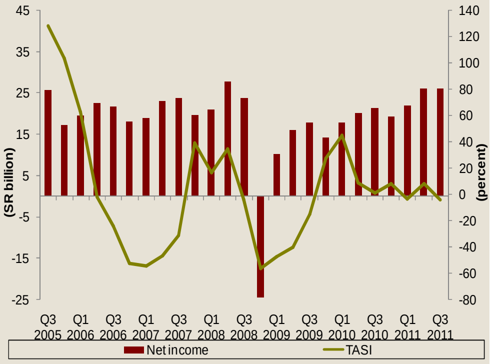
Jadwa Investment

November 2011

Monthly Bulletin

Petchems dominate third quarter earnings

Quarterly net income and the TASI



Results from listed companies for the third quarter were reasonable. Net income totaled SR26 billion, up by 22.3 percent in year-on-year terms and 0.6 percent higher than in the previous quarter. This was the highest net income level recorded since the second quarter of 2008 and was heavily dependent on the petrochemicals sector. Excluding petrochemicals, year-on-year profits growth was just 1.8 percent. The TASI did not respond to the results and traded in a fairly tight range in October.

Petrochemical earnings hit an all-time high in the third quarter and were up by 66 percent in year-on-year terms. This was largely due to higher product prices, supported by elevated production, particularly from Yansab and Sipchem. Despite the weakening of the global economy in the third quarter, there appears to have been little impact on volumes sold. Sabic's profits were another record and the company accounted for 73 percent of total earnings for the sector.

Outside of petrochemicals performance was much weaker, though this was distorted by the telecoms sector. Telecoms recorded the largest year-on-year decline in profits since the sector was liberalized. This was primarily the result of Saudi Telecoms (STC) posting a foreign exchange loss of SR789 million. STC has operations in India, Malaysia, Indonesia, Turkey, Kuwait and Bahrain and was affected by large exchange rate movements; for example, the Turkish lira depreciated by 15 percent against the riyal in the third quarter. STC still recorded a profit, unlike Zain, where current liabilities exceeded current assets, and Atheeb, whose losses have absorbed most of its capital.

Ten of the remaining thirteen sectors recorded year-on-year profit growth in the third quarter and 113 of the 147 listed companies posted positive growth, compared to 115 in the second quarter. Profit growth was fastest for the real estate sector, up by 81 percent. These gains were concentrated in two companies, Emaar Economic City, which is now selling housing units and has restructured its construction costs, and Taiba, which received a one-time payment for a land transaction in Medina.

Profits for the building and construction sector rose by over 30 percent, supported by strong demand and rising prices for building materials stemming from high construction spending. Bank profits grew by 29 percent. Although lending continued to pick up, the main reason for the growth was lower provisioning for bad debts. Profit growth for the retail sector slowed, but remained healthy, at 21 percent. The impact of the bonus awarded to public-sector workers earlier in the year has faded, but it is still evident; earnings of small luxury retail company Fitaihi were up by 115 percent year-on-year, after a gain of 371 percent in the second quarter.

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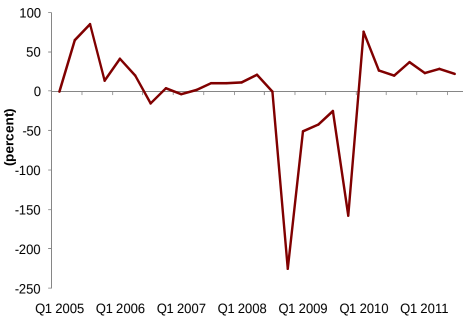
Net income of listed companies
(percent)

	Annual change	Quarterly change		Annual change	Quarterly change
Banks	29.3	-4.9	Multi-inv.	24.5	4.7
Petchems	66.4	4.9	Industrial inv.	1.7	-31.5
Cement	26.8	-21.3	Construction	31.3	-33.5
Retail	21.4	46.7	Real estate	80.8	-1.0
Energy	-6.1	60.5	Transport	-45.0	-45.7
Agriculture	7.5	23.1	Media	4.1	-46.5
Telecoms	-41.1	-22.8	Hotel	27.4	16.2
Insurance	-53.5	249.1	**TASI**	**22.3**	**0.6**

Annual change in net income



Insurance was the worst performing sector, with profits falling by 53 percent. The insurance sector has been hit by provisioning for bad debts in line with a SAMA policy that was implemented at the start of the year. Transport was the second worst performer owing to a sharp drop in profits at National Shipping. This was attributed to greater global shipping capacity reducing fees, higher fuel costs and the expiration of some contracts. Energy was the other faller, the 6 percent decline caused by less air conditioning use owing to lower temperatures than last summer (the sector is dominated by Saudi Electricity).

