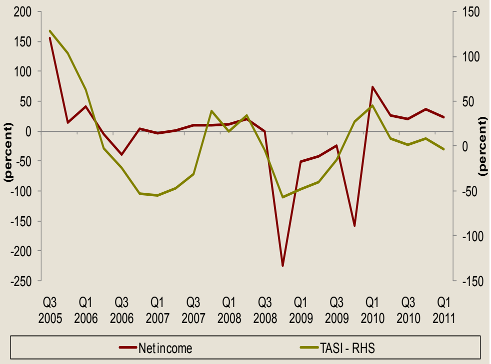
جدوى للإستثمار
Jadwa Investment

First quarter results affirm tough conditions

Annual change in profits and the TASI



Listed company results show that the first quarter was a tough one for much of the private sector. In total, listed company net income was 23 percent up on the first quarter of 2010 and 13 percent above the final quarter of last year. Petrochemicals was by far the best performing sector, however, this was driven by higher prices and generally greater international sales and did not reflect local or regional conditions. Excluding petrochemicals, total earnings were up by just 3.7 percent in year-on-year terms and were down by 2.3 percent compared to the previous quarter, the first quarterly decline since the final quarter of 2009.

Quarterly earnings for the petrochemicals sector as a whole, and for Sabic, the largest company, were at an all-time high owing to a jump in product prices. Petrochemical prices have been pulled up by the rise in oil prices and were well above their levels of the first quarter of last year. For example, prices of ethylene averaged 14 percent higher in the first quarter compared to the first quarter of 2010 and those of naphtha were up by 28 percent. Most other companies in the sector posted strong results, except for those still at the pre-operating stage. Total petrochemical profits were up by 51 percent in year-on-year terms and by 33 percent on the previous quarter.

Most other sectors were impacted negatively by the regional unrest. Earnings from six sectors were down in both year-on-year and quarter-on-quarter terms. Among those hardest hit were companies exposed to the unrest either by owning manufacturing facilities in affected countries, or by being major exporters to those countries, particularly Egypt. Several firms in the agriculture and food, building and construction and industrial investment sectors reported a shortfall in revenues and some noted that they were not anticipating a recovery in the short-term.

Soaring raw material prices were cited by many companies as a key reason for elevated operating costs, which ate into profits. Global prices of many commodities have surged and some, such as copper, hit all-time highs during the first quarter. Higher prices of metals and petrochemical products squeezed the earnings of companies in the industrial investment and building and construction sectors. The two largest dairy and food processors reported that rising packaging costs hit earnings and they were also affected by the greater cost of imported fodder, which in part reflects the surge in global food prices to an all-time high in the first quarter. High oil prices raised the cost of transportation outside the Kingdom, which added to the price of imported inputs. Exchange rate movements are unlikely to have affected import prices, as although the trade-weighted dollar is currently around a 31-month low, the average for the first quarter was in line with that for the same period of 2010.

For comments and queries please contact the author:

Paul Gamble
Head of Research
pgamble@jadwa.com

or:

Brad Bourland, CFA
Chief Economist
jadwaresearch@jadwa.com

Head office:
Phone +966 1 279-1111
Fax +966 1 279-1571
P.O. Box 60677, Riyadh 11555
Kingdom of Saudi Arabia
www.jadwa.com

First quarter performance
(percent)

	Annual change	Quarterly change		Annual change	Quarterly change
Banks	8.0	19.2	Multi-inv.	15.5	-59.7
Petchems	51.1	33.7	Industrial inv.	13.4	30.9
Cement	13.0	37.8	Construction	6.2	-2,257.1
Retail	23.8	23.1	Real estate	-18.9	7.3
Energy	-0.1	198.7	Transport	-149.5	-157.2
Agriculture	-36.4	36.6	Media	-15.4	-37.0
Telecoms	16.1	-37.8	Hotels	18.8	11.7
Insurance	-38.6	-68.3	**TASI**	**23.5**	**13.3**

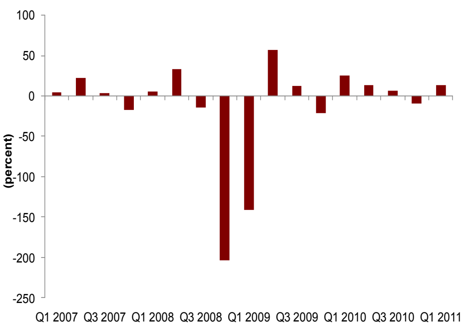
The huge additional spending announced in a series of Royal decrees issued on February 24 and March 18 did not have much impact on company performance. This is not surprising, as very little of the new spending occurred during the quarter. Indeed, it seems that companies were hit by the cost of paying a bonus of two-month's salary to their employees, to replicate the award to public sector workers contained in the Royal decrees. We have identified 27 listed companies that paid the bonus, though it is not clear in several cases whether this was done in the first or second quarter.

