

Market Research

Saudi Arabia Market

All Sectors - All Industries

08 September 2012

الراجحي المالية
Al Rajhi Capital



Closing price **7,049.5**
YTD performance (%) **9.8**
Avg daily volume (YTD mn) **390.6**

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Key themes

The initial rally seen in the Saudi stock market at the beginning of 2012 has softened and the market has moved to more sustainable levels. We believe speculation has taken a backseat for now and the market has returned to its fundamentals.

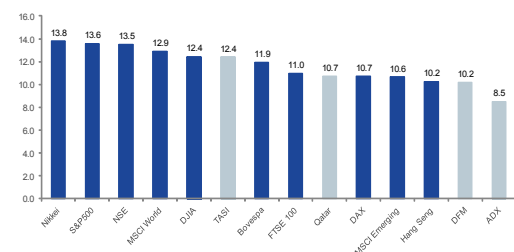
Implications

We expect volumes on the TASI index to continue increasing over the next few months. We expect large sectors such as agriculture, retail and food to perform better over the next 3-4 months on the back of favorable demographic factors in the Kingdom.

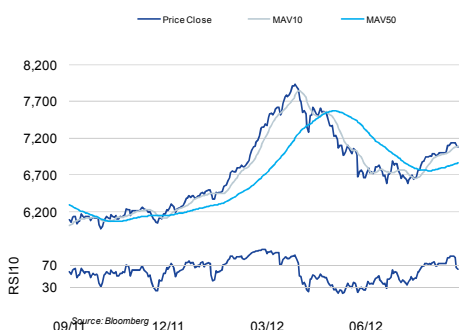
Top picks for remainder of 2012

Stock	Rating	Price Target
Al Othaim	Overweight	SAR109.4
Mobily	Overweight	SAR70.0
SABIC	Overweight	SAR113.4
NIC	Overweight	SAR40.5
SAFCO	Overweight	SAR221.4

P/E comparison



Saudi Arabia market index



Saudi Stock Market Moderate upside ahead

Our view that the Saudi stock market was driven by speculation in the early part of 2012 turned out to be true as TASI corrected sharply after hitting levels of close to 8,000. After that, the year-to-date returns have normalized (+9.8%). TASI has relatively underperformed its global peers over the past three months (TASI's +5.8% versus +6.9% for MSCI world), mainly due to a decline in crude prices and under-performance of its major sectors – petrochemicals and banking. With the end of the Ramadan season and approaching winter, we expect volumes to pick up in the next few months. Having said that, TASI is likely to remain range bound for the rest of 2012, especially if global central banks refrain from providing major stimulus measures.

Tadawul is emerging as a mature market: Tadawul has become more aligned with global markets in the last few years and relatively less correlated to crude prices. Further, retail participation remains strong with higher swap activity, despite the volatility witnessed during the first two quarters of 2012. We believe Tadawul as a market is maturing and hence is relatively lesser dependent on crude prices.

Moderate upside likely for TASI post Ramadan: Having analyzed the historic trend, we observed that TASI has given a positive return one month after Ramadan in 10 out of 12 instances between 2000 and 2011. Historical data also indicates that TASI movement is closely linked to trading volumes, which usually pick up post Ramadan. Hence, we believe that TASI will start moving northward post Ramadan. Having said that, we believe the upside will be moderate as the index is already trading at a premium over major GCC markets (at a 2012 PE of 12.4 versus 10.7x for Qatar and 10.2 for DFM).

Mid and small cap sector have performed better than large-caps: Mid and small-cap sectors such as real estate and insurance have performed much better than large cap sectors like petrochemicals and banking on a YTD basis, with healthy volumes. We believe the strong performance from these sectors would continue for the remainder of the year, driven by favorable domestic factors and continued investor optimism. Though the petrochemicals sector may face headwinds from weaker demand in rest of 2012, attractive valuation presents an investment opportunity for long term investors.

Conclusion: Though the Saudi market is likely to move higher after the holy month of Ramadan, upside potential is likely to be moderate. We expect the sectors focusing on domestic consumption (such as food and agriculture, retail, and telecom) to benefit from strong demand. Sectors dependent on exports such as petrochemicals may get affected from the weak global economic environment for the rest of 2012.

Al Othaim and Mobily remain our top picks from the sectors based on domestic consumption. Despite headwinds for the petrochemical sector in the near term, we remain optimistic on SABIC, NIC and SAFCO and view them as positive investment opportunities for a six to nine months horizon.