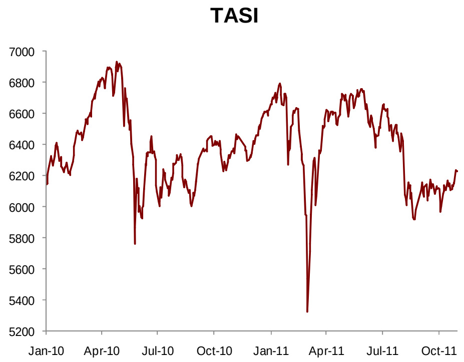
An interesting development was the first indication that the Nitaqat program, a new labor market policy, is impacting on company profits. Under Nitaqat, companies are required by late November to achieve a certain level of Saudiization, which varies from industry to industry, in order to avoid restrictions on their employment of foreigners. Building and construction company Al-Khodari noted that an increase in labor costs attributed to Nitaqat contributed to a near halving of its profits (in both year-on-year and quarterly terms). Nitaqat will impact on payroll costs, contributions to GOSI (the private-sector pension agency) and spending on training.

Quarterly change in net income

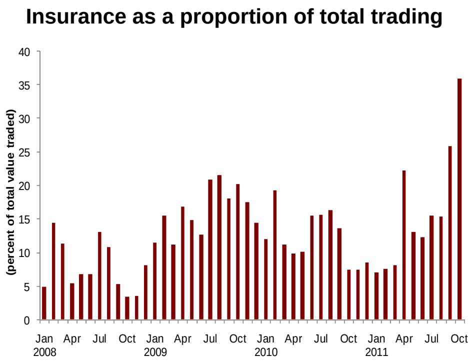
The slow quarterly growth in net income, of just 0.6 percent, is in line with the seasonal norm. The third quarter is the height of summer, when outdoor activity slows and many people take long holidays. In recent years it has also coincided with Ramadan, during which business hours are reduced and labor productivity declines. The impact is clearest in the building and construction and industrial investment sectors, both of which were down by over 30 percent in quarterly terms. Reduced construction activity and the difficulty of mixing cement in very high temperatures means cement sales decline and the 21 percent quarterly fall in profits for that sector was is in line with the seasonal norm.

In contrast, summer is the time of peak air conditioning use, meaning that the energy sector always performs strongly in the third quarter. This year was no exception, with quarterly profits up by 61 percent. It was not the fastest growing sector, however, as insurance surged by 249 percent. The volatility of the quarterly profits suggests that insurance companies are adopting differing approaches to the timing of the provisions for bad debts they are now required to make. The high quarterly growth in retail was also influenced by seasonal factors, as sales for the new school year, a key source of revenues for the largest companies in the sector, occur during the third quarter.

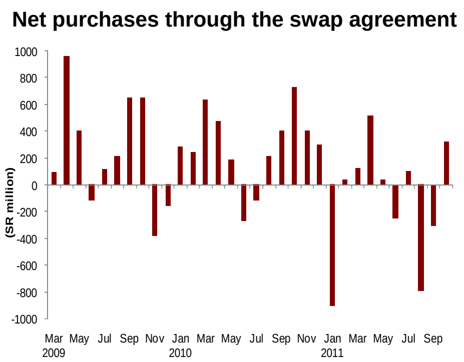
In brief: Stock market



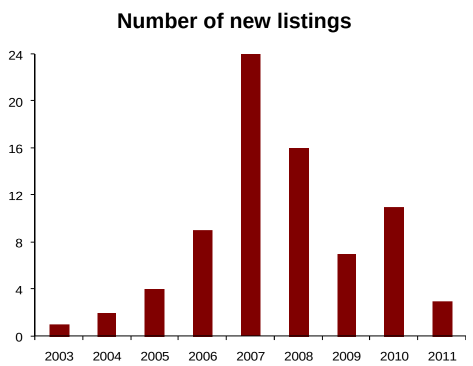
The TASI stayed fairly stable during October. It recorded a 1.8 percent gain over the month and has traded within a range between 5,975 and 6,240 since the second half of August. Insurance was the best performing sector and dominated trading (see below). Aside from this, sectors generally moved in line with investor perceptions of third quarter results. Although the results were reasonable, they did not trigger a revival in the market, even though many global markets posted double-digit gains during the month as greater comfort over the policy response to the debt problems in the Eurozone lifted investor sentiment.



