

**Key themes**

The political turmoil that has affected Tunisia and Egypt is likely to result in a reappraisal of risk prospects in the Middle East in general, even though the direct economic impact on Saudi Arabia is likely to be small. We expect stock price volatility to increase as a result.

**Implications**

Against this background, we recommend that investors in Saudi Arabia hold stocks with solid long-run growth prospects, high sales exposure to the domestic market or other markets unaffected by the turmoil, strong financial positions, reasonable dividend yields and attractive valuations.

**Al Rajhi Capital: Top Five Stocks**

Stock	Rating	Price Target
Mobily	Overweight	SAR78.2
SABIC	Overweight	SAR126.0
Almarai	Overweight	SAR118.7
Jarir	Overweight	SAR189.4
Ma'aden	Overweight	SAR28.2

**Why do we think it?**

Stock	3 year EBITDA CAGR	2011 EV/EBITDA
Mobily	14%	5.7x
SABIC	12%	8.0x
Almarai	13%	12.6x
Jarir	14%	11.8x
Ma'aden	141%	59.4x

## Saudi Equity Strategy: Top five stocks for harder times

*We expect political turmoil in Egypt and elsewhere to result in a reappraisal of risk prospects for Saudi Arabia and other MENA markets, limiting scope for multiple expansion. This is true even though we see only limited economic impact from the present crisis on Saudi Arabia and the region's other oil-exporting countries. At the very least, we expect share price volatility to rise. Against this background, we recommend that investors in Saudi Arabia hold stocks with solid long-run growth prospects, strong financial positions and attractive valuations. Our top five Overweight recommendations are Mobily, SABIC, Almarai, Jarir and Ma'aden.*

**Market volatility set to rise.** The Saudi stock market fell by 6% on 29th January after the start of serious political unrest in Egypt. Unrest there may continue and spread to other countries. As a result investors may decide to apply a higher risk premium to regional stock markets, including Saudi Arabia. This would prevent multiple expansion to the extent we had expected at the start of 2011. Even if markets do eventually perform well, stock prices are likely to remain volatile.

**Direct economic impact looks limited.** Declines in MENA equity markets have been accompanied by a surge in Egyptian bond yields and rising CDS spreads across the region. However, so far there has been no sign of severe impact on the real economy, e.g. disturbance of trade flow through the Suez Canal. If political turmoil is prolonged, money inflows to the oil-importing countries could dry up, potentially prompting balance of payments crises. However, we do not see much impact on the region's oil-exporting countries, notably Saudi Arabia. Direct trade between Saudi Arabia and Egypt is minuscule.

**But we prefer safer stocks.** Besides likely modest economic impact, it is worth stressing that few Saudi companies have direct exposure to Egypt; one of the exceptions is Savola, for which Egypt represents 11% of sales. Nevertheless, given the likelihood of greater price volatility we think investors in Saudi Arabia should hold companies with solid long-run growth prospects, high sales exposure to the domestic market or other countries unaffected by the turmoil, strong balance sheets, reasonable dividend yields and attractive valuations. We have five key recommendations for stocks to hold in the present environment.

**Top Five Stocks.** Our first stock is the telecoms operator Mobily, which offers high growth and strong finances and is one of the most attractively valued Saudi companies on a PE of 7.6x with a 2011 yield of 5.0%. Next is SABIC, the Middle East's largest petrochemicals group which is benefiting from capacity-driven volume growth and margin expansion led by recovery in prices. SABIC is strong financially and inexpensive on a PE of 11.6x. Almarai is Saudi Arabia's largest and strongest food producer, and should maintain its record of entering and developing new markets. We regard Almarai's premium valuation as justified considering its high qualities. Jarir is a respected company with strong positions in electronics, office and school supplies, and books; it achieves high same store sales growth and high economic profit. Jarir currently yields 5.9%, which is the highest level among our Top Five. Finally, we have high confidence in the long-run investment case for Ma'aden, whose state-supported drive into phosphate and aluminium should help create a new industrial pillar for Saudi Arabia.



## MENA political turmoil market volatility set to rise

A wave of political turmoil has swept the MENA region

The political situation in the Middle East and North Africa (MENA) region has taken a dramatic turn so far in 2011. Two weeks or so ago, a popular revolution took place in Tunisia which resulted in the fall of the regime of former President Zine El Abidine Ben Ali after more than two decades. Yemen has also witnessed major demonstrations. However, it is the continuing demonstrations against the regime of President Hosni Mubarak sweeping Egypt, the most populous country in the Arab world, which have affected sentiment among investors not just in the region but around the world.

