



Dividends – “Fruits of investment”

Dividends are the fruits of investment in equities. Paying generous dividends is a mark of a company’s commitment towards its investors. And paying out a larger dividend cheque in a year when the equity market initially expected the worst is the biggest testimony to a company’s financial and operational health. At a time when earnings growth is difficult to come by, thanks to the economic slowdown and rising input costs, it’s interesting to see how the companies in Saudi Arabia are trying their best to keep their investors happy. We analyzed all the companies listed in Tadawul, to come up with a list of 15 companies which have high dividend pay out, and 15 companies which distributed the lowest or no dividends, for last 3 financial years and the 9 months ended for 2009. High dividend payout normally implies high yield, although this depends on how the stock market has valued a stock. This report asks : **Should an investor bet on high payout to enhance overall portfolio return?**

Our research showed some interesting results: Regarding the portfolio of stocks with a high dividend payout:

- The weighted average payout over the past three years and nine months has been 55.8%, and the dividend yield currently stands at 5.4%.
- Sales growth, though below that for the low payout stocks, seems to be quite healthy at 16.4% for the last three financial years.
- The PE for these stocks is 17.8 compared to 23.7 for the low payout stocks which makes them relatively attractive.
- Returns (ROE & Net Margin) are impressive at 28.9% and 43.4%, much higher than for the low pay out stocks.

*The low payout stocks have performed better on a relative basis so far in 2009. However, both groups have outperformed the Tadawul Index, and we believe the high payout stocks will not be ignored by investors with low risk appetite seeking regular income. Moreover these stocks are mature companies with stable cash flows and are cheap on relative valuation vis-à-vis the low payout stocks which have rallied and are, we feel, close to a peak. **We think it makes sense to hold the portfolio of high payout stocks on a 9 to 12 month horizon.***

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To analyze the difference in performance between the two set of stock portfolios, we used a few parameters:

- **Liquidity** – We have calculated the average 6 monthly volume for the stocks, both for low dividend pay out as well as the stocks which have provided high dividends, to understand which of the group commands high liquidity in the market
- **Valuation** – We computed the relative valuation of the stocks, i.e., the PE as well as the PB ratio, to check which group commands the highest valuation in the market
- **Stock performance historically** – We have analyzed the last 1 yr daily stock performance on individual stocks, and calculated the average stock yield of companies
- **Revenue growth avg. (3 years)** – We calculated the last 3 years avg. for the revenues of the respective companies
- **Profitability** – We determined the margins and ROE of individual stocks to analyze whether the growth in revenue is translated into increase in margins.
- **Market Capitalization** – One the important parameters, is the market capitalization of the individual companies, , both the high payout and the low payout companies.

Our research shows that companies that distributed higher dividends are big sized mature companies, that offer a high dividend yield but suffered from low liquidity. On the contrary, companies that had a low dividend pay out provided higher total return due to capital appreciation.

Table (1)

Parameters	High Dividend Paying	Low Dividend Paying
1. Companies Analyzed	15	15
2. Liquidity		
- Avg. Turnover Ratio	0.1	0.3
- Avg. Value Traded (SAR' millions)	26,544	53,757
3. Average Market Cap. (SAR' millions)	22,319	6,188
4. Valuation		
- Avg. PE	17.8	23.7
- Avg. PB	3.1	2.8
5. Profitability		
- Avg. ROE	28.9%	17.6%
- Avg. Net Income Margin	43.4%	11.5%
6. Average Sales Growth	16.4%	49.7%
7. Avg. Dividend Pay out Ratio*	55.8%	15.4%
8. Total 1 year Return (Inc. Div. Yield)	0.0%	7.4%

Source: Bloomberg, Al Rajhi Capital

* Average of weighted average payout for the stocks in this grouping over the past three years.

