



FTSE REVIEW – POTENTIAL POSITIVE CATALYST

FTSE Russell Group, the global benchmark index provider, will be announcing the results of its country classification and index reviews on 29th September 2017. Saudi is currently on the watch list for inclusion in the benchmark FTSE Emerging Markets/FTSE Emerging Markets All Cap indices and is expected to be upgraded to full membership. The upgrade would lead to inflows of c.SR12.1bn (US\$3.2bn) into the Tadawul. Although we expect a majority of the Saudi stocks included in indices to benefit, we prefer stocks with strong fundamentals and positive outlooks. Our top picks are: Yansab, Sipchem, Jarir, Catering, SGS and Saudi German Hospital.

Background

- The Saudi market was added to FTSE Emerging markets shortlist in September 2015. A market that is shortlisted for potential inclusion in the benchmark index must remain in the watch list for at least one year before being considered for an upgrade.
- Since being short listed, several major developments that have been undertaken (including changing the settlement period from T+0 to T+2, reducing the requirements for QFIs and amending foreign ownership limits) are expected to enable the market to be upgraded during the upcoming review.
- Upgrading the Saudi market is expected to result in a total inflow of SR12.1bn.
- We believe there is a tactical opportunity for investors to benefit from these inflows. However, investors need to be selective, given the Tadawul trades at 2018E PE of 13.7x, a 12.3% premium to the FTSE Emerging Markets index.

FTSE Emerging Markets Indices

- There are two main FTSE emerging markets indices, namely the FTSE Emerging Markets Index (consisting of large and midcap companies) and the FTSE Emerging Markets All Cap Index (with the inclusion of small, mid and large cap companies).
- Total AUM of US\$115bn, including both passive (99.1%) and active investors (0.9%) are benchmarked against these two indices. It is understood a majority of international institutional investors that use FTSE as a benchmark are benchmarked against the FTSE Emerging Markets index.
- The FTSE Emerging Markets Index is a US\$4,245bn investibility weight adjusted market cap index, covering 992 stocks across 23 countries. It includes 34 Saudi companies with a total investibility weight adjusted market cap of US\$110bn, representing 2.6% of the index. These companies have a full market cap of US\$295bn, representing 63.8% of the Tadawul's market cap. With a total investibility weight adjusted market cap of US\$110bn and a weight of 2.6%, we expect inflows of US\$2.85bn once any potential upgrade is implemented.

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- The difference in terms of investibility weight adjusted market cap for Saudi companies in the two indices is 8.9% or US\$9bn, as a result of the 23 small cap companies included in one index and not the other.
- The FTSE Emerging Markets All Cap Index is a US\$4,778bn investibility weight adjusted market cap index, covers 2,122 stocks from 24 countries. It includes 57 Saudi companies with a total investibility weight adjusted market cap of US\$119bn, representing 2.51% of the index. These companies have a full market cap of US\$316.3bn, representing 67.8% of the Tadawul's market cap.

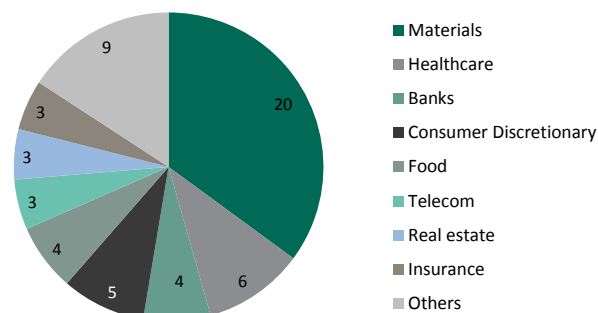
Inclusion process

- Following an upgrade, there will be a period of at least six months to allow investors to prepare to enter the market. Depending on market readiness, there are three potential scenarios:
 - 1) Full inclusion after the six months.
 - 2) Gradual inclusion, with 50% weight after six months and 50% after one year.
 - 3) Inclusion starts with a 25% weight, increasing gradually over a certain period of time.
- As the "No or simple registration process for foreign investors" criteria was not met during the FTSE review in March 2017, we believe the second scenario would probably be more applicable to the Saudi market. This would imply implementation with a 50% weighting at the end of March 2018 at the earliest, and initial inflows of SAR6.05bn.

Which stocks will be included?

