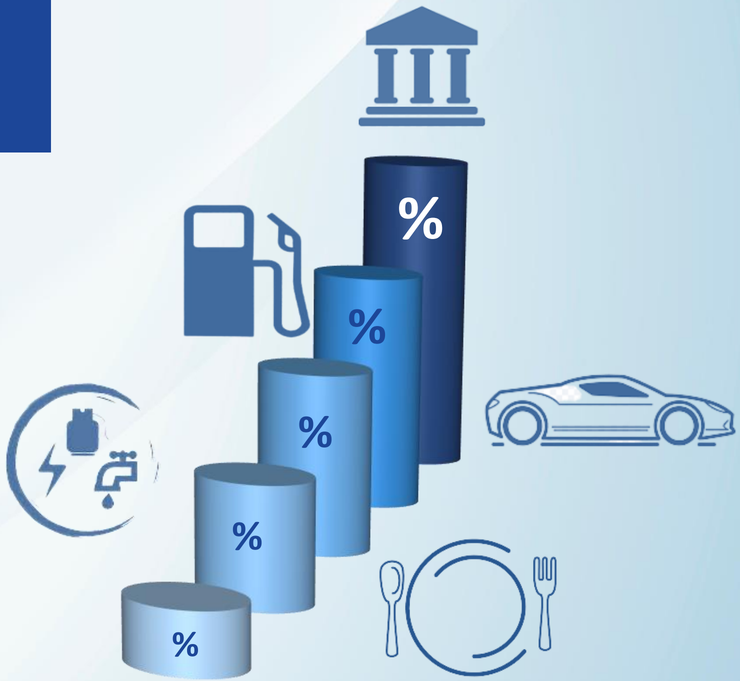
Al Rajhi Capital

الراجحي المالية

Saudi equity market report

2023 Outlook and top picks

29 December 2022



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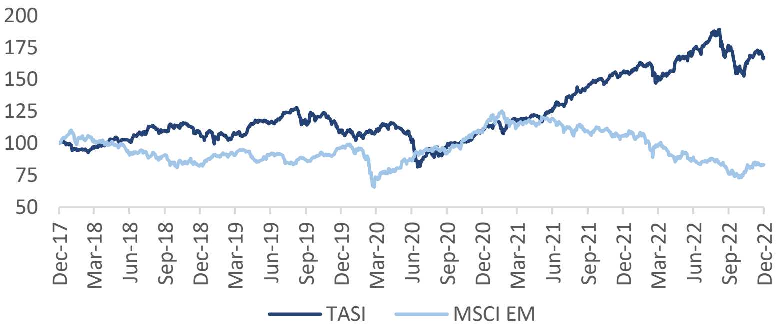
Contents

Saudi equities de-rate as SAIBOR goes up

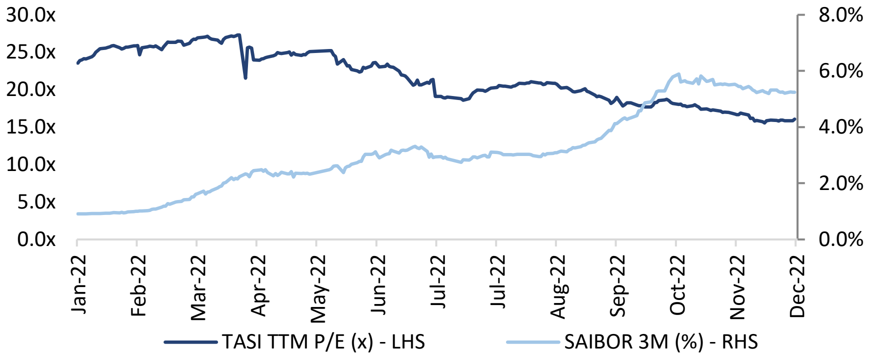
Saudi equities de-rate as SAIBOR goes up

- At the start of 2022, the market was worried about inflation and sought refuge in inflation protected sectors. In H1 2022, the market breadth was weak as the rally was concentrated in a few names. Only 55 out of the total 214 companies (listed back then) were up in H1 2022.
- As oil prices corrected from the peak and SAIBOR started going up, TASI's P/E saw a sharp correction from March/April 2022. As evident from the chart below, YTD TASI TTM P/E has notably corrected from 27x in March to 16x now (unadjusted).
- On a forward looking basis, our adjusted 2023 P/E implies TASI is trading at a 15.2x multiple and 15.8 x (ex-Aramco)

TASI and MSCI EM performance (Rebased to 100)

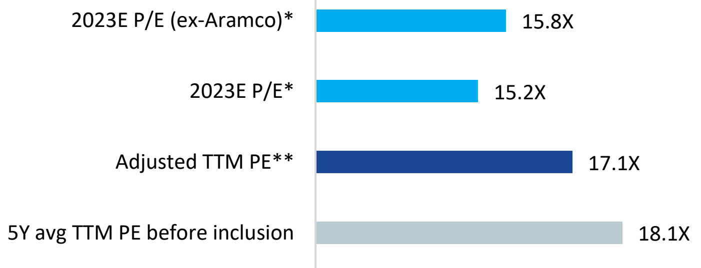


TASI P/E inverse relationship with SAIBOR



Source: Bloomberg, Al Rajhi Capital. Note: TASI TTM P/E is from Bloomberg and not adjusted for negative P/E or P/E above 150x that can bring the element of skewness

TASI PE below historical avg. pre MSCI inclusion



*Note: 5Y historical average is based on trailing PE from Bloomberg. For earnings, we have considered our estimates for our coverage, which accounts for about 83% of the free float market cap of TASI. For non-covered stocks, earnings from Bloomberg are considered. We have removed negative earnings and PE greater than 150x. ** Adjusted TTM PE is calculated after removing negative earnings and PE greater than 150x .*

