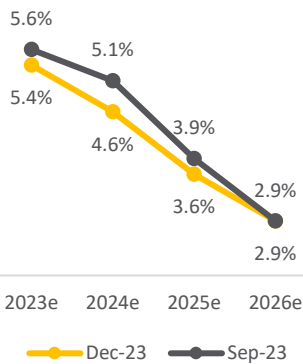


Saudi Arabia: Navigating the Year Ahead

Decoding the upcoming Rate Cut Cycle

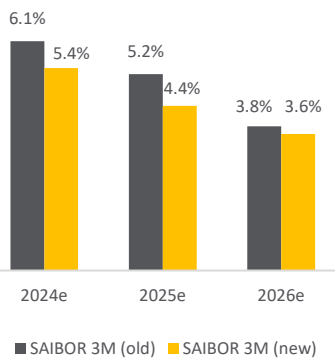
- The US Fed changed its stance from hawkish to dovish in its most recent meeting and has indicated 75bps possible rate cuts in 2024e and another 100bps in 2025e.
- Based on our calculation, we expect total finance costs of TASI companies (ex. Banks and Insurance) to decline by 9-15% in 2024-25e, with Consumer Durable witnessing the highest earnings expansion, followed by REITs, Materials, and Utilities sectors.
- Within our coverage, we expect SASCO, ADES, Marafiq, Tanmiah, First Milling, and Theeb to be notable beneficiaries of rate cuts, with a healthy upside to earnings.

US FOMC Dot Plot



Source: Bloomberg

SAIBOR 3M Forecast



Source: Bloomberg

The US Fed set to cut rates in 2024e, SAMA to follow suit: After an aggressive tightening cycle, (lifted interest rates 11 times or by more than 5ppts; Figure 1) since March 2022, the Fed maintained the interest rates at 5.25-5.50% (third consecutive time) in its December 2023 meeting, citing evidence pointing to a considerable decline in inflation and a decelerating economy. However, the Fed has signaled a significant policy shift in its latest meeting. It pointed out that interest rates have likely reached their peak and have indicated a possible rate cut by 75bps in 2024e (at least three cuts assuming 25bps each; Figure 2), marking a transition from a hawkish to dovish stance. In addition, the recent Dot Plot suggests a 1ppts rate cut in 2025e (Figure 2). While the Fed has not disclosed a specific timeline of implementation of these rate cuts, the first cut is likely to be implemented in March 2024. In line with the US Fed, SAMA is expected to implement a similar rate cut in KSA.

Implications of rate cuts on sectors: The impact across sectors and the economy will vary, influenced by factors like the size and timing of cuts, economic conditions, and market expectations. Based on our calculations (assuming a 50bps and a 75bps cumulative impact in 2024e and 2025e, respectively, considering a laggard effect of cuts), we project a 9% y/y reduction (excl. Aramco) in total finance costs for sectors listed on TASI (excl. Banks, Insurance) in 2024e (Figure 13). The impact would be even higher in 2025e with a likely reduction of ~15% y/y (excl. Aramco). These finance cost savings are poised to boost earnings growth, with an estimated overall earnings expansion of 5% y/y (excl. Aramco) and 7% in 2024e and 2025e, respectively (Figure 13). Within sectors, Consumer Durables are expected to see the most substantial earnings expansion at 20% y/y in 2024e, followed by REITs at 15% y/y, Materials at 11% y/y, and Utilities at 9% y/y.

Impact on our coverage: Within our coverage, SASCO (3.8x D/E including lease liabilities for 2023e) stands as a notable beneficiary, expecting a (-12%) decline in finance expenses for 2024e (assuming effective 50bps rate cut impact on our projected 2023e debt level; Figure 16). This reduction is expected to increase the bottom line by 29%, bolstering its strategic expansion of fuel station networks throughout KSA. ADES (1.6x) is also forecasted to benefit from the rate cuts, foreseeing a 7% decline in finance costs, which could lead to a 12% upswing in earnings. In the Utilities sector, Marafiq (1.5x) is projected to witness an 11% reduction in finance costs, potentially leading to a 10% surge in the bottom line. Additionally, Tanmiah (1.1x), First Milling (2.0x), and Theeb (1.6x) are also expected to witness a high-single-digit to low-double-digit reduction in interest expenses, resulting in a 4-5% improvement in earnings in 2024e. Akaria (0.7x) is also likely to benefit notably during the rate-cut cycle.