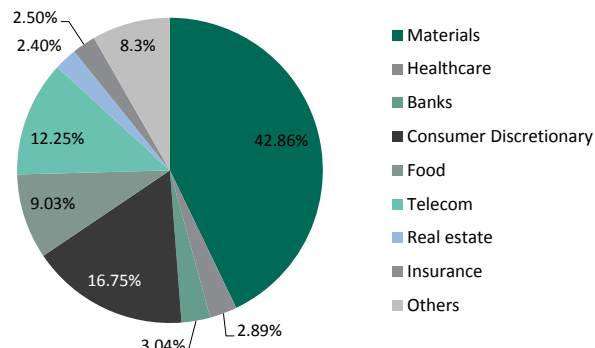
- As mentioned earlier, between 34 and 57 stocks will be part of the two different benchmark indices, the FTSE Emerging Markets Index (consisting of large and midcap companies) and the FTSE Emerging Markets All Cap Index (including small cap stocks). We note that this is a preliminary list and FTSE might add more stocks to the index at the review.
- The FTSE Emerging Markets All Cap Index included 57 Saudi companies from 11 sectors. The total market cap of these Saudi stocks is SR1,186bn, representing 67.8% of the total market cap of the market.
- The Materials sector will be represented by 20 stocks, with an expected weight of 42.9% of the total Saudi weight. In addition to Ma'aden (6.54% weight), the Materials sector include 10 petrochemical stocks with a weight of 33.1% and 9 cement companies with a weight of 3.27%. The Healthcare sector include 6 stocks and a weight of 2.9%, while the Consumer Discretionary sector has 6 names with a total weight of 16.8%.
- Only four banks are expected to be included in the index (Al Rajhi, Inma, Aljazira and Albilad). We believe the reason behind exclusion of other large cap banks is their low median average traded volume, which is a key factor that FTSE considers for inclusion.
- The top stocks by weight are: SABIC (20.1%), Alrajhi (12.1%), STC (10.2%), Ma'aden (6.5%) and Almarai (5.6%).

Exhibit 1: Number of Saudi stocks per sector included in FTSE Emerging Market All Cap index



Source: Bloomberg, FTSE Russell, NCBC Research

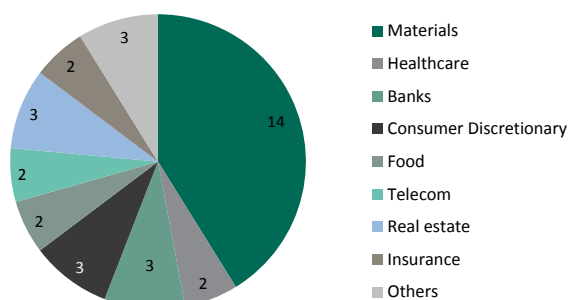
Exhibit 2: Saudi sectors weights to total Saudi exposure in FTSE Emerging Market All Cap index



Source: Bloomberg, FTSE Russell, NCBC Research

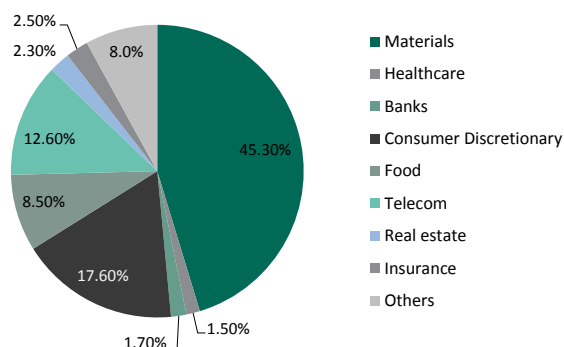
- The more broadly followed FTSE Emerging Markets Index is expected to include 34 stocks only. The Material sector will be represented by 14 stocks.
- Similar to FTSE Emerging Markets All Cap Index, 10 petrochemical stocks, in addition to Ma'aden, will be included, while 6 cement companies will be omitted.
- The Material sector weight will be 45.3%, followed by the Consumer Goods sector (17.6%) and the Telecoms sector (12.6%). The top five Saudi stocks by weight in this index are SABIC (21.9%), Al Rajhi (13.1%) and STC (10.9%), Ma'aden (7.3%) and Almarai (5.5%).

