3.0%, the lowest level in past several quarters
- The drop in NIM was primarily attributable to 61 bps decline in yield on credit, which more than offset a 26 bps drop in cost of funds

Note: Relation between elements above represents a functionality and not necessarily an exact mathematical formula  
Source: Financial statements, Investor presentations, A&M analysis

# Most Banks Reported Lower NIM

➔ Improved 
 ↔ Stable 
 ➔ Worsened

## Net Interest Margin (% Quarterly)



## KEY TAKEAWAYS

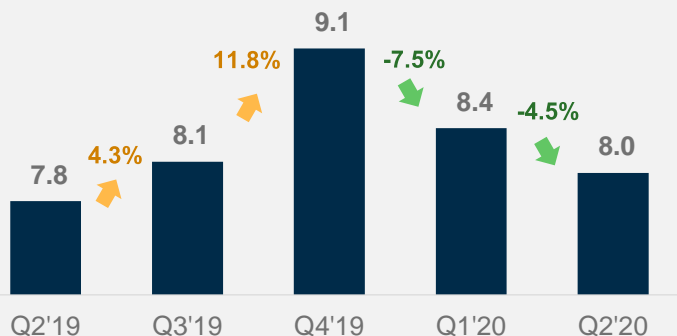
- NIM of seven out of the top ten banks declined largely due to the decline in system-wide rates
- SAMBA and ALRAJHI reported highest decline in NIM of 35 bps and 34 bps, respectively
- On the other hand, SIB (+6 bps QoQ) and BAJ (+16 bps QoQ) reported an increase in NIM

Note: Some numbers might not add up due to rounding  
 Source: Financial statements, investor presentations, A&M analysis

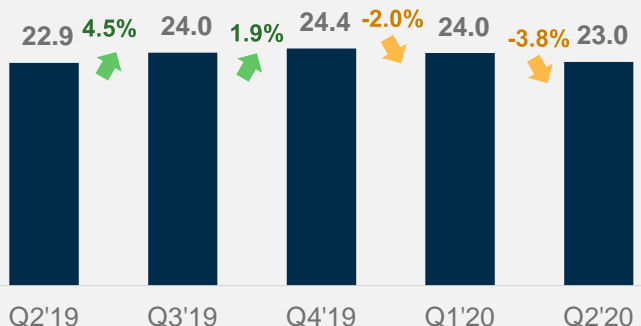
# C/I Ratio Improved for the Second Consecutive Quarter

→ Improved   ← Stable   → Worsened

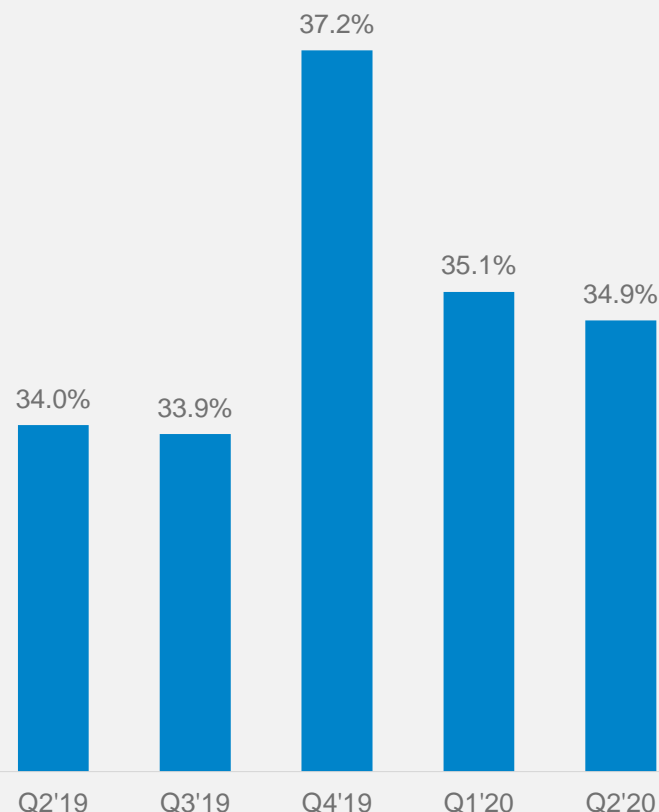
**Quarterly Operating Expenses**  
(SAR Bn)