This has affected stock markets which we expect to stay volatile

The unrest has had a severe impact on equity markets in the region. The stock exchange in Egypt is closed this week after slumping more than 21% last week. In other MENA markets including the GCC countries, stock markets declined in a range of 4%-6% when they opened this week. The Saudi TASI index fell by 6% on 29th January, 2011, the first day on which it had a chance to react to the Egyptian unrest. Although the index rallied by 2% on the following day, we expect the mood in the market to stay volatile.

At the start of 2011 we believed, together with certain other commentators, that the outlook for the TASI this year was positive, considering the background of favourable domestic growth, generally positive economic news globally, and the underperformance of the Saudi stock market relative to the Qatari market in particular in 2010. Our initial optimism may still prove to be correct over the year as a whole. However, again together with many other commentators, we had clearly underestimated the potential for political disruption in the greater MENA region. While we cannot claim to predict whether or not the Egyptian regime will survive, it seems probable that unrest in the country will continue. Other countries such as Jordan and Yemen have also suffered unrest, although we do not expect that unrest to spread to Saudi Arabia or the GCC countries.

Investors may decide to apply a higher risk premium to the region

If political turmoil in Egypt and elsewhere does continue, it is likely to dampen sentiment among investors in the region's stock markets. More specifically, it may be that investors collectively decide that it is appropriate to apply a higher risk premium to regional markets, including Saudi Arabia. If so, then market valuations may not expand to the extent we had hoped. Even if valuations do expand eventually, again it seems reasonable to expect stock prices to be more volatile than they would have been if the wave of unrest had not started.

## Potential economic impact limited on the oil-producing countries

Financial markets have felt an impact from the crisis

The impact of the situation in Egypt has been felt by debt markets as well as equity markets. Egypt's sovereign dollar bonds have plunged by almost 10% so far in January while the yield on dollar bonds due in 2020 has surged 67 basis points (bps) to 6.97% on 28th January. Meanwhile, the credit default swap (five year CDS) for securing Egypt's debt has risen from 304bps on 24th January to 429bps on 31st January. The government has delayed scheduled debt issuances this week. The impact of the Egyptian political crisis has been felt by other MENA region debt markets too, as the credit default swap has increased from 75bps to 110bps during the past week for Saudi Arabia. CDSs for other GCC countries have moved up in the range of 15bps-25bps.

The effect on the real economy has so far been modest, and we do not expect a big impact on the oil-exporting countries

While the impact on financial markets has been obvious, it is too early to gauge the impact of the crisis on the real economy of Egypt and the broader MENA region. There has been no report of disturbance in trade flow through the Suez Canal. That said, if the crisis is prolonged, there could be a lasting effect on the oil-importing countries of the MENA region (which include Egypt). These countries are largely dependent on foreign capital, remittances and foreign aid to balance their current account deficits. In the event that the political crisis spreads and money inflows dwindle significantly, several countries could potentially face a balance of payments crisis. However, we do not anticipate much impact on the oil-exporting countries of the region and on Saudi Arabia in particular. The current political crisis is unlikely to have a significant impact on global crude oil prices unless trade through the Suez



Canal is affected. For the moment this seems very improbable. Direct trade between Saudi Arabia and Egypt is miniscule at 2.5% of the Kingdom's total trade.

## Safe stocks to hold focus on growth, financial strength and valuation

While the direct impact of the present crisis on the Saudi economy may be limited, given the likelihood of greater price volatility what are the best and safest stocks for investors in Saudi Arabia to hold? We believe that investors should look to hold companies with the following characteristics:

- Solid long-term growth prospects
- High sales exposure to the domestic market, or to Asian or other foreign markets which are unaffected by unrest in the Middle East
- A strong balance sheet, which we would broadly define by a net debt/EBITDA ratio of below 2.0x
- A reasonably generous dividend yield
- An attractive valuation – whether on the basis of PE, EV/EBITDA, enterprise value/invested capital or implied upside to our target price (often though not exclusively determined by long-run discounted economic profit valuation)

