Global Research

Sector

Saudi Arabia

Saudi Arabia Banking Sector

Biggest beneficiary of the economic boom...

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Global

بيت الاستثمار العالمي

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Saudi Banking Sector Report

Outlook: POSITIVE

Investment Summary

- Saudi Arabia, the biggest economy in the region continued to surge ahead with the nominal Gross Domestic Product (GDP) estimated to have grown by 22.7% in 2005 to reach SR1,152.6bn (US$307.4bn) while real GDP is estimated to have grown by 6.3% to SR767.7bn (US$204.7bn). The regulatory steps to enhance economic activity is likely to establish a solid base for sustained growth of the economy. The biggest beneficiary is likely to be the banking sector.

- During the period 2002-05, consolidated assets of the bank's under review grew at a CAGR of 13.3%. Going forward, we expect the asset size of the universe of banks under coverage to grow at a CAGR of 11.3% for the period 2005-09E.

- During the period 2002-05, the number of branches in the Kingdom have increased from 1,203 in 2002 to 1,251 in 2005, witnessed a CAGR of 1.2%. The number of ATMs grew much faster by 13.8% CAGR from 3,108 in 2002 to 4,576 in 2005. Alternative delivery channels has gained importance to provide better services to customers and in turn help banks reduce transaction cost thereby enhancing operational efficiency.

- Deposit mobilized grew at a CAGR of 12.9% for 2002-05. We expect resource mobilization to grow at a CAGR of 11.8% (2005-09E) to reach SR832.7bn in 2009E. The contribution of demand deposit to total deposits increased marginally by 40bps from 44.4% in 2002 to 44.8% in 2005. We believe, that the growth in time deposits is likely to remain strong over the next two years as banks structure innovative products coupled with higher rates offered. In order to support loan growth, banks will require to increase their deposit franchise.

- Overall system loans grew at a CAGR of 29.0% for the period 2002-05. The key driver of credit growth during the last three years has been consumer loans, which grew at a CAGR of 50.6% for the period 2002-05.We expect gross loans to grow at a CAGR of 13.4% for the period 2005-09E. Gross loan portfolio of the banks under review is likely to increase from SR450.5bn in 2005 to SR744.9bn in 2009E.

- Saudi banks are among the most profitable in the GCC banking sector with the return on average assets and return on average equity at 4% and 33.1% respectively reported in 2005. Profits of the banks under review grew at a CAGR of 36.3% for the period 2002-05. Going forward, we expect core earnings to contribute towards bottom line. We expect profits of these banks to grow at a CAGR of 22.5% for the period 2005-2009E. Aggregate profits of these banks is likely to increase from SR27.0bn in 2005 to SR60.9bn in 2009E.

- Non-commission income of banks increased from SR7.9bn in 2004 to SR15.2bn, a growth of 91.0%. During the last three years, non-commission income has grown at a CAGR of 51.5%. Fees from banking services increased from SR5.6bn in 2004 to SR11.7bn in 2005, a growth of 108.1%.

- Saudi banking system is well on its way to the implementation of Basel II and we expect that banks will remain highly capitalized under the new standard. It is worth mentioning that SAMA's approach in applying Basel II Accord is an integrated one aimed at raising the level of risk management in order to maintain the continued strength of the banking system.

- Saudi banking sector is well capitalized to support strong growth in risk-weighted assets. As at end 2005, the Tier I ratio of the banks under review stood at 17.7%. Capital adequacy ratio as at end 2005 stood at 18.9% for the universe of banks under consideration.

- Total non-performing loans of the listed banks amounted to SR7.76bn in 2005 which represented 1.7% of the banks' aggregate loan portfolio at the end of year 2005. Saudi banks follow a conservative policy regarding provisioning for loan losses. In 2005, the average coverage ratio (PLLs-to-NPLs) was 179% with all the banks having coverage ratios of more than 100%.

- Most banks in the Kingdom have launched Islamic banking products, either through a separate Islamic window or a subsidiary. Islamic banking is turning into a fast-developing, highly-profitable banking product. Also the division between the Islamic banks and conventional banks is reducing as many banks have a large chunk of their deposits as non-interest bearing which positively affected its spreads.

- Saudi Arabia's financial regulator Saudi Arabian Monetary Agency (SAMA) has been active in liberalizing the sector and has licensed a number of GCC/foreign banks to establish their presence in the Saudi market.

- Most banks witnessed a surge in their cost of funds in 2005, as banks were offering higher rates on term deposits to attract depositors. In the bargain, their cost of funding increased. With the demand for funds being strong due to strong economic growth and massive infrastructure projects in different sectors being announced, we expect banking sector's growth to remain strong.

Table 1: "Global" Valuation Matrix

	Price	Target	Reco.	% Change	BV *	EPS *	P/BV	P/E
Al-Rajhi	302.5	311.0	Hold	2.8%	23.1	11.6	13.1	26.0
ANB	113.0	135.4	Buy	19.8%	23.1	8.3	4.9	13.6
BSF	145.0	148.5	Hold	2.4%	25.8	9.2	5.6	15.8
RB	79.5	92.7	Buy	16.6%	20.1	5.2	4.0	15.2
SABB	167.3	169.2	Hold	1.2%	22.6	8.4	7.4	19.9
SAIB	113.3	129.1	Buy	14.0%	26.8	9.2	4.2	12.3
SAMBA	156.0	187.0	Buy	19.8%	21.8	9.4	7.1	16.6
SHB	88.3	100.6	Buy	14.0%	17.9	4.8	4.9	18.5

*Note: * Based on 2006E*

*Source: **Global** Research, Market prices as on August 30, 2006*

Saudi Economy – An overview

Saudi Arabia, the biggest economy in the region continued to surge ahead with the nominal Gross Domestic Product (GDP) estimated to have grown by 22.7% in 2005 to reach SR1,152.6bn (US$307.4bn) while real GDP is estimated to have grown by 6.3% to SR767.7bn (US$204.7bn). The country continued on the strong growth recorded in the previous years as it notched real GDP growth of 5.2% and 7.7% respectively in 2004 and 2003. The high oil prices and increase in the production levels has a positive effect on the GDP growth as the country had to operate at around 9.5mn bpd capacity to maintain stability in the energy markets.

Saudi Arabia's 2006 National Budget projected the revenues at SR390bn and expenditure at SR335bn resulting in a surplus of SR55bn. The revenues are 29.7% lower than the year 2005 actual figures of SR555bn. Capital expenditure is estimated to account for SR126bn (37.6% of the total) while the current expenditure would account for the remaining SR209bn (62.4% of the total). Saudi Arabia's continuing stress on improving the skills of its nationals is evident from the allocations of the recently announced 2006 budget. Manpower development continued to account for the largest allocation in the budget and received SR87.3bn (26.1% of the total outlays) for 2006. This is up by about 25% from the last year's outlay of SR69.9bn. However, another theme for this year budget seems to have been improvement in allocation towards the infrastructure sector which will act as the base for the continued economic growth of the country. The allocations to the water, agriculture and infrastructure sector amounted to SR22.5bn which includes capital expenditure of SR18bn.

The public debt is expected to drop SR614bn reported at the end of 2004 to SR475bn in 2005, amounting to 41.2% of the country's GDP. The government has stated its intention to use the fiscal surplus to settle part of its outstanding public debt. The government has done a commendable job in bringing down the debt as a percent of GDP from 93.3% in 2001 to the current 41.2%. We expect that debt reduction policy will continue in the wake of strong surplus expected to be generated by the government.

Growth in money supply as measured by M3 was 11.4% in 2005 as compared to 19.1% reported in the previous year. M3 further increased by 8.2% in 1H-2006 to reach SR599.1bn at the of June-06. The strong advent of liquidity can be seen in the increase in the money supply at a CAGR of 13.4% over the period 2001-05. With the increase in the interest rates, Time and Savings deposits reported a strong yearly increase of 20.9% reaching SR165.2bn at the end of 2005. They further recorded an increase of 15.3% in first six months of 2006 to reach SR190.5bn at the end of June-06. As a result, broad money supply registered a yearly growth of 10% in 2005 reaching SR448.8bn and a year to date increase of 9.5% in 1H-2006 to reach SR491.4bn .

With interest rate expected to inch up further in 2006, we expect more money being channeled by way of bank deposits leading to further rise in money supply (M2). Inflation, as measured by the Consumer Price Index is estimated to have increased by 0.7% in 2005 and recorded a year to date growth of 0.5% in 1Q-2006. The non-oil GDP deflator has reported a yearly increase of 1.14% in 2005.

Saudi Arabia is currently in the midst of strong construction boom with many real estate projects currently under construction or announced. Some of the big-ticket civil projects at various stages of development in the Kingdom include Benaa City ($533mn), Jabal Khandama Real Estate Project in Makkah ($1.71bn), Saudi Construction Group's Housing Project on the outskirts of Riyadh ($16bn) and Saudi Land bridge Project ($3bn). Real Activity is particularly strong in the holy cities of Mecca and Medina which are seeing strong increase in Haj and Umrah pilgrims every year. In a significant development, hundred and fifty-three new residential towers will be constructed in Makkah under a major housing project, which is estimated to cost SR14bn. In what is considered the single largest private sector investment in Saudi Arabia, 'King Abdullah Economic City' was launched to be built off the Red Sea in the north of Jeddah with an investment of SR100bn.

Table 2: Annual Indicators

		2001	2002	2003	2004	2005
Economic Performance						
Nominal GDP	(SR bn)	686.3	707.1	804.6	939.6	1,152.6
Nominal GDP	(US$ bn)	183.0	188.6	214.6	250.6	307.4
Nominal GDP growth	(%)	(2.9)	3.0	13.8	16.8	22.7
Real GDP	(SR bn)	636.4	637.2	686.0	721.9	767.7
Real GDP growth	(%)	0.5	0.1	7.7	5.2	6.3
Per Capita GDP	(US$)	8,727	8,774	9,749	11,087	13,293
Population	(mn)	20.97	21.49	22.01	22.6	23.1
Oil Sector contribution to GDP	(SR bn)	255.5	261.8	321.0	393.0	N/A
Oil Sector/GDP	(%)	37.2	37.0	39.9	41.8	-
Government Finance						
Total Revenues	(SR bn)	228.2	213.0	293.0	393.0	555.0
Total Expenditures	(SR bn)	255.1	233.5	257.0	295.0	341.0
Surplus/(Deficit)	(SR bn)	(26.9)	(20.5)	36.0	98.0	214.0
Government Revenues/GDP	(%)	33.3	30.1	36.4	41.8	48.2
Oil Revenues	(SR bn)	183.9	166.1	247.0	345.0	N/A
Oil Revenues/Total Revenues	(%)	80.6	78.0	84.3	87.8	-
Government Domestic Debt	(SR bn)	640.0	650.0	660.0	614.0	475.0
Government Debt/GDP	(%)	93.3	91.9	82.0	65.3	41.2
Government Debt/Government Revenue	(%)	280.5	305.2	225.3	156.2	85.6
Money Supply and Inflation						
M2 (end-period)	(SR bn)	271.1	310.4	336.4	408.0	448.8
M3 (end-period)	(SR bn)	330.3	380.6	411.8	490.3	546.3
Avg. Inter Bank SR Deposit Rate (1M maturity)	(%)	4.0	2.1	1.5	1.6	3.6
Consumer Price Inflation	(%)	(1.1)	0.2	0.6	0.5	0.4

*Source: Saudi Arabian Monetary Agency, **Global** Research*

King Abdullah Economic City – The largest private sector investment...

In what is considered the single largest private sector investment in Saudi Arabia, 'King Abdullah Economic City' was launched to be built off the Red Sea in the north of Jeddah with an investment of SR100bn. This mega project would help to expand the economy, create employment and function as a catalyst to attract foreign investment, global trade, commerce and industry. Based on initial forecasts, the project and its several components will create up to 500,000 employment opportunities in the various industries and service-oriented companies that will open in the City. The project is jointly headed by Emaar from the UAE and Aseer (Aseer Company for Trade, Tourism, Industry, Agriculture, Real Estate and Construction) from Saudi Arabia. Other Saudi companies are participating in this initiative including Saudi Binladen Group. The company will offer 30% of the equity for an IPO in due course.

The second in a series of new economic cities in Saudi Arabia being planned by the Saudi Arabian General Investment Authority (SAGIA), the Prince AbdulAziz Bin Mousaed Economic City is a key element in Saudi Arabia’s recent initiative to further develop its economy, generate regional growth, and create employment opportunities for its youthful population. The new city will be developed at Hail in the Northern region of the Kingdom under the supervision of SAGIA. Hail’s economic city, which is set to become the largest transportation and logistics hub in the Middle East, is likely to see a total private sector investment of SR30bn (around $8bn) over the next 10 years.

According to reports, Saudi Arabia will have a total of six special economic zones with the addition of the three zones to be announced later this year. Saudi Arabia will require at least US$600bn in investment over the next 20 years, according to SAGIA including US$170bn alone in electricity generation and water desalination capacity. It is estimated that US$300bn would be needed for petrochemicals, US$100bn for ports, highways and railways, and another US$100bn in IT-related businesses, such as life-sciences and healthcare. The government aims to double the rate of economic growth, relative to population growth, over the next two decades. The Saudi population is averaging over 2 percent growth a year, and about three-quarters of the population is aged 29 years or lower. The country has an unofficial unemployment rate of about 25 percent and the government intends to make up the infrastructure so that the citizens can find job and start as entrepreneurs.

Saudi Banking Sector

The regulatory steps to enhance economic activity is likely to establish a solid base for sustained growth of the economy. The projects in the oil, gas, petrochemical, mining, transport, electricity & water sectors and infrastructure projects in housing, education, and health, would indicate the size and momentum of the economic expansion that will be accompanied by a notable rise in the per capita income.

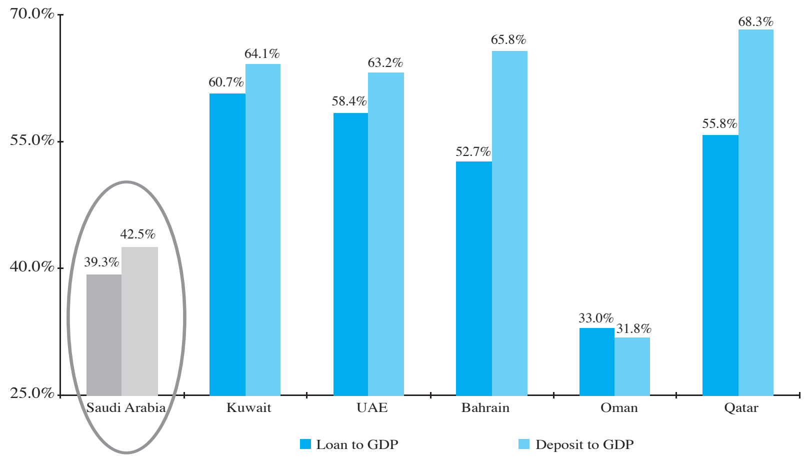
It is expected that the private sector will have a greater role in these projects and in the pace of the overall activity. Thus, the financial and banking sector is entering a very dynamic and exciting phase with acceleration in all areas.

Low penetration levels …

The ratio of credit deployment to GDP for Saudi Arabia is low as compared to other GCC countries. Oman has the lowest penetration level in terms of system credit to GDP. Saudi Arabia's ratio as at end 2005 is around 39% as compared to around 61% for Kuwait. For UAE, this ratio is around 70% and for Bahrain around 53%. In case of Qatar, this ratio is around 56%.

The penetration level in terms of deposit to GDP ratio for Saudi Arabia is low. As at end 2005, this ratio stood at around 43% as compared to 64% for Kuwait, 63% for UAE, 66% for Bahrain and 68% for Qatar. Oman has the lowest penetration in terms of deposit to GDP ratio and as at end 2005, this ratio was around 32%.

Chart 1: Regional Penetration



Source: ***Global*** *Research*

This fares well for the Saudi Banking sector, as the ratio of system loans to GDP and system deposits to GDP is low compared to its regional counterparts. Around SR600bn of infrastructure projects are in the pipeline. These are big ticket projects that will be long-term in nature. The current system loans for the entire Saudi banks is around SR450bn. Low penetration levels in terms of credit deployment and deposit mobilization coupled with the opportunities to deploy for these big ticket projects, the banking system is likely to witness strong core banking business growth.

Over the last three years, GDP (at current prices) grew at a CAGR of 18.1%, and private sector GDP by 6.7%. Money supply has grown by an annual average rate of 12.9%, providing adequate liquidity to growth requirements of the economy.

Interest Rates- Moving up with the dollar…

As a result of movement towards monetary union, the Saudi Arabian Monetary Agency (SAMA) has maintained and is likely to maintain the Saudi Riyal peg to the US Dollar (1 US$= 3.75SR). The monetary union agreement covers common standards for economic and fiscal performance in the GCC, including a maximum level of the budget deficit, public debt, current account deficit, interest rates, and inflation.

Following the rise in the US interest rates, SAMA too raised the interest rates. However, the central bank has significant foreign exchange reserves that it can use to maintain the parity in the foreign exchange markets. SAMA raised interest rate on riyal by a quarter percent to 3.50 percent from 3.25 percent on deposits and on loans to 4.0 percent from 3.75 percent. This decision preceded a decision by the US Federal Reserve Bank to raise the interest rate on the dollar by a quarter of a percent. This maintained the Saudi repo difference of half a percentage point above the US Dollar interest rate.

Differential in interest rates at the end of 2005 was about 0.502% in favor of the Saudi Riyal deposits for 3-month deposits, an increase from the differential of 0.044% reported at end of the previous year. The differential between the Riyal and the Dollar interest rates for a three-month period increased to 0.043%basis points for the Dollar at the end of the second quarter of 2006 against 0.012% basis points for the Riyal at the end of the first quarter of 2006. We believe that the interest rates are expected to increase further in the medium term. However, SAMA will continue to adjust its discounting rates with the Fed rates.

In 4Q2005, broad money supply (M3) increased by 3.1%. Recent economic conditions (including increase in economic growth, expansion in money supply, as a result of a great rise in bank credit) required the pursuit of a more tightened monetary policy. Therefore, SAMA raised Reverse Repo Rate twice in the fourth quarter of 2005 by 25 bps each from 4.25% to 4.75% at the end of the quarter. With the pursuance of tight monetary policy, and the rise in interest rates globally, inter-bank interest rates recorded a considerable increase during 2005. During the 2Q-2006, SAMA again raised the official repurchase agreements (Repo) rate one time by 20 basis points, from 5.00% to 5.20%. SAMA also raised reverse repurchase agreements (Reverse Repo) rate one time by 20 basis points from 4.50% to 4.70% percent during the second quarter of 2006.

Inter-bank 3-month (SIBOR) interest rate went up from 3.73% at the end of the 1H-05 to 4.97% at the end of 2005. Inter-bank interest rates recorded a slight decline during the second quarter of 2006, due to available sufficient liquidity. The three-month inter-bank interest rate (SIBOR) went down from 5.10% at the end of the first quarter of 2006 to 5.08% at the end of the second quarter of 2006.

Diversification of the economy…

Government's diversification plans are expected to bear fruit in the next couple of years and we expect the non-oil industries especially the manufacturing, construction and infrastructure sector to show strong growth. We are expecting more private and foreign interest in the infrastructure sectors due to the reforms undertaken by the regulatory authorities especially in the electricity and water and construction sectors. The development of gas initiatives and petrochemical is expected to add significantly to the GDP growth in the coming years.

On the back of strong increase in the petrodollar revenues and continued budget surpluses, Saudi government has proactively lined up ambitious plans to increase its capital spending in order to provide strong base for future growth in both oil and non-oil sectors. Fiscal surplus currently witnessed due to high oil prices is being invested in infrastructural projects which will further benefit the other sectors of the economy.

So this time around we are witnessing more emphasis on diversifying the economic base and overall economic development, unlike in the past. The oil sector's contribution to the real GDP has declined from 33.6% in 2000 to 32.4% in 2004 and is likely to remain in this range in 2005-06. However, we believe that oil sector contribution is likely to decline in post-2006 years due to the concerted efforts of the government and private sector in propping up the non-oil sectors of the economy.

We expect strong participation by the small and medium enterprises in the manufacturing sector as they take advantage of the economic zones and incentives provided by the government. Increased private sector involvement can be seen in the government procurement with the total number of government contracts signed with the private sector amounting to SR40bn (2,900 contracts) in 2005 as compared to SR38bn reported in the previous year.

Increased competition in the sector…

Saudi Arabia's financial regulator Saudi Arabian Monetary Agency (SAMA) has been active in liberalizing the sector and has licensed a number of GCC/foreign banks to establish their presence in the Saudi market. Gulf International Bank of Bahrain was the first to acquire a license to open a branch in KSA in 2000. A number of licenses for banks from the GCC countries including Emirates Bank International, National Bank of Kuwait and the National Bank of Bahrain followed. NBK opened its branch in Jeddah in May-2006.

Currently, 15 banks are operating in the Kingdom, including the branches of Gulf and foreign banks such as the Gulf International Bank, the Emirates Bank, BNP Paribas and Deutsche Bank. In addition, licenses were granted to several Gulf and foreign banks to open branches in the Kingdom. Also, the establishment of a Saudi bank with a paid-up capital of SR15bn has been approved. Preparations are currently underway on finalizing the procedures of its establishment under the name of "Bank Al-Enma".

The attraction of the Saudi banking sector surpassed the region, as 3 foreign banks namely, Deutsche Bank, JP Morgan Chase, and BNP Paribas were allowed to start operations in the Kingdom, further opening up the financial sector. Moreover, HSBC has been approved to establish an investment banking operation in Saudi Arabia. However, we expect that rather than the foreign banks, competition will be more from the newly set-up banks such as Al Bilad and Enmaa Bank.

In May 2006, Deutsche Bank launched its brokerage business on the Tadawul (Stock Exchange) in the Kingdom of Saudi Arabia. The bank's initial trade marks the first time a broker from outside the region has become a full member of the GCC's largest stock exchange. For the bank, broking business is an important addition to their product mix in the Kingdom. The bank envisages huge opportunities to contribute to the development of the Saudi market by launching equity finance, mutual fund, corporate advisory and money market businesses.

We believe that banking sector in the country is on the threshold of a new era, where foreign banks are likely to give tough time to local banks. The growth opportunities are abound in the region for players who are willing and ready to meet the challenges. Some of the areas ready to be tapped are affluent banking, small to medium enterprise (SME) banking, upper-mass banking for the growing middle class, bancassurance, mortgages, and Islamic banking. That's good news for banking customers, investors, and banking and finance professionals from all over the world with a stake in the growth market. Seeing how closely the country's banking sector is connected to the economy of Saudi Arabia, this is good news for the economic growth too.

Islamic Banking – The "in" thing

The "pure-play" Saudi Islamic banks have a clear competitive advantage over their conventional competitors. While conventional banks attract all kinds of depositors, Islamic banks' customers are more sensitive to the Islamic Sharia principles. As a result, Islamic banks have access to larger volumes of Non-Interest Bearing (NIBs) relative to their asset size, than do the conventional banks. This leads to very high spreads for the Islamic banks. As a consequence, many conventional banks have developed Sharia-compliant un-remunerated deposits in recent years. This is particularly true in Saudi Arabia, where conventional banks target aggressively Sharia-compliant deposits through Islamic windows that compete with the Islamic banks in the kingdom – Al Rajhi Bank, Bank al Jazira.

The deposit growth of Islamic banks have been higher than the Saudi banking sector as seen by the CAGR growth of 17.4% seen in the period 2002-05 as compared to 12.9% recorded by the Saudi banking sector for the same period. Bank Al Jazira too grew by a CAGR of 37.2% in the same period, albeit over a small base. As result of higher spreads, the profitability growth of Islamic banks too is markedly higher than their conventional peers. AlRajhi bank reported a net profit growth of 58.6% (CAGR) from 2002-05 as compared to the CAGR of 36.3% recorded by the Saudi banking sector over the same period.

In addition, the business model of the banks also made huge differences to their revenues. This can be illustrated from the fact that as with the conventional banks, Islamic banks that focus on retail customers perform better than those focusing on corporate banking. The case in point is that of Al Rajhi Banking & Investment Corp which has successfully leveraged retail banking potential as it has one of the largest branch and ATM networks in Saudi Arabia. The customers perception about the Islamic banking products and their appetite for returns on Islamic banking products also makes serious difference to the Islamic banks.

However, it is to be noted that most banks in the Kingdom have launched Islamic banking products, either through a separate Islamic window or a subsidiary. Islamic banking is turning into a fast-developing, highly-profitable banking product. Also the division between the Islamic banks and conventional banks is reducing as many banks such as SAMBA have a large chunk of their deposits as non-interest bearing which positively affected its spreads.

Credit concentration

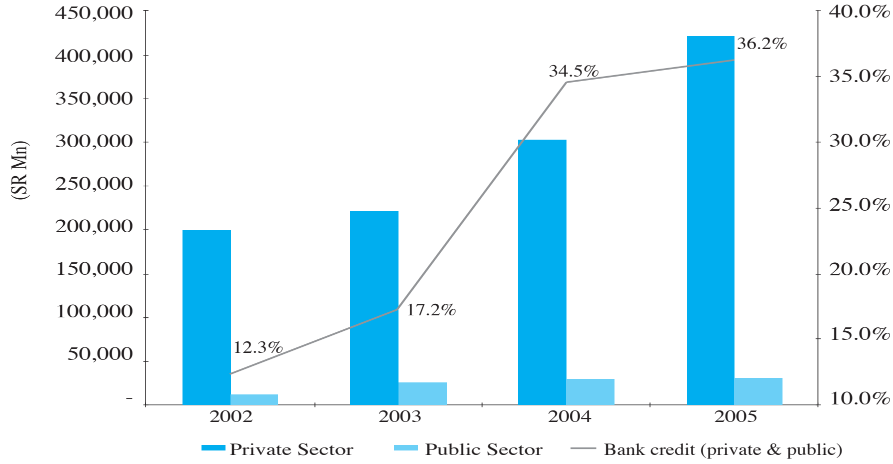
Overall system loans grew at a CAGR of 29.0% for the period 2002-05. The loan portfolio increased from SR210.7bn in 2002 to SR452.5bn in 2005. Bank credit grew by 17.2%, 34.5% and 36.2% in 2003, 2004 and 2005 respectively.

Total claims on the private sector registered a CAGR growth of 28.4% for the period under review and increased from SR198.7bn in 2002 to SR420.8bn in 2005. Claims on the public sector grew at a CAGR of 38.4% for 2002-05. Public sector claims increased from SR11.9bn in 2002 to SR31.7bn in 2005.

Consumer loans- The key driver to credit growth..

The key driver of credit growth during the last three years has been consumer loans. The consumer lending segment grew at a CAGR of 50.6% for the period 2002-05, much higher than the overall system credit growth of 29.0%. Consumer loans grew by 38.6%, 57.3% and 56.6% in 2003, 2004 and 2005 respectively. In order to keep a check on strong expansion in consumer lending so as not to affect the asset quality, the regulator issued guidelines on consumer lending.

Chart 2: System Loans



*Source: SAMA, **Global** Research*

Since 1998, consumer loans have increased dramatically. This can be largely attributed to the Saudi Arabian Riyal Interbank Express (SARIE) system which permits loans to be secured by salary assignments. These loans have provided access to banking system liquidity to a large segment of customers to meet their consumer and investment needs, thereby, supporting the pace of economic activity.

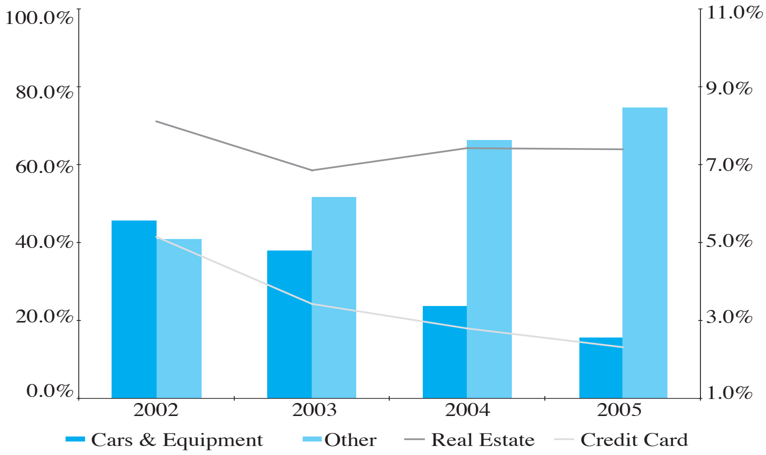
Consumer loans have been the key growth driver for overall growth in bank credit. It grew at a CAGR of 50.6% during the period 2002-05 from SR52.9bn in 2002 to SR180.5bn in 2005. The contribution of consumer loans as a percentage of private sector claims increased from 26.6% in 2002 to 42.9% in 2005. As a percentage of total bank credit, consumer loans' share increased from 25.1% in 2002 to 39.9% in 2005. The period 2002-05 has witnessed a sharp expansion of bank credit to the retail segment.

One of the major contributor in consumer lending was the real estate sector. Due to the availability of sufficient financing mechanisms, real estate financing portfolio grew from SR4.5bn in 2002 to SR13.7bn in 2005, reported a CAGR of 44.7%. The contribution of real estate sector to total bank credit has increased from 2.1% in 2002 to 3.0% in 2005.

With local banks expanding their credit portfolios coupled with abundant liquidity in the local economy, we believe building and construction facilities as well as real estate financing loans are likely to increase going forward. This would also be a result of the estimated growth in the population, increasing demand for housing and the current housing shortages.

Card loans has not grown as much as consumer lending. The card book increased from SR2.9bn in 2002 to SR4.3bn in 2005, a CAGR of 14.2%, much lower than both consumer loan growth of 50.6% and bank credit growth of 29.0%. However, in our opinion the concept of card loans is likely to gather momentum over the next couple of years.

Chart 3: Consumer Lending Break-Up



Source: SAMA, ***Global*** *Research*

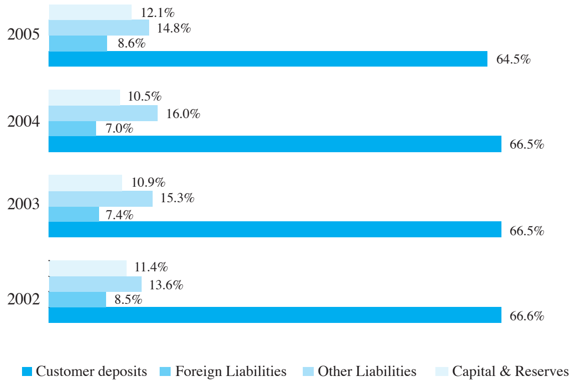
Shariah compliant banking services have recorded continued phenomenal growth in the area of retail, corporate services, and assets management. This area is demand driven and banks that offer new Shariah compliant solutions in response to the market need will benefit which will boost their growth and competition. There is also room to innovate and develop adequate products that would meet financing and investment needs of the customer.

Liability mix

Liabilities grew by 14.3% CAGR for the period 2002-05 from SR507.9bn in 2002 to SR759.1bn in 2005. During this period, the share of customer deposits has remained more or less the same. Deposits contributed 64.5% of the total balance sheet in 2005 as against 66.6% in 2002. During the same period, contribution of shareholder's equity as a percentage of total liabilities increased from 11.4% in 2002 to 12.1% in 2005.

Going forward, the banks' ability to increase their branch network will help mobilize deposits further. Strong deposit franchise will help banks to support loan growth (both from the corporate as well as retail segment). In our opinion, earnings from core banking activities will drive Saudi banking growth.

Chart 4: Liability Mix



*Source: SAMA, **Global** Research*

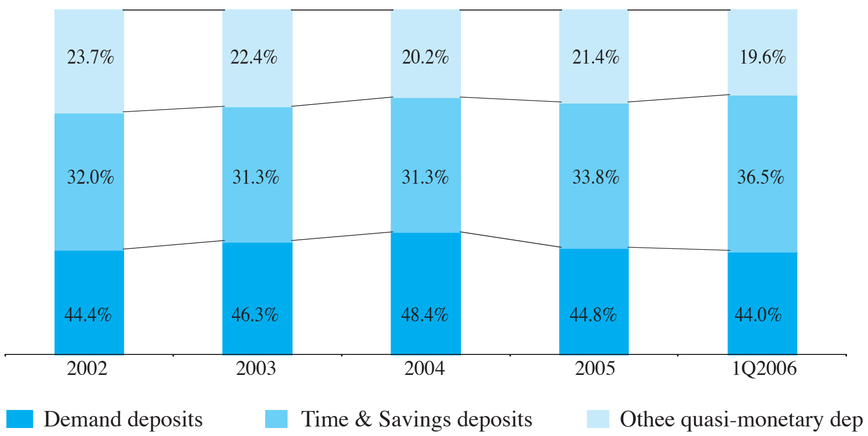
During the period 2002-05, demand deposits grew at a CAGR of 13.5% from SR150.0bn in 2002 to SR219.3bn in 2005. The contribution of demand deposit to total deposits increased marginally by 40bps from 44.4% in 2002 to 44.8% in 2005.

Time and savings deposits growth was higher as compared to the total deposit growth. These deposits grew at a CAGR of 15.2% for the period under consideration as against overall deposit growth of 13.1%. The contribution of time and saving deposits increased from 32.0% in 2002 to 33.8% in 2005. In absolute terms, these deposits increased from SR108.0bn in 2002 to SR165.3bn in 2005.

We believe that the growth in time deposits is likely to remain strong over the next two years as banks structure innovative products coupled with higher rates offered. In order to support loan growth, banks will require to increase their deposit franchise.

Most banks witnessed a surge in their cost of funds in 2005, as banks were offering higher rates on term deposits to attract depositors. In the bargain, their cost of funding increased. With the demand for funds being strong due to strong economic growth and massive infrastructure projects in different sectors being announced, we expect banking sector's growth to remain strong.

Chart 5: Deposit Mix

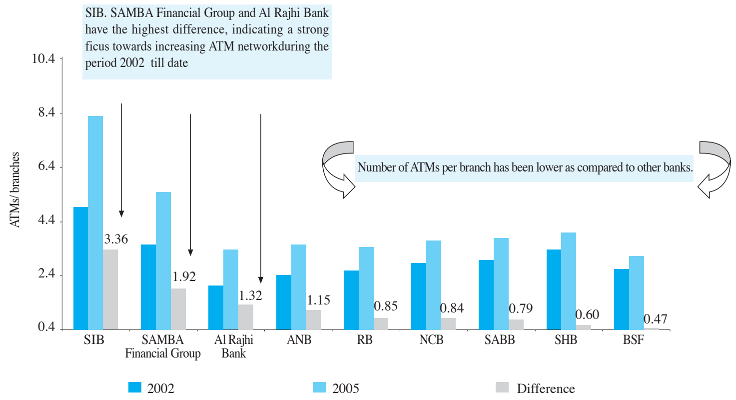


*Source: SAMA, **Global** Research*

Increased penetration in the Kingdom….

During the period 2002-05, the number of branches in the Kingdom have increased from 1,203 in 2002 to 1,251 in 2005, a CAGR of 1.2%. The number of ATMs grew much faster by 13.8% CAGR from 3,108 in 2002 to 4,576 in 2005. Alternative delivery channels has gained importance to provide better services to customers and in turn help banks reduce transaction cost thereby enhancing operational efficiency.

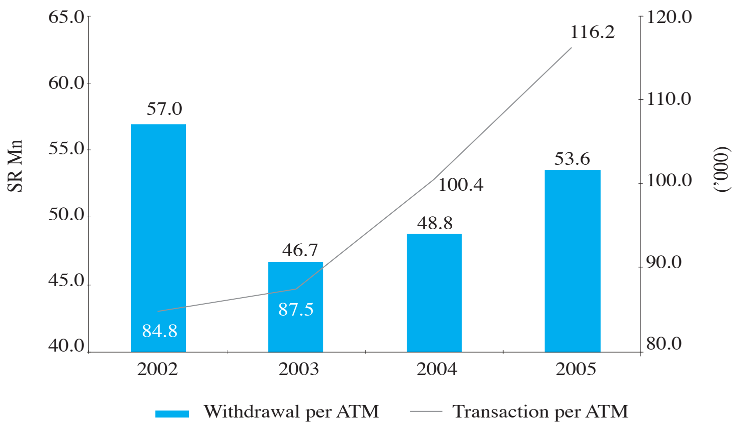
Chart 6: Alternative Delivery Channels



*Source: SAMA, **Global** Research*

The total number of transactions grew at a CAGR of 26.3% from 264.4mn in 2002 to 533.2mn in 2005. During the same period, ATMs grew at a CAGR of 13.8%. Number of transactions per ATM increased from 84,757 in 2002 to 116,217 in 2005, a CAGR of 11.1%.

Chart 7: ATM Statistics



*Source: SAMA, **Global** Research*

Recent Updates in the Regulatory Environment – *Getting more tougher and stricter*

Scope

This directive applies to Consumer Credit Agreements and related Guarantee Agreements. This directive is effective from 1st January 2006. However, Article 12 of these regulations will be effective from the date of this circular. The scope and application of various terms and conditions are covered under Definitions of Terms in Article 13 of these Regulations.
Consumer Credit includes loans to individuals, households and family members, granted on the following basis.

- Granted by the creditor to a borrower as a secondary activity for the borrower, i.e. outside the sphere of the borrower's principal commercial or professional activity. It would generally include personal loans, overdraft facilities, car loans, payment card loans, financial leases, etc.
- To finance purchase of goods and services for enjoyment, consumption and other such requirements of individuals as identified above e.g to purchase furniture, household items, vacations, education, etc.
- While mortgage loans are to be excluded, real estate and or home improvement financing is included.

Performance of a Guarantee Agreement

- Maximum guarantee period for open ended credits is 5 years. This guarantee may be extended only with the specific agreement of the guarantor at the end of that period.

- The creditor may take action against the guarantor only if the consumer having defaulted on repayment of the credit and has failed to comply with a default notice for a period of 30 days.

- The amount guaranteed will only cover the outstanding balance and arrears in accordance with the credit agreement and not include any other indemnities or penalties.

Maximum credit limit

Maximum limit would be such that the total monthly payments of the borrower on total borrowings, including credit cards borrowings, should not exceed one third of his net monthly salary. However, for retired persons this limit is set at 25% of pension payments.

Also, SAMA at its discretion, may put a limit on a creditor whereby its consumer credit portfolio may not exceed a specified percentage of its total loans portfolio.

Maximum term to maturity of Credit

Maximum term to maturity of a consumer credit agreement should not exceed 5 years.

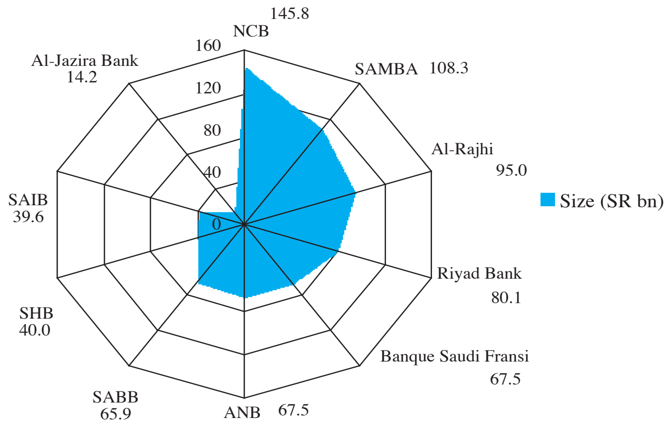
Peer Group Comparison

Balance Sheet growth…

The balance sheet size of the banks under our coverage increased from SR631.1bn in 2004 to SR723.8bn in 2005, a growth 14.7% over the previous year. In terms of size, the top three banks namely NCB, SAMBA and Al-Rajhi contributed 48.2% of the overall size of the banks under review in 2005. In 2002, the contribution of these banks to the total has remained more or less the same. These three banks constituted 48.7% in 2002.

During the period 2002-05, asset size of the banks grew at a CAGR of 13.3%. In our opinion, the banking sector is likely to witness strong growth in core banking due to the strong growth in the corporate sector coupled with favorable demographics resulting in growth in consumer lending of banks.

Chart 8: Balance Sheet Size



*Source: Company Reports, **Global** Research*

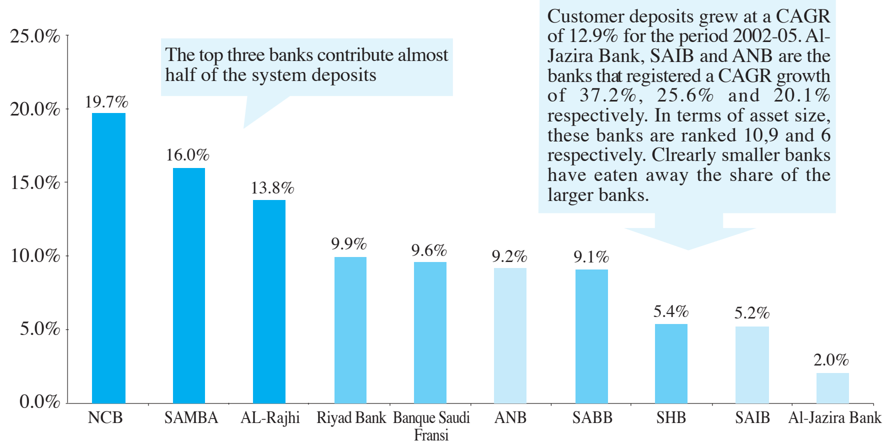
Customer Deposits…

Deposits grew at a CAGR of 12.9% for the period 2002-05 from SR370.5bn in 2002 to SR532.5bn in 2005. In order to support strong loan growth, resource mobilization is the key. Banks are increasingly focusing on expanding their branch and ATM network. A strong deposit franchise is likely to result in deposit mobilization. This will further help banks to shore up their lending book, thereby increasing their core banking activities.

In 2005, the buoyancy in the capital market resulted in shortage of liquidity in the system. Banks had to offer higher interest rates in order to lure deposits. Due to the increasing investor interest in the stock market, consumers were borrowing from banks. However with the recent downturn in the stock market, investor confidence was shaken which resulted in funds getting back by way of bank deposits.

Customer deposits grew by 13.3% in 2005 as compared to a growth of 17.5% in 2004. As at end 2005, the deposits of the banks under review reached SR532.5bn as compared to SR470.1bn in 2004.

Chart 9: Customer Deposits



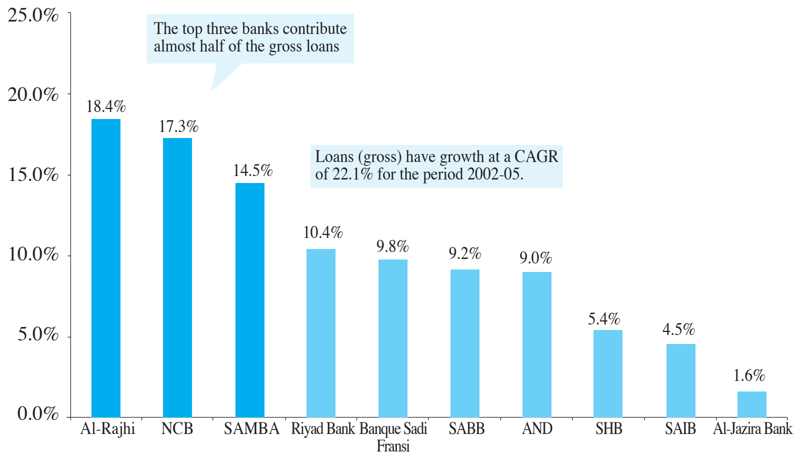
*Source: Company Reports, **Global** Research*

Loans & Advances….

Gross loans and advances grew at a CAGR of 22.1% for the period 2002-05. Gross loans increased from SR247.5bn in 2002 to SR450.5bn in 2005. In 2005, gross loans grew by 27.2% as compared to 2004. In 2005, the buoyancy in the stock market resulted in consumer lending segment witnessing significant growth. However, in 2006 the regulator issued guidelines on lending to the consumer segment. It was issued with the objective of limiting the rapid expansion of consumer loans.

Net loans grew at a CAGR of 23.8% during the same period. The net loan book increased from SR230.0bn in 2002 to SR436.6bn in 2005. In 2005, the growth was strong at 28.3% as compared to 2004. In our opinion, the growth in the consumer lending front is likely to slow down in 2006 due to the regulatory constraint. However mega projects in the fields of petroleum, gas, water, electricity, housing and petrochemicals are likely to boost the lending portfolio. Government's efforts to diversify the economy and improve the investment climate through regulatory and structural measures in various sectors will benefit the banking sector.

Chart 10: Gross Credit deployment



*Source: Company Reports, **Global** Research*

Medium rung banks improving their market share…..

NCB, Al-Rajhi Bank and SAMBA contributed 55.7% of the overall loans in 2002. During the period 2002-05, the market share of these three banks have declined by 5.5% to 50.2% in 2005. NCB's market share has been declining during this period. Its market share declined from 20.4% in 2002 to 19.1% in 2003 to 18.6% in 2004 and to 17.3% in 2005. Similar is the case with Al-Rajhi Bank whose market share has declined from 20.6% in 2002 to 20.2% in 2003 to 19.3% in 2004 and to 18.4% in 2005. SAMBA's market share has marginally declined by 0.2% during the period under review.

On the other hand, ANB, BSF and SAIB are the beneficiaries in terms of increasing share of lending book. ANB's share increased from 6.9% in 2002 to 9.0% in 2005 and BSF's contribution increased from 8.8% in 2002 to 9.8% in 2005.

Table 3: Market Share for Gross Loans

	2002	2005	Difference
NCB	20.4%	17.3%	-3.2%
Al-Rajhi	20.6%	18.4%	-2.2%
SAMBA	14.7%	14.5%	-0.2%
Riyad Bank	10.2%	10.4%	0.2%
SHB	5.1%	5.4%	0.3%
Al-Jazira Bank	1.0%	1.6%	0.6%
SABB	8.5%	9.2%	0.7%
SAIB	3.8%	4.5%	0.8%
Banque Saudi Fransi	8.8%	9.8%	0.9%
ANB	6.9%	9.0%	2.0%

*Source: **Global** Research*

Saudi banks- High profitability….

Profits of the banks under review, grew from SR10.7bn in 2002 to SR27.0bn in 2005 registering a CAGR of 36.3% for the period 2002-05. In 2005, the y-o-y profit growth was particularly strong at 60.5%.

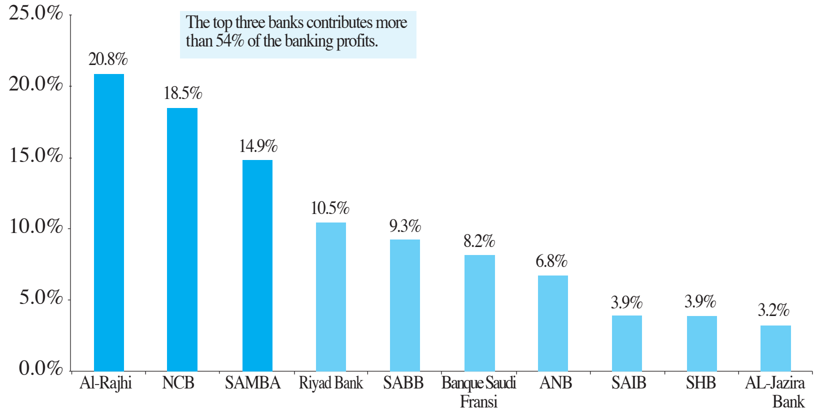
The key contributor for the strong growth in reported profits was fee from banking services which increased from SR5.6bn in 2004 to SR11.7bn, a growth of 108.1% y-o-y. Net commission income, which is from core banking activities grew from SR20.9bn in 2004 to SR25.1bn in 2005, a growth of 20.4%.

Saudi banks are among the most profitable in the GCC banking sector with the return on average assets and return on average equity at 4% and 33.1% respectively reported in 2005.

The sector's average ROAA and ROAE were 2.7% and 26.4% respectively in 2004. The bank with Islamic leaning stood out in terms of return ratio with Bank alJazira leading the way with the RoAA of 7% followed by AlRajhi Bank at 6.5% respectively in 2005. AlRajhi Bank also lead with the reported ROAE of 52.6% in 2005.

During 2002, the top three banks namely NCB, SAMBA and Riyad Bank contributed 53.4% of the total profitability. In 2005, the contribution of the top three banks increased to 54.2%. However, in 2005 Al-Rajhi Bank replaced Riyad Bank in the top 3 contributor in terms of profitability. Also Al-Rajhi Bank's contribution to total profits of the universe of banks under review was the highest at 20.8%.

Chart 11: Profitability



*Source: Company Reports, **Global** Research*

Saudi banks and their customers have benefited from the advancement in technology. Banks have been able to expand their businesses by offering an array of new and innovative products, control their costs and enhance profitability.

Consumers have benefited from access to a broad range of services and from reduction in costs. Telephone and internet banking is now rapidly expanding, and in 2006, the Saudi Payment System is well poised for further enhancement by SADAD (an electronic bill presentment and payment system) which provides the ability to pay major companies' bills electronically by debiting the accounts of their customers. This will further enhance efficiency and reduce costs for the banking sector in general.

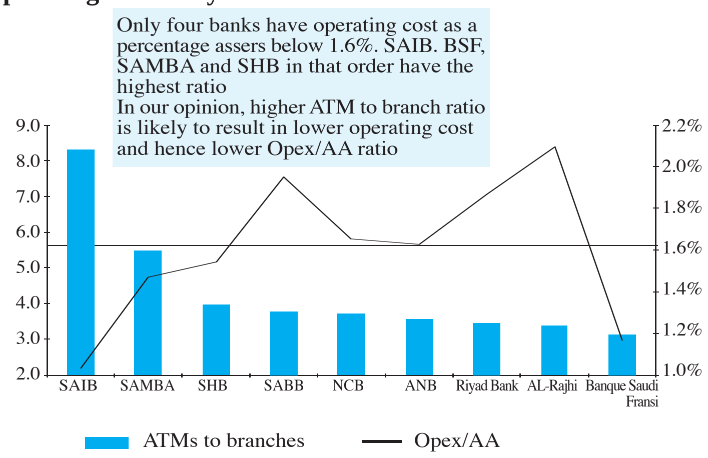
Trying to contain costs…..

Cost to income ratio of the banks under review ranged between 22% and 34%. In 2005, the lowest cost to income ratio was for Al-Rajhi Bank at 22.7% and the highest was for ANB at 33.9%. However, one has to consider that 2005 was the year when fees from banking services grew by more than 100% and hence cost to income ratio is likely to be distorted depending on the contribution of broking income of banks.

