Banking Pulse Quarterly Saudi Arabia

Market Analysis

Post-pandemic recovery, efforts for customer endurance and reflection of strong capital and liquidity base of Saudi Banks

Industry Insights

Recalibrated remedial strategies, upcoming merger, enhanced payments infrastructure and VAT reforms

Q3’20 Financial Performance

Analysis of the Q3 results of the performance of the eleven listed Saudi banks

Volume 3

The Banking Pulse Quarterly provides an overview of the major developments shaping the banking industry in Saudi Arabia– an engaging compilation of performance metrics and key trends from the industry

KPMG in Saudi Arabia
November 2020

Banking Pulse Quarterly

Market Analysis

Efforts for customer endurance and reflection of strong capital and liquidity base of Saudi Banks

It takes decades to alter attitudes, beliefs and ethos, though the Covid-19 outbreak seems to have made this statement redundant. As countries around the world brace for the second wave, the corporate and financial systems appear to be on better footing to tackle further challenges compared to those arising at the onset of the pandemic. This is in part courtesy of the continued support of governments and regulators, various mitigation measures since the outbreak and the overall adaptability of the financial sector. The Saudi banking sector in the past quarter has also experienced range of regulatory changes, including the VAT reforms and the institutionalization of the real estate transaction tax (RETT), while mortgage finance continued to recorded significant growth. NCB and SAMBA merger agreement has also brought more light to post-pandemic recovery, while the era itself seem to have awakened a renewed sense of purpose, indicating executives are more inclined to address their Environmental, Social, and Corporate Governance (ESG) policies.

The adaptability of Saudi banks is leading to a fundamental change into how entities have traditionally operated and therefore to a great extent represents a paradigm shift of the corporate ethos. The Kingdom continues to be at the fore front of such support initiatives as evidenced by the recent announcement of further extension in the payment holidays to the MSME sector, together with fresh liquidity supports to the financial services sector. With this the total funding support by SAMA to the sector in the form of interest free deposit now stands at SR 110 billion.

Despite all the adverse events that have transpired over the past months, the lending space in the Saudi banking sector has been rife with activity for varied reasons. This is particularly relevant for the auto and mortgage financing streams which have seen significant volumes of credit underwriting in real estate financing until end of Q3 2020. This iss an endorsement of the acute housing demand in the country and testament to the government measures to supporting home ownership. This has spiked public demand despite the generally distressed environment as a result of Covid-19. As a result, as per latest available statistics, the house ownership levels have climbed well over 50% which was previously identified as a milestone point by the end of FY 2020 as part of the Vision 2030. In summary, the loan books across the banking sectors have witnessed a period-on-period double digit growth during the 9 months ended 30 September 2020.

> The lending space in the Saudi banking sector has been rife with continued growth in mortgage financing throughout the Covid-19 environment; it is an endorsement of the housing demand in the country and testament of government support measures.
>
> **Khalil Ibrahim Al Sedais**
> Office Managing Partner – Riyadh
> KPMG in Saudi Arabia

Also pertinent to note is the implementation of RETT where essentially retail property buyers have welcomed the step-down of the tax rate from 15% back to 5% being a non-claimable component of purchase cost in general. If these past trends are representative for the last quarter, then, coupled with the introduction of RETT and the 'zealous sale drives' witnessed each year end, it is quite likely that the overall banking sector will end FY 2020 without major impact on profitability.

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Market Analysis

The loan growth as indicated above has contributed towards a total asset increase of 2% as at Q3 2020 relative to the previous quarter and 10% relative to FY 2019. Moreover, the customer deposit base has edged by approximately 3% as compared to Q2 2020 and 6% from FY 2019.

Overall net profitability has understandably declined by 6% for the year to date period relative to corresponding period of FY 2019 due to higher expected credit losses of SR 12 billion- a period-on-period increase of 41%. At present, the process of loss quantification continues to be a challenge for banks in the absence of 'dpd backstops' for facilities subject to payment holiday and useful qualitative information of borrowers in general. This translates into a continued need for judgmental overlays to cater for data gaps and therefore the overall ECL governance process is ever more important.

On a different front, the M&A space in the banking sector is moving towards the creation of the largest lender in the Kingdom with formal agreement between NCB and SAMBA. This bodes well for the merging entities and the sector in general. Certainly the entities can leverage on the experience of SABB and Alawwal Bank and focus on cost and revenue synergies. With significant investments in technology and people already made by Saudi banks in recent past; cultural and infrastructural integration will be a priority. As such, timely and effective stakeholder engagement as well as pre-merger planning remains to be the key for reaping all anticipated post-merger synergies.