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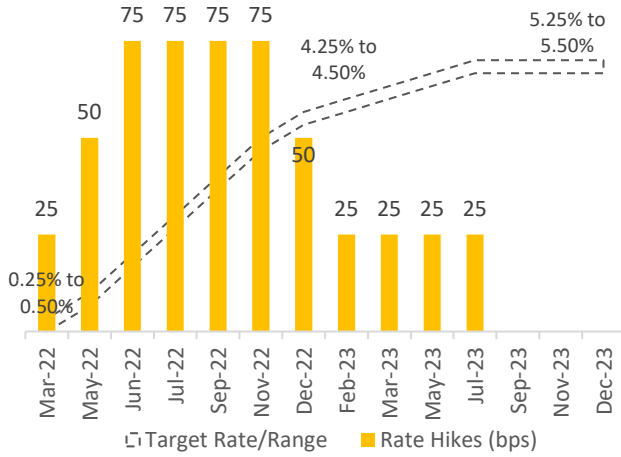
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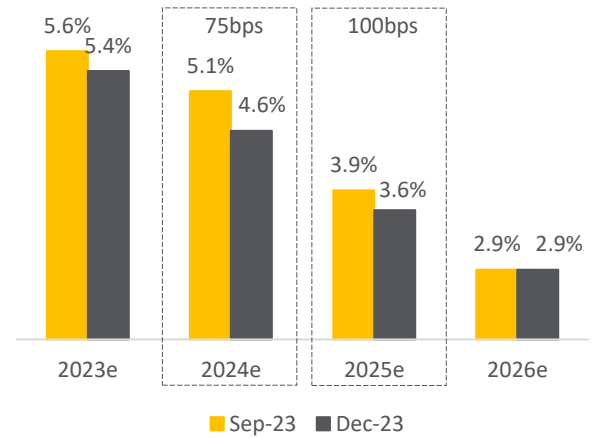
1. Rate Cuts: What you need to know

Figure 1: The US Fed indicated that interest rates have likely peaked...



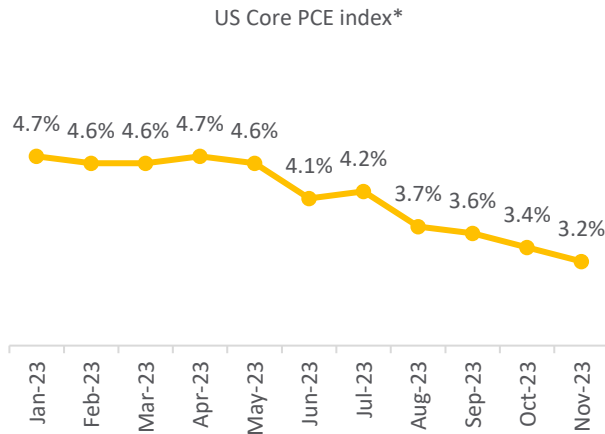
Source: Bloomberg, GIB Capital

Figure 2: ...and pointed towards at least three cuts in 2024e...



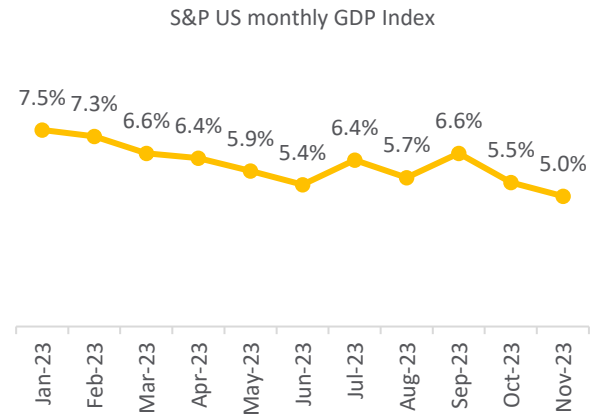
Source: Bloomberg, GIB Capital

Figure 3: ...as evidenced suggested towards cooling inflation and...