Listed company net income

The one area that probably benefitted from the new government spending was retail, which recorded the second fastest growth in profits in the first quarter, as it is likely that much of the two month's salary bonus was immediately spent (shops were notably busier in the weeks following the announcement). We think it will take several quarters for the real estate component of the new government spending to begin to be reflected in company performance. Although the bulk of the spending package was focused on the provision of real estate, listed real estate companies are generally focused on a few specific developments. Industrial investment, building and construction and cement companies are better placed to gain.

Results from the banking sector were generally disappointing. Profits were up for nine of the eleven listed banks, but in most cases the year-on-year growth was only in single digits and for the sector as a whole, profits were 8 percent higher. It is not yet possible to determine how much of the improvement was the result of reduced provisioning for bad loans, though we think this made a positive contribution for all banks. Lending rose, but low interest rates remain a drag on revenues from core banking activities.

Quarterly change in net income



For two of the sectors that recorded a quarterly fall in net income, the decline was in line with the seasonal trend. Earnings of telecoms and transport peak during the Hajj (which in recent years has occurred in the fourth quarter) owing to the large number of foreign pilgrims that are transported and that pay roaming rates on their phones. The fall in net income for the transport sector was exacerbated by one company realizing large investment losses that had built up over several years. As a result, the transport sector posted a loss in the first quarter, its first quarterly loss since at least 2004. The only other sector to record a loss was energy, which was again in line with the seasonal norm; Saudi Electricity, which dominates the sector, makes its profits during the second and third quarters, when air conditioning use is at its peak. Insurance posted the second largest fall in year-on-year terms owing to a regulatory change that necessitated companies setting aside funds against credit loss provisions.

Oil market watch

Risk premium keeps oil prices high

Oil prices have remained on an upward trend during April. Brent and WTI both hit their highest levels since October 2008 during the month, and while they are off their peaks, they are both up so far in April and well above where they were at the end of last year (by 33 percent for Brent and 22 percent for WTI). Ongoing high prices are primarily an indication of investor and consumer worries about the unrest in the region and the prospect for more supply disruption, rather than current market fundamentals.

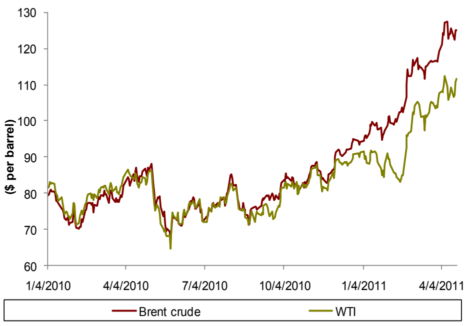
After lifting oil production in February, the Kingdom reduced significantly output in March because of concern that the global market was oversupplied. The Saudi oil minister revealed that oil production was cut to an average of 8.3 million barrels per day in March from 9.1 million barrels per day in February. Demand in March was hit by the natural disaster in Japan, which is the second largest market for Saudi oil exports, and inventories of crude are fairly high. According to the International Energy Agency (IEA), OECD stocks are 59 days of future demand (compared to Opec's preferred level of 52-54 days); stocks in the US have increased in each of the past six weeks and are in line with their recent norm for April.

Another reason for the cut to production in March is that the Kingdom's additional supplies are mainly heavy sour crude, whereas Libya produced light sweet crude, so new supplies from the Kingdom would not address the short-term shortfall. Aramco has developed two new light low-sulphur blends, but demand has been low. These two blends are close to the Libyan crude lost due to the civil conflict, but by mid-April the oil minister reported that sales were just 2 million barrels in total. Rather than reflecting oversupply, the weak demand is probably because of difficulties in refining the new blends of crude. Refineries are configured for specific blends of crude and it can be time consuming and expensive to make the alterations necessary to accommodate even a small change in the crude blend.