Figure 1. Preferred stocks in current environment

Stock	Share price	TASI sector	Rating	PE 2011 (x)	EV/EBITDA 2011 (x)	Div. yield 2011 (%)	Price/book (x)	EV/IC (x)	Net debt/EBITDA 2010 (x)	Target price (SAR)	Implied upside (%)	% of sales in Egypt or Tunisia
Mobily	53.0	Telecoms	Overweight	7.6	5.7	5.0%	2.4	1.8	1.0	78.2	47.5%	0%
SABIC	101.0	Petrochems	Overweight	11.6	8.0	3.5%	2.5	1.6	1.2	126.0	24.8%	N/A but likely to be low
Almarai	102.0	Food	Overweight	16.2	12.6	2.0%	3.8	2.6	2.2	118.7	16.4%	<1%
Jarir	147.0	Retail	Overweight	13.4	11.8	5.9%	7.3	5.6	0.3	189.4	28.8%	<3%
Ma'aden	22.7	Indus. investment	Overweight	136.5	59.4	0.0%	1.3	0.7	10.6	28.2	24.2%	0%

Note Valuations are correct as at 30th January, 2011 Price/book and EV/IC multiples are based on the end of 2010  
Source: Company data, Al Rajhi Capital

Below we comment on the investment attractions of these stocks in turn.

### Mobily

Mobily offers high growth, financial strength and a very attractive valuation

Mobily is the second largest telecoms operator in Saudi Arabia. The company dominates the Saudi mobile broadband market, with at least 50% of the market by our estimate. Mobily has a strong record of growth which it maintained in Q4 2010, reporting year-on-year growth in sales of 26% and in net profit of 39%. Another feature of the Q4 results was the continued strengthening of Mobily's balance sheet: Mobily's EV/EBITDA ratio is now under 1.0x, giving it the financial flexibility both to continue investing for growth and to increase its dividend. We have recently raised our forecasts for Mobily substantially, and now estimate fair value per share on a long-run discounted economic profit basis at SAR78.2. We have set this as our new target price, implying around 50% appreciation potential from the current share price. Mobily has underperformed the TASI by 4% over six months despite its recent sparkling results. We ascribe this poor performance to concern that the company's strong growth is set to slow sharply soon. We disagree with this view, since most evidence suggests to us that the Saudi mobile broadband market is still surging. Even if growth does start to slow, Mobily trades on a PE of 7.6x with a 2011 yield of 5.0%, making it one of the best-value Saudi stocks. We note further that Mobily is 100% focused on Saudi Arabia, with no exposure to Egypt, Tunisia or other markets facing political turmoil.



Benefiting from new capacity-driven volume growth and margin expansion as prices recover

## SABIC

SABIC is the largest listed company in the GCC and the Middle East's largest petrochemicals group. SABIC is 70% owned by the Saudi government, giving it solid financial and regulatory backing. As noted in our comprehensive sector report *Saudi Petrochemicals Sector: Advantage Saudi Arabia* (4th August, 2010), we like SABIC for its diverse business portfolio, its low-cost production, its ambitious strategy of heavy investment which should capitalise on robust Asian demand, and its strong R&D capability. Given SABIC's size and huge economies of scale, we expect it to remain very dominant within the Saudi petrochemicals market. SABIC's recent results for Q4 2010 fell slightly short of consensus estimates but exceeded our own forecasts. Looking forward, we expect prospects for SABIC to improve further owing to volume growth driven by new capacity and margin expansion led by a continuing recovery in petrochemicals prices. SABIC is strong financially with a net debt/EBITDA ratio of 1.2x and inexpensive on a PE of 11.6x. We retain our Overweight rating and target price of SAR126.0, implying 25% upside.

Almarai dominates the food market and has a fine record of expansion into new areas; it deserves its premium valuation

## Almarai

Almarai is the largest company in the food sector by market capitalisation. The company dominates the Saudi dairy market, with aggregate market share of 40% by our estimate. Almarai has a shown strong record of growth over the last couple of years. While Q4 2010 results were below expectations in terms of net profit, the full-year results were impressive and we believe that they can be repeated. In addition to improving its bakery and poultry segments, Almarai has great potential to expand by entering new areas: for example, we shall not be surprised to see the company enter new segments of the food market or new countries such as Iraq. Almarai has an impressive record of success after entering new market categories and we believe that it can maintain this. We also like the company's transparency and strong IR operation, which was recently recognised by the Middle East Investor Relations Society as the best such operation in Saudi Arabia. This year will definitely be a challenging year considering rising foodstuff prices, but we have confidence in the company's capability to overcome this pressure. Therefore, we remain Overweight and maintain our target price of SAR118.7, which is based on a combination of long-run discounted economic profit (DEP) valuation and comparative multiples analysis. This implies upside potential of 16%. Almarai currently trades on a PE ratio of 16.2x and an EV/EBITDA multiple of 12.6x. This valuation is not cheap, but we regard it as justified considering the company's undoubted qualities. It is worth highlighting that Almarai's exposure to Egypt is negligible, at under 1% of sales.

