

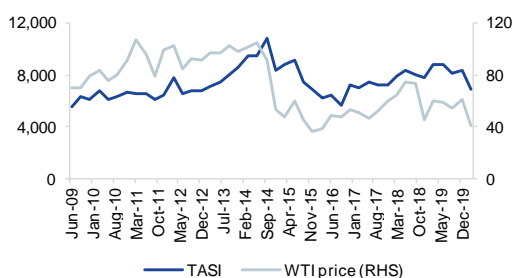


Recommend not buying into dips as we expect markets to correct further before a recover by 2H 2020

Holding defensive and dividend names may be safer bet

At the moment we see stable Q1 given the possibility of companies dipping into inventory for sales

TASI vs. Oil price movement



Source: Bloomberg, Al Rajhi Capital

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Saudi Equities

How to position amidst Coronavirus concerns

Increasing concerns on Corona virus outbreak have resulted in rising stock market volatilities and net declines as the market digests the impact on companies. We expect earnings estimates of companies to be gradually revised lower in H1 2020 before they likely stabilize or pick up towards the end of the year. Oil being one of the major causalities is expected to have a cascading effect on the local economy. Other than oil, companies exposed to Asian markets for exports, raw material imports from China, ones with high debt, high valuation multiples, Govt. receivables and the ones linked to travel/tourism are likely the most affected. The relatively more defensive names are the consumer staples, telecom services and local cement firms/retail banks to an extent. Concerns could increase if local demand drivers such as mortgage growth and allied sectors take a temporary backseat. On the other hand, those companies that face higher competition from Chinese exports such as Saudi Ceramics could benefit. Overall we recommend not buying into dips as we expect sustained correction. Some companies may not fully reflect the impact in Q1 results as there could be selling from inventories and impact may take longer with exceptions being cash rich companies that look attractive from a dividend perspective. Upside surprise could be seasonal fade out of virus implications, renewed OPEC+ agreement, increase in prices as supply reduces and sharp de-escalation of Chinese situation.

Oil/Government finances

As per the recently revised fiscal expenditure of the Government, based on our analysis previously published, the oil price factored into oil revenues of the Saudi Government is ~US\$55/b for WTI and ~US\$71/b for fiscal breakeven. Based on our calculations, every US\$5 decline could lead to SAR50bn increase in fiscal deficit if the expenditure remains the same. Current average WTI price is US\$53/b. The OPEC+ countries could not come to a conclusion to cut output and hence oil continued on its way down. This could have major implications for the sector if shale companies in the US fold into bankruptcy as they are operating at below breakeven prices with high debt levels, as per our analysis. In this juncture, we believe there are strong reasons to own Aramco as the company can pay the dividends that have been “soft” promised. Given that the eligible shareholders (non-Governmental minority) to receive the promised dividends is less than 1.7%, the actual cash outflows for dividends is only a paltry, US\$1.27bn (which is 1.7%*US\$75bn). Even otherwise with Brent even at US\$50/b, FCF can reach US\$70bn+ as per our calculations. Plus with higher chances of rate cut and the promised dividend being constant, the fair value of the company can jump higher.

Figure 1 Medium Term fiscal Estimates (as per pre budget 2019 announced)

| SAR 'bn | 2019 | 2020 | 2021 | 2022 |
|-------------|-------|-------|-------|------|
| Revenue | 917 | 833 | 839 | 863 |
| Expenditure | 1,048 | 1,020 | 990 | 955 |
| Deficit | (131) | (187) | (151) | (92) |

Source: MOF, Al Rajhi Capital

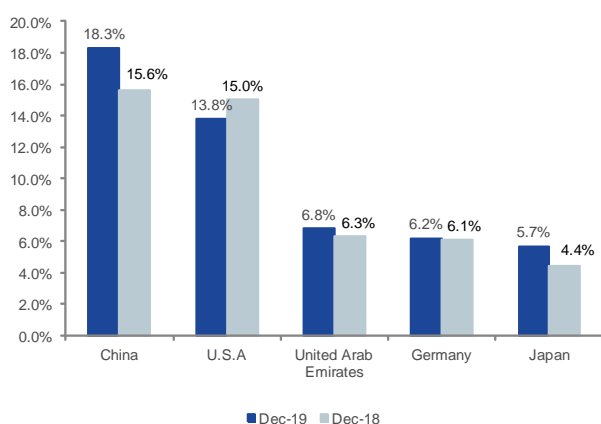


Figure 2 Top 5 Partner Countries for Imports (SAR 'mn)