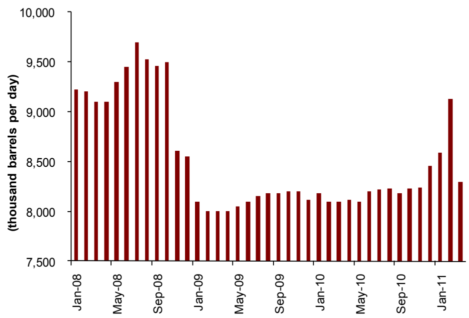
While the physical position is comfortable, the very high prices indicate that a large risk premium has been attached to oil prices. This risk premium suggests that consumers and investors want a greater cushion of excess supply than they have historically needed. As such, in the absence of further production it is likely that prices will stay around current levels over the near term unless there are clear signs of a decline in demand. In its latest report the IEA noted that higher oil prices were hitting demand growth in January and February, and prices have risen since then.

Given the consistent high prices, we have raised our oil price forecasts to $101 per barrel for Brent and $93 per barrel for WTI, though they are below the consensus. The market is plentifully supplied and with regional tensions expected to gradually ease, the risk premium in oil prices should fade in the second half of the year. In addition, a slowdown in demand growth is expected and the possibility of a general decline in commodity prices would exacerbate the likely fall in oil prices.

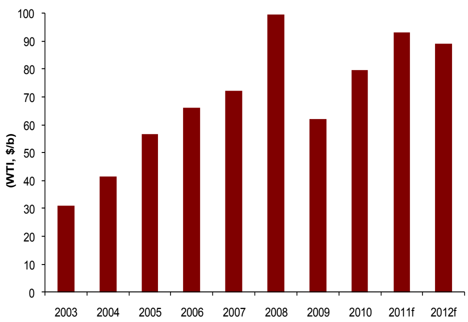
Oil prices



Saudi oil production



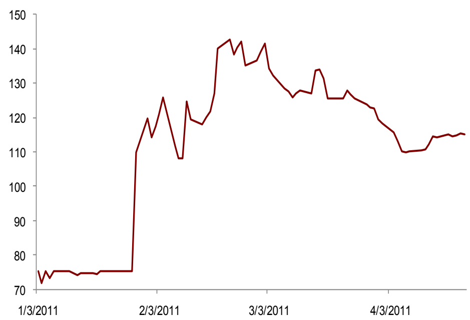
Average oil price



Economy watch

More trading lifts credit default swaps' relevance

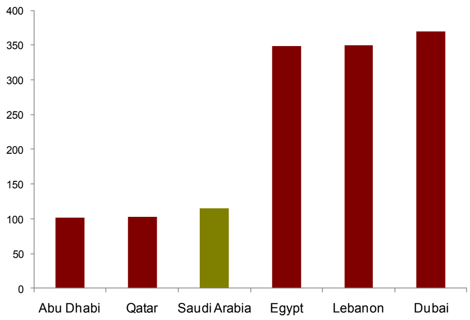
Credit default swap for Saudi Arabia



Prices of credit default swaps are used as measure of investor perceptions of country risk in much of the world and have increasingly been cited across the region at a time of fast changing events. Until very recently there had been little trading in credit default swaps for the Kingdom, but this has picked up, and they now give a rough guide to how foreign investors view sovereign risk.

The price of a credit default swap is a measure of risk. It is effectively the cost of insurance against an entity defaulting on its debt. Credit default swaps are available over various time periods, with those covering five-years most closely followed by investors. The price of a five-year Saudi credit default swap is currently 115 basis points, meaning that it costs $115 to insure $10,000 worth of five-year Saudi government debt. However, the Kingdom does not issue any five-year external debt, or indeed any external debt.

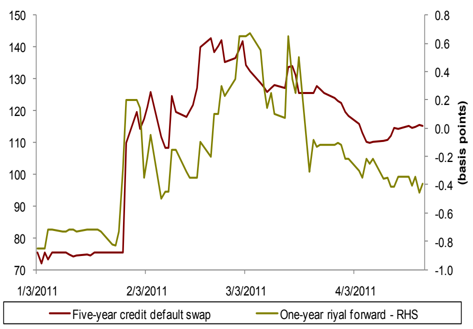
Regional credit default swaps



In the case of Saudi Arabia and other countries, rather than directly insuring against default, credit default swaps are used by companies to hedge the investments they have in the Kingdom or by investors that want exposure to Saudi sovereign risk. It is the latter area where the market is growing, as it is difficult for foreign investors to get exposure to Saudi risk owing to a lack of available instruments. For analysts, the price of a credit default swap provides a guide to foreign investors' views of country risk. Credit ratings also provide such a guide, but these are altered infrequently, whereas credit default swaps are traded and so should respond quickly to events.