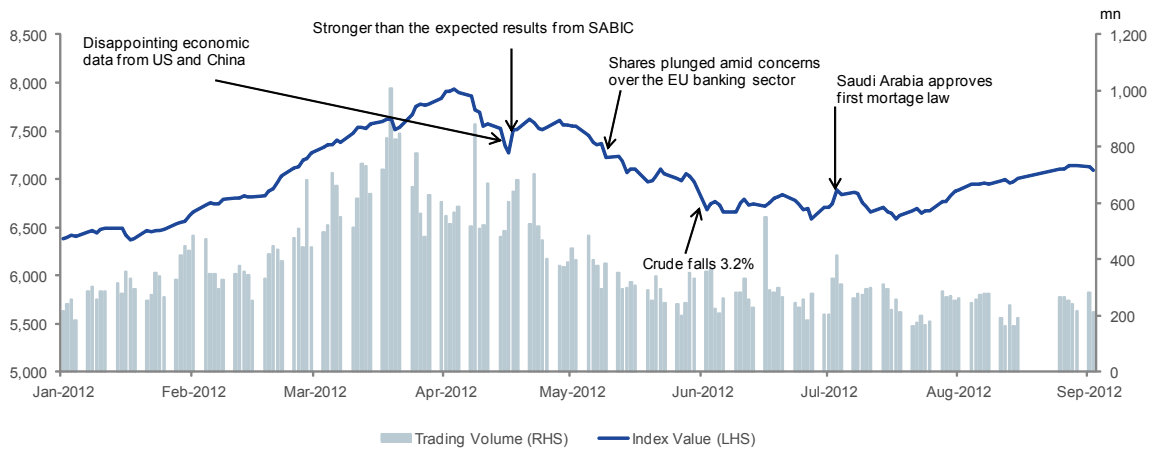


Saudi Stock Market: Higher volumes post Ramadan

TASI has rallied by 9.8% since the start of the year

Since the beginning of 2012, TASI rallied by 24% to reach at 7,900 levels in the beginning of April 2012. However, this rally was short-lived as apprehensions of a limited global economic recovery led to a decline in crude prices and a correction in the Saudi market, supporting our view that speculation by retail investors had been the driving force (refer our market report of March 2012). By the end of Q2 2012, TASI had declined by 17% (versus 23.5% decline in Brent crude prices during the same period), almost erasing the entire gains made earlier. The Saudi market has recovered about 7% since then on higher crude prices (Brent has recovered by 28% from the lows). However, this time around we believe that the recovery in TASI has not been driven by speculation. This is reflected by the normalized returns of the TASI from 22.7% in Q1 2012 to 9.8% YTD as compared to Dubai Financial Markets (14.5%) and S&P 500 (11.6%) during the same period.

Figure 1 TASI Index price and volume data

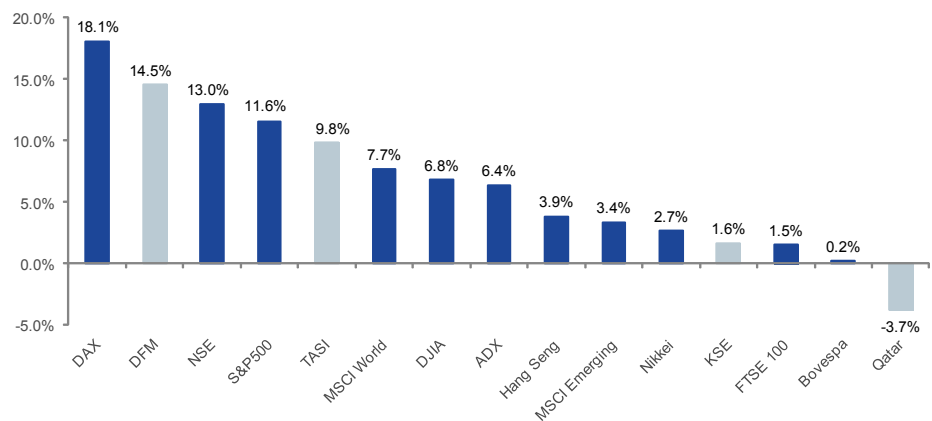


Source: Bloomberg, Al Rajhi Capital

TASI has been one of the best performing indices in the world (5th in terms of YTD returns), since the beginning of 2012.