** Avg. Turnover Ratio = Avg. 6 monthly daily volume/Free floated shares outstanding.



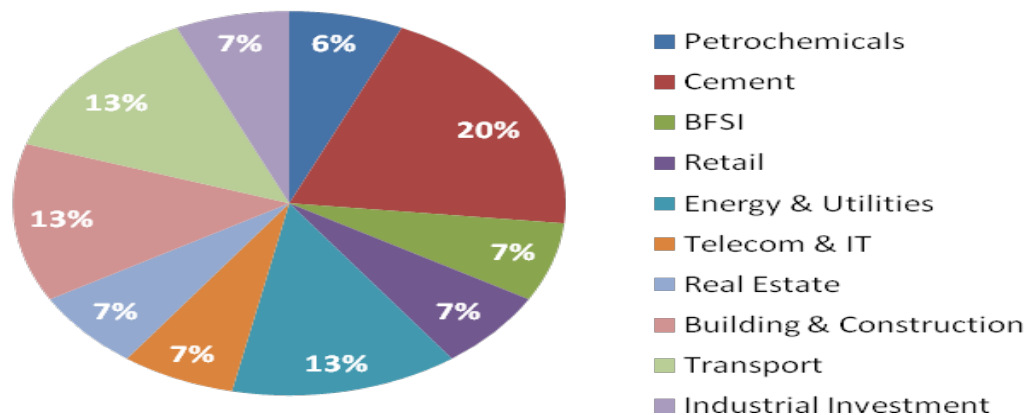
High Dividend Paying - We have selected the 15 companies traded in Tadawul, which have paid consistent dividends for last 3 years. Though, these companies have low liquidity (as implied by their low turnover ratio), the companies are mature and big in size (high average market cap.), have lower valuation (both PE and PB). The profitability of the companies is quite impressive, with an average ROE of 28.9% and Net Income Margin (NIM) of 43.4%, the NIM being higher than the low payout stocks. The average pay out ratio is at a robust 55.8% average for last 3 yrs and 9 months, which implies in a higher dividend yield for these companies.

Low Dividend Paying – These are small in market cap., high valuation stocks than the high pay outs. These companies have a robust sales growth (average 49.7%), however strangely, in terms of profitability (ROE/NIM), they have not matched the high dividend stocks though they are not bad by absolute standards.

High Dividend Paying – As mentioned earlier, these comprise companies that have consistently paid dividends for last 3 financial years and last 9 months. The companies included in this group are large cap. and mature companies, with stable profitability and growth.

In terms of sector break, 20% of the group operate in cement sector. The other noted industries under the group are the Financial Sector, Building & Construction and Transport. Companies, such as Qassim cement and Jarir Marketing company have a dividend yield of 12.3% and 9.8% respectively for trailing twelve months ending September 2009.

Chart (1) High Dividend Stocks "Sector break down"

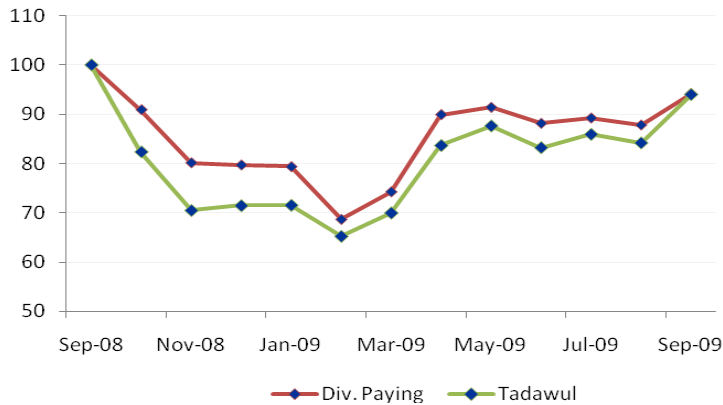


Source: Al Rajhi Capital



Portfolio Analytics – We constructed a portfolio comprising the 15 stocks, assigning them weights on the basis of their market capitalization, to evaluate their performance vis-à-vis the TASI Index, for a 1 year horizon (Sept '08-Sept' 09). The average dividend yield for the portfolio for a 1 year holding period is 5.8%. The dividend compensated for the loss of capital due to stock market fluctuations.

Chart (2) Dividend Paying Portfolio vs Tadawul



Source: Al Rajhi Capital Research

Table(2) Portfolio Performance

Period	Portfolio	Market
Q3 FY08	(20.3%)	(29.6%)
Q1 FY09	(6.9%)	(2.1%)
Q2 FY09	18.7%	19.0%
Q3 FY09	6.9%	13.0%
1 Year	(5.8%)	(6.0%)