Exhibit 3: Saudi stocks per sector included in FTSE Emerging Markets index



Source: Bloomberg, FTSE Russell, NCBC Research

Exhibit 4: Saudi sectors weights to total Saudi exposure in FTSE Emerging Markets index



Source: Bloomberg, FTSE Russell, NCBC Research

What do we prefer?

- Although the stocks included in the benchmark indices should benefit from higher inflows in the coming 12 months, we prefer stocks with strong fundamentals and a positive outlook. We also prefer stocks that are expected to benefit from Vision 2030 and its associated programs.
- Despite ongoing oil price volatility, we believe the outlook for the Petrochemical sector remains positive driven by OPEC efforts to cut production, which will support oil and petrochemical prices. Out of the 10 petrochemical stocks included in the index, our top picks are **Yansab**, **SIIG** and **Sipchem**.
- The religious tourism sector is also a key strategic sector for Saudi's economy. We believe **Al-Tayyar**, **Saudi Ground Services (SGS)** and **Saudi Airlines Catering (Catering)** are three companies in the Saudi market that are expected to benefit from this potential growth.
- The healthcare sector is a key defensive sector in Saudi with robust demand fundamentals and growth prospects, based on the prevalence of Non-Communicable Diseases, undersupply and population demographics. Our top pick in the sector is **Saudi German Hospital (SGH)**.
- The reinstatement of allowances in April 2017 is expected to be a key driver for the retail sector in Saudi. Our top picks in the sector are **Jarir** and **Al Othaim**.

Exhibit 5: Top picks - Valuation summary

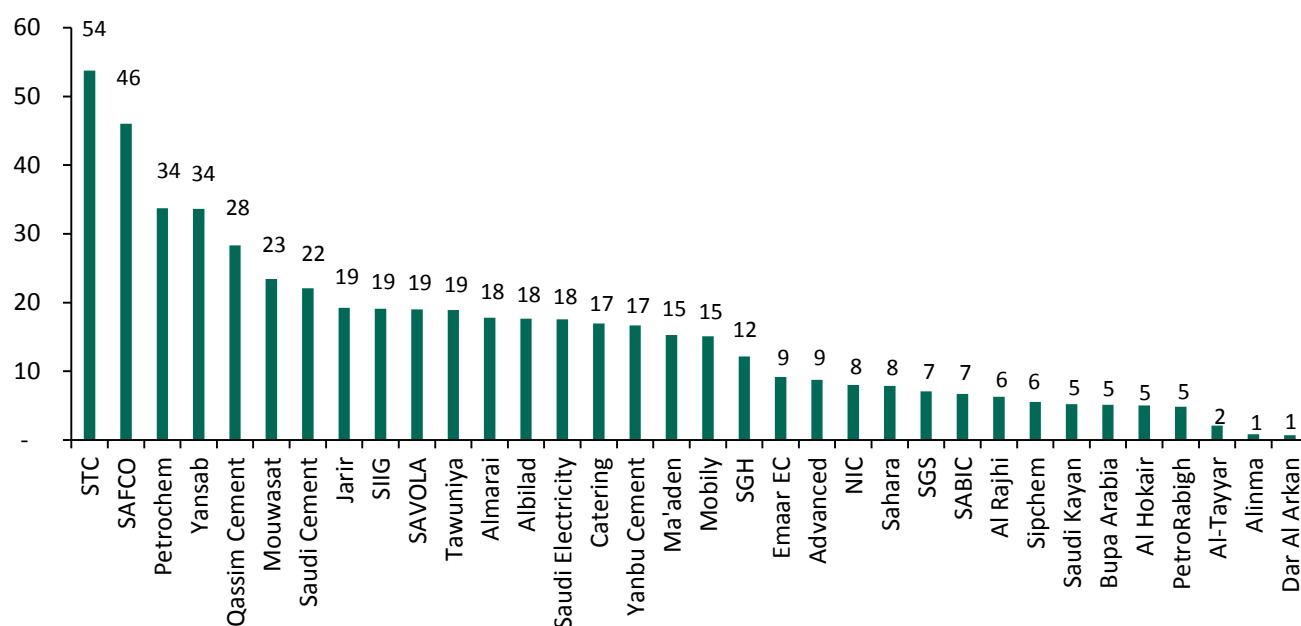
		Current	PT	Upside/	Mcaps	P/E	Implied	EV/	P/BV	DY	ROE
	Rating	Price	(SR)	Downside	SR mn	(x)	P/E (x)	EBITDA	(x)	(%)	(%)
						'17	'17	'17	'17	'17	'17
Yansab	OW	56.6	64.7	14%	31,854	14.0	16.0	9.0	1.9	6.2	13.9
SIIG	OW	21.1	22.9	9.0%	9,491	10.4	11.3	8.1	1.4	4.7	14.4
Sipchem	OW	15.0	16.6	11%	5,496	17.7	19.6	8.5	1.0	0.0	5.7
Catering	OW	86.3	103.4	20%	7,077	11.5	13.8	10.6	5.4	7.8	47.9
SGS	OW	43.6	60.8	40%	8,187	10.7	14.9	8.0	2.5	6.3	24.1
Al-Tayyar	OW	34.9	40.0	15%	7,317	8.5	9.7	6.8	1.2	4.3	14.8
SGH	OW	63.8	95.3	49%	5,870	15.6	23.2	18.3	3.3	3.1	20.9
Jarir	OW	149.6	168.3	13%	13,462	16.1	18.2	15.4	8.2	5.1	53.0
Al Othaim	OW	121.6	121.5	0.0%	5,470	18.1	18.1	12.0	3.8	1.9	22.7