TASI is one of the better performing markets in the GCC on a YTD basis

Figure 2 YTD performance of key global markets



Source: Bloomberg, Al Rajhi Capital

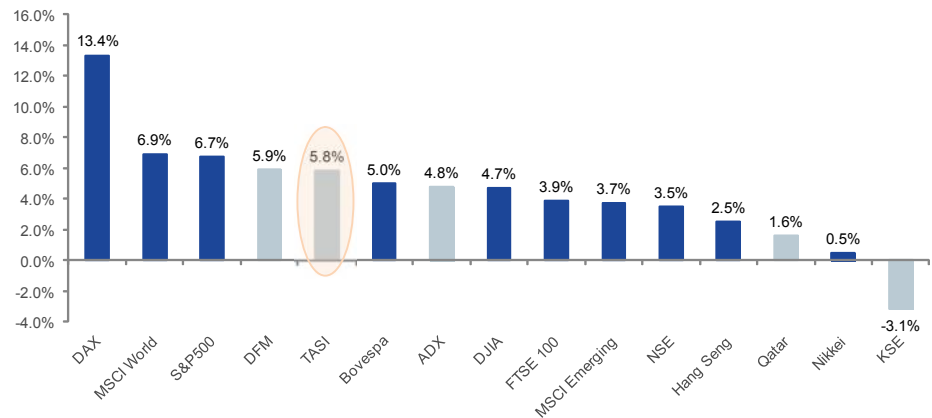


However, TASI has not done well during the past three months

Tadawul has been one of the best performing markets in the GCC region, and has also performed better than other benchmark indices such as MSCI World Index, MSCI Emerging Market Index, and Dow Jones. It has also done better than some of the emerging market indices such as Bovespa (Brazil). However, most of this performance is stemming from Q1 2012, when crude prices were at all-time highs.

This is substantiated by the fact that TASI has been an underperformer over the past three months, while Kuwait Stock Exchange and the Qatar Exchange index have been the worst performing indices in the GCC region. The reason for this underperformance can be explained by the sharp decline in crude prices in Q2 2012 and the resultant impact on the Kingdom's oil & gas-based economy. The petrochemicals sector, whose products are invariably linked to crude prices, has been adversely impacted due to declining prices and a contraction in profit margins as reflected by the poor Q2 2012 results.

Figure 3 3-month performance of key global markets



Source: Bloomberg, Al Rajhi Capital

Mid-caps have performed better than large-caps

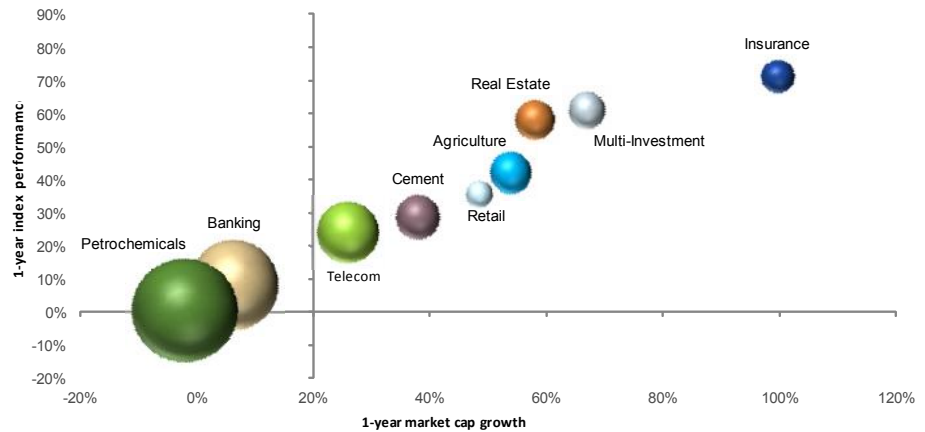
Mid-cap sectors have performed better

Mid-cap sectors such as insurance, agriculture and real estate have out-performed the market over the past twelve months, while large-cap sectors such as telecom, banking and petrochemicals have under-performed. The insurance sector performed exceedingly well both in terms of returns and volumes mainly due to growing speculation activity despite weaker operating performance. Further, sectors such as real estate and cement have also performed well on account of the massive housing development activities planned in the Kingdom. According to news reports, Saudi Arabia will need 1.5mn units over the next few years to avoid a shortage in affordable housing caused by a growing population (around 45% of the population are in the 15-40 age-group). Going forward, we expect sectors such as agriculture and retail to perform well on the back of strong consumer demand. The real-estate sector may continue its strong performance, supported by the huge investment planned in the housing sector and the new Saudi mortgage law.

The petrochemicals sector (largest in terms of market capitalization) has in fact seen a negative performance, on account of its weak results in the second-half of 2011 and Q2 2012. We expect the sector to under-perform for the remainder of 2012 due to the prevailing slowdown across global economies. Nevertheless, we remain positive on the sector over the medium-term due to the feedstock cost advantage that it enjoys over its global peers and the significant investments for diversification being made in this sector. We also expect traction in the banking sector as the new mortgage law gets implemented and lending increases for building new housing facilities across Saudi Arabia.