Insurance companies have accounted for a disproportionately large share of trading in the past few weeks. For the whole of October, trading in insurance stocks was 36 percent of the total, even though they only account for 2 percent of market capitalization. As a result of the high turnover of insurance stocks, the total number of stock market transactions was the highest since July 2009. Insurance companies tend to be targets for speculators, but the proportion of trading in October is unprecedented. Although trading in other sectors may have been affected by investors being cautious about taking positions ahead of the forthcoming one-week closure of the market for Eid al-Adha, this does not justify the surge in trading of insurance companies. The Capital Market Authority is reportedly monitoring the situation.

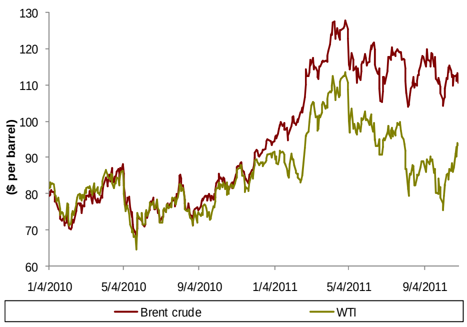


Foreign investors through the swap agreement were net buyers of local shares for the first time in three months in October. At $325 million, net purchases were the highest since April and total sales were the lowest since September 2010. The inflows reflect reasonable company results, particularly for petrochemicals, in addition to an improvement in global risk appetite during the month, which saw large gains in stock markets and stronger oil prices. For the year as a whole, foreigners have sold $1.1 billion more shares than they have brought. This is due to caution among foreign investors in the face of an uncertain global environment and some disappointment over the performance of the TASI.

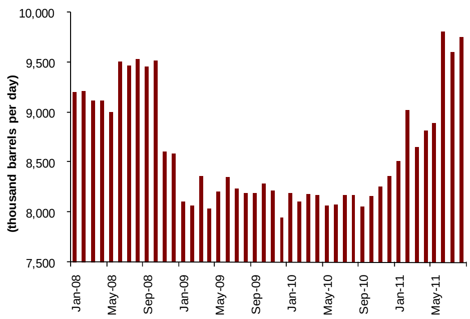


Hail Cement became the third new listing on the stock market this year in mid-October. It was the largest listing so far this year, raising SR490 million. In common with most new listings, the share price jumped on the first day of trading, rising by 26 percent on October 16. It is currently a little above this price. Further IPOs are planned this year; that of electronics retailer Extra was announced recently, but for the year as a whole new listings are set to be the lowest since 2005. Volatile market conditions and low valuations are the main factors hitting local companies' appetite for listing.

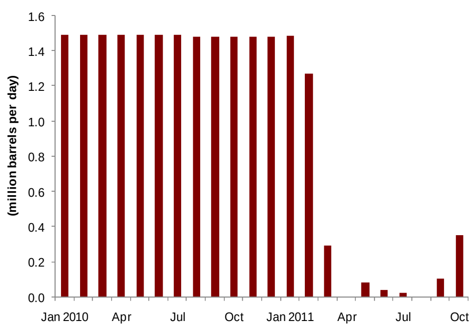
Oil prices



Saudi oil production



Libyan oil production



Oil market watch

Saudi oil output to decline as Libya's recovers

Oil production has been raised to long-term highs this year to compensate for the disruption to Libyan output. Higher output is a key factor behind our expectation that economic growth this year will be over 7 percent. With stability being restored in Libya and oil output rising, the path of the Kingdom's oil production cuts will distort growth next year and in 2013. We assume that Saudi Arabia will try to calibrate its moves so as not to unduly influence global oil prices.

There are varying estimates as to how quickly Libyan crude can be restored to its pre-conflict level of around 1.6 million barrels per day. Reports indicate that most production and export infrastructure are not badly damaged and output reportedly rose to 350,000 barrels per day in early October. However, Libya is very reliant on outside help for its oil industry and there needs to be an improvement in security before foreign oil workers will be comfortable returning. The Libyan National Oil Company is targeting output of 700,000 barrels per day by the end of this year and a return to full pre-conflict output in early 2013; some independent analysts only expect pre-conflict production to be reached in late-2014.