Oil and SAIBOR to play major role

Oil prices to remain healthy on supply shortfall

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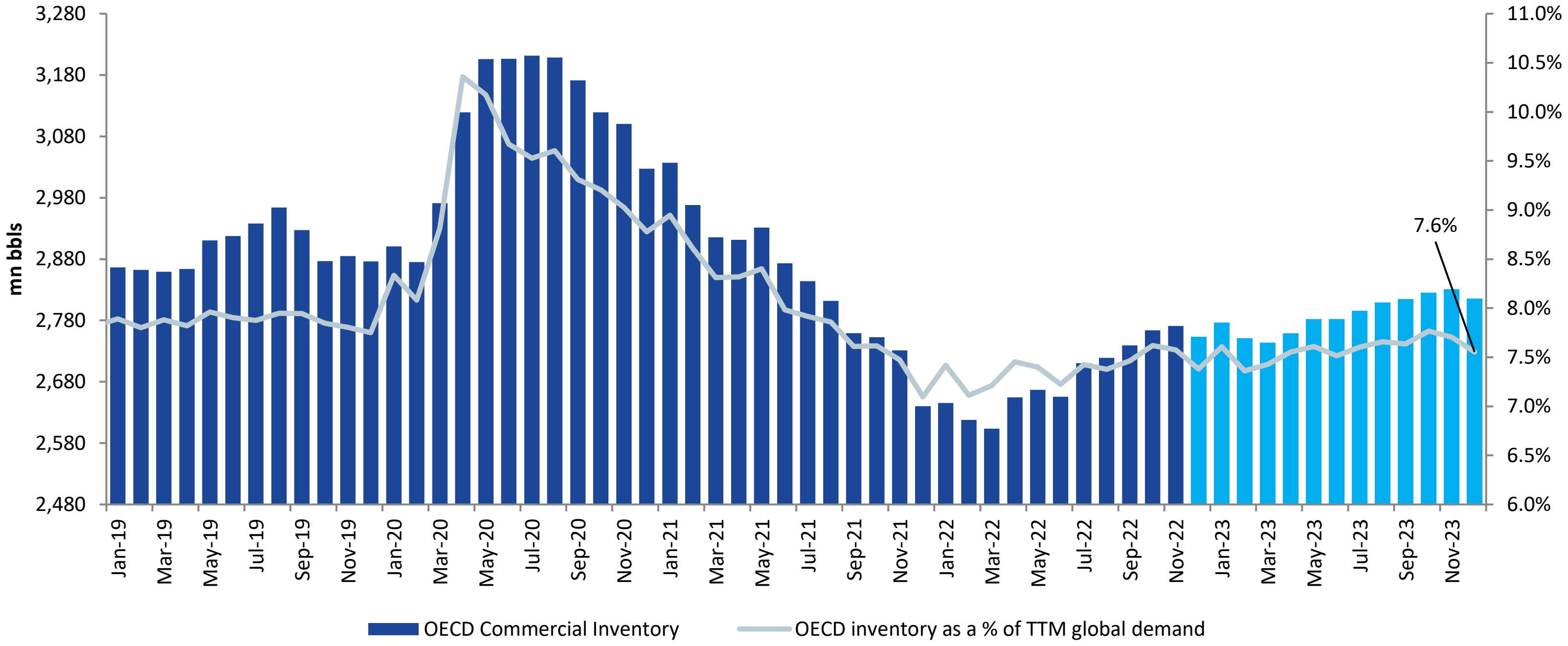
- Oil demand is expected to improve (+2.3mmbbl rise; source OPEC) next year, aided by relaxation of China's zero-COVID policy.
- We believe that oil prices are expected to remain firm with limited downside risks, as indicated by the forward contract curve for 2023, likely aided by:
  - Healthy demand growth
  - lower OECD inventory levels (remain below 8% as a % of global demand)
  - supply shortfalls on account of OPEC+ 2mmbd production cut deal and ongoing sanction on Russian supply
  - the US plan to refill oil for SPR next year
- As per the current trading forward contracts, crude prices are expected to average at ~US$79/bbl for 2023. Overall, healthy oil prices will continue to support government revenues and reforms.

Brent oil prices (US$/bbl)*

*Source: Bloomberg, Al Rajhi Capital. * As of 21 Dec 2022*

Monthly OECD inventory with a % of global demand*

- Below 8% OECD inventory as a % of demand indicates more balanced markets, aiding oil prices
- On the other hand, above 8% inventory levels shows the oversupplied markets, pushing oil prices lower



*Source: EIA, Bloomberg, Al Rajhi Capital. * EIA forecasted data from Dec 22 to Dec 23*

Inventories level

US inventories level

	2017	2018	2019	2020	2021	2022E*	2023E*
US Commercial inventories (mbbls)	1,229	1,259	1,282	1,343	1,199	1,184	1,219
Average US oil consumption (m b/d)	19.9	20.5	20.5	18.2	19.9	20.4	20.5
% of average US oil consumption	16.9%	16.8%	17.1%	20.2%	16.5%	15.9%	16.3%
Average global oil demand (m b/d)	98.5	100.0	100.8	92.0	97.5	99.8	100.8
US inventory as a % of global demand	3.4%	3.4%	3.5%	4.0%	3.4%	3.2%	3.3%