Source: NCBC Research. Prices as of 13 September 2017

Stock Performance

- Single line stock performance will be driven by fundamental outlook, expected inflows, weighting in the FTSE Emerging markets index and liquidity. Whilst large caps would naturally see substantial inflows, some of the smaller caps could paradoxically see better share price performance due to their lower liquidity.
- Country indices typically rise before full inclusion in a benchmark, as active fund managers position themselves to take advantage of the upcoming inclusions. However, given that virtually all institutions who use FTSE Emerging Markets index as a benchmarks are passive, they will typically only invest once the upgrade is implemented. Hedge funds would however be expected to take positions prior to implementation in anticipation of passive flows.
- The total number of days of inflows is based on the 3 month Average Daily Value Traded for each stock. It assumes that all funds will be deployed.

- Based on the Tadawul average daily trading volume of SR3.5bn and a total inflow of SR12.1bn, we expect that the market will need around 4 days to absorb the incremental inflow. However, as stock specific daily volume varies, we believe the number of days required may be significantly higher than 4 days.

Exhibit 6: Total Inflows - Nos of days of inflows

Source: Bloomberg, FTSE, NCBC Research

It should be noted that there are several factors that will determine the level of actual active inflows, such as

- Relative valuation of Saudi stocks vs the FTSE Emerging Markets indices, sector outlook and fundamental prospects for each stock
- The average daily value traded changes on an ongoing basis.

As a result the number of days of inflow for individual stocks could vary significantly from the maximum estimated above. In addition investors will try to minimise price movements and hence each individual institutional investor would not be expected to account for more than 25% of the value traded on any given day, hence the number of days of inflows could be materially higher by a factor of 4x.

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Exhibit 7: FTSE Emerging Markets All Cap Index Constituents

