Kuwait Financial Centre "Markaz"
RESEARCH

GCC markets break their losing streak

U.S. Markets buoyant on potential U.S.-China trade truce

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GCC markets broke their three-month losing streak, aided by gains in Saudi and Kuwait equities. Optimism surrounding Saudi Aramco IPO, Morgan Stanley's "overweight" recommendation on Kuwait equities and a potential trade truce between U.S. and China helped GCC equities to end the month of November on a positive note. Global markets remained largely positive, with announcements from U.S. and China that they are close to reaching agreement on the first phase of trade deal.

We see the following issues as key developments during the month of November:

1. **Kuwaiti Insurance Industry – Regulatory changes expected to breathe life into a dormant sector -** Cultural and religious reservations, lack of awareness and transient nature of expatriates have resulted in low levels of insurance penetration in Kuwait. However, recent regulatory changes such as mandatory health insurance, establishment of an independent regulator and the amendment of the insurance law bode well for the development of Kuwait's insurance industry moving forward.

2. **GCC companies with high cash holdings -** GCC's cash leaders study provide an insight on the companies in GCC with very high levels of cash. It identifies various sources/reasons that caused them to be the cash leaders and explores if there is a link between high cash holding and shareholder returns.

3. **Saudi Aramco IPO-A dressed-up Bond -** Saudi Aramco has set a price range for its massive listing that implies the oil giant is worth between USD 1.6 trillion and USD 1.7 trillion, below the USD 2 trillion envisioned earlier, underscoring plans to use the company as a tool for diversifying the kingdom's crude-reliant economy. The stock is a dressed-up bond where dividends will remain the primary form of return with lower expectations for price appreciation.

GCC Market Commentary

GCC Market Trends –November 2019

Index	M. Cap (USD Bn)	Last close	2018 %	Nov - 19	YTD %	S&P correlation**	ADVT* (USD mn)	P/E TTM	P/B TTM	Div. Yield
S&P GCC	405.1	110	8.4	1.3	2.3	0.123	N.A	14.8	2.0	3.4
Saudi Arabia	491.8	7,859	8.3	1.5	0.4	0.064	777.5	16.4	1.8	4.1
Qatar	141.9	10,148	20.8	-0.4	-1.5	0.096	70.7	14.1	1.4	4.2
Abu Dhabi	139.5	5,031	11.7	-1.5	2.4	0.092	43.7	12.8	1.4	5.0
Kuwait (All Share PR)	112.7	5,928	5.2	3.7	16.7	0.015	84.7	14.3	1.4	3.6
Dubai	76.5	2,679	-24.9	-2.5	5.9	0.122	57.4	6.6	0.9	4.4
Bahrain	25.1	1,527	0.4	0.2	14.2	0.046	2.1	10.4	0.9	4.6
Oman	13.2	4,064	-15.2	1.6	-6.0	-0.010	3.8	8.3	0.7	7.1

Source: Reuters, Zawya, Note: * Average Daily Value Traded ** - 3-year daily return correlation with S&P 500 index

S&P GCC composite index gained by 1.3% for the month with four of the seven markets posting gains. Kuwait was the best performer in November, gaining 3.7% followed by Oman and Saudi Arabia, whose indices increased by 1.6% and 1.5% respectively. Abu Dhabi, Dubai, Qatar ended November in negative territory, with their indices decreasing by 1.5%, 2.5%, 0.4% respectively.

Monthly returns heat-map of S&P GCC Composite index

S&P GCC	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
2014	3.4%	3.7%	2.7%	2.8%	3.2%	-7.4%	8.1%	6.4%	-1.4%	-6.8%	-10.9%	-4.4%	-2.6%
2015	2.8%	4.4%	-6.9%	10.1%	-2.3%	-3.5%	0.1%	-13.2%	-1.1%	-2.7%	-2.3%	-2.4%	-17.3%
2016	-10.7%	3.7%	1.9%	5.7%	-5.1%	1.1%	-0.1%	-1.2%	-3.9%	2.2%	7.9%	4.2%	4.3%
2017	1.6%	-0.8%	-1.5%	-0.4%	-1.4%	3.2%	-0.4%	0.9%	-0.6%	-2.7%	-1.5%	3.4%	-0.4%
2018	5.3%	-2.5%	3.4%	2.9%	-0.4%	1.1%	2.2%	-2.5%	0.2%	0.1%	-2.0%	0.7%	8.5%
2019	6.8%	-1.0%	2.8%	4.4%	-5.6%	2.5%	1.1%	-5.8%	-0.7%	-2.6%	1.3%		2.3%