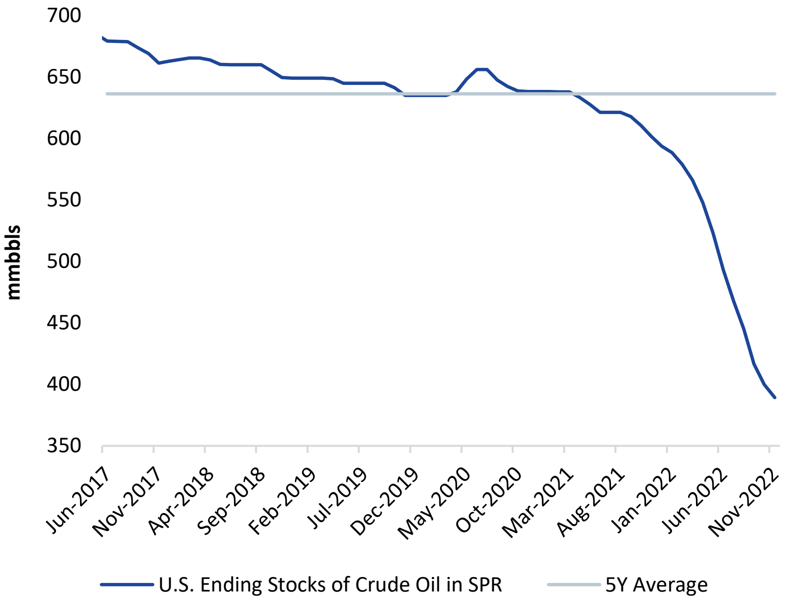
OECD inventories level

	2017	2018	2019	2020	2021	2022E*	2023E*
OECD Commercial inventories (mbbls)	2,849	2,859	2,876	3,028	2,640	2,753	2,816
Average OECD consumption (m b/d)	47.5	47.7	47.7	42.1	44.9	46.1	45.8
% of average OECD consumption	16.4%	16.4%	16.5%	19.7%	16.1%	16.4%	16.8%
Average global oil demand (m b/d)	98.5	100.0	100.8	92.0	97.5	99.8	100.8
OECD inventory as a % of global demand	7.9%	7.8%	7.8%	9.0%	7.4%	7.6%	7.7%

*Source: EIA, Al Rajhi Capital. * EIA estimates*

U.S. ending stocks of crude oil in SPR

The current program of the releases of crude oil from SPR is likely to end by the end of 2022. Further, the US plans to start purchasing oil next year, which may support oil prices.

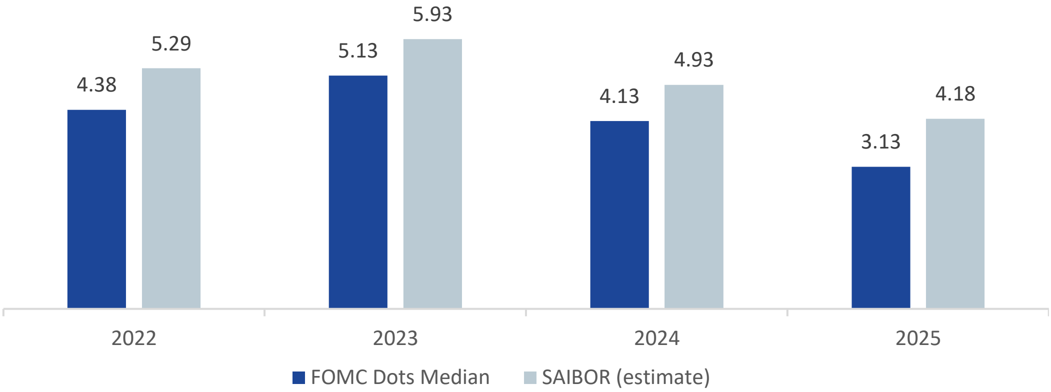


Source: EIA, Al Rajhi Capital

SAIBOR – not far away from the peak

- Post the latest Fed decision to raise rates to 4.50% and guide for 2023 year-end exit rate of 5.13%, we have updated our SAIBOR estimates.
- Our new peak SAIBOR estimate is 5.93%, which indicates the current level is not far away from the peak. However, we also believe that rates will remain high for a relatively longer period of time.
- Despite our belief that higher interest rates will stay for a longer period, we are positive on the corporate loan story given its strong balance sheet.

Fed rate and our SAIBOR estimate (%)

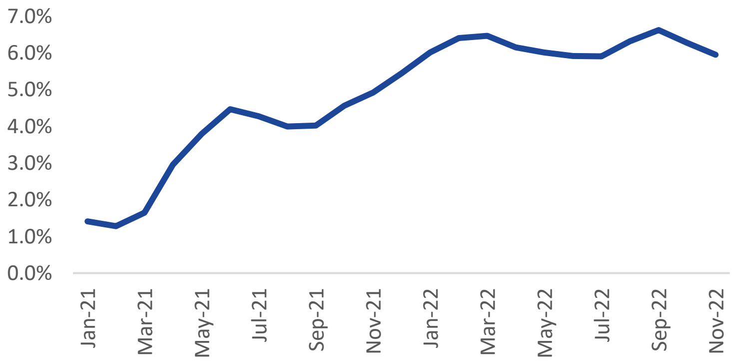


Source: Bloomberg, Al Rajhi Capital

US Inflation trend

- Core inflation in November marginally fell, though it remained high due to high energy and food prices.
- We believe that core inflation will be sticky and is unlikely to be impacted by rising interest rates.
- As a result, we expect the core inflation to remain elevated. This makes us believe that interest rates will remain high for a fairly long period of time.

US Core Inflation trend (y-o-y)



Source: Bloomberg, Al Rajhi Capital

US Inflation Segments

		Index			Change	
Category	**Wt**	**Nov-21**	**Oct-22**	**Nov-22**	**y-o-y**	**q-o-q**
All items	**100.0%**	**278**	**298**	**298**	**7.1%**	**-0.1%**
Food	**13.7%**	**286**	**315**	**316**	**10.6%**	**0.2%**
Food at home	8.5%	266	298	298	12.0%	0.0%
Food away from home	5.2%	315	341	342	8.5%	0.5%
Energy	**8.1%**	**259**	**300**	**293**	**13.1%**	**-2.5%**
Energy commodities	**4.4%**	**303**	**351**	**340**	**12.2%**	**-3.2%**
Gasoline (all types)	4.1%	297	339	327	10.1%	-3.6%
Fuel oil	0.2%	334	544	553	65.7%	1.7%
Energy services	**3.6%**	**228**	**264**	**260**	**14.2%**	**-1.5%**
Electricity	2.6%	228	262	259	13.7%	-1.2%
Utility (piped) gas service	1.0%	224	265	259	15.5%	-2.2%
Core inflation	**78.2%**	**283**	**299**	**300**	**6.0%**	**0.1%**
Commodities less food and energy	21.0%	159	167	165	3.7%	-0.8%
New vehicles	4.1%	165	176	176	7.2%	0.1%
Used cars and trucks	3.7%	200	199	194	-3.3%	-2.8%
Apparel	2.5%	122	129	127	3.6%	-2.1%
Medical care commodities	1.5%	379	391	391	3.1%	0.2%
Services less energy services	57.2%	359	382	383	6.8%	0.4%
Shelter	32.7%	340	362	364	7.1%	0.6%
Transportation services	6.0%	328	359	374	14.2%	4.4%
Medical care services	6.8%	577	607	602	4.4%	-0.7%