	Company	Industry	Price	Market Cap, SR mn	PE 2016	Div Yield 2016	Total inflows, SR mn	% of Saudi inflow
1	SABIC	Chemicals	100	303,600	15.4	4.4	2455	20.2%
2	Al Rajhi	Banks	68.3	111,800	12.6	3.6	1480	12.2%
3	STC	Diversified Telecom Svs	75.3	150,800	17.0	5.5	1,223	10.1%
4	Ma'aden	Metals & Mining	52.9	62,864	-	-	833	6.8%
5	Almarai	Food Products	81.7	60,960	27.0	1.3	622	5.1%
6	Saudi Electricity	Electric Utilities	23.8	98,915	44.3	3.1	502	4.1%
7	Yansab	Chemicals	56.5	31,894	13.2	5.6	422	3.5%
8	Alinma	Banks	17.9	26,970	14.9	3.3	357	2.9%
9	SAFCO	Chemicals	61.8	25,833	29.5	3.3	342	2.8%
10	SAVOLA	Food Products	47.5	25,231	-	2.5	334	2.7%
11	Mobily	Wireless Telecom Svs	17.8	13,860	-	-	184	1.5%
12	Jarir	Specialty Retail	150	13,500	14.0	6.1	179	1.5%
13	Saudi Kayan	Chemicals	8.78	13,335	98.2	-	177	1.5%
14	Emaar EC	Real Estate Management & Dev	15.5	13,056	156	-	173	1.4%
15	Tawuniya	Insurance	97.8	12,225	14.8	4.6	162	1.3%
16	Albilad	Banks	19.8	11,916	15.3	2.4	150	1.2%
17	Tasnee	Chemicals	15.0	10,248	80.7	-	136	1.1%
18	SIIG	Chemicals	20.8	9,441	17.0	2.6	125	1.0%
19	Bupa Arabia	Insurance	121	9,760	20.0	1.5	125	1.0%
20	Advanced	Chemicals	45.5	8,974	12.4	6.2	119	1.0%
21	Petrochem	Chemicals	17.7	8,544	25.0	2.4	113	0.9%
22	Mouwasat	Health Care Providers & Svc	160	7,970	28.9	1.7	102	0.8%
23	Al-Tayyar	Hotels, Restaurants & Leisure	35.6	7,422	9.20	-	98.3	0.8%
24	Al Othaim	Food & Staples Retailing	121	5,463	19.3	2.0	97.9	0.8%
25	Dar Al Arkan	Real Estate Management & Dev	6.39	6,901	26.8	-	91.4	0.8%
26	Saudi Cement	Construction Materials	44.9	6,816	12.1	7.7	90.3	0.7%
27	Bank Aljazira	Banks	13.0	6,791	6.50	-	89.9	0.7%
28	Sahara	Chemicals	13.7	6,064	15.9	5.1	80.3	0.7%
29	Catering	Commercial Svs & Supplies	86.4	7,134	15.6	6.8	79.4	0.7%
30	PetroRabigh	Oil, Gas & Consumable Fuels	13.3	11,703	294	-	79.1	0.7%
31	SGS	Transportation Infrastructure	43.2	8,159	18.1	2.7	72.8	0.6%
32	Sipchem	Chemicals	14.8	5,493	99.5	-	72.7	0.6%
33	Al Hokair	Specialty Retail	42.0	8,747	14.2	-	72.8	0.6%
34	SGH-MEAHCO	Health Care Providers & Svc	63.8	5,872	18.7	-	71.4	0.6%
35	Zain	Wireless Telecom Svs	8.95	5,230	-	-	69.3	0.6%
36	Dallah	Health Care Providers & Svc	109	6,455	24.8	2.1	61.6	0.5%
37	Yanbu Cement	Construction Materials	28.5	4,505	11.9	7.4	59.7	0.5%
38	Qassim Cement	Construction Materials	45.2	4,086	14.8	7.1	54.1	0.4%
39	Spimaco	Pharmaceuticals	34.1	4,092	13.0	2.4	54.2	0.4%
40	Al Hammadi	Health Care Providers & Svc	35.1	4,188	67.0	-	53.6	0.4%

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Exhibit 8: FTSE Emerging Markets All Cap Index Constituents (contd)

	Company	Industry	Price	Market Cap, SR mn	PE 2016	Div Yield 2016	Total inflows, SR mn	% of Saudi inflow
41	SADAFCO	Food Products	121	3,933	15.4	3.2	51.2	0.4%
42	Yamama Cement	Construction Materials	16.9	3,353	12.6	4.4	44.4	0.4%
43	Arabian Cement	Construction Materials	32.0	3,200	9.10	9.0	42.4	0.3%
44	Arriyadh Development	Real Estate Management & Dev	18.8	2,501	11.6	5.7	33.1	0.3%
45	NADEC	Food Products	29.6	2,511	20.3	-	33.3	0.3%
46	National Gas	Gas Utilities	32.0	2,404	17.0	3.8	31.8	0.3%
47	Saudi Chemical	Chemicals	35.8	2,261	17.9	-	29.9	0.2%
48	Herfy	Hotels, Restaurants & Leisure	51.6	3,357	16.6	3.8	28.2	0.2%
49	Eastern Cement	Construction Materials	24.0	2,064	12.7	4.3	27.3	0.2%
50	City Cement	Construction Materials	11.0	2,074	13.5	6.5	27.5	0.2%
51	Care	Health Care Providers & Svc	40.9	1,839	59.9	1.1	24.4	0.2%
52	Aseer	Diversified Financial Svs	15.5	1,959	-	5.6	22.9	0.2%
53	Al-Hokair Group	Hotels, Restaurants & Leisure	30.9	1,716	14.3	3.4	22.7	0.2%
54	Northern Cement	Construction Materials	9.55	1,714	16.7	7.4	22.7	0.2%
55	Najran Cement	Construction Materials	9.34	1,588	16.3	-	21.0	0.2%
56	Budget	Road & Rail	22.2	1,611	11.8	3.7	21.3	0.2%
57	MedGulf	Insurance	13.0	1,296	39.8	-	17.2	0.1%
Total				1,186,196			12,164	