Figure 4 Performance of key sectors in TASI

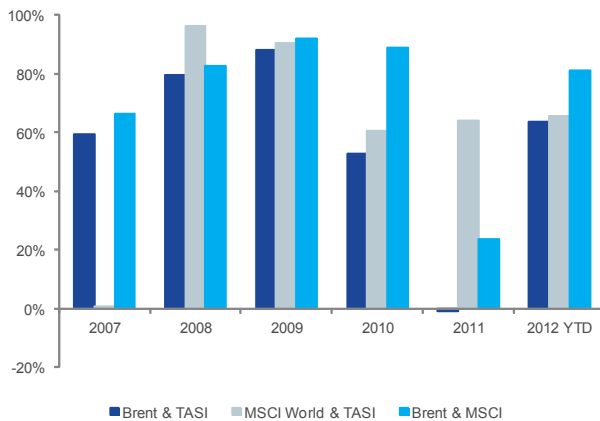


Source: Bloomberg, Al Rajhi Capital

Trends indicate maturing Saudi market

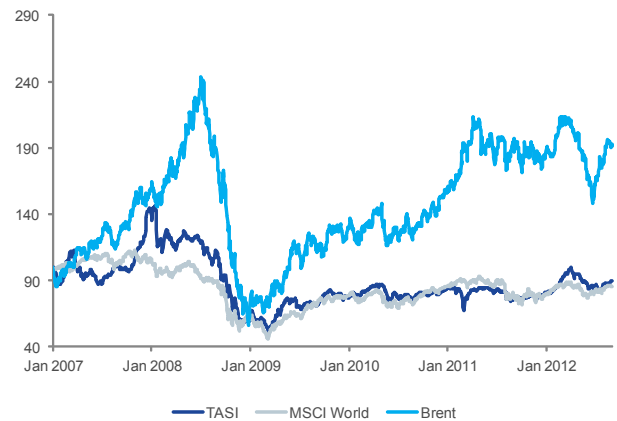
The correlation between TASI and Brent is weakening: Given that the Saudi economy is driven by oil and petrochemicals exports, TASI's movement is implied to be correlated with the movement in Brent crude prices. This trend has held true in the past except for 2011, when the correlation between the market and Brent price movements was surprisingly negative.

Figure 5 Correlation of TASI to Brent and MSCI World



Source: Bloomberg, Al Rajhi Capital

Figure 6 Performance of TASI vs. MSCI World and Brent



Source: Bloomberg, Al Rajhi Capital

We can attribute for this negative correlation to the Arab uprisings in the MENA region. Some of these disturbances spilled over to Saudi Arabia, resulting in a sharp decline of TASI in February and March 2011 by more than 20%, while they led to a surge in crude prices on concerns about supply disruptions.

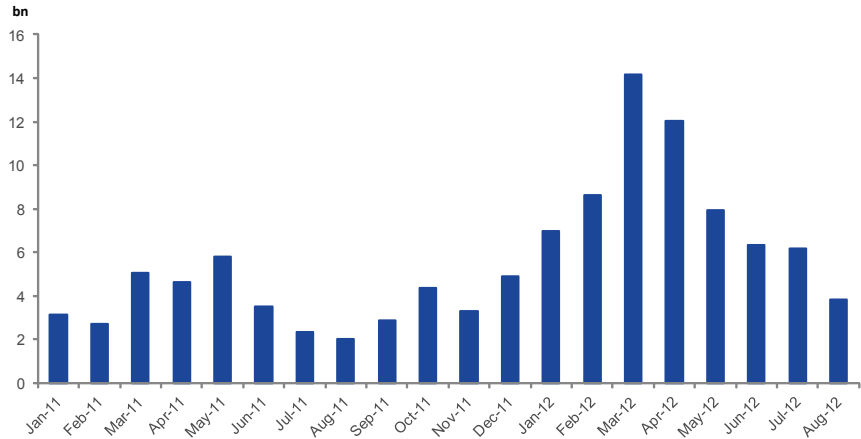
TASI remains linked to crude, but has gained more stability

Although the correlation between TASI and Brent price movements has become positive since the beginning of 2012, we note that it remains subdued in comparison with correlation with a benchmark index like MSCI World. We consider this a positive trend and as an indicator that the Saudi market has become mature and more stable (Refer to Figure 6 above prior to January 2009), also taking into account the fact that much of the upside to crude prices was on account of the quantitative easing policies undertaken by the governments in the US, Europe and China rather than actual demand.



Retail participation continues to be strong: Retail investor participation, which accounts for bulk of the trades carried out on Tadawul, has remained strong despite the volatility seen in the Saudi market this year. Though we can see a big drop in volumes post March 2012, we believe that it can be mainly attributed to the end of speculation activity, escalating global economic crisis and approaching summer/Ramadan season. Traded volumes by retail investors increased by 90.5% y-o-y during the month of August to 3.8bn. This continued strong participation by retail investors is a positive signal for the Saudi market.

