

Equity themes: Diversification away from oil

- The glass half empty view is that the downward pressure on oil prices over the past 18 months has put strain on regional government balances
- The glass half full view is that lower oil prices are the catalyst for major structural changes in the region, encouraging the re-thinking of economic models, away from oil dependence. This is the view that we prefer to take
- In the region the UAE has long been the pioneer of this shift, offering other countries a blueprint to follow
- Saudi Arabia is the most recent and most high profile country to embrace these changes, announcing its Saudi Vision 2030
- The focus of this theme is therefore on the Kingdom, where sectors such as banks, real estate and tourism will likely to be the key long-term beneficiaries
- However, recently announced equity market reforms also mean that there is near-term option value in the form of the Saudi equity market's potential inclusion into mainstream Emerging Market indices such as MSCI and S&P, this would result in large inflows of liquidity tracking EM benchmarks

Regional shift away from oil dependence with extra option value

There appears to be an acceptance among major oil producing nations that the oil price decline over the past 18 months may be more structural than cyclical. Although this does put pressure on government balances in those countries in the immediate term, it also provides a much more credible incentive for the region's transition away from oil reliance than might have been the case in the past. The UAE has been the pioneer of this trend, diversifying its economy towards sectors such as tourism and financial services. However, others, in particular Saudi Arabia are now following this blueprint in a concrete manner.

Saudi Arabia's Vision 2030 vision outlines the Kingdom's social, economic and development objectives over the coming 14 years. Enhanced private sector involvement as well as a more business friendly environment should support diversification prospects for the economy. The sectors which will benefit most from these initiatives are the non-oil sectors of the economy. In particular **banks, real estate and tourism**.

Not only are there major structural changes coming to address the economy, but announced reforms are also aimed at the equity market, in particular easing foreign ownership restrictions to encourage foreign participation and improving equity market infrastructure. These changes are much more immediate and will facilitate Saudi Arabia's eventual inclusion in major Emerging Market benchmarks such as the MSCI Emerging Markets index. Estimates of Saudi's weight in EM indices range from 3-4%, clearly significant and putting the index in the same bracket as Russia, Mexico and Malaysia.

Below we have run a screen of the names which we believe provide a good way to play this long-term theme, while also trying to benefit from the potential Emerging Markets index inclusion. Where possible, we try to overlap other themes in the screen, such as our preference for high dividend yield stocks.

Please refer to the disclaimer at the end of this publication.

Wietse Nijenhuis

Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Luciano Jannelli, Ph.D., CFA

Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

Rahmatullah Khan

Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Investment Strategy Note

23 May 2016

بنك أبوظبي التجاري
ADCB

Theme-related sector preferences

Real Estate: Housing has been a priority for the Kingdom for some time, but received additional attention in the new Vision 2030. According to private estimates, there is a shortage of roughly half a million units currently (mostly young families now staying with parents not able to find suitable/affordable housing), although this number can swell to a million when factoring in the new households which will be formed over the next 5 years. A key part of the government's plan is to increase ownership of homes by Saudis to 52% from 47% currently by 2020. The government has also committed to building 100,000 homes for low income Saudis over the next year while private developers will be given a greater role in filling the housing shortage. Other initiatives such as a new residency system also provide a boost to population dynamics, which are already among the best in the world in Saudi Arabia.

Banks: Linked to the real estate theme, is the banks theme. Much greater home ownership will only be possible with a widespread roll out of mortgages in the Kingdom. In fact banks are the key intermediary in the transition away from oil dependency. Most of the new homes which will be created will be mortgaged, this will have a positive impact on net income and earnings. The diversification of the economy will also mean a boost to the SME sector, another area which will need to be funded by banks.

Tourism/consumer: The UAE has very successfully diversified its economy over the years, while becoming a popular tourist destination. Other countries in the region, Qatar for example are following this same blueprint.

The 2030 vision in Saudi Arabia also identifies tourism as a key area for growth, the difference is that the Kingdom is focusing on religious tourism. The Vision states that the government plans to increase the number of religious visas to 15m by 2020 and 30m by 2020 (from 4m in 2013-14). As a share of the population this would be very high (estimated at 29m in 2013). Naturally the hotel, food & beverage and transportation sectors would benefit significantly.

