



GCC equities: KSA is attractive

Saudi Arabia clearly stands out as the market to bet on among the GCC markets. But there are others as well, and a careful, disciplined stock picking approach will pay ample dividends, writes **Matein Khalid**.

There is no shortage of macro-momentum factors to explain the recent rally in GCC equities. One, crude oil prices have more than doubled from US\$32 last winter to US\$75. Two, the dollar has plunged by more than 15 points on the US Dollar Index as risk appetites have soared. Three, capital flows into emerging markets have resumed with a vengeance after the post-Lehman fund manager exodus. Four, the sovereign credit default swaps of GCC states, which priced in worst case default scenarios only six months ago, have plummeted. Five, the capital markets now price in global growth, not another Great Depression. Six, GCC public finance (budget surpluses) and current account balances have improved

due to conservative spending. Seven, the Saad Group and Nakheel debt shocks seem closer to resolution. Eight, the sukuk/Eurobond new issue market has unfrozen. And nine, GCC valuations are cheap in a global context.

The market to bet on

Saudi Arabia offers the best macro metrics and long-term value in the GCC. The Saudi government boasts US\$400 billion in accumulated foreign exchange reserves, even though the Kingdom has borne the brunt of the OPEC supply cuts and has lost market share to Russia, now the world's largest oil producer. While Saudi Arabia's dependence on oil exports and its status as the swing producer in

OPEC means that the Kingdom's GDP is hostage to the mood swings in black gold, I believe 2010 will offer a windfall macroeconomic prize to Riyadh as crude oil trades above US\$80.

The Saudi government also injected a fiscal stimulus as high as seven per cent of GDP, higher on a relative basis than both the American and German stimuli, to offset the Saudi private sector from the draconian falls in bank credit and frozen capital markets. The news that Saudi banks have restructured Saad/Al Gosaibi debt obligations may also lead to a pick-up in bank credit growth, particularly as oil prices rise and the Eurobond/sukuk market opens to new borrowers.



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In essence, the Tadawul index was the victim of the Saad Group debt shock in May 2009 and Saudi equities naturally lagged the rally in global emerging markets as Saudi bank shares tanked. Samba, for instance, lost one-third of its market value in June 2009, but the bellwether Saudi bank's share price soared by 30 per cent with the recent resolution of the Kingdom's most high profile corporate debt default since the 1970s. The relief rally in Saudi bank shares and US\$76 crude oil are unquestionably positive for the Tadawul. Yet, I am reluctant to invest new money at 6300 Tadawul in the Kingdom. It would make far more sense to wait for a correction and buy Saudi banks or consumer shares such as Almarai or Savola in a correction, preferably at 5800 Tadawul.

Saudi valuations are, however, not excessive. Despite its meteoric post-Saad surge, Samba still trades at a reasonable 12 times earnings. At SAR48, I consider Saudi Telecom to be one of the most

undervalued telecoms in the world, with a growth kicker due to its holdings in Turkey, Indonesia, Malaysia and India. Yet, Saudi Telecom trades at only seven times earnings, while its historic valuation multiples have been double its current metric. I believe Saudi Telecom is worth SAR65/75.


I am not bullish about Kuwaiti equities because the political gridlock between parliament and the government leads to populist policies that inhibit foreign direct investment and encourage capital flight. While Kuwait clearly benefited from the Iraqi reconstruction boom and the fall in systemic risk after the overthrow of the Saddam Hussein regime, the corporate governance crisis and debt default at Global Investment House, one of the largest, most swashbuckling independent investment banks in the GCC, has hit international and even Kuwaiti investor confidence in the Kuwait Stock Exchange (KSE), where several listed investment companies are de facto financial zombies, massacred by the crash in the regional property and stock market bubbles. Yet, it is ironic that while sentiment on the KSE remains skeptical, the Kuwaiti current account surplus could soar above 30 per cent of GDP if crude oil prices trade above US\$80 for a protracted period. The resolution of the convoluted merger bids for Kuwaiti telecom Zain by an Indian-Chinese consortium and systemic distress in several distressed investment companies makes me reluctant to cherry pick value on the KSE.

Time for discipline

It is an axiom of GCC investing that Oman is the ultimate petrocurrency market, with the MSM index highly correlated to oil prices. I believe Oman is a long-term macro turnaround story in the GCC, as decades of falling crude oil production and mediocre success in the LNG export plan is reversed by the Omani government's US\$10 billion investment plan to increase oil and gas recovery. In fact, oil production, declining since 2002, has actually risen in 2009 by a respectable seven per cent. Oman's gross external debt is US\$16 billion, or one-fifth of the GDP, but the Omani central bank

currency reserves are now an impressive US\$25 billion. Bank Muscat dominates Omani banking and is a pure play on the growth of retail banking, capital markets, project finance and home mortgages in the sultanate. Galfar is one of the GCC's largest contractors and engineering firms, with a multibillion-dollar pipeline of projects from the Omani government and the national oil company (PDO where Shell has a strategic stake).

The UAE stock market has soared, as have the credit default swaps of Dubai plummeted on optimism that Nakheel will refinance its sukuk in November 2009. However, with the DFM dominated almost completely by property and banking stocks, I am reluctant to aggressively buy shares at current levels, as I expect bank non-performing loan ratios to rise and property prices to fall in the next 12 months. It is a dangerous illusion to assume that the current market euphoria means that the macro-storm clouds are no longer an issue. It is therefore dangerous to buy shares off the DFM at 50 times current earnings or 48 times enterprise value/EBITDA, making it the most expensive listed stock exchange in the world. I prefer low-beta telecom Etisalat, albeit at lower levels.

I am also cautious on Qatar at current levels, although I am bullish in the long term. LNG exports will double in the next four years, making Qatar the richest, fastest-growing country in the Middle East. A clear proxy for Qatar's economic transformation is its largest commercial bank Qatar National Bank (QNB), which is a proxy on domestic consumer growth and whose government ownership, ample capital base and cheap funding costs make it the lowest-risk bank stock in Doha. QNB shares, though, are a buy only at QAR120 for a QAR170-180 target. The proxy for Qatar's LNG potential is clearly Nakilat (Qatar Gas Transport Co), the world's largest operator of an LNG tanker fleet. The easy money in the GCC rally has been made and now it is time for careful, disciplined stock picking. 

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