A respected company with high organic sales growth and high economic profit, together with a 5.9% dividend yield

## Jarir

Jarir Marketing is a well-respected company with strong positions in the electronics, office and school supplies, and books markets. Although the Q4 2010 results were below our estimates, the full-year results were respectable and not far below our forecasts. Opening new stores and strong like-for-like sales growth should drive the company's growth over the next three years. Moreover, we still expect strong same store sales growth, a handsome dividend yield, high economic profit and the company's overall transparency to support the stock price. We therefore remain Overweight, although we indicated in our Flash View comment on Jarir's Q4 results of 9th January that we expected to trim our target price of SAR189.4, which is based on a combination of long-run DEP valuation and comparative multiples analysis. By our estimate, Jarir's exposure to Egypt is less than 3% in terms of revenues. The share price has slipped to SAR147. At this level, Jarir trades on a PE ratio of 13.4x and an EV/EBITDA multiple of 11.8x, and offers an attractive dividend yield of 5.9%. This is the highest yield among our Top Five stocks.

Ma'aden's expansion into phosphate and aluminium should create a new industrial pillar for Saudi Arabia

## Ma'aden

It may appear surprising that our list of recommended stocks should include a loss-making company which currently has a high gearing level. However, we have high confidence in the investment case for the company. Ma'aden is a gold mining company which is planning major diversification into two new businesses: phosphate to start in 2011, and aluminium to start in 2013. We believe Ma'aden will utilise low-cost materials and government support to be a success story for the long run. The Saudi government, in our view, wishes to create a third industrial pillar for the economy after oil production and petrochemicals. The government owns 50% of Ma'aden through the Public Investment Fund, and is offering the company the following benefits: cheap raw materials, a special railway line, a special port, cheap loans and capital and a free industrial city. We expect revenues and profits to expand significantly this year even though the phosphate operation has been delayed by about three quarters; further



growth will follow next year. After strong performance over most of the past six months, Ma'aden dropped by 10% on 29th January and has barely recovered since. We think this weakness provides a good buying opportunity for investors who missed out on the previous rally. Our target price is SAR28.2 which implies 24% upside.

#### Note 1: Ma'aden's valuation multiples

Ma'aden's PE and EV/EBITDA multiples for 2011 look very stretched because the underlying earnings for 2011 reflect only the gold business and the launch of the phosphate operations. We believe that price/book value and enterprise value/invested capital (EV/IC) multiples are more appropriate to measure Ma'aden's relative valuation. Ma'aden trades on a 2011 price/book value ratio of 1.3x and an EV/IC multiple of 0.7x.

#### Note 2: Ma'aden's valuation multiples

Ma'aden's net debt/EBITDA ratio of 2010 is arguably misleading because it only includes EBITDA from the gold business, whereas the net debt reflects sums borrowed to finance investment in gold, phosphate and aluminium. If we look in absolute terms, the net debt looks more modest at SAR1.76bn in 2010. We expect net debt to halve to around 5.5x by the end of 2011 following the launch of the phosphate operations, and to fall further to 3.8x by 2012, by which time we expect phosphate to dominate the overall business.

## Stocks with exposure to Egypt Savola is the key group affected

Egypt accounts for 11% of sales and 18% of production for Savola

Relatively few Saudi companies have high direct exposure to Egypt. One of the exceptions is the Savola group. Savola is a well-respected group with strong positions in the retail and food markets. Savola's share price has fallen by 10% since the start of 2011 as a result of unexciting Q4 2010 results and the political turmoil in Egypt. While Q4 results were weak, the full-year results were acceptable considering the market environment of rising prices for commodity foodstuffs. Savola's revenues from Egypt comprise around 11% of total turnover. Moreover, Savola owns sugar and edible oil plants in Egypt which contribute around 18% of the company's total food production by our estimate. Hence, if production is stopped in these plants due to the current circumstances, the proportion of Savola's revenues which may be affected may exceed 11%. In our Flash View comment of 18th January on Savola's Q4 results, we indicated that we expected to lower our target price of SAR39.5 and to downgrade our Overweight rating. However, it is possible that the damage to Savola's share price (which now stands at SAR29) has already been done, considering that the company currently trades on a 2011 PE ratio of 12.2x and an EV/EBITDA multiple of 7.0x, or levels well below of those of peer companies such as Almarai and Jarir. We will follow up with further comment on Savola as soon as possible.



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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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