



First quarter results generally uninspiring

Results of listed companies for the first quarter of 2010 were generally uninspiring. Total earnings were well up on the equivalent quarter of last year, but this was anticipated given that the low point for the global economy and most financial markets and commodity prices was during the first quarter of 2009. While earnings were up nearly 30 percent on the final quarter of last year, in many cases they were below analysts' expectations. Nonetheless, the growth in earnings reinforces our view that the economy is picking up. The TASI is little changed since the beginning of the result announcements and we are comfortable with our projection for end-year fair value of 7,400.

On a sectoral basis, **petrochemicals** lead the way in year-on-year terms, owing largely to higher product prices and greater sales volumes. Petrochemicals was the clearest beneficiary from the pickup in the global economy over the last 12 months. **Bank** results fell short of analysts' expectations, though they were well up on the fourth quarter, when large sums were set aside to cover bad debts. Lower income on lending and ongoing provisions for bad loans inhibited bank performance. Results from the **telecoms** sector were mixed. All operators were hit by intense competition that is triggering lower fees and increased capital spending (the quarterly decline was distorted by a drop in roaming revenues, which were boosted by Hajj pilgrims in the fourth quarter).

Among the smaller sectors, **insurance** did the best, recording annual earnings growth of 279 percent, owing to a significant recovery in investment income and more of the new companies moving into profitability. **Agriculture and food** was the next best performer. Smaller food processors boosted their revenues due to the launch of new projects and the streamlining of operations. Below consensus results from the largest company in the sector were offset by strong gains from the second largest company, owing to the proceeds from a one-time sale. Three agricultural companies recorded losses in the first quarter, compared to eight in the final quarter of 2009. **Cement** earnings, while down, were above expectations. Companies in the central, eastern and northern regions posted strong gains owing to cement prices holding up despite much higher production and inventory levels; as a result some producers ceased to offer price discounts on bulk sales.

Net income for the **energy and utilities** sector was down by nearly 60 percent compared to the fourth quarter, in line with the usual season trend for Saudi Electricity Company, which dominates the sector (in year-on-year terms earnings were virtually unchanged). Typically, earnings are negative during the cooler months of the year, when less air conditioning is used. Increased electricity purchases from independent energy producers and escalating



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depreciation charges contributed to the weaker performance. Results were healthy for the **retail** sector owing to an increased number of outlets, greater operational efficiencies and lower costs. **Hotels and tourism** also performed well as the dominant company in the sector took on new contracts and utilized existing facilities more efficiently.

Earnings and stock market performance by sector
(percent change)

	Earnings growth versus		Change in price since April 4
	Q1 2009	Q4 2009	
Banking	-9.5	110.2	-2.1
Petrochemicals	429.2	45.5	8.5
Cement	-0.8	39.9	-0.3
Retail	26.5	6.1	8.6
Energy & utilities	-0.9	-59.6	-6.1
Agriculture & food	79.9	42.6	2.3
Telecoms	-17.2	-45.4	-3.6
Insurance	279.1	-38.4	-3.9
Multi-investment	64.9	-47.2	2.0
Industrial investment	18.7	14.8	4.2
Building & construction	-25.8	21.5	0.7
Real estate	-4.3	-13.5	-0.4
Transport	-16.5	13.9	5.2
Media & publishing	-27.4	49.5	-3.6
Hotels & tourism	11.2	76.1	-2.6
TASI	43.4	29.0	1.6

Earnings for **building and construction** and **real estate** were mixed. In the case of the former, severe competition from existing and new companies, declining sales, delayed orders and fewer awarded contracts were among the various reasons cited by listed companies for a decline in earnings on an annual basis. Real estate earnings were slightly below expectations. Greater occupancy and operational efficiency translated into higher revenues for a few developers, but many large projects are still at the early stages of development and one major developer took units off the market for renovation.