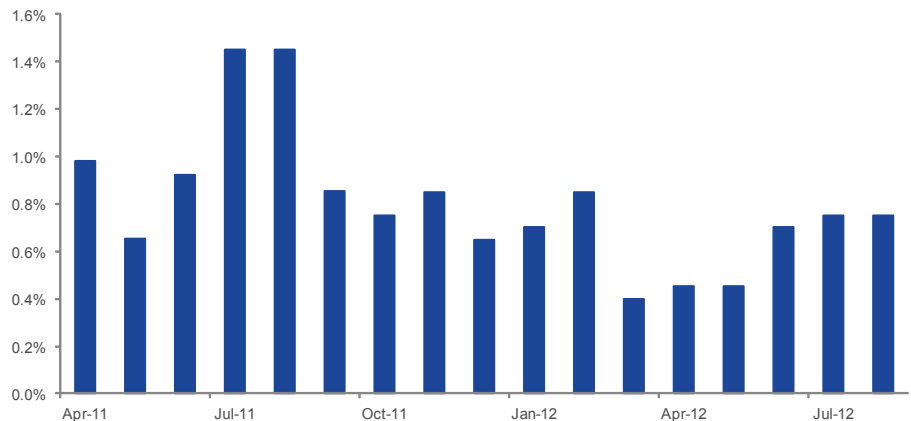
Figure 7 Retail participation has increased significantly y-o-y



Source: Tadawul, Al Rajhi Capital

Swaps activity has increased over the past few months: Net purchases through swap agreement stood at SAR171.3mn in August. Since foreign investors can enter the Saudi market only through this route, we consider this as a positive driver for the market. Average trading activity through swaps reached 0.75% in August, compared to 0.40% in March 2012.

Figure 8 Trading activity through swaps as a percentage of total turnover is rising in H2 2012



Source: Tadawul, Al Rajhi Capital

Strong uptick in trading activity through swaps in H2 2012

Although the trends mentioned above are disparate, all of them point towards the Saudi market becoming more mature and acquiring depth, which bodes well for the market as well as for investors over the long-term.



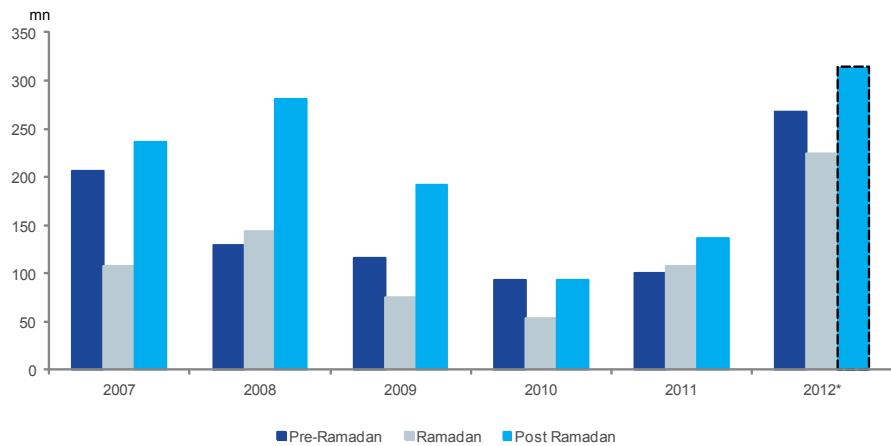
The Ramadan month has an impact on TASI volumes and value

What to expect post Ramadan

With the 2012 Ramadan holidays coming to a close, we believe it is a good time to look at the historical stock market movements to find any patterns that are witnessed after the holy month. Based on our observations, the holy month has a noticeable impact on both trading volumes and market return.

Volumes likely to increase after Ramadan: In the figure below, we have compared the one-month average trading volume for the month before Ramadan, during the holy month and the month after Ramadan, from 2007 onward. As one would expect, trading turnover declines sharply during the month of Ramadan with reduction in trading hours and investors tending to stay away from the markets. After Ramadan, trading volumes pick-up again – especially after the first week – as investors/traders return from holidays. We expect a similar trend for 2012, despite the high level of volumes seen in the beginning of the year. As a result, we are likely to witness an uptick in trading activity after Ramadan, assuming slightly higher growth levels as compared to 2011 (one of the lowest in the past five years).