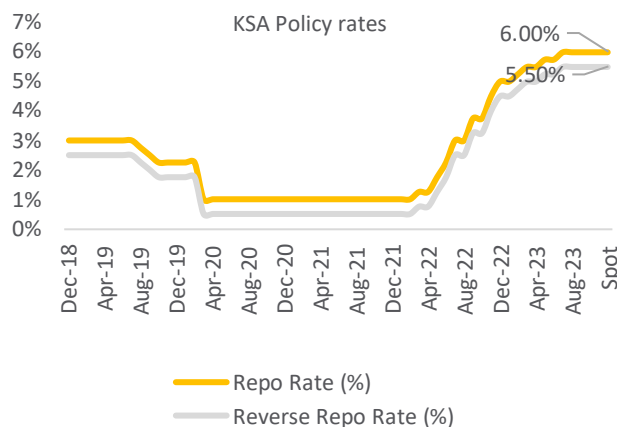
Source: US Department of Commerce, GIB Capital *excl. food and energy

Figure 4: ...slowing economic activities in recent months



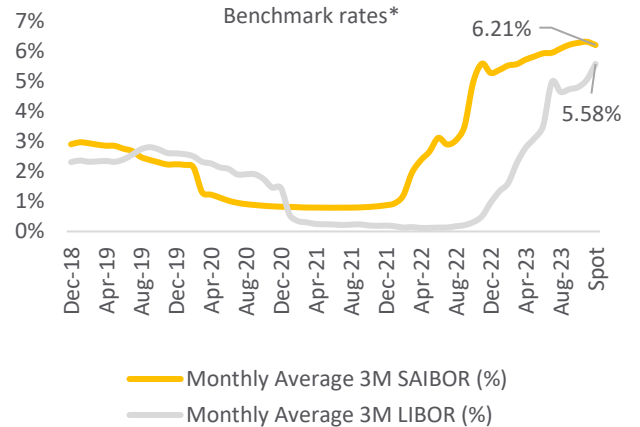
Source: S&P, GIB Capital

Figure 5: In line with the Fed, SAMA is expected to cut its policy rates...



Source: SAMA, GIB Capital

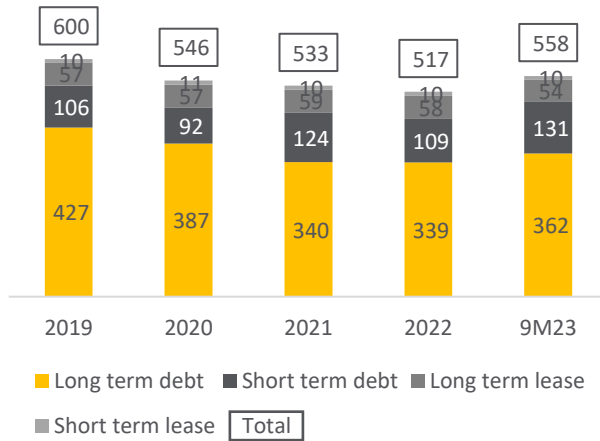
Figure 6: ...thereby benefiting most leveraged companies in KSA