The pace at which the Kingdom lowers its oil production will not just be driven by Libyan output. Oil prices will play an important role. This is clear from the pattern in which production was increased, which occurred in two distinct phases. First, in February, when the bulk of Libyan production ceased, exports were raised by around 600,000 barrels per day to 7 million barrels per day.

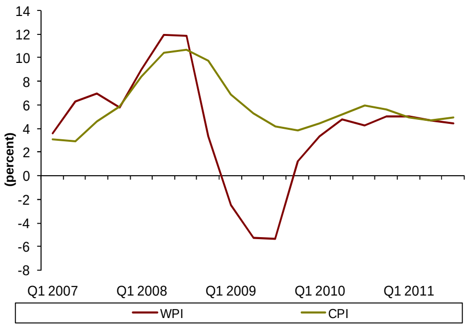
In the following months Saudi exports fell, in part because the oil the Kingdom put onto the market was different to that produced by Libya. Then in June, exports rose by around 550,000 barrels per day to 7.4 million barrels per day (and owing to the seasonal growth in domestic consumption, total output rose by 1 million barrels per day). June was the month that the Opec meeting broke down amid disagreement on whether output should be raised to lower prices. After the meeting the Kingdom lifted production, owing to concern that prices could reach a level that would cause permanent demand destruction or destabilize the global economy.

Although the outlook for most of the leading economies is weak, performance should be stronger in emerging markets, which are the main source of oil demand. Global stocks of oil have fallen, suggesting some tightness in the market. However, this is caused partly by supply issues. Aside from Libya, there have been small output disruptions in Nigeria, some non-Opec areas (Yemen, Gulf of Mexico), and heavy maintenance of facilities on the North Sea. If these unwind and add to recent downward pressure on oil prices the Kingdom will be cautious about how much oil it takes off the market. However, if prices stay high Saudi Arabia may reduce output by less than that reintroduced by Libya.

We project a gradual decline in the Kingdom's oil production to an average of 8.8 million barrels per day next year, 4.4 percent lower than this year. We assume that Libyan output will return to its pre-crisis level by end-2013, but with global and domestic oil demand rising, Saudi oil output is likely to be little changed that year.

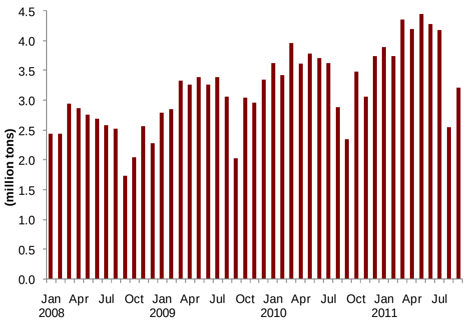
In brief: Economy

Consumer and wholesale price inflation



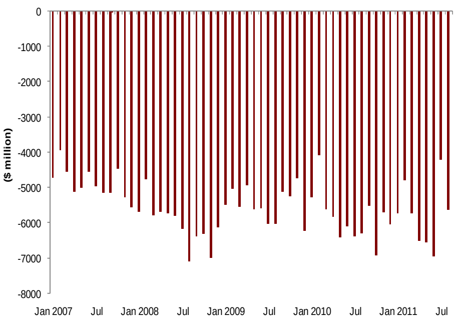
Wholesale price inflation remained fairly subdued in the third quarter, easing to 4.5 percent from 4.7 percent in the second quarter. The trends are similar to those for consumer price inflation, with food prices low (up by 1.3 percent year-on-year) and “other commodities”, primarily gold, high (up by 33.8 percent year-on-year). Chemicals and fertilizers were the other main sources of wholesale price inflation. Moves in wholesale prices tend to be reflected quickly in consumer prices and the current data suggest that wholesale prices will not be a source of significant upward pressure on consumer prices in the near term.