In our opinion, a better parameter to gauge operating efficiency would be to analyze operating expense (Opex) as a percentage of average assets (AA). The thrust of banks' towards increasing their ATM network is also a key parameter that will aid in judging the operating efficiency. Increasing ATM network is likely to reduce transaction costs done through branches. Therefore, a higher ATM to branch network is likely to reduce costs and thereby improve operating efficiency.

Operating expense to average assets ratio for 2005 was in the range of 1.0% and 2.1%, which was the lowest for SAIB and highest for Al-Rajhi Bank. Number of ATMs per branch was highest for SAIB (8.3) and lowest for BSF (3.1).

Chart 12: Operating Efficiency



*Source: Company Reports, **Global** Research*

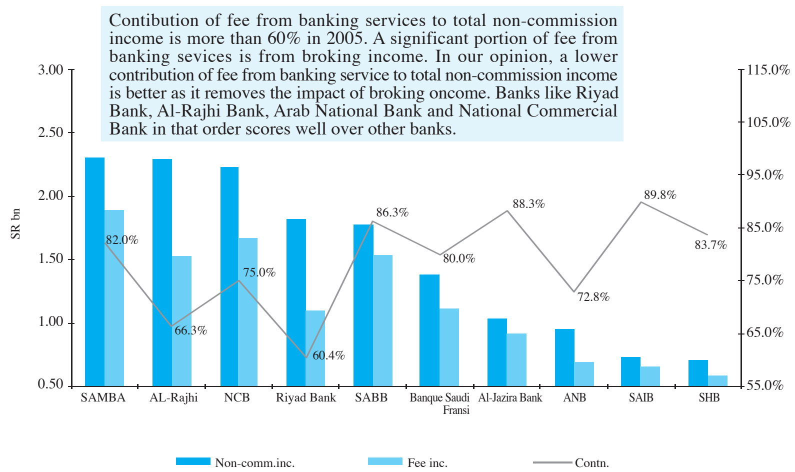
Saudi banks have benefited greatly from the Universal Banking Model permitted by SAMA and offer a range of financial services including investment management, mutual funds, brokerage, and other services. It is expected that the financial market will both broaden and deepen, and the competitive edge will be with banks that can innovate and harness new technologies.

Non-commission income driving profit growth….

Non-commission income of banks increased from SR7.9bn in 2004 to SR15.2bn, a growth of 91.0%. During the last three years, non-commission income has grown at a CAGR of 51.5%. Fees from banking services increased from SR5.6bn in 2004 to SR11.7bn in 2005, a growth of 108.1%.

Due to the buoyancy in the stock market, banks made windfall income from broking business. However, in our opinion as more and more broking licenses are being issued, broking income is unlikely to register significant growth going forward. Hence we prefer banks with lower contribution of fee income as percentage of non-commission income as these banks will be able to show earnings growth without much impact by way of low broking income.

Chart 13: Non-Commission Income



*Source: Company Reports, **Global** Research*

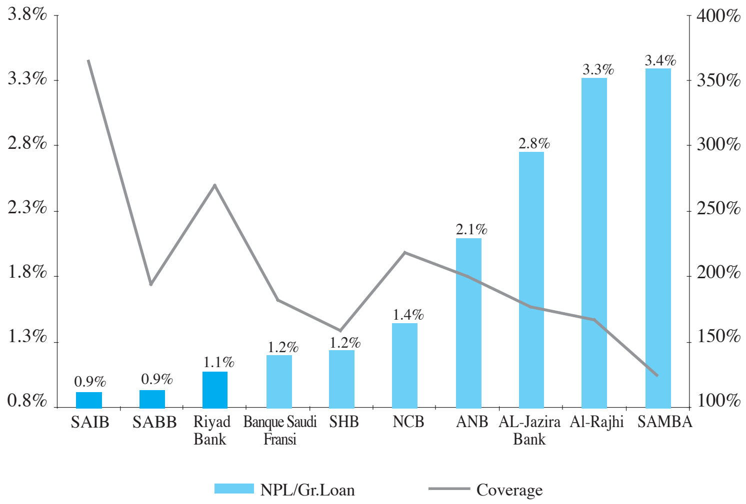
Astute asset quality….

Saudi banks follow a conservative policy regarding provisioning for loan losses. In 2005, the average coverage ratio (PLLs-to-NPLs) was 179% (2004: 177.2%) with all the banks having coverage ratios of more than 100%. SAIB had the highest coverage ratio of 364% followed by Riyad Bank with 269.5% coverage. SAMBA with the ratio at 124.4% in 2005 had the lowest coverage ratio within the peer group.

Total non-performing loans of the listed banks amounted to SR7.76bn in 2005 (2004: 6.4bn) which represented 1.7% of the banks' aggregate loan portfolio at the end of year 2005 (2004 : 2.3%). SAMBA had the highest non-performing loans (NPLs) amongst the peer group, representing 28.5% of the sector's total NPLs and 3.4% of the bank's gross loans, which is the highest in the sector.

However, SAMBA has done well in reducing its NPLs to Gross Loans ratio from 4.9% reported in 2004. Al Rajhi had the second highest share of non-performing loans amounting to (SR1.65bn) in 2005 (2004:SR95mn). The average NPL/Gross Loans ratio in the Saudi banking sector was at 1.72% in 2005 which is among the lowest in the GCC arena.

Chart 14: Asset Quality

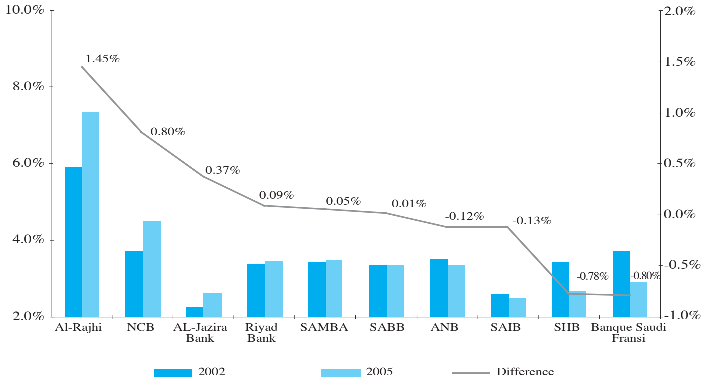


*Source: Company Reports, **Global** Research*

High margins=Strong profits…

In 2005, commission margins of the bank's under review ranged between 2.5% and 7.4%. The range for these banks in 2002 were 2.3% and 5.9%. The highest difference between 2002-05 was for Al-Rajhi Bank (1.4%) followed by NCB (0.8%), Bank Aljazira (0.4%) and RB (0.2%). ANB, SAIB, SHB and BSF witnessed a marginal decline in commission margin during the period under consideration. The margins for SAMBA and SABB were more or less the same in 2005 as compared to 2002.

Chart 15: Commission Margins



*Source: Company Reports, **Global** Research*

Result Highlights: Second Quarter 2006

- Net income for the below mentioned Saudi banks has been strong in the second quarter of the current financial year. Barring a couple of banks, net income growth on a y-o-y basis was strong. The lowest growth in net income was for NCB (22.5%) and the highest for SAIB (200.0%). The yearly decline in net income was for SHB (-79.8%) followed by RB (-27.3%). In 2Q2005, RB's net income included SR295.6mn representing gain on sale of land. Adjusted for this exceptional, non-recurring item, net income of the bank increased by 6.2% in 2Q2006 as compared to 2Q2005.

- The growth in net special commission income for the below mentioned banks has been stable and it ranged between 9%-34%, the lowest for NCB (9.1%) and the highest for SABB (34.0%).

- The key contributor to 2005 earnings for all the Saudi banks was fee from banking services, and within that broking income. The growth in fee income continues to remain strong in 2Q2006. The range for the growth in fee income for the quarter was between 7-70%, the lowest growth was in case of SABB (7.6%) and the highest for ANB (69.2%). In case of SABB, growth in fee from banking services in 2005 stood at 127.1% and in the case of ANB, the fee income growth in 2005 stood at 64.4%.

- From the above, it is evident that core earnings are going to drive growth in net income. Broking income contribution is likely to move in line with the stock market activity. Banks are taking initiatives to shore up its fee based income.

Table 4: Key Income Statement Indicators - 2Q2006

Growth yoy	Net special Commission income	Fee income	Non-commission income	Net income
Al-Rajhi	19.1%	25.7%	13.1%	33.0%
ANB	13.2%	69.2%	34.9%	38.4%
BSF	17.4%	66.3%	48.2%	39.9%
NCB	9.1%	31.1%	115.1%	22.5%
Riyad Bank	15.6%	14.0%	-47.1%	-27.3%
SABB	34.0%	7.6%	0.6%	10.6%
SAIB	25.5%	28.5%	301.3%	200.0%
SAMBA	22.1%	53.2%	50.3%	41.1%
SHB	16.9%	19.9%	21.0%	-79.8%

Note: Net special commission income for Al-Rajhi Bank refers to net investment income
*Source: **Global** Research*

- Most of the banks have registered a sequential (q-o-q) growth in customer deposits except SAIB (-8.1%) and SAMBA (-7.2%). The strongest q-o-q growth in customer deposits was for NCB (16.3%) followed by RB (12.7%).

- On a q-o-q basis, 2 out of the nine banks registered a decline in net loans. The decline in net loans was for SAIB (-2.2%) and SABB (-1.0%). Out of the nine banks, six banks have registered a decline in net investments on a sequential basis. The three banks that witnessed a growth in net investments on a sequential basis are Al-Rajhi (30.3%) followed by NCB (11.0%) and RB (5.2%).

Table 5: Key Balance Sheet Parameters - 2Q2006

	Balance Sheet size			Customer Deposits			Net Loans & Advances			Investments		
	y-o-y	q-o-q	y-t-d	y-o-y	q-o-q	y-t-d	y-o-y	q-o-q	y-t-d	y-o-y	q-o-q	y-t-d
Al-Rajhi	15.0%	4.8%	6.5%	9.4%	1.2%	5.8%	15.4%	5.1%	10.1%	-5.4%	30.3%	48.6%
ANB	11.3%	-4.2%	2.0%	16.6%	2.6%	11.7%	30.3%	7.8%	12.0%	-13.6%	-6.3%	-8.5%
BSF	13.8%	2.6%	11.8%	12.8%	0.0%	11.4%	22.9%	4.0%	8.0%	-8.4%	-5.2%	-5.1%
NCB	11.3%	7.8%	6.4%	12.8%	16.3%	11.5%	5.7%	2.8%	0.8%	12.3%	11.0%	10.0%
RB	19.6%	6.3%	15.4%	30.3%	12.7%	30.1%	25.4%	2.1%	9.8%	4.7%	5.2%	5.0%
SABB	20.3%	-1.2%	10.4%	24.0%	1.1%	13.5%	10.4%	-1.0%	-4.2%	-10.1%	-16.8%	-6.8%
SAIB	15.0%	-6.2%	-1.0%	10.1%	-8.1%	-3.3%	12.4%	-2.2%	-2.4%	0.5%	-10.6%	-11.8%
SAMBA	7.9%	-1.7%	3.9%	6.6%	-7.2%	1.6%	15.7%	2.5%	6.2%	-12.8%	-3.9%	-6.0%
SHB	26.8%	3.9%	11.3%	32.5%	6.4%	13.4%	37.9%	1.9%	9.2%	8.0%	-3.9%	0.1%

Note: In case of Al-Rajhi loans refers to net investments
*Source: **Global** Research*

Saudi Banking Sector Outlook

Saudi banks are expected to benefit from positive economic conditions currently prevailing in the country. With the oil revenues at its lifetime high and the government focusing its efforts to increase the non-oil sectors' contribution to the country's economic development and growth, it augurs well for the banks and other private sector players. This positive economic environment has already increased interest of regional banks as well as large international banks in the Saudi banking sector.

We expect healthy competition existing in the banking sector to encourage Saudi banks to better position themselves for the forthcoming competition by improving their operational efficiency further as well as providing their clients with an array of products and services. Improved services and the financial market conditions will help in the repatriation of the Saudi wealth invested abroad back into the economy which will fuel further growth of the banking sector.

The investment income of the banks reported strong growth in 2005 as the stock market gave fabulous returns which had a strong impact on the profitability and valuations of the banks. Although the core earnings growth of the banks remains strong, the increased proportion of the investment income/one time gains makes the future earnings of the banks volatile.

The bond market is also estimated to grow and provide more liquidity to the Saudi banks in terms of corporate bonds. Islamic banking is one of the promising areas for Saudi banks in which we are expecting the competition to be fierce. Most of the Saudi banks have been working hard during the last few years to capture a slice of this low-cost funding source by introducing new products and services to attract deposits of corporate as well as individual clients. Saudi banks are also expanding in providing different types of Islamic Sharia-complaint products to meet the growing demand for such products. Saudi banks are currently offering a wide range of Islamic products ranging from Islamic corporate loans to Islamic consumer loans and even credit cards.

The growth of the Islamic investment avenues will act as a strong motivator for the investors to invest their money in these instruments. We are optimistic about the economic profile of Saudi Arabian economy in the future in view of the comfortable risk profile and attractive investment opportunities that the economy offers. Investment spending and liquidity will remain at high levels, which will be conducive to the growth of the banking sector. We expect the banks to continue investing heavily in the adoption of new technology platforms and international best practices which should lead to better customer services.

Currently, banks are working closely with SAMA in the implementation of the Basle II Capital Accord. We expect all banks operating in Saudi Arabia to implement the standardized approach for credit risk by 1 January 2008 and then continue to move towards more sophisticated Internal Rating Based approaches. For operational risk all banks are likely to move to standardized approach with one or two banks experimenting with the Advanced Management approaches.

SAMA is also encouraging banks to consider a National Data Pooling initiative to help them in credit risk management. All in all Saudi banking system is well on its way to the implementation of Basel II and we expect that banks will remain highly capitalized under the new standard. It is worth mentioning that SAMA's approach in applying Basel II Accord is an integrated one aimed at raising the level of risk management in order to maintain the continued strength of the banking system.

The Saudi economy is undergoing unprecedented boom covering all sectors of the economy, including oil and gas, heavy, medium and light industries; banking, investment and insurance services; and transport and tourism, etc. The favorable demographic structure further reinforces our view that the demand for banking services from this segment is likely to remain strong. These factors make the banking and financial services sector to grow exponentially, with great opportunities for banks to expand in providing conventional services in addition to investment banking.

Banks will benefit greatly from their expertise and experience to provide advisory services in the areas of underwriting and covering of IPOs, corporate finance, financing projects, particularly mega projects (in the fields of petroleum and gas, petrochemicals, water, electricity, housing, education and health), mergers and acquisitions, securities advisory services and domestic and international brokerage, private wealth management and asset management businesses.

Valuation & Recommendation

For arriving at the fair value of the banks under review, we have used two valuation methods:

1. Cash flow approach represented by the Dividend Discounting Model

2. Market approach represented by Peer Group valuation.

Dividend Discounting Model - DDM

The DDM model constructed is based on a 4-year forecast of dividends as cash flows (2006-09). The dividends for the forecasted period and the terminal value are then discounted back at the cost of equity to arrive at the total net present value (NPV) of the company. In our calculations, we have made the following assumptions in order to arrive at the equity value of individual banks:

1. Cost of Equity of 10.125% derived using Capital Asset Pricing Model.

2. Risk free rate of 5.125%.

3. Equity risk premium of 5.0%.

4. Beta of 1. The actual beta of the banks is less than 1, but to more appropriately reflect the market risk we have taken it as 1.

5. Terminal growth rate of 5.0%.

Table 6: Value as per DDM Approach

SR	DDM value
Al-Rajhi	311.0
ANB	126.9
BSF	138.3
Riyad Bank	79.1
SABB	170.2
SAIB	112.3
SAMBA	193.7
SHB	93.1

*Source: **Global** Research*

Peer Group Valuation

The peer group valuation is done by comparing the price to book value (P/BV) multiples enjoyed by similar companies.

Table 7: Companies average P/BV ratios in the banking sector

	Equity 2006 (SR mn)	Shares Out. (mn)	BV/Share (SR)	Price (SR)	Market Cap. (SR bn)	P/BV (x)
Al Rajhi	15,624.4	675.0	23.1	302.5	204.2	13.07
ANB	7,575.2	325.0	23.3	113.0	36.7	4.85
BAJ	3,204.1	112.5	28.5	307.0	34.5	10.78
BSF	8,754.6	337.5	25.9	145.0	48.9	5.59
RB	12,531.9	625.0	20.1	79.5	49.7	3.96
SAMBA	13,100.9	600.0	21.8	156.0	93.6	7.15
SABB	7,753.1	375.0	20.7	167.3	62.7	8.09
SHB	3,835.7	220.5	17.4	88.3	19.5	5.07
SAIB	6,458.8	240.6	26.8	113.3	27.3	4.22
Total/Average	**78,827.2**	**3,511.1**	**22.5**		**577.1**	**7.32**

*Source: **Global** Research, Market prices as on August 30, 2006*

As indicated in the table 7, the average P/BV multiple for the banks in Saudi is around 7.32x. Therefore, on the basis on industry average P/BV of 7.32x, the value of the banks under review is given in the table below.

Table 8: Value as per Market Approach

SR	P/B Value
ANB	169.3
BSF	185.4
Riyad Bank	146.8
SABB	165.2
SAIB	196.5
SAMBA	159.8
SHB	130.8

*Source: **Global** Research*

Note: We have valued Al-Rajhi Bank based only on Income Approach

As the book value multiples vary with time and are dependent on several factors such as market sentiment and other qualitative factors, we have provided 20% weightage to the P/BV multiple and 80% to the DDM method.

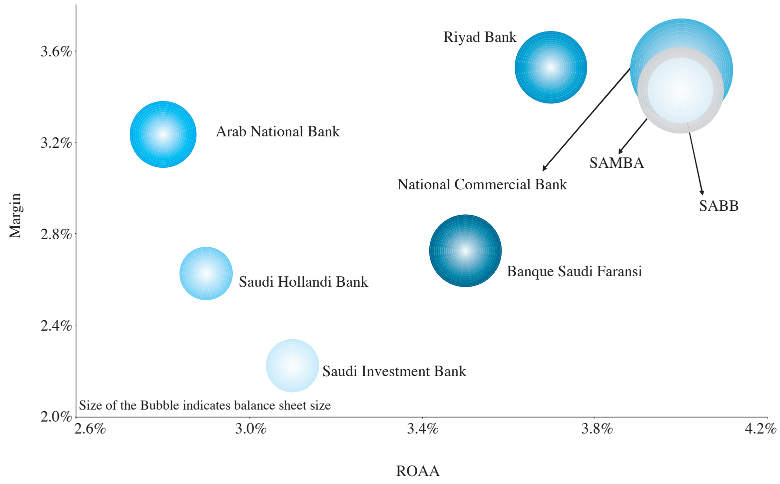
Table 9: Valuation

SR	DDM value	P/B Value	Weighted Price
Al-Rajhi	311.0	NA	311.0
ANB	126.9	169.3	135.4
BSF	138.3	185.4	147.7
Riyad Bank	79.1	146.8	92.7
SABB	170.2	165.2	169.2
SAIB	112.3	196.5	129.1
SAMBA	193.7	159.8	187.0
SHB	93.1	130.8	100.6

*Source: **Global** Research*

Note: We have valued Al-Rajhi Bank based on Income Approach

Chart 16: Relative Comparison based on ROAA, Commission Margin & Asset Size



*Source: **Global** Research*

** The banks under consideration are conventional banks*

Table 10: "Global" Valuation Matrix

	Price	Target	Reco.	% Change	BV *	EPS *	P/BV	P/E
Al-Rajhi	302.5	311.0	Hold	2.8%	23.1	11.6	13.1	26.0
ANB	113.0	135.4	Buy	19.8%	23.1	8.3	4.9	13.6
BSF	145.0	148.5	Hold	2.4%	25.8	9.2	5.6	15.8
RB	79.5	92.7	Buy	16.6%	20.1	5.2	4.0	15.2
SABB	167.3	169.2	Hold	1.2%	22.6	8.4	7.4	19.9
SAIB	113.3	129.1	Buy	14.0%	26.8	9.2	4.2	12.3
SAMBA	156.0	187.0	Buy	19.8%	21.8	9.4	7.1	16.6
SHB	88.3	100.6	Buy	14.0%	17.9	4.8	4.9	18.5

*Note: * Based on 2006E*

*Source: **Global** Research, Market prices as on August 30, 2006*

PLAYER PROFILES

Al Rajhi Bank

Reuters Code:
1120.SE

August 30, 2006

Hold

Listing:
Saudi Stock Exchange

CMP:
SR302.5

Key Data

EPS (SR)*	11.6
BVPS (SR)*	23.1
P / E (x)	26.0
P / BV (x)	13.1
Avg. daily vol.('000)	1,157.4
52 week Lo / Hi	224.5/548.8
Market Cap (SR mn)	204,187.5
Target Price	311.0

*Source: **Global** Research*
** Projected (2006)*

Background

- The origins of **Al Rajhi Bank** date back to the mid-1900s when four Al Rajhi brothers started a bullion arbitrage and money-changing business. In 1978 they amalgamated their money changing operations under Al-Rajhi Company for Currency Exchange and Commerce, which in 1987 was converted into a joint stock company and in 1988 the company was developed into Al Rajhi Banking and Investment Corporation. In 1Q-2006, Al Rajhi Banking and Investment Corporation (ALRAJHI) introduced its new name Al Rajhi Bank and new logo.

- Al Rajhi is a full-fledged Islamic Bank providing wholesale, retail and commercial banking products and services in addition to investment banking. ALRAJHI is the 3rd largest bank in the Kingdom in terms of the total assets, having a market share of 13.1% of the aggregate banking assets at the end of 2005 (2004: 12.3%).

- The bank has one of the largest branch network in the kingdom with 385 (2004: 383) branches with 6,681 (2004: 5,711) employees, the largest ATM network (more than 1,300 machines) and over 8,700 POS installed all over the Kingdom. The bank has got Islamic banking license and has started operations in a major Islamic banking hub, Malaysia. Al-Rajhi Bank plans to open 50 branches in Malaysia within five years.

Recent developments

- Al-Rajhi Bank signed a US$500mn three-year murabaha financing facility. Initially, Al-Rajhi went to the market with a US$300mn loan that was oversubscribed by $535 million when lead arrangers closed the facility at US$500mn.

- Al Rajhi Bank launched the Al Rajhi Fund for India and China. The fund is an open-ended fund that will invest in Indian and Chinese listed companies in compliance with Sharia rules and specifications set by Al Rajhi Bank's compliance committee.

Rating Reviews

- In January-2006, S&P upgraded ALRAJHI's ratings to A/Stable/A-1 from A-/Stable/A-2.

- In Nov-2005, Moody's upgraded Al Rajhi Bank's long-term foreign currency deposit rating to A3 from Baa2. The Prime-2 short-term foreign currency deposit rating and the D+ financial strength rating remain unchanged.

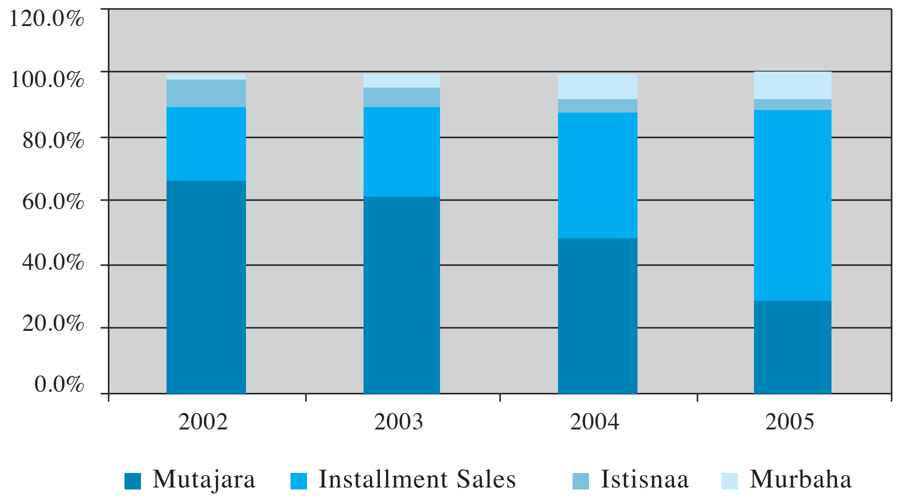
Financial Performance – 2005

- ALRAJHI results beat our expectations made in our May-05 report. The bank reported net profit of SR5.63bn as compared to our estimates of SR4.13bn resulting in variation of 36.3% from our estimates. The bank's assets in 2005 reported a variation of 2.6% as it reached SR95.04bn at the end of 2005 as compared to our forecast of SR92.6bn for 2005.

- ALRAJHI's assets reported a strong CAGR growth of 17% in 2002-05 period as it grew from SR59.4bn in 2002 to SR95.04bn in 2005. The bank reported a higher than industry average growth in 2005, registering a growth of 22.1% as compared to the previous year.

- The investment (net) grew at a CAGR of 18% over 2002-05 reaching SR80.1bn at the end of 2005. The installment sales investment have grown at a strong CAGR of 62.9% in 2002-05 as it accounted for 59.6% of the total investment in 2005 as compared to 22.8% of the total investments in 2002. Mutjara Investment have registered a decline in 2002-05 on CAGR basis, down 10.2%. Its proportion in the total investment too declined from 66.3% in 2002 to 29.1% in 2005.

Chart 1: Investment Portfolio



*Source: Company Reports, **Global** Research*

- The thrust on the retail sector can be seen from the fact that the investment to the sector increased from SR24.9bn in 2004 to SR47.9bn in 2005.

- The customers deposit grew at a CAGR of 17.4% over the same period. Out of the total customer deposits, current deposits accounted for 82.5% although the proportion has declined from 98.2% reported in 2004. The year 2005 saw the bank registering a strong increase in customer time deposits, from SR1.04bn in 2004 to SR12.45bn in 2005.

- ALRAJHI's asset quality has declined in 2005 as Non-Performing Investment to Gross Investment increased from 1.4% in 2004 to 2% in 2005 as the absolute value of NPI too increased from SR950.8mn in 2004 to SR1.65bn in 2005. In-line with the growth in investments in the "Personal" Category, the NPI too increased in the sector from SR439.1mn in 2004 to SR1.19bn in 2005.

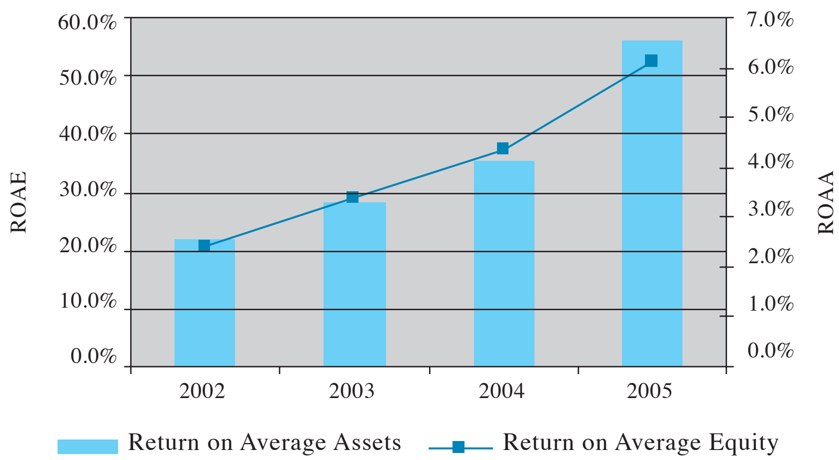
- The incremental increase in non-performing investments is mainly attributed to the exercise carried on in respect of the implementation of IAS 39 as per which criteria for portfolio and specific provisioning were redefined.

- ALRAJHI's net profit posted a whopping 91.9% yearly growth in its net profit as it increased to SR5.63bn in 2005 as compared to SR2.93bn reported in the previous year. The special investment income increased by 43.9% as it reached SR5.96bn in 2005 which is mainly attributed to its thrust on the retail sector and the general rise in the yields in Saudi market.

- For the first time in 2005, ALRAJHI saw the payout in term of special investment expenses to the tune of SR273.6mn which was the result of increased time deposits in the bank. We expect it to increase as the yield rates increases in future and as the proportion of time deposits increases.

- Like all other Saudi banks, ALRAJHI's fee-based income also grew strongly in 2005, registering an yearly growth of 127.5% as it reached SR1.52bn in 2005.

Chart 2: Strong Profitability



*Source: Company Reports, **Global** Research*

- The presence of the low cost deposits as a result of it being a pure play Islamic bank gave it the leeway in terms of strong spreads as compared to its conventional peers. The spreads of ALRAJHI increased from 6.5% in 2004 to 7.3% in 2005.

- As a result, ALRAJHI boasted of one of the highest return ratios in the Saudi banking sector with ROAE and ROAA at 52.6% and 6.5% respectively in 2005. The bank's capital adequacy ratios too are at comfortable levels with the tier-1 ratio at 18.2% at the end of 2005.

- ALRAJHI increased its share capital from SR4.5bn to SR6.75bn through the transfer from retained earnings and gave 1:2 bonus shares.

Financial Performance – 1H-2006

- ALRAJHI's asset size increased by a good 6.5% as compared to 2005 to reach SR101.2bn at the end of 1H-2006. The bank reported a strong sequential growth of 4.8% in 2Q-2006.

- However, in 1H-2006, the customer deposits of the bank registered a lower 5.8% growth on YTD basis which was mainly due to the marginal growth of 1.2% reported in 2Q-2006 over 1Q-2006. This is different from the other banks as they reported strong numbers in terms of sequential growth of customer deposits in 2Q-2006. However, we believe that the customer deposits growth is likely to increase in the remaining part of the year as Islamic investors move their funds from the poorly performing capital markets to the Islamic deposits.

- However, the bank continued to report strong growth in the investment book as it registered a strong YTD growth of 10.1% with net investment reaching SR88.2bn at the end of 2Q-2006.

Table 1: Key Financial Data - 1H-2006

Balance Sheet SR mn	**2Q2005**	**2005**	**1Q2006**	**2Q2006**	**Growth-YoY**	**Growth - QoQ**	**Growth - YTD**
Investments, net	76,431.5	80,137.7	83,951.8	88,225.9	15.4%	5.1%	10.1%
Investments Property, other AFS Investments	656.4	418.1	476.6	621.2	-5.4%	30.3%	48.6%
Total Assets	**88,038.0**	**95,038.0**	**96,530.1**	**101,209.7**	**15.0%**	**4.8%**	**6.5%**
Customer deposits	71,212.8	73,684.0	76,991.0	77,935.38	9.4%	1.2%	5.8%
Total Liabilities	**77,229.5**	**82,160.4**	**81,898.1**	**84,801.46**	**9.8%**	**3.5%**	**3.2%**
Share capital	4,500.0	4,500.0	6,750.0	6,750.00	50.0%	0.0%	50.0%
Total shareholders' equity	**10,808.3**	**12,877.6**	**14,632.0**	**16,408.24**	**51.8%**	**12.1%**	**27.4%**
Total Liabilities and Shareholders' Equity	**88,037.7**	**95,038.0**	**96,530.1**	**101,209.70**	**15.0%**	**4.8%**	**6.5%**

*Source: Company Reports, **Global** Research*

- ALRAJHI reported net profit of SR3.53bn at the end of 1H-2006, up 55.4% as compared to the corresponding period of the previous year. This was achieved on the back of strong growth in fee income which continued to register a strong y-o-y growth of 79.7%, reaching SR978.1mn in 1H-2006. However, the bank saw a reduced growth of 25.7% in 2Q-2006 as compared to the corresponding quarter of the previous year indicating slowdown in the brokerage and investment banking business.

Table 2: Key Financial Data - 1H-2006

Income Statement 'SR mn'	**2Q2005**	**2Q2006**	**Growth**	**1H-2005**	**1H-2006**	**Growth**
Special commission income	1,443.1	1,874.9	29.9%	2,688.9	3,666.7	36.4%
Special commission expense	(30.4)	(189.7)	524.3%	(33.8)	(425.7)	1160.5%
Net special commission income	**1,412.7**	**1,685.2**	**19.3%**	**2,655.1**	**3,241.0**	**22.1%**
Fees from banking services	367.5	462.0	25.7%	544.2	978.1	79.7%
Gains on non-trading investments	4.6	4.8	4.7%	9.2	9.2	-0.7%
Provisions for loan losses	(191.3)	(79.6)	-58.4%	(449.2)	(145.7)	-67.6%
Total operating income	**1,787.0**	**2,242.7**	**25.5%**	**3,091.2**	**4,454.2**	**44.1%**
Total operating expenses	**(451.3)**	**(466.5)**	**3.4%**	**(819.9)**	**(923.5)**	**12.6%**
Net Income	**1,336.7**	**1,776.2**	**32.9%**	**2,272.3**	**3,530.7**	**55.4%**

*Source: Company Reports, **Global** Research*

- ALRAJHI's provision for loan losses reduced considerably, reaching only 145.7mn in 1H-2006, down 67.6% compared to SR449.22mn recorded in 1H-2005. However, we expect the provisioning to increase in the 2H-2006 as the bank increases its coverage ratios.

- ALRAJHI's total operating expenses have grown by 12.6% in 1H-2006 over the corresponding period of the previous year mainly due to the 24% rise in the employee expenses.

Outlook

ALRAJHI seems to have braced itself for the upcoming competition by increasing its product offerings and using its branch network to penetrate the local market. Till now the growing competition has had little effect on ALRAJHI's position as the leading financial institution in the banking sector. ALRAJHI is one of the best known financial brands in the country and it plans to leverage on this to further increase its market share in the lucrative retail banking sector. We believe that ALRAJHI will continue to enjoy the investors support keeping in mind the image of being the "pure-play" Islamic Bank in the country. The bank also enjoys a loyal customer base in the remittances sector which is important keeping in mind the presence of the large expatriate population who have the tendency to send money back to their home countries. In a move to serve customers in a high-tech way, Al-Rajhi Bank has launched some new services, including an innovative remittance service called «Cash Online», which ensures delivery of funds to beneficiaries within two hours.

ALRAJHI is also diversifying geographically as it entered Malyasia, one of the major hubs of Islamic banking. We believe that this will provide it the hedge of operating in a single country and the bank can cross-sell its products in the ASEAN countries through its operations in Malaysia.

The outlook for 2006-2007 is quite positive for the banks in Saudi Arabia and the GCC region. Oil revenues will be much better than forecasted which will result in a huge inflow of liquidity. We believe that the expanding Saudi economy has enough room to absorb new competition as the volume of the Islamic banking sector in Saudi Arabia is increasing at a phenomenal pace. However, the increase in the competition will be healthy for the banking sector and consumers who will get better services and more diverse product offerings. We believe that the bank is well-positioned to take advantage of the growth in the Saudi economy and will leverage its franchise to attract and retain the customers by offering innovative products and services.

Valuation:

Based on the current market price of SR302.5, ALRAJHI stock is trading at a 24.2x 2005 earnings and 10.6x 2005 book value. On a one year forward basis, the stock is trading at 26x 2006F earnings and 13.1x 2006F book value. ALRAJHI will continue to enjoy the depositors' confidence keeping in mind the image of being the "pure-play" Islamic Bank in the country. Based on the DDM valuation method, we recommend a **HOLD** on the stock with a price target of SR311.0, an upside of 2.8% from current levels.

BALANCE SHEET

	Al Rajhi Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Cash & Balances with SAMA	5,683.9	8,795.9	8,682.8	6,462.2	6,314.7	5,908.3	6,163.3
Due from Banks and other FIs	796.4	827.1	2,430.9	1,823.2	1,367.4	1,230.7	1,107.6
Investments Property, other AFS Investments	373.0	536.8	418.1	440.5	465.1	492.2	522.0
Net Investments	55,027.0	65,089.2	80,137.7	95,201.8	106,991.5	117,556.8	126,777.4
Net Fixed Assets	891.0	950.3	1,303.1	1,923.9	2,162.0	2,435.7	2,750.5
Other Assets	1,907.1	1,655.4	2,065.3	2,478.4	2,528.0	2,578.5	2,630.1
Total Assets	**64,678.3**	**77,854.8**	**95,038.0**	**108,330.0**	**119,828.6**	**130,202.2**	**139,950.9**
Due to Banks and other FIs	638.9	1,052.6	2,151.2	3,226.8	4,033.5	4,840.2	5,324.2
Customers' Accounts	49,268.9	63,572.2	73,684.0	82,837.3	91,121.0	99,349.6	107,358.4
Other Liabilities	7,521.5	4,694.0	6,325.2	6,641.5	6,973.6	7,322.3	7,688.4
Total Liabilities	**57,429.2**	**69,318.8**	**82,160.4**	**92,705.5**	**102,128.0**	**111,512.0**	**120,371.0**
Share Capital	2,250.0	2,250.0	4,500.0	6,750.0	6,750.0	6,750.0	6,750.0
Statutory Reserve	2,250.0	2,250.0	3,658.3	5,620.4	6,750.0	6,750.0	6,750.0
General Reserves	1,400.0	1,400.0	1,400.0	2,184.8	3,121.9	3,671.7	4,307.2
Retained Earnings	1,349.1	2,636.0	3,319.3	1,069.3	1,078.6	1,518.5	1,772.7
Total Shareholders' Equity	**7,249.1**	**8,536.0**	**12,877.6**	**15,624.4**	**17,700.6**	**18,690.2**	**19,579.9**
Total Liabilities and Shareholders' Equity	**64,678.3**	**77,854.8**	**95,038.0**	**108,330.0**	**119,828.6**	**130,202.2**	**139,950.9**

INCOME STATEMENT

	Al Rajhi Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Special Investment Income	3,537.7	4,140.8	5,959.9	8,109.6	9,399.8	10,522.2	11,561.1
Special Investment Expense	0.0	0.0	(273.6)	(911.2)	(1,139.0)	(1,241.9)	(1,342.0)
Net Special Investment Income	**3,537.7**	**4,140.8**	**5,686.3**	**7,198.4**	**8,260.8**	**9,280.3**	**10,219.1**
Provision for Investment Losses	(865.3)	(860.1)	(536.0)	(340.6)	(497.6)	(493.2)	(510.9)
Net special investment income after PILs	**2,672.3**	**3,280.7**	**5,150.3**	**6,857.8**	**7,763.1**	**8,787.1**	**9,708.2**
Mudarba Fee	16.4	27.7	135.3	169.1	202.9	243.5	280.0
Fees from Banking services	288.6	669.8	1,523.5	2,285.3	3,085.2	3,856.5	4,820.6
Exchange Income	186.7	242.5	360.9	364.5	368.2	371.9	375.6
Net gains on Investments	16.4	18.2	17.7	18.6	19.6	20.5	21.6
Other Operating Income	91.8	92.6	258.9	297.8	327.5	360.3	378.3
Total Non-commission Income	**599.9**	**1,050.8**	**2,296.4**	**3,135.3**	**4,003.3**	**4,852.6**	**5,876.0**
Total Operating Income	**3,272.2**	**4,331.5**	**7,446.7**	**9,993.1**	**11,766.5**	**13,639.8**	**15,584.2**
Salaries & Employee related Expenses	(626.9)	(651.2)	(791.0)	(949.2)	(1,063.1)	(1,169.4)	(1,262.9)
Rent & Premises related Expenses	(104.0)	(110.4)	(115.6)	(132.9)	(146.2)	(157.9)	(170.6)
Depreciation and Amortization	(164.5)	(154.9)	(155.9)	(199.3)	(236.5)	(271.9)	(312.7)
Board of Directors Remuneration	(2.2)	(1.9)	(1.8)	(2.2)	(2.3)	(2.4)	(2.5)
Other G & A Expenses	(336.5)	(477.2)	(749.0)	(861.4)	(947.5)	(1,042.2)	(1,125.6)
Total Operating Expenses	**(1,234.1)**	**(1,395.6)**	**(1,813.4)**	**(2,145.0)**	**(2,395.6)**	**(2,643.9)**	**(2,874.4)**
Net Income	**2,038.1**	**2,935.9**	**5,633.3**	**7,848.2**	**9,370.9**	**10,995.9**	**12,709.8**
Statement of Retained Earnings	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Beginning retained earnings	**1,398.3**	**1,349.1**	**2,636.0**	**3,319.3**	**1,069.3**	**1,078.6**	**1,518.5**
Net Income	2,038.1	2,935.9	5,633.3	7,848.2	9,370.9	10,995.9	12,709.8
Adjustments	0.0	0.0	650.0	0.0	0.0	0.0	0.0
Bonus Share issue	0.0	0.0	(2,250.0)	0.0	0.0	0.0	0.0
Transfer to Statutory Reserve	0.0	0.0	(1,408.3)	(1,962.0)	(1,129.7)	0.0	0.0
Transfer to other Reserves	(460.6)	0.0	0.0	(784.8)	(937.1)	(549.8)	(635.5)
Gross Dividends	(1,626.7)	(1,649.0)	(1,941.7)	(5,101.3)	(7,294.8)	(10,006.2)	(11,820.1)
Ending balance	**1,349.1**	**2,636.0**	**3,319.3**	**3,319.3**	**1,078.6**	**1,518.5**	**1,772.7**

CASH FLOW STATEMENT

	Al Rajhi Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Net Income	2,038.1	2,935.9	5,633.3	7,848.2	9,370.9	10,995.9	12,709.8
Depreciation and Amortization	164.5	154.9	155.9	199.3	236.5	271.9	312.7
Provision for Investment Losses	865.3	860.1	536.0	340.6	497.6	493.2	510.9
Due from Banks and other FIs	(4.3)	(30.8)	(1,603.8)	607.7	455.8	136.7	123.1
Investments	(7,149.1)	(10,922.2)	(14,934.5)	(15,404.7)	(12,287.3)	(11,058.5)	(9,731.5)
Other Assets	(321.7)	251.7	(409.9)	(413.1)	(49.6)	(50.6)	(51.6)
Due to Banks and FIs	(300.2)	413.7	1,098.6	1,075.6	806.7	806.7	484.0
Customers Deposits	3,773.3	14,303.3	10,111.7	9,153.3	8,283.7	8,228.6	8,008.9
Other Liabilities	1,064.3	(2,849.8)	2,688.6	908.0	332.1	348.7	366.1
CF from Operations	**130.2**	**5,116.8**	**3,275.9**	**4,314.9**	**7,646.4**	**10,172.6**	**12,732.4**
Non-trading Investments	164.9	(163.9)	118.7	(22.4)	(24.6)	(27.1)	(29.8)
Capital Expenditure	(146.8)	(214.2)	(508.7)	(820.1)	(474.5)	(545.7)	(627.5)
CF from Investing	**18.1**	**(378.1)**	**(390.0)**	**(842.5)**	**(499.1)**	**(572.8)**	**(657.3)**
Dividend and Zakat paid	(1,295.6)	(1,626.7)	(2,999.0)	(5,693.0)	(7,294.8)	(10,006.2)	(11,820.1)
CF from Financing	**(1,295.6)**	**(1,626.7)**	**(2,999.0)**	**(5,693.0)**	**(7,294.8)**	**(10,006.2)**	**(11,820.1)**
Change in Cash	(1,147.3)	3,112.0	(113.1)	(2,220.7)	(147.5)	(406.4)	255.0
Beginning Cash	6,831.3	5,683.9	8,795.9	8,682.8	6,462.2	6,314.7	5,908.3
Ending Cash	**5,683.9**	**8,795.9**	**8,682.8**	**6,462.2**	**6,314.7**	**5,908.3**	**6,163.3**

RATIOS

	Al Rajhi Bank						
	2003	2004	2005	2006F	2007F	2008F	2009F
Profitability							
- Return on Average Assets	3.3%	4.1%	6.5%	7.7%	8.2%	8.8%	9.4%
- Return on Average Equity	28.9%	37.2%	52.6%	55.1%	56.2%	60.4%	66.4%
- Net Special Investment Income After PIL's/ Total Op. Income	81.7%	75.7%	69.2%	68.6%	66.0%	64.4%	62.3%
- Non-Investment Income/ Total Op. Income	18.3%	24.3%	30.8%	31.4%	34.0%	35.6%	37.7%
- Non-Investment Expense/ Total Op. Income	37.7%	32.2%	24.4%	21.5%	20.4%	19.4%	18.4%
- Fees From Banking Services/ Total Op. Income	8.8%	15.5%	20.5%	22.9%	26.2%	28.3%	30.9%
- Dividend Payout Ratio	79.8%	56.2%	34.5%	65.0%	77.8%	91.0%	93.0%
Margins							
- Net (Or Profit) Margin	62.3%	67.8%	75.6%	78.5%	79.6%	80.6%	81.6%
- Yield On Average Earning Assets	6.4%	6.5%	7.7%	8.7%	8.9%	9.0%	9.1%
- Cost Rate On Average Commission Bearing Liabilities	0.0%	0.0%	0.4%	1.1%	1.3%	1.2%	1.2%
- Spread	6.4%	6.5%	7.3%	7.6%	7.6%	7.7%	7.8%
- Commission Margin (Earning Assets)	6.4%	6.5%	7.4%	7.4%	7.3%	7.5%	7.6%
Efficiency							
- Cost/ Total Op. Income	37.7%	32.2%	24.4%	21.5%	20.4%	19.4%	18.4%
- Staff Expenses/ Total Op. Expenses	50.8%	46.7%	43.6%	44.3%	44.4%	44.2%	43.9%
- G&A Expenses/ Total Op. Expenses	35.7%	42.1%	47.7%	46.4%	45.7%	45.4%	45.1%
- Non-Investment Expense/ Average Total Assets	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	2.1%
Liquidity							
- Investments / Commission Earning Assets	98.6%	98.8%	97.2%	98.2%	98.8%	99.0%	99.2%
- Investments/ Customer Deposits	116.7%	107.4%	112.5%	118.7%	121.4%	122.4%	122.4%
- Customer Deposits/ Equity	679.7%	744.8%	572.2%	530.2%	514.8%	531.6%	548.3%
- Customer Deposits/ Total Assets	76.2%	81.7%	77.5%	76.5%	76.0%	76.3%	76.7%
- Due From Banks/ Due To Banks	124.7%	78.6%	113.0%	56.5%	33.9%	25.4%	20.8%
Credit Quality							
- Provisions /Total Op. Income	26.4%	19.9%	7.2%	3.4%	4.2%	3.6%	3.3%
- Provisions /Average Investments	1.6%	1.4%	0.7%	0.4%	0.5%	0.4%	0.4%
- Non Performing Investments (SR mn)	1,246.1	950.8	1,655.3	1,966.0	2,211.7	2,554.5	2,758.9
- Provision For Investments Losses (SR mn)	2,719.9	3,173.6	2,755.8	3,096.4	3,594.0	4,087.2	4,598.1
- NPL's /Gross Investments	2.2%	1.4%	2.0%	2.0%	2.0%	2.1%	2.1%
- NPL's /(Equity+Provision For Investments Losses)	12.5%	8.1%	10.6%	10.5%	10.4%	11.2%	11.4%
- PLL's / Gross Investments	4.7%	4.6%	3.3%	3.2%	3.3%	3.4%	3.5%

RATIOS - Continued

	Al Rajhi Bank						
	2003	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
- NPL Coverage	218.3%	333.8%	166.5%	157.5%	162.5%	160.0%	166.7%
Capital Adequacy							
- Equity/ Total Assets (Equity Capital Ratio)	11.2%	11.0%	13.5%	14.4%	14.8%	14.4%	14.0%
- Equity/ Gross Investments	12.6%	12.5%	15.5%	15.9%	16.0%	15.4%	14.9%
Constitution Of Total Operating Income							
- Net Special Investments Income After PIL's/ Total Op. Income	81.7%	75.7%	69.2%	68.6%	66.0%	64.4%	62.3%
- Fees From Banking Services/ Total Op. Income	8.8%	15.5%	20.5%	22.9%	26.2%	28.3%	30.9%
- Investments Income/ Total Op. Income	0.5%	0.4%	0.2%	0.2%	0.2%	0.2%	0.1%
- FX Income/ Total Op. Income	5.7%	5.6%	4.8%	3.6%	3.1%	2.7%	2.4%
- Other Income/ Total Op. Income	3.3%	2.1%	3.5%	3.0%	2.8%	2.6%	2.4%
- PIL's/ Total Op. Income	26.4%	19.9%	7.2%	3.4%	4.2%	3.6%	3.3%
Operating Performance							
- Change In Special Investment Income	22.6%	17.0%	43.9%	36.1%	15.9%	11.9%	9.9%
- Change In Fees From Banking Services	83.2%	132.1%	127.5%	50.0%	35.0%	25.0%	25.0%
- Change In Investments Income	-2.0%	10.9%	-2.3%	5.0%	5.0%	5.0%	5.0%
- Change In Fx Income	-3.6%	29.9%	48.8%	1.0%	1.0%	1.0%	1.0%
- Change In Other Income	-13.9%	0.9%	179.5%	15.0%	10.0%	10.0%	5.0%
RATIO'S USED FOR VALUATION							
- Par Value Per Share (SR)	50.0	50.0	50.0	10.0	10.0	10.0	10.0
- Shares in issue (mn)	45.0	45.0	90.0	675.0	675.0	675.0	675.0
- EPS (SR)	45.3	65.2	62.6	-	-	-	-
- EPS (SR) - Adjusted for Split	9.1	13.0	12.5	11.6	13.9	16.3	18.8
- DPS (SR)	35.0	36.6	21.6	-	-	-	-
- DPS (SR) - Adjusted for Split	7.0	7.3	4.3	7.6	10.8	14.8	17.5
- Book Value Per Share (SR)	161.1	189.7	143.1	-	-	-	-
- Book Value Per Share (SR) - Adjusted for Split	32.2	37.9	28.6	23.1	26.2	27.7	29.0
- Market Price Year End (SR) *	975.0	2,005.0	2,710.0	-	-	-	-
- Market Price Year End (SR) - Adjusted for Split *	195.0	401.0	542.0	302.5	302.5	302.5	302.5
- Market Cap. (SR Mn)	43,875.0	90,225.0	243,900.0	204,187.5	204,187.5	204,187.5	204,187.5
- P/E	21.5	30.7	43.3	26.0	21.8	18.6	16.1
- P/BV	6.1	10.6	18.9	13.1	11.5	10.9	10.4
- Dividends Yield	3.6%	1.8%	0.8%	2.5%	3.6%	4.9%	5.8%

** Market Price of 2006 and subsequent years as on August 30, 2006*

Arab National Bank

Reuters Code:
1080.SE

Listing:
Saudi Stock Exchange

CMP:
SR113.0

August 30, 2006

Buy

Key Data

EPS (SR)*	8.3
BVPS (SR)*	23.1
P / E (x)	13.6
P / BV (x)	4.9
Avg. daily vol.('000)	135.9
52 week Lo / Hi (SR)	106/171
Market Cap (SR mn)	36,725.0
Target Price (SR)	135.4

*Source: **Global** Research*
** Projected (2006)*

Background

- **Arab National Bank (ANB)** was established in 1979 upon the Saudization of the six branches of Arab Bank of Jordan that had been operating in the Kingdom for 30 years. ANB now has a branch network of 116 branches in the Kingdom and one branch in London. The bank had 2,869 staff at the end of 2005 as compared to 2,491 reported at the end of the previous year.