Source: Bloomberg, SAMA, GIB Capital *monthly average

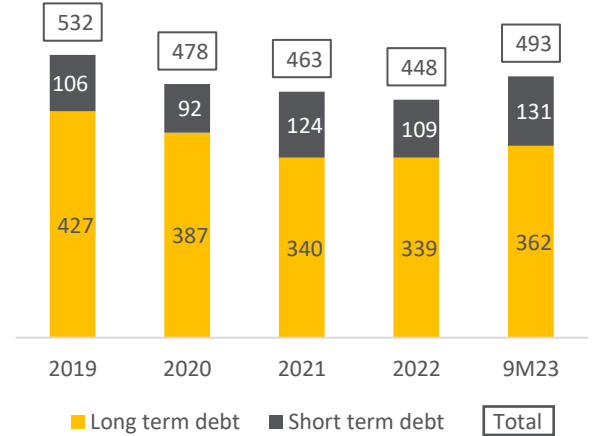
2. Current leverage scenario in KSA

Figure 7: Total Debt including lease liabilities (SAR mn)*



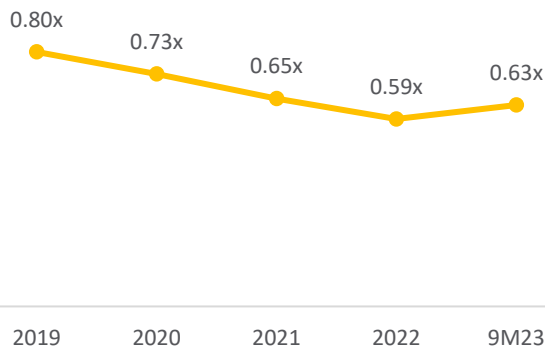
Source: Argaam, GIB Capital, * Ex-Banks, Insurance and Aramco

Figure 8: Total debt excluding lease liabilities (SAR mn)*



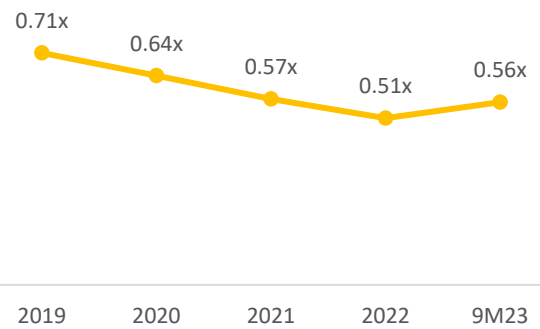
Source: Argaam, GIB Capital, * Ex-Banks, Insurance and Aramco

Figure 9: Trend in D/E ratio including lease liabilities*



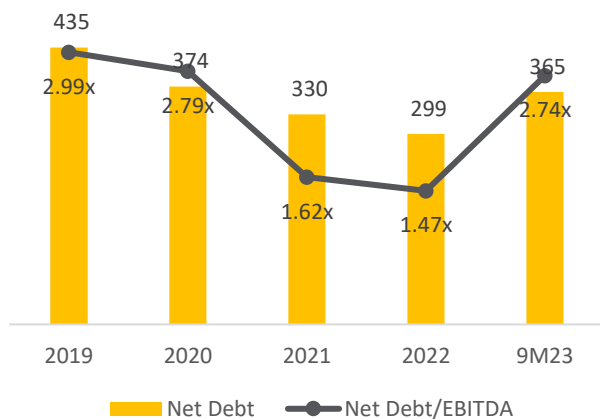
Source: Argaam, GIB Capital, * Ex-Banks, Insurance and Aramco

Figure 10: Trend in D/E ratio excluding lease liabilities*



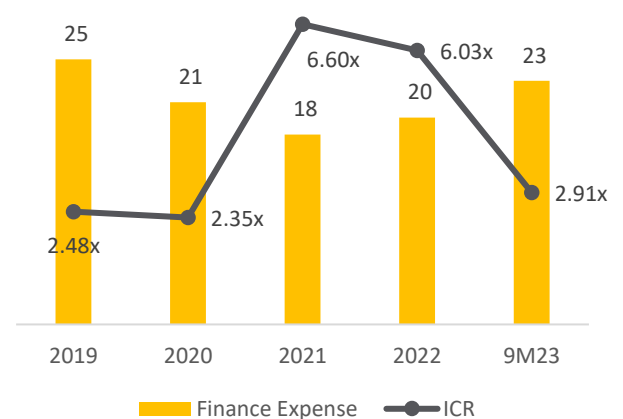
Source: Argaam, GIB Capital, * Ex-Banks, Insurance and Aramco