| | December 2018 | December 2019 | | |
|----------------------|---------------|---------------|--------------|--------------|
| | | Value | Change | Change (%) |
| China | 6,533 | 9,052 | 2,519 | 38.6% |
| U.S.A | 6,279 | 6,824 | 545 | 8.7% |
| United Arab Emirates | 2,629 | 3,392 | 762 | 29.0% |
| Germany | 2,548 | 3,075 | 526 | 20.7% |
| Japan | 1,855 | 2,806 | 952 | 51.3% |
| Total | 19,845 | 25,149 | 5,304 | 26.7% |

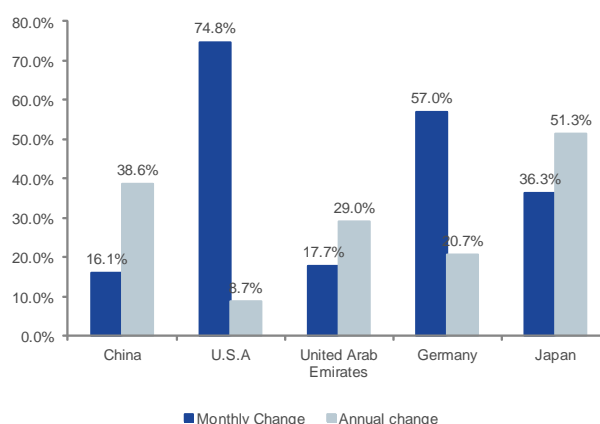
Source: GASTAT, Al Rajhi Capital

Figure 3 Top 5 Partner Countries for Imports, December 2019 (Share in total, %)



Source: GASTAT, Al Rajhi Capital

Figure 4 Change in Imports from Top 5 Countries, December 2019



Source: GASTAT, Al Rajhi Capital

Figure 5 Main Import Products (SAR 'mn)

| Imports by Section (by section of the Harmonized System) | December 2018 | December 2019 | | |
|---|---------------|---------------|--------------|--------------|
| | | Value | Change | Change (%) |
| Machinery and Mechanical Appliances; Electrical Equipment | 9,578 | 10,703 | 1,125 | 11.7% |
| Vehicles and Associated Transport Equipment | 6,049 | 10,089 | 4,040 | 66.8% |
| Products of the Chemical or Allied Industries | 4,696 | 4,876 | 180 | 3.8% |
| Base Metals and Articles of Base Metal | 3,358 | 4,019 | 661 | 19.7% |
| Prepared Foodstuffs; Beverages and Vinegar; Tobacco | 2,369 | 2,430 | 61 | 2.6% |
| Vegetable Products | 2,705 | 2,330 | -375 | -13.9% |
| Arms and Ammunition; Parts and Accessories Thereof | 1,154 | 1,939 | 785 | 68.0% |
| Textiles and Textile Articles | 1,508 | 1,710 | 202 | 13.4% |
| Plastics and Rubber and Articles Thereof | 1,504 | 1,624 | 120 | 8.0% |
| Other | 8,981 | 9,867 | 886 | 9.9% |
| Total | 41,901 | 49,586 | 7,685 | 18.3% |

Source: GASTAT, Al Rajhi Capital

Banks

In 2020, banks are likely to be in a challenging phase with expectations of a decline in lower interest rates translating to lower NIMs and economic situation leading to marginally higher cost of risk. Though loan growth was guided to be around the mid-single digit on an average, this can be guided lower if oil weakness and corona virus implications continue. As such factoring a 75bps rate cut, 6% loan growth and a 5-10bps increase in CoR implies net profit to decline ~16%. However, the list of downside risks is:

- 1) Decline in mortgage lending activities if Government decides to lower the subsidies given for mortgages
- 2) Lower loan growth or even a de-growth as business get impacted due to lower demand



- 3) Lower money supply in the economy leading to lower deposit growth
- 4) Further rate cuts leading to lower SAIBOR and NIMs for the Saudi banks
- 5) As businesses weakens, cost of risk could increase for banks

For now, one could factor a flat growth in 2Q and 3Q and a gradual recovery in 4Q lending implying overall lending growth of 1-2% in 2020. However some of the stocks could face strong support given healthy dividends. While we believe whole banking sector is likely to see a challenge, we favour retail banks over corporate banks. Below are the initial guidance before the rate cuts came into place.