Potential EM inclusion

Structural reforms will take time to implement. Of course, investors will start pricing them in as they develop. However another angle to this theme is the inclusion of Saudi equities in mainstream Emerging Market indices. This is something which could get traction much quicker than other reforms, with industry experts citing 2017-2018 as a realistic timeframe. Recently changes have been announced which mean that Saudi equities will meet the technical criteria for inclusion into EM indices while also bringing the market's infrastructure much more in line with international standards. With around \$500bn tracking emerging market equities, inclusion into these benchmarks will see significant inflows of capital for Saudi companies.

How to play it

Below we provide a list of Saudi stocks active in our preferred sectors, which are not our specific recommendations, but which have been screened on the basis of two very simple automatic and non-discretionary criteria: 1) market capitalization above 5 billion; 2) Bloomberg consensus survey rating of 3 and above.

A quantitative screen of our Saudi theme*

Name	Ticker	Market Cap (SAR bn)	Div Yield (%)	Price (23/05/16)
NATIONAL COMMERCIAL BANK	NCB	83.96	3.03	41.98
KINGDOM HOLDING CO	KINGDOM	43.73	3.16	11.8
SAMBA FINANCIAL GROUP	SAMBA	43.18	3.86	21.59
ALMARAI CO	ALMARAI	42.87	1.47	53.59
RIYAD BANK	RIBL	33.15	5.64	11.05
SAUDI BRITISH BANK	SABB	32.76	3.35	21.84
BANQUE SAUDI FRANSI	BSFR	28.25	4.11	23.44
SAVOLA	SAVOLA	19.6	3.98	36.7
ARAB NATIONAL BANK	ARNB	19.04	4.25	19.04
SAUDI HOLLANDI BANK	AAAL	14.08	1.8	12.32
EMAAR ECONOMIC CITY	EMAAR	11.74	-	13.81
JARIR MARKETING CO	JARIR	10.34	4.76	114.91
FAWAZ ABDULAZIZ ALHOKAIR & C	ALHOKAIR	9.5	2.33	45.23
SAUDI INVESTMENT BANK/THE	SIBC	8.71	4.35	12.45
NATIONAL INDUSTRIALIZATION C	NIC	8.19	-	12.24
AL TAYYAR TRAVEL GROUP	ALTAYYAR	8.02	-	38.26

* Saudi real estate, banks, tourism and consumer stocks with market capitalization above SAR 5 billion and Bloomberg consensus survey rating of 3 and above (source: Bloomberg)

Investment Strategy Note

23 May 2016



Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

Disclaimer

This publication is intended for general information purposes only. It should not be construed as an offer, recommendation or solicitation to purchase or dispose of any securities or to enter in any transaction or adopt any hedging, trading or investment strategy. Neither this publication nor anything contained herein shall form the basis of any contract or commitment whatsoever. Distribution of this publication does not oblige Abu Dhabi Commercial Bank PJSC ("ADCB") to enter into any transaction.

The content of this publication should not be considered legal, regulatory, credit, tax or accounting advice. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in this publication.

Information contained herein is based on various sources, including but not limited to public information, annual reports and statistical data that ADCB considers accurate and reliable. However, ADCB makes no representation or warranty as to the accuracy or completeness of any statement made in or in connection with this publication and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this publication. This publication is intended for qualified customers of ADCB.

Charts, graphs and related data or information provided in this publication are intended to serve for illustrative purposes only. The information contained in this publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. All statements as to future matters are not guaranteed to be accurate. ADCB expressly disclaims any obligation to update or revise any forward looking statements to reflect new information, events or circumstances after the date of this publication or to reflect the occurrence of unanticipated events.

ADCB does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its publications. As a result, recipients of this publication should be aware that any or all of the foregoing services may at time give rise to a conflict of interest that could affect the objectivity of this publication.

Past performance does not guarantee future results. Investment products are not bank deposits and are not guaranteed by ADCB. They are subject to investment risks, including possible loss of principal amount invested. Please refer to ADCB's Terms and Conditions for Investment Services.

This publication is being furnished to you solely for your information and neither it nor any part of it may be used, forwarded, disclosed, distributed or delivered to anyone else. You may not copy, reproduce, display, modify or create derivative works from any data or information contained in this publication.