**Quarterly Operating Income**  
(SAR Bn)



**Cost to Income Ratio**  
(%, Quarterly Annualized)



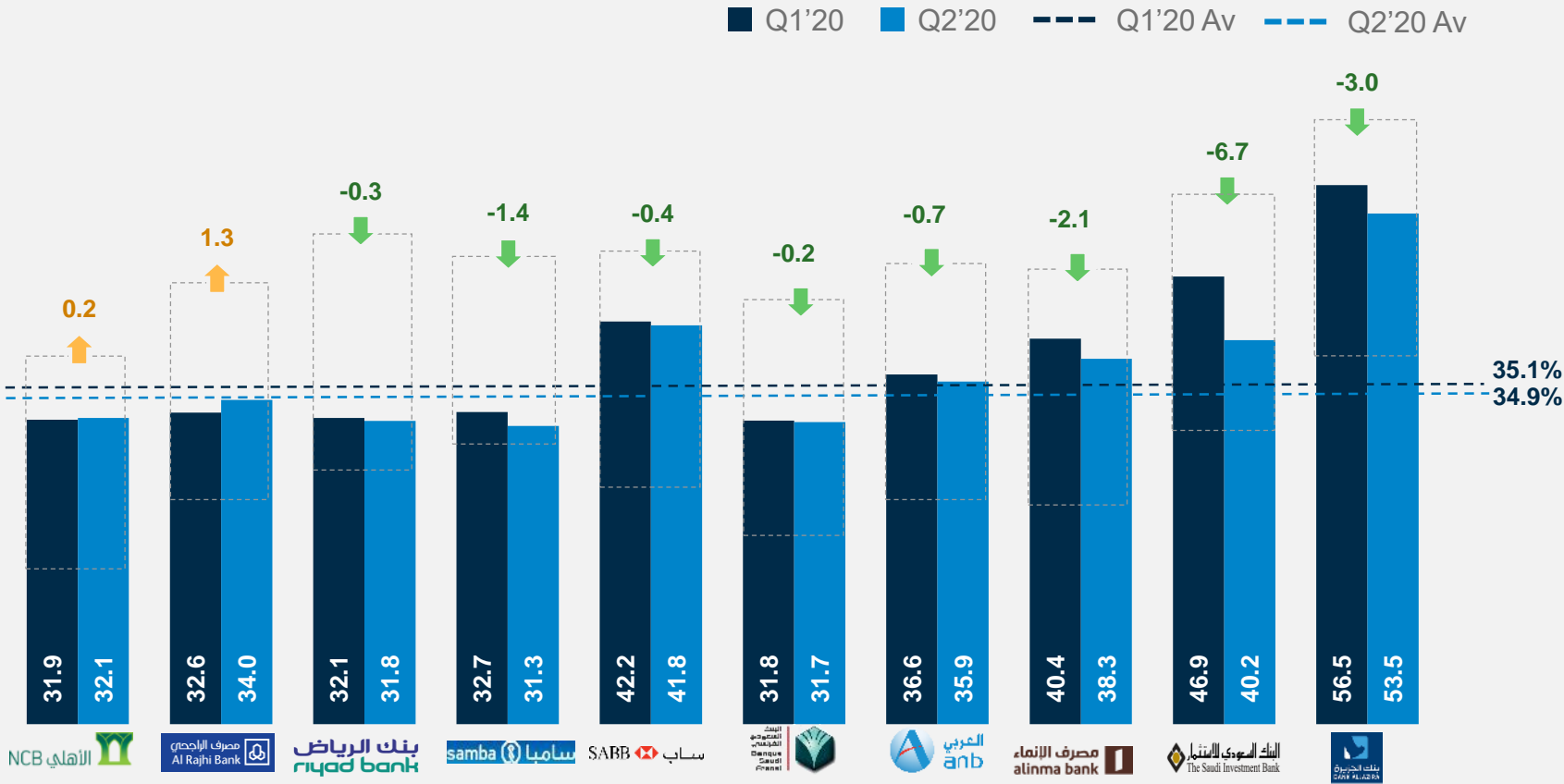
## KEY TAKEAWAYS

- C/I ratio continued to decline for second consecutive quarter by 0.2% QoQ to 34.9% driven by cost optimization
- Operating expenses fell 4.5% QoQ, as banks incurred lower operational, marketing and travel expenses during the lockdown
- Despite continuous decline, C/I ratio still remains above the average achieved in FY'19 (34.6%), leaving more room for improvement

# Operating Efficiency Improved Across Most of the Banks

➔ Improved
 ↔ Stable
 ➔ Worsened

Cost to Income Ratio (% Quarterly)



## KEY TAKEAWAYS

- C/I ratio improved for majority of the banks except NCB and ALRAJHI
- SIB saw the highest improvement in C/I ratio of 6.7% points, due to 14.8% QoQ decline in operating expense
- BAJ continued to report highest C/I ratio at 53.5%, while SAMBA reported the lowest C/I ratio at 31.3%

