

**From:** "Ens, Amanda" <[REDACTED]>

**To:** "jeffrey E." <jeevacation@gmail.com>, Richard Kahn <[REDACTED]>

**Subject:** INTERNATIONAL TODAY: SAUDI TRANSFORMATION CONTINUES => BUY SABIC

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**BAML MENA team in the USA this week talking about the Saudi Trade:** Very topical, great timing, key themes:

- Fiscal Balance plan for 2020 as part of the longer term National Transformation Plan (2030)
- **Update on MSCI Timeline** (Best guess: **Watchlist** next week, **Announcement** June 2018, **Inclusion** May 2019)  
Expectation is 3.6% MSCI Weight with Aramco, 2.5% without Aramco (assuming \$263bn passive and \$1.4tn active AUMs tracking)
- Recent changes to simplify **QFI Process**, clients getting signed up to trade cash
- Settlement recently moved from T+0 to T+2
- **Shorting stocks** allowed, for the first time
- **ARAMCO IPO** - Saudi intends to IPO Aramco in 2018 in a bid to diversify away from oil and fund the Saudi Sovereign Wealth Fund (PIF) with ample ammunition for global purchasing spree. This will also increase transparency and help to attract foreign oil companies in to the country.
- **Saudi Peg**, No Change expected in the near future

**SABIC remains our top pick with 24% Total Return potential and a new PO of 118 SAR.**

Large & Liquid, Trades nearly \$100mn/day

Strong Cash generator with 30% Ebitda margin

Net Cash Balance Sheet & Strong FCF support the Dividend Yield of 4.5%, with scope to go higher.

Development of Ethylene Cracker (JV with Exxon) in USA provides Growth Opportunity

Valuation Supportive, Trading at 20% Discount to peers on 7x EV/Ebitda

**SABIC AB: Positioning for growth; government support to continue; "National Champion"**

**Saudi Arabia: Transformation starts now (102 page Report on Macro, Strategy, Top Picks by Hootan Yazhari, Jean-Michel Saliba & Team)**

- The launch of the Fiscal Balance 2020 Program in early 2H17, the MSCI EM watch list announcement in mid-June and possible Aramco IPO in 2018 are likely to mark the start of a fundamental transformation of the economy's structure and growth model. Still, risks remain.
- Domestic liquidity improvement has likely run its course. Still, absent geopolitics, Saibor-Libor and SAR-US swap spreads could narrow short-term as SAMA repo hikes lag Fed hikes. The USD peg holds but more risk premium should be priced in long-dated Fx forwards as Fx reserves fall and as fiscal consolidation success depends partly on oil prices. EXD is well priced, and sukuks have better risk/reward than conventionals.
- Be selective in equities. Given likely subdued medium-term growth and a rising burden on the private sector, Saudi corporates could face a difficult operating environment. Along with relatively rich valuations vs GEMs, we advise a highly selective approach to investing in the market, with a preference towards high quality large caps. We highlight those that could benefit from government support measures and the focus on developing "National Champions". **Top picks: SABIC, NCB**

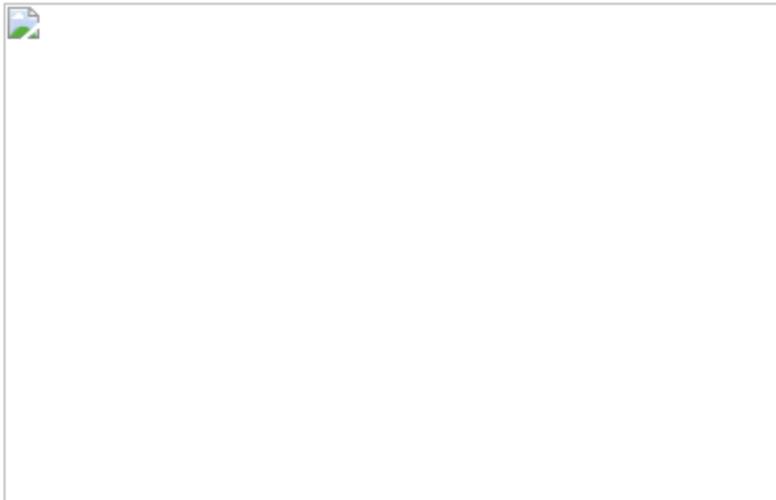
## **How to play Saudi: We are the number one international broker in Saudi**

**Single Stock:** Swap and Warrant access via Delta One desk

### **Get paid \$\$\$ to wait - Top 5 names on the index (50% weight combined):**

- **Sabic** (5% Yield): \$78bn market cap, \$150mn ADTV (Largest producer of chemicals globally, 7.5x EV/EBITDA)
- **RJHI** (3.5% Yield) : \$28bn market cap, \$35mn ADTV (Largest bank in MENA, 15% ROE, 1.9x P/B)
- **NCB** (4% Yield) : \$22bn market cap, \$9mn ADTV (Commercial bank, 15% ROE, 1.4x P/B)
- **STC** (6.2% Yield): \$35bn market cap, \$12mn ADTV (Largest telco in Saudi, 11% FCF yield, 6.5x EBITDA)
- **Samba** (4.4% Yield) :\$22bn market cap, \$5mn ADTV (Best play on US rate hikes, 10% ROE, 0.9x P/B)

**MSCI Saudi Provision Index (M1SAP)** on swap (3mL+80, std comms apply) or warrant (Lux-listed, std comms apply). A 32-name index that trades \$110m/ day that will rebalance into the full MSCI EM index upon inclusion.