Another key element gathering swift momentum in the sector is the aspect of ESG, referring to three central factors in measuring the sustainability and societal impact of a business. The global financial sector has recently witnessed an update of initiatives in the ESG space, including the Dow Jones Sustainability Index, Sustainalytics and MSCI's continued efforts.

Approaching the end of FY 2020, with these macro-economic developments in perspective, we foresee that the final quarter of this already eventful year is likely to be a nexus of several divergent themes and in the grand scheme of things the closure would depend on the continued tenacity and resilience of the sector founded on measures taken by both SAMA and individual banks. We have observed multiple efforts towards customers endurance at the back of strong capital base and funding structure of the industry and we do not foresee a different proposition for rest of the year.

> With evolving customer and investors expectations, banks in Saudi Arabia are also becoming more conscious about their standing with regards to Environmental, Social and Corporate Governance (ESG). ESG is here to stay and is rising on the agendas of executives at regulators and financial organizations alike.
>
> **Ovais Shahab**
> Head of Financial Services
> KPMG in Saudi Arabia

We wish you an insightful read of the third edition of our Banking Pulse which is part of a series of our industry-wide endeavor to share and seek insights in the banking space. We wish you all a good read and look forward to your feedback

Recalibrated remedial strategies, upcoming merger, enhanced payments infrastructure and VAT reforms

NCB and SAMBA announce merger

This merger of NCB and SAMBA would create a clear national champion that will transform the local banking sector and catalyze the delivery of Saudi Arabia's Vision 2030

Saeed Mohammed Al-Ghamdi, *Chairman of NCB*

Our goal is to approach this merger with the objective to maximize opportunities for our customers, employees, local communities and shareholders. Together, SAMBA and NCB could truly become a bank for all

Ammar Alkhudairy, *Chairman of SAMBA*

Risk management during Covid-19

The Covid-19 pandemic is an event that no risk management policy or system could have predicted or avoided. Our systems and policies are well-tested and designed to manage the effects of high intensity crisis, and whether the cause of the crisis is linked to the financial markets or a pandemic should not affect the quality of our response. Our liquidity position has remained comfortable throughout the year and our business continuity programs have performed extremely well. With respect to the credit portfolio, our problem-recognition triggers and tests have enabled us to identify vulnerable names at an early stage and ensure internal escalation and implementation of remedial strategies where appropriate. Our credit risk models are pro-cyclical and sensitive to macro-economic scenarios and enable us to set-aside reasonable levels of provisions.

CRO, Tadawul-listed corporate bank

Impact of VAT increase

The recent increase in VAT rate from 5 to 15% has introduced some complexities to the tax considerations of the banking sector. Given the mixture of taxable and exempt supplies that banks provide, the increased VAT rate will lead to deductibility challenges on operational and capital expenditure relating to exempt supplies. Therefore, in addition to managing the impact of VAT on fee-based services, banks face the challenge of managing a 10% increase in VAT incurred on their purchases. Tax technology solutions will be needed more than ever before to minimize risk, while taking into account competitiveness, profitability, and cashflows.

Wadih AbouNasr, *Head of Tax, KPMG Saudi Levant Cluster*

Digital payment infrastructure

The robust electronic payments infrastructure developed in Saudi has definitely contributed much into lessening the impacts of COVID-19 on our citizens and residents. The growth achieved in the last ten months was truly unprecedented for payments over the internet and POS devices. The number of POS devices has grown by 56% to reach more than 650K, which have resulted in a significant growth reaching more than 72% transactions in comparison with same period last year. Additionally, the number of active mada e-commerce merchants in the first 10 months has exceeded 7,700, resulting in a staggering growth in volume with over 132 million transactions using mada cards.

Fahad Alakeel, *Managing Director, Saudi Payments*

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Q3'2020 financial performance of 11 listed banks in Saudi Arabia

Net Profit after zakat and tax*

6.4%

Q3 – 2020 net income SAR 32.56 billion
(Q3 -2019: SR 34.79 billion)

* *Net profit after zakat and tax is calculated excluding the impact of goodwill impairment in SABB. Had it been included, overall net profit after zakat and tax would have reduced by **27.7%** to **SR 25.15 billion**.*

Total assets

9.8%

As of Q3 – 2020 SAR 2,686 billion
(Q4 -2019: SAR 2,446)

Total customer deposit

5.7%

As of Q3 – 2020 SAR 1,912 billion
(Q4-2019: SAR 1,809 billion)

ECL charge for nine months

41.4%

Q3 – 2020 SAR 11.8 billion
(Q3 2019: SAR 8.4 billion)