Figure 11: Trend in net debt and net debt to EBITDA ratio (SAR mn)*



Source: Argaam, GIB Capital, * Ex-Banks, Insurance, REITs and Aramco

Figure 12: Trend in finance expense and interest coverage ratio (SAR mn)*



Source: Argaam, GIB Capital, * Ex-Banks, Insurance, REITs and Aramco

3. Rate cuts beneficiaries: Analyzing the impact on KSA sectors

To estimate the impact of rate cuts on finance costs, we held debt constant at its 9M23 level and multiplied it by the assumed 50bps effective rate cut for 2024e. These calculated finance cost savings were then added to the annualized 9M23 earnings for each sector to arrive at the expected earnings growth in 2024e. We used the same approach with a 75bps effective rate cut for 2025e, to determine the estimated finance cost savings and earnings growth for that year.

Figure 13: Impact on finance cost and earnings¹ of TASI sectors (excl. Banks and Insurance)

Sectors (SAR mn)	9M23 Total Debt**	9M23 Total Equity	9M23 D/E (x)	Finance Cost Impact			Earnings Impact		
				Annualized finance cost*	2024e 50bps [^]	2025e 75bps [^]	Annualized Earnings*	2024e 50bps [^]	2025e 75bps [^]
Consumer Durables & Apparel	1,713	2,888	0.6x	64	-13%	-23%	44	+20%	+25%
REITs ^{^^}	9,335	16,599	0.6x	520	-9%	-15%	316	+15%	+19%
Materials	116,246	349,204	0.3x	7,059	-8%	-13%	5,516	+11%	+14%
Utilities	154,835	125,175	1.2x	7,912	-10%	-16%	8,589	+9%	+12%
Real Estate Mgmt & Dev't	48,643	73,646	0.7x	2,341	-10%	-17%	2,968	+8%	+11%
Financial Services	16,611	40,259	0.4x	1,281	-6%	-10%	1,690	+5%	+7%
Consumer Discretionary Dist. & Retail	12,152	5,109	2.4x	653	-9%	-15%	1,289	+5%	+7%
Food & Beverages	31,067	33,120	0.9x	1,857	-8%	-14%	3,691	+4%	+6%
Capital Goods	7,711	10,351	0.7x	516	-7%	-12%	1,176	+3%	+5%
Transportation	7,619	9,393	0.8x	607	-6%	-10%	1,376	+3%	+4%
Consumer Services	9,606	13,557	0.7x	600	-8%	-13%	1,873	+3%	+4%
Commercial & Professional Svc	1,818	2,912	0.6x	121	-8%	-12%	432	+2%	+3%
Consumer Staples Distribution & Retail	8,581	7,879	1.1x	486	-9%	-15%	2,213	+2%	+3%
Health Care Equipment & Svc	13,310	20,264	0.7x	547	-12%	-21%	3,702	+2%	+3%
Pharma, Biotech & Life Sciences	1,132	2,911	0.4x	72	-8%	-13%	379	+1%	+2%
Telecommunication Services	46,325	106,096	0.4x	2,423	-10%	-16%	17,971	+1%	+2%
Media and Entertainment	2,221	4,210	0.5x	140	-8%	-13%	1,054	+1%	+2%
Energy	353,539	1,578,791	0.2x	13,487	-13%	-23%	464,935	+0%	+1%
Software & Services	1,933	7,586	0.3x	156	-6%	-10%	2,879	+0%	+1%
Total	844,397	2,409,948	0.4x	40,839	-10%	-17%	522,092	+1%	+1%
Total (ex-Aramco)	559,348	864,792	0.6x	31,131	-9%	-15%	55,577	+5%	+7%

Source: Argaam, GIB Capital **includes lease liabilities ¹assumed no tax impact *9M23 annualized numbers (1H23 for REITs), ^^ 1H23 numbers for REITs [^]proforma impact

Figure 14: Impact on finance cost and earnings¹ of most leveraged TASI companies (excl. coverage companies)