Source: Reuters

The long awaited Saudi Aramco IPO picked up pace with Saudi Arabia announcing the start of IPO process and appointing banks for its book building process earlier in the month. Final price would be announced on 5th December 2019. Due to the sheer size of the listing and its importance in moving Saudi Arabia towards a non-oil economy, there has been a general optimism around Saudi markets. However, the gains in emerging GCC markets were truncated towards the close of the month due to MSCI's rebalancing of its EM indices. This led to passive funds outflow in turn causing a slide in GCC markets, particularly Saudi Arabia.

Kuwait All Share index extended its gains, posting an increase of 3.7% in November. Morgan Stanley's "overweight' recommendation on Kuwait equities ahead of its upgrade to emerging markets triggered a positive reaction from investors. Among Kuwait's Blue Chip companies, National Bank of Kuwait and Kuwait Finance House were the top gainers with monthly gains of 7.4% and 6.6% respectively. During the month, MSCI announced that it would increase the weight of National Bank of Kuwait in its indices. This helped NBK's shares register sizeable gains over the course of the month. Kuwait's banking sector was the best performer in November, with the Banking index rising by 5.1% while the Financial services sector was the top loser, falling by 0.7%.

GCC Blue Chip companies excluding Kuwait, National Commercial Bank was the top gainer for the month with its stock price rising by 5.7%. Mesaieed Petrochemical Holding Co ranked second among gainers posting a 4.0% increase.

Global Market Trends – November 2019

Equity	Last close	November change (%)	2019 change (%)
S&P GCC	110	1.3	2.3
MSCI World	2,292	2.6	21.7
S&P 500	3,141	3.4	25.3
MSCI EM	1,040	-0.2	7.7
MSCI FM	957	1.3	5.7
Commodities			
IPE Brent($)	62.4	3.6	16.0
Gold($)	1,466	-3.1	14.3

Source: Reuters

The performance of Global equity markets were largely positive with the MSCI World Index gaining 2.6% for the month. U.S. equities (S&P 500) extended its gains with a rise of 3.4% in November. Announcements from U.S. and China that they are close to reaching agreement on the first phase of trade deal and that expectations that it would remove threats of further trade war invoked positivity in equity markets. The UK market (FTSE 100 index) closed 1.4% higher during November, as investors expect the U.K. elections to provide a definitive resolution to Brexit. Emerging markets ended the month in negative, with the MSCI EM posting monthly loss of 0.2%.

Oil markets closed at USD 62.4 per barrel at the end of November, which is 3.6% higher than October. Signs of progress in U.S.-China trade deal and the expectation that the OPEC would continue to maintain production cuts contributed to the increase in oil price while limiting volatility. Oil's gain comes despite OPEC's projection of lower oil demand in 2020 and the observation that rivals were pumping more despite a smaller surplus of crude in the global market.

Kuwaiti Insurance Industry – Regulatory changes expected to breathe life into a dormant sector

Kuwait's insurance industry, much like in other GCC countries, is one that is grossly underdeveloped and also one that offers a lot of headroom for growth. Cultural and religious reservations, lack of awareness and transient nature of expatriates are a few prominent reasons as to why the penetration levels have remained low historically in the country. The average insurance penetration (Gross premium collected to GDP) in 2018 across the GCC region stood at 1.7%, which is lower than the emerging market average of 3.2% and the global average of 6.1%. Among GCC countries, Kuwait has had the lowest penetration level at 0.9%, mainly due to outdated regulations and the lack of government support. The UAE is the market leader in the GCC region in terms of number of operators, gross premium collected as well as penetration levels.