SAMA Stimulus Program

Gross Modification loss recorded on deferral of installment due from MSME sector

SAR 1.71 billion

Gross Income recorded on the deposit received from SAMA

SR 2.57 billion

Total deposit received from SAMA as of 30th September 2020

SR 109.5 billion

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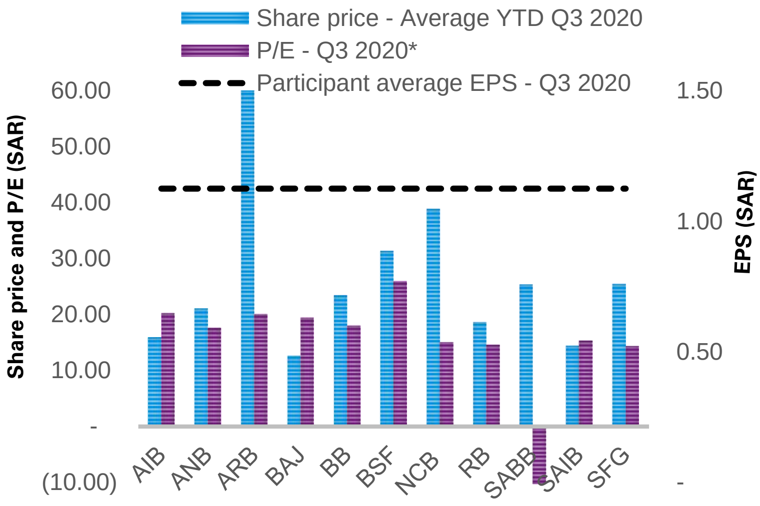
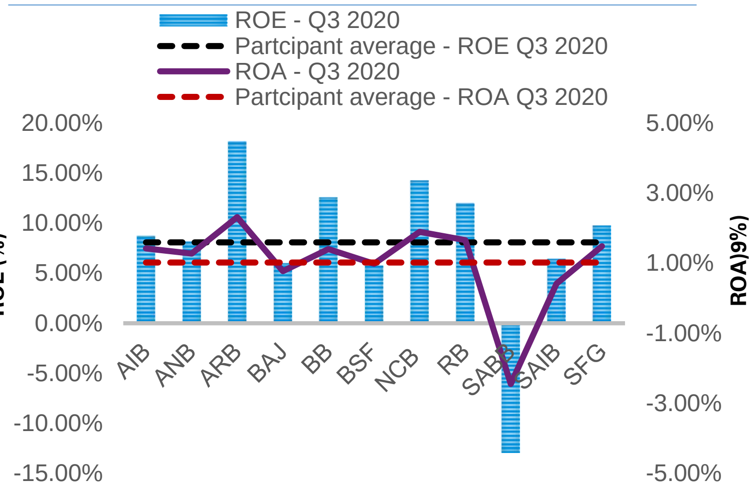
Q3'2020 financial performance of
11 listed banks in Saudi Arabia