- ANB is among the medium-sized banks in the Saudi banking sector, ranking 5th amongst Saudi commercial banks in terms of asset size with a 9.3% market share of the sector's aggregate total assets for the year in 2005 (2004: 10%). The bank had an 9.2% market share of the total banking deposits.

- ANB has been a front-runner in adopting newer technologies and has made substantial investments in upgrading its IT infrastructure. The management believes that investments important to the future growth of the bank will continue to be made in modernizing its branch network, expanding its ATM network and enhancing its delivery capabilities through the use of technology. The bank is in the process of revisiting the whole retail banking operation which include relocating some of the branches and thrust on e-banking initiatives.

Management Change

- ANB witnessed change in management, wherein Dr. Robert Eid was named the new Managing Director after Mr. Nemeh Sabagh left the organization.

Recent developments

- Saudi and international investors signed a memorandum of understanding to set up an Islamic housing finance company with a capital of SR 2bn. Arab National Bank will own 40% of the company's shares. Other shareholders include Saudi Arabia's Dar Al Arkan Real Estate Development Co. and the International Finance Corp.

- Arab National Bank opened a number of new TeleMoney Centers at Safa & Sharafiya/ Jeddah, Naseem/Riyadh, Jizan and Qunfutha, Hail, Buraidan, Mubarraz, Azizia Makkah, bringing the number of dedicated TeleMoney Centers to 32.

- India's IT major Infosys won an estimated US$30-$40mn order from Arab National Bank to implement its Finacle core banking solution. The project is expected to be completed in early 2008 and will be implemented across 116 branches of the bank in Saudi Arabia.

Rating Reviews

- In July-06, Standard & Poor's Ratings Services assigned its 'A/A-1' long- and short-term counterparty credit ratings to ANB. The outlook is stable. According to S&P, the ratings on ANB reflect the bank's strong financial performance, robust asset quality, and satisfactory liquidity. These strengths are somewhat offset by ANB's below-domestic-average, although adequate, capitalisation, and limited geographic diversification, as well as increasing competition in the Saudi banking market. The ratings could be raised following significant and sustained improvements in the diversification and liberalisation of the Saudi economy and a stronger credit culture among domestic corporate borrowers. The ratings could come under pressure, however, if ANB's profitability starts to erode, and if capital ratios or asset quality deteriorate significantly.

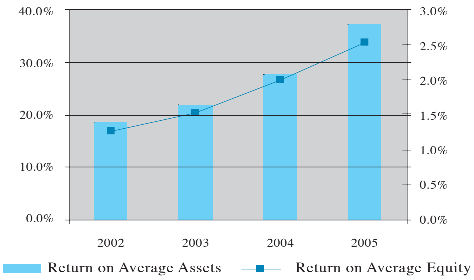
- In July-06, Capital Intelligence upgraded Arab National Bank's long-term foreign currency rating from A to A+. The financial strength rating of A was assigned a positive outlook, in view of the forthcoming subordinated bond issue under the bank's EMTN programme. The short-term foreign currency rating of A1 and support of 2 are affirmed. The ratings upgrade reflected several improvements at the bank with loan volumes rising, boosting profitability. This loan growth has been driven mainly by growth in consumer finance volumes. Asset quality remained good with a reduction in NPLs and an improved level of provision coverage. However capitalization, while good in absolute terms, still trails the peer group, according to CI.

- In Dec-05, Fitch Ratings upgraded the long-term rating of the ANB from BBB+ to A-. According to Fitch, the upgrade of the long-term rating reflected ANB's continued large franchise, consistent profitability, sound capitalization and a strengthening economic environment in Saudi Arabia.

Financial Performance – 2005

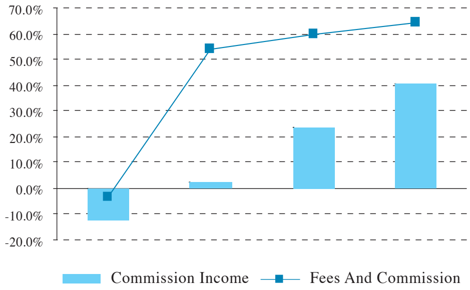
- ANB showed excellent results in 2005 exceeding our expectations made in our previous report (May-05) on the bank. The bank reported net profit of SR1.82bn, up 8.5% as compared to our forecasted net profit of SR1.68bn for 2005. However, the bank's assets in 2005 reported a lower growth, down 13.5% compared to our estimates.

Chart 1: Return Ratios



Source: Company Reports, ***Global*** *Research*

Chart 2: Operating Performance



Source: Company Reports, ***Global*** *Research*

- ANB assets reported a CAGR growth of 15.1% from SR44.3bn in 2002 to SR67.5bn reported in 2005. The bank reported a lower than industry average growth in 2005, registering a growth of 6.6% as compared to the previous year.

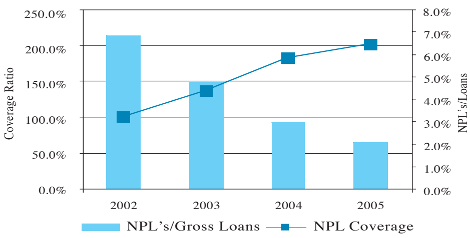
- The loans and advances (net) grew at a CAGR of 34.3% over 2002-05 reaching SR38.8bn at the end of 2005. The thrust on the retail sector can be seen from the strong growth in the retail portfolio, which grew from SR9.3bn in 2004 to SR15.6bn in 2005. The management believes that retail banking in Saudi will continue to show good growth on the back of strong population growth and favorable demographic situation in the country. But the management believes that corporate loan growth is also going to be a key growth driver in 2006-07.

- However, the customers deposit grew at a lower CAGR of 20.4% over the same period. The customers deposit in the Saudi banking sector saw a slowdown in 2005 due to the flight of funds to the booming capital market. ANB too witnessed only a marginal growth of 5.4% in the customer deposits reaching SR48.8bn at the end of 2005. The deposits market also became very competitive which resulted in the decline in the spreads. ANB's spreads too declined from 3.7% in 2004 to 3.5% in 2005.

- The bank's time deposits are usually of 1-3 month tenure and gets readjusted to new interest rates. According to the management, Saudi banking sector deposits have 40% deposits as NIB and this situation is same in ANB as well. ANB is looking to get a chunk of Islamic deposits and now has 12 "Islamic branches" and is in the process of converting more branches into "Islamic branches".

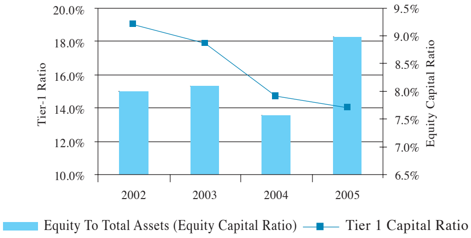
- ANB's asset quality has shown strong improvement in the last couple of years as NPLs to Gross Loans ratio declined from 6.8% in 2002 to 2.1% in 2005. Also, in absolute terms, the NPLs declined from SR1.17bn in 2002 to SR847mn reported at the end of 2005 despite a strong growth in the loan book. The coverage ratio too has improved to 200.6% in 2005 as compared to 181.7% reported in the previous year.

Chart 3: Asset Quality



Source: Company Reports, ***Global*** *Research*

Chart 4: Capital Adequecy



Source: Company Reports, ***Global*** *Research*

- ANB's net profit increased by 56.6% in 2005 reaching SR1.82bn in 2005. The net special commission income of the bank increased by 16.1% to SR2.19bn in 2005. The lower growth was mainly due to the strong growth of 120% in special commission expenses on account of rising competition for customer deposits and overall increase in the cost of funds.

- ANB witnessed strong yearly growth of 64.4% in its fee income which was a key driver in achieving strong overall profit growth. The bank also made a significant SR90.7mn from the gains in investments in 2005.

- ANB's operating expenses increased by 13.4% which was mainly due to the 15.6% growth in staff costs as the number of employees increased significantly this year. However, the bank performed well in terms of reduction in cost to income ratio as it declined from 60.6% in 2002 to only 36.8% in 2005.

- In March-2005, ANB entered into a three year syndicate term loan facility agreement for an amount of US$350mn for general banking purposes. The facility was drawn down in full in April-2005 and is repayable in 2008.

Financial Performance – 1H-2006

- ANB's asset size increased by a marginal 2% as compared to the 2005 to reach SR68.8bn at the end of 1H-2006. However, the bank has recorded a decline in assets, notching a negative growth of 4.2% over 1Q-2006

- However, in 1H-2006, the bank performed well in attracting customer deposits which registered a YTD growth of 11.7% till June-06. This is primarily attributed to the higher interest rate scenario in Saudi Arabia coupled with the drastic fall in the stock market which led to investors parking their funds in less risky bank deposits. However, a closer look reveals that after the strong growth of 8.9% recorded in the 1Q-2006, the customer deposits only recorded a marginal sequential growth of 2.6% in 2Q-2006.

- However, the situation is opposite in the case of loans and advances which grew by 3.9% in 1Q2006 but registered a strong sequential growth of 7.8% in 2Q-2006 reaching SR43.4bn at the end of 2Q-2006. The bank has been consciously reducing its investment which registered a YTD decline of 8.5% in 1H-2006.

Table 1: Key Financial Data - 1H-2006

Balance Sheet 'SR mn'	2Q2005	FY 2005	1Q2006	2Q2006	Growth-YoY	Growth - QoQ	Growth - YTD
Investments	21,613.5	20,422.7	19,930.5	18,681.8	-13.6%	-6.3%	-8.5%
Loans and advances	33,327.8	38,778.6	40,291.2	43,435.2	30.3%	7.8%	12.0%
Total Assets	**61,903.8**	**67,492.1**	**71,904.6**	**68,872.7**	**11.3%**	**-4.2%**	**2.0%**
Customer deposits	46,776.5	48,832.5	53,159.3	54,530.3	16.6%	2.6%	11.7%
Total Liabilities	**56,504.0**	**61,430.1**	**65,273.7**	**61,937.0**	**9.6%**	**-5.1%**	**0.8%**
Share capital	2,500.0	2,500.0	3,250.0	3,250.0	30.0%	0.0%	30.0%
Total shareholders' equity	**5,399.9**	**6,061.9**	**6,630.9**	**6,935.7**	**28.4%**	**4.6%**	**14.4%**
Total Liabilities and Shareholders' Equity	**61,903.8**	**67,492.1**	**71,904.6**	**68,872.7**	**11.3%**	**-4.2%**	**2.0%**

*Source: Company Reports, **Global** Research*

- ANB reported net profit of SR1.35bn at the end of 1H-2006, up 51.9% as compared to the corresponding period of the previous year. This was achieved on the back of strong growth in fee income which continued to register a strong y-o-y growth of 89.7%, reaching SR613.2mn in 1H-2006.

- ANB's gain from investments has been more broad based in 1H-2006 as compared to the corresponding period of the previous year. The bank registered SR47.5mn gains in 2Q-2006 (out of total SR97.5mn in 1H-2006) as compared to SR72mn (out of the total of SR78.2mn in 1H-2005).

- ANB's provision for loan losses reduced considerably, reaching only SR67.5mn in 1H-2006, down 51.7% compared to SR139.8mn recorded in 1H-2005. We expect this trend to continue as the bank has enough coverage which does not warrant significant contribution to the provisioning pool.

Table 2: Key Financial Data - 1H-2006

Income Statement 'SR mn'	2Q2005	2Q2006	Growth QoQ	1H-2005	1H-2006	Growth
Special commission income	817.8	1,087.5	33.0%	1,560.16	2,146.2	37.6%
Special commission expense	(265.9)	(462.6)	74.0%	(494.60)	(949.7)	92.0%
Net special commission income	**551.9**	**624.9**	**13.2%**	**1,065.56**	**1,196.6**	**12.3%**
Fees from banking services	196.0	331.7	69.2%	323.19	613.2	89.7%
Gains on non-trading investments	72.0	47.5	-34.0%	78.17	97.5	24.7%
Provisions for loan losses	(68.2)	(15.7)	-77.0%	(139.82)	(67.5)	-51.7%
Total operating income	**795.8**	**1,030.1**	**29.4%**	**1,406.57**	**1,929.3**	**37.2%**
Total operating expenses	**(266.6)**	**(297.6)**	**11.6%**	**(514.99)**	**(575.4)**	**11.7%**
Net Income	**529.1**	**732.5**	**38.4%**	**891.59**	**1,353.9**	**51.9%**

*Source: Company Reports, **Global** Research*

- ANB's total operating expenses have grown at the same rate of around 11.6% both in terms of sequential and yoy growth reaching SR575.4mn in 1H-2006.

- ANB's General Assembly has approved the issuance of Euro Medium Term Notes (EMTN) and the bank is in the process of completing the issue. ANB intends to have an EMTN program in 2006 – 1st tranche of US$500-600mn.

- ANB announced that it will pay SR1 per share in dividends for the first half of 2006. The total dividend payout will be SR325mn for 1H-2006.

Outlook

We believe that the retail loan book will grow at a lower rate (see SAMA regulations) and this is likely to impact the bank's margins which become more important keeping in mind that 77% of the banks net income in 2005 was derived from the retail operations. According to the management, the bank is likely to push its efforts in terms of corporate banking especially project financing. This can be seen from the increased thrust of ANB whereby it was part of the consortium and was one of the lead arrangers of SR3.5bn 15-year financing package to enable Saudi Electricity Co. to expand its Shaiba power plant. Another big-ticket deal done by ANB was to lead a consortium of banks to provide a 12-year SR1.8bn financing arrangement to Saudi Arabian Airline to upgrade its fleet.

According to the management, the competition from foreign banks will be on the corporate lending, investment and private banking side. We do not expect strong competition from the retail side and rather than the foreign banks, competition will be more from the newly set-up banks, Bank Al Bilad and Enmaa Bank which have a Saudi background and customer base of their parent organizations.

However, we still believe that the contribution of retail to the overall profitability will remain strong as the consumer loans and credit card continue to provide it with strong growth in income. We expect to see stability in spread and expect them to be in the range of 3.4%-3.5% in the coming years. Even after the decline seen in the stock markets, management expects volumes to remain high and this can be seen in the continuing growth in the fee income where brokerage income constitutes a big chunk.

The bank has been the exclusive bank for the pension-related payments which provides it with a very loyal and stable customer base. The bank will also attract Islamic banking customers as in 2005 it launched 'Al Manzil Al Mubarak', an Islamic housing finance product. We expect the bank to improve its credit quality further. Although the bank has done a good job in reducing its NPL ratio, we expect it to further go down as it writes-off NPLs and imparts additional loans with strict credit norms. With the rise in the loan book, we expect that the bank will maintain coverage ratio above 150% in the coming years. In terms of dividend payout ratio, we expect it to range between 45%-65%, growing steadily over the next few years.

Valuation:

Based on the current market price of SR113.0, ANB stock is trading at a 15.5x 2005 earnings and 4.7x 2005 book value. On a one year forward basis, the stock is trading at 13.6x 2006F earnings and 4.9x 2006F book value. We believe that ANB's strong profitability, increased thrust on fee income and venture in new unexploited income streams are likely to support valuations. Based on the combination of DDM and Relative valuation method, we recommend a **BUY** on the stock with a price target of SR135.4, an upside of 19.8% from current levels.

BALANCE SHEET

SR mn	Arab National Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
Cash & balances with SAMA	1,677.8	7,061.5	2,495.2	4,391.3	3,994.8	2,983.6	3,635.9
Due from Banks and other FIs	4,194.7	4,731.9	3,933.7	4,012.3	4,092.6	4,174.4	4,257.9
Trading Investments	98.0	199.1	307.2	383.9	479.9	599.9	749.9
Non-trading Investments	21,383.2	20,999.2	20,115.5	20,645.9	21,162.1	21,691.3	22,233.7
Net Loans and Advances	20,172.2	28,558.0	38,778.6	48,728.0	57,587.0	66,354.5	74,317.0
Net Fixed Assets	323.1	382.4	418.1	583.9	672.6	706.3	743.5
Other Assets	1,351.9	1,403.9	1,443.9	1,660.5	1,826.5	1,917.9	2,013.8
Total Assets	**49,200.9**	**63,335.8**	**67,492.1**	**80,405.9**	**89,815.6**	**98,428.0**	**107,951.7**
Due to Banks and other FIs	9,108.6	9,820.8	8,376.9	8,548.1	8,722.8	8,901.3	9,083.5
Customers' Deposits	33,723.0	46,315.7	48,832.5	59,975.4	67,775.5	74,907.2	82,814.9
Other Liabilities	2,392.0	2,404.8	2,908.2	3,053.7	3,206.3	3,270.5	3,335.9
Term Loan	0.0	0.0	1,312.5	1,312.5	1,312.5	1,312.5	1,312.5
Total Liabilities	**45,223.5**	**58,541.4**	**61,430.1**	**72,889.7**	**81,017.2**	**88,391.5**	**96,546.8**
Share Capital	1,800.0	2,000.0	2,500.0	3,250.0	3,250.0	3,250.0	3,250.0
Statutory Reserve	1,800.0	2,000.0	2,500.0	3,250.0	3,250.0	3,250.0	3,250.0
Other Reserves	370.7	776.8	997.7	924.9	1,726.2	2,610.6	3,588.0
Retained Earnings	6.6	17.7	64.2	91.3	572.1	925.9	1,316.9
Total Shareholders' Equity	**3,977.3**	**4,794.4**	**6,061.9**	**7,516.2**	**8,798.4**	**10,036.5**	**11,404.9**
Total Liabilities and Shareholders' Equity	**49,200.9**	**63,335.8**	**67,492.1**	**80,405.9**	**89,815.6**	**98,428.0**	**107,951.7**

INCOME STATEMENT

	Arab National Bank						
SR mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Special Commission Income	1,989.4	2,456.3	3,445.2	4,554.2	5,110.5	5,482.2	5,877.3
Special Commission Expense	(469.4)	(570.0)	(1,256.1)	(1,912.8)	(2,095.3)	(2,192.9)	(2,292.2)
Net Special Commission Income	**1,520.1**	**1,886.3**	**2,189.1**	**2,641.5**	**3,015.2**	**3,289.3**	**3,585.2**
Provision for loan losses	(316.8)	(321.2)	(248.4)	(226.2)	(287.8)	(336.9)	(305.9)
Net Special commission Income after PLL's	**1,203.3**	**1,565.1**	**1,940.7**	**2,415.3**	**2,727.4**	**2,952.5**	**3,279.2**
Fees from banking services	264.2	422.2	693.9	1,145.0	1,431.2	1,645.9	1,810.5
Exchange Income	92.4	93.1	114.0	119.7	122.0	124.5	127.0
Income from FVIS Instrument	0.0	0.0	0.0	15.4	19.2	24.0	30.0
Net Trading Income	14.2	9.2	17.6	13.2	13.9	14.6	15.3
Dividend Income	0.0	1.1	2.4	1.8	1.9	2.0	2.1
Net gains on Investments	2.1	8.4	90.7	181.3	199.5	219.4	241.4
Other Operating Income	7.6	7.6	34.0	35.7	37.5	39.4	41.3
Total Non-interest Income	**380.4**	**541.7**	**952.6**	**1,496.7**	**1,806.0**	**2,045.7**	**2,237.5**
Total Operating Income	**1,583.6**	**2,106.7**	**2,893.3**	**3,912.0**	**4,533.4**	**4,998.2**	**5,516.8**
Salaries & employee related expenses	(500.8)	(568.9)	(657.7)	(756.3)	(832.0)	(915.2)	(1,006.7)
Rent & premises related expenses	(50.2)	(56.3)	(62.1)	(68.4)	(75.2)	(82.7)	(91.0)
Depreciation and amortization	(63.6)	(60.1)	(75.5)	(89.3)	(102.7)	(113.0)	(124.3)
Other G & A expenses	(202.1)	(247.9)	(251.3)	(289.0)	(317.9)	(349.7)	(384.7)
Other provisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Impairment of other financial assets, net	0.0	0.0	(18.8)	0.0	0.0	0.0	0.0
Other operating expenses	(0.5)	(6.7)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Total Operating Expenses	**(817.1)**	**(939.9)**	**(1,065.7)**	**(1,203.3)**	**(1,328.0)**	**(1,460.8)**	**(1,606.9)**
Net Income	**766.5**	**1,166.8**	**1,827.6**	**2,708.7**	**3,205.4**	**3,537.4**	**3,909.9**

Statement of Retained Earnings	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Beginning retained earnings	**5.7**	**6.6**	**17.7**	**64.2**	**91.3**	**572.1**	**925.9**
Net income	766.5	1,166.8	1,827.6	2,708.7	3,205.4	3,537.4	3,909.9
Adjustmernts	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bonus share issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transfer to statutory reserve	(150.0)	(200.0)	(500.0)	(750.0)	0.0	0.0	0.0
Transfer to other reserves	(200.0)	(550.0)	(730.0)	(677.2)	(801.3)	(884.3)	(977.5)
Gross dividends	(415.7)	(390.0)	(547.7)	(1,254.4)	(1,923.2)	(2,299.3)	(2,541.4)
Net change in fair value	0.0	(15.7)	(3.4)	0.0	0.0	0.0	0.0
Ending balance	**6.6**	**17.7**	**64.2**	**91.3**	**572.1**	**925.9**	**1,316.9**

CASH FLOW STATEMENT

	Arab National Bank						
SR mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Net Income	766.5	1,166.8	1,827.6	2,708.7	3,205.4	3,537.4	3,909.9
Accertion of Discounts	(39.7)	(32.1)	(15.9)	-	-	-	-
Gains on Investments	(2.1)	(8.4)	(90.7)	(181.3)	(199.5)	(219.4)	(241.4)
Depreciation and amotization	63.6	60.1	75.5	89.3	102.7	113.0	124.3
Loss/gain on disposal of Fixed Assets	(0.5)	0.0	(1.2)	0.0	0.0	0.0	0.0
Provision for loan losses	316.8	321.2	248.4	226.2	287.8	336.9	305.9
Unrealised revaluation loss on Real Estate	0.0	6.5	18.8	-	-	-	-
Due from banks and other FIs	192.3	(537.2)	798.2	(78.7)	(80.2)	(81.9)	(83.5)
Trading portfolio	(98.0)	(101.1)	(14.1)	(76.8)	(96.0)	(120.0)	(150.0)
Loans and Advances	(4,471.3)	(8,701.4)	(10,456.3)	(10,175.6)	(9,146.7)	(9,104.4)	(8,268.5)
Other Real Estate	(58.4)	6.6	33.0	0.0	0.0	0.0	0.0
Other Assets	161.1	(257.4)	(231.1)	(216.6)	(166.0)	(91.3)	(95.9)
Due to Banks and FIs	(932.2)	712.3	(1,443.9)	171.2	174.8	178.4	182.2
Customers Deposits	5,563.4	12,592.3	2,513.3	11,143.0	7,800.1	7,131.7	7,907.7
Other Liabilities	(153.0)	474.1	564.7	145.4	152.7	64.1	65.4
CF from Operations	**1,308.8**	**5,702.4**	**(6,173.5)**	**3,754.7**	**2,034.9**	**1,744.5**	**3,656.2**
Net sale /purchase of investments	(2,233.4)	421.6	876.1	(349.0)	(316.8)	(309.8)	(301.0)
Capex	(87.2)	(123.2)	(110.1)	(255.1)	(191.3)	(146.7)	(161.4)
CF from Investing	**(2,320.6)**	**298.4**	**766.0**	**(604.2)**	**(508.1)**	**(456.5)**	**(462.4)**
Dividend and Zakat paid	(444.8)	(617.1)	(471.3)	(1,254.4)	(1,923.2)	(2,299.3)	(2,541.4)
Term Loan			1,312.5	0.0	0.0	0.0	0.0
CF from Financing	**(444.8)**	**(617.1)**	**841.2**	**(1,254.4)**	**(1,923.2)**	**(2,299.3)**	**(2,541.4)**
Change in Cash	(1,456.6)	5,383.6	(4,566.3)	1,896.1	(396.5)	(1,011.2)	652.3
Beginning Cash	3,134.4	1,677.8	7,061.5	2,495.2	4,391.3	3,994.8	2,983.6
Ending cash	**1,677.8**	**7,061.5**	**2,495.2**	**4,391.3**	**3,994.8**	**2,983.6**	**3,635.9**

RATIOS

	Arab National Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
Profitability							
- Return on Average Assets	1.6%	2.1%	2.8%	3.7%	3.8%	3.8%	3.8%
- Return on Average Equity	20.4%	26.6%	33.7%	39.9%	39.3%	37.6%	36.5%
- Net Special Commission Income After PLL's/ Total Op. Income	76.0%	74.3%	67.1%	61.7%	60.2%	59.1%	59.4%
- Non-Commission Income/ Total Op. Income	24.0%	25.7%	32.9%	38.3%	39.8%	40.9%	40.6%
- Non-Commission Expense/ Total Op. Income	51.6%	44.6%	36.8%	30.8%	29.3%	29.2%	29.1%
- Fees & Commissions/ Total Op. Income	16.7%	20.0%	24.0%	29.3%	31.6%	32.9%	32.8%
- Assets Utilization	3.2%	3.3%	4.3%	4.9%	5.0%	5.1%	5.1%
- Earning Power	94.4%	88.1%	96.1%	93.7%	94.7%	96.3%	96.0%
- Dividend Payout Ratio	54%	33%	30%	46%	60%	65%	65%
Margins							
- Net (Or Profit) Margin	48.4%	55.4%	63.2%	69.2%	70.7%	70.8%	70.9%
- Commission Expense/ Commission Income	23.6%	23.2%	36.5%	42.0%	41.0%	40.0%	39.0%
- Yield On Average Earning Assets	4.6%	4.8%	5.7%	6.5%	6.4%	6.1%	5.9%
- Cost Rate On Average Commission Bearing Liabilities	1.2%	1.2%	2.2%	3.0%	2.8%	2.7%	2.6%
- Spread	3.4%	3.7%	3.5%	3.5%	3.5%	3.4%	3.4%
- Commission Margin (Earning Assets)	3.3%	3.4%	3.4%	3.5%	3.5%	3.5%	3.5%
Efficiency							
- Cost/ Total Op. Income	51.6%	44.6%	36.8%	30.8%	29.3%	29.2%	29.1%
- Staff Expenses/ Total Op. Expenses	61.3%	60.5%	61.7%	62.9%	62.6%	62.6%	62.6%
- Rent, G&A Expenses/ Total Op. Expenses	30.9%	32.4%	29.4%	29.7%	29.6%	29.6%	29.6%
- Non-Commission Expense/ Average Total Assets	1.7%	1.7%	1.6%	1.6%	1.6%	1.6%	1.6%
Liquidity							
- Loans / Commission Earning Assets	46.4%	54.1%	62.4%	67.3%	70.3%	72.7%	74.4%
- Loans/ Customer Deposits	63.9%	65.2%	82.9%	84.5%	88.2%	92.0%	93.2%
- Customer Deposits/ Equity	847.9%	966.0%	805.6%	797.9%	770.3%	746.4%	726.1%
- Customer Deposits/ Total Assets	68.5%	73.1%	72.4%	74.6%	75.5%	76.1%	76.7%
- Due From Banks/ Due To Banks	46.1%	48.2%	47.0%	46.9%	46.9%	46.9%	46.9%
Credit Quality							
- Provisions /Total Op. Income	20.0%	15.2%	8.6%	5.8%	6.3%	6.7%	5.5%
- Provisions /Average Loans	1.6%	1.2%	0.7%	0.5%	0.5%	0.5%	0.4%
- Non Performing Loans (SR Mn)	1,025.7	890	847	1,115	1,344	1,681	1,882

RATIOS - Continued

	Arab National Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
- Provision For Loan Losses (SR Mn)	1,387.8	1,618	1,699	1,925	2,213	2,549	2,855
- NPL's /Gross Loans	4.8%	3.0%	2.1%	2.2%	2.2%	2.4%	2.4%
- NPL's /(Equity+Provision For Loan Losses)	19.1%	13.9%	10.9%	11.8%	12.2%	13.4%	13.2%
- Provision For Loan Losses/ Gross Loans	6.4%	5.4%	4.2%	3.8%	3.7%	3.7%	3.7%
- NPL Coverage	135.3%	181.7%	200.6%	172.7%	164.6%	151.7%	151.7%
Capital Adequacy							
- Equity To Total Assets (Equity Capital Ratio)	8.1%	7.6%	9.0%	9.3%	9.8%	10.2%	10.6%
- Equity To Gross Loans	18.4%	15.9%	15.0%	14.8%	14.7%	14.6%	14.8%
Constitution Of Total Income							
- Net Commission Income After PLL's/ Total Op. Income	76.0%	74.3%	67.1%	61.7%	60.2%	59.1%	59.4%
- Fees & Comm./ Total Op. Income	16.7%	20.0%	24.0%	29.3%	31.6%	32.9%	32.8%
- Investment Income/ Total Op. Income	1.0%	0.9%	3.8%	5.0%	4.7%	4.7%	4.7%
- FX Income/ Total Op. Income	5.8%	4.4%	3.9%	3.1%	2.7%	2.5%	2.3%
- Other Income/ Total Op. Income	0.5%	0.4%	1.2%	0.9%	0.8%	0.8%	0.7%
- Provisions/ Total Op. Income	20.0%	15.2%	8.6%	5.8%	6.3%	6.7%	5.5%
Operating Performance							
- Change In Commission Income	2.5%	23.5%	40.3%	32.2%	12.2%	7.3%	7.2%
- Change In Fees And Commission	54.0%	59.8%	64.4%	65.0%	25.0%	15.0%	10.0%
- Change In Investment Income	-54.4%	15.4%	490.7%	77.4%	9.6%	9.6%	9.6%
- Change In Fx Income	19.3%	0.8%	22.4%	5.0%	2.0%	2.0%	2.0%
- Change In Other Income	-31.1%	0.5%	347.5%	5.0%	5.0%	5.0%	5.0%
RATIO'S USED FOR VALUATION							
- Par Value Per Share (SR)	50.00	50.00	50.00	10.00	10.00	10.00	10.00
- Shares in Issue (mn)	36.0	40.0	50.0	325.0	325.0	325.0	325.0
- EPS (SR)	21.3	29.2	36.6	-	-	-	-
- EPS (SR) - Adjusted for Split	4.3	5.8	7.3	8.3	9.9	10.9	12.0
- DPS Declared (SR)	11.5	9.3	10.4	-	-	-	-
- DPS Declared (SR) - Adjusted for Split	2.3	1.9	2.1	3.7	5.6	6.7	7.4
- Book Value Per Share (SR)	110.5	119.9	121.2	-	-	-	-
- Book Value Per Share (SR) - Adjusted for Split	22.1	24.0	24.2	23.1	27.1	30.9	35.1
- Market Price Year End (SR) *	395.0	771.0	995.3	-	-	-	-
- Market Price Year End (SR) - Adjusted for Split *	79.0	154.2	199.1	113.0	113.0	113.0	113.0
- Market Cap. (SR Mn)	14,220.0	30,840.0	49,762.5	36,725.0	36,725.0	36,725.0	36,725.0
- P/E	18.6	26.4	27.2	13.6	11.5	10.4	9.4
- P/BV	3.6	6.4	8.2	4.9	4.2	3.7	3.2
- Dividends Yield	2.9%	1.2%	1.0%	3.2%	5.0%	5.9%	6.6%

** Market price of 2006 and subsequent years as on August 30, 2006*

Banque Saudi Fransi

Reuters Code:
1050.SE

Listing:
Saudi Stock Exchange

CMP:
SR145.0

August 30, 2006

Hold

Key Data

EPS (SR) *	9.2
BVPS (SR) *	25.8
P / E (x)	15.8
P / BV (x)	5.6
Avg. daily vol. ('000)	119.5
52 week Lo - Hi	141.5 – 213.3
Market Cap (SR mn)	48,937.5
Target Price (SR)	148.5

*Source: **Global** Research*
** Projected (2006)*

Background

- **Banque Saudi Fransi (BSF)** was the second bank to open shop in Saudi Arabia in March 1948 as a branch of Banque de l'Indochine. In 1975 Banque de l'Indochine merged with Compagnie de Suez to become Banque Indosuez. In 1977, BSF was formally incorporated as a joint stock company established by Royal Decree No. M/23. Banque Indosuez contributed the assets of its branch network in return for a 40% stake in the new entity.

- The bank is affiliated with Calyon of France, which is 100% owned by Credit Agricole Group, rated among the world's top ten banks by total equity and total assets. It is a full service commercial bank serving the local and international banking needs of its clients. It is a leading provider of comprehensive financial services and products in the Kingdom of Saudi Arabia and other markets.

Recent developments

- During July 2006, the bank has announced cash dividend of SR 1.5 per share (face value SR 10) for the first half of the current financial year. For the full year 2005, the bank had declared SR 13 per share (face value SR 50) by way of dividends.

- BSF's net profit for 1H2006 increased by 68% to SR1.68bn. Net income from commissions grew by 16.7% to SR977.3mn for the same period. The bank's total assets stood at SR75.5bn, a growth of 14% compared to the same period of 2005.

Analysis of financial performance – 2005

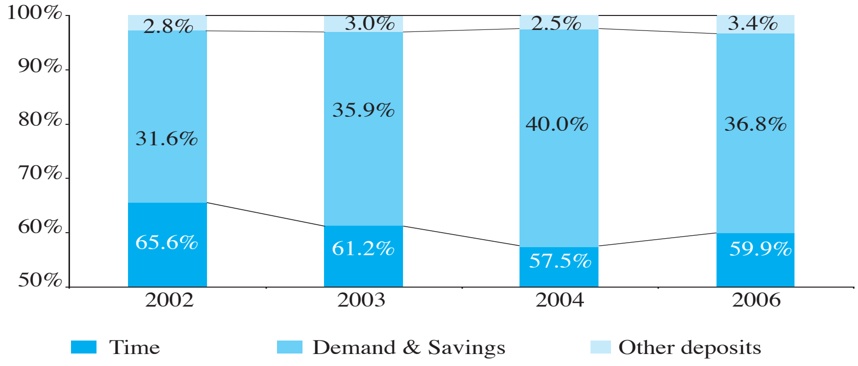
Balance sheet size of the bank increased at a CAGR of 14.7% for the period 2002-05. Asset size increased from SR44.7bn in 2002 to SR67.5bn in 2005. During this period, the market share in terms of size increased from 9.0% in 2002 to 9.3% in 2005.

Customer deposits increased from SR36.2bn in 2002 to SR51.1bn in 2005, CAGR growth of 12.2%. System deposit grew at a CAGR of 12.9% for the period 2002-05. Market share in terms of customer deposits declined marginally from 9.8% in 2002 to 9.6% in 2005. The contribution of customer deposits to total balance sheet declined from 80.9% in 2002 to 75.7% in 2005.

The contribution of demand and saving deposits to total deposits increased by 5.2% from 31.6% in 2002 to 36.8% in 2005. However, the share of time deposits have declined from 65.6% in 2002 to 59.9% in 2005.

In June 2005, the bank entered into a five year syndicated term loan facility for an amount of USD650mn (SR2,437.5mn) repayable in 2010 for general banking purposes. The bank had drawn down the full facility. The term loan contributes 3.6% of the total balance sheet size.

Chart 1: Deposit Mix

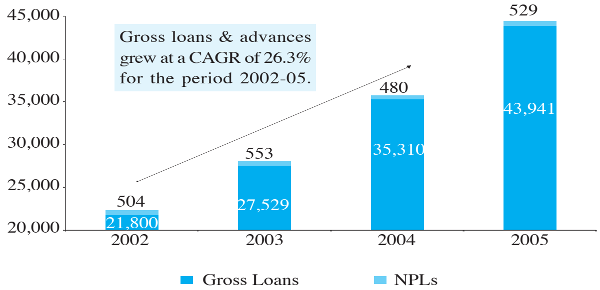


*Source: Company Report, **Global** Research*

During the last three years, the bank has focused on spreading credit concentration over various economic segments. This is clear from the fact that the bank's loan to customer deposit ratio has increased from 60.2% in 2002 to 86.0% in 2005.

Gross loans grew at a CAGR of 26.3% from SR21.8bn in 2002 to SR43.9bn in 2005. Correspondingly, the investment book (both trading and non-trading) was maintained around the same levels (CAGR of 0.2% for the period) to facilitate funding of its fast growing loans portfolio. As a result the investments (trading as well as non-trading) to customer deposit ratio has declined from 49.8% in 2002 to 35.5% in 2005.

Chart 2: Gross Loans



*Source: Company Report, **Global** Research*

The share of commerce and building & construction in aggregate loan portfolio has declined from 38.3% in 2002 to 35.1% in 2005. The contribution of consumer loans and credit cards increased from 6.3% in 2002 to 8.1% in 2005. The consumer lending book grew at a CAGR of 37.0% for the period under review as against industry growth rate of 22.1% and the bank's gross loan growth of 26.3%.

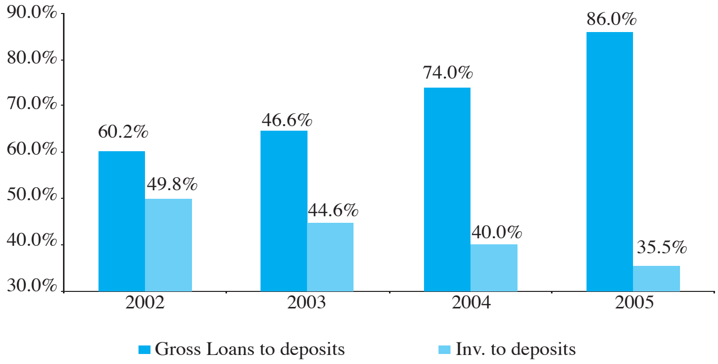
The thrust towards consumer lending has resulted in increasing contribution. However, the growth in consumer lending segment is likely to slow due to the new guidelines issued by the regulator. In case of BSF, the impact is marginal as the bank is comfortably placed in terms of the limits defined.

Gross NPLs in the building and construction segment have declined from SR194.7mn in 2002 to SR171.8mn in 2005. The contribution of this segment to total gross loans have declined from 38.6% in 2002 to 32.5% in 2005. The bank has more than 100% provision cover on this segment. The provision cover for the building and construction segment increased from 138.1% in 2002 to 157.3% in 2005.

Gross NPLs in the commerce segment increased from SR78.4mn in 2002 to SR108.3mn in 2005. The contribution of this segment to the overall gross NPLs increased from 15.5% in 2002 to 20.5% in 2005. The provision coverage ratio for the commerce segment increased from 147.4% in 2002 to 181.2% in 2005.

The gross NPLs in the consumer loan and credit card segment increased from SR62.2mn in 2002 to SR97.4mn in 2005. Correspondingly, the share of this segment to overall gross NPLs increased from 12.3% in 2002 to 18.4% in 2005. Most importantly, the coverage ratio for this segment increased from 100.2% in 2002 to 126.6% in 2005.

Chart 3: Gross Loans to customer deposits

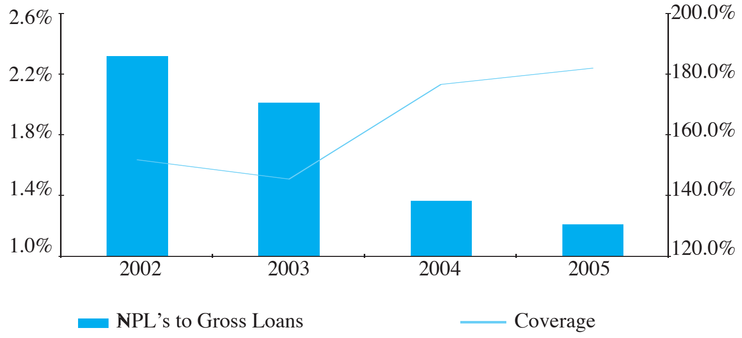


*Source: Company Reports, **Global** Research*

Overall loan book grew at a CAGR of 26.3% for the period 2002-05. This has not come at the cost of deteriorating asset quality. Gross NPLs have increased at a CAGR of 1.6% for the period under review, despite the strong growth in loan book.

Gross NPLs in absolute terms increased from SR504.4mn in 2002 to SR529.3mn in 2005. In percentage terms, gross NPLs to gross loans have declined from 2.3% in 2002 to 1.2% in 2005. The bank's coverage ratio has increased during this period from 151.7% in 2002 to 181.8% in 2005.

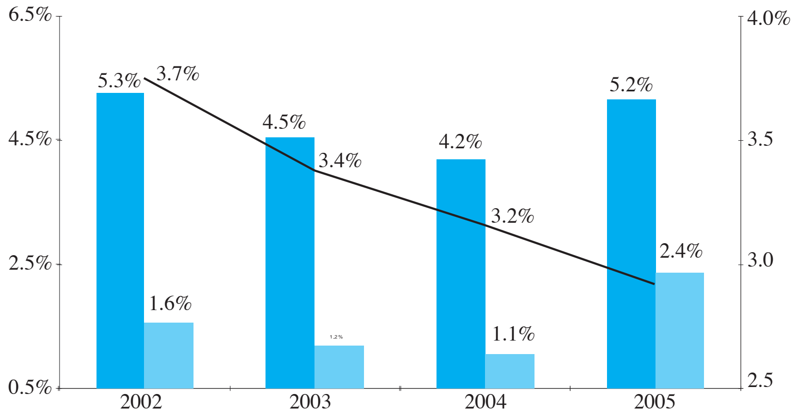
Chart 4: Improving Asset Quality



Source: Company Reports, ***Global*** *Research*

The bank's commission margins have declined during the period 2002-05. Commission margins declined from 3.7% in 2002 to 2.9% in 2005. The yield on average earning assets has marginally declined from 5.3% in 2002 to 5.2% in 2005. However, the cost of average commission bearing liabilities increased from 1.6% in 2002 to 2.4% in 2005. On a y-o-y basis, the cost of average commission bearing liabilities increased from 1.1% in 2004 to 2.4% in 2005. In the second half of the previous year, banks were short of deposits and there was an extensive loan growth. Hence banks started offering higher rates to lure deposits thereby resulting in increasing cost of funds.

Chart 5: Margins

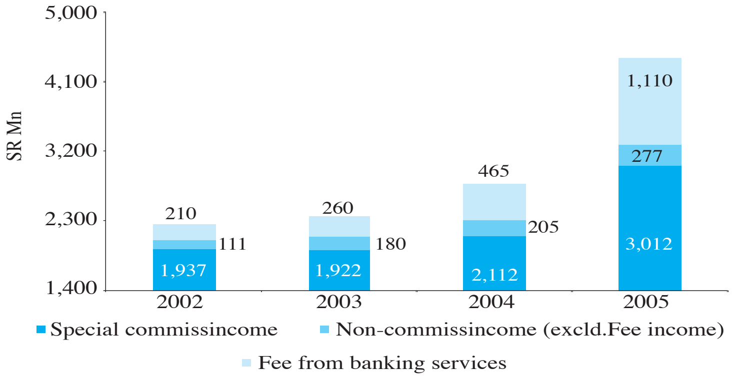


Source: Company Reports, ***Global*** *Research*

The bank's total income grew at a CAGR of 24.9% from SR2,258mn in 2002 to SR4,400mn 2005. This is on the back of 74.3% growth in fee from banking services, which increased from SR210mn in 2002 to SR1,110mn in 2005. Special commission income grew at a CAGR of 15.9% from SR1,937mn in 2002 to SR3,012mn in 2005. Non-commission income excluding fee from banking services increased from SR111mn in 2002 to SR277mn in 2005, CAGR of 35.6%.

The contribution of fee from banking services to total income increased from 9.3% in 2002 to 25.2% in 2005. Due to the buoyancy in the capital market, broking income of the bank was significant. Hence the share of fee income has increased sharply for the bank. The proportion of special commission income has declined from 85.8% in 2002 to 68.5% in 2005. Going forward, we believe contribution of core income to increase due to improving economic conditions especially the need to fund the big ticket projects which are expected to come up for implementation.

Chart 6: Income Break-Up

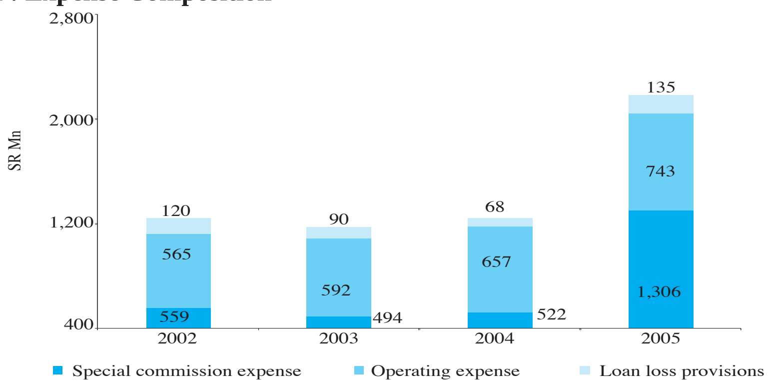


*Source: Company Report, **Global** Research*

BSF's total expenses grew at a CAGR of 20.6% from SR1,244mn in 2002 to SR2,184mn in 2005. Special commission expense grew by 32.7% CAGR for the period under review. Operating expenses grew from SR565mn in 2002 to SR743mn in 2005, CAGR of 9.6%.

The contribution of special commission expense to total expenses increased from 44.9% in 2002 to 59.8% in 2005. On the other hand, operating expenses share of total expenses decreased from 45.4% in 2002 to 34.0% in 2005. Provision for loan loss reserves grew at a CAGR of just 3.9% from SR120mn in 2002 to SR135mn in 2005. Provision for loan loss reserves as a percentage of average gross loans decreased from 0.6% in 2002 to 0.3% in 2005.

Chart 7: Expense Composition

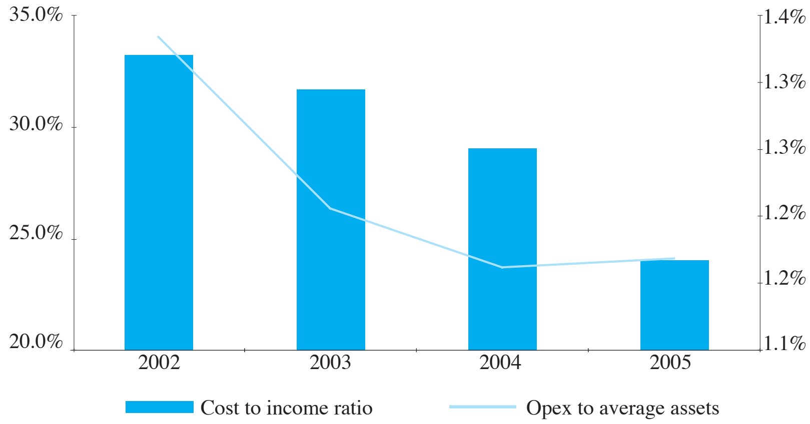


*Source: Company Report, **Global** Research*

During the period 2002-05, total revenue grew at a CAGR of 22.1% from SR1,699mn in 2002 to SR3,094mn in 2005. Operating overheads grew at a CAGR of 9.6% from SR565mn in 2002 to SR743mn in 2005. Due to operating efficiency, the bank's cost to total income ratio declined from 33.2% in 2002 to 24.0% in 2005.

In 2005, fee from banking services was the major contributor to earnings. Broking income was the main driver due to the strong capital market activity. In our opinion, to gauge operating performance, operating expense (opex) as a percentage of average assets is a better indicator. The bank's operating cost to average assets declined from 1.33% in 2002 to 1.17% in 2005.

Chart 8: Cost Structure



*Source: Company Report, **Global** Research*

Analysis of 1st Half performance

- BSF's asset size increased by 13.8% from SR66.3bn in 2Q2005 to SR75.5bn in 2Q2006. Sequentially, balance sheet size increased by 2.6% compared to 1Q2006. On a year to date basis, the asset size of the bank has increased by 11.8%.

- Customer deposits grew by 12.8% from SR50.4bn in 2Q2005 to SR56.9bn in 2Q2006. On a sequential basis, deposits have marginally increased. However, year to date deposits have increased by 11.4%.

- Net loans increased from SR37.7bn in 2Q2005 to SR46.4bn in 2Q2006, a growth of 22.9% y-o-y. On a sequential basis net loan book increased by 4.0%. Year to date, the credit portfolio of the bank has increased by 8.0%.

- The investment book of the bank declined by 8.4% y-o-y from SR18.8bn in 2Q2005 to SR17.2bn in 2Q2006. Sequentially, the investment portfolio of the bank has also declined by 5.2%. On a year to date basis, the investment book declined by 5.1%.

Table 1: Key Balance Sheet Items

Amount SR mn	2Q2005	FY2005	1Q2006	2Q2006	y-o-y	q-o-q	y-t-d
Investments	18,779.0	18,127.8	18,136.5	17,198.6	-8.4%	-5.2%	-5.1%
Net Loans	37,748.5	42,978.7	44,599.2	46,405.2	22.9%	4.0%	8.0%
Customer Deposits	50,446.2	51,093.4	56,912.2	56,915.9	12.8%	0.0%	11.4%
Balance Sheet Size	66,313.5	67,501.4	73,571.1	75,450.2	13.8%	2.6%	11.8%

*Source: Company Report, **Global** Research*

- For the first half of the current fiscal, the bank's net income increased from SR1,004.2mn in 1H2005 to SR1,685.4mn in 1H2006, a growth of 67.8%. Net special commission income for the first half increased by 16.7% and fees from banking services registered a growth of 135.1% as compared to the first half of 2005.

- Net commission income increased from SR837.7mn in 1H2005 to SR977.3mn in 1H2006. Non-commission income, increased from SR590.4mn in 1H2005 to SR1157.1mn in 1H2006, a growth of 96.0%.

- Fees from banking services, increased from SR412.2mn in the first half of 2005 to SR968.8mn in 1H2006, a growth of 135.1%. Adjusted for fees from banking services, non-commission income grew by just 5.6% from SR178.2mn in 1H2005 to SR188.2mn in 1H2006.

- Operating cost increased by 17.7% from SR343.3mn in 1H2005 to SR404.1mn in 1H2006. Manpower cost and rent & premises related expenses increased by 20.3% and 18.5% respectively. The bank's cost to total income ratio declined from 24.0% in 1H2005 to 18.9% in 1H2006.

- Provision for loan losses declined from SR80.5mn in 1H2005 to SR44.9mn in 1H2006.