Multi-investment was one of the sectors hardest hit by the financial crisis, so large annual growth in earnings in year-on-year terms was not surprising. Quarterly data was affected by a major restructuring at the dominant company in the sector. Higher investment income also lifted earnings for **industrial investment** companies.

The TASI is up by 1.6 percent since the first of the first quarter results were announced on April 4; it closed at a new 20-month high of 6,921 on April 26. Moves of greater than one percent occurred on three days over this period. The market jumped on April 10 owing to strong results by fertilizer producer Safco, which set the scene for healthy performance from the petrochemicals sector. Below expectations results from Saudi Telecoms combined with ongoing disappointment about the banks pushed the TASI down by over 2 percent to a four-week low on April 20. This decline was largely reversed on April 24, though this was the result of stronger global markets, rather than local results; the TASI has underperformed most global markets during April.



Economy watch

Steps towards GCC single currency

A single currency within the GCC has come one step closer with the inaugural meeting of the Gulf monetary council in Riyadh in March. The council is a precursor to a regional central bank and will examine a variety of technical issues related to the new currency. Progress within the GCC comes at a time of great strain within the eurozone, the model for the single currency in the Gulf.

The monetary council is tasked with preparations for the launch of the currency and the regional central bank. Its near term priority is establishing the appropriate regulatory and organizational framework. This includes harmonization of regulations, payment and settlement systems and economic data, and accord on the appropriate exchange rate regime, pooling of foreign exchange reserves and reserve management policy. Agreement on these technical issues is vital to the sound functioning of the currency, though each of the individual steps will have little impact on business and investors until the currency is launched. The monetary council will determine the launch date for the new currency.

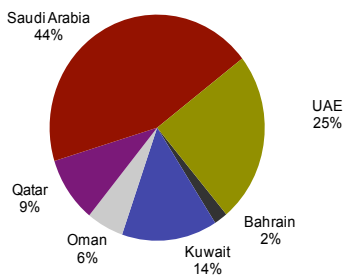
Only four GCC members attended the monetary council meeting. The UAE withdrew from the project in May 2009 and Oman decided not to participate in 2006. SAMA governor Mohammed al-Jasser was elected as the chairman of the council for a one-year term. The appointment reflects the dominant role of the Kingdom within the GCC (it accounts for 44 percent of the GDP and 65 percent of the population). At the inaugural council meeting, those present expressed their hope that the UAE and Oman will rejoin the project, while emphasizing that the processes will continue regardless.

The progress within the GCC comes at a time of exceptional strains within the eurozone stemming from economic problems in Greece. These could have implications for the GCC single currency. Much of the preparatory work in the GCC was based on what preceded the introduction of the euro and technical support from the European Central Bank has been used widely. Therefore, in the unlikely event that stresses in Greece or elsewhere irrecoverably damage the eurozone it could trigger a rethink within the GCC.

Greece's problems are largely due to its high budget deficit. Because of its eurozone membership Greece was able to borrow abroad cheaply to finance the deficit. However, the recession worsened the budget deficit and investors became more cautious, raising the cost of servicing the deficit. Without the ability to devalue its exchange rate, a painful adjustment to domestic economy is necessary. Greece's problems highlight the need for greater coordination of economies before joining the union, measures to tackle imbalances within the union, internal procedures to resolve a crisis and ultimately highlight the difficulty of having a monetary, but not fiscal, union.

For the GCC, the likelihood of similar problems arising is far less owing to similarity of the region's largely oil-based economies, which means that major imbalances between countries are less likely. Furthermore, the region does not have a history of devaluations to restore competitiveness and reserves are such that any country that runs a fiscal deficit can currently finance it from domestic sources rather than international capital markets.