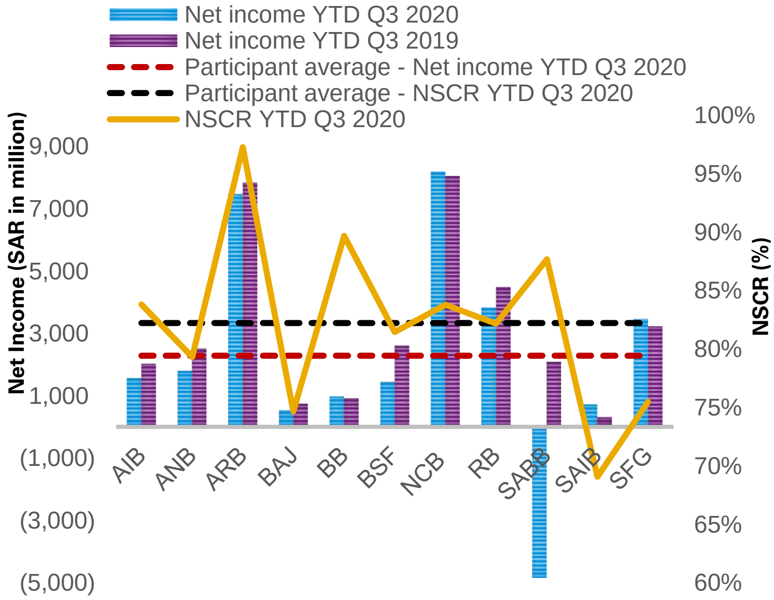
Share price, P/E & EPS



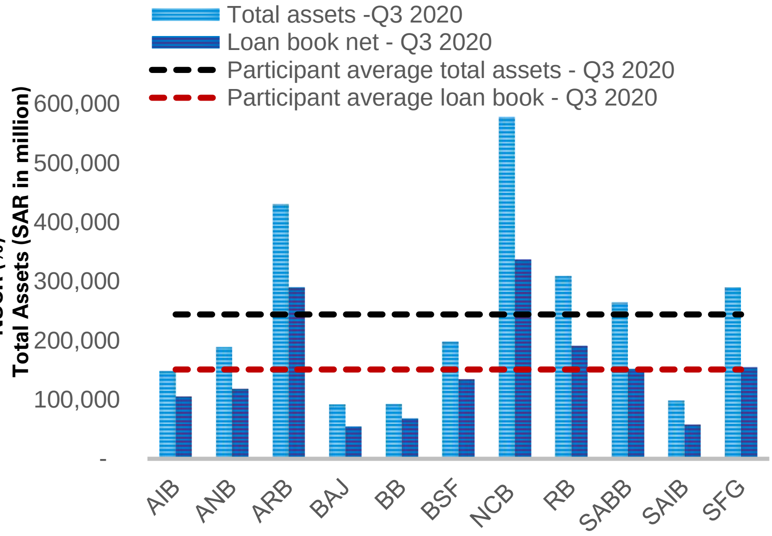
ROE & ROA



Net income – YTD Q1 2020 & Net special commission income ratio (NSCR)



Total assets & Total loan book



Legend:

Alinma Bank	AIB
Arab National Bank	ANB
Al Rajhi Bank	ARB
Bank Al Jazira	BAJ

Bank Al Bilad	BB
Banque Saudi Fransi	BSF
National Commercial Bank	NCB
Riyad Bank	RB

Saudi British Bank	SABB
Saudi Investment Bank	SAIB
Samba Bank	SFG

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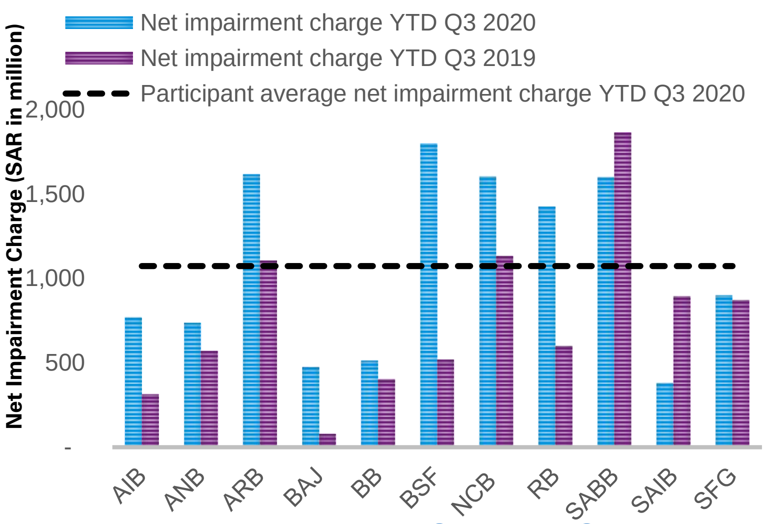
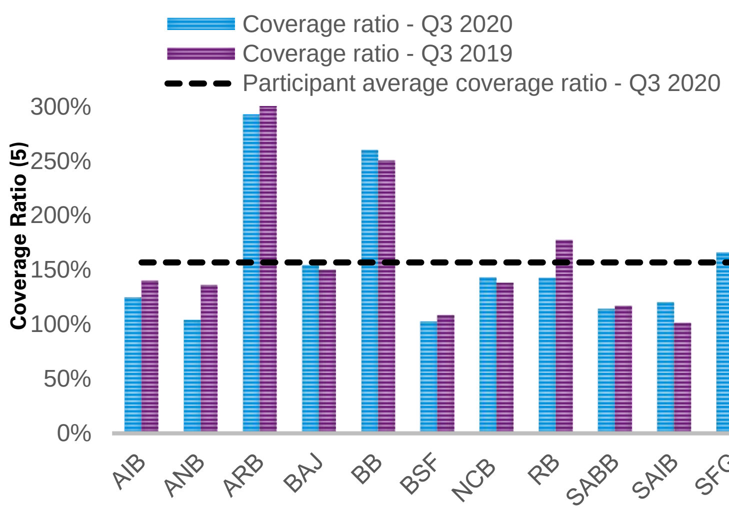
Q3'2020 financial performance of 11 listed banks in Saudi Arabia