Insurance Landscape in the GCC

Country	Insurance Premium Written (USD Mn)*			Insurance Penetration	Regulatory stance		Total Number of Insurers	Insurers by Type		Insurers by Domicile	
	Life	Non-Life	Total		Health	Motor		Conventional	Islamic	Foreign	National
Saudi Arabia	283	9,434	9,717	1.2%	Mandatory for all	Mandatory for all	35	-	35	-	35
Kuwait	153	668	821	0.9%	Mandatory for Expats	Mandatory for all	39	26	13	11	28
UAE	3,133	10,388	13,521	2.9%	Mandatory for all	Mandatory for all	62	50	12	27	35
Bahrain	139	623	762	1.9%	Not Mandatory	Mandatory for all	36	30	6	12	24
Oman	161	1,053	1,214	1.4%	Not Mandatory	Mandatory for all	20	18	2	10	10
Qatar	-	2,941	-	1.6%	Mandatory for Expats	Mandatory for all	12	8	4	8	4

Source: Regulatory Authorities, Insurance Information Institute, Swiss Re; Note: * - as of 2017, Insurance Penetration – Gross written premium/GDP

The total premiums collected in Kuwait declined during 2015 and 2016 due to the fall in oil prices. However, the improvement in broader economic conditions and the decision of Ministry of Health to increase the fees for healthcare services helped in the recovery of premiums collected in 2017. Across the GCC, premiums collected in the non-life segment has been much higher than life insurance segment. The case is similar for Kuwait, which ranks the second lowest in the GCC by gross premiums collected. Steps have been taken by Kuwait in recent times to improve its insurance market and provide a push from the regulatory side.

Despite Kuwait being the first country in the GCC to regulate the insurance sector by issuing a legislation in 1981, there haven't been much regulatory developments since. In 2019, Kuwait's national assembly approved a new insurance law, which is the first amendment to the law that was published more than two decades ago. The government earlier suggested that the insurance sector would be regulated by the Capital Market Authority. However, in January 2019, it was announced that an independent authority would be established to oversee insurance operations in the country. Kuwait's new regulator would operate under the supervision of the Minister of Commerce and Industry. GCC countries differ in their approach towards regulating the insurance industry. For instance, in the case of Bahrain, Qatar and Saudi Arabia, their Central Banks are the governing authority in terms of regulations. In Oman, insurance regulations come under the purview of the Capital Market Authority.

In terms of Capital requirements for insurance companies, the minimum capital required for life and non-life insurance companies is KD 5 million (USD 16 million), which is lower than all GCC countries barring Bahrain. In March 2019, the government made health insurance mandatory for expatriates to reduce the pressure on its public healthcare expenditure. This development is also expected to be another positive for insurance players in the country.

In Kuwait, there are seven domestic insurance companies that are listed in Kuwait's stock exchange. The sectoral representation of the Insurance sector in Kuwait's stock exchange is low, accounting for only 0.96% of Kuwait's market by market capitalization. Gulf Insurance Group is the largest listed insurance company in Kuwait, with a market cap. of KD 120 million. The gross written premium of Gulf Insurance group stood at KD 364.6 million in 2018, which was a 12.4% uptick compared to the previous year. Earnings of insurance companies have bounced back after a subdued performance in 2016 due to low oil prices. On a broader level, as insurance premiums are largely renewed on an annual basis, revenues of Insurance companies have remained cyclical. The first quarter usually tends to see a spike in revenue while the other quarters remain subdued in comparison. Kuwaiti insurance companies posted their best quarter in three years during Q1 2019, with aggregate earnings of KD 15.1 million.

Key Insurance companies in Kuwait

Company	Company Market Cap (KD Mn.)	2019 YTD Share Price Returns	Gross Premiums Collected* in 2018 (KD Mn.)
Gulf Insurance Group	115.0	-5.4%	364.6
Al Ahleia Insurance	86.2	0.9%	84.0
Kuwait Insurance Company	63.1	-7.1%	36.4
Kuwait Reinsurance Company	29.8	-15.4%	44.1
Warba Insurance Company	10.5	-18.7%	28.5
First Takaful Insurance	4.4	-5.3%	5.2
Wethaq Takaful Insurance	3.1	0.4%	5.0

Source: Reuters, Company Annual Reports 2018; Note: * - Includes premiums collected outside Kuwait as well

Low availability of insurance products, poor distribution network and the prohibition of bancassurance are some of the key challenges that need to be addressed to improve the growth of Kuwait's insurance sector. The establishment of an independent regulatory body is a step in the right direction for Kuwait as it will improve supervision, initiate necessary reforms, enhance stakeholder participation and establish better control mechanisms. This would also increase the confidence of foreign companies to establish their presence in Kuwait. Initiation of new infrastructure projects as part of the measures to diversify the local economy is expected to be a growth driver for the insurance industry in the future as it would potentially increase the size of insurable assets. In addition, supportive government measures similar to the introduction of mandatory health insurance are also positive signs for the industry moving forward.