Figure 6 2020 Guidance

| Banks | NIM | Loan Growth | C/I | COR | Deposit Growth |
|----------|---|---|--|---|---|
| ARB | NA | Mid Single digit | Below 31% | 60-70bps | NA |
| NCB | 3.6% - 3.8% | 10-12% | Below 32% | 60 to 80 bps | NA |
| RB | -10bps to -15bps | Low double digit growth % | Below 34% | 55bps to 65bps | Focus will be on no. of depositors and NIB. Behind NCB and Rajhi by huge margin and aim to achieve fair market share. |
| SAMBA | Should be higher with interest rate cut | 6-7% | 33% | 40-50 bps | NA |
| SABB | Every 25bps decline in saibor will lead to 10bps decline in NIM | Mid single digits | | More likely higher end of 30-60bps | |
| BSF | +5 to +15bps | High single digit growth % | Guidance should be available in 2Q or 3Q 2020. There will not be any sizeable on-offs that will swing the ratio. | 75bps - 90bps | NA |
| ANB | NA | NA | NA | NA | NA |
| Albilad | Likely to be at current levels; however, there might be some decline as the bank expects 25bps cut in SAIBOR rate | See growth in mortgage, infrastructure projects, healthcare, education and entertainment | Current is 51% and bank aims to lower it to industry average. Improvement will be led by revenue growth | NA | Optimistic |
| Alinma | NA | NA | NA | NA | NA |
| AlJazira | NA | Entertainment, Health and Education sector growing fast. Large infrastructure projects could also lead to increase. | To achieve below 50% in 2-3 years | 70-80 bps; may get even higher due to SAMA regulations. | NA |
| SIB | NA | NA | NA | NA | NA |

Source: Company data, Al Rajhi Capital



Petchem

Given the majority of the sector sells to Asian economies, the overall sales volumes can weaken due to lower demand. Add to already existing supply-side pressures, all product prices are likely to contract further. Expectations of a recovery in H2 2020 will likely now shift to H2 2021.

Among the product prices, we see that current spot prices are below average 2019 prices by 4-15% so far this year. Among the major product prices, PP is down 14%, PE 10-15% depending on grade, MEG 10%, PC 11%, and Methanol 4%. While Urea prices could relatively perform better because of lower-than-expected Chinese exports, we believe weakness in demand from other areas as well as record-low Natural gas prices could lower Urea prices eventually. Urea spot prices are now 6% below 2019 average levels. The only support is from those companies that can pay dividends such as APPC and Yansab. In the recently held conference call, SABIC hinted that it may focus on maintaining dividends. Upside surprise is permanent closure of plants but we believe this may be only gradual and not material in a short period of time. Companies may choose to have extended maintenance shutdowns in this phase. In case of a rally in product prices, the Saudi Petchems will rally more than the global Petchems given the operating leverage.

Figure 7 Spot prices declined by double digit % vs. five years averages

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y Avg. price | 2020 YTD | Spot price | % decline from 2019* |
|----------------------------------|-------|-------|-------|-------|-------|---------------|----------|------------|----------------------|
| Average oil prices | | | | | | | | | |
| Brent (US\$/bbl) | 54 | 45 | 55 | 72 | 64 | 58 | 59 | 45 | -29% |
| WTI (US\$/bbl) | 49 | 43 | 51 | 65 | 57 | 53 | 53 | 41 | -28% |
| Feedstock prices (US\$/t) | | | | | | | | | |
| Naphtha | 491 | 399 | 496 | 616 | 525 | 505 | 514 | 434 | -17% |
| Propane | 416 | 323 | 468 | 542 | 435 | 437 | 500 | 430 | -1% |
| Butane | 437 | 356 | 502 | 539 | 442 | 455 | 538 | 480 | 9% |
| Product prices (US\$/t) | | | | | | | | | |
| HDPE | 1,238 | 1,144 | 1,180 | 1,302 | 991 | 1,171 | 857 | 840 | -15% |
| LDPE | 1,256 | 1,193 | 1,255 | 1,181 | 997 | 1,176 | 922 | 900 | -10% |
| PP | 1,130 | 1,003 | 1,123 | 1,258 | 1,082 | 1,119 | 977 | 930 | -14% |
| PS | 1,219 | 1,179 | 1,351 | 1,466 | 1,179 | 1,279 | 1,068 | 1,030 | -13% |
| Methanol | 295 | 249 | 340 | 409 | 286 | 316 | 282 | 274 | -4% |
| Polycarbonates | 2,361 | 2,328 | 2,736 | 3,293 | 2,047 | 2,553 | 1,837 | 1,825 | -11% |
| MEG | 938 | 796 | 1,028 | 1,103 | 741 | 921 | 709 | 670 | -10% |
| VAM | 938 | 808 | 967 | 1,258 | 943 | 983 | 852 | 865 | -8% |
| TiO2 | 2,406 | 2,158 | 2,653 | 3,066 | 2,760 | 2,609 | 2,775 | 2,775 | 1% |
| Urea | 282 | 206 | 232 | 275 | 259 | 251 | 237 | 245 | -6% |