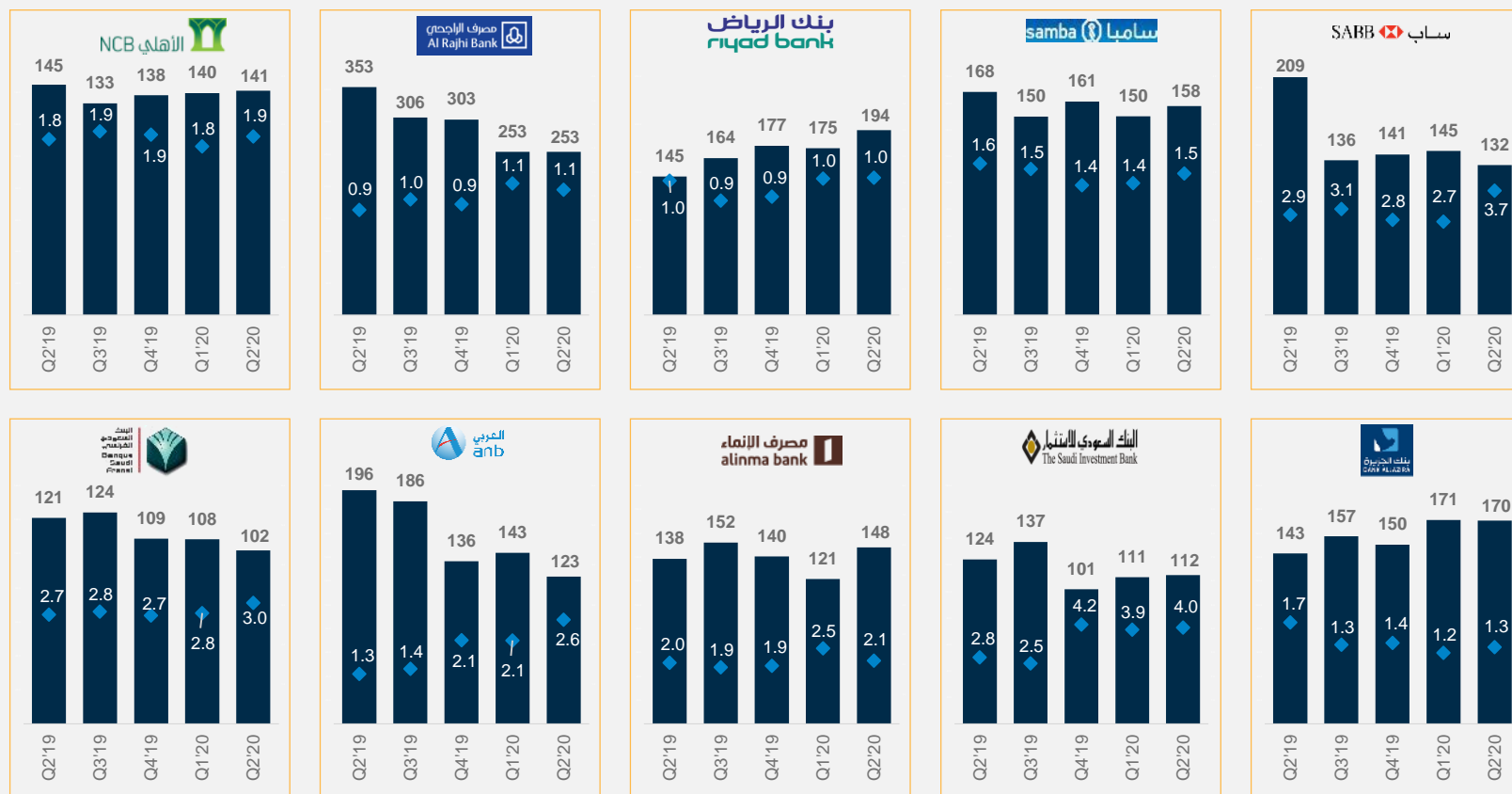
Note: Scaling and some numbers might not add up due to rounding  
 Source: Financial statements, investor presentations, A&M analysis  
 \*Comparison on QoQ basis



# Coverage and NPL/Net Loan Ratio Deteriorated Further

■ Coverage Ratio, % ◆ NPL / Net loans, %

## Coverage Ratio<sup>1</sup> and NPL / Net Loans Ratio (% , Quarterly)



Note: Scaling and some numbers might not add up due to rounding

Source: Financial statements, investor presentations, A&M analysis, <sup>1</sup> accumulated allowance for impairment / NPL