Source: Al Rajhi Capital Research

Table (3) Top Picks - High Dividend Paying Stocks

	PE	PB	Avg. ROE	Avg. Rev. growth	Avg. NIM	Avg. Div. Pay out	Div. Yield TTM*
SAFCO	15.0	4.4	42%	47%	69%	87%	6%
Jarir Marketing Co	15.5	7.9	46%	28%	15%	71%	10%
Yanbu Cement	10.1	2.3	26%	13%	56%	75%	6%
Saudi Telecom Co	10.8	2.4	34%	26%	32%	47%	5%
Qassim Cement	12.4	3.9	32%	26%	62%	82%	12%

Source: Al Rajhi Capital Research

*TTM – Trailing twelve months

** The averages are for the period of last 3 financial years

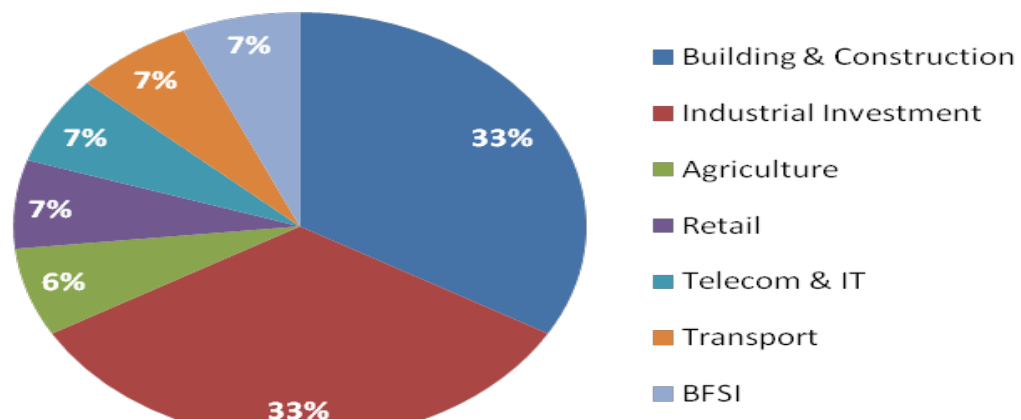
We have identified the above 5 stocks from the dividend paying portfolio because we believe the fundamentals of these companies are quite strong, and they have been paying dividends consistently and offer both low downside risk and the potential to generate decent returns. These are established companies and have a proven track record. These stocks are usually preferred by passive, conservative long-term investors who wish to enjoy good capital appreciation with little chance of losing money.



Low Dividend Paying - Our portfolio consists of companies with a low pay out ratio for the last 3 years. The weighted average dividend payout for the group on a trailing twelve months basis is 19.6%. These are generally small and mid cap. companies, concentrated in sectors which require high investment and capacity expansion. This could be a reason for these companies to retain their profits to invest back into the business. The turnover ratio is higher than the high dividend paying stocks, the average turnover ratio being 0.31, due to the presence of heavily traded stocks like Al Khaleej Training and Basic Chemical Industries. These stocks enjoy high valuations with good sales growth and profitability.

In terms of sectoral representation, 5 each of the 15 stocks in this group operate in Building & construction and Industrial investment. The Agriculture, Retail, Telecom, Transport and Financial Services share 1 place each. Etihad Etisalat (Mobily), with a market capitalization of SAR 31,920 mn, is the largest company, with Alinma Bank in the second place with a market cap of SAR 21,000 mn.

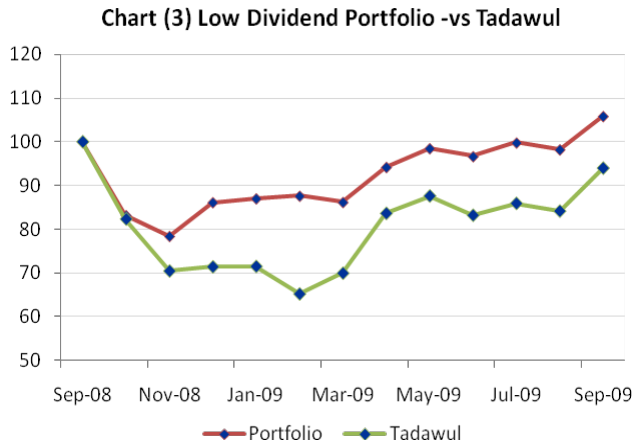
Low Dividend Stocks Sector break down



Source: Al Rajhi Capital Research



Portfolio Analytics – A 15 stock portfolio with low dividend paying stocks, provided a one year return of 5.9% as against the negative return of 6.0% by Tadawul (Sept '08 – Sept '09). The total return after including the average dividend yield would be 7.4%.