Table 2: Income Statement

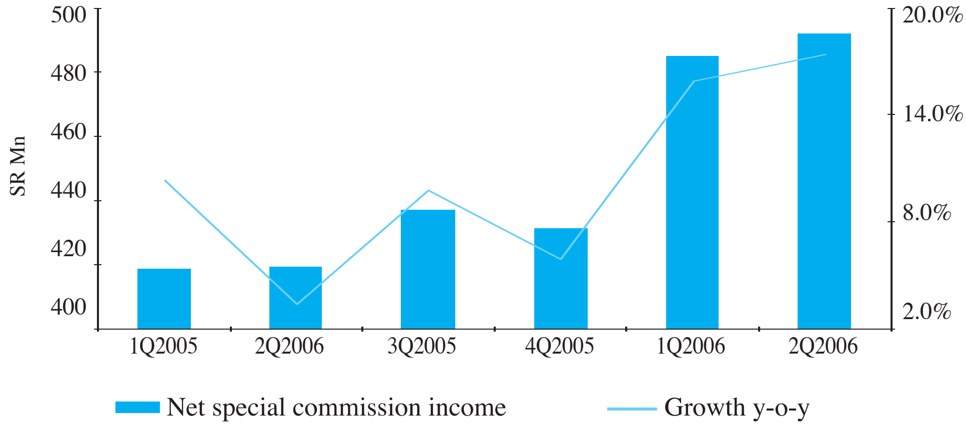
SR mn	2Q2005	2Q2006	%	1H2005	1H2006	%
Special commission income	707.5	1,040.3	47.0%	1,336.5	2,012.9	50.6%
Special commission expense	(288.2)	(548.2)	90.2%	(498.8)	(1,035.6)	107.6%
Net special commission income	**419.2**	**492.2**	**17.4%**	**837.7**	**977.3**	**16.7%**
Fees from banking services	269.0	447.3	66.3%	412.2	968.8	135.1%
Exchange income	33.9	33.8	-0.3%	57.9	69.5	20.1%
Income from FVIS investments	0.0	0.0	NA	11.2	13.7	22.5%
Trading income	45.6	59.1	29.6%	62.2	93.2	49.7%
Dividend income	0.3	0.5	62.4%	0.3	0.5	62.4%
Gains on non-trading investments	16.6	2.7	-83.8%	42.2	9.4	-77.8%
Other operating income	1.8	0.8	-52.7%	4.3	1.9	-55.1%
Provisions for loan losses	(35.3)	(22.6)	-36.0%	(80.5)	(44.9)	-44.3%
Total operating income	**751.2**	**1,013.8**	**35.0%**	**1,347.5**	**2,089.5**	**55.1%**
Salaries & employee related expenses	(96.8)	(115.3)	19.1%	(186.7)	(224.7)	20.3%
Rent & premises related expenses	(14.2)	(16.8)	18.7%	(27.2)	(32.2)	18.5%
Depreciation and amortization	(15.0)	(16.3)	8.6%	(30.5)	(31.7)	3.6%
Other G & A expenses	(50.6)	(60.1)	18.7%	(98.5)	(113.9)	15.7%
Other operating expenses	(0.2)	(1.6)	632.1%	(0.4)	(1.6)	346.0%
Total operating expenses	**(176.8)**	**(210.1)**	**18.8%**	**(343.3)**	**(404.1)**	**17.7%**
Net Income	**574.3**	**803.7**	**39.9%**	**1,004.2**	**1,685.4**	**67.8%**

*Source: Company Report, **Global** Research*

- BSF's net income increased by 39.9% from SR574.3mn in 2Q2005 to SR803.7mn in 2Q2006. The growth in net income is backed by a 17.4% growth in core income and 66.3% growth in fees from banking services.

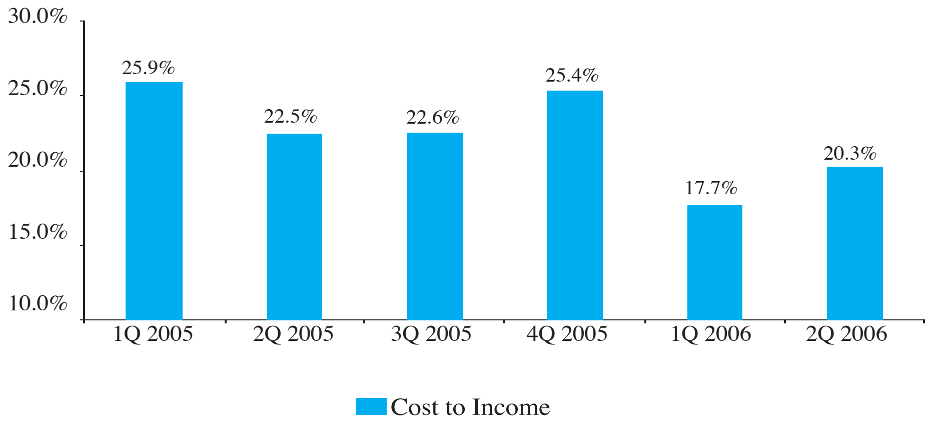
- Total operating expenses increased by 18.8% in 2Q2006 as compared to 2Q2005. Salaries grew by 19.1% from SR96.8mn in 2Q2005 to SR115.3mn in 2Q2006. Rent and premises related expenses grew by 18.7% in 2Q2006 as compared to the same quarter last year. Other general and administrative expenses grew by 18.7% for the period under review. The bank's cost to income ratio declined from 22.5% in 2Q2005 to 20.3% in 2Q2006.

Chart 9: Net Special Commission Income



Source: Company Report, ***Global*** *Research*

Chart 10: Cost to income ratio



Source: Company Report, ***Global*** *Research*

Outlook:

- Over the next two years, BSF plans to strengthen its core competencies in corporate banking and further improve its market share in Retail segment. The bank has plans to launch new and innovative retail products and also introduce business models that have been successful world-wide. The bank currently has negligible exposure in real estate sector but going forward it may launch mortgage products.

- The Bank also plans to introduce a range of products and services in the areas of investment banking and corporate finance to provide its customers a comprehensive investment and wholesale banking offer.

- The Bank has an Insurance subsidiary called InSaudi and is awaiting the license applied under the brand name of Assurance Saudi Fransi. While currently the contribution of this activity is marginal to the bank's revenue, it has significant long term potential.

- The bank continues to work towards expansion of its delivery channels both brick and mortar and electronic to expand its customer reach..

- The entry of foreign banks is unlikely to result in significant cannibalization of market share of existing banks, hence not an immediate concern to BSF and other existing Banks.

- In July 2006, the Bank successfully implemented Oracle HRMS. The project involved establishing an efficient, automated and fully integrated system for management of human resources and payroll processes. It was a one year project, taken up in order to help streamline HR procedures towards improving the performance and productivity of the bank's employees and managers. Integrating systems is likely to improve performance and productivity of the banks' personnel towards meeting growing business needs.

Valuation:

Based on the current market price of SR145.0, the stock is trading at a 14.7x 2005 earnings and 4.7x 2005 book value. On a one year forward basis, the stock is trading at 15.8x 2006F earnings and 5.6x 2006F book value. Based on our valuation methods, we initiate coverage on the stock with a **HOLD** recommendation with a price target of SR148.5, higher by 2.4% from current levels.

BALANCE SHEET

	Banque Saudi Fransi						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Assets							
Cash and balances with SAMA	4,147.2	2,009.3	2,317.3	2,811.4	3,333.8	3,668.7	3,799.1
Due from banks and other FI's	1,291.3	2,486.1	2,277.1	3,277.9	4,360.4	5,889.8	7,789.8
Investments	19,029.7	19,097.1	18,127.8	17,699.9	18,407.8	19,512.3	21,040.1
Loans and advances	26,725.8	34,463.4	42,978.7	51,471.9	57,744.7	62,946.3	68,188.7
Fixed assets	453.8	451.9	475.9	537.6	587.8	621.5	646.3
Other assets	1,855.1	1,161.7	1,324.5	1,589.4	1,875.5	2,250.6	2,700.8
Total Assets	**53,502.9**	**59,669.5**	**67,501.4**	**77,388.1**	**86,310.0**	**94,889.3**	**104,164.9**
Liabilities and Shareholders' Equity							
Liabilities							
Due to banks and other financial institutions	3,674.0	4,171.2	4,946.4	5,935.7	6,232.5	6,855.7	7,335.6
Customer deposits	42,634.3	47,704.2	51,093.4	57,735.5	64,086.4	69,533.8	75,791.8
Other liabilities	2,144.3	2,281.9	2,094.8	2,555.6	2,760.1	2,953.3	3,130.5
Term Loans	0.0	0.0	2,437.5	2,437.5	2,437.5	2,437.5	2,437.5
Total Liabilities	**48,452.5**	**54,157.2**	**60,572.1**	**68,664.4**	**75,516.5**	**81,780.3**	**88,695.4**
Shareholders' Equity							
Share capital	2,250.0	2,250.0	2,250.0	3,375.0	3,375.0	3,375.0	3,375.0
Statutory reserve	2,100.0	2,250.0	2,250.0	3,375.0	3,375.0	3,375.0	3,375.0
Other reserves	691.0	1,010.5	2,397.6	1,427.3	1,615.4	1,838.1	2,100.3
Retained Earnings	9.4	1.8	31.7	546.5	2,428.1	4,520.9	6,619.1
Total shareholders' equity	**5,050.4**	**5,512.3**	**6,929.3**	**8,723.7**	**10,793.5**	**13,109.0**	**15,469.4**
Total Liabilities and Shareholders' Equity	**53,502.9**	**59,669.5**	**67,501.4**	**77,388.1**	**86,310.0**	**94,889.3**	**104,164.9**

Income Statement

	Banque Saudi Fransi						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Special commission income	1,921.6	2,111.7	3,011.6	3,506.4	4,038.1	4,549.4	5,091.6
Special commission expense	(493.9)	(521.6)	(1,305.9)	(1,497.3)	(1,675.9)	(1,897.6)	(2,099.0)
Net special commission income	**1,427.6**	**1,590.1**	**1,705.8**	**2,009.1**	**2,362.3**	**2,651.8**	**2,992.6**
Fees from banking services	260.2	465.4	1,110.4	1,776.6	2,220.8	2,709.3	3,251.2
Exchange income	72.3	81.0	143.4	166.3	189.6	214.2	239.9
Trading income	85.6	110.2	109.8	52.4	51.2	53.7	56.7
Dividend income	1.3	1.2	1.6	1.4	1.4	1.5	1.6
Gains on non-trading investments	14.3	4.0	12.9	13.5	10.2	10.7	11.5
Other operating income	6.1	8.9	9.8	10.3	10.8	11.4	11.9
	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Provisions for loan losses	(90.3)	(67.6)	(134.9)	(105.1)	(147.4)	(157.6)	(167.3)
Total operating income	**1,777.2**	**2,193.2**	**2,958.8**	**3,924.5**	**4,698.9**	**5,495.2**	**6,398.1**
Salaries & employee related expenses	(317.5)	(350.1)	(394.9)	(438.3)	(482.2)	(525.6)	(567.6)
Rent & premises related expenses	(82.0)	(55.6)	(59.0)	(62.8)	(67.8)	(72.9)	(79.5)
Depreciation and amortization	(68.9)	(64.1)	(60.9)	(61.7)	(70.3)	(78.8)	(86.6)
Other G & A expenses	(120.5)	(175.9)	(221.6)	(260.4)	(307.3)	(356.4)	(409.9)
Other operating expenses	(3.2)	(11.6)	(6.9)	(7.5)	(8.1)	(8.6)	(9.2)
Total operating expenses	**(592.0)**	**(657.3)**	**(743.2)**	**(830.7)**	**(935.6)**	**(1,042.3)**	**(1,152.7)**
Net Income	**1,185.2**	**1,535.9**	**2,215.6**	**3,093.9**	**3,763.2**	**4,452.9**	**5,245.4**
Statement of Retained Earnings							
Beginning retained earnings	**18.5**	**9.4**	**1.8**	**31.7**	**546.5**	**2,428.1**	**4,520.9**
Net income	**1,185.2**	**1,535.9**	**2,215.6**	**3,093.9**	**3,763.2**	**4,452.9**	**5,245.4**
Adjustments							
Transfer to statutory reserve	(300.0)	(450.0)	0.0	(1,125.0)	0.0	0.0	0.0
Transfer to other reserves	(100.0)	(150.0)	(1,545.0)	(154.7)	(188.2)	(222.6)	(262.3)
Gross dividends	(794.3)	(938.4)	(640.6)	(1,299.4)	(1,693.5)	(2,137.4)	(2,884.9)
Net change in fair value	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ending balance	**9.4**	**1.8**	**31.7**	**546.5**	**2,428.1**	**4,520.9**	**6,619.1**

CASH FLOW STATEMENT

	Banque Saudi Fransi						
SR mn	2003	2004	2005	2006F	2007F	2008F	2009F
Net income	**1,185.2**	**1,535.9**	**2,215.6**	**3,093.9**	**3,763.2**	**4,452.9**	**5,245.4**
Accertion of discounts	(1.6)	16.9	24.6	27.0	29.7	32.7	36.0
Gains on investments	(14.3)	(4.0)	(12.9)	(13.5)	(10.2)	(10.7)	(11.5)
Depreciation and amotization	68.9	64.1	60.9	61.7	70.3	78.8	86.6
Loss/gain on disposal of fixed assets	(0.1)	0.2	0.1	0.0	0.0	0.0	0.0
Provision for loan losses	90.3	67.6	134.9	105.1	147.4	157.6	167.3
	1,328.5	1,680.7	2,423.0	3,274.1	4,000.5	4,711.2	5,523.8
Net (increase) decrease in operating assets							
Statutory deposit with SAMA	(264.6)	(240.7)	(206.7)	(378.6)	(382.2)	(194.0)	11.3
Trading portfolio	1,122.3	277.2	149.1	87.3	(40.1)	(62.6)	(55.3)
Loans and advances	(5,782.0)	(7,805.2)	(8,650.1)	(8,598.2)	(6,420.2)	(5,359.2)	(5,409.7)
Other assets	63.5	556.4	(306.2)	(264.9)	(286.1)	(375.1)	(450.1)
Net increase (decrease) in operating liabilities							
Due to banks and FI's	2,357.6	497.2	775.2	989.3	296.8	623.2	479.9
Customers deposits	6,441.8	5,069.9	3,389.2	6,642.1	6,350.9	5,447.3	6,258.0
Other liabilities	(365.2)	20.6	116.6	460.9	204.5	193.2	177.2
Net cash (used in) from operating activities	**4,901.9**	**56.0**	**(2,309.8)**	**2,211.9**	**3,724.0**	**4,984.0**	**6,535.1**
Net sale /purchase of investments	(2,108.7)	(356.1)	793.9	582.8	(687.4)	(1,063.8)	(1,497.0)
Capex	(66.5)	(62.4)	(84.8)	(123.4)	(120.5)	(112.5)	(111.4)
Net cash (used in) from investing activities	**(2,175.2)**	**(418.5)**	**709.0**	**459.5**	**(807.9)**	**(1,176.3)**	**(1,608.4)**
Dividend paid	(737.8)	(821.4)	(944.3)	(1,555.0)	(1,693.5)	(2,137.4)	(2,884.9)
Term Loan	0.0	0.0	2,437.5	0.0	0.0	0.0	0.0
Net cash (used in) from financing activities	**(737.8)**	**(821.4)**	**1,493.2**	**(1,555.0)**	**(1,693.5)**	**(2,137.4)**	**(2,884.9)**
Change in cash	**1,988.9**	**(1,183.9)**	**(107.6)**	**1,116.3**	**1,222.6**	**1,670.3**	**2,041.8**
Beginning cash	1,966.2	3,955.1	2,771.2	2,663.6	3,780.0	5,002.6	6,672.9
Ending cash	**3,955.1**	**2,771.2**	**2,663.6**	**3,780.0**	**5,002.6**	**6,672.9**	**8,714.7**

RATIOS

	Banque Saudi Fransi						
	2003	2004	2005	2006F	2007F	2008F	2009F
Profitability							
- Return on average assets	2.4%	2.7%	3.5%	4.3%	4.6%	4.9%	5.3%
- Return on average equity	24.2%	29.1%	35.6%	39.5%	38.6%	37.3%	36.7%
- Net special commission income after PLL's/ Total op. income	75.2%	69.4%	53.1%	48.5%	47.1%	45.4%	44.2%
- Non-commission income/ Total op. income	24.8%	30.6%	46.9%	51.5%	52.9%	54.6%	55.8%
- Non-commission expense/ Total op. income	33.3%	30.0%	25.1%	21.2%	19.9%	19.0%	18.0%
- Fees from banking services/ Total op. income	14.6%	21.2%	37.5%	45.3%	47.3%	49.3%	50.8%
- Assets utilization	3.3%	3.7%	4.4%	5.1%	5.4%	5.8%	6.1%
- Earning power	85.8%	91.8%	92.0%	92.2%	92.1%	92.1%	92.2%
- Dividend payout ratio	67.0%	61.1%	28.9%	42.0%	45.0%	48.0%	55.0%
- Sustainable growth rate	8.0%	11.3%	25.3%	22.9%	21.2%	19.4%	16.5%
Margins							
- Net (or profit) margin	66.7%	70.0%	74.9%	78.8%	80.1%	81.0%	82.0%
- Special commission expense/ Special commission income	25.7%	24.7%	43.4%	42.7%	41.5%	41.7%	41.2%
- Yield on average earning assets	4.5%	4.2%	5.2%	5.3%	5.4%	5.5%	5.6%
- Cost rate on average commission bearing liabilities	1.2%	1.1%	2.4%	2.4%	2.4%	2.5%	2.6%
- Spread	3.4%	3.1%	2.8%	2.9%	2.9%	3.0%	3.0%
- Commission margin (earning assets)	3.4%	3.2%	2.9%	3.0%	3.1%	3.2%	3.3%
Efficiency							
- Cost/ Total op. income	33.3%	30.0%	25.1%	21.2%	19.9%	19.0%	18.0%
- Staff expenses/ Total op. income	17.9%	16.0%	13.3%	11.2%	10.3%	9.6%	8.9%
- Rent, G&A expenses/ Total op. income	11.4%	10.6%	9.5%	8.2%	8.0%	7.8%	7.6%
- Non-commission expense/ Average total assets	1.2%	1.2%	1.2%	1.1%	1.1%	1.2%	1.2%
Liquidity							
- Gross loans / Commission earning assets	59.9%	64.5%	70.7%	73.6%	74.2%	73.6%	72.6%
- Gross loans/ Customer Deposits	64.6%	74.0%	86.0%	91.0%	92.0%	92.5%	92.0%
- Customer Deposits/ Equity	844.2%	865.4%	737.4%	661.8%	593.7%	530.4%	489.9%
- Customer Deposits/ Total assets	79.7%	79.9%	75.7%	74.6%	74.3%	73.3%	72.8%
- Due from Banks/ Due to Banks	35.1%	59.6%	46.0%	55.2%	70.0%	85.9%	106.2%
Credit Quality							
- Provisions /Total op. income	5.1%	3.1%	4.6%	2.7%	3.1%	2.9%	2.6%
- Provisions /Average loans	0.4%	0.2%	0.3%	0.2%	0.3%	0.3%	0.2%
- Non Performing Loans (SR'000)	552,625	479,787	529,278	551,663	589,595	627,108	672,880
- Provision for loan losses (SR'000)	803,045	846,570	962,381	1,067,460	1,214,858	1,372,439	1,539,788
- NPL's /Gross Loans	2.0%	1.4%	1.2%	1.1%	1.0%	1.0%	1.0%

RATIOS - Continued

	Banque Saudi Fransi						
	2003	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
- NPL's /(Equity+provision for loan losses)	9.4%	7.5%	6.7%	5.6%	4.9%	4.3%	4.0%
- PLL's / Gross Loans	2.9%	2.4%	2.2%	2.0%	2.1%	2.1%	2.2%
- NPL Coverage	145.3%	176.4%	181.8%	193.5%	206.0%	218.9%	228.8%
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	9.4%	9.2%	10.3%	11.3%	12.5%	13.8%	14.9%
- Equity/ Gross Loans	18.3%	15.6%	15.8%	16.6%	18.3%	20.4%	22.2%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	75.2%	69.4%	53.1%	48.5%	47.1%	45.4%	44.2%
- Fees from banking services/ Total op. income	14.6%	21.2%	37.5%	45.3%	47.3%	49.3%	50.8%
- Investment Income/ Total op. income	5.7%	5.3%	4.2%	1.7%	1.3%	1.2%	1.1%
- FX Income/ Total op. income	4.1%	3.7%	4.8%	4.2%	4.0%	3.9%	3.8%
- Other Income/ Total op. income	0.3%	0.4%	0.3%	0.3%	0.2%	0.2%	0.2%
- PLL's/ Total op. income	5.1%	3.1%	4.6%	2.7%	3.1%	2.9%	2.6%
Operating Performance							
- Change in special commission income	-0.8%	9.9%	42.6%	16.4%	15.2%	12.7%	11.9%
- Change in Fees from banking services	24.0%	78.9%	138.6%	60.0%	25.0%	22.0%	20.0%
- Change in Investment Income	147.7%	14.1%	7.7%	-45.9%	-6.6%	5.0%	5.8%
- Change in Fx Income	11.3%	12.0%	77.0%	16.0%	14.0%	13.0%	12.0%
- Change in Other Income	11.3%	44.3%	10.8%	5.0%	5.0%	5.0%	5.0%
RATIO'S USED FOR VALUATION							
- Par value per share (SR)	50.0	50.0	50.0	10.0	10.0	10.0	10.0
- Shares in issue (mn)	45.0	45.0	45.0	337.5	337.5	337.5	337.5
- EPS (SR)	26.3	34.1	49.2	-	-	-	-
- EPS (SR) - Adjusted for Split	5.3	6.8	9.8	9.2	11.2	13.2	15.5
- DPS (SR)	17.0	20.0	13.0	0	0	0	0
- DPS (SR) - Adjusted for Split	3.4	4.0	2.6	3.7	4.9	6.1	8.3
- Book value per share (SR)	112.2	122.5	154.0	0	0	0	0
- Book Value Per Share (SR) - Adjusted for Split	22.4	24.5	30.8	25.8	32.0	38.8	45.8
- Market price year end (SR) *	411.0	774.0	1,350.0	0	0	0	0
- Market Price Year End (SR) - Adjusted for Split *	82.2	154.8	270.0	144.5	144.5	144.5	144.5
- Market Cap. (SRbn)	18.5	34.8	60.8	48.8	48.8	48.8	48.8
- P/E	15.6	22.7	27.4	15.8	13.0	11.0	9.3
- P/BV	3.7	6.3	8.8	5.6	4.5	3.7	3.2

** Market Price of 2006 and subsequent years as on August 30, 2006*

Riyad Bank

Reuters Code:
1010.SE

Listing:
Saudi Stock Exchange

CMP:
SR79.5

August 30, 2006

BUY

Key Data

EPS (SR) *	5.2
BVPS (SR) *	20.1
P / E (x)	15.2
P / BV (x)	4.0
Avg. daily vol. ('000)	340.2
52 week Lo - Hi (SR)	79.5 – 153.8
Market Cap (SR mn)	49,687.5
Target Price (SR)	92.7

*Source: **Global** Research*
** Projected (2006)*

Background

- **Riyad Bank (RB)** was established in November 1957 as a Saudi joint stock company and is the oldest fully Saudi owned bank. The bank is wholly owned by Saudi shareholders with majority of the shareholding with private individuals and balance being held by government and quasi government agencies. The bank has a strong corporate and retail banking franchise in both Shariaa compliant and conventional banking.

- RB provides a full range of banking services through a network of 195 domestic branches with 4,169 employees. It also has international operations with a branch in London, an agency in USA, a representative office in Singapore.

- With total assets of SR80.1bn in 2005, RB ranks 4th amongst the banks under review in-terms of balance sheet size and holds a market share of 11.1% of the sector's aggregate assets.

Recent developments

- In June 2006, Moody's Investors service changed the outlook on RB's C- Financial strength rating (FSR) from stable to positive. The outlook for the bank's A3/Prime-2 foreign currency deposit ratings remains unchanged at stable. As per Moody's, this rating action recognizes the bank's strengthened franchise, improved financial fundamentals and strong capital base. In our opinion, the clean and strong balance sheet coupled with improving operating performance has been the key drivers for the ratings upgrade.

- In May 2006, RB launched a US dollar denominated fund named «Future Equity Fund». The objective of the fund is to achieve long-term capital growth by investing in emerging markets namely China, India, Latin America, Eastern Europe and South Africa. The per unit launch price was set at $10 and minimum subscription was at $10,000.

- RB launched its first issue of medium term floating rate notes in the international markets under its $1.6 bn Euro Medium Term Notes Program in April 2006. Standard & Poor's assigned «A» and «A-1» for its long-term and short-term liabilities, respectively. Fitch Agency assigned «A» and «F1» for the bank's long-term and short-term liabilities, respectively. The $500mn notes representing the first tranche have been issued at a rate of LIBOR + 36 bps.

Analysis of financial performance – 2005

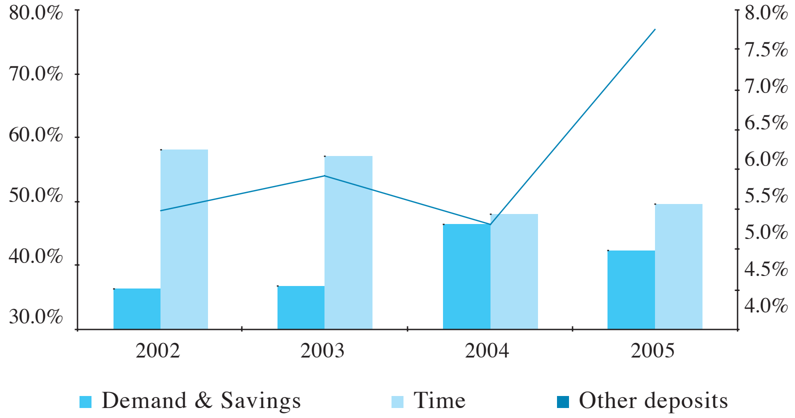
- RB outperformed our earnings estimates for 2005 on the back of a sharp increase in fees from banking services. Variation in reported profits was 9.8% against our estimate. Net special commission income increased by 11.0% to reach SR2,671.8mn in 2005 against our estimate of SR2,732.6mn, which is just 2.2% lower than our estimates.

- RB reported profit of SR2,837.3mn in 2005 as against SR2005.6mn in the previous year, a growth of 41.5% y-o-y. The growth in profits has been on the back of sharp increase in fee from banking services and other operating income. Majority of this fee income was from Assets under management and broking income from stock market activity.

- RB's asset size grew at a CAGR of 6.0% for the period 2002-05. In 2005, its balance sheet size increased from SR74.2bn in 2004 to SR80.1bn, registering a growth of 7.9%.

- Customer deposits increased from SR43.0bn in 2002 to SR52.9bn in 2005, CAGR of 7.2% for the period under review. In 2005, the y-o-y growth in customer deposits was 6.4%. The contribution of demand deposit to total customer deposits increased from 35.1% in 2002 to 41.9% in 2005. Correspondingly, the contribution of time deposits has declined from 58.1% in 2002 to 49.7% in 2005.

Chart 1: Deposit Mix

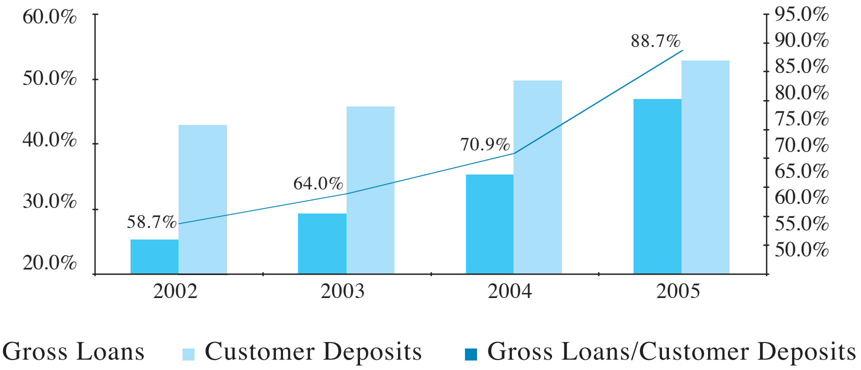


*Source: Company Reports, **Global** Research*

- Gross loans and advances of the bank grew at a CAGR of 23.0% for the period 2002-05. Gross advances increased from SR25.2bn in 2002 to SR46.9bn in 2005. The buoyancy in the economy due to high oil prices and changing demographics has resulted in a strong demand for credit both from the corporate as well as the retail segment.

- Gross loans to customer deposits increased from 58.7% in 2002 to 88.7% in 2005. The lending growth during this period was higher due to strong demand for funds from the corporate as well as the consumer segments. Going forward, we expect loan growth to remain strong due to the announcement of big ticket projects. The ability to garner customer deposits is likely to be the key to support strong growth in lending portfolio.

Chart 2: Gross Loans to customer deposits

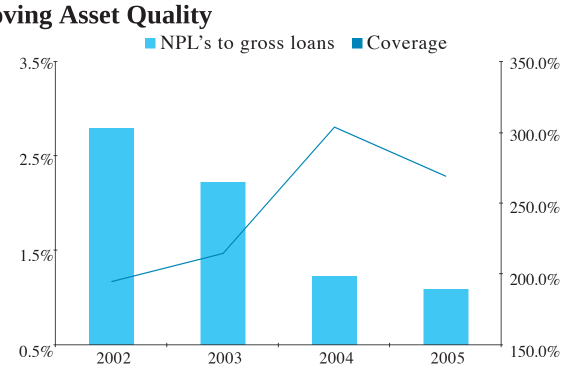


Source: Company Reports, ***Global*** *Research*

- The bank's asset quality has been improving during the last three years. Control strategies covering credit, market, liquidity and operational risks have helped the bank to monitor and control incremental slippage. Gross non-performing loans (NPLs) as a percentage of gross loans have declined from 2.8% in 2002 to 1.1% in 2005. Even in absolute terms, gross NPLs have declined from SR706.0mn in 2002 to SR507.2mn in 2005.

- Aggressive provisioning during this period has helped the bank to increase its coverage ratio from 194.7% in 2002 to 269.5% in 2005. The high coverage ratio is a comforting signal to cover higher delinquency going forward in case that happens.

Chart 3: Improving Asset Quality



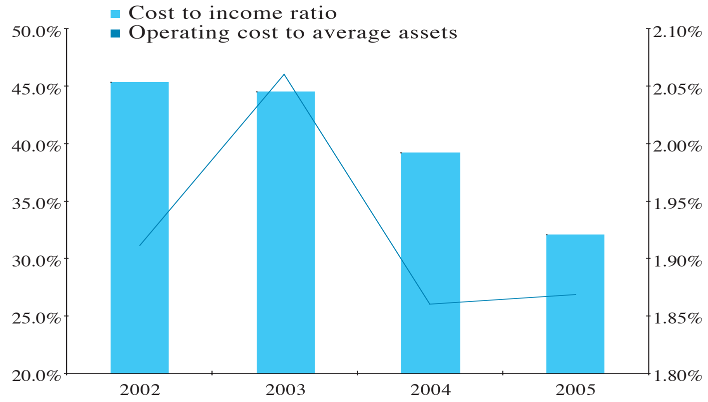
Source: Company Reports, ***Global*** *Research*

- Net special commission income increased from SR2,222.9mn in 2002 to SR2,671.8mn in 2005, CAGR growth of 6.3%. During 2005, the growth in core income was 11.0%. The key driver for earnings in 2005 was fees from banking services, which grew from SR612.3mn to SR1,097.8mn, a yearly growth of 79.3%. Majority of this fee income was from Assets under Management and broking income from stock market activity. In our opinion, sustainability of this rate is unlikely in the near future as more and more brokers are being given license to handle the stock market transactions.

- During the last three years, the bank's operating expenses grew at a CAGR of just 3.9%. Manpower expenses grew at a CAGR of 4.3% for the same period. Strong growth in non-commission income due to significant contribution from fees and other operating income, the bank's cost to income ratio has declined from 45.5% in 2002 to 32.1% in 2005.

- Operating cost to average assets has also declined from 1.91% in 2002 to 1.87% in 2005. In our opinion, operating efficiency will start flowing in as the bank focuses on increasing its ATM network that will help in reducing the transaction costs.

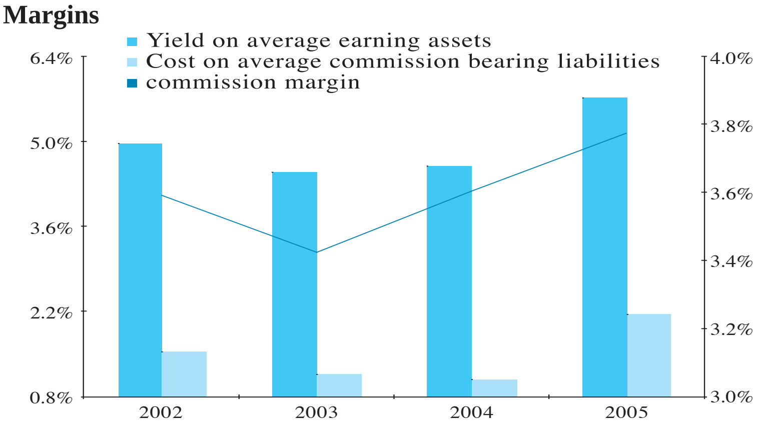
Chart 4: Cost structure



*Source: Company Reports, **Global** Research*

- RB's extensive network has allowed it to establish a strong presence in the high-margin, low delinquency consumer lending business, while also benefiting from low funding costs. Commission margin of the bank increased from 3.6% in 2002 to 3.8% in 2005. Yield on earning assets increased from 5.0% in 2002 to 5.7% in 2005. Correspondingly, cost of funds has also increased from 1.5% in 2002 to 2.2% in 2005. In 2005, due to the buoyancy in the capital markets, banks were experiencing strong demand for funds from the consumer segment.

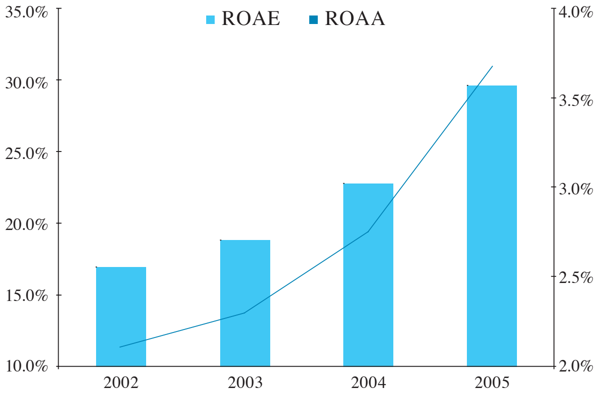
Chart 5: Margins



*Source: Company Reports, **Global** Research*

- With the improvement in core operations, RB's return ratios have improved considerably during the last three years. Return on average assets increased from 2.1% in 2002 to 3.7% in 2005. Also return on average equity increased from 17.0%in 2002 to 29.7% in 2005.

Chart 6: Return Ratios



*Source: Company Report, **Global** Research*

Analysis of Half-Yearly Performance

- RB's asset size increased by 19.6% from SR77.3bn in 2Q2005 to SR92.4bn in 2Q2006. On a sequential basis, the size increased by 6.3% compared to 1Q2006. Year till date, the asset size of the bank has increased by 15.4%.

- As mentioned earlier, the ability of the bank to increase its deposit franchise will be well placed in terms of credit deployment. On a y-o-y basis, customer deposits grew by 30.3% from SR52.7bn in 2Q2005 to SR68.6bn in 2Q2006. Deposits grew by 12.7% sequentially and on a year till date, customer deposits have registered a robust growth of 30.1%.

- Net loans increased from SR39.9bn in 2Q2005 to SR50.1bn in 2Q2006, a growth of 25.4%. On a sequential basis net loans portfolio increased by 2.1% and on a year till date, lending book has increased by 9.8%.

Table 1: Key Balance Sheet Items

Amount SR mn	2Q2005	FY2005	1Q2006	2Q2006	y-o-y	q-o-q	y-t-d
Investments	27,333.3	27,239.9	27,201.6	28,613.9	4.7%	5.2%	5.0%
Net loans	39,926.8	45,606.0	49,041.1	50,081.7	25.4%	2.1%	9.8%
Customer deposits	52,649.7	52,729.8	60,874.2	68,580.2	30.3%	12.7%	30.1%
Balance sheet size	77,294.4	80,078.7	86,948.9	92,413.0	19.6%	6.3%	15.4%

- For the first half of the current fiscal, the bank's net income increased from SR1,459.6mn in 1H2005 to SR1,554.4mn in 1H2006, a growth of 6.5% on the back of 16.1% growth in net special commission income.

- Net commission income increased from SR1,286.5mn in 1H2005 to SR1,493.8mn in 1H2006. Fees from banking services increased from SR476.5mn in the first half of 2005 to SR806.2mn in 1H2006, a whopping 69.2% growth on y-o-y basis.

- Operating cost increased by 15.5% from SR679.9mn in 1H2005 to SR785.1mn in 1H2006. Depreciation and rent & premises related expenses increased by 31.6% and 21.5% respectively.

- Provision for loan losses increased by 64.9% from SR84.3mn in 1H2005 to SR138.9mn in 1H2006.

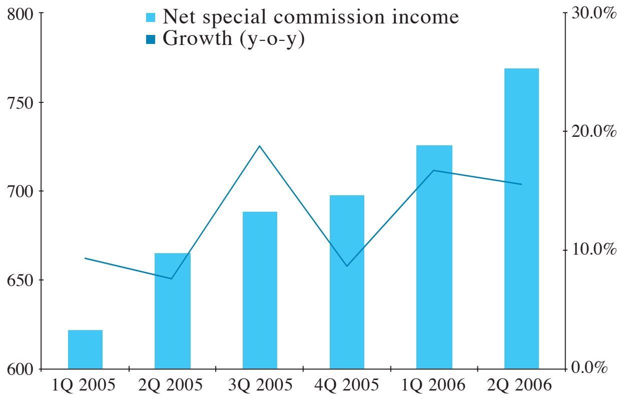
Table 2: Income Statement

Amount SR mn	2Q2005	2Q2006	%	1H2005	1H2006	%
Special commission income	968.0	1394.5	44.1%	1839.2	2682.7	45.9%
Special commission expense	(303.1)	(626.0)	106.5%	(552.7)	(1188.9)	115.1%
Net special commission income	**664.8**	**768.5**	**15.6%**	**1286.5**	**1493.8**	**16.1%**
Fees from banking services	302.2	344.5	14.0%	476.5	806.2	69.2%
Exchange income	21.9	35.6	62.2%	42.0	62.2	48.2%
Trading income	49.6	(11.9)	(123.9%)	84.8	113.5	33.8%
Gains on non-trading investments	14.9	(6.0)	(140.5%)	19.9	(4.3)	(121.4%)
Other operating income	302.9	3.8	(98.7%)	314.1	6.9	(97.8%)
Provisions for loan losses	(41.1)	(71.5)	73.9%	(84.3)	(138.9)	64.9%
Total operating income	**1315.3**	**1063.0**	**(19.2%)**	**2139.6**	**2339.5**	**9.3%**
Salaries & employee related expenses	(197.1)	(206.9)	5.0%	(366.2)	(429.9)	17.4%
Rent & premises related expenses	(24.7)	(29.6)	20.2%	(49.6)	(60.2)	21.5%
Depreciation and amortization	(26.7)	(34.6)	29.7%	(50.9)	(67.0)	31.6%
Other G & A expenses	(122.0)	(105.4)	(13.6%)	(202.1)	(218.4)	8.1%
Other operating expense	(6.8)	(4.5)	(34.2%)	(11.1)	(9.7)	(13.3%)
Total operating expenses	**(377.3)**	**(381.1)**	**1.0%**	**(679.9)**	**(785.1)**	**15.5%**
Net Income	**938.0**	**681.9**	**(27.3%)**	**1459.6**	**1554.4**	**6.5%**

- RB's net income declined by 27.3% from SR938.0mn in 2Q2005 to SR681.9mn in 2Q2006, despite a growth in net special commission income by 15.6%. In the second quarter of 2005, the bank realized gain on sale of land amounting to SR295.6mn. Normalized net income (adjusted for gain on sale of land) grew by 6.2% y-o-y from SR642.4mn in 2Q2005 to SR681.9mn in 2Q2006.

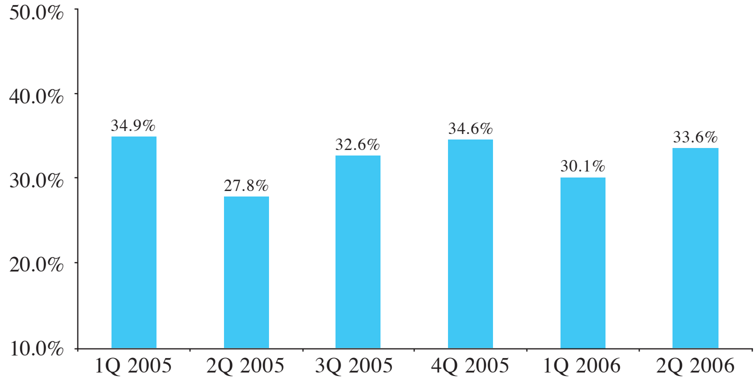
- Non-commission income for the quarter declined from SR691.5mn in 2Q2005 to SR366.1mn in 2Q2006, a decline by 47.1%. In 2Q2005, gain on sale of land amounted to SR295.6mn. Adjusting for this non-recurring item, non-commission income declined by 7.5% in 2Q2006 as compared to the same quarter previous year.

Chart 7: Net Special Commission Income



Source: Company Reports, ***Global*** *Research*

Chart 8: Cost to income ratio



Source: Company Reports

Outlook:

- Wholesale loan growth to be the main growth driver over the next two years due to lot of projects in the pipeline. New projects, government privatization, 3rd mobile company and the King Abdullah city are the key drivers of corporate loan growth. The share of retail loans for the bank is currently 20%. As per the new guidelines issued by SAMA (discussed earlier), the consumer lending growth is likely to slow down.

- The bank's exposure to real estate sector is minimal due to legal constraints. According to the management, the underserved SME segment is likely to witness strong growth over the next two years. Non-interest bearing liabilities currently constitute 47% of total deposits. Margins are likely to marginally decline due to increasing cost of funds.

- According to the management, the entry of foreign banks is not an immediate concern on the retail lending front. In order to provide services and array of products, these banks will require branch network to tap the consumer segment. Hence, the entry of foreign banks is not likely to be an immediate concern. Moreover, these banks will be concentrating on corporate banking, investment and private banking.

- Branch expansion is going to be in the domestic segment and the bank has no immediate plans to expand overseas. In the current fiscal, more branches are likely to be opened. The bank's emphasis on increasing its alternative delivery channels i.e. ATM network will help reduce transaction cost and thereby increase operating efficiency.

Valuation:

Based on the current market price of SR79.5, the stock is trading at 14.0x 2005 earnings and 3.9x 2005 book value. On a one year forward basis, the stock is trading at 15.2x 2006E earnings and 4.0x 2006E book value. Based on strong fundamentals, improving asset quality, comfortable capital adequacy to support growth and increasing return ratios, we upgrade the stock to **BUY** from HOLD. We recommend a BUY on the stock with a target price of SR92.7 (upside 16.6%). At our target price, the stock will be trading at 17.7x 2006E earnings and 4.6x 2006E book value.