Figure 9 TASI volume change pattern during Ramadan



Source: Bloomberg, Al Rajhi Capital
Post Ramadan are forecasted numbers

TASI has given positive returns 10 times out of 12 instances after Ramadan, during the 2000 to 2011 period

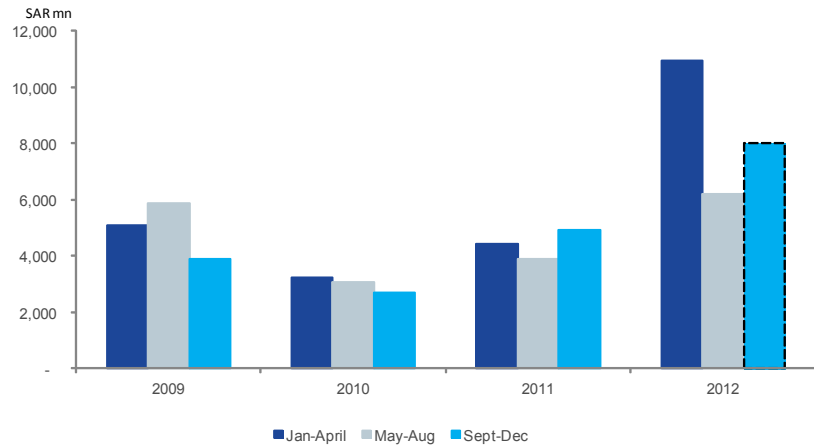
TASI likely to be range bound till the year-end: Other than the predictable effect on trading volumes, the holy month also has an impact on stock market returns. Similar to our analysis of volumes, we analyzed the historical return pattern using monthly average value of TASI for the month before Ramadan, during the holy month and one month after Ramadan, since 2000. As per our analysis, TASI has given positive returns 10 times out of 12 instances after Ramadan, during the 2000 to 2011 period. The two exceptions were in 2006 and 2008. While, the first one was on account of the Saudi stock market crash, the second one was on account of the unprecedented financial meltdown in equity markets across the globe.

In 2012, the Saudi market has made a marginal positive return during the holy month. For the rest of the year, we believe TASI will end up moderately higher from the current levels. In addition, the positive correlation between volumes and returns also indicates toward a positive return on TASI.

We expect trading activity to pick up in the winter season between the months of September to December, similar to the trend witnessed in 2011. From the figure below, one can see that the average daily trading turnover improved during the winter months in 2011. However, before 2011, average trading turnover used to be comparatively lower in the Sept-Dec period since Ramadan season used to fall during this period.



Figure 10 Value traded likely to increase in the next four months



Source: Bloomberg, Al Rajhi Capital
 Post Ramadan are forecasted numbers

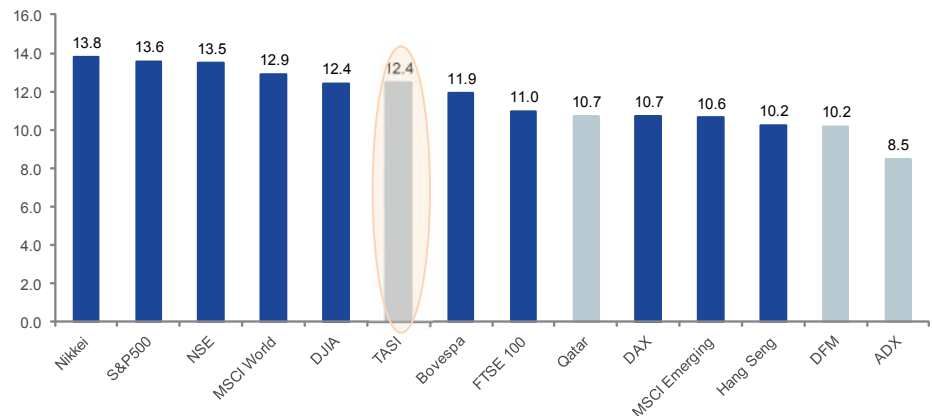
Valuations imply limited upside over the near-term

TASI is trading at a premium to most markets, which indicates limited upside

The Saudi stock market appears to be fairly valued: The 2012 P/E multiple for TASI is higher than many of the GCC markets, which we believe is justified by the higher economic growth potential of the Kingdom. TASI currently trades at a P/E multiple of 12.4x, which is at a marginal premium to major markets across the GCC region.

Compared to international indices, the Saudi market looks fairly valued (refer to Figure 11 below), trading at a discount to developed markets like US and Japan, and emerging markets like India, but at the same time trading at a premium to Brazil and Hong Kong. While we believe chances exist for an upside on TASI, but they are limited.