GCC companies with high cash holdings

Investors look at various parameters to understand and evaluate a company's attractiveness. One such item in the balance sheet is the level of cash that a company holds. If the cash balance has been consistently growing it is generally considered to be a good indicator that the company is performing well and is therefore able to accumulate cash reserves on its balance sheet. However, it is essential to determine the cause behind growth in cash flow and reason for holding high cash balance before concluding whether it is good or bad for the company and its shareholders.

In our report GCC Listed Companies with high cash holding – what can one learn we evaluated GCC's cash leaders i.e., companies in GCC with very high levels of cash. We identified various sources/reasons that caused them to be the cash leaders and explored if there is a link between high cash holding and shareholder returns.

In the coveted list, capital expenditure was the primary source of cash outflows. In addition, consistent dividend payment by majority of the companies was also one of the key source of cash outflows. In contrast, growth in profitability, debt issuance, sale of assets and maturity of investments were the leading sources of cash inflows.

For instance, Qatar Fuel Company, which has the highest cash balance in proportion to its total assets, has spent cash on investment activities over the last five years. Etisalat, the largest telecom player in UAE and second largest in GCC by market cap, had the highest cash to assets ratio among GCC telecom players on average. Its high cash balance particularly in 2018 was due to lower cash outflow as a result of lower term deposits (with maturity of over 3 months) as compared to previous year and proceeds from sale of subsidiary and associates. Slowdown in real estate sector in Dubai in past couple of years affected the cash balance of real estate companies. Both Emaar and Aldar properties have registered a decline in cash balance of 63% and 44% respectively as of Jun-2019 compared to 2017 levels. Aldar properties in particular saw a decline in their profitability during this period. However, they still make it to the top 10 in our analysis.

GCC companies with high cash holdings as % of assets

Rank	Country	Company	Sector	M. Cap (USD Mn)	Avg. cash holding	Avg. cash to assets
1	Qatar	Qatar Fuel Company (QFC)	Energy	6,416	**1,047**	**32%**
2	Qatar	Qatar Insurance Company (QIC)	Insurance	3,193	**1,682**	**20%**
3	UAE	ETISALAT	Telecom	39,733	**6,587**	**19%**
4	Qatar	Ooredoo	Telecom	6,509	**4,553**	**18%**
5	Qatar	Qatar Electricity and Water Company	Utilities	4,773	**794**	**18%**
6	Bahrain	Bahrain Telecom Company	Telecom	1,703	**421**	**17%**
7	Kuwait	Kuwait Projects Company Holding (KIPCO)	Others	1,450	**5,419**	**16%**
8	UAE	Emaar Properties	Real Estate	9,455	**4,067**	**16%**
9	UAE	Aldar Properties	Real Estate	4,667	**1,514**	**15%**
10	UAE	Air Arabia	Industrials	1,550	**481**	**15%**
11	Saudi Arabia	SABIC	Basic Materials	73,428	**11,320**	**13%**
12	Saudi Arabia	Saudi Industrial Investment Group (SIIG)	Basic Materials	2,680	**842**	**13%**
13	UAE	Dana Gas	Energy	1,804	**389**	**11%**
14	Saudi Arabia	National Petrochemical Company (NPC)	Basic Materials	2,944	**617**	**11%**

Source: Reuters, Marmore research, as of 23, Sep 2019 | Cash holdings and cash to asset are for period 2014-H1 2019

All the companies in our coveted list have a much higher cash holdings as compared to their respective sectoral average. Majority of the companies have yielded either negative or low positive returns to the shareholders (for more details refer our report). Few exceptions were Etisalat and Dana gas that have yielded high returns to the shareholders. One of the reason behind the surge in the stock price of Etisalat was due to synergies from the acquisition of 53% stake in Maroc Telecom (~USD 5.7bn) in cash in 2014, which was one of the largest cross border deals in the region. Further, during the year 2015, Etisalat was one of the constituents that was included in the MSCI index upon UAE's EM upgradation. The share price of Etisalat surged by 61.7% in 2015 alone.