BALANCE SHEET

	Riyad Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Assets							
Cash & balances with SAMA	2,246.4	2,523.5	2,949.1	5,536.5	6,663.3	8,431.2	9,572.2
Due from banks and other FI's	3,967.6	3,099.9	1,734.7	2,602.0	3,252.6	3,968.1	4,761.7
Investments	33,897.8	32,117.6	27,239.9	30,468.8	32,817.7	36,005.6	40,224.8
Loans and advances	27,952.3	33,943.8	45,606.0	58,680.4	71,976.9	81,383.3	88,774.1
Fixed assets	788.4	749.2	851.3	928.0	970.1	1,061.3	1,185.4
Other assets	2,654.6	1,812.9	1,697.7	2,291.8	2,796.0	3,355.2	4,026.3
Total assets	**71,507.0**	**74,247.0**	**80,078.7**	**100,507.6**	**118,476.6**	**134,204.7**	**148,544.6**
Liabilities and Shareholders' Equity							
Liabilities							
Due to banks and other financial institutions	13,914.9	11,924.2	12,963.4	10,594.4	9,535.0	8,772.2	8,070.4
Customer deposits	45,878.9	49,742.1	52,928.9	70,924.7	87,946.6	102,018.1	114,260.2
Other liabilities	3,167.0	3,534.0	4,095.1	4,586.5	5,045.1	5,448.8	5,775.7
Debt securities in issue	-	a -	-	1,870.1	1,870.1	1,870.1	1,870.1
Total Liabilities	**62,960.7**	**65,200.3**	**69,987.3**	**87,975.7**	**104,396.9**	**118,109.1**	**129,976.5**
Shareholders' Equity							
Share capital	4,000.0	4,000.0	5,000.0	6,250.0	6,250.0	6,250.0	6,250.0
Statutory Reserve	4,000.0	4,000.0	3,709.3	6,250.0	6,250.0	6,250.0	6,250.0
Other reserves	90.6	71.4	(52.2)	(52.2)	(52.2)	(52.2)	(52.2)
Retained earnings	455.6	975.3	1,434.3	84.1	1,632.0	3,647.8	6,120.3
Total Shareholders' Equity	**8,546.2**	**9,046.6**	**10,091.4**	**12,531.9**	**14,079.7**	**16,095.6**	**18,568.1**
Total Liabilities and Shareholders' Equity	**71,507.0**	**74,247.0**	**80,078.7**	**100,507.6**	**118,476.6**	**134,204.7**	**148,544.6**

INCOME STATEMENT

	Riyad Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Special commission income	2,856.6	3,071.8	4,050.4	5,437.8	6,237.7	7,266.8	8,000.5
Special commission expense	(679.6)	(663.8)	(1,378.5)	(2,202.3)	(2,479.5)	(2,761.4)	(2,960.2)
Net special commission income	**2,177.0**	**2,408.0**	**2,671.8**	**3,235.5**	**3,758.2**	**4,505.4**	**5,040.3**
Fees from banking services	380.0	612.3	1,097.8	1,536.9	1,813.5	2,103.6	2,482.3
Exchange income	92.1	73.8	91.5	118.9	142.7	168.4	195.3
Trading income	447.1	305.1	245.8	147.5	118.0	106.2	111.5
Dividend income	0.9	-	-	-	-	-	-
Gains on non-trading investments	78.0	37.7	51.0	10.2	10.7	11.3	12.4
Other operating income	32.1	21.4	332.9	16.2	17.5	19.2	21.9
	-	-	-	-	-	-	-
Provisions for loan losses	(186.2)	(96.8)	(212.1)	(238.7)	(292.7)	(373.2)	(362.5)
Total operating income	**3,021.0**	**3,361.5**	**4,278.7**	**4,826.4**	**5,567.8**	**6,540.8**	**7,501.1**
Salaries & employee related expenses	(752.6)	(750.0)	(792.9)	(832.5)	(899.1)	(971.0)	(1,019.6)
Rent & premises related expenses	(89.7)	(92.2)	(106.9)	(117.6)	(130.6)	(145.6)	(160.1)
Depreciation and amortization	(163.8)	(144.7)	(102.4)	(115.0)	(126.5)	(113.9)	(124.1)
Other G & A expenses	(401.1)	(358.0)	(412.8)	(454.1)	(508.6)	(584.9)	(660.9)
Other operating expense	(22.2)	(11.0)	(26.4)	(30.3)	(33.4)	(37.4)	(41.9)
Total operating expenses	**(1,429.4)**	**(1,355.9)**	**(1,441.4)**	**(1,549.6)**	**(1,698.2)**	**(1,852.7)**	**(2,006.6)**
Net Income	**1,591.7**	**2,005.6**	**2,837.3**	**3,276.8**	**3,869.7**	**4,688.0**	**5,494.5**
Statement of Retained Earnings							
Beginning retained earnings	**275.0**	**455.6**	**975.3**	**1,434.3**	**84.1**	**1,632.0**	**3,647.8**
Net income	1,591.7	2,005.6	2,837.3	3,276.8	3,869.7	4,688.0	5,494.5
Adjustments							
Transfer to statutory reserve	-	-	(709.3)	(2,540.7)	-	-	-
Gross dividends	(1,402.0)	(1,486.0)	(1,669.0)	(2,086.3)	(2,321.8)	(2,672.2)	(3,022.0)
Net change in fair value	(9.1)	0.0	-	-	-	-	-
Ending balance	**455.6**	**975.3**	**1,434.3**	**84.1**	**1,632.0**	**3,647.8**	**6,120.3**

CASH FLOW STATEMENT

	Riyad Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Net income	**1,591.7**	**2,005.6**	**2,837.3**	**3,276.8**	**3,869.7**	**4,688.0**	**5,494.5**
Accertion of discounts	(33.0)	8.8	(16.6)	-	-	-	-
Gains on investments	(78.0)	(37.7)	(51.0)	(10.2)	(10.7)	(11.3)	(12.4)
Depreciation and amotization	163.8	144.7	102.4	115.0	126.5	113.9	124.1
Gain on disposal of fixed assets	2.9	(3.1)	(303.2)	-	-	-	-
Provision for loan losses	186.2	96.8	212.1	238.7	292.7	373.2	362.5
Impairment of other financial assets	2.9	-	-	-	-	-	-
	1,836.4	2,215.2	2,781.0	3,620.3	4,278.2	5,163.9	5,968.8
Net (increase) decrease in operating assets							
Statutory deposit with SAMA	1,954.3	(371.5)	(152.2)	(867.3)	(650.5)	(715.6)	(793.6)
Due from banks and other FI's	-	165.9	1,119.3	-	-	-	-
Trading portfolio	(385.7)	(219.0)	170.1	(439.0)	(265.8)	(375.7)	(507.2)
Loans and advances	(4,289.0)	(6,088.3)	(11,874.3)	(13,313.1)	(13,589.2)	(9,779.7)	(7,753.4)
Other assets	(620.4)	841.7	115.5	(594.2)	(504.2)	(559.2)	(671.0)
Net increase (decrease) in operating liabilities							
Due to banks and FI's	1,362.0	(1,990.7)	1,039.2	(2,368.9)	(1,059.4)	(762.8)	(701.8)
Customers deposits	2,879.8	3,863.3	3,186.7	17,995.8	17,021.9	14,071.5	12,242.2
Other liabilities	(207.6)	262.8	494.9	491.4	458.6	403.6	326.9
Net cash used in operating activities	**2,529.7**	**(1,320.6)**	**(3,119.9)**	**4,524.9**	**5,689.6**	**7,446.1**	**8,110.9**
Net sale /purchase of investments	**(1,276.9)**	**2,008.9**	**4,670.3**	**(2,779.6)**	**(2,072.4)**	**(2,800.9)**	**(3,699.7)**
Capex	(122.1)	(102.5)	98.8	(191.7)	(168.7)	(205.0)	(248.3)
Net cash from investing activities	**(1,399.0)**	**1,906.4**	**4,769.1**	**(2,971.4)**	**(2,241.1)**	**(3,005.9)**	**(3,948.0)**
	-	-	-	-	-	-	-
Dividend and zakat paid	(1,298.5)	(1,381.8)	(1,621.7)	(2,086.3)	(2,321.8)	(2,672.2)	(3,022.0)
Net cash used in financing activities	**(1,298.5)**	**(1,381.8)**	**(1,621.7)**	**(216.1)**	**(2,321.8)**	**(2,672.2)**	**(3,022.0)**
	-	-	-	-	-	-	-
Increase / (Decrease) in cash	**(167.7)**	**(796.1)**	**27.5**	**1,337.4**	**1,126.7**	**1,768.0**	**1,141.0**
Beginning cash	2,414.2	3,145.6	2,349.5	2,949.1	5,536.5	6,663.3	8,431.2
Ending cash	**2,246.4**	**2,349.5**	**2,377.0**	**4,286.5**	**6,663.3**	**8,431.2**	**9,572.2**

RATIOS

	Riyad Bank						
	2003	2004	2005	2006F	2007F	2008F	2009F
Profitability							
- Return on average assets	2.3%	2.8%	3.7%	3.63%	3.53%	3.71%	3.89%
- Return on average equity	18.8%	22.8%	29.7%	28.97%	29.08%	31.07%	31.70%
- Net special commission income after PLL's/ Total op. income	65.9%	68.8%	57.5%	62.1%	62.2%	63.2%	62.4%
- Non-commission income/ Total op. income	34.1%	31.2%	42.5%	37.9%	37.8%	36.8%	37.6%
- Non-commission expense/ Total op. income	47.3%	40.3%	33.7%	32.1%	30.5%	28.3%	26.8%
- Fees from banking services/ Total op. income	12.6%	18.2%	25.7%	31.8%	32.6%	32.2%	33.1%
- Assets utilization	4.2%	4.5%	5.3%	4.8%	4.7%	4.9%	5.0%
- Earning power	91.6%	91.9%	91.6%	90.6%	90.7%	90.1%	89.9%
- Dividend payout ratio	88.1%	74.1%	58.8%	63.7%	60.0%	57.0%	55.0%
- Sustainable growth rate	2.2%	5.9%	12.2%	10.5%	11.6%	13.4%	14.3%
Margins							
- Net (or profit) margin	52.7%	59.7%	66.3%	67.9%	69.5%	71.7%	73.2%
- Special commission expense/ Special commission income	23.8%	21.6%	34.0%	40.5%	39.8%	38.0%	37.0%
- Yield on average earning assets	4.5%	4.6%	5.7%	6.6%	6.3%	6.4%	6.3%
- Cost rate on average commission bearing liabilities	1.2%	1.1%	2.2%	3.0%	2.7%	2.6%	2.5%
- Spread	3.31%	3.50%	3.56%	3.66%	3.57%	3.76%	3.79%
- Commission margin (earning assets)	3.42%	3.60%	3.77%	3.64%	3.49%	3.62%	3.68%
Efficiency							
- Cost/ Total op. income	47.3%	40.3%	33.7%	32.1%	30.5%	28.3%	26.8%
- Staff expenses/ Total op. income	24.9%	22.3%	18.5%	17.2%	16.1%	14.8%	13.6%
- G&A expenses/ Total op. income	16.2%	13.4%	12.1%	11.8%	11.5%	11.2%	10.9%
- Non-commission expense/ Average total assets	2.1%	1.9%	1.9%	1.7%	1.6%	1.5%	1.4%
Liquidity							
- Loans / Commission earning assets	44.8%	51.7%	64.0%	66.2%	68.7%	69.1%	68.5%
- Loans/ Customer Deposits	64.0%	70.9%	88.7%	85.0%	84.0%	82.0%	80.0%
- Customer Deposits/ Equity	536.8%	549.8%	524.5%	566.0%	624.6%	633.8%	615.4%
- Customer Deposits/ Total assets	64.2%	67.0%	66.1%	70.6%	74.2%	76.0%	76.9%
- Due from Banks/ Due to Banks	28.5%	26.0%	13.4%	24.6%	34.1%	45.2%	59.0%
Credit Quality							
- Provisions /Total op. income	6.2%	2.9%	5.0%	4.9%	5.3%	5.7%	4.8%
- Provisions /Average loans	0.7%	0.3%	0.5%	0.4%	0.4%	0.5%	0.4%
- Non Performing Loans (SR'000)	651,096	432,617	507,171	602,860	701,814	711,066	776,970

RATIOS - Continued

	Riyad Bank						
	2003	2004	2005	2006F	2007F	2008F	2009F
- Provision for loan losses (SR'000)	1,394,613	1,314,171	1,366,848	1,605,580	1,898,274	2,271,521	2,634,046
- NPL's /Gross Loans	2.2%	1.2%	1.1%	1.0%	1.0%	0.9%	0.9%
- NPL's /(Equity+provision for loan losses)	6.5%	4.2%	4.4%	4.3%	4.4%	3.9%	3.7%
- PLL's / Gross Loans	4.8%	3.7%	2.9%	2.7%	2.6%	2.7%	2.9%
- NPL Coverage	214.2%	303.8%	269.5%	266.3%	270.5%	319.5%	339.0%
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	12.0%	12.2%	12.6%	12.5%	11.9%	12.0%	12.5%
- Equity/ Gross Loans	29.1%	25.7%	21.5%	20.8%	19.1%	19.2%	20.3%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	65.9%	68.8%	57.5%	62.1%	62.2%	63.2%	62.4%
- Fees from banking services/ Total op. income	12.6%	18.2%	25.7%	31.8%	32.6%	32.2%	33.1%
- Investment Income/ Total op. income	17.4%	10.2%	6.9%	3.3%	2.3%	1.8%	1.7%
- FX Income/ Total op. income	3.0%	2.2%	2.1%	2.5%	2.6%	2.6%	2.6%
- Other Income/ Total op. income		1.1%	0.6%	7.8%	0.3%	0.3%	0.3%
- PLL's/ Total op. income		6.2%	2.9%	5.0%	4.9%	5.3%	5.7%
Operating Performance							
- Change in special commission income		-7.1%	7.5%	31.9%	34.3%	14.7%	16.5%
- Change in Fees from banking services		11.1%	61.1%	79.3%	40.0%	18.0%	16.0%
- Change in Investment Income		207.2%	-34.8%	-13.4%	-46.9%	-18.4%	-8.8%
- Change in Fx Income		62.1%	-19.9%	23.9%	30.0%	20.0%	18.0%
- Change in Other Income		-2.3%	-33.3%	1452.9%	-95.1%	8.0%	10.0%
RATIO'S USED FOR VALUATION							
- Par value per share (SR)		50	50	50	10	10	10
- Shares in issue (000's)		80,000.0	80,000.0	100,000.0	625,000.0	625,000.0	625,000.0
- EPS (SR)		19.9	25.1	28.4	-	-	-
- EPS (SR) - Adjusted for Split		4.0	5.0	5.7	5.2	6.2	7.5
- DPS (SR)		17.0	18.0	16.0	-	-	-
- DPS (SR) - Adjusted for Split		3.4	3.6	3.2	3.3	3.7	4.3
- Book value per share (SR)		106.8	113.1	100.9	-	-	-
- Book value per share (SR) - Adjusted for Split		21.4	22.6	20.2	20.1	22.5	25.8
- Market price year end (SR)		348.0	600.0	850.0	-	-	-
- Market price year end (SR) - Adjusted for Split		69.6	120.0	170.0	79.5	79.5	79.5
- Market Cap. (SRmn)		27,840.0	48,000.0	85,000.0	49,687.5	49,687.5	49,687.5
- P/E		17.5	23.9	30.0	15.2	12.8	10.6
- P/BV		3.3	5.3	8.4	4.0	3.5	3.1

* *Market Price of 2006 and subsequent years as on August 30, 2006*

The Saudi British Bank

Reuters Code:
1060.SE

Listing:
Saudi Stock Exchange

CMP:
SR167.25

August 30, 2006

Hold

Key Data

EPS (SR)*	8.4
BVPS (SR)*	22.6
P / E (x)	19.9
P / BV (x)	7.4
Avg. daily vol. (‘000)	104.8
52 week Lo - Hi	160.0 – 231.6
Market Cap (SR mn)	62,718.8
Target Price (SR)	169.2

*Source: **Global** Research*
** Projected (2006)*

Background

- **The Saudi British Bank (SABB)** was established in January 1978 as Saudi joint stocks company to takeover the operations of The British Bank of The Middle East in Saudi Arabia. SABB is one of the most technologically sophisticated banks in the Kingdom of Saudi Arabia thanks to its main shareholder, HSBC, which provides the bank with access to its systems, technology and expertise.

- The bank successfully implemented its strategic plan for 2005-2007 designed to transform a traditional bank into a leading financial services company. The plan includes the development of Amanah Islamic banking services and launching new Amanah products in light of the growing demand for this kind of services.

- During 2005, the bank undertook a complete re-branding as evidenced visually by a new logo with abbreviated name, SABB, in both English and Arabic, alongside the Hexagon logo of HSBC. By doing this, the bank intends to add an international dimension to its brand and at the same time manifesting the longstanding association with HSBC.

- SABB is among the medium-sized banks, ranking 6th amongst Saudi commercial banks in terms of assets size with a 9.1% market share of the sector’s aggregate total assets for the year 2005 (2004: 9.2%). As at end 2005, SABB’s Saudisation ratio stood at 83.47%.

Recent developments

- In July 2006, Euromoney’s 2006 Foreign Exchange Awards classified the bank as Best Local Bank of Saudi Riyal Foreign Exchange provider. The bank’s treasury department provides an array of products ranging from foreign exchange and interest rate protection to money market operations, precious metals, fixed income instruments and Islamic solutions.

- During June 2006, SAMA Investment Products Committee has awarded the bank as the Best Investment Funds Manager for the year 2005. The clients' confidence in the quality of investment products and services offered by the bank has resulted in an increased demand for such products, which is primarily due to the ability and quality of its highly skilled and professional investment management team.

- In April 2006, the bank issued a EUR325mn 5-year Floating Rate Note under its increased US$1bn Euro Medium Term Note Programme. It is the first ever Euro currency international bond by any Middle Eastern Issuer. The bank has maintained its position in terms of product innovation and financial engineering by the issue of this bond. The success of this programme is due to the bank's strong fundamentals, excellent credit ratings, the HSBC tag and the ability to innovate newer products.

- In order to provide finance to small and medium enterprises, the Government started giving guarantees to local banks. By doing this, economic activity in the Kingdom is likely to gather momentum as banks will be willing to offer loans backed by Government guarantee. The scheme guarantees local banks a share of the finance extended to this segment. In March 2006, the bank obtained the first guarantee by SIDF that manages SME Finance scheme in consideration of financing a national enterprise which is involved in recycling of industrial products by way of Murabaha, a product of the bank's Amanah Islamic Banking Services for corporations.

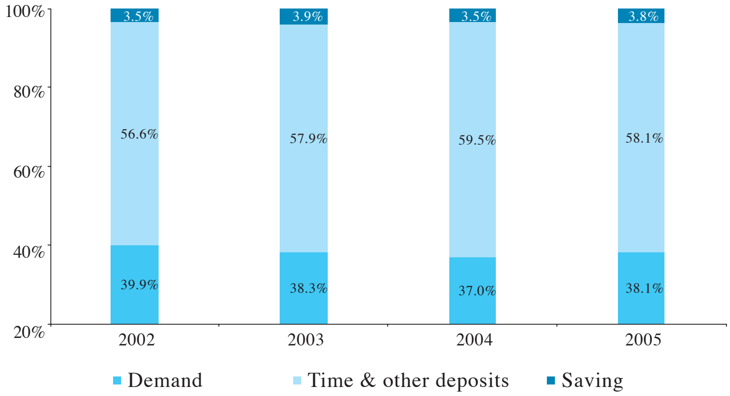
Financial Performance – 2005

- SABB outperformed our earnings estimates for 2005 on the back of a sharp increase in non-commission income. Variation in reported profits was 17.5% against our estimate. Net special commission income increased by 21.7% to reach SR2,045mn in 2005 against our estimate of SR2,052mn. The bank reported a 52.2% growth in profit in 2005 primarily due to 100.5% growth in non-commission income.

- Customer deposits increased at a CAGR of 11.5% from SR35.0bn in 2002 to SR48.5bn in 2005. Demand and savings deposits grew at CAGR of 9.9% and 14.5% respectively for the period under review. For the period 2002-05, time and other deposits grew at a CAGR of 12.3% and 22.9% respectively.

- During the year 2005, the bank issued USD 600mn (SR2,246.9mn) 5-year floating rate note at LIBOR plus 37.5 bps. The bank also raised funds by an issue of 12-year floating rate note at LIBOR plus 65 bps to the tune of SR187.5mn. The total of these two borrowings (SR2,434.4mn) contributed 4.5% of the total external funding of the bank in 2005.

Chart 1: Deposit Mix



Source: Company Report, ***Global*** *Research*

- On the lending side, the bank's gross loan book grew at a CAGR of 25.4% from SR20.9bn in 2002 to SR41.2bn in 2005. The buoyancy in the economy due to high oil prices and changing demographics has resulted a strong demand for credit both from the corporate as well as the retail segment. The major contributor has been the consumer and credit card segment, which grew at a CAGR of 34.1% for the period 2002-05. Due to the thrust towards this segment, consumer and credit card segment's contribution to overall gross loan book increased from 20.6% of gross loans in 2002 to 25.2% in 2005. We expect consumer lending growth to slow down because of recent changes in SAMA guidelines.

Chart 2: Gross Loans Break-Up

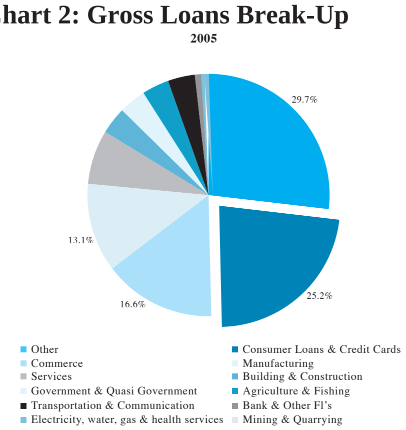
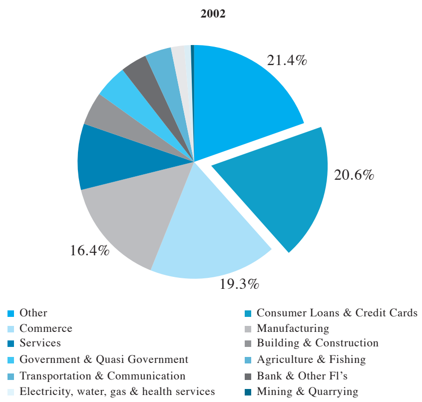


Chart 3: Gross Loans Break-Up



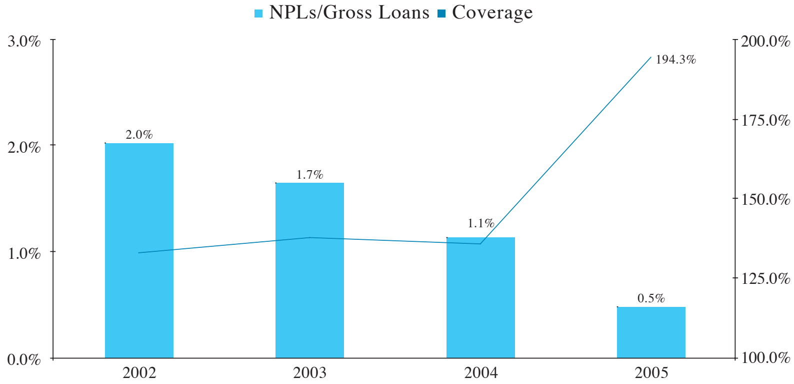
Source: Company Report, ***Global*** *Research*

- The bank's asset quality has been improving during the last three years. Monitoring credit exposures, limiting transactions with specific counterparties and continuously assessing the creditworthiness of counterparties have helped the bank to control credit risk. Gross non-performing loans (NPLs) as a percentage of gross loans have declined from 2.0% in 2002 to 0.5% in 2005. Even in absolute terms, gross NPLs have declined from SR424.5mn in 2002 to SR198.6mn in 2005.

- Gross NPLs on the consumer and credit card segment has declined from 0.4% in 2002 to 0.2% in 2005. Electricity, water, gas and health services segment contributed 10.2% of the total gross NPLs. The bank has 100% coverage on this segment by way of provisions. The other major contributor is building and construction segment, which contributed 4.7% of total bad loans. On this segment, the provision coverage ratio is 53.2% in 2005. However, the share of building and construction segment to the total gross loan book as at end 2005 was 3.0%, which in our view is not very significant.

- Aggressive provisioning during this period has helped the bank to increase its coverage ratio from 133.0% in 2002 to 194.3% in 2005. The higher coverage ratio is a comforting signal to cover incremental delinquency going forward in case that happens.

Chart 4: Non-Performing Loans

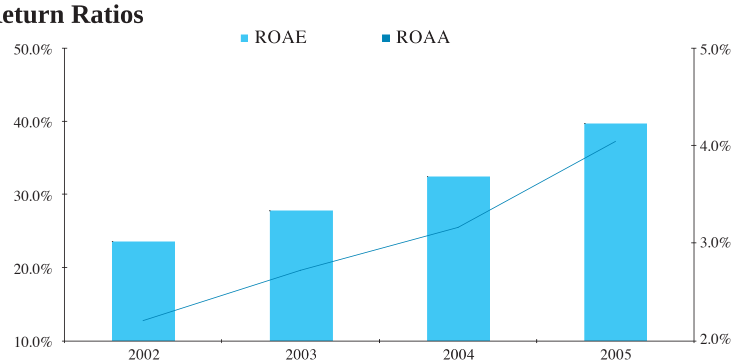


*Source: Company Report, **Global** Research*

- Net special commission income increased from SR1,445.9mn in 2002 to SR2,045.0mn in 2005, CAGR growth of 12.2%. During 2005, the growth in core income was 21.7%. The key driver for earnings in 2005 was fees from banking services, which grew from SR674.3mn in 2004 to SR1,531.5mn in 2005, a growth of 127.1%. Majority of this fee income was due to broking income from stock market activity. In our opinion, sustainability of this rate is unlikely in the near future as more and more brokers are being given license to handle the stock market transactions.

- Due to the improvement in core operations, SABB's return ratios have improved considerably during the last three years. Return on average assets increased from 2.2% in 2002 to 4.0% in 2005. Also return on average equity increased from 23.6%in 2002 to 39.7% in 2005.

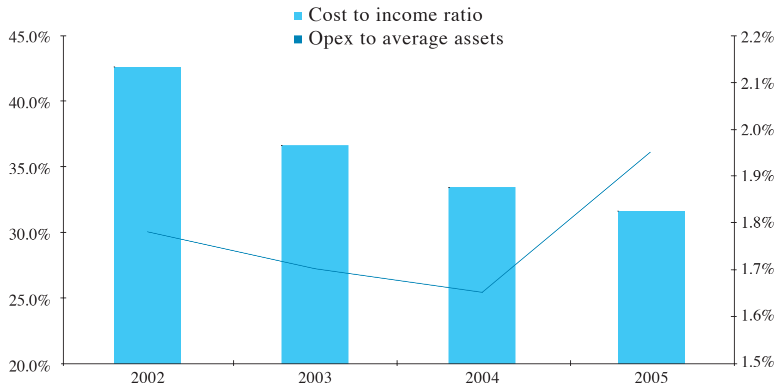
Chart 5: Return Ratios



*Source: Company Report, **Global** Research*

- During the period 2002-05, operating costs increased from SR784.9mn in 2002 to SR1,208.3mn in 2005, a CAGR growth of 15.5%. Cost to income ratio of the bank declined from 42.6% in 2002 to 31.6% in 2005. Operating cost as a percentage of average assets has marginally increased from 1.8% in 2002 to 2.0% in 2005.

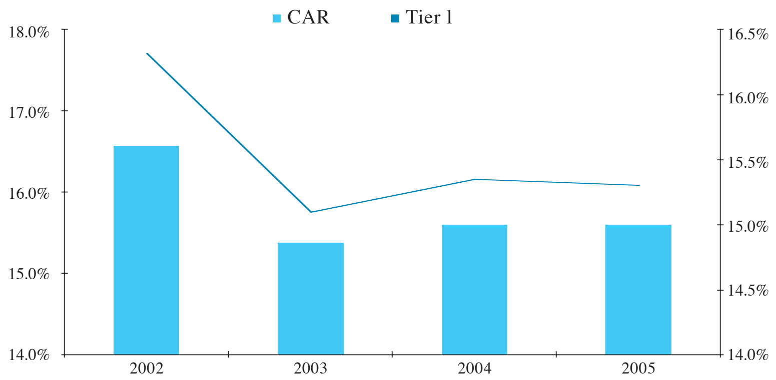
Chart 6: Operating Efficiency



Source: Company Report, ***Global*** *Research*

- SABB is well capitalized to support business growth. As at end 2005, the bank's Capital Adequacy Ratio stood at 15.6% with Tier I ratio at 15.3%. The bank manages its capital in a balanced manner with the objective of maintaining strong capital ratios. The capital management framework is so designed to meet the objective of maximizing its return on capital as well as providing sufficient cushion to cover any unexpected losses.

Chart 7: Capital Adequacy Ratio



Source: Company Report, ***Global*** *Research*

Analysis of Half-Yearly Performance

- SABB's asset size increased by 20.3% from SR60.5bn in 2Q2005 to SR72.8bn in 2Q2006. On a sequential basis, the size declined by 1.2% compared to 1Q2006. This decline is on the back of a strong sequential growth in asset size in 1Q2006 of 11.7%.

- Customer deposits registered a strong y-o-y growth of 24.0% from SR44.5bn in 2Q2005 to SR55.1bn in 2Q2006. On q-o-q basis (sequential), deposits have increased by 1.1% in 2Q2006. The growth in customer deposits comes on the back of a strong sequential growth of 12.3% in 1Q2006. Growth in deposit base is the key to support strong loan growth.

- Net loans increased from SR35.4bn in 2Q2005 to SR39.1bn in 2Q2006, a growth of 10.4%. However on a sequential basis, this is the second consecutive quarter where the net loans portfolio have declined. Sequentially, the net loan book declined by 3.3% in 1Q2006 and by 1.0% in 2Q2006. We believe, this is a conscious strategy of the bank to reduce its indirect exposure to the capital market.

Table 1: Key Balance Sheet Items

Amount SR mn	2Q2005	FY 2005	1Q2006	2Q2006	y-o-y	q-o-q	y-t-d
Investments	16,969.3	16,372.6	18,334.2	15,262.7	-10.1%	-16.8%	-6.8%
Net Loans	35,423.7	40,846.6	39,504.7	39,118.2	10.4%	-1.0%	-4.2%
Customer deposits	44,459.6	48,534.1	54,522.6	55,109.4	24.0%	1.1%	13.5%
Balance sheet size	60,498.0	65,927.9	73,665.8	72,779.4	20.3%	-1.2%	10.4%

*Source: Company Report, **Global** Research*

- For the first half of the current fiscal, the bank's net income increased from SR1.2bn in 1H2005 to SR1.8bn in 1H2006, a growth of 50.8% on the back of a strong growth in core income (35.4%) and 82.3% growth from fee income.

- Net commission income increased from SR945.7mn in 1H2005 to SR1,280.7mn in 1H2006, registering a growth of 35.4%.

- Non-commission income, increased from SR795.3mn in 1H2005 to SR1,347.0mn in 1H2006, a growth of 69.4%. Fees from banking services, increased from SR667.5mn in the first half of 2005 to SR1,217.2mn in 1H2006, a whopping 82.3% growth on y-o-y basis.

- Operating cost increased by 50.3% from SR488.4mn in 1H2005 to SR734.2mn in 1H2006. Depreciation and other general and administrative expenses increased by 39.3% and 106.5% respectively.

- Provision for loan losses increased by 60.4% from SR52.6mn in 1H2005 to SR84.4mn in 1H2006. This resulted in net special commission income after provision for loan losses to increase by 34.0%.

Table 2: Income Statement

Amount SR mn	2Q2005	2Q2006	%	1H2005	1H2006	%
Special commission income	748.5	1,089.7	45.6%	1,407.2	2,132.0	51.5%
Special commission expense	(251.6)	(423.9)	68.4%	(461.4)	(851.2)	84.5%
Net special commission income	**496.9**	**665.9**	**34.0%**	**945.7**	**1,280.7**	**35.4%**
Provision for loan losses	(32.9)	(36.7)	11.7%	(52.6)	(84.4)	60.4%
Net special commission income after PLL's	**464.0**	**629.2**	**35.6%**	**893.1**	**1,196.3**	**34.0%**
Fees from banking services, net	450.6	484.8	7.6%	667.5	1,217.2	82.3%
Exchange income, net	43.1	40.0	-7.2%	80.7	79.1	-1.9%
(Loss) / income from FVIS Financial Instruments	1.3	4.0	218.0%	(2.5)	2.6	-204.0%
Trading income, net	11.8	7.5	-36.6%	14.2	22.2	56.5%
Dividend income	3.5	2.9	-14.8%	3.5	2.9	-14.8%
Gains on non-trading investments, net	27.0	0.6	-97.8%	31.1	21.4	-31.1%
Other operating income	0.8	1.2	42.7%	0.9	1.5	76.8%
Total non-commission income	**538.0**	**541.0**	**0.6%**	**795.3**	**1,347.0**	**69.4%**
Total operating income	**1,002.0**	**1,170.2**	**16.8%**	**1,688.4**	**2,543.3**	**50.6%**
Salaries & employee related expenses	(165.2)	(192.5)	16.6%	(313.7)	(412.7)	31.6%
Rent & premises related expenses	(11.2)	(15.4)	36.6%	(21.8)	(26.7)	22.6%
Depreciation and amortization	(16.8)	(24.4)	44.7%	(33.7)	(47.0)	39.3%
Other G & A expenses	(64.6)	(114.9)	77.8%	(119.0)	(245.9)	106.5%
Other operating expenses	(0.1)	(0.1)	60.0%	(0.1)	(1.9)	1413.7%
Total operating expenses	**(257.9)**	**(347.3)**	**34.7%**	**(488.4)**	**(734.2)**	**50.3%**
Net income	**744.1**	**822.9**	**10.6%**	**1,200.0**	**1,809.1**	**50.8%**

*Source: Company Report, **Global** Research*

- SABB's net income increased from SR744.1mn in 2Q2005 to SR822.9mn in 2Q2006, a growth of 10.6%. Net commission income increased from SR496.9mn in 2Q2005 to SR665.9mn in 2Q2006, registering a growth of 34.0%.

- Non-commission income, increased from SR538.0mn in 2Q2005 to SR541.0mn in 2Q2006, a growth of just 0.6%. Fees from banking services, increased from SR450.6mn in the second quarter of 2005 to SR484.8mn in the 2Q2006, a growth of 7.6%.

- Broking income has been the key contributor to fee income, and we believe 1Q2006 had been an exceptional quarter in terms of contribution to fee income. Going forward, we expect a higher contribution coming in from investment banking activities.

- Operating cost increased by 34.7% from SR257.9mn in 2Q2005 to SR347.3mn in 2Q2006. Depreciation and other general and administrative expenses increased by 44.7% and 77.8% respectively. Hence, the cost to income ratio increased from 24.9% in 2Q2005 to 28.8% in 2Q2006.

Chart 8: Net Commission Income

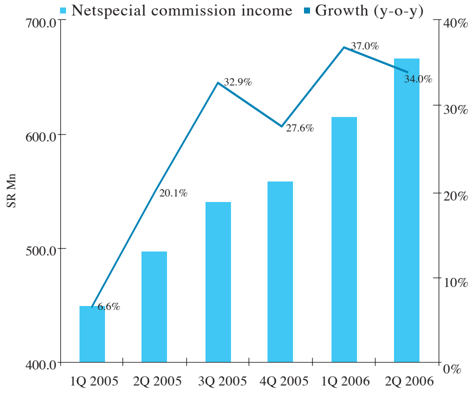
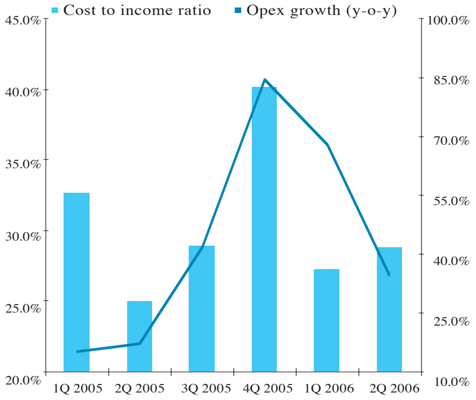


Chart 9: Operating Expenses



*Source: Company Report, **Global** Research*

Outlook:

- According to the management, the outlook for the Saudi Banking sector is strong. On the lending side, the big ticket projects that are in the pipeline are likely to boost the loan book of banks. Given the size of these projects, the Saudi banking sector looks under-banked.
- Another key thrust area for credit growth is the SME segment, which is likely to give further fillip to the economic development of the Kingdom. The changing demographics is likely to result in a lot of SME sector deployment.
- In order to shore up fee income the bank is focusing on corporate advisory, IPO financing, loan syndication, portfolio management services, etc. Currently the bank has more than 1000 direct sales agents. Increasing the direct sales workforce and emphasizing on marketing is likely to increase cross sell ratio, in turn helping the bank to boost its fee income.
- The bank is looking at regional expansion and intends to add another 9 branches by the end of this year. No overseas expansion is on the anvil. The growth in the number of ATMs is likely to be around 10 to 15%. As at end 2005, the bank had a network of 68 branches and 258 ATMs.
- The bank's thrust towards branch expansion and other alternative delivery channels is likely to help the bank increase its deposits franchise. A stable deposit franchise will support strong growth in loan book both from the corporate as well as the retail segment. The portion of non-interest bearing liabilities as at end 2005 stood at around SR20bn. The bank has the only variable floating Islamic lease product in the market.

Valuation:

Based on the current market price of SR167.25, the stock is trading at a 16.7x 2005 earnings and 5.8x 2005 book value. On a one year forward basis, the stock is trading at 19.9x 2006E earnings and 7.4x 2006E book value. The estimated fair value works out to SR169.2 based on DDM and peer group valuation method, which is higher by 1.2%. Hence, we reiterate our earlier rating and recommend a **HOLD** on the stock.

BALANCE SHEET

	The Saudi British Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Assets							
Cash & balances with SAMA	2,356.0	2,242.7	3,029.3	3,977.2	4,563.8	4,926.6	5,020.3
Due from banks and other FI's	338.5	8,186.2	4,234.3	5,716.3	7,262.1	8,424.1	10,108.9
Investments, net	15,971.2	14,676.0	16,372.6	15,553.9	15,865.0	16,591.6	17,919.0
Loans & advances, net	26,116.6	31,627.1	40,846.6	46,735.4	54,093.6	64,135.3	73,426.7
Fixed assets, net	547.9	565.1	527.7	552.4	565.9	584.0	615.5
Other assets	731.3	640.8	917.4	1,238.5	1,511.0	1,752.7	1,963.1
Total assets	**46,061.6**	**57,937.8**	**65,927.9**	**73,773.8**	**83,861.4**	**96,414.3**	**109,053.4**
Liabilities & Shareholders' Equity							
Liabilities							
Due to banks and other financial institutions	3,420.2	5,663.3	4,049.6	3,239.7	2,915.7	3,149.0	3,463.9
Customer deposits	36,089.9	44,665.8	48,534.1	56,299.5	65,307.5	75,756.6	86,362.6
Debt securities in issue	-	-	2,246.9	2,246.9	2,246.9	2,246.9	2,246.9
Borrowings	-	-	187.5	187.5	187.5	187.5	187.5
Other liabilities	1,805.3	2,210.8	3,703.6	3,333.3	3,499.9	3,919.9	4,233.5
Total liabilities	**41,315.4**	**52,539.9**	**58,721.8**	**65,306.9**	**74,157.6**	**85,260.0**	**96,494.4**
Shareholders' Equity							
Share capital	2,000.0	2,500.0	2,500.0	3,750.0	3,750.0	3,750.0	3,750.0
Statutory reserve	2,000.0	2,409.0	2,500.0	3,750.0	3,750.0	3,750.0	3,750.0
Other reserves	176.8	185.9	302.8	460.4	647.2	870.7	1,140.8
Retained Earnings	569.4	303.0	1,903.3	506.5	1,556.6	2,783.6	3,918.2
Total Shareholders' Equity	**4,746.2**	**5,397.9**	**7,206.2**	**8,466.9**	**9,703.8**	**11,154.3**	**12,559.0**
Total Liabilities & Shareholders' Equity	**46,061.6**	**57,937.8**	**65,927.9**	**73,773.8**	**83,861.4**	**96,414.3**	**109,053.4**

INCOME STATEMENT

	The Saudi British Bank						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Speical commission income	2,066.8	2,146.4	3,241.9	4,045.4	4,657.5	5,485.9	6,439.0
Special commission expense	(462.4)	(466.6)	(1,196.9)	(1,678.9)	(1,956.1)	(2,304.1)	(2,704.4)
Net special commission income	**1,604.4**	**1,679.8**	**2,045.0**	**2,366.6**	**2,701.3**	**3,181.8**	**3,734.6**
Provision for loan losses	(99.3)	(60.6)	(107.8)	(170.2)	(208.5)	(250.8)	(261.5)
Net special commission income after PLL's	**1,505.1**	**1,619.2**	**1,937.3**	**2,196.3**	**2,492.9**	**2,931.0**	**3,473.1**
Fees from banking services, net	377.0	674.3	1,531.5	2,067.6	2,543.1	3,051.8	3,662.1
Exchange income, net	86.1	125.3	178.3	210.4	244.1	278.3	306.1
(Loss) / income from FVIS Financial Instruments	-	10.0	(12.4)	-	-	-	-
Trading income, net	0.2	10.3	22.6	18.1	16.3	15.0	14.2
Dividend income	2.2	2.5	5.6	5.8	5.9	6.1	6.3
Gains on non-trading investments, net	70.6	64.0	36.3	32.6	33.3	34.9	37.7
Other operating income	1.8	9.0	1.1	1.6	1.9	2.2	2.5
Total non-commission income	**537.9**	**895.4**	**1,763.0**	**2,336.1**	**2,844.6**	**3,388.2**	**4,028.9**
Total operating income	**2,043.1**	**2,514.5**	**3,700.3**	**4,532.4**	**5,337.5**	**6,319.2**	**7,502.1**
Salaries & employee related expenses	(514.5)	(542.3)	(716.0)	(816.3)	(906.1)	(1,014.8)	(1,116.3)
Rent & premises related expenses	(46.3)	(45.7)	(50.5)	(55.1)	(59.2)	(63.9)	(69.1)
Depreciation and amortization	(64.5)	(65.5)	(121.8)	(80.3)	(100.6)	(101.9)	(110.3)
Other G & A expenses	(152.1)	(202.7)	(319.3)	(427.9)	(534.9)	(668.6)	(802.3)
Impairment of other financial assets, net	(3.6)	-	-	-	-	-	-
Other operating expenses	(4.3)	(2.4)	(0.6)	(0.9)	(1.1)	(1.3)	(1.5)
Total operating expenses	**(785.2)**	**(858.6)**	**(1,208.3)**	**(1,380.5)**	**(1,601.8)**	**(1,850.5)**	**(2,099.4)**
Net income	**1,257.9**	**1,655.9**	**2,492.0**	**3,151.9**	**3,735.6**	**4,468.7**	**5,402.7**
Appropriation:							
Beginning retained earnings	156.7	569.4	303.0	1,903.3	506.5	1,556.6	2,783.6
Net income	1,257.9	1,645.9	2,504.3	3,151.9	3,735.6	4,468.7	5,402.7
Adjustments:							
Bonus share issue	-	(500.0)	-	(1,250.0)	-	-	-
Adj. arising from application of revised 2b	-	(13.3)	-	-	-	-	-
Transfer to statutory reserve	-	(409.0)	(91.0)	(1,250.0)	-	-	-
Gross dividends	(832.0)	(990.0)	(813.0)	(1,891.1)	(2,498.7)	(3,018.2)	(3,998.0)
Net change in fair value	(13.2)	-	-	-	-	-	-
Ending balance	**569.4**	**303.0**	**1,903.3**	**506.5**	**1,556.6**	**2,783.6**	**3,918.2**

CASH FLOW STATEMENT

	The Saudi British Bank						
SR mn	2003	2004	2005	2006F	2007F	2008F	2009F
Net income	**1,257.9**	**1,645.9**	**2,504.3**	**3,151.9**	**3,735.6**	**4,468.7**	**5,402.7**
Amortization of premiums	10.9	6.6	5.3	5.4	5.5	5.6	5.8
Gains on investments, net	(70.6)	(64.0)	(36.3)	(32.6)	(33.3)	(34.9)	(37.7)
Loss / (Gain) from FVIS financial instruments	-	(10.0)	12.4	(2.5)	(2.5)	2.1	2.4
Depreciation and amotization	64.5	65.5	121.8	80.3	100.6	101.9	110.3
Loss / gain on disposal of fixed assets	4.0	(6.2)	(0.0)	-	-	-	-
Provision for loan losses	99.3	60.6	107.8	170.2	208.5	250.8	261.5
Impairment of other financial assets	3.6	-	-	-	-	-	-
Change in fair value	-	(30.3)	10.0	-	-	-	-
	1,369.5	1,668.1	2,725.3	3,372.8	4,014.4	4,794.2	5,744.8
Net (increase) decrease in operating assets:							
Statutory deposits with SAMA	(32.5)	(371.2)	(217.7)	(612.3)	(398.8)	(230.9)	135.6
Investments held for trading	-	-	(270.1)	-	-	-	-
Loans and advances	(5,856.7)	(5,555.6)	(9,359.2)	(6,059.1)	(7,566.7)	(10,292.5)	(9,552.9)
Other assets	(16.5)	86.7	(153.6)	(321.1)	(272.5)	(241.8)	(210.3)
Net increase (decrease) in operating liabilities:							
Due to banks and FI's	(1,260.4)	2,243.1	(1,613.7)	(809.9)	(324.0)	233.3	314.9
Customers deposits	1,109.8	8,576.8	3,867.6	7,765.5	9,007.9	10,449.2	10,605.9
Other liabilities	(606.0)	319.4	1,535.8	(370.4)	166.7	420.0	313.6
Net cash (used in) from operating activities	**(5,292.8)**	**6,967.3**	**(3,485.6)**	**2,965.4**	**4,627.1**	**5,131.5**	**7,351.5**
	-	-	-	-	-	-	-
Net sale /purchase of investments	4,521.8	1,372.0	(1,212.1)	848.3	(280.8)	(699.5)	(1,297.7)
Capex	(71.7)	(76.2)	(84.4)	(105.1)	(114.0)	(120.0)	(141.8)
Net cash from investing activities	**4,450.1**	**1,295.8**	**(1,296.6)**	**743.3**	**(394.8)**	**(819.5)**	**(1,439.5)**
Debt securities in issue	-	-	2,246.9	-	-	-	-
Borrowings	-	-	187.5	-	-	-	-
Dividends paid	(703.4)	(900.0)	(1,035.2)	(1,891.1)	(2,498.7)	(3,018.2)	(3,998.0)
Net cash used in financing activities	**(703.4)**	**(900.0)**	**1,399.2**	**(1,891.1)**	**(2,498.7)**	**(3,018.2)**	**(3,998.0)**
	-	-	-	-	-	-	-
Change in cash	**(1,546.1)**	**7,363.2**	**(3,382.9)**	**1,817.6**	**1,733.5**	**1,293.8**	**1,914.1**
Beginning cash	2,953.9	1,407.8	8,771.0	5,388.1	7,205.7	8,939.2	10,233.0
Ending cash	**1,407.8**	**8,771.0**	**5,388.1**	**7,205.7**	**8,939.2**	**10,233.0**	**12,147.1**

RATIOS

	The Saudi British Bank						
	2003	2004	2005	2006F	2007F	2008F	2009F
Profitability							
- Return on average assets	2.7%	3.2%	4.0%	4.5%	4.7%	5.0%	5.3%
- Return on average equity	27.9%	32.4%	39.7%	40.2%	41.1%	42.8%	45.6%
- Net special commission income after PLL’s/ Total op. income	73.7%	64.7%	52.2%	48.5%	46.7%	46.4%	46.3%
- Non-commission income/ Total op. income	26.3%	35.3%	47.8%	51.5%	53.3%	53.6%	53.7%
- Non-commission expense/ Total op. income	38.4%	34.3%	32.5%	30.5%	30.0%	29.3%	28.0%
- Fees from banking services/ Total op. income	18.5%	26.9%	41.3%	45.6%	47.6%	48.3%	48.8%
Margins							
- Net (or profit) margin	61.6%	65.7%	67.5%	69.5%	70.0%	70.7%	72.0%
- Special commission expense/ Special commission income	22.4%	21.7%	36.9%	41.5%	42.0%	42.0%	42.0%
- Yield on average earning assets	4.8%	4.4%	5.6%	6.2%	6.4%	6.5%	6.7%
- Cost rate on average commission bearing liabilities	1.2%	1.0%	2.3%	2.9%	2.9%	3.0%	3.1%
- Spread	3.7%	3.3%	3.3%	3.3%	3.4%	3.5%	3.6%
- Commission margin (earning assets)	3.8%	3.4%	3.5%	3.6%	3.7%	3.8%	3.9%
Efficiency							
- Cost/ Total op. income	38.4%	34.3%	32.5%	30.5%	30.0%	29.3%	28.0%
- Staff expenses/ Total op. income	25.2%	21.7%	19.3%	18.0%	17.0%	16.1%	14.9%
- Rent, G&A expenses/ Total op. income	9.7%	9.9%	10.0%	10.7%	11.1%	11.6%	11.6%
- Non-commission expense/ Average total assets	1.7%	1.7%	2.0%	2.0%	2.0%	2.1%	2.0%
Liquidity							
- Gross performing loans / Commission earning assets	62.2%	58.5%	66.8%	69.1%	70.4%	72.3%	72.8%
- Gross Loans/ Customer Deposits	74.1%	71.9%	85.0%	84.0%	84.0%	86.0%	86.5%
- Customer Deposits/ Equity	760.4%	827.5%	673.5%	664.9%	673.0%	679.2%	687.7%
- Customer Deposits/ Total assets	78.4%	77.1%	73.6%	76.3%	77.9%	78.6%	79.2%
Credit Quality							
- Provisions /Total op. income	4.9%	2.4%	2.9%	3.8%	3.9%	4.0%	3.5%
- Provisions /Average loans	0.4%	0.2%	0.3%	0.4%	0.4%	0.4%	0.4%
- Non Performing Loans (SR’000)	441,703	365,572	198,621	264,833	340,121	436,510	522,925
- Provision for loan losses (SR’000)	609,311	496,269	385,920	556,170	764,631	1,015,461	1,276,924
- NPL’s /Gross Loans	1.7%	1.1%	0.5%	0.6%	0.6%	0.7%	0.7%
- NPL’s /(Equity+provision for loan losses)	8.2%	6.2%	2.6%	2.9%	3.2%	3.6%	3.8%
- PLL’s / Gross Loans	2.3%	1.5%	0.9%	1.2%	1.4%	1.6%	1.7%
- NPL Coverage	137.9%	135.8%	194.3%	210.0%	224.8%	232.6%	244.2%

RATIOS - Continued

	The Saudi British Bank						
	2003	2004	2005	2006F	2007F	2008F	2009F
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	10.3%	9.3%	10.9%	11.5%	11.6%	11.6%	11.5%
- Equity/ Gross Loans	17.8%	16.8%	17.5%	17.9%	17.7%	17.1%	16.8%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	73.7%	64.7%	52.2%	48.5%	46.7%	46.4%	46.3%
- Fees from banking services/ Total op. income	18.5%	26.9%	41.3%	45.6%	47.6%	48.3%	48.8%
- Investment Income/ Total op. income	3.6%	3.1%	1.7%	1.2%	1.0%	0.9%	0.8%
- FX Income/ Total op. income	4.2%	5.0%	4.8%	4.6%	4.6%	4.4%	4.1%
- Other Income/ Total op. income	0.1%	0.4%	0.0%	0.0%	0.0%	0.0%	0.0%
- PLL's/ Total op. income	4.9%	2.4%	2.9%	3.8%	3.9%	4.0%	3.5%
Operating Performance							
- Change in special commission income	3.1%	3.8%	51.0%	24.8%	15.1%	17.8%	17.4%
- Change in Fees from banking services	33.7%	78.9%	127.1%	35.0%	23.0%	20.0%	20.0%
- Change in Investment Income	72.9%	5.0%	-16.1%	-12.4%	-1.8%	1.0%	4.0%
- Change in Fx Income	25.1%	45.5%	42.4%	18.0%	16.0%	14.0%	10.0%
- Change in Other Income	-23.2%	405.7%	-88.2%	50.0%	18.0%	16.0%	14.0%
RATIO'S USED FOR VALUATION							
- Par value per share (SR)	50	50	50	10	10	10	10
- Shares in issue (000's)	40,000.0	50,000.0	50,000.0	375,000.0	375,000.0	375,000.0	375,000.0
- EPS (SR)	31.4	32.9	50.1	-	-	-	-
- EPS (SR) - Adjusted for Split	6.3	6.6	10.0	8.4	10.0	11.9	14.4
- DPS (SR)	20.0	19.3	15.5	-	-	-	-
- DPS (SR) - Adjusted for Split	4.0	3.9	3.1	4.8	6.3	7.6	9.1
- Book value per share (SR)	118.7	108.0	144.1	-	-	-	-
- Book value per share (SR) - Adjusted for Split	23.7	21.6	28.8	22.6	25.9	29.7	34.5
- Market price year end (SR) *	505.0	805.0	1,650.0	-	-	-	-
- Market price year end (SR) - Adjusted for Split *	101.0	161.0	330.0	167.3	167.3	167.3	167.3
- Market Cap. (SR mn)	20,200.0	40,250.0	82,500.0	62,718.8	62,718.8	62,718.8	62,718.8
- P/E	16.1	24.5	32.9	19.9	16.8	14.0	11.6
- P/BV	4.3	7.5	11.4	7.4	6.5	5.6	4.8

** Market Price of 2006 and subsequent years as on August 30, 2006*

The Saudi Investment Bank

Reuters Code:
1030.SE

August 30, 2006

Buy

Listing:
Saudi Stock Exchange

CMP:
SR113.25

Key Data

EPS (SR)*	9.2
BVPS (SR)*	26.8
P / E (x)	12.3
P / BV (x)	4.2
Avg. daily vol.('000)	201.3
52 week Lo / Hi	98.0/161.4
Market Cap (SR mn)	27,250.8
Target Price (SR)	129.1

*Source: **Global** Research*
** Projected (2006)*

Background

- **The Saudi Investment Bank (SAIB)** was established on June 23, 1976 and began operations in March 1977. Its earlier objective was to provide medium to long term financing for industrial projects but in 1984, it approached Saudi Arabian Monetary Authority (SAMA) and was allowed to provide full-fledged conventional banking activities.

- SAIB is one of the smaller banks in Saudi Arabia in terms of total assets, having a market share of 5.5% of the total banking assets in 2005 (2004: 4.5%). SAIB has 5.2% (2004: 4.3%) market share in terms of the total banking deposits. The bank has traditionally focused on corporate banking activities but has changed its strategy in the last couple of years to concentrate more on retail banking and has therefore entered the retail banking business of credit cards, leasing and consumer lending. The bank has a small branch network of 16 branches in the Kingdom with 700 (2004: 569) employees in 2005.

Recent developments

- The Saudi Investment Bank (SAIB) floated a new “SAIB IPO Opportunities Fund” for underwriting. The fund was launched in September-2005 and its subscriptions exceeded the targeted US$100mn to reach US$226.7mn. The fund was designed to achieve growth in capital invested through the stock market and Gulf company’s stocks that are under establishment. In June-06, SAIB announced that the Fund achieved 47 percent profit by trading its stocks in three companies.

- In Feb-06, ALUMCO LLC - one of UAE’s largest manufacturers of aluminum facades signed an agreement with Global Investment House of Kuwait and Saudi Investment Bank which has acquired a significant equity investment in Alumco through its Opportunistic Fund.

- SAIB signed a joint loan contract for US$380mn with a group of international, regional and local banks. The loan was led by City Bank of America, Commerzbank of Germany, RZD Bank of Austria, Standard Chartered Bank and other banks, a consortium of 18 banks. Coverage of the loan reached more than 190 percent, which persuaded the bank to increase the amount from US$200mn to US$380mn.

Rating Reviews

- In June-06, Fitch Rating agency assigned SAIB (A-) for Long Term and (F2) for Short Term with a stable outlook. According to Fitch, the rating reflects SAIB's track record of performance, strong profitability, sound asset quality, comfortable liquidity, and satisfactory capitalization.

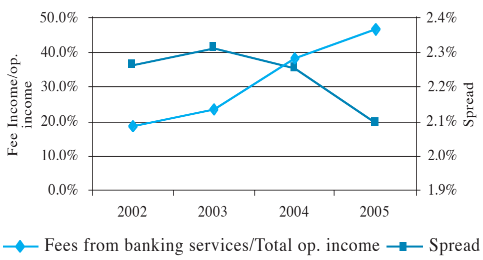
- In May-06, Standard & Poor's Ratings Services assigned its 'A-/A-2' long- and short-term counterparty credit ratings to SAIB. The outlook is stable. According to S&P, the ratings on SAIB reflected the bank's robust financial performance, good asset quality supported by a conservative strategy, satisfactory liquidity profile, and good capitalization. Offsetting these positive factors are the bank's limited customer franchise, smaller size, significant concentration risks, and limited geographic diversification. The long-term rating includes a one-notch uplift from the stand-alone rating for expected government support in case of distress. Saudi Arabia (A+/Stable/A-1), through public institutions, owns 38.4 percent of SAIB.

- In Nov-05, Moody's upgraded the long-term foreign currency deposit ratings for ten Saudi Arabian banks to A3 from Baa2. This rating action follows Moody's recent upgrade of Saudi Arabia's foreign currency country ceiling for bonds and bank deposits to A3 from Baa2. The outlooks for all deposit ratings are stable, in line with the outlook for the country ceiling. SAIB long-term foreign currency deposit rating was upgraded to A3 from Baa2. The Prime-2 short-term foreign currency deposit rating and the D+ financial strength rating remained unchanged.