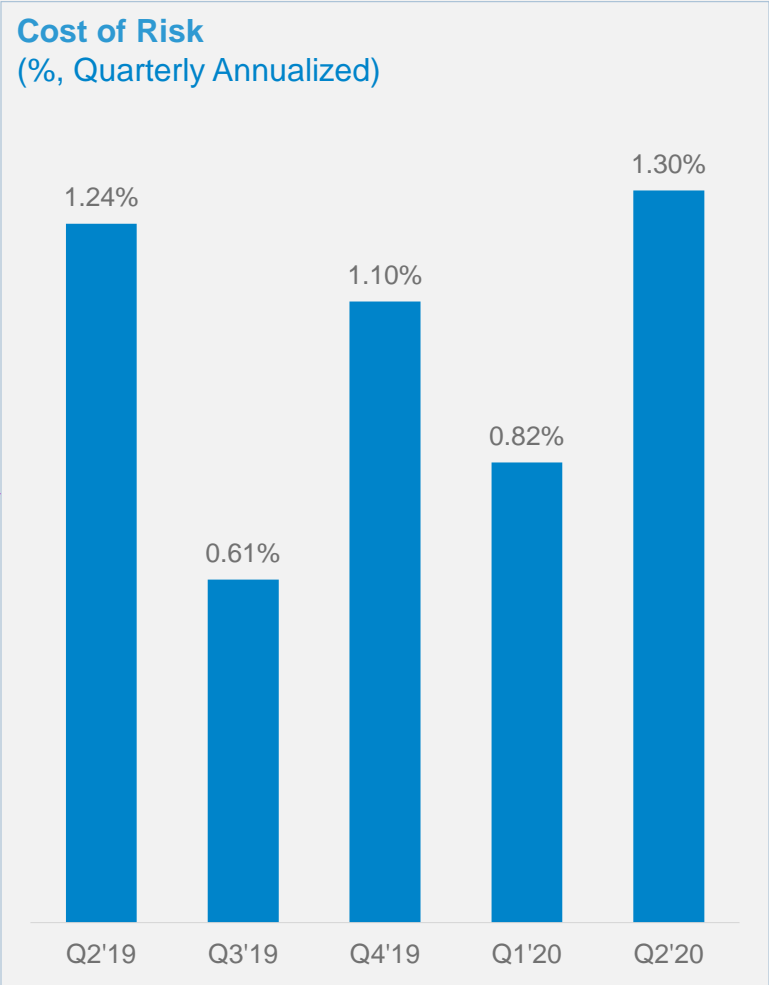
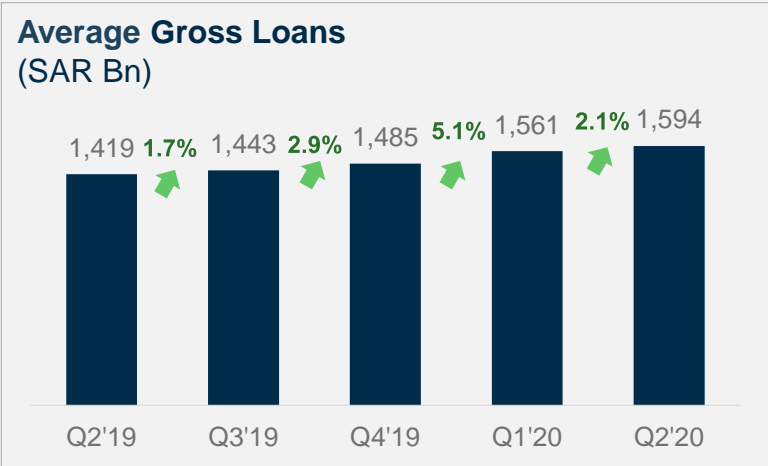
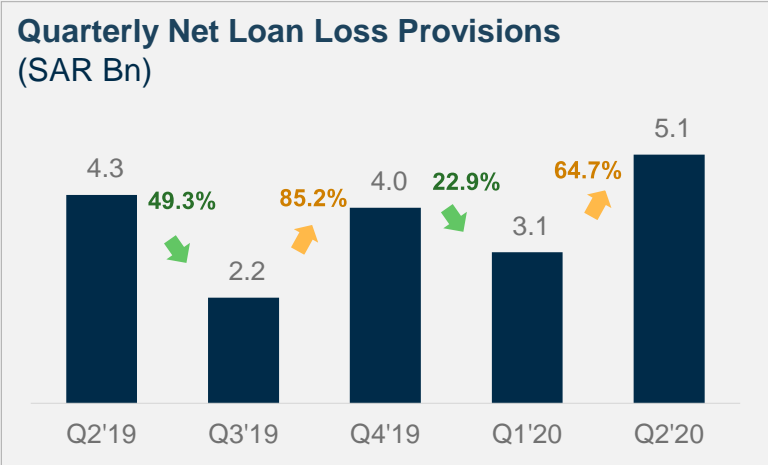
## KEY TAKEAWAYS

- Aggregate coverage ratio decreased to 146.2% (-1.6% points), while NPL / net loan ratio increased to 2.0% (+0.1% points), for the fifth consecutive quarter
- ALINMA reported the highest increase in coverage ratio of 26.3% points
- ANB's coverage ratio declined at the highest rate (-20.0% points), as NPLs rose by ~22%
- SABB's NPL / net loan ratio increased the most (+0.9% points), as the bank's NPL increased sharply by ~29%