In the aftermath of financial crisis followed by recent oil price crisis, the importance of holding liquid assets have been growing across globe and even more so in GCC region which has significant exposure to oil prices. However as holding cash has opportunity cost associated, in case of dearth of attractive investment opportunities companies have other alternatives to utilize their cash balance. Investors generally look for stocks that pay dividends and companies that share excess cash with shareholders in the form of dividends are likely to experience better share prices as compared to non-dividend paying stocks. Holding cash over and above the desired levels may ultimately be perceived as inefficient utilization of resources and therefore companies with high level of cash holdings for long periods may underperform compared to their potential intrinsic value when cash is well utilized.

Saudi Aramco IPO-A dressed-up Bond

Saudi Aramco has set a price range for its massive listing that implies the oil giant is worth between USD 1.6 trillion and USD 1.7 trillion, below the USD 2 trillion envisioned earlier, underscoring plans to use the company as a tool for diversifying the kingdom's crude-reliant economy. It comes amid concerns from overseas investors about the security of energy assets after September's devastating aerial assault on Saudi oil installations, as well as corporate governance questions given the creeping state control over company strategy.

Following the announcement by Saudi Aramco on 3 November 2019 of its intention to list its shares on the Tadawul Stock Exchange, and the publication of a red herring prospectus on 9 November 2019, Aramco announced the following offer details on 17 November:

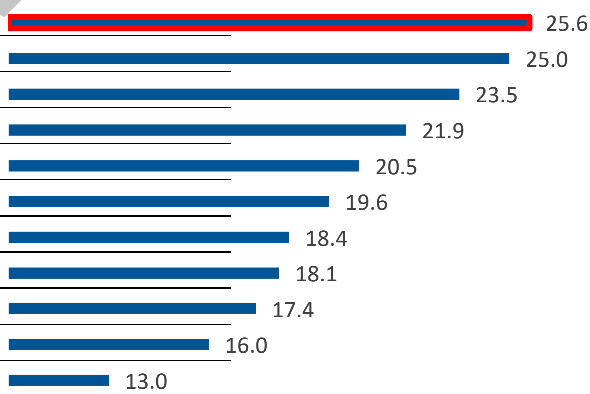
- The Offer Price Range for the Offering has been set at SAR 30 to SAR 32 per Share, which is roughly USD 8 – USD 8.50 per share. Final Offer Price will be determined at the end of the book-building period starting from 17 Nov 2019 until 4 Dec 2019. Individual Investors will subscribe based on a price of SAR 32, which is the top end of the price range.

- The base offer size will be 1.5% of the Company's outstanding shares, or about 3 billion shares, and therefore valuing the IPO at as much as USD 25.6 billion. Saudi Arabia intends to sell 0.5% of the company to local retail shareholders. The remaining 1% of the company is expected to be taken largely by Saudi institutions and funds in the region.

- If the Final Offer Price is below SAR 32, Individual Investors can, in respect of the difference between the highest price of the Offer Price Range and the Final Offer Price, elect to have the surplus subscription amount refunded in cash by crediting the account of Individual Investors, or be considered for an allotment of additional Offer Shares.