Source: Bloomberg, Al Rajhi Capital. * Spot price decline over 2019.

Cement

Our outlook on mortgages, which has been driving the sales volume of the cement companies has not changed and hence we have reasons to believe that the sales volumes could continue to be marginally up in 2020 as well. One could continue to hold on the cement names with zero debt and high dividends. We do not expect the cement prices to drop but any further upside from the mega projects may take temporary backseat. The companies that are trading with a 6%+ dividend yield are Saudi Cement, Qassim Cement and Arabian Cement.



Figure 8 Saudi Cement Companies - P/E and Dividend yield

| | 2020E EPS | 2020E DPS | 2020E P/E | 2020E Div Yield |
|-----------------|-----------|-----------|-----------|-----------------|
| Saudi Cement | 3.39 | 3.75 | 15.6x | 7.1% |
| Southern Cement | 3.4 | 2.75 | 15.3x | 5.3% |
| Yanbu Cement | 1.86 | 1.75 | 17.0x | 5.5% |
| Qassim Cement | 4.25 | 4 | 13.7x | 6.9% |
| Yamama Cement | 1.31 | 0.6 | 15.8x | 2.9% |
| Arabian Cement | 2.3 | 2 | 13.0x | 6.7% |

Source: Company data, Al Rajhi Capital

Telecom

Telecom sector in general could be viewed as a relatively defensive bet. However, in Saudi Arabia, with temporary suspension of Umrah for nationals and residents and visa restrictions, ARPU could weaken due to lower calling and roaming revenues though it could be partially offset by higher data consumption. The growth witnessed in 2019 came from a mix of B2B and consumer growth and the low base also helped. In 2020, both of these drivers could moderately weaken. This comes at a time when there are increase in costs expected for 5G. Some supply of equipment for 5G could slow down. Given high debt for the smaller players, some of the impact could be mitigated from the Fed rate cuts. Given the seasonally strong sector is only Q3, overall on a relative context, Telecoms are a better bet in the current environment.

Consumer

In consumer space, corona virus and falling oil prices will lead to a supply as well as demand issues as consumer and government spending both could be under pressure which will have an adverse impact on the business and hiring. Though it is difficult to quantify the actual disruptions the severity of the circumstances could be assessed from the fact that China accounts for almost 20% of the kingdom's total imports and this is expected to have a near term supply issues in the country till the existing inventory gets sold. Consumer loan growth could also weaken. All in all both corona virus outbreak as well as falling oil prices poses a challenging environment for consumer companies.

In our view the worst impacted in consumer space will be **electronics retailers** as they will be hit due to supply disruptions. As per our analysis and discussion with the companies the impact of slowdown will not be seen much in the first quarter as the companies were able to meet the demand from their inventory. However if the corona virus situation escalates then we might observe a flattish to negative growth in second and third quarters. **Grocery retailers** will remain defensive due to non-cyclical nature of the business. Stocking up groceries to avoid any unforeseen circumstances due to outbreak of virus could even have a positive impact on Q1 2020 numbers. In our view **discretionary retailers** will have a tough time due to negative sentiments in the market.

As for **hospitality and tourism** sectors we believe the temporary suspension of Umrah visas and reduced leisure tourism will have an adverse impact on hotel occupancy rates. Even business travelers from Dubai, Bahrain and other nearby countries are impacted and prohibited temporarily to enter in the Kingdom and could even further impact the occupancy rates of 4-5 star rated hotels which usually remain defensive. In terms of malls and other entertainment avenues such as restaurants, cinemas, parks and other places of public gathering may observe reduced footfall till concerns regarding corona virus spread is over.