Source: US Bureau of Labor Statistics, Al Rajhi Capital

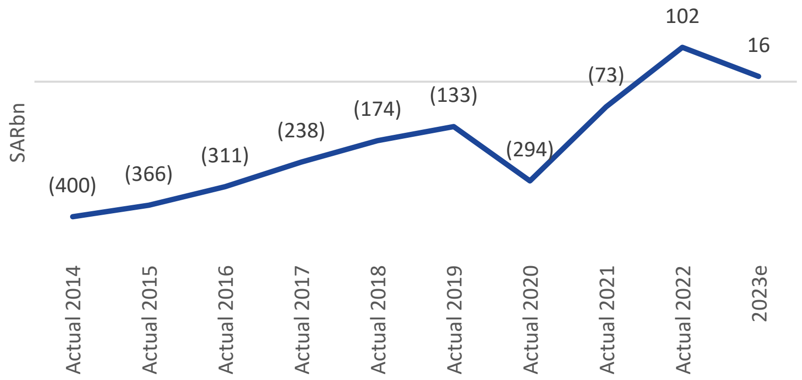
Saudi budget performance

- Saudi Arabia is likely to produce 10.75mmb/d oil in in 2023.
- Based on our assessment, the budget breakeven is ~US$77/b Brent while Govt's 2023 revenue is likely based on Brent at US$78/b, lower than the anticipated Brent prices for 2023.
- Despite OPEC+ production cut deal, firm oil prices will translate into healthy oil revenues (SAR754bn for 2023 based on our estimated oil price of ~US$85/bbl) for the Saudi government, helping to witness the second fiscal surplus since 2013.
- Overall, fiscal surplus, along with the ambitious Vision 2030 plans, would keep the investment spending in the domestic economy intact, limiting the impact due to global recession concerns.

KSA budget

SARbn	2021A	2022A	ARC est. (2022)	2023E Revised	ARC est. (2023)	2024P**	2025P**
Revenue	**965**	**1,234**	**1,248**	**1,130**	**1,171**	**1146**	**1205**
Oil*	562	842	823		754		
Non-oil*	403	392	425		417		
Expenditure	**1,039**	**1,132**	**1,132**	**1,114**	**1,114**	**1125**	**1134**
Deficit	**(73)**	**102**	**116**	**16**	**57**	**21**	**71**
Deficit % GDP	-2.35%	2.6%		0.4%		0.50%	1.70%
Debt	938	985		951		959	962
Debt % GDP	30.0%	24.9%		24.6%		24.2%	22.6%

Budget surplus / (deficit) - SARbn



*Source: MoF, Al Rajhi Capital . Only ARC estimates for 2023. ** Based on previous announcements.*

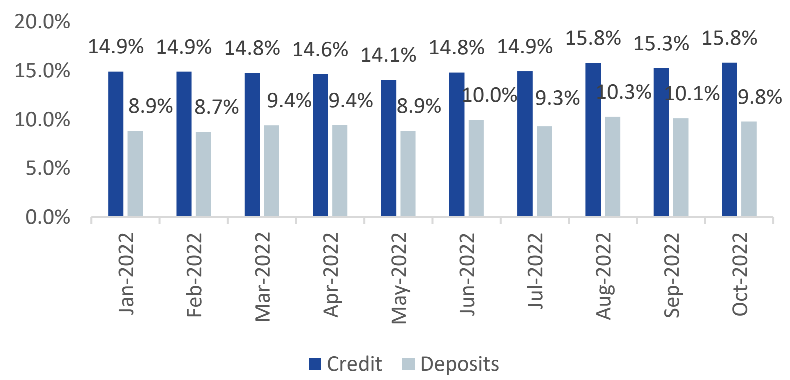
Sector view

Banks - Loan growth estimate raised

Corporate loans to be the key driver

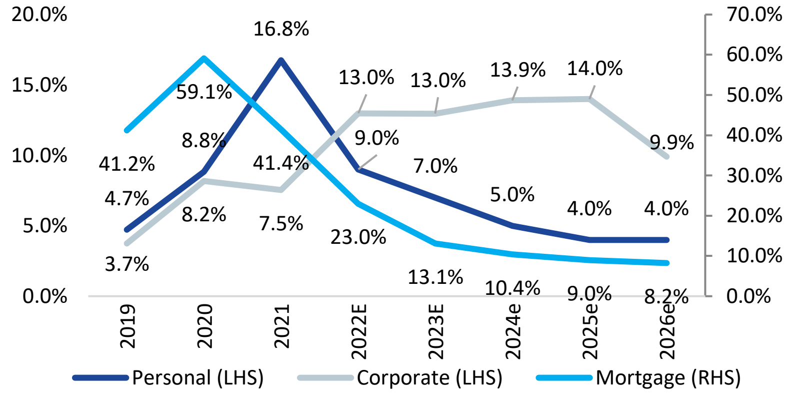
- We raise our total loan growth estimates (for the industry) for 2022 and 2023 to 14% and 12%, respectively, from 13% and 11% before. At the same time, we make major changes to our loan growth estimates for 2024e and 2025e and believe the total loans to grow by about 11% in 2024e and 2025e (from 9% and 7%, resp. before).
- We keep our estimates for mortgages unchanged, while reduce our personal finance loan growth numbers. The driver for the notable change in our total loan growth forecasts is the corporate loan growth.
- Mid and large corporate loan category to see higher uptick from 2023 onwards supported by implementation of Giga projects and many other initiatives under vision 2030.