Financial Performance – 2005

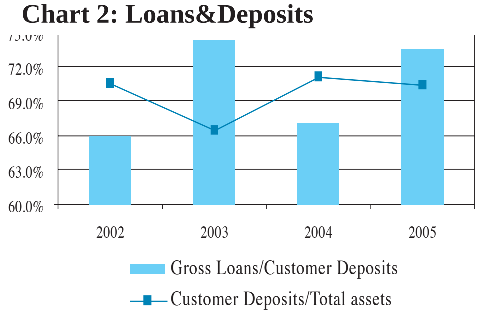
- SAIB, in its 2005 results, reported net profit of SR1.06bn, exceeding our expectations by 33% made in our last report (May-05). However, it reported net commission income of SR785.7mn in 2005, only 1.8% over our estimates made in the same report. The bank's assets at the end of 2005 reached SR39.6bn, exceeding our estimates of SR34.9bn.

Chart 1: Changing growth drivers



Source: Company Reports, ***Global*** *Research*

Chart 2: Loans&Deposits



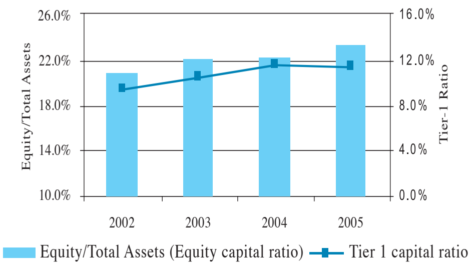
Source: Company Reports, ***Global*** *Research*

- SAIB assets reported a CAGR growth of 25.6% from SR19.9bn in 2002 to SR39.6bn reported in 2005. The bank reported a strong growth of 38.7% in total assets in 2005 over the previous year.

- The loans and advances (net) grew at a CAGR of 30.6% over 2002-05 reaching SR19.8bn at the end of 2005. Most of the loan growth in 2005 can be attributed to the strong rise in commercial loans, its key area, which grew from SR8.2bn in 2004 to SR12.3bn in 2005. In terms of economic sectors concentration in loan book, commerce continue to lead as it accounted for 32.8% of total loans as compared to 29.7% reported in the previous year.

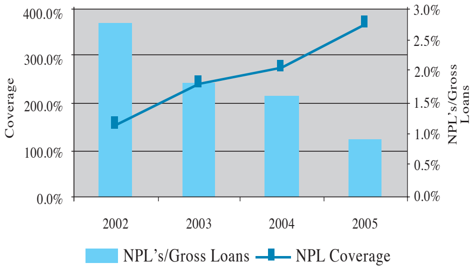
- The effect of small branch network can be seen in terms of lower proportion of consumer loans which constituted only 9.9% of the total loans in 2005. This had a direct effect on the historical spreads of the bank which is below the industry average as compared to its peers. Moreover, the spreads further declined in 2005 to 2.2% from 2.3% reported in the previous year.

Chart 3: Capital Adequaecy



*Source: Company Reports, **Global** Research*

Chart 4: Asset Quality



*Source: Company Reports, **Global** Research*

- SAIB's customer deposits grew at a strong CAGR of 25.6% over the period to reach SR27.8bn at the end of 2005. In terms of yearly growth the bank notched an impressive growth of 37.3% in 2005. However, most of the growth in 2005 came from the relatively expensive time deposits which grew from SR16.1bn in 2004 to SR19.1bn in 2005.

- In July-05, SAIB entered into a three-year syndicated term loan facility agreement for an amount of SR1.43bn. The facility has been fully utilized and is repayable in August 2008.

- The bank gave bonus shares of 13.75mn whereby the total number of issued and outstanding shares increased to 48.12mn and the share capital was increased from SR 1.7bn to SR2.41bn through a transfer from general reserve. With the split of the par value of the shares of the Saudi joint stock companies, the par value of the bank's shares was changed to SR10 instead of SR 50. Accordingly, the number of the Bank's issued and outstanding shares became 240.63mn.

- SAIB asset quality has been good historically, and the NPLs/Gross Loans further declined to 0.9% in 2005 from 1.6% registered in the previous year, indicating strong credit measure in the bank. The coverage ratio of 364% is among the highest in the Saudi banking sector in 2005.

- SAIB net profit increased by 81.3% in 2005 reaching SR1.06bn in 2005. The net special commission income of the bank increased by 33.7% to reachSR785.7mn in 2005. With the increase in depositors' base and rise in the interest rate the special commission expenses registered a whopping growth of 144% as compared to 78% growth in special commission income.

- However, SAIB has been able to leverage its strong potential in the fee-based income as it recorded a strong YoY growth of 95.7% reaching SR655.7mn in 2005 as compared to SR335mn reported in the previous year. The bank has been pretty strong in the brokerage business and the strong trading volumes registered in 2005 on Saudi stock exchange helped it to record a strong brokerage income. The bank has also widened its array of funds by launching new funds which added significantly to its fee income.

- ANB's operating expenses increased by 18.6% which was mainly due to 34% growth in the staff costs.

- SAIB is well capitalized and its Tier-1 ratio of 21.3% is among the highest in the Saudi banking sector.

Financial Performance – 1H-2006

- SAIB's asset size decreased by a marginal 1% as compared to the 2005 to reach SR39.2bn at the end of 1H-2006. However, in 2Q-06, the bank recorded a larger decline in assets, notching a negative growth of 6.2% on a sequential basis.

- Customer deposits have declined by 3.3% in 1H-2006 reaching SR26.95bn at the end of June-06. This is a cause of concern as most of the Saudi banks have seen strong increase in customer deposits as the investors have been shifting their investments from stock market to bank deposits. The decline in the net profit can be attributed to its smaller branch network which could not garner the incremental deposits emanating out of the investors selling their investments in the market.

- The situation is same in the case of loans and advances which reported decline of 2.2% on YTD basis in 1H-2006. However, we expect growth in 2H-2006 as the bank increases its thrust towards garnering customers deposits and deploying them in increasing its loan book.

Table 1: Key Financial Data - 1H-2006

Balance Sheet 'SR mn''	2Q2005	2005	1Q2006	2Q2006	Growth-YoY	Growth - QoQ	Growth - YTD
Investments	9,890.1	11,276.2	11,119.4	9,941.4	0.5%	-10.6%	-11.8%
Loans and advances	17,194.0	19,793.6	19,752.4	19,318.8	12.4%	-2.2%	-2.4%
Total Assets	**34,053.**	**39,580.7**	**41,780.8**	**39,172.1**	**15.0%**	**-6.2%**	**-1.0%**
Customer deposits	24,465.3	27,858.1	29,332.1	26,948.1	10.1%	-8.1%	-3.3%
Total Liabilities	29,552.5	34,274.0	36,159.3	33,521.8	13.4%	-7.3%	-2.2%
Total shareholders' equity	**4,500.4**	**5,306.7**	**5,621.5**	**5,650.3**	**25.6%**	**0.5%**	**6.5%**
Total Liabilities and Shareholders' Equity	**34,053.0**	**39,580.7**	**41,780.8**	**39,172.1**	**15.0%**	**-6.2%**	**-1.0%**

*Source: Company Reports, **Global** Research*

- SAIB reported net profit of SR1.38bn at the end of 1H-2006, up a whopping 181.09% compared to the corresponding period of the previous year. However, a point to note is that although the fee income increased by 79.6% in the 1H-06 over the corresponding period of last year, it has grown by a much lower 28.5% on YoY basis indicating a hit in the fee income due to the decrease capital market activities.

- SAIB registered a strong increase of SR667.2mn from gain of investments in 1H-2006 as it reduced its investments (especially Available for Sale) from SR11.28bn recorded at the end of 2005 to SR9.9bn at the end of 1H-2006.

Table 2: Key Financial Data - 1H-2006

Income Statement 'SR mn'	2Q2005	2Q2006	Growth QoQ	1H-2005	1H-2006	Growth
Special commission income	398.6	618.5	55.19%	736.3	1,253.1	70.18%
Special commission expense	(201.1)	(370.7)	84.36%	(367.5)	(780.5)	112.37%
Net special commission income	**197.5**	**247.9**	**25.49%**	**368.8**	**472.7**	**28.14%**
Fees from banking services	176.6	227.0	28.48%	274.4	492.9	79.64%
Gains on non-trading investments	0.4	500.3	111564.96%	23.6	667.2	2727.90%
Provisions for loan losses	(30.0)	(30.0)	0.00%	(50.0)	(70.0)	40.00%
Total operating income	**356.9**	**977.8**	**173.98%**	**639.8**	**1,607.5**	**151.25%**
Total operating expenses	**(77.5)**	**(139.5)**	**80.01%**	**(149.3)**	**(228.9)**	**53.27%**
Net Income	**279.4**	**838.3**	**200.05%**	**490.4**	**1,378.6**	**181.09%**

*Source: Company Reports, **Global** Research*

- SAIB's total operating expenses have grown by 53.3% reaching SR228.9mn in 1H-2006. General and administrative expenses recorded a strong increase of 97% in 1H-2005 reaching SR75.6mn.

Outlook

SAIB, which has traditionally been very active in the corporate banking business, is likely to take an active role in the major project finance deals as Saudi Arabia is gearing up towards setting up of new industrial projects to reduce its reliance on oil revenues. Due to the dominance of wholesale banking in its overall business, the bank has one of the lowest spreads in the sector. However we expect the spreads to improve from 2.4% in 2006 to 2.6% in 2008-09 as the bank enters more in the retail segment. The bank has been increasing its branch network and according to the reports, ten new branches have been constructed in the Central, Eastern and Western Regions and will be opened during the year.

SAIB recently launched "Aswaqnet", the bank's Internet local share trading service which is expected to enhance the interaction between the bank and its customers all over the Kingdom. However, the bank has been very active on the funds management. After the successful launch of the pre-IPO fund, SAIB launched two new capital-protected funds "Global Protection" and "Gulf Protection", which will bring the number of funds managed by the bank to 12 investment funds. We expect the proportion of fee income to its total operating to income exceed 50% in next couple of years. NPL coverage is expected to remain around 300% in medium term.

The bank is also likely to have a strong presence in the portfolio management services as it recently announced the formation of its investment portfolio management unit. According to its website, a new team with expertise in investment portfolio management from outside the bank joined SAIB to run the new unit. This will improve the bank's capacities to offer better investment services.

Valuation:

Based on the current market price of SR113.25 SAIB stock is trading at 18.3x of its 2005 earnings and 3.7x of its 2005 book value. On a one year forward basis, the stock is trading at 12.3x 2006F earnings and 4.2x 2006F book value. The bank has shown strong performance in its fee income and we expect it to show good growth, albeit at lower levels than the past as we expect its brokerage income growth to slowdown in the wake of reduced trading activity after the crash seen in the 1H-2006 in the Saudi markets. Based on the combination of DDM and Relative valuation method, we recommend a **BUY** on the stock with a price target of SR129.1, an upside of 14.0% from current levels.

BALANCE SHEET

	The Saudi Investment Bank						
SR mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Cash & Balances with SAMA	541.9	577.8	971.7	3,355.7	4,077.0	4,803.7	4,590.3
Due from Banks and other FIs	3,313.9	5,996.1	6,797.7	7,137.6	7,494.5	7,869.2	8,262.7
Non-trading Investments	7,260.6	8,501.7	11,276.2	10,193.1	10,702.8	11,153.6	11,625.3
Net Loans and Advances	10,231.6	13,031.1	19,793.6	21,742.8	23,853.0	25,613.0	27,461.9
Net Fixed Assets	97.9	144.8	204.6	244.2	272.6	283.5	295.4
Other Assets	262.4	292.1	536.8	939.4	1,080.4	1,134.4	1,191.1
Total Assets	**21,708.3**	**28,543.5**	**39,580.7**	**43,612.8**	**47,480.3**	**50,857.3**	**53,426.6**
Due to Banks and other FIs	4,086.1	3,971.0	3,990.7	4,070.5	4,151.9	4,235.0	4,319.7
Customers' Deposits	14,403.9	20,284.9	27,858.1	30,608.3	33,540.0	36,141.8	38,025.8
Other Liabilities	586.3	778.1	1,000.3	1,050.3	1,102.8	1,157.9	1,215.8
Term Loan	-	-	1,425.0	1,425.0	1,425.0	1,425.0	1,425.0
Total Liabilities	**19,076.4**	**25,034.1**	**34,274.0**	**37,154.0**	**40,219.7**	**42,959.7**	**44,986.3**
Share Capital	1,100.0	1,375.0	1,718.8	2,406.3	2,406.3	2,406.3	2,406.3
Statutory Reserve	1,037.0	1,184.0	1,450.0	2,003.9	2,406.3	2,406.3	2,406.3
General & Other Reserves	454.6	947.8	2,006.5	1,872.9	2,236.0	2,766.8	3,120.8
Retained Earnings	40.4	2.7	1.6	45.9	82.2	188.3	377.1
Proposed gross dividend	-	-	129.9	129.9	129.9	129.9	129.9
Total Shareholders' Equity	**2,632.0**	**3,509.4**	**5,306.7**	**6,458.8**	**7,260.6**	**7,897.6**	**8,440.4**
Total Liabilities and Shareholders' Equity	**21,708.3**	**28,543.5**	**39,580.7**	**43,612.8**	**47,480.3**	**50,857.3**	**53,426.6**

INCOME STATEMENT

	The Saudi Investment Bank						
SR Mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Special Commission Income	867.6	981.0	1,746.0	2,465.7	2,694.3	2,941.1	3,111.7
Special Commission Expense	(359.7)	(393.2)	(960.2)	(1,504.1)	(1,657.0)	(1,794.1)	(1,898.1)
Net Special Commission Income	**507.8**	**587.8**	**785.7**	**961.6**	**1,037.3**	**1,147.0**	**1,213.6**
Provision For Loan Losses	(81.0)	(130.0)	(100.0)	(158.9)	(185.6)	(146.1)	(160.4)
Net Special Commission Income After PLL's	**426.8**	**457.8**	**685.7**	**802.7**	**851.7**	**1,000.9**	**1,053.2**
Fees From Banking Services	163.3	335.0	655.7	1,081.9	1,352.4	1,555.3	1,788.6
Exchange Income	12.6	14.2	27.4	34.3	36.0	37.8	39.7
Dividend Income	11.4	16.4	21.8	38.1	41.9	46.1	50.7
Net Gains On Investments	87.2	59.9	25.4	735.2	73.5	77.2	81.1
Total Non-Commission Income	**274.4**	**425.5**	**730.3**	**1,889.5**	**1,503.8**	**1,716.4**	**1,960.0**
Total Operating Income	**701.2**	**883.4**	**1,416.0**	**2,692.2**	**2,355.5**	**2,717.3**	**3,013.2**
Salaries & Employee Related Expenses	(125.0)	(167.3)	(224.0)	(268.8)	(309.1)	(340.0)	(374.0)
Rent & Premises Related Expenses	(23.1)	(26.8)	(33.6)	(38.6)	(43.2)	(47.6)	(52.3)
Depreciation And Amortization	(13.6)	(17.5)	(23.9)	(28.7)	(33.0)	(36.2)	(39.9)
Other G & A Expenses	(75.7)	(84.7)	(70.3)	(140.6)	(154.7)	(170.2)	(187.2)
Total Operating Expenses	**(237.4)**	**(296.3)**	**(351.5)**	**(476.7)**	**(540.0)**	**(594.0)**	**(653.4)**
Net Income	**463.9**	**587.1**	**1,064.5**	**2,215.6**	**1,815.5**	**2,123.3**	**2,359.8**

Statement Of Retained Earnings	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Beginning Retained Earnings	**54.1**	**40.4**	**2.7**	**1.6**	**45.9**	**82.2**	**188.3**
Net Income	463.9	587.1	1,064.5	2,215.6	1,815.5	2,123.3	2,359.8
Transfer To Statutory Reserve	(116.0)	(147.0)	(266.0)	(553.9)	(402.4)	0.0	0.0
Transfer To Other Reserves	(275.0)	(343.8)	(668.5)	(553.9)	(363.1)	(530.8)	(354.0)
Gross Dividends	(76.3)	(97.4)	(129.9)	(1,063.5)	(1,013.7)	(1,486.3)	(1,817.0)
Net Change In Fair Value	(10.3)	(36.7)	(0.9)	0.0	0.0	0.0	0.0
Ending Balance	**40.4**	**2.7**	**1.9**	**45.9**	**82.2**	**188.3**	**377.1**

CASH FLOW STATEMENT

	The Saudi Investment Bank						
SR Mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Net Income	463.9	587.1	1,064.5	2,215.6	1,815.5	2,123.3	2,359.8
Accertion of Discounts	(62.2)	(98.0)	(160.5)	--	-	-	-
Gains on Investments	(87.2)	(59.9)	(25.4)	(735.2)	(73.5)	(77.2)	(81.1)
Depreciation And Amotization	13.6	17.5	23.9	28.7	33.0	36.2	39.9
Provision for Loan Losses	81.0	130.0	100.0	158.9	185.6	146.1	160.4
Due from Banks and other FIs	510.1	(2,682.2)	(801.7)	(339.9)	(356.9)	(374.7)	(393.5)
Loans And Advances	(1,421.8)	(2,929.5)	(6,862.5)	(2,108.1)	(2,295.8)	(1,906.0)	(2,009.4)
Other Assets	41.6	(29.7)	(244.7)	(402.6)	(140.9)	(54.0)	(56.7)
Due To Banks And FIs	1,161.8	(115.1)	19.7	79.8	81.4	83.0	84.7
Customers Deposits	338.9	5,881.0	7,573.1	2,750.2	2,931.7	2,601.8	1,884.0
Other Liabilities	(23.7)	170.8	319.5	50.0	52.5	55.1	57.9
CF From Operations	**1,015.9**	**872.0**	**1,006.0**	**1,697.3**	**2,232.6**	**2,633.7**	**2,046.0**
Net Sale /Purchase Of Investments	(573.1)	(695.4)	(1,855.7)	1,818.3	(436.1)	(373.6)	(390.6)
Capex	(35.5)	(64.4)	(83.7)	(68.2)	(61.4)	(47.1)	(51.8)
CF From Investing	**(608.5)**	**(759.8)**	**(1,939.4)**	**1,750.1**	**(497.5)**	**(420.7)**	**(442.4)**
Term Loan	-	-	1,425.0	-	--	-	-
Dividend And Zakat Paid	(273.7)	(76.3)	(97.4)	(1,063.5)	(1,013.7)	(1,486.3)	(1,817.0)
CF From Financing	**(273.7)**	**(76.3)**	**1,327.7**	**(1,063.5)**	**(1,013.7)**	**(1,486.3)**	**(1,817.0)**
Change In Cash	133.7	35.9	394.3	2,384.0	721.3	726.7	(213.4)
Beginning Cash	408.2	541.9	577.8	971.7	3,355.7	4,077.0	4,803.7
Ending Cash	**541.9**	**577.8**	**972.1**	**3,355.7**	**4,077.0**	**4,803.7**	**4,590.3**

RATIOS

	The Saudi Investment Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
Profitability							
- Return on average assets	2.2%	2.3%	3.1%	5.3%	4.0%	4.3%	4.5%
- Return on average equity	19.4%	19.1%	24.1%	37.7%	26.5%	28.0%	28.9%
- Net special commission income after PLL's/ Total op. income	60.9%	51.8%	48.4%	29.8%	36.2%	36.8%	35.0%
- Non-commission income/ Total op. income	39.1%	48.2%	51.6%	70.2%	63.8%	63.2%	65.0%
- Non-commission expense/ Total op. income	33.9%	33.5%	24.8%	17.7%	22.9%	21.9%	21.7%
- Fees from banking services/ Total op. income	23.3%	37.9%	46.3%	40.2%	57.4%	57.2%	59.4%
- Dividend payout ratio	16%	17%	12%	48%	56%	70%	77%
Margins							
- Net (or profit) margin	66.1%	66.5%	75.2%	82.3%	77.1%	78.1%	78.3%
- Special commission expense/ Special commission income	41.5%	40.1%	55.0%	61.0%	61.5%	61.0%	61.0%
- Yield on average earning assets	4.3%	4.1%	5.5%	6.7%	7.0%	7.1%	7.0%
- Cost rate on average commission bearing liabilities	2.0%	1.8%	3.3%	4.3%	4.4%	4.4%	4.4%
- Spread	2.3%	2.3%	2.2%	2.4%	2.5%	2.6%	2.6%
- Commission margin (earning assets)	2.5%	2.5%	2.5%	2.6%	2.7%	2.8%	2.7%
Efficiency							
- Cost/ Total op. income	33.9%	33.5%	24.8%	17.7%	22.9%	21.9%	21.7%
- Staff expenses/ Total op. Expenses	52.7%	56.5%	63.7%	56.4%	57.2%	57.2%	57.2%
- Rent, G&A expenses/ Total op. Expenses	41.6%	37.6%	29.6%	37.6%	36.7%	36.7%	36.7%
- Non-commission expense/ Average total assets	1.1%	1.2%	1.0%	1.1%	1.2%	1.2%	1.3%
Liquidity							
- Gross Loans / Commission earning assets	51.5%	50.1%	56.7%	60.7%	61.8%	62.4%	62.9%
- Gross Loans/ Customer Deposits	74.3%	67.2%	73.5%	73.8%	74.2%	74.1%	75.7%
- Customer Deposits/ Equity	547.3%	578.0%	525.0%	473.9%	461.9%	457.6%	450.5%
- Customer Deposits/ Total assets	66.4%	71.1%	70.4%	70.2%	70.6%	71.1%	71.2%
- Due from Banks/ Due to Banks	81.1%	151.0%	170.3%	175.3%	180.5%	185.8%	191.3%
Credit Quality							
- Provisions /Total op. income	11.6%	14.7%	7.1%	5.9%	7.9%	5.4%	5.3%
- Provisions /Average loans	0.8%	1.1%	0.6%	0.7%	0.8%	0.6%	0.6%
- Non Performing Loans (SR mn)	195.6	218.5	189.1	267.9	331.5	395.9	425.6
- Provision for loan losses (SR mn)	469.4	596.0	688.2	847.1	1,032.8	1,178.8	1,339.3
- NPLs /Gross Loans	1.8%	1.6%	0.9%	1.2%	1.3%	1.5%	1.5%

RATIOS - Continued

	The Saudi Investment Bank						
	2003	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
- NPLs /(Equity+provision for loan losses)	6.3%	5.3%	3.2%	3.7%	4.0%	4.4%	4.4%
- PLLs / Gross Loans	4.4%	4.4%	3.4%	3.8%	4.2%	4.4%	4.7%
- NPL Coverage	240.0%	272.8%	364.0%	316.3%	311.6%	297.7%	314.7%
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	12.1%	12.3%	13.4%	14.8%	15.3%	15.5%	15.8%
- Equity/ Gross Loans	24.6%	25.8%	25.9%	28.6%	29.2%	29.5%	29.3%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	60.9%	51.8%	48.4%	29.8%	36.2%	36.8%	35.0%
- Fees from banking services/ Total op. income	23.3%	37.9%	46.3%	40.2%	57.4%	57.2%	59.4%
- Investment Income/ Total op. income	14.1%	8.6%	3.3%	28.7%	4.9%	4.5%	4.4%
- FX Income/ Total op. income	1.8%	1.6%	1.9%	1.3%	1.5%	1.4%	1.3%
- Other Income/ Total op. income	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- PLL's/ Total op. income	11.6%	14.7%	7.1%	5.9%	7.9%	5.4%	5.3%
Operating Performance							
- Change in Special commission income	2.0%	13.1%	78.0%	41.2%	9.3%	9.2%	5.8%
- Change in Fees from banking services	61.6%	105.2%	95.7%	65.0%	25.0%	15.0%	15.0%
- Change in Investment Income	68.1%	-22.6%	-38.2%	1541.6%	-85.1%	6.8%	6.9%
- Change in Fx Income	57.7%	13.1%	93.0%	25.0%	5.0%	5.0%	5.0%
RATIO'S USED FOR VALUATION							
- Par value per share (SR)	50.0	50.0	50.0	10.0	10.0	10.0	10.0
- Shares in issue (mn)	22.0	27.5	34.4	240.6	240.6	240.6	240.6
- EPS (SR)	21.1	21.3	31.0	-	-	-	-
- EPS (SR) - Adjusted for Split	4.2	4.3	6.2	9.2	7.5	8.8	9.8
- DPS (SR)	3.0	3.5	3.8	-	-	-	-
- DPS (SR)- Adjusted for Split	0.6	0.7	0.8	4.4	4.2	6.2	7.6
- Book value per share (SR)	119.6	127.6	154.4	-	-	-	-
- Book value per share (SR)- Adjusted for Split	23.9	25.5	30.9	26.8	30.2	32.8	35.1
- Market price year end (SR) *	348.8	562.0	643.0	-	-	-	-
- Market price year end (SR)- Adjusted for Split *	69.8	112.4	128.6	113.3	113.3	113.3	113.3
- Market Cap. (SR'mn)	7,673	15,455	22,103	27,251	27,251	27,251	27,251
- P/E	16.5	26.3	20.8	12.3	15.0	12.8	11.5
- P/BV	2.9	4.4	4.2	4.2	3.8	3.5	3.2
- Dividends yield	0.9%	0.6%	0.6%	3.9%	3.7%	5.5%	6.7%

** Market price of 2006 and subsequent years as on August 30, 2006*

SAMBA Financial Group

Reuters Code:
1090.SE

Listing:
Saudi Stock Exchange

CMP:
SR156.0

August 30, 2006

Buy

Key Data

EPS (SR)*	9.4
BVPS (SR)*	21.8
P / E (x)	16.6
P / BV (x)	7.1
Avg. daily vol.('000)	513.2
52 week Lo / Hi	146.3/222.4
Market Cap (SR mn)	93,600.0
Target Price (SR)	187.0

*Source: **Global** Research*
** Projected (2006)*

Background

- **SAMBA Financial Group (SAMBA)** was established on 12 February, 1980 to take over the then existing Citibank branches in Riyadh and Jeddah which had established presence in Saudi Arabia since 1955. In 1999 SAMBA merged with United Saudi Bank (USB) to create one of the largest banks in the Middle East. Citibank had a 20% stake in the bank but in 2Q04 Citibank sold its entire stake to the government-owned Public Investment Fund. On October 31, 2003 the technical management contract between SAMBA & Citigroup ended and the management was transitioned to the local partner.

- SAMBA is one of the largest banks in the Middle East in terms of total assets, having a market share of 15% of the total banking assets in 2005 (2004: 15%). SAMBA had 15.9% market share in terms of the total banking deposits in 2005 (2004: 14.3%). The bank currently has 65 branches with 2,750 employees and more than 350 ATMs in the Kingdom and one branch in London.

- SAMBA is considered to be one of the biggest banking brands with strong customer loyalty. The bank plans to ride on this brand franchise to increase its market share for banking assets by aggressively marketing its product portfolio. The bank has been able to retain its #2 ranking in terms of asset size despite its relatively smaller branch network (65 branches) which is indicative of its successful marketing of its brand. Recently, Samba was named "Best Bank in Saudi Arabia" by pre-eminent international finance magazines, "Euromoney" & "The Banker".

Recent developments

- SABIC entered into agreement with BNP Paribas, Arab Banking Corporation ABC and SAMBA as financial advisers and lead arrangers for approximately US$4.8bn loan for Sabic affiliate, Saudi Kayan. Sabic also signed an agreement with Samba Financial Group appointing it as financial adviser and IPO manager for the Saudi Kayan Petrochemical Company's public subscription.

- SAMBA and Dar Al Arkan Real Estate Development Company signed a SR810mn Murabaha agreement. The Saudi real estate developer will use the funds to finance four out of five segments of its SR3bn Al Qasr real estate project in Riyadh.

- Saudi Formaldehyde Chemical Company plans to sell US$200mn of shares in an initial public offering, to build new plants to meet rising demand for chemicals in Saudi Arabia. SAMBA is advising the company on the sale of a 50 per cent stake.

- SAMBA signed an agreement with National Petrochemical Industrialization Company (NPIC) for a SR1.39bn loan to finance the establishment of NPIC's new subsidiary, Saudi Ethylene and Polyethylene Company. Under the deal, Samba will provide the Sharia-compliant funds to NPIC in two installments. The first amounting to SR1bn is a short-term Murabaha loan to finance NPIC's contribution to the capital of the new ethylene and polyethylene complex in Jubail Industrial City on the east coast of Saudi Arabia. The second installment totaling SR390mn is a five-year Murabaha loan.

- Arriyadh Development Co. (Ardco) is planning to increase its capital by SR1bn in an initial public offering (IPO). Ardco appointed SAMBA as the company's financial adviser and the IPO manager for the capital increase.

- SAMBA managed the IPO of Saudi Research & Marketing Group (SRMG) which was oversubscribed nearly four times. SRMG had offered 24 million shares for SR46 each with a total value of SR1.104 billion in the IPO, which was launched on April 8, 2006.

Rating Reviews

- In July-06, Samba's financial long-term foreign currency rating was upgraded to A+ by Capital Intelligence, with a short-term foreign currency rating of A1, financial strength rating of A+ and support of 2 are affirmed with a stable outlook. According to CI, factors supporting the upgrade are an increase in the capital base and the buoyant local economy. The recent correction in the Saudi stock market is unlikely to impact asset quality.

- In May-06, Standard & Poor's assigned its 'A' long-term senior unsecured debt rating to the U.S. dollar-denominated five-year floating-rate notes to be issued by Samba. At the same time, Standard & Poor's assigned its 'A/A-1' senior unsecured debt ratings to Samba's US$1.6bn EMTN program.

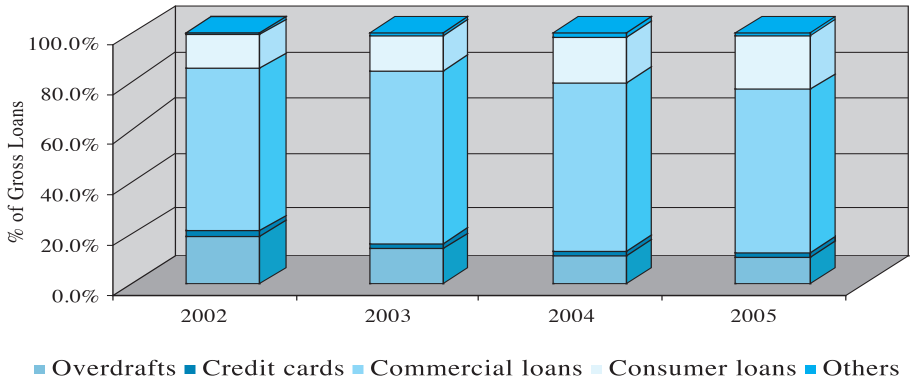
- In Sep-05, Fitch assigned SAMBA a long term 'A' rating and short term 'F1' rating with a 'Stable' outlook. According to Fitch, SAMBA's ratings reflected strong profitability, significant franchise, good asset quality, a low cost base and good liquidity.

Financial Performance – 2005

- SAMBA's net profit exceeded our expectation as it reached SR4.01bn in 2005, up 10.3% over our estimate of SR3.64bn made in our May-05 report. The bank's asset size recorded a negative deviation of only 3.2% from our estimates in the same report as they reached SR108.3bn as compared to our estimates of SR111.8bn.

- SAMBA's assets reported a CAGR growth of 12.4% from SR76.4bn in 2002 to SR108.3bn in 2005. The growth is lower than the peer group growth as the medium and smaller banks, on account of their reduced base size grew at a much faster rate in the same period as compared to the larger banks like SAMBA. However, the bank reported a strong yearly growth of 14.4% in 2005.

Chart 1: Loan Portfolio



Source: Global Research

- The loans and advances (net) grew at a CAGR of 22.1% over 2002-05 reaching SR62.4bn at the end of 2005. The strong thrust on the retail sector can be seen from strong CAGR growth of 44.4% in the same period reaching SR13.6bn at the end of 2005. Retail loan accounted for 21.7% of the loan book as compared to only 13.6% in 2002. However, commercial loans still constitutes the bulk of loans book with around 65.5% of the total loans in 2005. Loans and advances included Shariah approved non-interest based banking products in respect of Murabaha, Ijara and Tawarroq finance, amounting to SR20.7bn as compared to SR12.9bn in 2004 indicating strong thrust in its Islamic financing activities.

- One of the credible achievement of the bank has been the growth in customer deposits despite its smaller branch network as compared to its large-cap peer group. The bank registered a CAGR of 13.2% in customer deposits in 2002-05 and recorded a strong yearly growth of 27.1% in 2005 with customer deposits reaching SR85.2bn in 2005.

Table 1: Customer Deposits

	2002	2003	2004	2005
Demand	34.5%	37.7%	44.4%	39.1%
Saving	1.8%	1.9%	2.2%	1.8%
Time	58.1%	53.7%	46.2%	50.9%
Other	5.6%	6.7%	7.2%	8.2%

Source: SAMBA

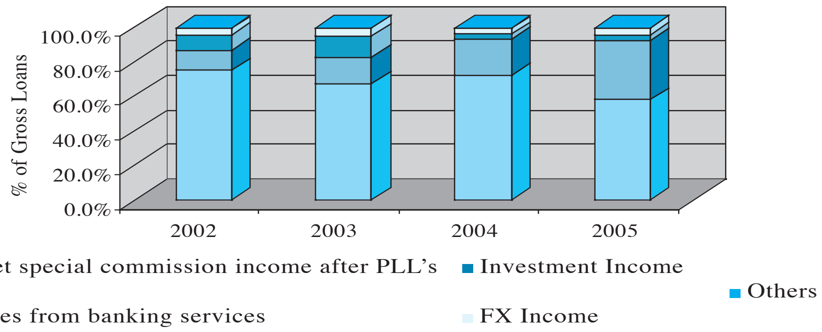
- The bank's time deposits registered a strong yearly growth of 40% as they reached SR 43.4bn at the end of 2005. The increase in the higher-cost time deposits can be seen in terms of decline in spread which declined from 3.7% in 2004 to 3.6% in 2005. Also the proportion of non-commission bearing deposits declined from 52% in 2004 to 47% in 2005 which had a effect on the declining spreads.

- SAMBA asset quality improved as the NPLs to Gross Loan ratio of the bank declined from 7.9% in 2002 to 3.4% in 2005. We expect this figure to reduce further in coming years. The coverage ratio too has improved to 124.4% in 2005 as compared to 102.9% reported in the previous year.

- In Dec- 2004, SAMBA entered into a five-year syndicate term loan facility agreement for US$600mn. The facility is repayable in 2009.

- SAMBA recorded a strong growth of 60.4% with net profit reaching SR4.02bn in 2005. The bank has recorded a whopping growth of 142.2% in its fee income as it dominates the internet brokerage, IPOs management and underwriting business. The over-the counter brokerage income too added to its bottom-line as the Saudi market saw record trading activity in 2005.

Chart 2: Changing growth drivers



Source: Global Research

- In terms of costs, the cost to total operating income registered a strong decline as it reached 25.7% in 2005 from 32.7% registered in the previous year. The revenue to expense ratio of 3.9 as compared to 3.1 last year indicates that the expenses have been controlled in comparison to the revenue growth.

- The 2005 Tier-1 capital adequacy ratio stood at 16.02 % which is well above the mandated norms, both domestic as well as international.

Financial Performance – 1H-2006

- SAMBA's asset size increased by a marginal 3.9% as compared to the 2005 to reach SR112.6bn at the end of 1H-2006. Also, in 1H-2006, the bank has only recorded a marginal YTD growth of 1.6% as the customer deposits reached SR86.6bn.

- SAMBA's loan book increased at a healthy rate of 6.2% (YTD) in 1H-2006 reaching SR66.3bn (on net basis). The bank has been realigning its investment portfolio which stood at SR34.2bn at the end of 1H-2006 as compared to SR36.4bn reported at the end of 2005.

Table 2: Key Financial Data - 1H-2006

Balance Sheet 'SR mn'	2Q2005	FY 2005	1Q2006	2Q2006	Growth- YoY	Growth - QoQ	Growth - YTD
Investments	39,177.5	36,356.8	35,592.4	34,187.2	-12.7%	-3.9%	-6.0%
Loans and advances	57,260.1	62,385.6	64,649.8	66,270.8	15.7%	2.5%	6.2%
Total Assets	**103,735.4**	**108,306.3**	**114,524.9**	**112,572.6**	**8.5%**	**-1.7%**	**3.9%**
Customer deposits	81,238.1	85,240.2	93,343.8	86,638.8	6.6%	-7.2%	1.6%
Total Liabilities	92,887.9	95,400.2	102,106.4	98,896.7	6.5%	-3.1%	3.7%
Total shareholders' equity	10,847.5	12,906.2	12,418.4	13,675.9	26.1%	10.1%	6.0%
Total Liabilities and Shareholders' Equity	**103,735.4**	**108,306.3**	**114,524.9**	**112,572.6**	**8.5%**	**-1.7%**	**3.9%**

*Source: **Global** Research*

- In 2Q-2006, SAMBA issued US$500mn of 5-year floating rate notes under its US$1.6bn EMTN program which carry a commission rate of LIBOR+30bps.

- SAMBA reported net profit of SR2.83bn at the end of 1H-2006, up 56.4% as compared to the corresponding period of the previous year. This was achieved on the back of strong growth in fee income which continued to register a strong y-o-y growth of 106.2%, reaching SR1.42bn in 1H-2006.

Table 3: Key Financial Data - 1H-2006

Income Statement 'SR mn'	1H-2005	1H-2006	Growth	2Q2005	2Q2006	Growth
Special commission income	2,465.3	3,395.8	37.7%	1,277.3	1,753.4	37.3%
Special commission expense	(746.1)	-1,317.8	76.6%	(406.5)	(689.8)	69.7%
Net special commission income	1,719.2	2,077.9	20.9%	870.8	1,063.6	22.1%
Fees from banking services	688.3	1,417.69	106.0%	445.1	680.5	52.9%
Gains on non-trading investments	99.9	44.89	-55.1%	72.5	36.1	-50.1%
Provisions for loan losses	(153.8)	(166.31)	8.1%	(95.6)	(70.6)	-26.2%
Total operating income	2,646.1	3,828.40	44.7%	1,436.0	1,906.3	32.8%
Total operating expenses	(682.5)	(832.33)	21.9%	(346.5)	(433.7)	25.2%
Net Income	1,809.8	2,829.75	56.4%	993.9	1,402.0	41.1%

*Source: **Global** Research*

- SAMBA's total operating expenses have grown at around 21.9% as compared to 1H-2005 reaching SR832.3mn in 1H-2006.

- SAMBA announced that it will pay SR1.07bn in cash dividends for the first half of 2006 which amounts to SR1.70 per share, after deducting zakat.

Outlook

SAMBA, one of the largest players in the surging Saudi banking industry, is well-positioned to take advantage of the increased banking business in the country. The bank has been able to maintain its market share and withstand competition from NCB and AlRajhi which have the advantage of a strong branch network. We believe that the bank is likely to show ROAE of excess of 40% in the medium term.

SAMBA has a significant chunk of non-commission bearing deposits which provides it with one of the highest spread among the conventional banks. However, we are seeing a decline in these lucrative deposits which could have an adverse effect on spread of the bank. However, the spreads are likely to be stable ranging from 3.6%-3.7% in the medium term. One of the concern is that the bank continues to have high level of NPLs, which are reducing.

We believe that SAMBA will be an active player in the burgeoning Saudi Arabian infrastructure and project finance industry which will diversify its fee income. We do not expect SAMBA to take a major hit on the fee income side as it has got a strong pipeline of IPO and underwriting business for the 2H-2006 as well as for the coming years. SAMBA Financial Group has been undertaking initiatives to increase its market share in key segments. It recently launched a co-branded Samba Sony Credit Card, the first of its kind in Saudi Arabia with the Japanese giant Sony Company.

Valuation:

Based on the current market price of SR156.0 SAMBA stock is trading at a 23.3x 2005 earnings and 8.4x 2005 book value. On a one year forward basis, the stock is trading at 16.6x 2006F earnings and 7.1x 2006F book value. Strong brand name, improved profitability and strong activity in project financing is likely to support premium valuations on the stock. The bank has been very strong in fee-based activity and has acted as the lead-manager in most of the high-profile IPOs including that have hit the Saudi market. Based on the combination of DDM and Relative valuation method, we recommend a **BUY** on the stock with a price target of SR187, an upside of 19.8% from current levels.

BALANCE SHEET

	SAMBA Financial Group						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Cash & Balances with SAMA	5,001.2	3,007.5	4,139.1	6,617.6	7,948.3	9,589.0	11,092.2
Due from Banks and other FIs	2,823.6	2,442.9	2,791.2	2,847.1	2,904.0	2,962.1	3,021.3
Trading Investments	847.3	1,625.7	2,263.8	2,225.1	2,558.9	2,814.8	3,096.3
Non-trading Investments	33,028.3	37,071.7	34,093.0	33,836.1	33,171.8	33,840.8	34,523.4
Net Loans and Advances	34,918.3	48,177.7	62,385.6	71,096.1	79,819.0	86,114.6	92,753.3
Net Fixed Assets	697.7	685.1	673.9	740.5	769.9	799.4	818.7
Other Assets	1,721.1	1,702.9	1,959.7	2,253.7	2,366.4	2,484.7	2,608.9
Total Assets	**79,037.6**	**94,713.5**	**108,306.3**	**119,616.1**	**129,538.2**	**138,605.3**	**147,914.0**
Due to Banks and other FIs	7,212.8	13,119.2	4,399.0	4,660.0	4,940.4	5,241.8	5,566.5
Customers' Deposits	60,410.8	67,044.7	85,240.2	91,911.2	99,082.9	105,224.8	111,569.1
Term Loan	0.0	2,250.0	2,250.0	2,250.0	2,250.0	2,250.0	2,250.0
Debt Securities	0.0	0.0	0.0	1,870.9	1,870.9	1,870.9	1,870.9
Other Liabilities	2,535.9	3,040.3	5,293.7	5,823.0	6,405.3	7,045.9	7,750.4
Total Liabilities	**70,159.5**	**85,454.2**	**97,182.8**	**106,515.2**	**114,549.5**	**121,633.4**	**129,007.0**
Share Capital	4,000.0	4,000.0	6,000.0	6,000.0	6,000.0	6,000.0	6,000.0
Statutory Reserve	4,001.9	4,000.0	4,254.6	5,663.0	6,008.2	6,008.2	6,008.2
Other Reserves	482.9	327.6	(14.5)	548.9	1,756.1	3,342.6	5,185.7
Retained Earnings	393.3	1,150.2	1,221.5	1,227.1	1,562.4	1,959.1	2,051.2
Employee Stock Option Shares	0.0	(218.5)	(338.1)	(338.1)	(338.1)	(338.1)	(338.1)
Total Shareholders' Equity	**8,878.1**	**9,259.3**	**11,123.5**	**13,100.9**	**14,988.7**	**16,971.8**	**18,907.1**
Total Liabilities and Shareholders' Equity	**79,037.6**	**94,713.5**	**108,306.3**	**119,616.1**	**129,538.2**	**138,605.3**	**147,914.0**

INCOME STATEMENT

	SAMBA Financial Group						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Special commission income	3,217.6	3,757.4	5,321.8	7,128.9	7,610.9	8,178.9	8,635.1
Special commission expense	(761.9)	(806.1)	(1,813.9)	(3,101.1)	(3,272.7)	(3,578.3)	(3,777.8)
Net special commission income	**2,455.7**	**2,951.3**	**3,507.9**	**4,027.8**	**4,338.2**	**4,600.6**	**4,857.2**
Provision for loan losses	(621.7)	(183.0)	(298.1)	(323.5)	(421.1)	(369.9)	(298.3)
Net special commission income after PLLs	**1,833.9**	**2,768.3**	**3,209.8**	**3,704.3**	**3,917.1**	**4,230.7**	**4,558.9**
Fees from banking services	408.6	780.3	1,890.0	3,024.1	4,082.5	5,103.1	6,123.8
Exchange income	125.6	142.3	216.2	227.0	238.4	250.3	262.8
Income from FVIS	0.0	10.8	52.0	100.0	105.0	110.3	115.8
Net trading income	54.9	59.5	91.2	136.7	157.2	173.0	190.3
Dividend income	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net gains on investments	285.0	34.1	44.1	100.9	105.9	111.2	116.8
Other operating income	6.8	17.5	10.4	9.9	10.4	10.9	11.5
Total non-commission income	**881.3**	**1,044.5**	**2,251.9**	**3,598.6**	**4,594.5**	**5,648.5**	**6,705.1**
Total operating income	**2,715.2**	**3,812.7**	**5,461.8**	**7,303.0**	**8,511.5**	**9,879.3**	**11,264.0**
Salaries & employee related expenses	(742.3)	(846.5)	(909.6)	(1,018.8)	(1,100.3)	(1,188.4)	(1,247.8)
Rent & premises related expenses	(101.1)	(119.0)	(124.8)	(137.3)	(144.1)	(151.4)	(158.9)
Depreciation and amortization	(87.8)	(94.5)	(94.6)	(101.9)	(109.6)	(119.9)	(130.6)
Other G & A expenses	(343.2)	(247.0)	(356.3)	(409.8)	(450.8)	(486.8)	(511.2)
Other operating expenses	(4.3)	0.0	(10.2)	(1.5)	(0.2)	(0.2)	(0.3)
Total operating expenses	**(1,278.6)**	**(1,307.0)**	**(1,495.5)**	**(1,669.3)**	**(1,805.0)**	**(1,946.7)**	**(2,048.7)**
Net Income	**1,436.6**	**2,505.7**	**4,018.3**	**5,633.7**	**6,706.5**	**7,932.6**	**9,215.3**

Statement of Retained Earnings	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Beginning retained earnings	**262.4**	**393.3**	**1,150.2**	**1,221.5**	**1,227.1**	**1,562.4**	**1,959.1**
Net income	1,436.6	2,505.7	4,018.3	5,633.7	6,706.5	7,932.6	9,215.3
Bonus share issue	0.0	0.0	(1,150.0)	0.0	0.0	0.0	0.0
transfer to statutory reserve	0.1	1.9	0.0	(1,408.4)	(345.3)	0.0	0.0
Transfer to other reserves	0.0	0.0	(1,004.6)	(563.4)	(1,207.2)	(1,586.5)	(1,843.1)
Gross dividends	(1,321.6)	(1,737.7)	(1,782.7)	(3,656.3)	(4,818.8)	(5,949.4)	(7,280.1)
Net change in fair value	15.9	1.2	(9.8)	0.0	0.0	0.0	0.0
Ending balance	**393.4**	**1,164.4**	**1,221.5**	**1,227.1**	**1,562.4**	**1,959.1**	**2,051.2**

CASH FLOW STATEMENT

	SAMBA Financial Group						
SR mn	**2003**	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
Net income	1,436.6	2,505.7	4,018.3	5,633.7	6,706.5	7,932.6	9,215.3
Accretion of discounts	102.8	115.3	66.5	-	-	-	-
Gains on investments	(285.0)	(34.1)	(44.1)	(100.9)	(105.9)	(111.2)	(116.8)
Depreciation and amortization	87.8	94.5	94.6	101.9	109.6	119.9	130.6
Loss/gain on disposal of fixed assets	(0.7)	(3.0)	(0.4)	-	-	-	-
Provision for loan losses	621.7	183.0	298.1	323.5	421.1	369.9	298.3
Due from banks and other FI's	1,299.1	380.7	(348.3)	(55.8)	(56.9)	(58.1)	(59.2)
Trading portfolio	(846.4)	264.0	96.7	38.7	(333.8)	(255.9)	(281.5)
Loans and advances	(1,308.4)	(13,442.4)	(14,506.0)	(9,034.0)	(9,144.1)	(6,665.5)	(6,937.0)
Other assets	(227.5)	(176.0)	(433.3)	(294.0)	(112.7)	(118.3)	(124.2)
Due to banks and FI's	1,404.9	5,906.4	(8,720.3)	261.1	280.3	301.4	324.7
Customers deposits	1,659.6	6,633.9	18,195.6	6,670.9	7,171.7	6,141.9	6,344.3
Other liabilities	62.3	149.5	1,346.8	529.4	582.3	640.5	704.6
CF from operations	**4,006.9**	**2,577.6**	**64.0**	**4,074.5**	**5,518.2**	**8,297.4**	**9,499.1**
Net sale /purchase of investments	(1,335.9)	(5,168.1)	2,145.6	357.8	770.3	(557.8)	(565.9)
Capex	(71.0)	(78.9)	(83.0)	(168.5)	(139.0)	(149.4)	(149.9)
CF from investing	**(1,407.0)**	**(5,265.0)**	**2,062.6**	**189.3**	**631.3**	**(707.2)**	**(715.8)**
Term Loan	-	2,250.0	--	-	-	-	-
Proceeds from Debt Securities	-	-	-	1,870.9	--	-	-
Employee Stock Option Shares	-	(179.7)	(119.6)	-	-	-	-
Dividend and zakat paid	(1,741.4)	(1,376.6)	(875.5)	(3,656.3)	(4,818.8)	(5,949.4)	(7,280.1)
CF from Financing	**(1,741.4)**	**693.7**	**(995.1)**	**(1,785.3)**	**(4,818.8)**	**(5,949.4)**	**(7,280.1)**
Change in cash	858.5	(1,993.7)	1,131.6	2,478.5	1,330.7	1,640.7	1,503.2
Beginning cash	4,142.8	5,001.2	3,007.5	4,139.1	6,617.6	7,948.3	9,589.0
Ending cash	**5,001.3**	**3,007.5**	**4,139.1**	**6,617.6**	**7,948.3**	**9,589.0**	**11,092.2**

RATIOS

	SAMBA Financial Group						
	2003	2004	2005	2006F	2007F	2008F	2009F
Profitability							
- Return on average assets	1.8%	2.9%	4.0%	4.9%	5.4%	5.9%	6.4%
- Return on average equity	16.2%	27.6%	39.4%	46.5%	47.8%	49.6%	51.4%
- Net special commission income after PLL's/ Total op. income	67.5%	72.6%	58.8%	50.7%	46.0%	42.8%	40.5%
- Non-commission income/ Total op. income	32.5%	27.4%	41.2%	49.3%	54.0%	57.2%	59.5%
- Non-commission expense/ Total op. income	47.1%	34.3%	27.4%	22.9%	21.2%	19.7%	18.2%
- Fees from banking services/ Total op. income	15.0%	20.5%	34.6%	41.4%	48.0%	51.7%	54.4%
- Dividend payout ratio	92.0%	69.3%	44.4%	64.9%	71.9%	75.0%	79.0%
Margins							
- Net (or profit) margin	52.9%	65.7%	73.6%	77.1%	78.8%	80.3%	81.8%
- Special commission expense/ Special commission income	23.7%	21.5%	34.1%	43.5%	43.0%	43.8%	43.8%
- Yield on average earning assets	4.6%	4.7%	5.7%	6.8%	6.7%	6.8%	6.7%
- Cost rate on average commission bearing liabilities	1.2%	1.1%	2.1%	3.2%	3.0%	3.1%	3.1%
- Spread	3.4%	3.7%	3.6%	3.6%	3.7%	3.7%	3.6%
- Commission margin (earning assets)	3.5%	3.4%	3.5%	3.7%	3.7%	3.7%	3.7%
Efficiency							
- Staff expenses/ Total Op. Expenses	58.1%	64.8%	60.8%	61.0%	61.0%	61.0%	60.9%
- Rent, G&A expenses/ Total Op. Expenses	34.7%	28.0%	32.2%	32.8%	33.0%	32.8%	32.7%
- Non-commission expense/ Average total assets	1.6%	1.5%	1.5%	1.5%	1.4%	1.5%	1.4%
Liquidity							
- Loans / Commission earning assets	52.6%	57.9%	64.9%	67.9%	71.0%	72.2%	73.5%
- Loans/ Customer Deposits	61.9%	75.7%	76.4%	80.7%	84.1%	85.5%	86.9%
- Customer Deposits/ Equity	680.4%	724.1%	766.3%	701.6%	661.1%	620.0%	590.1%
- Customer Deposits/ Total assets	76.4%	70.8%	78.7%	76.8%	76.5%	75.9%	75.4%
- Due from Banks/ Due to Banks	39.1%	18.6%	63.5%	61.1%	58.8%	56.5%	54.3%
Credit Quality							
- Provisions /Total op. income	22.9%	4.8%	5.5%	4.4%	4.9%	3.7%	2.6%
- Provisions /Average loans	1.7%	0.4%	0.5%	0.5%	0.5%	0.4%	0.3%
- Non Performing Loans (SR mn)	2,701.0	2,502.0	2,214	1,809	2,269	2,451	2,823
- Provision for loan losses (SR mn)	2,453.4	2,573.6	2,755	3,078	3,499	3,869	4,168
- NPL's /Gross Loans	7.2%	4.9%	3.4%	2.4%	2.7%	2.7%	2.9%
- NPL's /(Equity+provision for loan losses)	23.8%	21.1%	16.0%	11.2%	12.3%	11.8%	12.2%

RATIOS - Continued

	SAMBA Financial Group						
	2003	**2004**	**2005**	**2006F**	**2007F**	**2008F**	**2009F**
- PLL's / Gross Loans	6.6%	5.1%	4.2%	4.2%	4.2%	4.3%	4.3%
- NPL Coverage	90.8%	102.9%	124.4%	170.2%	154.2%	157.9%	147.6%
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	11.2%	9.8%	10.3%	11.0%	11.6%	12.2%	12.8%
- Equity/ Gross Loans	23.8%	18.2%	17.1%	17.7%	18.0%	18.9%	19.5%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	67.5%	72.6%	58.8%	50.7%	46.0%	42.8%	40.5%
- Fees from banking services/ Total op. income	15.0%	20.5%	34.6%	41.4%	48.0%	51.7%	54.4%
- Investment Income/ Total op. income	12.5%	2.5%	2.5%	3.3%	3.1%	2.9%	2.7%
- FX Income/ Total op. income	4.6%	3.7%	4.0%	3.1%	2.8%	2.5%	2.3%
- Other Income/ Total op. income	0.3%	0.5%	0.2%	0.1%	0.1%	0.1%	0.1%
- PLL's/ Total op. income	22.9%	4.8%	5.5%	4.4%	4.9%	3.7%	2.6%
Operating Performance							
- Change in special commission income	-7.2%	16.8%	41.6%	34.0%	6.8%	7.5%	5.6%
- Change in Fees from banking services	13.3%	91.0%	142.2%	60.0%	35.0%	25.0%	20.0%
- Change in Investment Income	27.1%	-72.5%	44.5%	75.7%	10.8%	8.0%	8.0%
- Change in Fx Income	10.5%	13.3%	51.9%	5.0%	5.0%	5.0%	5.0%
- Change in Other Income	-60.7%	156.4%	-40.5%	-5.0%	5.0%	5.0%	5.0%
RATIOS USED FOR VALUATION							
- Par value per share (SR)	50.0	50.0	50.0	10.0	10.0	10.0	10.0
- Shares in issue (mn)	80.0	80.0	120.0	600.0	600.0	600.0	600.0
- EPS (SR)	18.0	31.3	33.5	-	-	-	-
- EPS (SR) - Adjusted for Split	3.6	6.3	6.7	9.4	11.2	13.2	15.4
- DPS (SR)	16.1	21.7	14.9	-	-	-	-
- DPS (SR) - Adjusted for Split	3.2	4.3	3.0	6.1	8.0	9.9	12.1
- Book value per share (SR)	111.0	115.7	92.7	-	-	-	-
- Book value per share (SR) - Adjusted for Split	22.2	23.1	18.5	21.8	25.0	28.3	31.5
- Market price year end (SR)	394.0	800.0	975.0	-	-	-	-
- Market price year end (SR) - Adjusted for Split	78.8	160.0	195.0	156.0	156.0	156.0	156.0
- Market Cap. (SRmn)	31,520.0	64,000.0	117,000.0	93,600.0	93,600.0	93,600.0	93,600.0
- P/E	21.9	25.5	29.1	16.6	14.0	11.8	10.2
- P/BV	3.6	6.9	10.5	7.1	6.2	5.5	5.0
- Dividends yield	4.1%	2.7%	1.5%	3.9%	5.1%	6.4%	7.8%

** Market price of 2006 and subsequent years as on August 30, 2006*

Saudi Hollandi Bank

Reuters Code:
1040.SE

Listing:
Saudi Stock Exchange

CMP:
SR88.25

August 30, 2006

Buy

Key Data

EPS (SR)*	4.8
BVPS (SR)*	17.9
P / E (x)	18.5
P / BV (x)	4.9
Avg. daily vol.('000)	120.5
52 week Lo / Hi	81/159
Market Cap (SR mn)	19,459.1
Target Price	100.6

*Source: **Global** Research*
** Projected (2006)*

Background

- **Saudi Hollandi Bank (SHB)** is the oldest bank in Saudi Arabia. It was established in 1926 as the Netherlands Trading Society in Jeddah. In 1964, the Netherlands Trading Society became the Algemene Bank Nederland NV (ABN). In 1976 SHB was established as a joint venture with local partners, with ABN (now ABN Amro) holding a 40% stake in return for its local assets.