# Cost of Risk Reached Multi-period High Level, on COVID-19 Adjustments

➡ Improved   ⬅ Stable   ➡ Worsened



## KEY TAKEAWAYS

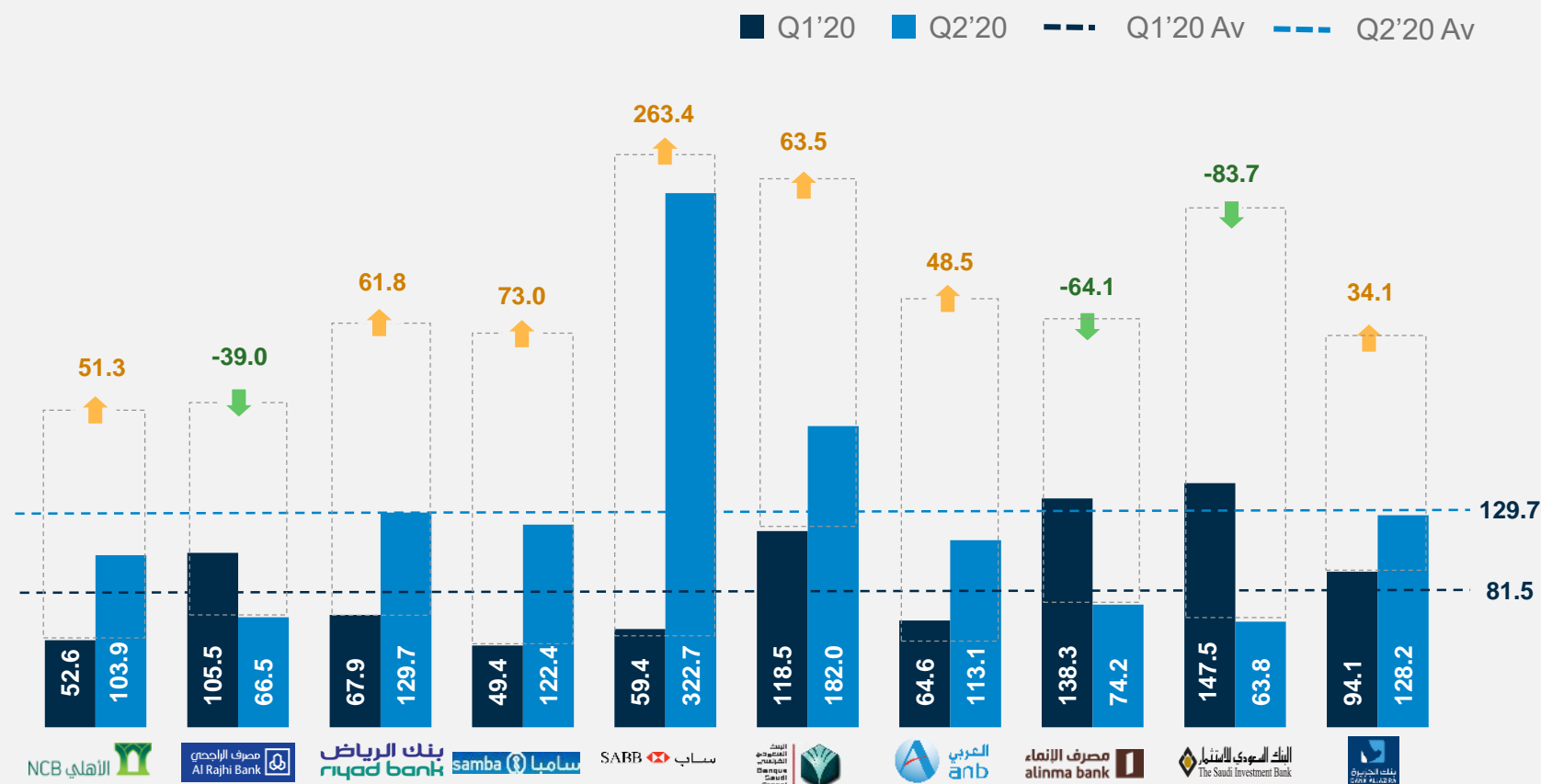
- Cost of Risk increased 48 bps QoQ to 1.30% in Q2'20, due to increase in provisioning (primarily on account of SABB's provisions)
- Aggregate provisioning increased by 64.7% QoQ to SAR 5.1bn in Q2'20, continuing its volatile trend
- Gross L&A continued to increase, albeit at a slower pace (+2.1% QoQ)

Note: Scaling and some numbers might not add up due to rounding  
Source: Financial statements, investor presentations, A&M analysis