Companies (SAR mn)	9M23 Total Debt**	9M23 Total Equity	9M23 D/E (x)	Finance Cost Impact			Earnings Impact		
				Annualized finance cost*	2024e 50bps [^]	2025e 75bps [^]	Annualized Earnings*	2024e 50bps [^]	2025e 75bps [^]
Cenomi Retail	5,254	311	16.9x	349	-8%	-12%	(122)	+21%	+41%
Red Sea	374	65	5.7x	13	-14%	-24%	(70)	+3%	+4%
Amiantit	1,134	204	5.6x	67	-9%	-14%	(184)	+3%	+5%
Alhokair Group	1,434	269	5.3x	78	-9%	-15%	(30)	+24%	+48%
Zamil Indust	2,545	530	4.8x	181	-7%	-11%	(308)	+4%	+6%
Aldrees	4,062	1,168	3.5x	153	-13%	-23%	278	+7%	+10%
Petro Rabigh	38,672	11,950	3.2x	2,160	-9%	-15%	(4,407)	+4%	+7%
Takween	1,091	341	3.2x	63	-9%	-14%	(115)	+5%	+7%
Lazurde	1,192	374	3.2x	33	-18%	-33%	58	+10%	+14%
MIS	719	317	2.3x	43	-8%	-14%	36	+10%	+14%
Alyamamah Steel	1,142	539	2.1x	67	-9%	-14%	(143)	+4%	+6%
Farm Superstores	1,233	655	1.9x	70	-9%	-14%	25	+25%	+30%
BATIC	832	458	1.8x	18	-24%	-47%	(8)	+51%	NM
Naseej	198	111	1.8x	11	-9%	-15%	8	+13%	+17%
APC	366	206	1.8x	23	-8%	-13%	122	+2%	+2%

Source: Argaam, GIB Capital **includes lease liabilities ¹assumed no tax impact *9M23 annualized numbers [^]proforma impact

Figure 15: Impact on finance cost and funds from operations (FFO)¹ of REITs

REITs (SAR mn)	1H23	1H23	1H23 D/E (x)	Finance Cost Impact			Funds from operations impact		
	Total Debt**	Total Equity		Annualized finance cost*	2024e 50bps [^]	2025e 75bps [^]	Annualized FFO*	2024e 50bps [^]	2025e 75bps [^]
Mefic REIT	539	538	1.0x	30	-9%	-15%	2	+108%	+78%
Musharaka REIT	880	800	1.1x	58	-8%	-12%	(11)	+40%	NM
Derayah REIT	778	853	0.9x	54	-7%	-12%	23	+17%	+21%
Sico Saudi REIT	150	362	0.4x	11	-7%	-11%	5	+15%	+19%
Mulkia REIT	593	808	0.7x	39	-8%	-12%	20	+15%	+19%
Jadwa REIT Alharamain	251	488	0.5x	17	-7%	-12%	12	+11%	+15%
Riyad REIT	1,419	1,523	0.9x	46	-15%	-27%	101	+7%	+10%
Alkhabeer REIT	889	1,057	0.8x	33	-14%	-24%	64	+7%	+10%
Al Rajhi REIT	896	1,187	0.8x	50	-9%	-15%	65	+7%	+10%
Sedco Capital REIT	796	1,557	0.5x	54	-7%	-12%	62	+6%	+9%
Alinma Retail REIT	199	884	0.2x	4	-25%	-50%	20	+5%	+7%
Alahli REIT 1	648	1,254	0.5x	36	-9%	-15%	68	+5%	+7%
Jadwa REIT Saudi	453	1,746	0.3x	33	-7%	-11%	56	+4%	+6%
Taleem REIT	298	546	0.5x	21	-7%	-11%	37	+4%	+6%
Al Maather REIT	205	514	0.4x	7	-16%	-28%	40	+3%	+4%
Bonyan REIT	341	1,371	0.2x	27	-6%	-10%	128	+1%	+2%
Alinma Hospitality REIT	0	1,023	0.0x	0	NA	NA	91	+0%	+0%
Aljazira REIT	0	88	0.0x	0	NA	NA	4	+0%	+0%
Total	9,335	16,599	0.6x	520	-9%	-15%	790	+6%	+8%

Source: Argaam, GIB Capital **includes lease liabilities ¹assumed no tax impact *1H23 annualized numbers [^]proforma impact