- SHB provides wholesale, retail and commercial banking products and services in addition to investment banking. In particular, the bank is active in arranging financing for quasi-government and private industrial enterprises and also arranges trade-financing products for companies involved in foreign trade.

- SHB is among the smaller banks of the country in terms of total assets, having a market share of 5.5% of the total banking sector assets in 2005 (2004: 5.3%). SHB has a network of 40 branches (with 1,341 employees) that cover the central, western and eastern regions of the country.

Recent developments

- ABN Amro and Saudi Hollandi Bank closed Saudi Arabia's largest ever Greenfield project financing for Saudi Basic Industry Corporation's (Sabic) US$5bn subsidiary, Yanbu National Petrochemicals Company (Yansab). ABN Amro and Saudi Hollandi Bank acted as Financial Advisers to Yansab on the deal which raised US$3.5bn of debt.

- Saudi Hollandi Bank (SHB) announced the launch of its new image with the title"Evolution of Good Banking" reaffirming its determination to provide better and innovative services to its clients across the Kingdom.

- Al Khorayef Group appointed the Saudi Hollandi Bank (SHB) as financial adviser, lead manager and lead underwriter in the IPO where it plans to offer 30% in an initial public offering on the Saudi Stock Exchange later in 2006.

- The Gulf Stevedoring Contracting Company Ltd. (GSCCO) appointed the Saudi Hollandi Bank (SHB) as the financial adviser and underwriter for its initial public offering. It plans to issue an IPO in the last quarter of this year depending on approval by the Capital Market Authority (CMA) and the Ministry of Commerce and Industry.

- Al Kifah Building Materials Company Ltd. appointed the Saudi Hollandi Bank (SHB) as the financial adviser and arranger for its initial public offering.

Rating Reviews

- In Nov-05, Moodys upgraded Saudi Hollandi Bank's long-term foreign currency deposit rating to A3 from Baa2. The Prime-2 short-term foreign currency deposit rating and the C- financial strength rating remain unchanged.

Financial Performance – 2005

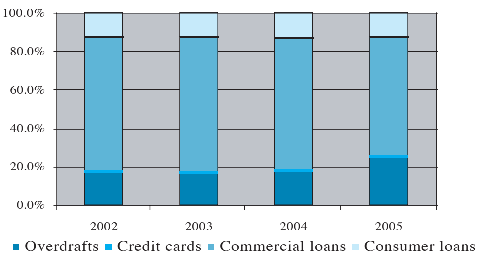
- SHB showed excellent results in 2005 exceeding our expectations made in our last report (May-05). The bank reported net profit of SR1.05bn, up 6% as compared to our forecasted net profit of SR992.1mn for 2005. The bank's assets in 2005 reported a marginally higher growth, up 2.6% compared to our estimates.

- SHB assets reported a CAGR growth of 14.1% from SR26.9bn in 2002 to SR39.9bn reported in 2005. The asset growth has been higher on YoY basis wherein it notched a healthy growth of 19.5% in 2005.

- The loans and advances (net) grew at a strong CAGR of 25.1% over 2002-05 reaching SR23.8bn at the end of 2005. The bank has been traditionally very strong in corporate banking which can be seen from the fact that commercial loans constitutes 61.9% of total loans in 2005 (2004: 69.5%). However, strong growth of 38.8% was seen in retail loans in 2005 as compared to the previous year. However, retail loans still accounted for 15% of total loans in 2005.

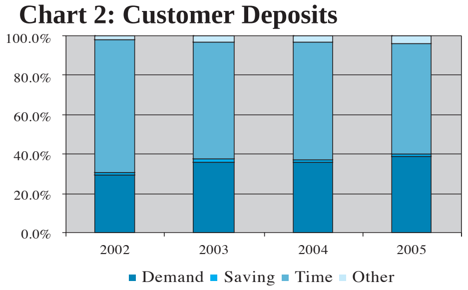
- SHB reported 14.4% yearly growth in its investments in 2005. The bank has been conservative in investment as government and quasi-government securities accounted for 91.9% of the total investments in 2005.

Chart 1: Loans & Advaces Portfolio



*Source: Company Reports, **Global** Research*

Chart 2: Customer Deposits

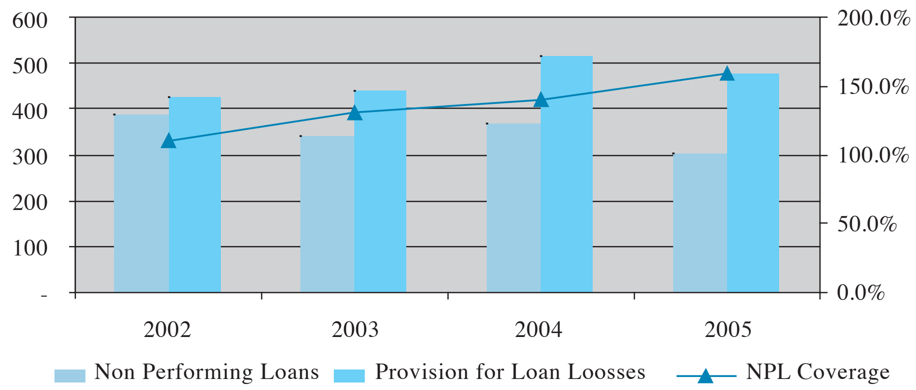


*Source: Company Reports, **Global** Research*

- SHB's customers deposit grew at a lower CAGR of 12% over 2002-05 period. However, the bank reported above-average yearly growth of 19.7% in customer deposits in 2005. SHB's deposits mainly consists of time deposits which accounted for 56.6% of total deposits and demand deposits accounting for 39% of total deposits in 2005.

- SHB's asset quality has been good with the coverage ratio improving from 110.8% in 2002 to 158.4% in 2005. The NPL in absolute numbers saw a decline from SR370mn reported in 2004 to SR300mn reported in 2005. Also NPLs as a percentage of gross loans declined from 11.3% in 2003 to 7.6% in 2005.

Chart 3: Asset Quality



Source: Company Reports, ***Global*** *Research*

- SHB's net profit reported a CAGR growth of 23.7% in the period 2002-05 as it reached SR1.05bn in 2005, recording an yearly increase of 41.6% in 2005. However, the net commission income reported a marginal yearly growth of only 11% as it reached SR1.01bn in 2005. This is mainly attributed to the strong commission expenses which registered an yearly growth of 105% in 2005. As the major chunk of bank's deposits are in time deposits, it was greatly affected by the upward movement in interest rates in the year.

- However, the bank seems to have made amends for the lower growth in its commission income from its stronghold, the fee based activities. The fee from banking services reported an yearly increase of 67% in 2005 as it reached SR589.3mn in 2005. With the bank having number of mandates in the pipeline for IPOs, we expect this strong growth to continue in coming years, albeit at a lower pace.

Table 1: Segment Information

(2005) SR '000	**Corporate Banking**	**Consumer Banking**	**Treasury**	**Total**
Total Assets	20,179,317	5,113,814	14,665,169	39,958,300
Total Liabilties	9,055,381	12,572,819	14,658,469	36,286,669
Net Income	512,677	425,190	113,990	1,051,857

Source: Company Reports, ***Global*** *Research*

- SHB has seen regular decline in spreads in last couple of years as it declined from 3.4% in 2002 to 2.7% in 2005. This is mainly due to its leaning towards the corporate banking blue-chip clientele as well the presence of large amount of time deposits. However, we feel that the bank is likely to improve on its spread in retail banking business.

Financial Performance – 1H-2006

- SHB's asset size reported a strong YTD growth of 11.3% till the end of June-06. The bank recorded a sequential growth of 3.9% in 2Q-2006 which is higher than its peer group banks.

- In 1H-2006, the bank has done well in attracting customer deposits which registered YTD growth of 13.4% till June-06 as the investors moved their money towards relatively safer bank deposits from the capital markets. The growth has been pretty even in both the quarters with the growth of 6.4% recorded in the 2Q-2006 over the 1Q2006.

Table 2: Key Financial Data - 1H-2006

Balance Sheet 'SR mn'	2Q2005	FY 2005	1Q2006	2Q2006	Growth-YoY	Growth - QoQ	Growth - YTD
Investments	9,721.2	10,483.7	10,919.6	10,494.6	8.0%	-3.9%	0.1%
Loans and advances	18,825.8	23,776.5	25,487.6	25,961.4	37.9%	1.9%	9.2%
Total Assets	**35,066.5**	**39,958.3**	**42,797.9**	**44,457.9**	**26.8%**	**3.9%**	**11.3%**
Customer deposits	24,458.9	28,565.0	30,443.7	32,406.9	32.5%	6.4%	13.4%
Total Liabilities	31,736.9	36,491.2	39,047.8	40,667.4	28.1%	4.1%	11.4%
Total shareholders' equity	**3,329.6**	**3,467.1**	**3,750.1**	**3,790.5**	**13.8%**	**1.1%**	**9.3%**
Total Liabilities and Shareholders' Equity	**35,066.5**	**39,958.3**	**42,797.9**	**44,457.9**	**26.8%**	**3.9%**	**11.3%**

*Source: Company Reports, **Global** Research*

- However, the bank saw a relatively slower growth in the loan book as it increased only by 1.9% on sequential basis.

- SHB shareholders approved an increase in the share capital from SR1.26mn to SR2.21bn by the issuance of three shares for every four shares held funded by the transfer of SR945mn from the general reserve.

Table 3: Key Financial Data - 1H-2006

Income Statement 'SR mn'	2Q2005	2Q2006	Growth	1H-2005	1H-2006	Growth
Special commission income	421.5	646.5	53.4%	815.8	1,270.3	55.7%
Special commission expense	(172.3)	(355.1)	106.1%	(326.0)	(702.3)	115.4%
Net special commission income	**249.2**	**291.4**	**16.9%**	**489.8**	**568.0**	**16.0%**
Fees from banking services	150.2	180.1	19.9%	244.9	367.2	49.9%
Provisions for loan losses	(32.0)	(295.3)	822.8%	(56.1)	(316.2)	464.0%
Total operating income	**393.8**	**209.9**	**-46.7%**	**733.2**	**678.8**	**-7.4%**
Total operating expenses	**(141.1)**	**(158.7)**	**12.5%**	**(277.4)**	**(313.9)**	**13.1%**
Net Income	**252.8**	**51.2**	**-79.8%**	**455.8**	**364.9**	**-19.9%**

*Source: Company Reports, **Global** Research*

- SHB reported net profit of SR364.4mn, down 19.9% as compared to SR455.8mn reported in the first half of 2005. This was mainly due to the increased provisioning undertaken by the bank in 2Q-2005 wherein it made a provisioning to the tune of SR295.3mn.

- However, the fee from banking activity reported a strong growth of 49.9% in 1H-2006 as compared to the corresponding period of the previous year. However, it registered a growth of only 19.9% in 2Q-2006 over 2Q-2005 indicating a slowdown in the IPO and brokerage related business.

Outlook

SHB has been traditionally seen as a corporate bank and it continues to put thrust on the corporate banking and fee income as it intends to focus on "Class Banking" rather than on "mass banking". The bank intends to become a preferred corporate bank for big blue chip corporates and is not intending to enter SME segment in a big way. However, the bank is not ignoring retail in any ways as it recently hired a consumer banking head and plan to revamp the operations giving autonomous control. We believe that the profitability of the bank will take a hit from the one-time provision the bank has undertaken to clean its books. Due to its thrust on corporate banking the bank's spreads are likely to remain low in the range of 2.6% to 2.7% in the medium term.

The bank intends to increase real estate exposure and plans to develop Islamic products, the impact of which is likely to flow through from 2007. We believe that investment banking, corporate finance, private banking will continue to drive fee income growth. SHB is looking at expanding private banking business in a big way and wants to enter middle market and increase penetration. SHB "Van Gogh Banking" has a good brand image and it plans to make it a cornerstone of its wealth management business. In 2005, SHB opened 3 new Van Gogh Preferred Banking Centers including 2 exclusively for women.

The bank plans to open an Islamic branch at Mecca/Medina and intends to double both branches and ATM network over the next two years. According to the management, the bank already has around 12 mandates for IPO's (including Obeikan Investment Group), SAMCO, MESC Specialized Cables and floatation manager for Red Sea Housing IPO). A capital guaranteed fund and Islamic fund are likely to be launched in near future boosting its fee income.

The bank has one of the lowest CAR ratio among the Saudi banks and we feel that the bank is likely to go for a capital expansion plan in next couple of years. We expect that the bank will maintain its dividend payout ratio in the range of 50% to 60% in the medium term.

Valuation:

Based on the current market price of SR88.0, SHB stock is trading at a 10.6x 2005 earnings and 3.2x 2005 book value. On a one year forward basis, the stock is trading at 18.5x 2006F earnings and 4.9x 2006F book value. Based on the combination of DDM and Relative valuation method, we recommend a **BUY** on the stock with a price target of SR100.6, an upside of 14.0% from current levels.

BALANCE SHEET

	Saudi Hollandi Bank						
SR mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Cash & balances with SAMA	937.1	1,042.5	1,204.6	2,883.9	3,643.4	4,118.0	4,178.0
Due from banks and other FI's	4,409.2	5,300.6	3,334.7	4,501.9	4,727.0	4,963.3	5,211.5
Trading investments	9.4	84.5	195.2	204.9	215.2	225.9	237.2
Non-trading investments	7,351.6	9,077.5	10,288.6	10,496.4	11,023.0	11,576.1	12,157.0
Net Loans and advances	13,961.7	16,633.2	23,776.5	28,230.0	32,464.5	36,360.2	40,723.5
Net fixed assets	266.7	289.9	313.3	345.2	365.0	386.7	410.6
Other assets	1,029.0	1,015.4	845.4	862.3	879.6	897.2	915.1
Total Assets	**27,964.6**	**33,443.6**	**39,958.3**	**47,524.7**	**53,317.6**	**58,527.5**	**63,833.0**
Due to banks and other financial institutions	4,170.7	4,427.3	5,796.5	6,086.4	6,390.7	6,710.2	7,045.7
Customers' deposits	19,697.5	23,857.5	28,565.0	35,225.0	39,808.1	43,772.7	47,675.2
Other liabilities	1,545.7	1,568.6	1,429.6	1,572.6	1,729.9	1,902.9	2,093.1
Subordinated Debt		700.0	700.0	700.0	700.0	700.0	700.0
Total Liabilities	**25,413.9**	**30,553.4**	**36,491.2**	**43,584.0**	**48,628.7**	**53,085.7**	**57,514.0**
Share capital	945.0	1,260.0	1,260.0	2,205.0	2,205.0	2,205.0	2,205.0
Statutory reserve	945.0	1,260.0	1,260.0	1,522.5	1,937.3	2,205.0	2,205.0
General & Other Reserves	655.2	363.9	939.5	204.5	536.4	924.4	1,472.7
Retained Earnings	5.5	6.2	7.6	8.6	10.3	107.3	436.3
Total shareholders' equity	**2,550.7**	**2,890.2**	**3,467.1**	**3,940.7**	**4,688.9**	**5,441.8**	**6,319.0**
Total liabilities and shareholders' Equity	**27,964.6**	**33,443.6**	**39,958.3**	**47,524.7**	**53,317.6**	**58,527.5**	**63,833.0**

INCOME STATEMENT

SR mn	Saudi Hollandi Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
Special commission income	1,196.9	1,315.4	1,843.4	2,548.2	2,934.8	3,205.5	3,524.8
Special commission expense	(351.6)	(404.7)	(829.8)	(1,401.5)	(1,584.8)	(1,731.0)	(1,903.4)
Net special commission income	**845.3**	**910.7**	**1,013.5**	**1,146.7**	**1,350.0**	**1,474.5**	**1,621.4**
Provision for loan losses	(71.1)	(109.5)	(99.2)	(397.1)	(131.0)	(120.5)	(134.9)
Net special commission income after PLL's	**774.2**	**801.2**	**914.3**	**749.6**	**1,219.1**	**1,354.1**	**1,486.5**
Fees from banking services	204.9	352.8	589.3	825.0	1,031.2	1,237.5	1,423.1
Exchange income	49.5	51.7	64.0	65.3	66.6	68.0	69.3
Net trading income	30.7	47.2	47.8	57.4	63.1	66.3	69.6
Net gains on investments	9.5	0.0	3.2	3.2	3.2	3.2	3.2
Total non-commission income	**294.6**	**451.7**	**704.3**	**950.9**	**1,164.2**	**1,374.9**	**1,565.2**
Total operating income	**1,068.8**	**1,252.8**	**1,618.6**	**1,700.5**	**2,383.2**	**2,729.0**	**3,051.7**
Salaries & employee related expenses	(287.0)	(314.9)	(327.3)	(366.5)	(403.2)	(435.4)	(470.3)
Rent & premises related expenses	(36.1)	(38.9)	(44.3)	(50.9)	(56.0)	(61.6)	(67.7)
Depreciation and amortization	(42.3)	(45.6)	(53.5)	(60.2)	(66.2)	(72.8)	(80.1)
Other G & A expenses	(102.7)	(110.7)	(141.7)	(172.9)	(198.8)	(218.7)	(240.6)
Other operating expenses	(0.3)	0.0	0.0	0.0	0.0	0.0	0.0
Total operating expenses	**(468.4)**	**(510.1)**	**(566.8)**	**(650.5)**	**(724.2)**	**(788.6)**	**(858.7)**
Net Income	**600.4**	**742.7**	**1,051.9**	**1,050.0**	**1,659.0**	**1,940.4**	**2,193.0**

Statement of Retained Earnings	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
Beginning retained earnings	**5.3**	**5.5**	**6.2**	**7.6**	**8.6**	**10.3**	**107.3**
Net income	600.4	742.7	1,051.9	1,050.0	1,659.0	1,940.4	2,193.0
transfer to statutory reserve	0.0	0.0	0.0	(262.5)	(414.8)	(267.8)	0.0
Transfer to other reserves	(260.0)	(345.0)	(645.0)	(210.0)	(331.8)	(388.1)	(548.2)
Gross dividends	(336.8)	(397.0)	(405.5)	(576.5)	(910.8)	(1,187.5)	(1,315.8)
Net change in fair value	(3.8)	0.0	0.0	0.0	0.0	0.0	0.0
Ending balance	**5.1**	**6.2**	**7.6**	**8.6**	**10.3**	**107.3**	**436.3**

CASH FLOW STATEMENT

	Saudi Hollandi Bank						
SR mn	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009**
Net Income	600.4	742.7	1,051.9	1,050.0	1,659.0	1,940.4	2,193.0
Accretion Of Discounts	37.0	(47.6)	(69.4)	-	-	-	-
Gains On Investments	(9.5)	0.0	(3.2)	(3.2)	(3.2)	(3.2)	(3.2)
Depreciation And Amortization	42.3	45.6	53.5	60.2	66.2	72.8	80.1
Provision For Loan Losses	71.1	109.5	99.2	397.1	131.0	120.5	134.9
Fair Value Adjustment On Hedged AFS And Originated Debt Securities	9.5	10.7	-	-	-	-	-
Due From Banks And Other FI's	1,695.8	(891.4)	1,965.8	(1,167.2)	(225.1)	(236.3)	(248.2)
Trading Portfolio	117.6	(75.1)	(110.7)	(9.8)	(10.2)	(10.8)	(11.3)
Loans And Advances	(1,886.6)	(2,781.0)	(7,242.6)	(4,850.5)	(4,365.5)	(4,016.2)	(4,498.2)
Other Assets	(259.1)	16.2	169.9	(16.9)	(17.2)	(17.6)	(17.9)
Due To Banks And FI's	1,288.5	256.7	1,369.2	289.8	304.3	319.5	335.5
Customers Deposits	(647.4)	4,159.9	4,707.5	6,660.0	4,583.1	3,964.5	3,902.5
Other Liabilities	161.1	71.6	(139.0)	143.0	157.3	173.0	190.3
CF From Operations	**1,220.7**	**1,617.9**	**1,852.3**	**2,552.5**	**2,279.6**	**2,306.6**	**2,057.5**
Sale/Purchase Of Investments	(1,049.5)	(1,688.5)	(1,207.9)	(204.6)	(523.4)	(549.9)	(577.7)
Capex	(50.8)	(68.9)	(76.9)	(92.1)	(86.0)	(94.6)	(104.0)
CF From Investing	**(1,100.3)**	**(1,757.4)**	**(1,284.7)**	**(296.7)**	**(609.4)**	**(644.5)**	**(681.7)**
Issue Of Debt	-	700.0	--	-	-	-	-
Dividend And Zakat Paid	(326.9)	(455.0)	(405.5)	(576.5)	(910.8)	(1,187.5)	(1,315.8)
CF From Financing	**(326.9)**	**245.0**	**(405.5)**	**(576.5)**	**(910.8)**	**(1,187.5)**	**(1,315.8)**
Change In Cash	(206.4)	105.5	162.1	1,679.3	759.4	474.6	60.0
Beginning Cash	1,143.0	937.1	1,042.5	1,204.6	2,883.9	3,643.4	4,118.0
Ending Cash	**936.6**	**1,042.5**	**1,204.6**	**2,883.9**	**3,643.4**	**4,118.0**	**4,178.0**

RATIOS

	Saudi Hollandi Bank						
	2003	2004	2005	2006 F	2007 F	2008 F	2009 F
Profitability							
- Return on Average Assets	2.2%	2.4%	2.9%	2.4%	3.3%	3.5%	3.6%
- Return on Average Equity	24.7%	27.3%	33.1%	28.3%	38.5%	38.3%	37.3%
- Net special commission income after PLL's/ Total op. income	72.4%	63.9%	56.5%	44.1%	51.2%	49.6%	48.7%
- Non-commission income/ Total op. income	27.6%	36.1%	43.5%	55.9%	48.8%	50.4%	51.3%
- Non-commission expense/ Total op. income	43.8%	40.7%	35.0%	38.3%	30.4%	28.9%	28.1%
- Fees from banking services/ Total op. income	19.2%	28.2%	36.4%	48.5%	43.3%	45.3%	46.6%
- Dividend Payout Ratio	56.1%	53.5%	38.6%	54.9%	54.9%	61.2%	60.0%
Margins							
- Net (or profit) margin	56.2%	59.3%	65.0%	61.7%	69.6%	71.1%	71.9%
- Special commission expense/ Special commission income	29.4%	30.8%	45.0%	55.0%	54.0%	54.0%	54.0%
- Yield on average earning assets	4.7%	4.6%	5.3%	6.2%	6.3%	6.2%	6.2%
- Cost rate on average commission bearing liabilities	1.5%	1.5%	2.6%	3.6%	3.6%	3.5%	3.6%
- Spread	3.2%	3.0%	2.7%	2.6%	2.7%	2.7%	2.6%
- Commission margin (earning assets)	3.2%	2.9%	2.7%	2.6%	2.7%	2.7%	2.7%
Efficiency							
- Cost/ Total op. income	43.8%	40.7%	35.0%	38.3%	30.4%	28.9%	28.1%
- Staff expenses/ Total op Expenses	61.3%	61.7%	57.7%	56.3%	55.7%	55.2%	54.8%
- Rent and G&A expenses/ Total op. Expenses	29.6%	29.3%	32.8%	34.4%	35.2%	35.5%	35.9%
- Non-commission expense/ Average total assets	1.7%	1.7%	1.5%	1.5%	1.4%	1.4%	1.4%
Liquidity							
- Loans / Commission earning assets	55.3%	54.4%	63.8%	65.8%	67.8%	69.2%	70.6%
- Loans/ Customer Deposits	73.1%	71.9%	84.9%	82.6%	84.1%	85.6%	88.1%
- Customer Deposits/ Equity	772.2%	825.5%	823.9%	893.9%	849.0%	804.4%	754.5%
- Customer Deposits/ Total assets	70.4%	71.3%	71.5%	74.1%	74.7%	74.8%	74.7%
- Due from Banks/ Due to Banks	105.7%	119.7%	57.5%	74.0%	74.0%	74.0%	74.0%
Credit Quality							
- Provisions /Total op. income	6.7%	8.7%	6.1%	23.3%	5.5%	4.4%	4.4%
- Provisions /Average loans	0.5%	0.7%	0.5%	1.5%	0.4%	0.3%	0.3%
- Non Performing Loans (SR mn)	338	380	300	361	415	464	520
- Provision for loan losses (SR mn)	440	517	476	873	1,004	1,125	1,259
- NPL's /Gross Loans	2.3%	2.2%	1.2%	1.2%	1.2%	1.2%	1.2%
- NPL's /(Equity+provision for loan losses)	11.3%	10.8%	7.6%	7.5%	7.3%	7.1%	6.9%
- PLL's / Gross Loans	3.1%	3.0%	2.0%	3.0%	3.0%	3.0%	3.0%

RATIOS - Continued

	Saudi Hollandi Bank						
Profitability	**2003**	**2004**	**2005**	**2006 F**	**2007 F**	**2008 F**	**2009 F**
- NPL Coverage	130.2%	139.9%	158.4%	242.1%	242.1%	242.1%	242.1%
Capital Adequacy							
- Equity/ Total Assets (Equity capital ratio)	9.1%	8.6%	8.7%	8.3%	8.8%	9.3%	9.9%
- Equity/ Gross Loans	17.7%	16.9%	14.3%	13.5%	14.0%	14.5%	15.1%
Constitution of Total Operating Income							
- Net special commission income after PLL's/ Total op. income	72.4%	63.9%	56.5%	44.1%	51.2%	49.6%	48.7%
- Fees from banking services/ Total op. income	19.2%	28.2%	36.4%	48.5%	43.3%	45.3%	46.6%
- Investment Income/ Total op. income	3.8%	3.8%	3.2%	3.6%	2.8%	2.5%	2.4%
- FX Income/ Total op. income	4.6%	4.1%	4.0%	3.8%	2.8%	2.5%	2.3%
- PLL's/ Total op. income	6.7%	8.7%	6.1%	23.3%	5.5%	4.4%	4.4%
Operating Performance							
- Change in special commission income	-8.4%	9.9%	40.1%	38.2%	15.2%	9.2%	10.0%
- Change in Fees from banking services	34.9%	72.1%	67.0%	40.0%	25.0%	20.0%	15.0%
- Change in Investment Income	84.6%	17.5%	8.0%	18.7%	9.5%	4.8%	4.8%
- Change in Fx Income	14.0%	4.5%	23.9%	2.0%	2.0%	2.0%	2.0%
RATIO'S USED FOR VALUATION							
- Par value per share (SR)	50.00	50.00	50.00	10.00	10.00	10.00	10.00
- Shares in issue (mn)	18.9	25.2	25.2	220.5	220.5	220.5	220.5
- EPS (SR)	31.8	29.5	41.7	-	-	-	-
- EPS (SR)- Adjusted for Split	6.4	5.9	8.3	4.8	7.5	8.8	9.9
- DPS (SR)	17.3	15.3	15.4	-	-	-	-
- DPS (SR)- Adjusted for Split	3.5	3.1	3.1	2.5	4.0	5.2	5.7
- Book value per share (SR)	135.0	114.7	137.6	-	-	-	-
- Book value per share (SR)- Adjusted for Split	27.0	22.9	27.5	17.9	21.3	24.7	28.7
- Market price year end (SR) *	496.0	727.0	1040.0	-	-	-	-
- Market price year end (SR)- Adjusted for Split *	99.2	145.4	208.0	88.3	88.3	88.3	88.3
- Market Cap. (SR bn)	9.4	18.3	26.2	19.5	19.5	19.5	19.5
- P/E	15.6	24.7	24.9	18.5	11.7	10.0	8.9
- P/BV	3.7	6.3	7.6	4.9	4.2	3.6	3.1
- Dividends yield	3.5%	2.1%	1.5%	2.8%	4.5%	5.9%	6.5%

** Market price of 2006 and subsequent years as on August 30, 2006*

National Commercial Bank

August 30, 2006

Not Listed

Key Data

EPS (SR)*	8.4
BVPS (SR)*	34.1
ROAE (%)	29.3
ROAA (%)	3.6

*Source: **Global** Research*
** Based on 2005 numbers, (post split)*

Background

- **The National Commercial Bank** (NCB) was the first bank established in Saudi Arabia and was formed in 1953 pursuant to a Royal Decree by the late King Abdulaziz Bin Abdul Rahman Al Saud to convert the partnership of Saleh & Abdulaziz Kaki and Salem Bin Mahfouz into the National Commercial Bank. The NCB was founded with a paid-up capital of SR 30 million (US$ 8 million).

- The Bank was constituted as a General Partnership from its founding in 1953 until July 01, 1997, when it was reconstituted as a Joint Stock Company. In 1999, the Government through the Ministry of Finance's Public Investment Fund (PIF), acquired a majority holding in the Bank. NCB is a privately held bank and the major shareholders are PIF (69.3%), General Organization for Social Insurance (10.0%) and other private investors (20.7%).

Recent Developments:

- During July 2006, S&P announced NCB's AlAhli Saudi Stock Fund as the best performing investment fund in the world for the month of June for 2006. This comes on the back of the funds exceptional financial performance, asset strength and administrative policies. The bank's Investment Services Division Head indicated that this fund achieved a net growth of 26.1% during the month of June. This fund achieved a net growth of 1020.6% since its launch in June 1998. Its assets reached SR6.4bn by the end of June 2006.

- In June 2006, NCB opened the "AlSalam" branch in the city of Riyadh. This is in line with the bank's strategy to open branches in a bid to increase it deposit franchise as well as to better serve its clients. In order to meet individual's demands for service, more service channels are required.

- During June 2006, the bank launched its Islamic Car Leasing Program, the first of its kind in the Kingdom. The launch of this program is a part of the bank's strategic plan to use its revenues to develop banking products and services for its clients.

- In May 2006, the bank signed an agreement of cooperation in the field of real estate development with the Hamad Bin Seadan Company. The aim of this agreement was to promote investment opportunities in the real estate sector within the Kingdom.

Financial Performance – 2005

NCB is the largest commercial bank in the Kingdom with a market share of 20.1% in balance sheet size as at end 2005. During the period 2002-05, the bank's asset size grew at a CAGR of 11.0% from SR106.7bn in 2002 to SR145.8bn in 2005. By year end 2005, the bank's customer base surpassed 1.3mn. At year end 2005, the bank had 4,744 employees of whom 86.1% were Saudis.

Customer deposits grew at a CAGR of 7.2% from SR85.3bn in 2002 to SR104.9bn in 2005. The bank's share of customer deposits as at end 2005 was 19.7%. During the period under review, customer deposits for the system grew at a CAGR of 13.3%. Deposit accumulation for NCB is likely to remain under pressure due to increasing competition and the entry of newer banks. As per the management, growth in time deposits is likely to remain strong. The bank's non-interest bearing liabilities as at end 2005 stood at around 48% of the deposit base.

On the lending side, gross loans of the bank grew at a CAGR of 15.4% from SR50.6bn in 2002 to SR77.8bn in 2005. NCB's market share in terms of gross loans as at end 2005 stood at 17.3%. During the period under review, the gross loans to customer deposits ratio increased from 59.3% in 2002 to 74.1% in 2005.

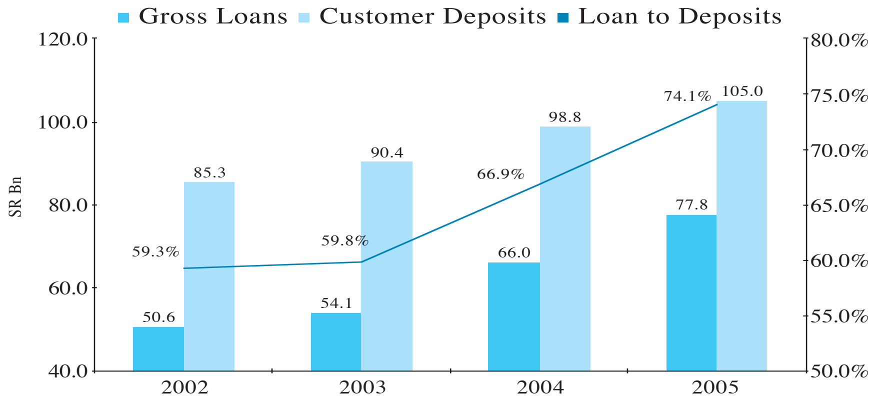
On the corporate side, thrust on project finance such as power, oil, gas, petrochemicals, railways, airlines, desalination, etc are expected to remain strong. The increased thrust towards infrastructure development is likely to result in strong demand for funds for construction activity. According to the management, the big infrastructure projects are likely to be financed by international syndication.

Demand for funds on the consumer lending front is also expected to remain strong due to the favorable demographics in the Kingdom. Consumer lending segment contributes 35% of total loans with an average duration of around 7 years. Over the next three years, due to the new SAMA guidelines, the duration is likely to fall to around 3 years.

Small and Medium Enterprise (SME) segment is the underserved segment, and the bank intends more exposure towards this segment over the next two years. During the last two years, the bank had focused on SME segment; however the emphasis to increased lending to the SME segment is likely gather steam over the next two years. Exposure towards real estate is minimal as legal environment is the biggest hurdle.

In our opinion, with the credit expansion expected over the next two to three years, this ratio is likely to go up further, resulting in profitability to be driven by core earnings. A stable deposit base, with an increasing loan to deposit ratio and stable margins are likely to drive earnings growth over the next two years.

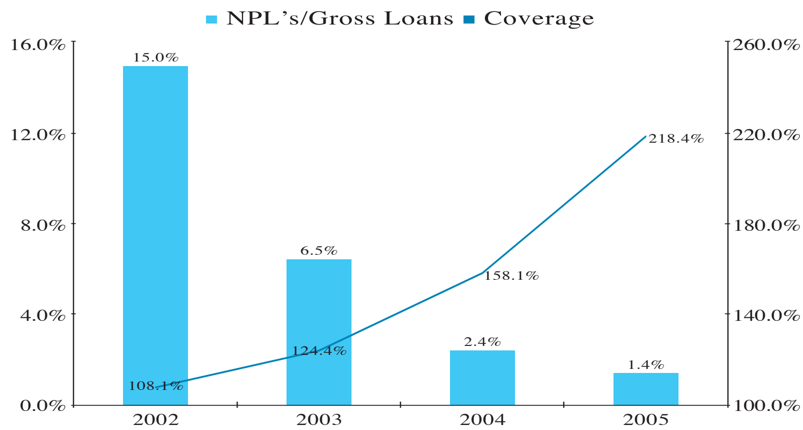
Chart 1: Gross Loans to Deposit



Source: Company Report, ***Global*** *Research*

NCB's asset quality has improved during the last three years. Gross NPLs as a percentage of gross loans declined from 15% in 2002 to 1.4% in 2005. In absolute terms, gross NPLs have declined from SR7.6bn in 2002 to SR1.1bn in 2005. During the same period, coverage ratio of the bank has increased from 108.1% in 2002 to 218.4% in 2005. Worth mentioning is the fact that despite a CAGR growth of 15.4% in gross loans, the gross NPLs have declined at a CAGR of 47.0% for the period 2002-05.

Chart 2: Asset Quality

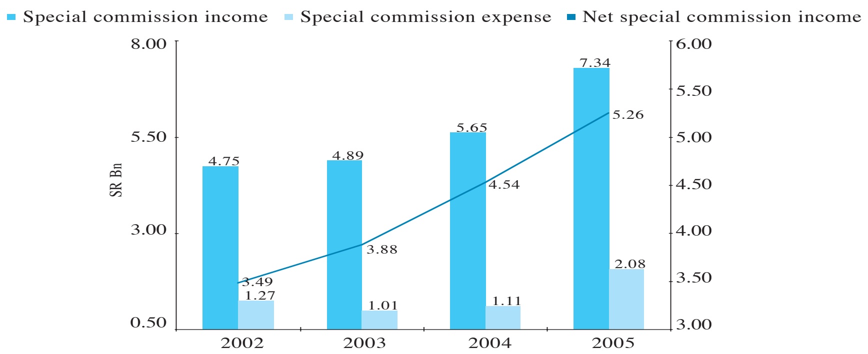


Source: Company Report, ***Global*** *Research*

The bank's core income, as defined by net special commission income, grew at a CAGR of 14.7% from SR3.5bn in 2002 to SR5.3bn in 2005. Core income for the entire banking system grew at a CAGR of 14.8% for the period 2002-05. During this period, special commission income grew at a CAGR of 15.6% and special commission expense grew at a CAGR of 17.9%.

However, what is most striking is that the growth in special commission expense in 2005 was a staggering 86.9% compared to 2004. In our opinion, due to buoyancy in the capital market last year, banks were witnessing strong growth in loan book. In order to lure deposits to support such strong loan growth, banks offered higher interest rates in a bid to increase and strengthen their deposit franchise. In the bargain, the cost of funds increased.

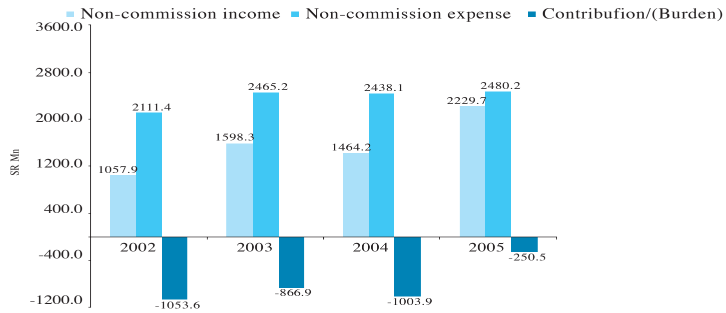
Chart 3: Core income



*Source: Company Report, **Global** Research*

Contribution / burden is defined as the excess of non-commission income over non-commission expense. During the period 2002-05, the bank has a burden as its non-commission expense has been more than its non-commission income. This means that other banking income did not take care of operating overheads and hence a drain on the bank's profits. However, in the case of NCB, burden has declined from SR1,053.6mn in 2002 to SR250.5mn in 2005.

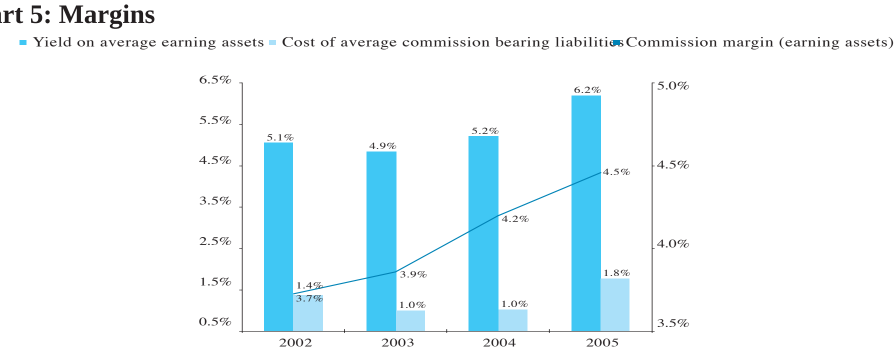
Chart 4: Contribution / (Burden)



*Source: Company Report, **Global** Research*

NCB's commission margins are second best to that of Al-Rajhi Bank. In 2005, the bank's margins were 4.5%. During the period 2002-05, the bank's commission margins increased from 3.7% in 2002 to 3.9% in 2003 to 4.2% in 2004 and to 4.5% in 2005. Yield on average earning assets increased by 114bps from 5.1% in 2002 to 6.2% in 2005. Cost of average commission bearing liabilities increased by just 41bps from 1.4% in 2002 to 1.8% in 2005.

Chart 5: Margins

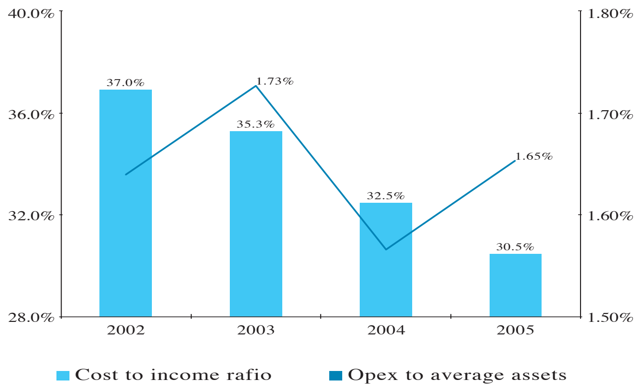


Source: Company Report, Global Research

During the period 2002-05, operating cost of the bank grew at a CAGR of 10.8%. The bank's cost to income ratio declined from 37.0% in 2002 to 30.5% in 2005. In our opinion, cost to average assets is a better indicator to gauge operating efficiency as it removes the impact of fees from banking services, which contributed significantly in 2005.

Operating cost as a percentage of average assets for the bank increased marginally from 1.64% in 2002 to 1.65% in 2005. At year end 2005, NCB operated 261 branches throughout the Kingdom, including 243 branches dedicated exclusively to Islamic Banking services. It has 942 ATMs and 7,000 POS terminals. During 2005, more than 80% of customer transactions were executed through alternative delivery channels.

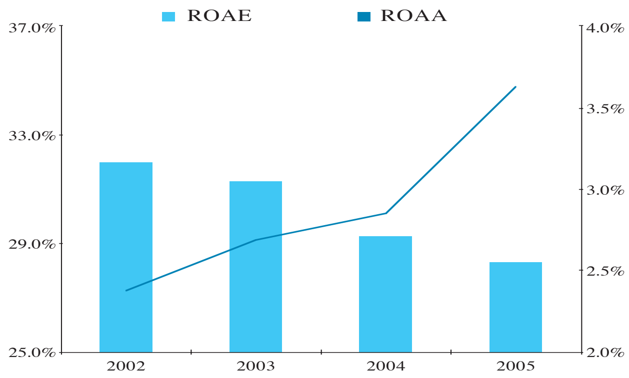
Chart 6: Operating Efficiency



*Source: Company Report, **Global** Research*

Net income of the bank grew at a CAGR of 27.2% from SR2.4bn in 2002 to SR5.0bn in 2005. The bank's return on average equity ranged between 29-32% during the period 2002-05. Return on average assets of the bank increased from 2.4% in 2002 to 3.6% in 2005.

Chart 7: Return Ratios



*Source: Company Report, **Global** Research*

Analysis of Half-Yearly Performance

- NCB's asset size increased by 11.3% from SR139.3bn in 2Q2005 to SR155.1bn in 2Q2006. On a sequential basis, the size increased by 7.8% compared to 1Q2006. Year to date, the asset size of the bank increased by 6.4%.

- As mentioned earlier, the ability of banks to increase its deposit franchise will be well placed in terms of credit deployment. On a y-o-y basis, customer deposits grew by 12.8% from SR103.7bn in 2Q2005 to SR117.0bn in 2Q2006. Deposits grew by 16.3% sequentially and on a year to date, customer deposits have registered a growth of 11.5%.

- Net loans increased from SR71.8bn in 2Q2005 to SR75.9bn in 2Q2006, a growth of 5.7%. On a sequential basis net loans portfolio increased by 2.8% and on a year to date, lending book has marginally increased by 0.8%.

Table 1: Key Balance Sheet Items

SR mn	2Q2005	FY2005	1Q2006	2Q2006	y-o-y	q-o-q	y-t-d
Investments	51,898.3	52,994.9	52,504.6	58,306.2	12.3%	11.0%	10.0%
Net Loans	71,830.2	75,336.4	73,866.7	75,930.1	5.7%	2.8%	0.8%
Customer deposits	103,749.2	104,958.6	100,558.2	116,996.7	12.8%	16.3%	11.5%
Balance sheet size	139,331.8	145,788.9	143,860.0	155,078.0	11.3%	7.8%	6.4%

*Source: Company Report, **Global** Research*

- For the first half of the current fiscal, the bank's net income increased from SR2.4bn in 1H2005 to SR3.3bn in 1H2006, a growth of 37.4% on the back of 8.3% growth in net special commission income and 90.4% growth in fees from banking services.

- Net commission income increased from SR2.6bn in 1H2005 to SR2.8bn in 1H2006. Non-commission income, increased from SR850.7mn in 1H2005 to SR2,199.5mn in 1H2006, a growth of 158.6%. Fees from banking services, increased from SR641.9mn in the first half of 2005 to SR1,222.3mn in 1H2006, a whopping 90.4% growth on y-o-y basis.