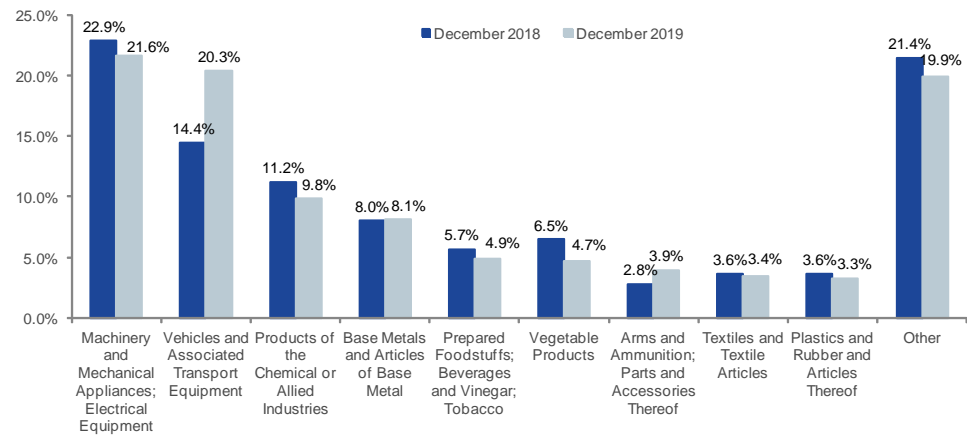


Others

Healthcare: We expect the focus of KSA companies in the healthcare space to be more on outpatient than the inpatient services as some may choose to avoid hospital visits and defer surgeries till the situation is under total control. Given most of the medicines are imported, there could be cost escalations. However, broadly speaking, companies with newly opened hospitals which have not yet reached optimal operating rates could witness a pressure on margins, mainly due to high operating expenses during the initial period of operations. Hospitals exposed to Govt. receivables are likely in a weaker position.

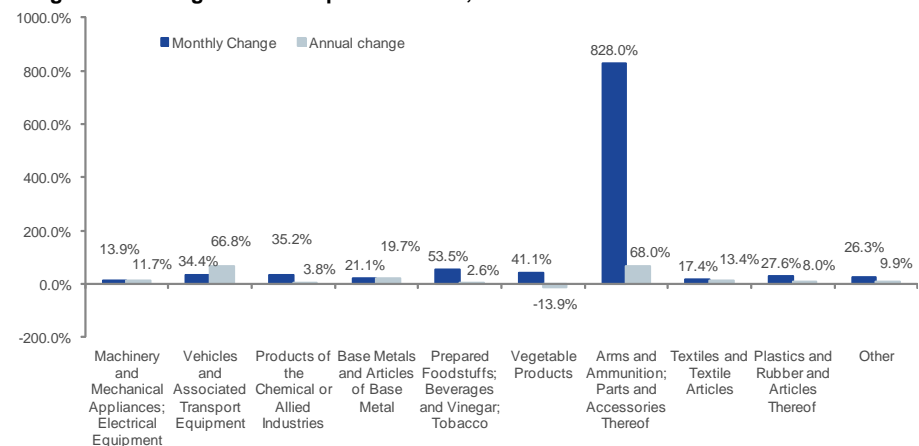
Building Materials: For building materials we expect Saudi ceramics from our coverage to have a positive impact from corona virus as the supply cuts of Chinese tiles will lead to an increase in local tiles demand which should improve the overall level of prices for tiles in the Kingdom.

Figure 9 Main Import Products in December 2019 (Share in total, %)



Source: GASTAT, Al Rajhi Capital

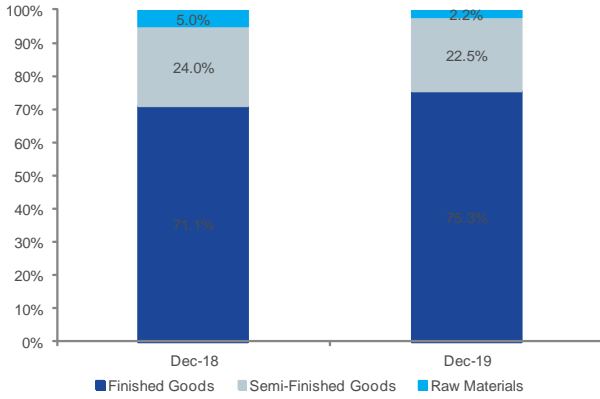
Figure 10 Change in Main Import Products, December 2019