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## GEMs Paper #28

### **Saudi Arabia: Transformation starts now**

12 June 2017

#### **Key takeaways**

- Reforms narrow fiscal deficit to mid-single digits by 2020. Corporates, expats are main losers. Oil policy stays the course.
- The USD peg holds but consolidation success depends partly on oil prices. EXD is well priced, favour Fx forward steepeners.
- Be selective in equities. MSCI EM inclusion, National Champions program favour high quality large caps. Top picks: SABIC, NCB

## Preparing to shift gears

The launch of the Fiscal Balance 2020 Program in early 2H17, the MSCI EM watch list announcement in mid-June and possible Aramco IPO in 2018 are likely to mark the start of a fundamental transformation of the economy's structure and growth model. Still, risks remain. We analyse the macro and asset price implications in this GEMs paper.

## Macro: fiscal consolidation narrows imbalances, at a cost

Fiscal targets are unlikely to be met but will help narrow fiscal imbalances to mid-single digits by 2020. Stabilizing Fx reserves will however require oil prices rebounding above US\$50/bbl and a moderation in capital outflows. Despite forthcoming support measures, fiscal austerity is likely to keep growth muted. Non-strategic corporates and expatriates are the main losers of reforms. Energy policy will aim to support oil prices but 2018 market dynamics are more challenging. Geopolitics may delay but not derail reforms.

## FI/Fx Strategy: MW EXD, favour Fx forward steepeners

Domestic liquidity improvement has likely run its course. Still, absent geopolitics, Saibor-Libor and SAR-US swap spreads could narrow short-term as SAMA repo hikes lag Fed hikes. The USD peg holds but more risk premium should be priced in long-dated Fx forwards as Fx reserves fall and as fiscal consolidation success depends partly on oil prices. EXD is well priced, and sukuks have better risk/reward than conventionals.

## Commodities: oil's new medium-term range, US\$50-70/bbl

Brent crude oil prices could average US\$50-70/bbl over the next five years. Below this price band, oil supply rationing and rapid EM demand growth push prices higher. Above, a surge in global oil supplies and EM demand destruction curb any additional price gains.

## Equity Strategy: focus on the National Champions

Given likely subdued medium-term growth and a rising burden on the private sector, Saudi corporates could face a difficult operating environment. Along with relatively rich valuations vs GEMs, we advise a highly selective approach to investing in the market, with a preference towards high quality large caps. We highlight those that could benefit from government support measures and the focus on developing "National Champions". In this regard, we highlight SABIC and NCB as our top picks on this theme.

## MSCI inclusion: driving rerating; favour large caps

We see support for the larger cap/higher quality names coming from Saudi Arabia's potential inclusion in the MSCI EM index, which we see happening in 2019 (with a watch list announcement on June 20 or off-cycle). Upon inclusion, Saudi could represent up to 4.4% of the EM index, making it the 7th largest constituent. Although highly reliant on assumptions, our calculations indicate the event could comfortably attract inflows above US\$30bn, with c.67% of that being allocated to the top ten Saudi MSCI constituents.

## Contents

[Macro: major adjustment underway](#)

[A comprehensive reform agenda](#)

[2017 budget calls for higher oil prices](#)

[Capital outflows overshadow fiscal reforms](#)

[Sustaining the shift in energy policy](#)

[Fiscal Balance program - counting costs, reaping benefits](#)

[Macro assumptions](#)

[Macro table](#)

[FI/Fx strategy: MW EXD, favor Fx forward steepeners](#)

[Commodities: oil new's range: \\$50-70/bbl](#)

[Crude reality](#)

[Equity strategy: selective focus on high quality, national champions](#)

[Changes abound in Saudi Arabia](#)

[Index inclusion: making Saudi Arabia more relevant](#)

[Banks: financing the transformation of the Kingdom](#)

[NTP looking to boost private sector growth; supportive of corporate focussed banks](#)

[Healthcare: reform plans on track](#)

[Three strategic objectives set out for healthcare](#)

[Telecom: full throttle on broadband](#)

[Spectrum for Saudi Arabia](#)

[STC: substantial fibre investments ahead](#)

[Tower sale: still on the cards?](#)

[Petrochemicals & refining: less subsidies, more support](#)

[Focus on ensuring downstream competitiveness](#)

[Consumer: a mixed bag](#)

[Cost perspective analysis](#)

[Real estate: a significant push to boost affordable housing and mortgage access](#)

[A big focus on addressing the affordable housing deficit...](#)

[Utilities: a bold agenda in a short timeline](#)

[8 strategic initiatives in the NTP incl. cutting subsidies](#)

[Defence: sustained government focus](#)

[Increasing scope of role supports budget growth](#)

[Disclosures](#)

[Research Analysts](#)

**Jean-Michel Saliba** [Se](#)  
MENA Economist/Strategist  
MLI (UK)  
+44 20 7995 8568

**Hootan Yazhari, CFA** [Se](#)  
Research Analyst  
Merrill Lynch (DIFC)  
+971 4 4258218

This report is intended for Hamdy Hamoudi



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Europe, Middle East, Africa: +44 20 7996 4444  
Japan: +81 3 6225-8900  
Publication: 1372287-11755048.pdf

Recipient: Hamdy Hamoudi  
[REDACTED]

**Cole Mackay, CFA, Director**  
**Emerging Europe, Middle East & Africa Equity Sales**  
Bank of America Merrill Lynch  
Office: +1 212 449 5271 | Cell: +1 917 678-9716  
[REDACTED]

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