Source: Al Rajhi Capital Research

Table (4) Quarterly Performance

Period	Portfolio	Market
Q3 FY08	(13.9%)	(28.6%)
Q1 FY09	0.0%	(2.1%)
Q2 FY09	12.2%	19.0%
Q3 FY09	9.5%	13.0%
1 Year	5.9%	(6.0%)

Source: Al Rajhi Capital Research

Table (5) Top Picks - Low Dividend Paying Stocks

	PE	PB	Avg. ROE	Avg. Rev. growth	Avg. NIM	Avg. Div. Pay out	Div. Yield TTM
Etihad Etisalat Co	10.6	2.9	23%	112%	16%	12%	2%
Almarai Co Ltd	17.5	4.5	27%	33%	18%	40%	2%
Zamil Industrial Investment Co	14.5	2.4	26%	24%	6%	33%	2%
Saudi Chemical Co	8.4	1.9	17%	18%	11%	25%	0%
Al Babbtain Power & Telecom Co	11.6	3.1	25%	23%	12%	36%	2%

Source: Al Rajhi Capital Research

Under low dividend paying stocks, we like Etihad Etisalat, Almarai Co, Zamil Industrial Investment, Saudi Chemical Co., Albabbtain Power. The main driver would be the industries which they operate in. We believe the telecom, retail and construction sectors are the important sectors to look at after Petrochemicals and Banking. These companies are growing rapidly, well supported by an impressive ROE, which we feel will translate to addition of shareholders' wealth in a year horizon.



Table (6) High Dividend Payout

Name	Industry	Turnover Ratio	Value Traded	Market Cap.	P/E	P/B	SD	ROE		
								2006	2007	2008
SAFCO	Petrochemicals	0.03	42,134	29,375	15.0	4.4	15.7%	24.5%	41.6%	60.9%
Qassim Cement	Cement	0.05	15,888	6,435	12.4	3.9	12.0%	25.4%	38.4%	31.8%
Southern Province Cement Co	Cement	0.01	3,313	9,275	12.7	4.1	7.8%	29.9%	31.0%	33.6%
Al Rajhi Bank	BFSI	0.03	140,109	115,875	17.2	4.2	14.0%	43.4%	29.5%	25.8%
Yanbu Cement	Cement	0.01	3,741	5,276	10.1	2.3	11.6%	25.4%	30.0%	23.9%
Jarir Marketing Co	Retail	0.03	9,053	5,430	15.5	7.9	6.8%	42.6%	44.5%	51.4%
National Gas & Industrialization	Energy & Utilities	0.05	6,593	1,808	17.6	1.9	12.7%	10.5%	13.6%	14.6%
Saudi Telecom Co	Telecom & IT	0.02	38,936	97,600	10.8	2.4	13.0%	38.2%	34.3%	30.0%
National Gypsum	Build & Construction	0.07	5,973	1,400	14.2	2.6	12.3%	33.0%	22.0%	24.8%
Saudi Public Transport Co	Transport	0.30	27,388	1,119	22.4	0.8	7.7%	25.5%	7.1%	2.1%
Taiba Holding Co	Real Estate	0.07	13,480	2,535	31.3	0.9	11.3%	5.1%	13.5%	5.5%
National Shipping Co	Transport	0.12	47,158	5,686	13.8	1.2	5.7%	15.8%	11.0%	15.4%
Saudi Pharmaceutical	Industrial Investment	0.05	7,428	2,286	17.1	1.1	31.9%	5.2%	5.0%	6.0%
Saudi Ceramics	Build. & Construction	0.06	10,494	2,975	16.2	3.7	15.3%	17.8%	22.0%	26.6%
Saudi Electricity Co*	Energy & Utilities	0.01	26,473	47,708	37.6	1.0	3.7%	3.0%	3.3%	2.3%
Weighted Average		0.06	26,544	22,319	17.8	3.1	12.1%	31.9%	27.8%	26.9%