Cement sales



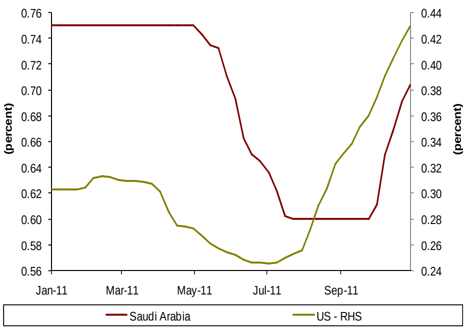
Cement sales have rebounded after their usual Ramadan drop. Sales were 26 percent higher in September than they were in August. In year-on-year terms the growth was 37 percent, though in part this is because Ramadan ended in September in 2010. Nonetheless, there has been a consistent rise in cement sales this year, reflecting a buoyant construction sector. Cement sales in the first three quarters of the year were 12.6 percent higher than in the same period of 2010; the growth rate for cement production over the corresponding period is similar, at 12.1 percent.

Non-oil trade balance



Trade data for August show that the non-oil trade balance widened to $5.6 billion. Non-oil exports dipped to $3.4 billion from $3.5 billion in July, though much of the decline was due to a fall in re-exports (goods that transit through the Kingdom with minimal local value added). Exports of petrochemicals and plastics, which accounted for 69 percent of the total, were higher than in July. Imports recovered from an 18-month low of $7.7 billion in July to $9 billion in August, though this is the second lowest since February. Unusually, the breakdown was not published.

Interbank interest rates



Interbank interest rates have ticked up in the Kingdom, as those elsewhere in the world have increased as a result of the stresses in the Eurozone banking sector. Three-month Saibor (the rate at which banks lend to one another) has risen steadily from 0.6 percent at the end of September to 0.7 percent. In the US the rise started earlier, in early August, and has been of a greater magnitude, from 0.25 percent to 0.43 percent. The increase in Saibor has been far less than the jump around the collapse of Lehman Brothers in 2008, which was from around 2 percent to over 4.5 percent, reflecting both the gravity of the situation in 2008 and the healthier finances of local banks now.

Key data

	2004	2005	2006	2007	2008	2009	2010	2011F	2012F
Nominal GDP									
(SR billion)	938.8	1182.5	1335.6	1442.6	1786.1	1397.5	1630.0	2023.4	1950.5
($ billion)	250.3	315.3	356.2	384.7	476.3	372.7	434.7	539.6	520.1
(% change)	16.7	26.0	12.9	8.0	23.8	-21.8	16.6	24.1	-3.6
Real GDP (% change)									
Oil	6.7	6.2	-0.8	-3.6	4.2	-7.6	2.1	14.4	-2.8
Non-oil private sector	5.3	5.8	6.1	5.5	4.6	2.7	3.7	4.2	4.9
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	7.1	2.7
Oil indicators (average)									
WTI ($/b)	41.5	56.6	66.1	72.3	99.7	62.0	79.5	90.0	82.0
Saudi ($/b)	34.7	49.5	60.5	68.1	93.4	60.5	77.7	99.3	88.8
Production (million b/d)	9.0	9.5	9.2	8.7	9.2	8.1	8.2	9.2	8.8
Budgetary indicators (SR billion)									
Government revenue	392	564	674	643	1101	510	742	1035	795
Government expenditure	285	346	393	466	520	596	645	809	753
Budget balance	107	218	280	177	581	-87	97	226	41
(% GDP)	11.4	18.4	21.0	12.2	32.5	-6.2	5.9	11.2	2.1
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	7.9	8.2
Monetary indicators (average)									
Inflation (% change)	0.3	0.7	2.3	4.1	9.9	5.1	5.3	4.9	4.4
SAMA base lending rate (%, year	2.50	4.75	5.20	5.50	2.50	2.00	2.00	2.00	2.00
External trade indicators ($ billion)									
Oil export revenues	110.4	161.6	188.2	205.3	281.0	163.1	214.9	289.4	226.0
Total export revenues	125.7	180.4	210.9	233.1	313.4	192.2	251.0	330.9	270.5
Imports	41.1	53.8	63.0	81.5	100.6	86.4	96.7	102.5	114.7
Trade balance	84.6	126.6	147.8	151.6	212.7	105.8	154.3	228.4	155.7
Current account balance	51.9	90.0	98.9	93.3	132.3	22.8	66.8	147.0	74.8
(% GDP)	20.7	28.5	27.8	24.3	27.8	6.1	15.4	27.2	14.4
Official foreign assets	127.9	195.5	273.4	359.8	502.0	474.2	520.3	626.1	681.5
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	19317	18059

Sources: Jadwa forecasts for 2011 and 2012. 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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