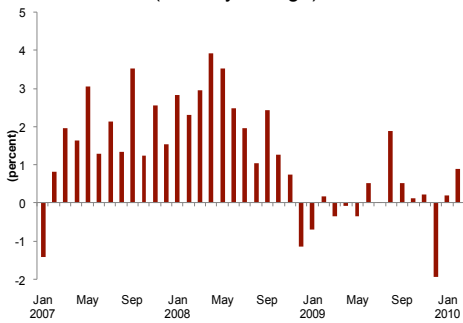
Breakdown of GCC GDP
(2008 data)





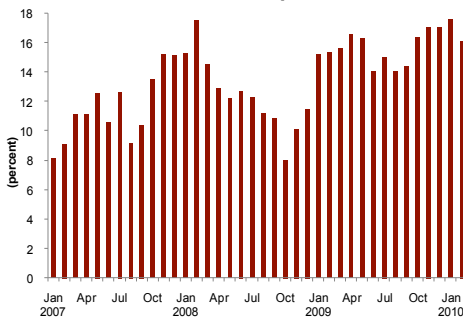
In brief: Economy

Bank lending to the private sector
(monthly change)



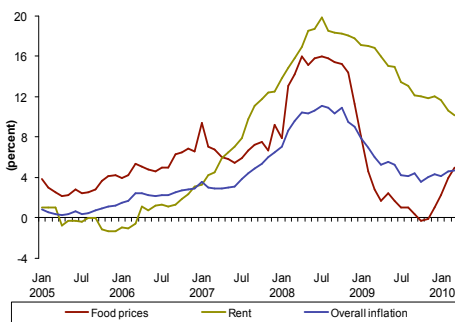
Bank lending to the private sector rose by 0.9 percent in February, the second largest monthly gain since the end of 2008. Credit to the private sector has increase in eight of the past nine months, but the total is only 1.6 percent higher than it was one-year earlier. We view bank lending as a key indicator of the health of the private sector. Lack of availability of suitably priced credit has been a major impediment to the ability of the private sector to benefit fully from the stimulatory government policy. In this context, the growth in lending is encouraging, though it is well below the average monthly growth of 1.8 percent over 2007 and 2008.

Bank reserves to deposits ratio



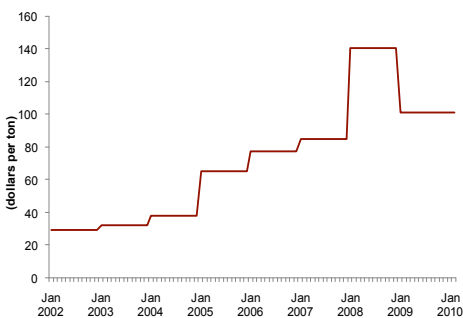
The new lending to the private sector may have been financed by commercial banks drawing down some of their excess deposits at SAMA. The value of funds deposited by banks at SAMA in excess of the statutory requirement dropped by SR11.6 billion in February, the largest fall in six months. Commercial bank foreign assets and lending to the public sector also rose substantially during the month as banks search for higher returns on their funds; the interest rate on funds deposited at SAMA is currently just 0.25 percent. As a result of the decline in deposits at SAMA, the ratio of bank reserves to total deposits fell to its lowest level since the end of September, though it remains high on an historical basis, a reflection of the cautious attitude of banks towards lending.

Inflation



Inflation rose again in March, reaching a nine-month high of 4.7 percent. Higher food prices remained the main reason for the pickup in inflation, climbing for the sixth consecutive month to 5 percent as a result of higher global food prices. In part this reflects recovery since the very sharp fall in food prices in the final quarter of 2008 in addition to recent rises in some prices owing to concerns about poor harvests. Rents remained the main source of inflation. Although rental inflation fell to 10.1 percent, its lowest in year-on-year terms since August 2007, the monthly increase of 1 percent was the highest since June of last year.