Credit and Deposit growth (YTD)



Source: SAMA, Al Rajhi Capital

Corporate and Personal Loan estimates



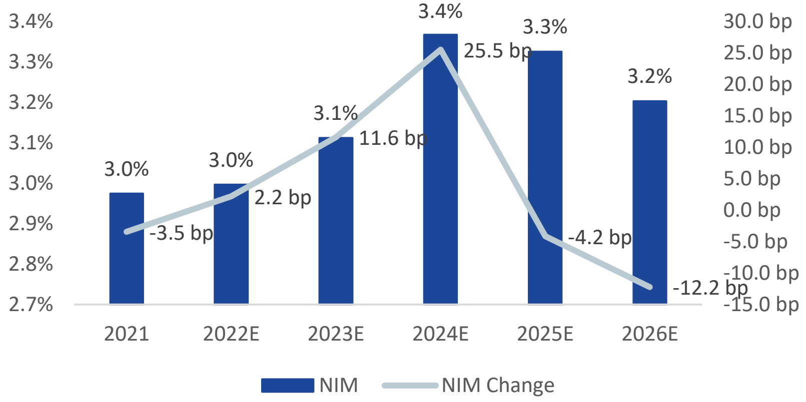
Source: SAMA, Bloomberg, Al Rajhi Capital

Banks - NIM and Yield

NIM estimates trimmed

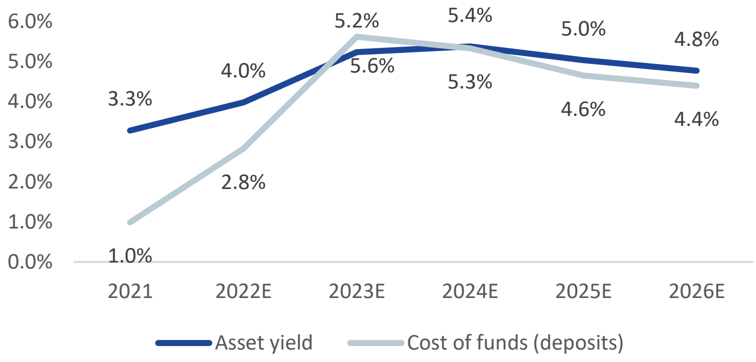
- Most of the banks kept their FY22 NIM guidance unchanged, citing pressures on asset yields and cost of funding.
- Given the rising cost of funding for incremental deposits, some of the banks have guided their NIM sensitivity to interest rates downwards
- Although, the SAIBOR-LIBOR spread has narrowed after spiking in October and the higher interest rates have started to attract time deposits, we are now more cautious in terms of NIM expansion expectations for next year.
- We believe banks would continue to prioritize loan growth over NIM expansion, thus we reduce our NIM expectations to +2 bp and +12 bp, from +10 bp and +65 bp in 2022 and 2023, respectively. We would be following a wait and watch approach for revising our NIM estimates.

NIM and NIM change



Source: Company Data, Al Rajhi Capital

Asset yield and cost of funds



Source: Company filings, Al Rajhi Capital, Note: Asset yield and cost of funds are as per our calculations, could differ from the ones reported by banks. Cost of funds are rates paid on interest bearing deposits

Banks - Outlook and valuations

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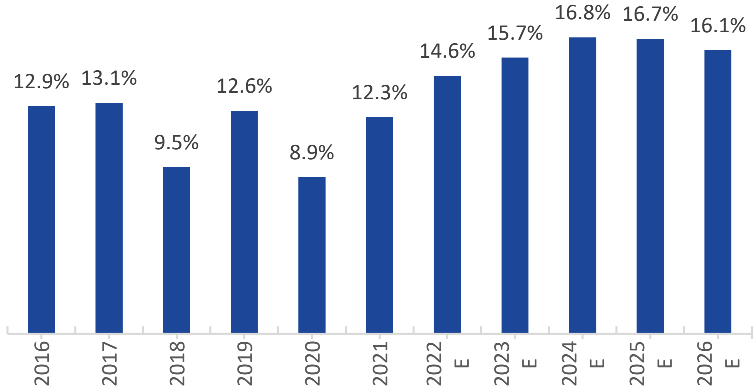
ROE to hit peak in 2024e

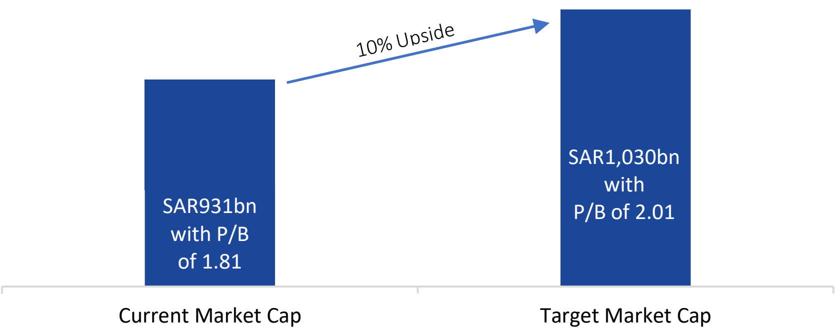
- Total loans for the ten banks to grow by 16% in 2022 and 13% in 2023 and thereafter grow by a high single digit to low teens rate till 2026e.
- Based on the strong loan growth but flattish to modest NIM improvement over the medium term, our estimate for net income growth is mid to high teens over the next two years. This would add a sharp improvement in ROE levels from 12.3% in 2021 to 16.8% by 2024.
- Current valuations of price/book of 1.8x compared to its 10-year historical average of 1.5x, should be looked in the context of the sharp expansion in ROEs and the strong asset growth expected in the next 3-5 years.
- Based on our target prices for each, the banks in aggregate offer ~10% upside from the current level. However, we believe the rally to be led by selective banks, mainly the large size ones.