# SABB Reported Highest Increase in Cost of Risk

→ Improved ↔ Stable → Worsened

## Cost of Risk (bps) – Net of Reversals

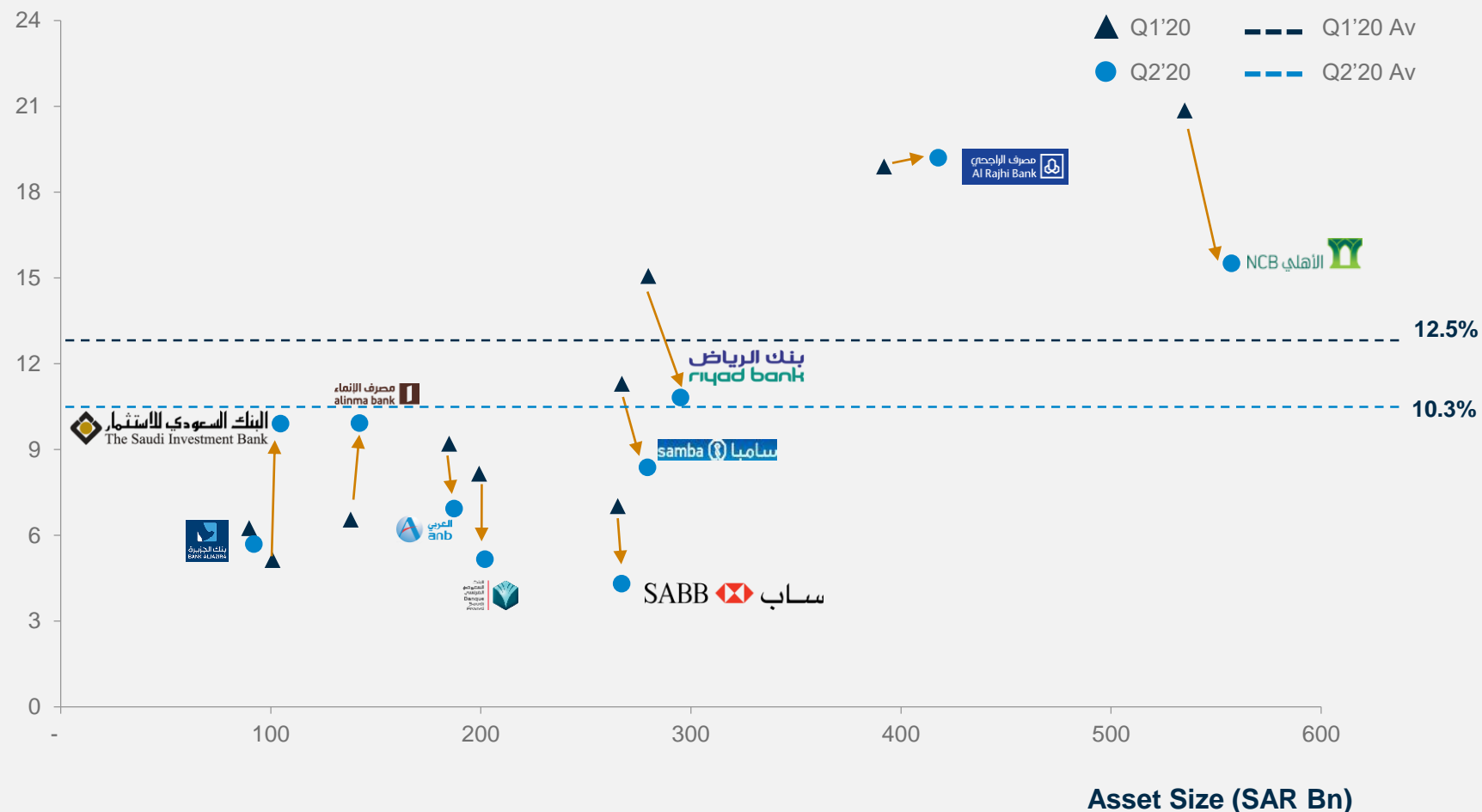


## KEY TAKEAWAYS

- SABB reported the highest increase in cost of risk (+263.4 bps QoQ), followed by SAMBA (+73.0 bps QoQ) and BSF (+63.5 bps QoQ)
- SIB reported the highest decline (-83.7 bps QoQ), followed by ALINMA (-64.1 bps QoQ) and ALRAJHI (-39.0 bps QoQ)
- ALRAJHI's cost of risk declined, as the bank reported strong recoveries during the quarter (+36% QoQ)