Iron ore prices

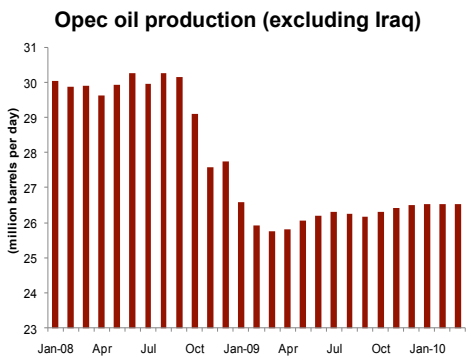
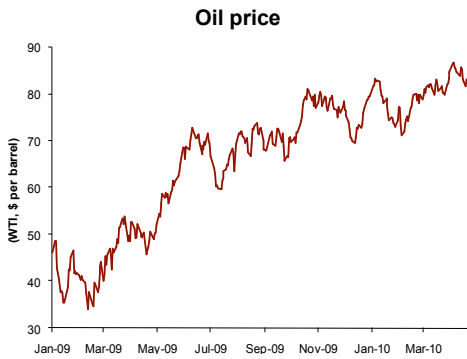


Steel prices are set to rise owing to a change in the global system for pricing iron ore, the key ingredient. For the past 40 years, iron ore prices were set on an annual basis after negotiation between leading global suppliers and consumers. In late March this system was ended and prices will now be linked to spot market prices and set on a quarterly basis. Spot prices are well above those negotiated under the old system, making a jump in steel prices inevitable. Contractors within the Kingdom are already complaining of higher prices owing to suppliers hoarding stocks and the international move will add upward pressure to prices. This is likely to swell construction costs and raise the prices of goods with a large steel content such as cars and home appliances.



Oil market watch

Oil prices higher despite Opec caution



Oil prices hit an 18-month high in early-April and have been above \$80 per barrel (WTI) for all but a few days since the start of March. While this appears to be slightly above the level Opec producers are comfortable with, we do not think that concern about prices will be sufficient to cause Opec to raise production quotas. Opec members held production quotas unchanged at their meeting in March, highlighting that the growth in demand anticipated for this year would be offset by an expected expansion of non-Opec supply.

In addition to voicing concern about the sustainability of the global economic recovery, Opec highlighted the high level of stocks. Commercial stocks in the OECD are equivalent to around 60 days of future demand compared to a medium-term average of around 52 days. Stocks have been above Opec's preferred level for two years, but this does not seem to have put downward pressure on prices. Stocks are currently rising in line with the usual seasonal demand pattern (demand is highest in the Northern hemisphere winter, because of use for heating, and in the summer, which is the time of maximum transportation and air conditioner use).

Little was said on the growing lack of compliance to the agreed quotas. According to independent estimates for March, Opec was only adhering to around 50 percent of the 4.2 million barrels per day of agreed production cuts and total Opec production was at its highest level since the cuts were introduced in December 2008. Angola, Iran, Nigeria and Venezuela were the main countries producing above their quotas. In most cases these countries have now have little spare production capacity.

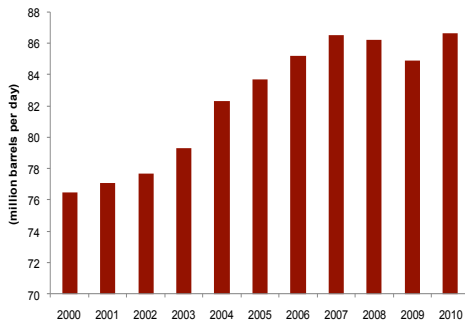
While prices remain around current levels overproduction is unlikely to be much of a concern. Indeed, it is easier for Opec members to respond to the improvement in demand by informal increases in production rather than by formally raising production quotas at a time when there is uncertainty about the strength of the global recovery. Gradual increases in production are also serving to prevent oil prices getting to a level that producers and consumers would be uncomfortable with. Contentment with the oil price environment was reflected Opec's decision to schedule its next meeting for October 14, and not to have the usual summer meeting. Although prices subsequently climbed from their mid-March level to reach a high of \$86.7 per barrel on April 6, we do not think that Opec will consider holding an interim meeting unless prices head to \$100 per barrel.