How useful a potential guide credit default swaps are to country risk is influenced by how actively they are traded. We have been cautious about paying much attention to credit default swaps for the Kingdom owing to their very low liquidity. However, this seems to be changing. For the week ending March 25, Saudi credit default swaps were for the first time among the top 100 traded according to the US Depository Trust and Clearing Corporation, the body responsible for the clearance and settlement of securities transactions. On April 15, there were 233 Saudi credit default swap contracts outstanding with a value of $1.8 billion. Nonetheless, trading is still thin. There are only a small number of quotes available for investors looking to buy or sell credit default swaps and the spread between the bid and offer prices is large, at 4 percent, compared to 1.6 percent for Spain, currently the most actively traded credit default swap.

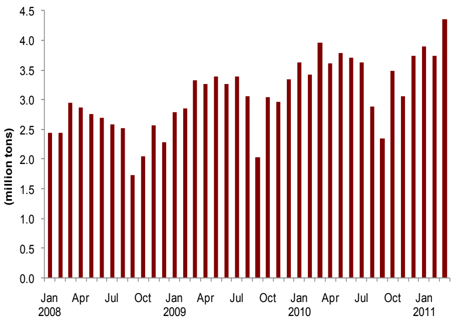
Credit default swaps and riyal forwards



An indication of the reliability of credit default swaps as a guide to country risk is possible by comparing them to one-year riyal forwards. While these measure investors' views on what the riyal's exchange rate against the dollar will be in one year's time, they are one of the few instruments open to foreign investors and are influenced by perceptions of sovereign risk. The graph on the left shows that there is a fairly close relationship between five-year credit default swaps and one-year riyal forwards, particularly since the intensification of regional unrest towards the end of January. This fits with our understanding of foreign investors' views of risk in the Kingdom. The credit default swap prices are also aligned with the long-term foreign currency credit ratings for the Kingdom and other countries in the region.

In brief: Economy

Cement sales

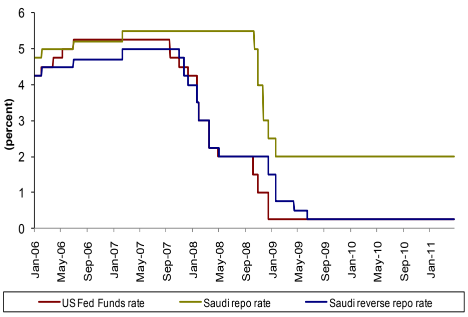


Cement sales hit an all-time high in March. At 4.3 million tons, sales were 16 percent higher than in February. For the last few years March has been around the annual high-point for cement sales as it is the time that new budgetary spending tends to have most impact and before construction slows because of the heat of summer and the religious holidays that have fallen in the second half of year in recent years. In year-on-year terms, sales were 9.8 percent higher, which is in line with the growth rate for the previous two months of 2011. Cement sales should give a good indication of the progress in the house building program contained in the recent Royal decrees. Cement production also hit an all-time high in March, though stocks of clinker (the raw material for cement) fell for the fourth successive month.

Trade-weighted dollar index

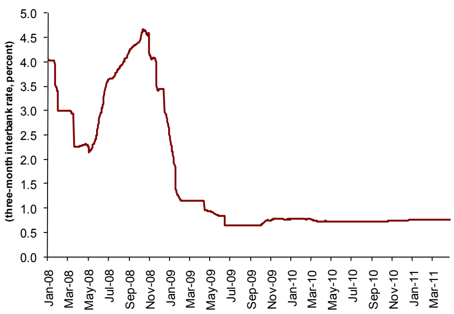
The dollar has slipped to a 31-month low on a trade-weighted basis, largely due to concerns about US government debt. The US recently approved a budget, but it appears that forthcoming negotiations on an increase in the maximum value of debt that can be outstanding will be tougher and markets are worried about the lack of larger steps to tackle the budget deficit. The dollar is around its lowest since December 2009 against the euro and the pound and since August 2008 against the Korean won, all currencies of key trading partners. By raising the price of imported goods, dollar weakness could add to inflation in the Kingdom, particularly as much of the recent windfall for consumers (through the two month's salary bonus) is probably being spent on imported products. Furthermore, the weak dollar may have contributed to the rise in oil prices.