# RoE of Majority of Banks Declined

## Return on Equity (%)

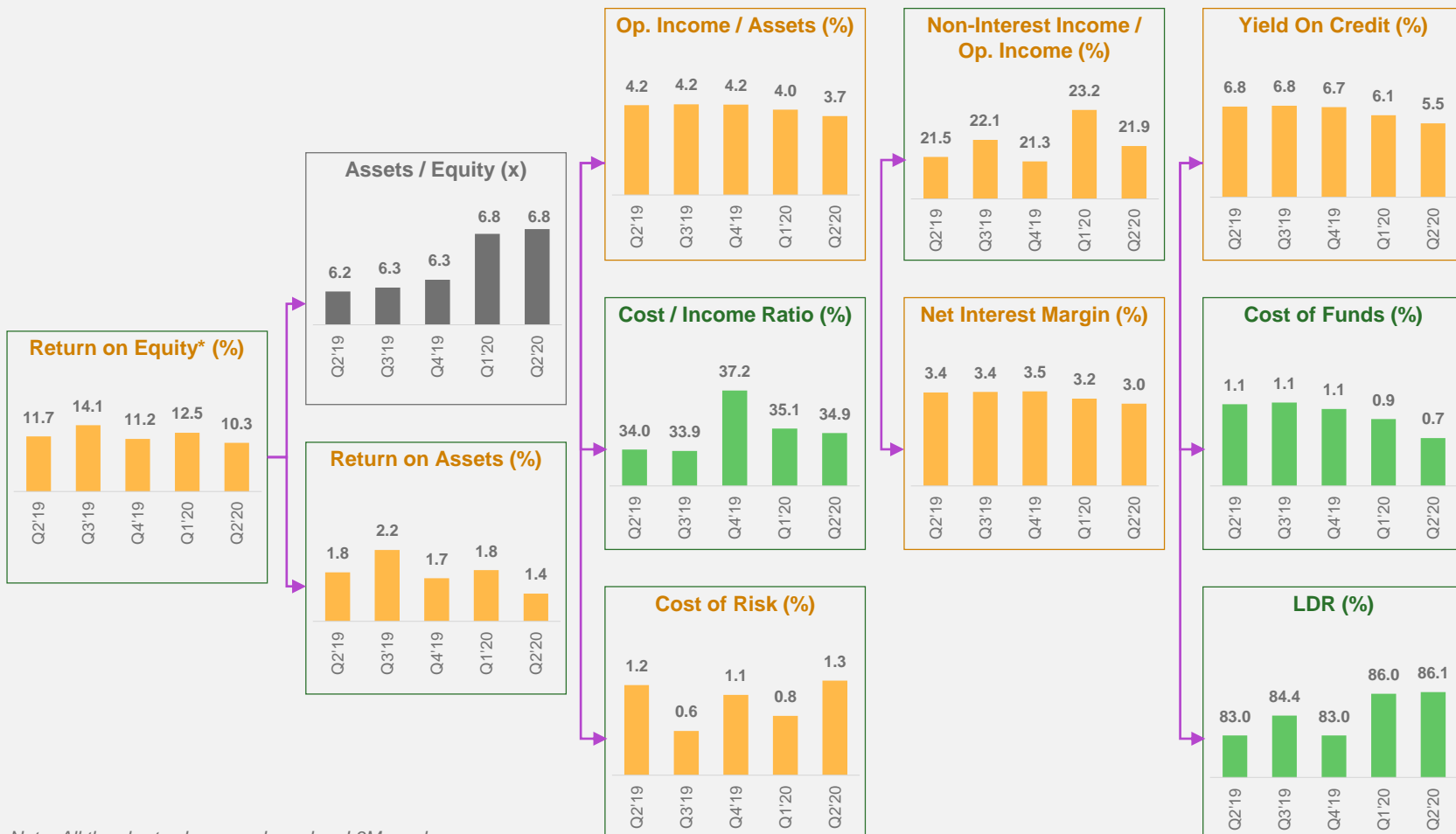


## KEY TAKEAWAYS

- RoE of majority of the banks decreased except for ALRAJHI, ALINMA and SIB
  - Aggregate RoE declined to 10.3%\* (-2.2% QoQ), as overall net income fell 17.8% QoQ
- SABB underperformed its top peers in terms of RoE (4.3%\*), as the bank's provisioning spiked
- Increase in ALRAJHI's RoE resulted in the bank reporting the highest RoE among its peers

# KSA Banking Sector: A Difficult Road Ahead

■ Improved ■ Stable ■ Worsened



Note: All the charts above are based on L3M numbers

Op Income stands for Operating Income

Scaling and some numbers might not add up due to rounding

Source: Financial statements, Investor presentations, A&M analysis, excludes goodwill impairment charges reported by SABB17

## KEY TAKEAWAYS

- Aggregate RoE reached its lowest level in past six quarters to 10.3%
  - Profitability was impacted by reduced operating income (-3.8% QoQ) and increased provisioning (+64.7% QoQ)
- KSA's banking sector is expected to witness strong headwinds in the coming period
  - Domestic economy is set to witness a deeper contraction largely due to low oil prices
  - Tough operating environment would likely weigh on asset quality and provisioning
  - Low interest environment would keep NII under pressure, limiting income growth
- Further cost optimization measures is expected to support profitability