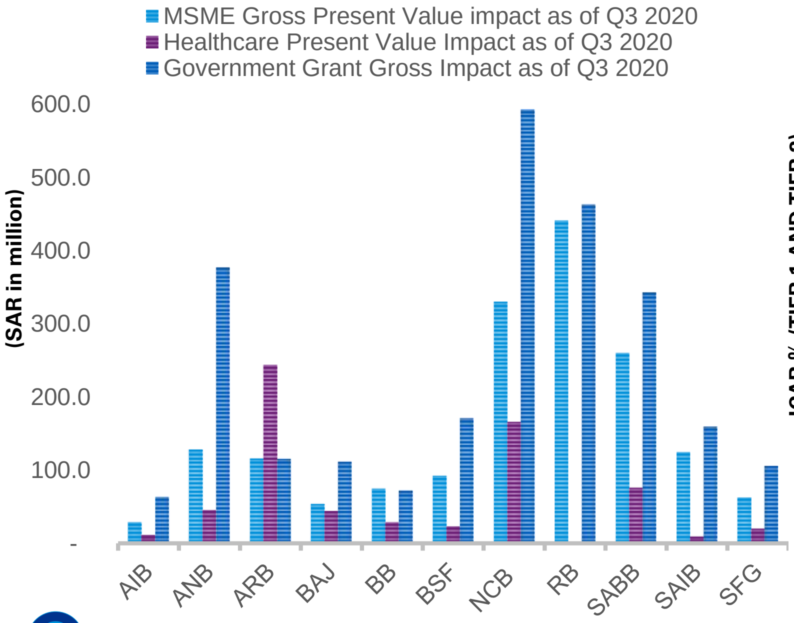
Net impairment charge



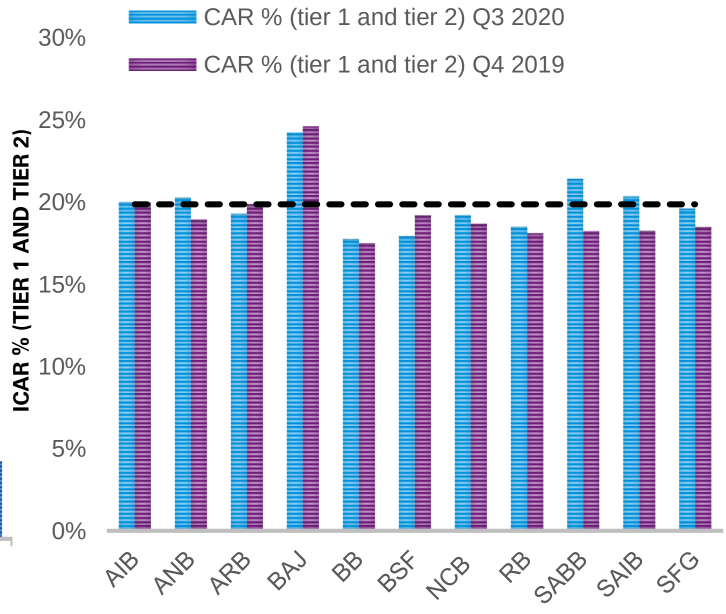
NPL coverage ratio



Impact driven by Covid-19



Capital adequacy ratio



Glossary:

P/E ratio is calculated as the average closing price for six months (as derived from Tadawul) divided by the earnings per share (EPS). **ROE** is the ratio of net income for the nine months period ended 30 Sep 2020 prorated to twelve months to total equity. **ROA** is the ratio of net income for the nine months period ended 30 Sep 2020 pro rated to twelve to total assets**. Interest margin** is the ratio of net special commission income to total special commission income. **Coverage ratio** is the ratio of total ECL for loans and advances to total NPL. **Loan to deposit ratio** is the ratio of total loans and advances to total deposits.

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KPMG contacts:

Khalil Ibrahim Al Sedais
Office Managing Partner - Riyadh
KPMG in Saudi Arabia
T: +966 11874 8500
E: ksedais@kpmg.com

Ovais Shahab
Head of Financial Services
KPMG in Saudi Arabia
T: +966 50979 1636
E: oshahab@kpmg.com

Contributors:

Farid Memon, Director, Financial Services
Shahzaib Zia, Manager, Financial Services
Peter Bannink, Manager, Thought Leadership Lead

kpmg.com/sa

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Disclaimer
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Statements by NCB and SAMBA Chairmen originally appeared on https://www.ncbsambastronger.com/. All other comments were made directly to KPMG.