ROE Expansion



Source: Company Filings, Al Rajhi Capital

Banks in aggregate offer upside



Source: Company data, Bloomberg, Al Rajhi Capital. P/B is a next year forward multiple. Market cap. is as of 27th December 2022

Petrochemical - Weak demand outlook to weigh sector earnings

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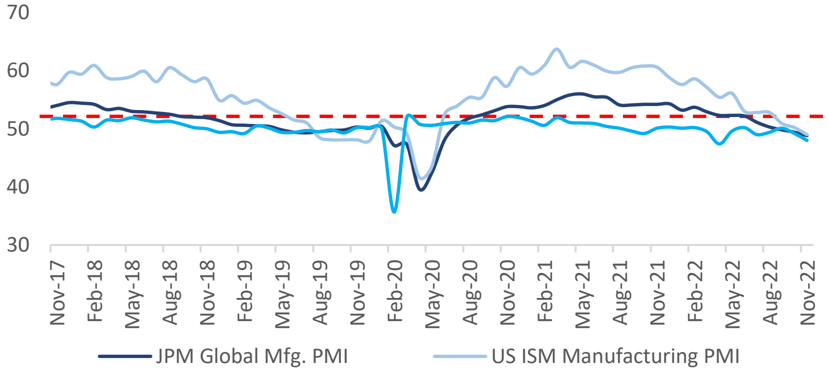
Insights

- The global economic slowdown, as witnessed from weak PMI data, implies a likely lower demand for petrochemical products in the future.
- Avg. polymer prices are down by ~20-30% from their 2Q22 avg. levels, due to the elevated demand concerns, and oversupplied markets. However, we believe polymer prices have reached the bottom.
- On the other side, feedstock prices are expected to witness a limited price correction aided by firm oil prices. Overall, we expect average product spreads to decline next year, impacting the sector's profitability.

Weak PMI data may weigh on petchem prices



Source: Bloomberg, Al Rajhi Capital

Product prices forecasts

	2019	2020	2021	2022	5Y Avg. price	Spot price	2023E
Average oil prices							
Brent (US$/bbl)	64	43	71	99	70	84	87
WTI (US$/bbl)	57	39	68	94	65	79	81
Feedstock prices (US$/t)							
Naphtha	525	382	649	789	592	663	672
Propane	435	398	620	747	551	650	606
Butane	441	405	606	740	546	650	588
Product prices (US$/t)							
HDPE	991	886	1,178	1,182	1,108	1,000	1,050
LDPE	997	1,006	1,523	1,438	1,229	1,120	1,134
PP	1,082	956	1,296	1,175	1,154	970	980
Polycarbonates	2,047	1,931	3,417	2,391	2,616	1,800	2,033
MEG	689	557	813	683	768	579	600
Methanol	323	276	409	400	371	365	350
Urea	244	227	479	606	363	453	450
Spreads (US$/t)*							
HDPE-Naphtha	466	504	529	392	516	337	378
PP-Propane	648	558	677	428	603	320	374

*Source: Bloomberg, Al Rajhi Capital. * As of 28 Dec 2022*

Construction

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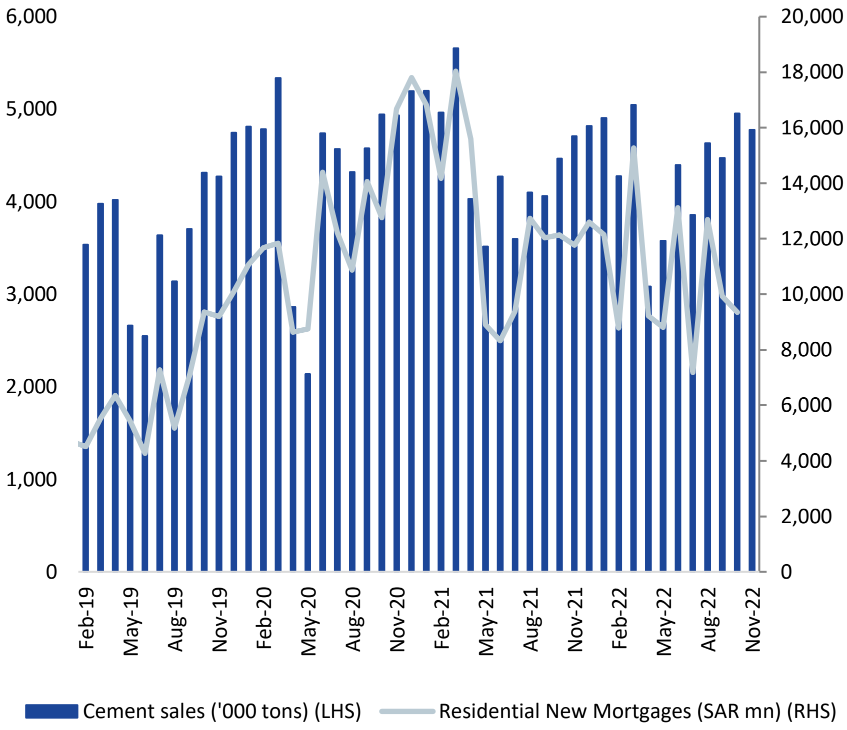
Insights

- The local cement sales grew by 5.4% y-o-y between Jul-Nov 2022 period, supported by volume growth, compared to a fall of 7.6% y-o-y for M6 2022. Going forward, we believe cement prices to remain resilient and see some improvement that can further support the sales.
- New residential mortgages averaged SAR10.7bn per month for the period Jan-Oct 2022 and we expect offtake in mortgages to remain strong and expect new mortgage to average SAR7bn per month in 2023, with the overall residential mortgage growing at a CAGR of 12% between 2022 and 2024.
- Based on the government budget figures, as per our assessment, the Government's 2023 budgeted revenues are likely based on Brent of ~US$78/bbl, (Bloomberg consensus estimate of Brent prices is USD79/bbl for 2023) which is likely to aid in strong government spending. In line with this, 2023e spending budget has been projected to increase by 9% y-o-y.