Figure 11 Forward PE comparison of TASI vs. major global markets

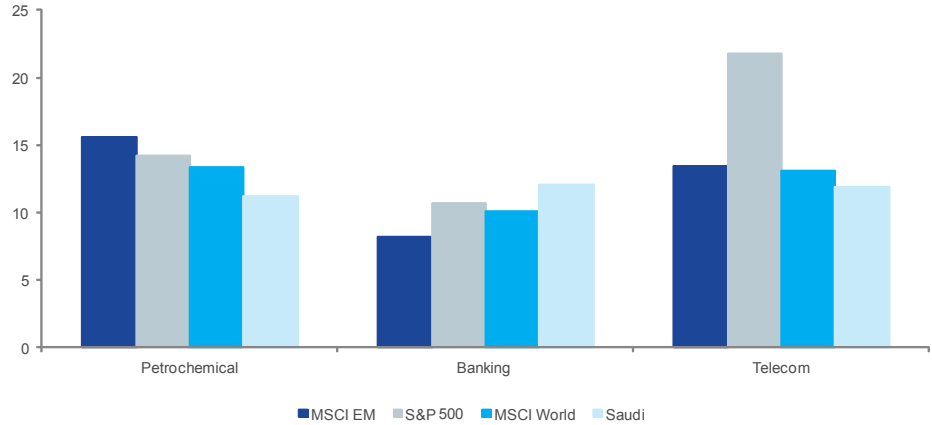


Source: Bloomberg, Al Rajhi Capital

Sector-wise breakup of the market indicates that the P/E multiple for two major sectors in TASI – petrochemicals and telecom – remains low, compared to global peers, suggesting a possibility of further upside. However, the banking sector, another major component of TASI, is trading at a premium on a forward P/E basis as compared to other regions, even though the sector has witnessed improved profitability in Q2 2012. We believe that the higher P/E ratio is justified as the Saudi banking sector continues to be strong and post solid results, which indicates that the sector is well protected from the global turmoil. We believe that there is still an upside potential for the banking sector even considering the valuation premium.



Figure 12 PE comparison of large-cap Saudi sectors



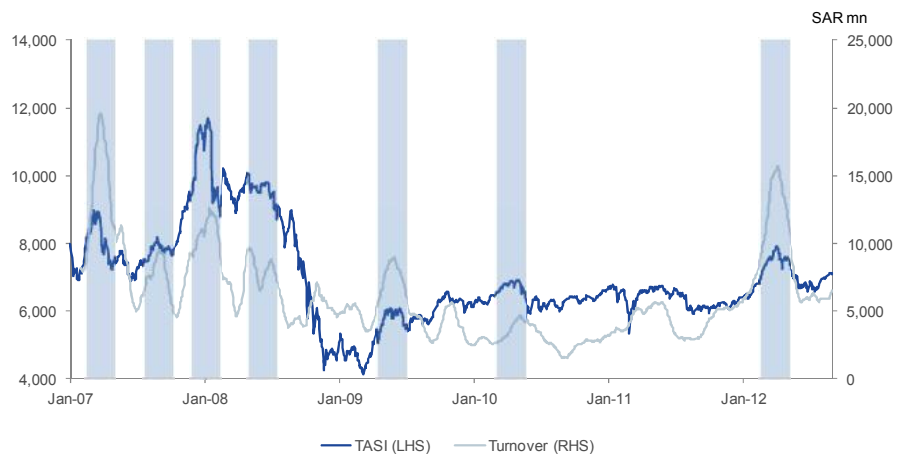
Source: Bloomberg, Al Rajhi Capital

Volume growth to support TASI at current levels

We expect TASI to remain at current levels supported by higher volumes

Volumes and returns positively correlated in Saudi market: We also looked at the correlation between volumes and returns. Analyzing TASI and trading volume movements since 2007, we observed a positive correlation between the trading turnover and TASI's performance. We observed that a sharp increase in trading turnover led to a positive performance on TASI. Further, a fall in trading volumes also coincides with a correction in TASI. This trend was observed several times since 2007 barring two instances, one of which was in January 2011, attributable to the Arab spring. The chart below highlights these trends, and shows the correlation between the turnover and performance. Most recently, this trend was witnessed in the first quarter of 2012, when trading volumes rose sharply and TASI crossed above the 7,900 level. This was followed by an equally sharp fall in trading volumes and a correction in TASI during the second quarter.

Figure 13 Correlation between TASI performance and exchange turnover



Source: Bloomberg, Al Rajhi Capital

We did not witness any specific decline in trading volumes during the Ramadan month, despite the reduced trading hours. Going ahead, we expect the volumes to rise significantly after the holy month, as traders/investors return to the market. Thus, it is likely that a pick-up in volumes would result in a positive performance on the TASI.

With retail participation in the speculation activity slowing down, we believe the market is gradually returning to its fundamentals. Despite lower earnings expectations from major companies (especially petrochemicals), the Saudi market remains buoyant on the back of



strong oil prices and increased liquidity. We believe the high volumes witnessed during the year will continue to support TASI at higher levels, assuming there is no major negative geopolitical or economic news flow.

The Saudi market is likely to move higher after Ramadan, on the back of high trading volumes (continuing the historical trend). However, we expect trading volumes to stabilize over the next couple of quarters leading to a consolidation before the market moves upward. We remain conservative in our forecasts considering the current weak global economic scenario and high forward P/E multiples of TASI as compared to other markets. We believe telecom, agriculture, and retail sectors will outperform the broader market.