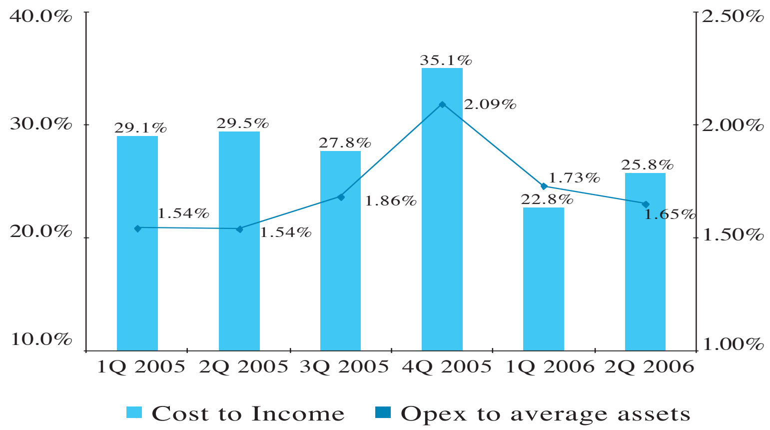
- Operating cost increased by 20.4% from SR1,000.3mn in 1H2005 to SR1,204.4mn in 1H2006. Employee cost and general and administrative expenses increased by 22.3% and 20.4% respectively.

Table 2: Income Statement

SR mn	2Q2005	2Q2006	%	1H2005	1H2006	%
Special commission income	1,725.7	2,210.3	28.1%	3,379.1	4,329.4	28.1%
Special commission expense	(442.7)	(810.3)	83.0%	(814.6)	(1,551.8)	90.5%
Net special commission income	**1,283.1**	**1,400.0**	**9.1%**	**2,564.5**	**2,777.6**	**8.3%**
Fees from banking services	410.1	537.6	31.1%	641.9	1,222.3	90.4%
Exchange income	47.5	33.3	-29.8%	91.0	62.3	-31.6%
Income from FVIS investments	(75.0)	8.1	-110.8%	40.2	243.2	504.6%
Trading income	25.1	(10.7)	-142.8%	7.4	1.4	-81.4%
Gains on non-trading investments	10.5	357.2	3286.5%	12.4	625.0	4938.7%
Dividend income	25.6	29.1	13.5%	57.7	45.4	-21.4%
Provisions for loan losses	(41.0)	(259.4)	532.4%	24.5	(420.8)	-1814.2%
Total operating income	**1,685.9**	**2,095.2**	**24.3%**	**3,439.7**	**4,556.3**	**32.5%**
Salaries & employee related expenses	(290.3)	(351.8)	21.2%	(575.1)	(703.1)	22.3%
Rent & premises related expenses	(37.0)	(46.8)	26.4%	(68.6)	(82.4)	20.3%
Depreciation and amortization	(37.3)	(40.4)	8.3%	(74.2)	(78.9)	6.4%
Other G & A expenses	(144.9)	(168.4)	16.2%	(282.5)	(340.0)	20.4%
Total operating expenses	**(509.5)**	**(607.3)**	**19.2%**	**(1,000.3)**	**(1,204.4)**	**20.4%**
Other expenses						
Donations	(6.3)	(6.0)	-5.3%	(11.3)	(12.0)	6.1%
Other non-operating expenses	43.5	4.8	-89.0%	2.5	(1.3)	-151.5%
Net Income	**1,213.7**	**1,486.7**	**22.5%**	**2,430.5**	**3,338.6**	**37.4%**

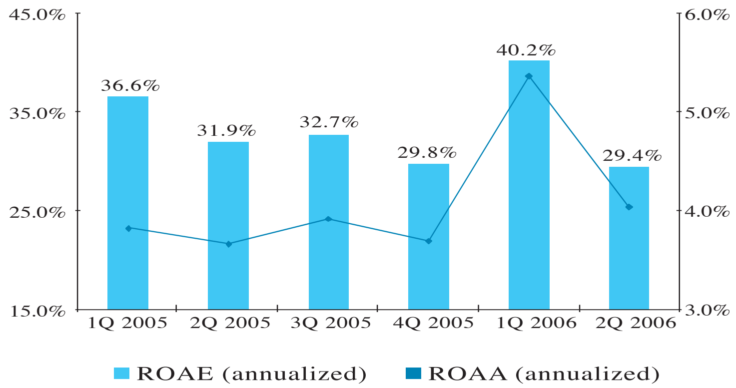
*Source: Company Report, **Global** Research*

Chart 8: Quarterly Cost Ratios



*Source: Company Report, **Global** Research*

Chart 9: Quarterly Return Ratios



*Source: Company Report, **Global** Research*

Outlook:

- On the corporate side, thrust on project finance such as power, oil, gas, petrochemicals, railways, airlines, desalination, etc to remain strong. Construction activity to remain strong due to increased thrust towards infrastructure.

- As at end 2005, the consumer lending segment contributed 35% of total loans with an average duration of around 7 years. Due to the improving demographic situation, young age population to increase employment, hence demand for funds on the consumer lending front to remain strong. Over the next three years, due to the new SAMA guidelines, the duration is likely to fall to around 3 years.

- SME segment is the underserved and untapped segment and the bank intends to increase focus on this segment over the next two years.

- Deposit accumulation is likely to remain under pressure due to increasing competition, setting up of newer banks, etc. Innovative products likely to help deposit accumulation. Time deposit growth is strong from corporate and institutional front. As per the management, growth in time deposits is likely to remain strong. Growth in current accounts is likely to grow at a rate of GDP growth rate. The proportion of Non-Interest Bearing Liabilities as at end 2005 stood at around 48%.

- Investment banking, corporate advisory, IPO financing, project management, wealth management activities etc are the key fee income generating segments. In 2006, contribution of broking fees to be around 40%.

- The key thrust area in the current year is conversion of all its existing branch network from conventional branch to an Islamic branch. Another 17 to 18 branches are left to be converted to Islamic branches. The reasons for converting all existing branches to Islamic branches are aligning with consumer preferences and also a move towards converting itself into an Islamic bank.

- Margins on the retail segment are contracting and the margins on the corporate segment are more or less the same. The bank expects a marginal decline in margins going forward. The bank witnessed strong recoveries in 2005 and is likely to witness strong recoveries in 2006 as well.

BALANCE SHEET

SR mn	National Commercial Bank 2002	2003	2004	2005
Assets				
Cash and balances with SAMA	6,199.8	4,517.6	5,562.0	5,867.4
Due from banks and other FI's	6,847.3	10,403.4	7,590.9	6,699.3
Investments	46,182.0	47,867.8	48,962.3	52,994.9
Loans and advances	42,389.1	49,750.0	63,512.9	75,336.4
Investment in associate and subsidiary	1,228.8	1,106.9	982.5	903.7
Other real estate	1,099.4	726.8	523.0	412.6
Fixed assets	1,566.0	1,521.0	1,448.6	1,534.9
Other assets	1,146.0	1,538.4	1,832.0	2,039.6
Total Assets	**106,658.4**	**117,431.8**	**130,414.1**	**145,788.9**
Liabilities and Shareholders' Equity				
Liabilities				
Due to banks and other financial institutions	9,270.5	12,306.8	13,974.2	10,852.7
Customer deposits	85,303.7	90,447.5	98,752.1	104,958.6
Debt securities issued	-	-	-	2,621.6
Other liabilities	3,166.5	4,345.7	3,913.3	6,919.6
Total Liabilities	**97,740.7**	**107,100.1**	**116,639.6**	**125,352.5**
Shareholders' Equity				
Share capital	6,000.0	6,000.0	6,000.0	6,000.0
Statutory reserve	2,100.3	2,854.0	3,737.3	4,990.7
General reserve	-	-	1,500.0	3,900.0
Other reserves (cumulative changes in fair value)	541.4	852.9	1,866.6	4,843.7
Retained Earnings	276.0	624.8	670.6	702.0
Total shareholders' equity	**8,917.8**	**10,331.7**	**13,774.5**	**20,436.4**
Total Liabilities and Shareholders' Equity	**106,658.4**	**117,431.8**	**130,414.1**	**145,788.9**

INCOME STATEMENT

	National Commercial Bank			
SR mn	**2002**	**2003**	**2004**	**2005**
Special commission income	4,752.5	4,894.6	5,645.2	7,336.6
Special commission expense	(1,266.0)	(1,014.8)	(1,110.1)	(2,075.1)
Net special commission income	**3,486.6**	**3,879.7**	**4,535.1**	**5,261.5**
Fees from banking services	689.4	787.3	986.8	1,671.5
Exchange income	130.0	119.1	155.5	171.4
Income from FVIS financial instruments	-	-	208.1	280.3
Trading income	39.3	235.3	33.2	10.9
Dividend income	71.7	88.3	48.9	78.8
Gains on non-trading investments	127.5	368.3	1.7	16.7
Total non-commission income	**1,057.9**	**1,598.3**	**1,434.2**	**2,229.7**
Provision for credit losses	(409.7)	(15.1)	(383.2)	(149.7)
(Reversal of) prov. for impairment for other financial assets	(71.1)	(88.9)	(7.1)	20.6
Total operating income	**4,063.6**	**5,374.0**	**5,579.0**	**7,362.1**
Salaries and employee related expenses	(957.9)	(1,057.2)	(1,075.1)	(1,253.5)
Rent and premises related expenses	(119.0)	(120.1)	(128.2)	(159.3)
Depreciation	(141.9)	(153.9)	(160.2)	(149.3)
Other general and administrative expenses	(460.8)	(603.1)	(576.6)	(721.3)
Total operating expenses	**(1,679.6)**	**(1,934.3)**	**(1,940.2)**	**(2,283.3)**
Other expenses				
Donations	(22.1)	(17.8)	(15.9)	(27.0)
Other non-operating expenses	71.1	(409.1)	(91.7)	(40.7)
Net income	**2,433.0**	**3,012.8**	**3,531.1**	**5,011.0**
Statement of Retained Earnings				
Beginning retained earnings	**(2,083.6)**	**276.0**	**624.8**	**670.6**
Adj. arising from app. Of IAS 39	-	-	(53.0)	-
Net income	2,433.0	3,012.8	3,531.1	5,011.0
Adjustments				
Transfer to statutory reserve	(65.2)	(753.2)	(882.8)	(1,252.8)
Transfer to other reserves	(1.0)	(35.3)	(1,500.6)	(2,400.8)
Net dividends	-	(1,875.5)	(960.0)	(1,200.0)
Zakat (included in other liabilities)	(7.2)	-	(89.0)	(126.0)
Ending balance	**276.0**	**624.8**	**670.6**	**702.0**

CASH FLOW STATEMENT

	National Commercial Bank			
SR mn	**2002**	**2003**	**2004**	**2005**
OPERATING ACTIVITIES				
Net income for the year	2,433.0	3,012.8	3,531.1	5,011.0
Adjustments to reconcile net income to net cash from operating activities:				
Amortization of premium on non-trading investments, net	(124.5)	(0.7)	42.0	14.5
(Gains) on non-trading investments, net	(127.5)	(368.3)	(1.7)	(16.7)
(Gains) on disposal of fixed assets, net	(0.4)	2.5	(0.6)	(2.8)
(Gains) on disposal of other real estate, net	(96.0)	(73.0)	(23.2)	(53.1)
Depreciation of fixed assets	141.9	153.9	160.2	149.3
Depreciation of other real estate	5.8	4.9	4.6	4.1
Provision for credit losses, net	409.7	15.1	383.2	149.7
Bank's share in unconsolidated subsidiary's losses	18.0	28.6	20.0	47.1
Impairment of investment in associate	24.4	93.3	104.3	31.7
(Reversal of) provision for impairment of other financial assets	71.1	88.9	7.1	(20.6)
Provision for (reversal of) unrealized revaluation losses of other real estate	2.4	88.1	(6.8)	
Net (increase) decrease in operating assets:				
Statutory deposits with SAMA	(588.9)	(335.2)	(883.8)	156.1
Due from banks and other financial institutions maturing after ninety days	(9.6)	100.9	(42.8)	(177.0)
Held for trading investments	(106.6)	(1,565.4)	(56.4)	(299.1)
Investment at fair value through income statement	-	-	(2,291.9)	(1,512.6)
Loans and advances	(4,854.4)	(7,376.0)	(14,146.0)	(11,973.3)
Other real estate	336.8	352.6	229.2	140.8
Other assets	300.5	(392.4)	(293.6)	(207.6)
Net increase (decrease) in operating liabilities:				
Due to banks and other financial institutions	(1,049.8)	3,036.3	1,667.4	(3,121.5)
Customers' deposits	6,867.1	5,143.9	8,304.6	6,206.5
Other liabilities	(44.2)	143.5	374.5	1,680.3
Net cash (used in) operating activities	**3,609.0**	**2,154.3**	**(2,918.6)**	**(3,774.7)**
INVESTING ACTIVITIES				
Proceeds from sale and maturities of non-trading investments	46,929.9	49,038.4	49,278.6	12,798.3
Purchase of non-trading investments	(52,513.9)	(48,601.8)	(47,111.6)	(12,019.6)
Purchase of fixed assets	(154.9)	(122.2)	(91.9)	(255.3)
Proceeds from disposal of fixed assets	17.4	10.9	4.7	22.5
Net cash from investing activities	**(5,721.5)**	**325.2**	**2,079.9**	**546.0**
FINANCING ACTIVITIES				
Debt securities issued	-	-	-	2,621.6
Dividends paid	-	(840.0)	(1,856.0)	-
Cash from (used in) financing activities	**-**	**(840.0)**	**(1,856.0)**	**2,621.6**
Net (decrease) in cash and cash equivalents	(2,112.6)	1,639.5	(2,694.7)	(607.1)
Cash and cash equivalents at the beginning of the year	11,857.5	9,744.9	11,384.4	8,689.7
Cash and cash equivalents at the end of the year	**9,744.9**	**11,384.4**	**8,689.7**	**8,082.6**

RATIOS

	National Commercial Bank			
	2002	2003	2004	2005
Profitability				
- Return on average assets	2.4%	2.7%	2.8%	3.6%
- Return on average equity	32.0%	31.3%	29.3%	29.3%
- Net special commission income after PLL's/ Total op. income	74.0%	70.3%	74.3%	69.7%
- Non-commission income/ Total op. income	26.0%	29.7%	25.7%	30.3%
- Non-commission expense/ Total op. income	41.3%	36.0%	34.8%	31.0%
- Fees from banking services/ Total op. income	17.0%	14.6%	17.7%	22.7%
Margins				
- Special commission expense/ Special commission income	26.6%	20.7%	19.7%	28.3%
- Yield on average earning assets	5.1%	4.9%	5.2%	6.2%
- Cost rate on average commission bearing liabilities	1.4%	1.0%	1.0%	1.8%
- Spread	3.7%	3.8%	4.2%	4.4%
- Commission margin (earning assets)	3.7%	3.9%	4.2%	4.5%
Efficiency				
- Cost/ Total op. income	41.3%	36.0%	34.8%	31.0%
- Staff expenses/ Total op. income	23.6%	19.7%	19.3%	17.0%
- G&A expenses/ Total op. income	11.3%	11.2%	10.3%	9.8%
- Non-commission expense/ Average total assets	1.6%	1.7%	1.6%	1.7%
Liquidity				
- Gross Loans/ Customer Deposits	59.3%	59.8%	66.9%	74.1%
- Customer Deposits/ Equity	956.6%	875.4%	716.9%	513.6%
- Customer Deposits/ Total assets	80.0%	77.0%	75.7%	72.0%
Credit Quality				
- Provisions /Total op. income	11.8%	1.9%	7.0%	1.8%
- Provisions /Average loans	1.0%	0.2%	0.6%	0.2%
- Non Performing Loans (SR'000)	7,573,597	3,523,275	1,592,058	1,125,559
- Provision for loan losses (SR'000)	8,190,641	4,381,875	2,517,258	2,457,964
- NPL's /Gross Loans	15.0%	6.5%	2.4%	1.4%
- PLL's / Gross Loans	16.2%	8.1%	3.8%	3.2%
- NPL Coverage	108.1%	124.4%	158.1%	218.4%

RATIOS - Continued

	National Commercial Bank			
	2002	**2003**	**2004**	**2005**
Capital Adequacy				
- Equity/ Total Assets (Equity capital ratio)	8.4%	8.8%	10.6%	14.0%
- Equity/ Gross Loans	17.6%	19.1%	20.9%	26.3%
Constitution of Total Operating Income				
- Net special commission income after PLL's/ Total op. income	74.0%	70.3%	74.3%	69.7%
- Fees from banking services/ Total op. income	17.0%	14.6%	17.7%	22.7%
- FX Income/ Total op. income	3.2%	2.2%	2.8%	2.3%
- PLL's/ Total op. income	11.8%	1.9%	7.0%	1.8%
Operating Performance				
- Change in special commission income	14.4%	11.3%	16.9%	16.0%
- Change in Fees from banking services	15.2%	14.2%	25.3%	69.4%
- Change in Fx Income	57.7%	-8.4%	30.5%	10.3%
Other Ratios				
- Par value per share (SR)	50	50	50	50
- Shares in issue (000's)	120,000	120,000	120,000	120,000
- EPS (SR)	20.3	25.1	29.4	41.8
- EPS (SR) - Adjusted for Split	4.1	5.0	5.9	8.4
- Book value per share (SR)	74.3	86.1	114.8	170.3
- Book value per share (SR) - Adjusted for Split	14.9	17.2	23.0	34.1

Bank AlJazira

Reuters Code:
1020.SE

Listing:
Saudi Stock Exchange

CMP:
SR307.0

August 30, 2006

Not Rated

Key Data

EPS (SR)*	11.7
BVPS (SR)*	34.7
P / E (x)	26.3
P / BV (x)	8.8
Avg daily vol. ('000)	390.8
52 week Lo - Hi	113.9 – 369.0
Market Cap (SR mn)	34,537.5

*Source: **Global** Research*
** Based on 2005 numbers, (post split)*

Background

- **Bank Aljazeera (BAJ)** was established in June of 1975 and began a restructuring process in 1992. At this point the bank started introducing modern technology, and new banking products. The bank currently offers a full range of conventional and Islamic banking and an array of investment products and services, including investment advisory, asset management, international brokerage, local shares trading and a range of mutual funds. The bank was also the first to launch an authorized Islamic life insurance program in the Kingdom of Saudi Arabia.

- BAJ is recognized as one of the leading financial institutions principally serving affluent individuals and successful national corporations in the Kingdom of Saudi Arabia. The bank is striving to provide innovative, high quality banking and investment products and services through highly skilled staff in order to improve services provided to its clientele.

Recent developments

- In July 2006, Moody's Investors Service upgraded the bank's outlook from stable to positive. This came on the back of improving fundamentals of the bank and its strategy of converting itself into a full Shariah-compliant bank. The bank's foreign currency deposit ratings remain unchanged at A3/Prime-2.

- The bank declared its first half results for the current financial year in July 2006. Profits for 1H2006 increased by a whopping 430% to reach SR1.347bn as compared to SR254mn for the same period last year. The earnings per share increased to SR11.98 for the period 1H2006 compared to SR2.26 from the same period last year.

- In June 2006, the bank's shareholders approved a capital increase to SR 1.125bn from SR 750mn. The increase will be carried out through the distribution of one bonus share for every two shares held. A dividend of SR 3 per share for Saudi shareholders was also approved. Non-Saudi shareholders will receive a dividend of SR 4.48 per share. The dividend distribution will be based on the number of shares held before the stock split.

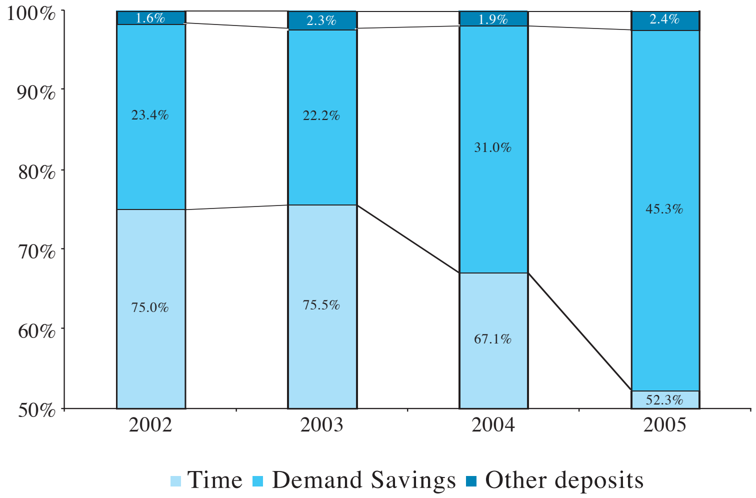
- In order to provide value added services to its customers, BAJ organized two seminars for its clients in February 2006. Out of the two seminars, one seminar was dedicated for the companies in the Saudi stock exchange. The other was to enlighten the customers about the appropriate ways for thinking economically in the stock market as well as discussions on the real estate finance in the Kingdom.

Financial Performance – 2005

- BAJ is the small-size bank with a market share in terms of balance sheet size of 2.0% in 2005 (1.2% in 2002). The asset size increased from SR5.7bn in 2002 to SR14.2bn in 2005, a CAGR growth of 35.3%. The bank's share in total deposit base increased from 1.1% in 2002 to 2.0% in 2005. During the period 2002-05, customer deposits grew at a CAGR of 37.2% from SR4.2bn in 2002 to SR10.8bn in 2005.

- The contribution of time deposits to total deposits declined from 75.0% in 2002 to 52.3% in 2005. Correspondingly, the share of demand and savings deposits has increased from 23.4% in 2002 to 45.3% in 2005. A significant achievement in 2005 was the transfer of all bank's time deposits to the Shari'ah-compliant Naqa'a program.

Chart 1: Deposit Mix

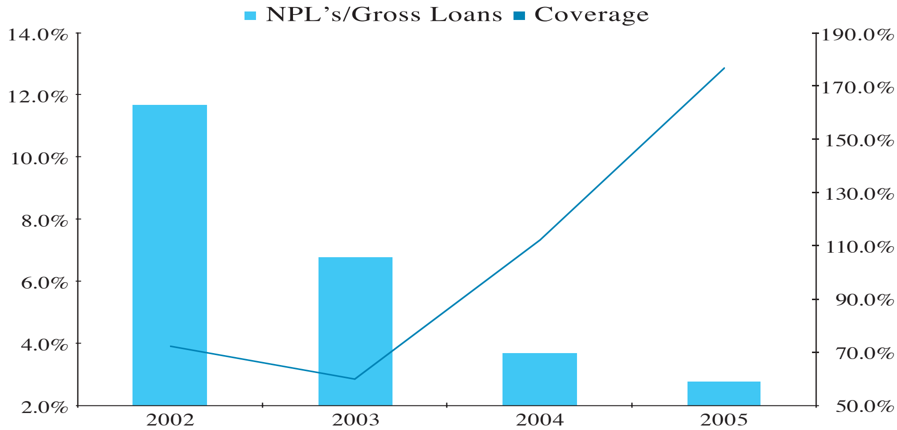


*Source: Company Report, **Global** Research*

- On the lending side, the bank's gross loan book grew at a CAGR of 41.1% from SR2.6bn in 2002 to SR7.3bn in 2005. High oil prices and changing demographics has resulted in strong demand for credit both from the corporate as well as the consumer segment. Gross performing loans and advances increased at a CAGR of 45.7% for the period 2002-05. In absolute terms, it increased from SR2.3bn in 2002 to SR7.1bn in 2005. The strong growth on the lending front is in line with the management's policy of spreading credit concentration over various economic segments.

- During the last three years, the bank's asset quality has improved. Gross non-performing loans (NPLs) as a percentage of gross loans declined from 11.7% in 2002 to 2.8% in 2005. In absolute terms, gross NPLs have declined from SR302.1mn in 2002 to SR200.1mn in 2005. Though the gross NPLs in percentage terms in 2002 was as high as 11.7%. It is worth noting that there has been a sharp improvement in asset quality. Strict adherence and close monitoring has helped the bank improve its credit risk during this period. Aggressive provisioning during this period has helped the bank to increase its coverage ratio from 72.4% in 2002 to 176.9% in 2005.

Chart 2: Non-Performing Loans



*Source: Company Report, **Global** Research*

During the last three years, the bank's net income after minority interest grew at a CAGR of 145.5%. During the same period, total income of the bank grew by 78.3% and total expense increased at a CAGR of 47.1%. Most notable is that fees from banking services grew at a whopping CAGR of 167.6% for the period under review. Next best in terms of growth has been dividend income, which grew at a CAGR of 56.2% followed by special commission income that grew by 37.8%.

On the expense front, loan loss provisions grew at a CAGR of 121.0% for the period 2002-05. Aggressive loan loss provisioning has helped increase the bank's coverage ratio from 72.4% in 2002 to 176.9% in 2005. Growth in special commission expense during the period under review stood at 43.9%.

During the period 2002-05, the revenue mix has significantly changed and has skewed more towards fees from banking services. To put things in perspective, the share of special commission income declined from 73.2% in 2002 to 33.7% in 2005. The contribution of non-commission income excluding fees from banking services declined from 9.5% in 2002 to 7.8% in 2005. Most importantly, the proportion of fee income increased from 17.3% in 2002 to 58.5% in 2005.

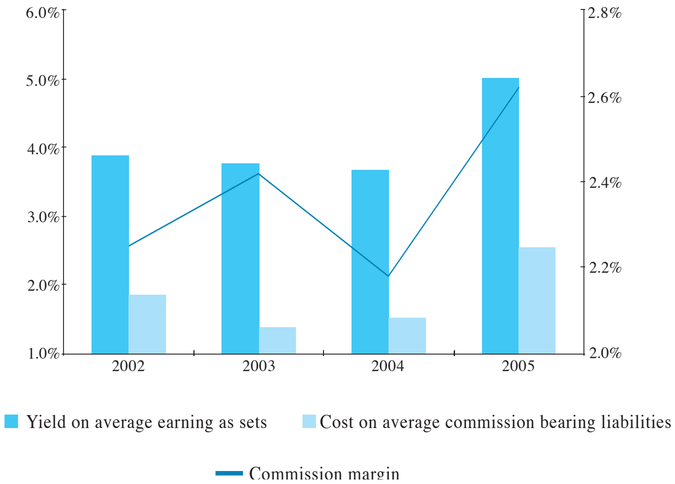
Table 1: Composition of Income and Expense

Amount SR mn	2002	2003	2004	2005	CAGR (2002-05)
Special commission income	202.9	246.8	317.3	530.9	37.8%
Fees from banking services	48.0	112.7	298.8	920.1	167.6%
Exchange income	2.4	3.2	3.1	4.8	25.9%
Net trading income	(6.7)	34.0	32.4	89.3	-337.6%
Dividend income	5.6	11.3	16.1	21.4	56.2%
Net gains on investments	24.1	19.3	53.4	6.2	-36.4%
Other operating income	1.0	3.2	8.5	0.4	-26.4%
Total Income	**277.3**	**430.5**	**729.6**	**1,573.1**	**78.3%**
Special commission expense	(85.5)	(88.8)	(129.4)	(254.5)	43.9%
Operating expense	(122.0)	(175.7)	(249.6)	(322.4)	38.3%
Loan loss provisions	(11.0)	(72.7)	(162.2)	(118.7)	121.0%
Total expense	**(218.5)**	**(337.3)**	**(541.2)**	**(695.6)**	**47.1%**
Net Income Before Minority Interest	**58.8**	**93.2**	**188.4**	**877.5**	**146.2%**
Net income after Minority Interest	**59.2**	**93.5**	**187.7**	**874.4**	**145.3%**

*Source: Company Report, **Global** Research*

- The bank's commission margin increased from 2.3% in 2002 to 2.6% in 2005. Yield on average earning assets increased by 114 bps from 3.9% in 2002 to 5.0% in 2005. During this period, the cost of average commission bearing liabilities increased from 1.9% in 2002 to 2.6% in 2005. The share of demand and savings deposits increased from 23.4% in 2002 to 45.3% in 2005. However, with the general increase in interest rates, cost of funds for the bank has gone up.

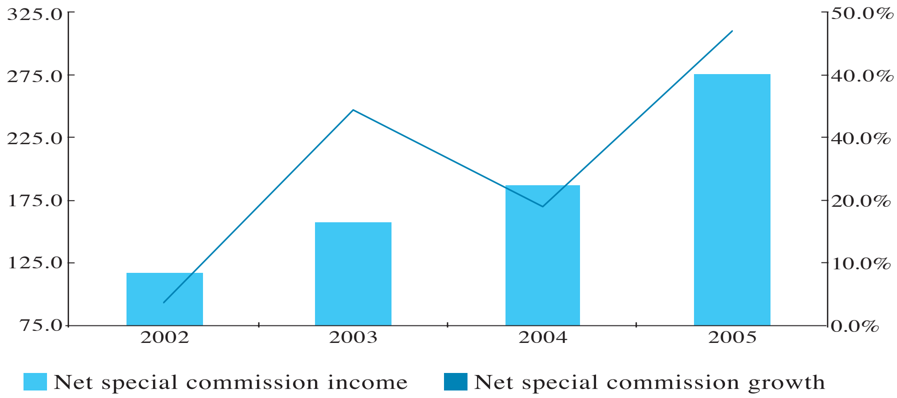
Chart 3: Margins



*Source: Company Report, **Global** Research*

- Net special commission income increased from SR117.4mn in 2002 to SR276.4mn in 2005, CAGR growth of 33.0%. During 2005, the growth in core income was a whopping 47.1%. The key driver for earnings in 2005 was fees from banking services, which grew from SR298.8mn in 2004 to SR920.1mn in 2005, a growth of 207.9%.

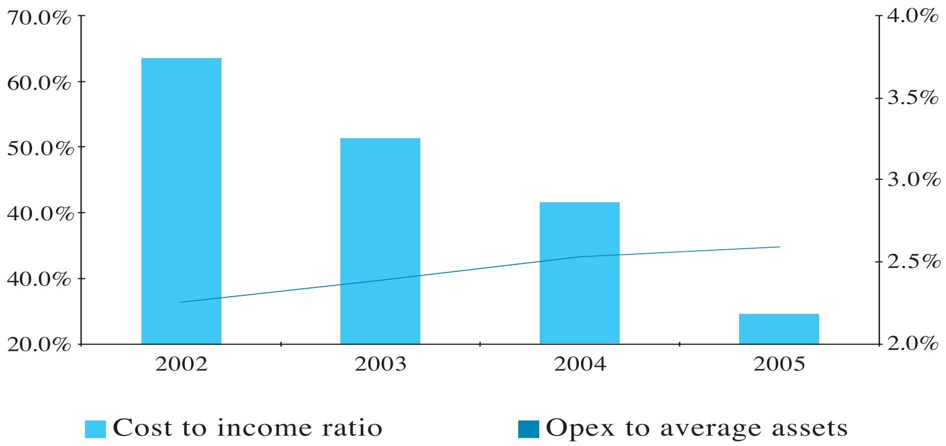
Chart 4: Net Special Commission Income



*Source: Company Report, **Global** Research*

- During the period 2002-05, operating costs increased from SR122.0mn in 2002 to SR322.4mn in 2005, a growth of 38.3%. Cost to income ratio of the bank declined from 63.6% in 2002 to 24.4% in 2005. However, the ratio of operating cost to average assets increased from 2.3% in 2002 to 2.6% in 2005.

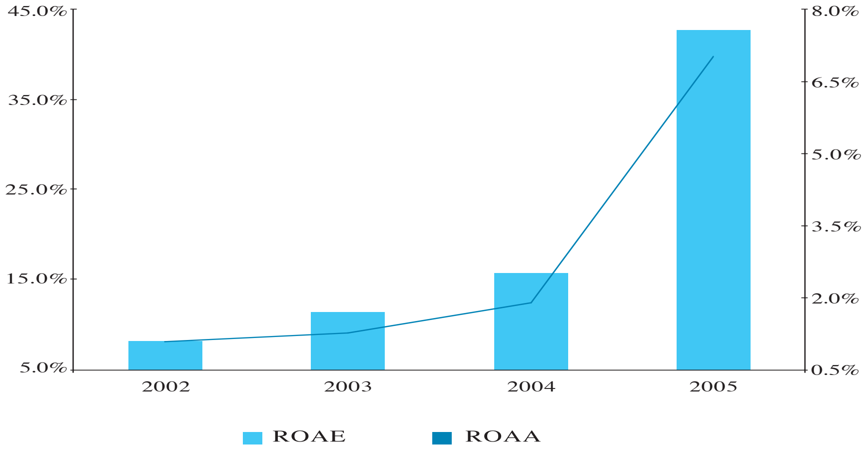
Chart 5: Operating Efficiency



Source: Company Report

- During the last three years, the bank's net profit increased at a CAGR of 145.3%. Net income of the bank increased from SR59.2mn in 2002 to SR874.4mn in 2005. Due to this, the bank's return ratios have increased significantly during this period. Return on average assets increased from 1.1% in 2002 to 7.0% in 2005. Also return on average equity increased from a mere 8.2% in 2002 to 42.7% in 2005.

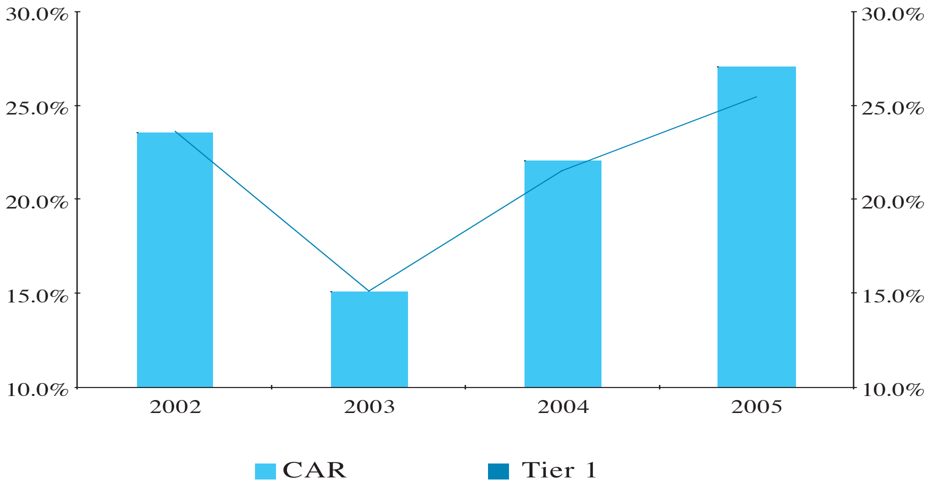
Chart 6: Return Ratios



Source: Company Report, ***Global*** *Research*

- BAJ is well capitalized to support growth in risk-adjusted assets. As at end 2005, the bank's Capital Adequacy Ratio stood at 27.1% as compared to that of 23.6% in 2002. The bank's Tier I ratio as at end 2005 was 25.4%, which gives the bank enough head room to grow its balance sheet size.

Chart 7: Capital Adequacy Ratio



Source: Company Report, ***Global*** *Research*

BALANCE SHEET

	Bank Al Jazira			
SR mn	**2002**	**2003**	**2004**	**2005**
Cash & balances with SAMA	196.0	641.8	382.4	726.4
Due from banks and other FI's	1,912.5	1,840.9	2,733.7	3,283.7
Trading investments	92.1	161.4	196.9	569.2
Non-trading investments	888.0	1,316.7	1,761.3	1,774.4
Net Loans and advances	2,368.3	4,661.4	5,186.7	6,910.9
Net fixed assets	42.4	97.9	143.7	262.8
Other assets	225.5	268.5	317.0	641.4
Total Assets	**5,724.8**	**8,988.7**	**10,721.8**	**14,168.8**
Due to banks and other financial institutions	659.6	446.2	836.8	157.2
Customers' deposits	4,191.1	7,535.1	8,141.6	10,816.1
Other liabilities	91.8	85.2	196.2	285.0
Total Liabilities	**4,942.4**	**8,066.4**	**9,174.7**	**11,258.3**
Minority interest	31.2	37.2	59.1	307.6
Share capital	600.0	600.0	750.0	750.0
Statutory reserve	48.0	71.4	360.0	580.0
Other reserves	94.6	175.5	294.8	620.4
Retained Earnings	8.5	38.2	83.2	652.5
Total shareholders' equity	**751.1**	**885.1**	**1,488.0**	**2,602.9**
Total liabilities and shareholders' Equity	**5,724.8**	**8,988.7**	**10,721.8**	**14,168.8**

INCOME STATEMENT

	Bank Al Jazira			
SR mn	**2002**	**2003**	**2004**	**2005**
Special commission income	202.9	246.8	317.3	530.9
Special commission expense	(85.5)	(88.8)	(129.4)	(254.5)
Net special commission income	**117.4**	**158.0**	**187.9**	**276.4**
Fees from banking services	48.0	112.7	298.8	920.1
Exchange income	2.4	3.2	3.1	4.8
Net trading income	(6.7)	34.0	32.4	89.3
Dividend income	5.6	11.3	16.1	21.4
Net gains on investments	24.1	19.3	53.4	6.2
Other operating income	1.0	3.2	8.5	0.4
Total non-commission income	**74.4**	**183.7**	**412.3**	**1,042.2**
Provision for loan losses	(11.0)	(72.7)	(162.2)	(118.7)
Total operating income	**180.8**	**269.0**	**438.0**	**1,199.9**
Salaries & employee related expenses	(70.8)	(89.6)	(122.5)	(168.8)
Rent & premises related expenses	(11.3)	(13.4)	(18.1)	(27.6)
Depreciation and amortization	(9.6)	(12.0)	(17.7)	(26.3)
Other G & A expenses	(29.8)	(52.0)	(83.8)	(97.0)
Other operating expenses	(0.5)	(2.8)	(7.4)	(2.8)
Total operating expenses	**(122.0)**	**(175.7)**	**(249.6)**	**(322.4)**
Income before minoity interest	58.8	93.3	188.4	877.5
Minority interest	0.4	0.2	(0.7)	(3.1)
Net Income	**59.2**	**93.5**	**187.7**	**874.4**
Statement of Retained Earnings				
Beginning retained earnings	**11.6**	**8.5**	**38.2**	**83.2**
Adjustment arising from app. Of revised IAS 39	-	-	-	(17.9)
Net income	59.2	93.5	187.7	874.4
Adjustmernts	(23.8)	-	-	-
transfer to statutory reserve	(18.0)	(23.4)	(48.6)	(220.0)
Transfer to other reserves	(10.0)	-	-	-
Gross dividends	-	(38.0)	(88.4)	(67.2)
Net change in fair value	(10.4)	(2.4)	(5.7)	-
Ending balance	**8.5**	**38.2**	**83.2**	**652.5**

CASH FLOW STATEMENT

	Bank Al Jazira			
'SR mn'	**2002**	**2003**	**2004**	**2005**
Net income	**59.2**	**93.5**	**187.7**	**874.4**
Accertion of discounts	0.3	(0.7)	(1.6)	(2.3)
Gains on investments	(17.2)	(53.3)	(53.4)	(6.2)
Depreciation and amotization	9.6	12.0	17.7	26.3
Loss / gain on disposal of fixed assets	0.0	0.0	0.2	0.1
Provision for loan losses	11.0	72.7	162.2	118.7
Trading income	-	-	(32.4)	(89.3)
	62.9	124.2	280.4	921.6
Due from banks and other FI's	(526.4)	71.7	(892.9)	(549.9)
trading portfolio	121.1	(35.3)	(35.5)	(372.3)
loans and advances	(282.2)	(2,365.8)	(687.5)	(1,842.9)
other assets	22.8	(43.0)	(48.5)	(324.4)
due to banks and FI's	(16.7)	(213.3)	390.6	(679.6)
customers deposits	544.6	3,343.9	606.6	2,674.5
Other liabilities	(16.2)	(8.0)	111.1	88.7
Minority interest	(13.4)	5.9	21.9	248.5
Cash flow from operations	**(103.7)**	**880.2**	**(253.7)**	**164.2**
Net sale /purchase of investments	186.1	(330.2)	(391.2)	(6.9)
Capex	(6.2)	(67.5)	(63.5)	(145.3)
Cash flow from investing	**179.9**	**(397.7)**	**(454.7)**	**(152.2)**
Dividend and zakat paid	-	(36.6)	(88.4)	(67.2)
Change in Equity	-	-	503.6	307.7
Cash flow from financing	**-**	**(36.6)**	**415.2**	**240.5**
Change in cash	76.2	445.9	(293.3)	252.4
Beginning cash	119.8	196.0	641.8	382.4
Ending cash	**196.0**	**641.8**	**348.6**	**634.9**

RATIOS

	Bank Al Jazira			
	2002	2003	2004	2005
Profitability				
- Return on average assets	1.1%	1.3%	1.9%	7.0%
- Return on average equity	8.2%	11.4%	15.8%	42.7%
- Net special commission income after PLL's/ Total op. income	58.8%	31.7%	5.9%	13.1%
- Non-commission income/ Total op. income	41.2%	68.3%	94.1%	86.9%
- Non-commission expense/ Total op. income	67.5%	65.3%	57.0%	26.9%
- Fees from banking services/ Total op. income	26.6%	41.9%	68.2%	76.7%
Margins				
- Net (or profit) margin	32.8%	34.8%	42.9%	72.9%
- Special commission expense/ Special commission income	42.1%	36.0%	40.8%	47.9%
- Yield on average earning assets	3.9%	3.8%	3.7%	5.0%
- Cost rate on average commission bearing liabilities	1.9%	1.4%	1.5%	2.6%
- Spread	2.0%	2.4%	2.2%	2.5%
- Commission margin (earning assets)	2.3%	2.4%	2.2%	2.6%
Efficiency				
- Cost/ Total op. income	67.5%	65.3%	57.0%	26.9%
- Staff expenses/ Total op. income	39.1%	33.3%	28.0%	14.1%
- Rent, G&A expenses/ Total op. income	22.7%	24.3%	23.3%	10.4%
- Non-commission expense/ Average total assets	2.3%	2.4%	2.5%	2.6%
Liquidity				
- Loans / Commission earning assets	48.7%	62.6%	57.0%	62.6%
- Loans/ Customer Deposits	61.7%	64.5%	66.4%	67.2%
- Customer Deposits/ Equity	558.0%	851.3%	547.2%	415.5%
- Customer Deposits/ Total assets	73.2%	83.8%	75.9%	76.3%
- Due from Banks/ Due to Banks	290.0%	412.6%	326.7%	2089.3%
Credit Quality				
- Provisions /Total op. income	6.1%	24.8%	37.0%	9.9%
- Provisions /Average loans	0.4%	1.8%	3.2%	1.9%
- Non Performing Loans (SR'000)	302.1	328.0	198.6	200.1
- Provision for loan losses (SR'000)	218.7	196.1	222.2	353.9

RATIOS - Continued

	Bank Al Jazira			
	2002	2003	2004	2005
- NPL's /Gross Loans	11.7%	6.8%	3.7%	2.8%
- NPL's /(Equity+provision for loan losses)	31.2%	30.3%	11.6%	6.8%
- PLL's / Gross Loans	8.5%	4.0%	4.1%	4.9%
- NPL Coverage	72.4%	59.8%	111.8%	176.9%
Capital Adequacy				
- Equity/ Total Assets (Equity capital ratio)	13.1%	9.8%	13.9%	18.4%
- Equity/ Gross Loans	29.0%	18.2%	27.5%	35.8%
- Tier 1 ratio	23.6%	15.1%	21.5%	25.4%
- CAR	23.6%	15.1%	22.1%	27.1%
Constitution of Total Operating Income				
- Net special commission income after PLL's/ Total op. income	58.8%	31.7%	5.9%	13.1%
- Fees from banking services/ Total op. income	26.6%	41.9%	68.2%	76.7%
- Investment Income/ Total op. income	12.8%	24.0%	23.3%	9.7%
- FX Income/ Total op. income	1.3%	1.2%	0.7%	0.4%
- PLL's/ Total op. income	6.1%	27.0%	37.0%	9.9%
Operating Performance				
- Change in special commission income	-26.1%	21.6%	28.6%	67.3%
- Change in Fees from banking services	9.7%	134.8%	165.0%	207.9%
- Change in Investment Income	-38.6%	179.8%	57.8%	14.8%
- Change in Fx Income	7.5%	33.6%	-2.4%	53.1%
RATIO'S USED FOR VALUATION				
- Par value per share (SR)	50	50	50	50
- Shares in issue (mn)	12	12	15	15
- EPS (SR)	4.9	7.8	12.5	58.3
- EPS (SR) - Adjusted for Split	1.0	1.6	2.5	11.7
- DPS (SR)	2.5	2.6	3.0	4.5
- DPS (SR) - Adjusted for Split	0.5	0.5	0.6	0.9
- Book value per share (SR)	62.6	73.8	99.2	173.5
- Book value per share (SR) - Adjusted for Split	12.5	14.8	19.8	34.7
- Market price year end (SR) *	69.8	144.0	261.5	1058.0
- P/E	14.1	18.5	20.9	18.1
- P/BV	1.1	2.0	2.6	6.1

** Closing Market Price of respective years*

Bank AlBilad

Reuters Code:
1140.SE

Listing:
Saudi Stock Exchange

CMP:
SR79.25

August 30, 2006

Not Rated

Key Data

Avg. daily vol.('000)	2,872.5
52 week Lo / Hi	70.5/186.7
Market Cap (SR mn)	23,775.0
Target Price	NA

Source: ***Global*** *Research*

Background

- **Bank AlBilad** was formed when in June 2004, eight money exchange organizations merged under the name Bank Al-Bilad. Saudi financial authority (SAMA) mandated the money exchangers to merge into a single commercial bank. The bank now has 34 branches in the Kingdom.

- The eight firms, that were part of the Bank AlBilad are Muhammad & Abdullah Ibrahim Al-Subaie Company, Al-Muqairen Money Exchange (run by the heirs of Abdul Aziz ibn Suleiman Al-Muqairen), Al-Rajhi Trading Establishment, Al-Rajhi Commercial Foreign Exchange, Muhammad Saleh Sairafi Establishment, Abdul Mohsen Saleh Al-Amri Est., Injaz Money Exchange (Yousuf Abdul Wahab Niamatullah Company), and Ali Hazza & Partners for Trade and Money Exchange.

- The IPO of Bank AlBilad where it offered 30mn shares generated huge investors' response. The issue raised SR7.75bn and was oversubscribed by more than 5 times as the number of subscribers reached 8.7mn. Bank AlBilad public subscription was considered to be the largest, not just in Saudi Arabia, but also in the region. The 30mn offered shares were distributed equally to subscribers at the rate of 3.45 shares for each subscriber. Bank AlBilad represented Saudi Arabia's first ever public flotation of bank shares via the Internet.

- In Feb-2006, the bank established 70 consumer service centers for fund remittances and currency exchange under the umbrella of Injaz Exchange, a subsidiary of Al Bilad. Enjaz Banking Services is one of Bank Albilad's groups serving its clients through a strategy of multi-branding customer service. Its current products include remittances, drafts, and cash currency exchange.

Major Shareholders	% Holding
Al Subeaei Group	21.28%
Heirs of Abdulaziz Sulaiman Al Mukairin	8.56%
Al Rajhi Commercial Foreign Exchange	7.90%
Al Rajhi Trading Establishment	7.10%
Mohammed Saleh Sayrafi Establishment	3.04%
Injaz Saleh Sayrafi Establishment	1.74%
Abdulmohsen Saleh Al Omari Establishment	0.19%
Ali Hazza and Company for Trading and Exchange	0.19%
Public	50.00%

Source: Zawya

Recent developments

- In a recent expansion measure, Bank AlBilad on February 20 signed an agreement with the financial transfer company, Western Union Financial Services, to provide money transfer services to its customers in Saudi Arabia, thus becoming the second Western Union representative company in the Kingdom after SAMBA Financial Group.

- Bank AlBilad plans to open 20 more consumer service centers for fund remittances in the coming months.

Financial Performance

- Bank AlBilad announced a net profit of SR147.1mn for the first half of 2006 compared with losses of SR98mn reported for the corresponding period of the previous year. The bank managed to diversify its sources of income and the total revenue from all operations reached SR368.8mn by the end of the first half of 2006.

- Bank AlBilad recovered its 2005 losses and reported net profit of SR102.9mn for Q1 2006.

- The bank had reported SR98mn in losses for its first year of operations.

- According to the bank's executive director Mr. Azzam Abalkhail, total financial transactions during the first quarter of 2006 grew by 26% to reach SR206mn.

- Bank AlBilad achieved Q1 revenues of SR121.9mn from banking services.

Balance Sheet

(SR'000)	1Q-2006	2005
Cash and Balances with SAMA	433,641	1,284,560
Due from banks and other financial institutions	68,651	109,158
Investments		
Murabaha	4,700,762	4,619,913
Bei Ajel	2,316,892	1,696,214
Musharaka	229,405	111,224
Total investments	**7,247,059**	**6,427,351**
Fixed assets,net	420,353	373,714
Other assets	51,213	26,387
Total assets	**8,220,917**	**8,221,170**
Liabilities		
Customer deposits	4,767,742	5,026,567
Other liabilities	450,970	295,280
Total liabilities	**5,218,712**	**5,321,847**
Shareholders' equity		
Share capital	3,000,000	3,000,000
Unallocated shares	(2,585)	(2,585)
Paid up capital	2,997,415	2,997,415
Retained earnings (accumulated losses)	4,790	(98,092)
Total shareholders' equity	**3,002,205**	**2,899,323**
Total liabilitiees	**8,220,917**	**8,221,170**

Income Statement

(SR'000)	1Q-2006	19th April - 31st Dec' 2005
Income from investments		
Murabaha	38,910	94,940
Bei Ajel	32,571	14,311
Musharaka	1,396	-
Total income from investment	**72,877**	**109,251**
Fees from banking services	121,972	44,861
Exchange differences income,net	11,309	9,376
Total operating income	**206,158**	**163,488**
Salaries and Employee-Related Exp.	53,675	104,561
Rent and premises-related expenses	10,997	24,240
Depreciation	13,593	8,727
Other G&A Expenses	25,031	44,184
Total operating expenses	**103,296**	**181,712**
Pre-operating expense,net	-	79,868
Net income/loss for the period	**102,862**	**(98,092)**
EPS (SR)	**0.34**	**(1.64)**

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	Ticker	Price	Disclosure
Al-Rajhi Bank	Hold	1120.SE	SR302.5	1,10
Arab National Bank	Buy	1080.SE	SR113.0	1,10
Banque Saudi Fransi	Hold	1050.SE	SR145.0	1,10
Riyad Bank	Buy	1010.SE	SR79.5	1,10
The Saudi British Bank	Hold	1060.SE	SR167.3	1,10
The Saudi Investment Bank	Buy	1030.SE	SR113.3	1,8,9,10
SAMBA Financial Group	Buy	1090.SE	SR156.0	1,10
Saudi Hollandi Bank	Buy	1040.SE	SR88.3	1,10

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Global rating	Definition
Buy	Fair value of the stock is >10% from the current market price
Hold	Fair value of the stock is between +10% and -10% from the current market price
Reduce	Fair value of the stock is between -10% and -20% from the current market price
Sell	Fair value of the stock is < -20% from the current market price

Global Research

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