Residential Mortgage and Cement sales volume



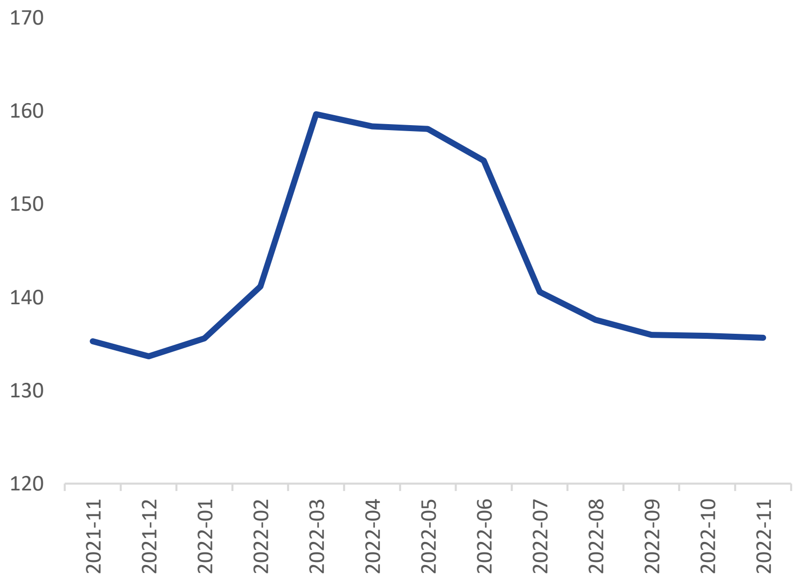
Source: SAMA, Yamama Cement and Al Rajhi Capital

Consumer / Retail / Food

Insights

- Based on their ability to pass inflation and maintain earnings, as well as the recent increase in government subsidies, we anticipate moderate demand and limited downside for food producer companies (Almarai, SADAFCO, Tanmiah, and Savola).
- In the short term, we believe food producer companies will benefit from falling input prices (refer to the chart on the right side), while the selling price will likely remain sticky due to strong demand.
- We believe the situation for food retailers (supermarkets) is similar to that of food producers. However, the increase in OPEX is making the retail less favorable.
- We believe the retail discretionary sector will be the least liked sector. Different reasons contribute to this, 1) the new entertainment venues are taking some of the money spent on discretionary items, 2) higher inflation that is pressuring the consumer wallet.
- Interest expenses will have a significant impact on highly leveraged companies, with the full impact seen at the end of 2023.

FAO Index (price of a basket of food items)



Source: Food and Agriculture organisation of the UN, Al Rajhi Capital

Telecom / Technology

Insights

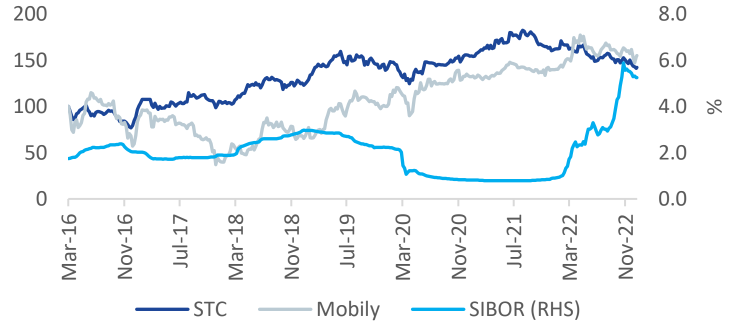
Telecom:

- STC and Mobily share prices are inversely correlated with SAIBOR. Recently, both stocks witnessed a mild drop as SAIBOR 3M touched 5.2%, with STC currently at a 4.4% dividend yield while Mobily is at 2.5% (with a high probability of a dividend increase for Mobily).
- We expect Mobily will grow earnings by a CAGR of 13% for the next three years, while STC will grow by 3% to 4% for the same period. However, Zain will see some abnormal volatility in the level of earnings due to the size of debt and the interest they are paying on it.

Technology:

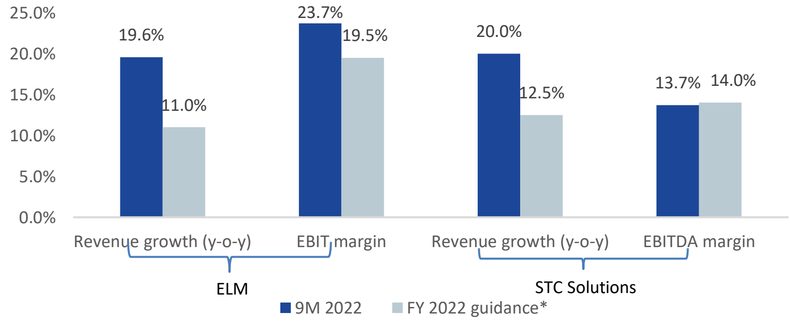
- In our view, the growth has peaked for both the tech. stocks and in the near term margins could come under pressure as we see slowdown in the digital solutions business.

Telecom stocks' inversely corporate with SAIBOR



Source: Bloomberg, Al Rajhi Capital

FY 2022 guidance indicates slowdown



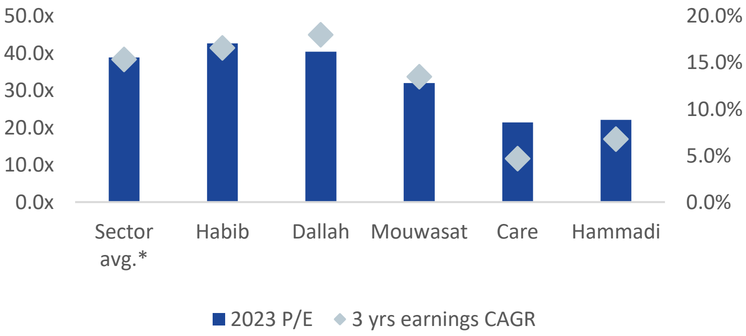
Source: Company presentations, Al Rajhi Capital