Fund managers & investors view

We talked to several fund managers to get their views on the Saudi market after Ramadan. Majority of the fund managers expect the Saudi market to move higher after Ramadan and expect liquidity to improve. Although fund managers are bullish on TASI, they do not expect it to cross the 8,000 level mark unless the ECB or the Federal Reserve announces more stimulus measures. Agriculture and real estate sectors - which are driven by domestic demand - are expected to outperform over the medium term, while the export oriented sectors are likely to face headwinds. They expect crude prices to be range bound near the current levels over the next 2-3 quarters. Moreover, a definitive solution to the Euro zone crisis is not expected over the near term and the Euro zone will continue to hamper the global recovery. Meanwhile, managers have diverse views about the Chinese economy. While some expect China to slowdown further by year-end, some feel that the country, with its favorable demographics and financial resources, will be able to hold firm. On the issue of the Saudi market opening up to foreign investors, the managers have a consensus feel it would take at least one to two years to materialize.

Fund managers expect moderate upside for TASI post Ramadan season

Technical View on TASI

Figure 14 TASI weekly technical chart



Source: Bloomberg, Al Rajhi Capital

Technical analysis also points towards continuing uptrend

On weekly charts, the TASI has been steadily moving upwards from its low of early 2009. The index bounced back from its support i.e. lower end of its trading channel in June this year. The index is trading above its 9 week EMA. The 9 week EMA and 34 week EMA has made a positive crossover indicating bullish strength. The uptrend in the RSI is still intact, while the MACD line is about to cross the signal line on the upside. TASI is likely to move higher over the next three months, if it holds on above the 7,000 level. The index is likely to face stiff resistance at 7,500. Once TASI breaches 7,500, the next major resistance for the index would be 8,000.



Sectors such as agriculture, food and retail and telecom are likely to benefit from rising demand in the Hajj season

Though headwinds persist, we are positive on the petrochemical sector over the medium-term

Sector outlook post Ramadan

We think that sectors driven by domestic demand such as food and agriculture, retail, and telecom could benefit the most post the Ramadan season. The coming Hajj period, wherein around 2mn people from abroad travel to the Kingdom to perform the annual pilgrimage, will also act as a major driver for these sectors over the next two months. Tourism and pilgrimage directly benefit sectors such a retail and food due to increased demand for food-stuffs and gifts. Further, telecom companies will benefit from an increase in international call traffic.

Under food and retail sector, though we are positive regarding an improvement in performance in the next two quarters, increasing raw material prices continue to remain our concern as it is likely to squeeze margins for companies like Savola and Almarai in 2013. Further, we believe that near-term growth is already reflected in their valuation premiums (P/E 2012 of 15.2x for Savola and 18.8x for Almarai). Our rating is thereby Neutral on them. We are overweight on Al Othaim and include it in our top picks for the remainder of the year.

Historically, telecom companies like STC and Mobily have performed better during Q3 & Q4 due to the Hajj season and we expect this trend to continue this year as well. We remain Overweight on both the companies and choose Mobily as our top pick from the telecom sector.

Despite being driven by domestic demand, we are not bullish on the cement sector as H2 has been a traditionally weak period due to slowing construction activity during the Hajj season. Profits for cement companies generally decline by around 15% on an average as compared to the first half of the year. We believe that this slowdown in business will reflect in the share price performance of cement companies in the next 3-4 months.

For petrochemical companies, we believe that global cues will drive the demand and profitability more than the domestic factors. Considering weak Chinese industrial growth and continuing European crisis, demand as well as prices for petrochemicals are expected to remain sluggish. Having said that, we think it is a good opportunity to buy a few fundamentally strong stocks for the long-term as the overall sector is trading at a discount compared to its international peers (P/E 2012 of 11.4x versus 13.5x for MSCI world chemicals). We pick SABIC and NIC due to their diversified product portfolio and healthy financials. We also like SAFCO for its exposure to fertilizers.

Our top picks for remainder of the year are as follows:

Figure 15 Top picks for remaining 2012

Company	Rating	Target Price	2012 PE	Dividend Yield
Al Othaim	Overweight	109.40	13.2	0.0
Mobily	Overweight	70.00	8.4	2.9
SABIC	Overweight	113.40	9.7	5.6
NIC	Overweight	40.50	8.6	3.8
SAFCO	Overweight	221.40	11.9	7.1

Source: Bloomberg, Al Rajhi Capital



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1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

"Overweight": Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

"Neutral": We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

"Underweight": Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

2. Definitions

"Time horizon": Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

"Fair value": We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

"Target price": This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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