The outcome of the Opec meeting was in line with our forecast and we do not think that Opec will alter its production quotas this year. Oil production in the Kingdom is expected to creep up over the first half of 2010, but may stabilize in the second half give the expected slowdown in global economic growth. As a result, prices should ease from current levels, but not by a significant amount. Our forecast is that the WTI will average \$75 per barrel this year (equivalent to \$71.3 per barrel for Saudi export crude) and Saudi production will average 8.3 million barrels per day. Revenues generated at these levels should be sufficient to generate budget and current account surpluses.



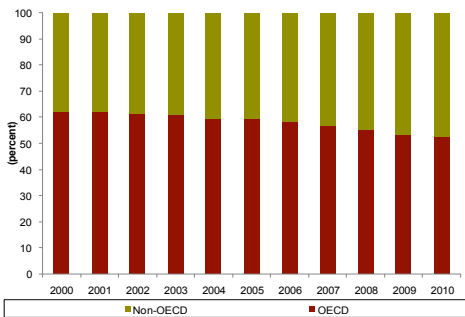
In brief: Oil market

Global oil demand



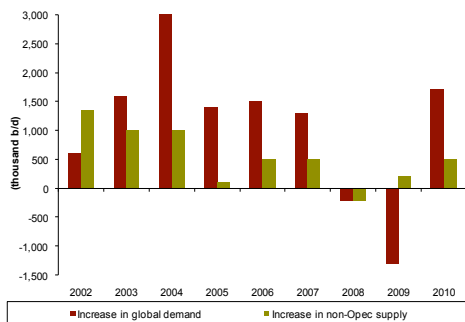
The International Energy Agency (IEA) has revised up its global oil demand projection for 2010 by 100,000 barrels per day to 86.6 million barrels per day owing to a healthier outlook in all leading consuming regions apart from Europe. This reflects the ongoing improvement in the global economy. Global demand is now forecast to be 1.7 million barrels per day higher than in 2009, the largest annual increase since 2004. Emerging economies within Asia (notably China) and the Middle East are the main source of the demand growth.

Breakdown of global oil demand



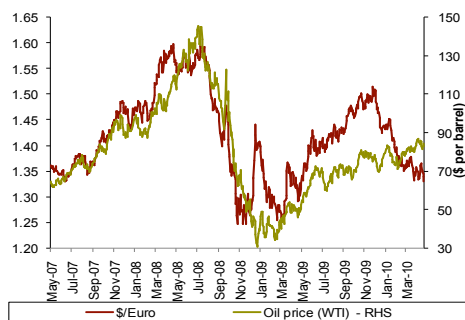
The revised IEA data puts global oil demand for 2010 at an all-time high, slightly exceeding the previous peak of 86.5 million barrels per day in 2007. Global oil demand was hit in the previous two years by record high prices and then recession. While the total is now above the 2007 level, the composition has changed. In 2007, OECD demand accounted for 49.2 million barrels per day (57 percent of the total), compared to 53 percent projected for 2010. The shift in demand is a long-term trend, with total OECD demand accounting for 62 percent of total demand in 2002. This reflects the rapid economic development of many emerging economies and greater efficiency and use of alternative fuels in the OECD.

Change in oil demand and non-Opec supply



Non-Opec supply has been revised up by 220,000 barrels per day in the IEA's latest projections for 2010. This is the result of higher output anticipated from some OECD countries. Total non-Opec supply is now expected to increase by 500,000 barrels per day this year, the largest rise since 2007. The difference between total demand and non-Opec production, suggests the required total supply from Opec to balance the market should be around 1.2 million barrels per day. Not all of this will be in the form of crude oil. The IEA estimates that in response to recent investment output of natural gas liquids in Opec will rise by 800,000 barrels per day this year, so far this year Opec oil production is around 300,000 barrels per day above the average for last year, indicating scope for modestly higher output over the remainder of the year.