Source: GASTAT, Al Rajhi Capital

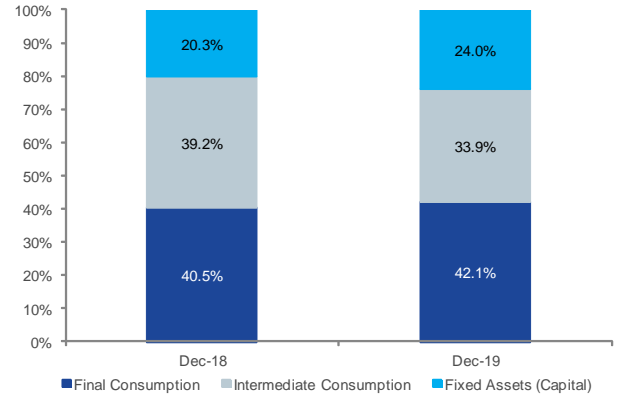


Figure 11 Share in Total Imports



Source: GASTAT, Al Rajhi Capital

Figure 12 Share in Total Imports



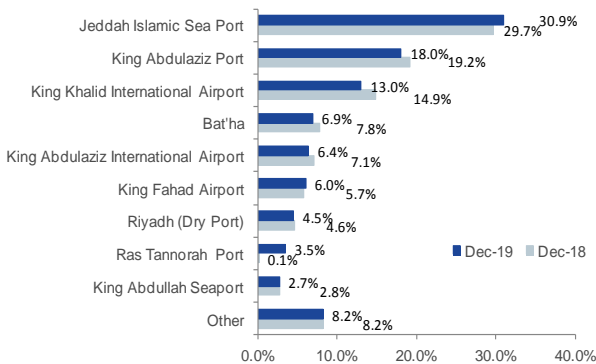
Source: GASTAT, Al Rajhi Capital

Figure 13 Imports by Mode of Transport and Customs Port (SAR 'mn)

| Mode of Transport and Customs Port | Dec-18 | Dec-19 | Change from previous year | Percentage Change (%) |
|--------------------------------------|---------------|---------------|---------------------------|-----------------------|
| Sea | | | | |
| Jeddah Islamic Sea Port | 12,456 | 15,318 | 2,862 | 23.0% |
| King Abdulaziz Port | 8,053 | 8,945 | 893 | 11.1% |
| Ras Tannorah Port | 40 | 1,742 | 1,702 | 4287.9% |
| Other Seaports | 3,140 | 3,908 | 768 | 24.5% |
| Total Sea | 23,689 | 29,913 | 6,224 | 26.3% |
| Air | | | | |
| King Khalid International Airport | 6,224 | 6,452 | 228 | 3.7% |
| King Abdulaziz International Airport | 2,970 | 3,158 | 188 | 6.3% |
| King Fahad Airport | 2,390 | 2,961 | 571 | 23.9% |
| Other Airports | 76 | 78 | 2 | 2.6% |
| Total Air | 11,660 | 12,649 | 988 | 8.5% |
| Land | | | | |
| Bat'ha | 3,267 | 3,400 | 132 | 4.1% |
| Riyadh (Dry Port) | 1,914 | 2,218 | 303 | 15.9% |
| King Fahad Bridge | 766 | 728 | -38 | -5.0% |
| Other Land Ports | 604 | 679 | 75 | 12.4% |
| Total Land | 6,552 | 7,025 | 473 | 7.2% |
| Grand total | 41,901 | 49,587 | 7,685 | 18.3% |

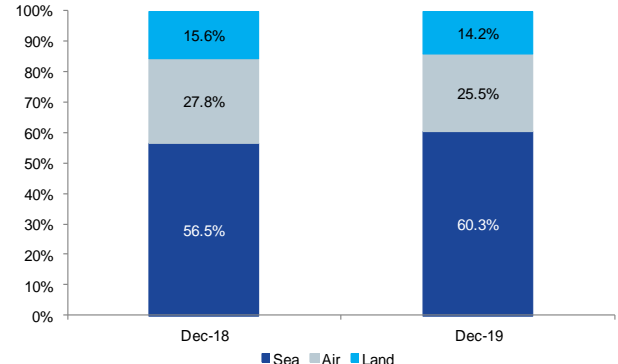
Source: GASTAT, Al Rajhi Capital

Figure 14 Imports by Customs Port (% of total)



Source: GASTAT, Al Rajhi Capital

Figure 15 Imports by Mode of Transport (% of total)



Source: GASTAT, Al Rajhi Capital



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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 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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