Interest rates



Early in April, the European Central Bank became the first of the leading global central banks to raise interest rates and many emerging market central banks have been hiking rates for some time owing to concerns about inflation. While inflation is likely to pick up in the coming months in the Kingdom, we do not expect any change in local interest rates over the near term. Local rates are heavily influenced by interest rates in the US. The US is still conducting a policy of quantitative easing (effectively, printing money) which is scheduled to end in June. Once this is complete the US Federal Reserve will wait for signs of less spare capacity in the economy before it considers raising rates. The consensus expectation is that US interest rates will be unchanged until the first quarter of 2012.

Three-month riyal interbank rate



Stability in the repo and reverse repo rates has kept Saudi interbank rates steady. Three-month Saibor has been at around 0.75 percent since June 2009, when the reverse repo rate was last cut. With the loan-to-deposit ratio below 80, we do not think that Saibor will be affected by liquidity pressures and therefore expect it to remain around current levels until the repo or reverse repo rates are altered. SAMA does have the scope to make small adjustments to these rates independently of the US Fed and we think that if credit growth and inflation rise notably then a hike in the reverse repo rate is possible in the final quarter of the year. Consensus forecasts are for a succession of US rate rises during 2012 (with the Fed funds rate ending that year at 1.5 percent compared to the current level of 0.25 percent), which SAMA is expected to follow.

Key data

	2004	2005	2006	2007	2008	2009	2010E	2011F	2012F
Nominal GDP									
(SR billion)	938.8	1182.5	1335.6	1442.6	1786.1	1397.5	1630.0	1951.0	1948.4
($ billion)	250.3	315.3	356.2	384.7	476.3	372.7	434.7	520.3	519.6
(% change)	16.7	26.0	12.9	8.0	23.8	-21.8	16.6	19.7	-0.1
Real GDP (% change)									
Oil	6.7	6.2	-0.8	-3.6	4.2	-7.6	2.1	8.9	-0.2
Non-oil private sector	5.3	5.8	6.1	5.5	4.6	2.7	3.7	4.2	5.0
Government	3.1	4.0	3.1	3.0	3.7	5.2	5.9	5.0	5.0
Total	5.3	5.6	3.2	2.0	4.2	0.2	3.8	5.6	3.5
Oil indicators (average)									
WTI ($/b)	41.5	56.6	66.1	72.3	99.7	62.0	79.5	93.0	89.0
Saudi ($/b)	34.7	49.5	60.5	68.1	93.4	60.5	77.7	95.8	89.0
Production (million b/d)	9.0	9.5	9.2	8.7	9.2	8.1	8.2	8.8	8.7
Budgetary indicators (SR billion)									
Government revenue	392	564	674	643	1101	510	735	916	833
Government expenditure	285	346	393	466	520	596	627	821	777
Budget balance	107	218	280	177	581	-87	109	95	56
(% GDP)	11.4	18.4	21.0	12.2	32.5	-6.2	6.7	4.9	2.9
Domestic debt	614	475	366	267	237	225	167	160	160
(% GDP)	65.4	40.2	27.4	18.5	13.3	16.1	10.2	8.2	8.2
Monetary indicators (average)									
Inflation (% change)	0.3	0.7	2.3	4.1	9.9	5.1	5.3	5.5	4.0
SAMA base lending rate (%, year	2.50	4.75	5.20	5.50	2.50	2.00	2.00	2.25	2.75
External trade indicators ($ billion)									
Oil export revenues	110.4	161.6	188.2	205.3	281.0	163.1	203.2	253.3	213.3
Total export revenues	125.7	180.4	210.9	233.1	313.4	192.2	236.3	289.0	252.6
Imports	41.1	53.8	63.0	81.5	100.6	86.4	87.0	97.4	109.1
Trade balance	84.6	126.6	147.8	151.6	212.7	105.8	149.3	191.6	143.5
Current account balance	51.9	90.0	98.9	93.3	132.3	22.8	69.6	103.8	55.0
(% GDP)	20.7	28.5	27.8	24.3	27.8	6.1	16.0	20.0	10.6
Official foreign assets	127.9	195.5	273.4	359.8	502.0	474.2	520.3	595.8	637.3
Social and demographic									
Population (million)	22.7	23.4	24.1	24.8	25.5	26.3	27.1	27.9	28.8
Unemployment (male, 15+, %)	11.0	11.5	12.0	11.0	9.8	10.5	10.2	11.0	10.5
GDP per capita ($)	11039	13503	14806	15523	18651	14158	16017	18625	18040

Sources: Jadwa forecasts for 2008 to 2010. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.

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