Insurance bullish, healthcare neutral to negative

Strong insured lives growth, healthcare valuations a concern

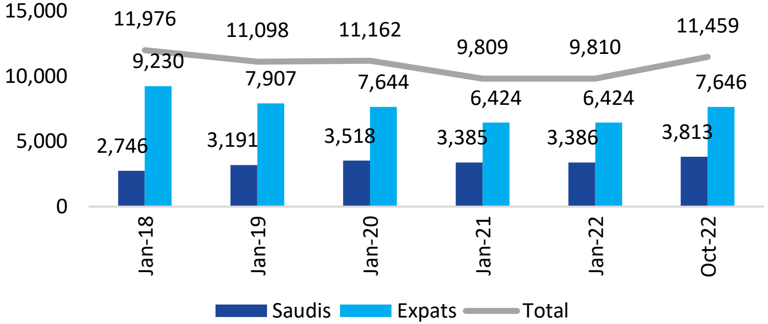
- The year 2022 has seen strong growth in the insured lives for the medical insurance sector, while for the motor segment the key development has been the sharp rise in policy prices. Although, the loss ratio for the segment is still high, but the top companies such as Tawuniya and Al Rajhi Takaful have already seen benefits of the price rise.
- With the new regulator for the insurance segment, we expect positive regulatory measures to be announced, that could include push for consolidation in the insurance segment as well as progress on the enforcement of the motor insurance policy.
- Given that the loss ratios are expected to improve in 2023, the valuations for selective names appear attractive.
- Healthcare sector is expected to post mid teens growth going forward supported by new projects as well as improvement in the utilization levels. However, the relatively high valuations is pricing in all the positives, in our view. We prefer selective names in the sector.

Healthcare stocks pricing in all the positives



Source: Al Rajhi Capital. Note: sector average is market cap. weighted

Sharp recovery in insured lives ('000)



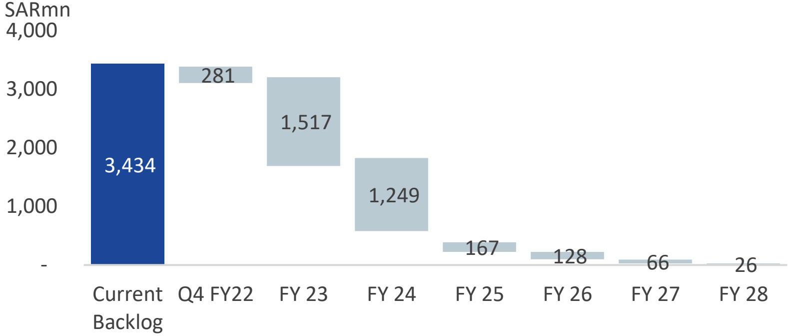
Source: Tawuniya 1H22 PPT, Al Rajhi Capital

Alkhorayef Water and Power Technologies

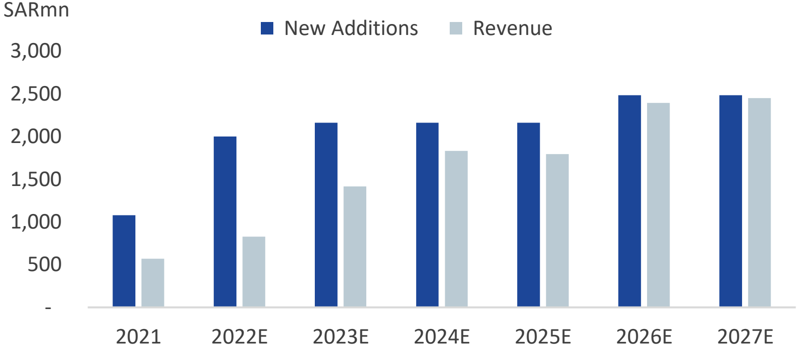
Steady stream of projects to drive growth

- AWPT is one of the leading O&M service providers in the Water, Wastewater, and Integrated Water Solutions segment.
- In line with Vision 2030, the water sector is undergoing a major transformation that involves: 1) an active effort to increase private sector participation, 2) improvement in sanitation practices and 3) expansion of desalination plants to ensure water security.
- AWPT is well-positioned to benefit from the upcoming stream of projects from National Water Company and Saudi Water Partnership Company and we expect AWPT to capture a decent chunk of these projects.
- AWPT backlog of revenue stands at SAR 3.4bn as of 9M22, up from SAR 1.6bn at the end of 2021. Resultantly, the topline is likely to grow at a 3-year CAGR of 29%.
- Since 2018, the company has added new projects at a CAGR of 47%. Going forward, we have assumed additions of SAR2.2bn annually.
- The company is trading at an attractive forward PE of 17x and provides an upside of 20% to our target price of SAR 164/sh.

Impressive future backlog



Revenue to grow at a 3-year CAGR of 29%



Source: Company Data, Al Rajhi Capital

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View and top picks

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View and preference:

- Our base case view is that SAIBOR is not far away from the peak, while oil prices to remain healthy.
- Despite the sharp correction in the equity markets and valuations correcting below the average levels, we believe TASI to consolidate and remain range-bound atleast over the next 3-6 months.
- At the same time, as clarity emerges over Fed's interest rate trajectory and its impact on the global economy, we believe modest rally to happen in H2 2023 mainly led by Banks and Petchem.
- We believe selective names to continue to outperform even amid a range-bound market. Our top picks are listed below.

(SAR)	Mcap (SARmn)*	Last Price (SAR)*	TP (SAR)	Upside (%)	ADTV (SARmn)	P/E (x)			EV/EBITDA (x)		
						2021A	2022E	2023E	2021A	2022E	2023E
AWPT	3,400	136	164	20.6	8.0	29.2x	17.4x	14.4x	28.0x	20.0x	12.5x
Bawan	1,743	29	36	23.9	7.1	10.2x	10.1x	9.6x	9.1x	7.9x	7.4x
Tawuniya	10,000	80	92	15.0	14.5	37.5x	27.8x	15.8x	NA	NA	NA
Hammadi	6,224	39	46	18.3	13.3	69.1x	24.4x	22.3x	27.6x	16.6x	14.9x
Tanmiah	2,496	125	145	16.2	25.0	NM	29.0x	20.3x	22.0x	12.0x	8.5x
Mobiliy	26,642	35	38	9.8	26.4	24.9x	18.5x	18.6x	6.6x	6.1x	6.0x
Yamama Cement	5,316	26	34	29.5	6.2	33.1x	13.3x	10.2x	36.2x	14.9x	8.4x
Sipchem	25,007	34	41	20.2	84.7	6.9x	6.8x	11.6x	4.9x	5.4x	8.2x

*Source: Bloomberg, Al Rajhi Capital. * As of 28 Dec 2022*

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Al Rajhi Capital

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"Overweight": Our target price is more than 10% above the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target 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.

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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