# GCC Banking Consolidation

## GCC list of M&A transactions in banking sector since January 2019

Announcement Date	Target Company	Target Country	Acquirer Company	% Sought	Consideration (SAR Mn)	Deal Status*
30-Jun-20	Al Khalij Commercial Bank PQSC	Qatar	Masraf Al Rayan QSC	100%	4,492	Pending
25-Jun-20	Samba Financial Group SJSC	Saudi Arabia	National Commercial Bank SJSC	100%	58,397	Pending
31-Dec-19	Alizz Islamic Bank SAOG	Oman	Oman Arab Bank SAOC	81%	NA	Pending
12-Sep-19	Ahli United Bank BSC	Bahrain	Kuwait Finance House KSCP	100%	21,860	Pending
15-Aug-19	Cqur Bank LLC	Qatar	VTB Bank PJSC	19%	NA	Completed
08-Aug-19	DenizBank AS	Turkey	Emirates NBD PJSC	0.20%	NA	Completed
20-Jun-19	Warba Bank KSCP	Kuwait	Kuwait & Middle East Financial Investment Co KSCP	75.70%	NA	Proposed
12-May-19	Gulf Bank KSCP	Kuwait	Alghanim Industries Ltd	16%	NA	Completed
21-Apr-19	HSBC Saudi Arabia Ltd	Saudi Arabia	HSBC Holdings PLC	2%	31	Completed
10-Apr-19	Invest bank PSC	UAE	Emirate of Sharjah United Arab Emirates	50%	1,009	Completed
07-Apr-19	Noor Bank PJSC	UAE	Dubai Islamic Bank PJSC	100%	NA	Completed
03-Apr-19	Oman United Exchange Co	Oman	Private Investor	25%	NA	Completed
15-Mar-19	Banque Saudi Fransi	Saudi Arabia	Olayan Investments, Ripplewood Advisors LLC	5%	1,641	Completed
29-Jan-19	Union National Bank PJSC	UAE	Abu Dhabi Commercial Bank PJSC	100%	11,762	Completed
29-Jan-19	Al-Hilal Bank PJSC	UAE	Abu Dhabi Commercial Bank PJSC	100%	NA	Completed

Source: Bloomberg

\*Proposed Status: Board suggests shareholders to consider the acquisition

\*Pending Status: Acquisition has announced

\*Completed Status: Acquisition has completed













# GLOSSARY



# Glossary

	Metric	Abbreviation	Definition
Size	Loans and Advances Growth		QoQ growth in EOP net loans and advances for the top 10
	Deposits Growth		QoQ growth in EOP customer deposits for the top 10
Liquidity	Loan-to-Deposit Ratio	LDR	(Net EOP loans and advances / EOP customer deposits) for the top 10
Income & Operating Efficiency	Operating Income Growth		QoQ growth in aggregate quarterly operating income generated by the top 10
	Operating Income / Assets		(Annualized quarterly operating income / quarterly average assets) for the top 10
	Non-Interest Income / Operating Income		(Quarterly non-interest income / quarterly operating income) for the top 10
	Net Interest Margin	NIM	(Aggregate annualized quarterly net interest income) / (quarterly average earning assets) for the top 10 Earnings assets are defined as total assets excluding goodwill, intangible assets, and property and equipment
	Yield on Credit	YoC	(Annualized quarterly gross interest income / quarterly average loans & advances) for the top 10
	Cost of Funds	CoF	(Annualized quarterly interest expense + annualized quarterly capital notes & tier I sukuk interest) / (quarterly average interest bearing liabilities + quarterly average capital notes & tier I sukuk interest) for the top 10
	Cost-to-Income Ratio	C/I	(Quarterly operating expenses / quarterly operating income) for the top 10
Risk	Coverage Ratio		(Loan loss reserves / non-performing loans) for the top 10
	Cost of Risk	CoR	(Annualized quarterly provision expenses net of recoveries / quarterly average gross loans) for the top 10
Profitability	Return on Equity	RoE	(Annualized quarterly net profit attributable to the equity holders of the banks – annualized quarterly capital notes & tier I sukuk interest) / (quarterly average equity excluding capital notes) for the top 10
	Return on Assets	RoA	(Annualized quarterly net profit / quarterly average assets) for the top 10
	Return on Risk-Weighted Assets	RoRWA	(Annualized quarterly net profit generated / quarterly average risk-weighted assets) for the top 10
Capital	Capital Adequacy Ratio	CAR	(EOP tier I capital + tier II capital) / (EOP risk-weighted assets) for the top 10

## Glossary (cont'd.)

Bank	Assets (SAR Bn)*	Abbreviation	Logo
National Commercial Bank	557.3	NCB	 NCB الأهلي
Al Rajhi Bank	417.7	ALRAJHI	 مصرف الراجحي Al Rajhi Bank
Riyad Bank	295.1	RIBL	 بنك الرياض riyad bank
Samba Financial Group	279.3	SAMBA	 sambam سامبا
Saudi British Bank	267.0	SABB	 SABB ساب
Banque Saudi Fransi	202.0	BSF	 البنك السعودي الفرنسي Banque Saudi Fransi
Arab National Bank	187.3	ANB	 العربي anb
Alinma Bank	142.2	ALINMA	 مصرف الإنماء alinma bank
Saudi Investment Bank	104.6	SIB	 البنك السعودي للاستثمار The Saudi Investment Bank
Bank Al-Jazira	91.9	BAJ	 بنك الجزيرة BANK ALJAZIRA

Note: Banks are sorted by assets size

\* As on 30<sup>th</sup> June 2020