Largest International IPOs:

Company	Year	Deal Size (USD Bn.)
Saudi Aramco*	**2019**	**25.6**
Alibaba	2014	25.0
SoftBank	2018	23.5
ICBC H	2006	21.9
AIA Group	2010	20.5
Visa	2008	19.6
NTT DOCOMO	1998	18.4
General Motors	2010	18.1
Enel Group	1999	17.4
Facebook	2012	16.0
Deutsche Telekom	1996	13.0



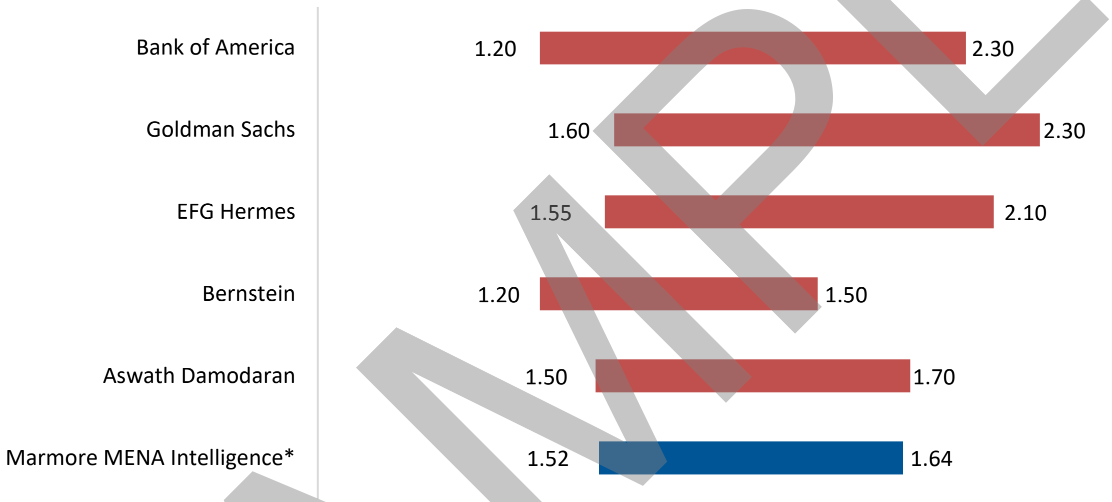
Source: Gulfnews.com / *Estimated IPO price based on offer price of SAR 32 for 1.5% of total shares

The latest issue to arise with the much-hyped listing process involves Saudi Arabia abandoning plans to formally market Aramco shares outside the kingdom and its Gulf neighbours. The Saudi kingdom believes it can achieve a USD 1.7 trillion valuation by banking heavily on demand from retail investors domestically as well as Saudi and other state funds. Saudi bankers report abundant domestic demand for the issuance, with pressure on large families and institutions to apply for allocations of shares at the higher end of the valuation. Saudi officials have also visited China and Russia in recent weeks in a bid to strengthen demand for the IPO from these countries that have been keen to deepen ties with the oil-rich kingdom.

NYU Stern professor Aswath Damodaran said in his latest blog post that Aramco is more or less valued their IPO correctly, but that he still wouldn't invest because of the inherent limited upside as well as the political risk that surrounds the company. Damodran wrote in his blog post that the stock is a dressed-up bond where dividends will remain the primary form of return and there will be little price appreciation. Valuing the company from three different perspectives (dividends, potential dividends, and free cash flow to firm), Damodaran initially came up with valuations of USD 1.63 trillion, USD 1.65 trillion and USD 1.67 trillion respectively, all of which are within a close proximity of Aramco's own valuation. He then pointed out that the government has absolute control of the company and a regime change could cause upheaval. He further noted that even if the price of oil went up, the upside will be limited for Aramco investors since the company's royalty structure states that royalties will rise as the price of oil rises. After factoring in these risks components, he came up with a final valuation, which was close to USD 1.5 trillion for Aramco.

Banks and other financial institutions have issued research with a wide range of about USD 1.1 trillion to USD 2.5 trillion, underlining the difficulties of coming up with a valuation that would appease investors and Saudi authorities

Saudi Aramco Valuation range estimates (USD Trillion)



Source: Economictimes.indiatimes.com, Aswathdamodaran.blogspot.com

A wave of retail investment is expected for the 0.5% of shares earmarked for Saudis retail shareholders. Aramco has announced a massive USD 75 billion-a-year minimum dividend prioritizing non-government shareholders. Additionally, each eligible retail investor who continuously and uninterruptedly holds offer shares for 180 days from and including the debut date on Tadawul will be entitled to receive one bonus share for every ten allocated offer shares, up to a maximum of 100 bonus shares. The Saudi government has also instructed banks to lend for the IPO adding to the list of measures taken to make the company look more attractive to domestic investors.

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