4. Coverage companies in focus: Analyzing the impact of rate cuts

Figure 16: Impact on finance cost and earnings¹ on coverage companies

Companies (SAR mn)	Sectors	Total Debt 2023e**	Total Equity 2023e	2023e D/E (x)	Finance Cost Impact			Earnings Impact		
					Finance cost 2023e	2024e 50bps [^]	2025e 75bps [^]	Earnings 2023e	2024e 50bps [^]	2025e 75bps [^]
Alujain	Petrochemical	818	3,364	0.2x	62	-7%	-11%	38	+11%	+15%
Sipchem	Petrochemical	3,493	17,083	0.2x	258	-7%	-11%	1,249	+1%	+2%
Kayan	Petrochemical	10,235	13,438	0.8x	689	-7%	-12%	(2,100)	+2%	+4%
Arabian Drilling	Energy	2,630	5,710	0.5x	160	-8%	-13%	582	+2%	+3%
ADES	Energy	9,434	5,777	1.6x	722	-7%	-10%	405	+12%	+16%
Luberef	Materials	2,115	5,694	0.4x	142	-7%	-12%	1,679	+1%	+1%
AMAK	Materials	109	1,171	0.1x	8	-7%	-11%	61	+1%	+1%
Marafiq	Utilities	12,082	8,270	1.5x	539	-11%	-19%	576	+10%	+14%
Jarir	Retailing	754	1,753	0.4x	45	-8%	-14%	936	+0%	+1%
SASCO	Retailing	3,857	1,007	3.8x	155	-12%	-21%	67	+29%	+33%
Tanmiah	Food & Beverages	755	673	1.1x	31	-12%	-21%	80	+5%	+7%
First milling	Food & Beverages	1,579	809	2.0x	94	-8%	-14%	209	+4%	+5%
Americana	Consumer Services	497	442	1.1x	30	-8%	-13%	293	+1%	+1%
Alamar	Consumer Services	246	356	0.7x	17	-7%	-12%	85	+1%	+2%
Leejam	Consumer Services	1,303	1,083	1.2x	82	-8%	-13%	361	+2%	+3%
Riyadh Cable	Capital Goods	979	2,299	0.4x	103	-5%	-7%	515	+1%	+1%
Gas Arabian	Capital Goods	4	355	0.0x	2	-1%	-1%	77	+0%	+0%
Astra	Capital Goods	828	2,132	0.4x	74	-6%	-9%	432	+1%	+1%
Obeikan	Capital Goods	42	558	0.1x	5	-4%	-6%	90	+0%	+0%
Theeb	Transportation	1,181	741	1.6x	58	-10%	-17%	150	+4%	+6%
Budget	Transportation	688	1,838	0.4x	38	-9%	-15%	282	+1%	+2%
Lumi	Transportation	1,181	1,060	1.1x	63	-9%	-16%	216	+3%	+4%
SAL	Transportation	1,813	1,255	1.4x	86	-11%	-18%	462	+2%	+3%
ELM	Software & Services	133	3,876	0.0x	8	-8%	-14%	1,382	+0%	+0%
AZM***	Software & Services	20	83	0.2x	2	-5%	-8%	27	+0%	+1%
Jamjoom	Pharma	2	1,365	0.0x	1	-2%	-3%	289	+0%	+0%
Akaria	Real Estate	3,265	4,773	0.7x	233	-7%	-11%	(33)	+49%	NM
Retal	Real Estate	978	722	1.4x	86	-6%	-9%	181	+3%	+4%
Mawarid	Comm. & Prof. Svc.	27	341	0.1x	0	NA	150%	93	+0%	+0%
AlArabia	Media & Ent.	1,474	1,034	1.4x	91	-8%	-13%	352	+2%	+3%

Source: Argam, GIB Capital **includes lease liabilities ¹assumed no tax impact [^]proforma impact, ***for the period Jan-Dec 2023e. We have not calculated the impact on APPC as the company is currently capitalizing the financial costs due to its ongoing expansion projects.

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