Source: Bloomberg, FTSE, NCBC Research

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Exhibit 9: FTSE Emerging Markets Index Constituents

	Company	Industry	Price	Market Cap, SR mn	PE 2016	Div Yield 2016	Total inflows, SR mn	% of Saudi inflow
1	SABIC	Chemicals	100.73	302,190	15.4	4.4	2,449	21.8%
2	Al Rajhi	Banks	68.28	110,955	12.6	3.6	1,473	13.1%
3	STC	Diversified Telecom Svs	75.3	150,600	17.0	5.5	1,224	10.9%
4	Ma'aden	Metals & Mining	52.9	61,766	-	-	820	7.3%
5	Almarai	Food Products	81.7	65,392	27.0	1.3	669	5.9%
6	Alinma	Banks	17.9	26,850	14.9	3.3	356	4.5%
7	Saudi Electricity	Electric Utilities	23.8	99,248	44.3	3.1	504	3.7%
8	Yansab	Chemicals	56.5	31,753	13.2	5.6	421	3.2%
9	SAFCO	Chemicals	61.8	25,729	29.5	3.3	341	3.0%
10	SAVOLA	Food Products	47.5	25,353	-	2.5	336	3.0%
11	Mobily	Wireless Telecom Svs	17.8	13,683	-	-	185	1.6%
12	Jarir	Specialty and Retail	149	13,482	14.0	6.1	179	1.6%
13	Emaar EC	Real Estate Mgt & Dev	15.5	13,133	156	-	174	1.6%
14	Saudi Kayan	Chemicals	8.78	13,170	98.2	-	175	1.5%
15	Tawuniya	Insurance	97.8	12,226	14.8	4.6	162	1.4%
16	Albilad	Banks	19.8	11,856	15.3	2.4	150	1.3%
17	Tasnee	Chemicals	15.0	10,014	80.7	-	133	1.2%
18	Bupa Arabia	Insurance	122	9,754	20.0	1.5	125	1.1%
19	SIIG	Chemicals	20.8	9,356	17.0	2.6	124	1.1%
20	Advanced	Chemicals	45.5	8,954	12.4	6.2	119	1.1%
21	Petrochem	Chemicals	17.7	8,515	25.0	2.4	113	1.0%
22	Mouwasat	Health Care Providers & Svc	160	8,000	28.9	1.7	103	0.9%
23	Al-Tayyar	Hotels, Rest & Leisure	35.6	7,455	9.20	-	99	0.9%
24	Dar Al Arkan	Real Estate Mgt & Dev	6.39	6,901	26.8	-	92	0.8%
25	Saudi Cement	Construction Materials	44.9	6,862	12.1	7.7	91	0.8%
26	Sahara	Chemicals	13.7	6,020	15.9	5.1	80	0.7%
27	PetroRabigh	Oil, Gas & Consumable Fuel	13.3	11,677	294	-	79	0.7%
28	Catering	Commercial Svs & Supplies	86.4	7,081	15.6	6.8	79	0.7%
29	Al Hokair	Specialty Retail	42.0	8,826	14.2	-	74	0.7%
30	SGS	Transportation Infrastructure	43	8,122	18.1	2.7	73	0.6%
31	SGH-MEAHCO	Health Care Providers & Svc	63.8	5,873	18.7	-	72	0.6%
32	Sipchem	Chemicals	14.8	5,430	99.5	-	72	0.6%
33	Yanbu Cement	Construction Materials	28.5	4,492	11.9	7.4	60	0.5%
34	Qassim Cement	Construction Materials	45.2	4,068	14.8	7.1	54	0.5%
Total				1,114,787			11,258	

Source: Bloomberg, FTSE, NCBC Research

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