Oil price and the dollar



The relationship between oil prices and the dollar appears to have changed in recent months. Despite the appreciation of the dollar since the end of November (by 8 percent on a trade weighted basis) oil prices (WTI) have risen by 9 percent over this period, whereas for the bulk of the last few years there has been a clear inverse relationship between these two variables. This may suggest that fundamentals are playing a stronger role in determining oil prices and the impact of financial flows is diminishing. However, it could also reflect a shift in investor perceptions of the dollar, whereby structural problems in other leading economies may make the US best positioned to benefit from the resumption in global growth. In these circumstances the dollar would rise in line with commodity prices, stock markets and other indications of risk appetite.



Key data

	2003	2004	2005	2006	2007	2008	2009E	2010F	2011F
Nominal GDP									
(SR billion)	804.6	938.8	1182.5	1335.6	1442.6	1781.6	1384.4	1554.0	1680.1
(\$ billion)	214.6	250.3	315.3	356.2	384.7	475.1	369.2	414.4	448.0
(% change)	13.8	16.7	26.0	12.9	8.0	23.5	-22.3	12.2	8.1
Real GDP (% change)									
Oil	17.2	6.7	6.2	-0.8	-3.6	4.2	-6.4	3.8	3.9
Non-oil private sector	3.9	5.3	5.8	6.1	5.5	4.8	2.5	3.8	4.4
Government	3.1	3.1	4.0	3.1	3.0	3.7	4.0	3.6	3.4
Total	7.7	5.3	5.6	3.2	2.0	4.3	0.1	3.8	4.0
Oil indicators (average)									
WTI (\$/b)	31.1	41.5	56.6	66.1	72.3	99.7	62.0	75.0	80.0
Saudi (\$/b)	26.9	34.7	49.5	60.5	68.1	93.4	60.5	71.3	74.8
Production (million b/d)	8.8	9.0	9.5	9.2	8.7	9.2	8.1	8.3	8.5
Budgetary indicators (SR billion)									
Government revenue	293	392	564	674	643	1101	505	626	672
Government expenditure	257	285	346	393	466	520	550	603	621
Budget balance	36	107	218	280	177	581	-45	23	51
(% GDP)	4.5	11.4	18.4	21.0	12.2	32.6	-3.3	1.5	3.0
Domestic debt	660	614	475	366	267	237	225	220	215
(% GDP)	82.0	65.4	40.2	27.4	18.5	13.3	16.3	14.2	12.8
Monetary indicators (average)									
Inflation (% change)	0.6	0.3	0.7	2.3	4.1	9.9	5.1	4.5	3.4
SAMA base lending rate (% , year end)	1.75	2.50	4.75	5.20	5.50	2.50	2.00	2.25	3.00
External trade indicators (\$ billion)									
Oil export revenues	82.0	110.4	161.6	188.2	205.3	281.0	157.4	186.4	192.2
Total export revenues	93.0	125.7	180.4	210.9	233.1	313.3	184.5	215.7	223.8
Imports	33.9	41.1	53.8	63.0	81.5	100.6	80.4	86.8	95.5
Trade balance	59.1	84.6	126.6	147.8	151.6	212.7	104.1	128.9	128.3
Current account balance	28.0	51.9	90.0	98.9	93.3	134.0	20.5	37.3	34.3
(% GDP)	13.1	20.7	28.5	27.8	24.3	28.2	5.6	9.0	7.6
Official foreign assets	97.1	127.9	195.5	273.4	359.8	502.0	461.1	491.1	519.0
Social and demographic indicators									
Population (million)	22.0	22.5	23.1	23.7	24.2	24.8	25.5	26.3	27.0
Unemployment (male, 15+, %)	8.2	8.5	8.8	9.1	9.0	8.8	8.5	8.2	8.0
GDP per capita (\$)	9745	11112	13640	15041	15868	19151	14462	15774	16572

Sources: Jadwa forecasts for 2010 to 2011. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. Central Department of Statistics and Jadwa estimates for oil, social and demographic indicators.



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