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Name	SALES GROWTH			Net Income Margin			Dividend Pay Out			Div. Yield	
	2006	2007	2008	2006	2007	2008	2006	2007	2008		TTM
SAFCO	0.4%	92.0%	48.9%	62.9%	62.8%	81.7%	76.4%	45.3%	75.9%	149.6%	6.2%
Qassim Cement	10.0%	56.0%	-3.2%	58.1%	63.8%	63.0%	65.6%	52.4%	69.7%	95.1%	12.3%
Southern Province Cement Co	0.2%	12.5%	12.4%	60.8%	60.9%	60.9%	89.7%	89.5%	35.4%	86.4%	6.8%
Al Rajhi Bank	32.2%	-6.7%	13.0%	66.9%	63.3%	56.7%	9.2%	41.9%	69.0%	66.9%	3.8%
Yanbu Cement	8.3%	38.8%	-6.6%	60.7%	56.5%	51.2%	93.8%	79.4%	75.0%	80.7%	6.5%
Jarir Marketing Co	24.4%	15.7%	44.7%	16.2%	15.9%	13.2%	74.0%	86.9%	81.1%	103.8%	9.8%
National Gas & Industrialization Co	4.6%	3.9%	5.7%	8.3%	10.0%	10.1%	67.3%	53.8%	60.4%	109.8%	6.8%
Saudi Telecom Co	3.8%	2.0%	37.8%	37.9%	34.9%	23.3%	NA	83.2%	67.9%	71.9%	5.1%
National Gypsum	-4.3%	-13.1%	16.4%	49.9%	42.5%	43.2%	NA	83.5%	70.5%	80.3%	5.2%
Saudi Public Transport Co	8.9%	5.7%	4.7%	45.5%	13.8%	3.9%	22.2%	62.0%	207.7%	125.3%	5.1%
Taiba Holding Co	13.7%	191.3%	-35.9%	61.0%	77.6%	49.3%	81.2%	11.5%	140.5%	208.7%	5.6%
National Shipping	3.1%	3.1%	52.3%	26.7%	24.8%	28.9%	51.0%	74.5%	63.0%	113.4%	6.9%
Saudi Pharmaceutical	12.2%	9.6%	9.3%	14.4%	15.3%	14.7%	NA	73.9%	0.0%	67.3%	4.0%
Saudi Ceramics	17.6%	22.9%	39.4%	18.6%	20.7%	20.8%	67.0%	49.0%	35.1%	34.0%	2.1%
Saudi Electricity Co	13.1%	6.5%	6.2%	7.2%	7.4%	5.0%	38.2%	37.5%	46.6%	42.7%	1.2%
Weighted Average	15.3%	11.3%	22.7%	46.3%	44.3%	39.6%	24.3%	57.3%	65.6%	76.1%	5.8%

* Saudi Electric pays out over 200% of EPS to the approx. 24% of its shareholders other than the Saudi government, which has waived its dividend rights for ten years.

Source: Bloomberg, Al Rajhi Capital Research



Table (7) Low Dividend Payout Stocks

Name	Industry	Turnover Ratio	Value Traded	Market Cap.	P/E	P/B	SD	ROE		
								2006	2007	2008
Arabian Pipes Co	Building & Construction	0.29	25,701	1,005	29.3	1.4	15.9%	16.2%	21.6%	17.3%
Al Abdullatif Ind. Investment Co	Industrial Investment	0.26	30,218	3,583	22.8	2.7	9.9%	23.5%	19.8%	17.3%
Filing & Packing Materials Man.	Industrial Investment	0.44	18,022	476	27.2	3.9	23.6%	15.2%	17.1%	18.8%
Al Khaleej Training and Edu. Co	Retail	1.01	25,417	680	18.4	3.4	13.0%	NA	NA	23.7%
Almarai Co Ltd	Agriculture	0.03	20,485	18,666	17.5	4.5	5.2%	28.0%	27.0%	27.3%
EtiHAD Etisalat Co	Telecom & IT	0.04	41,916	31,920	10.6	2.9	12.3%	16.7%	26.4%	26.7%
Saudi Chemical Co	Industrial Investment	0.29	53,834	2,479	8.4	1.9	21.3%	19.1%	12.8%	20.1%
Saudi Paper Manufacturing Co	Industrial Investment	0.23	16,592	1,688	19.1	3.5	14.3%	25.0%	23.9%	20.4%
Al Babbain Power & Telecom Co	Building & Construction	0.20	34,336	1,523	11.6	3.1	11.0%	22.5%	24.6%	28.4%
Saudi Arabian Amiantit Co	Building & Construction	0.10	24,062	2,691	14.8	1.7	17.5%	1.8%	5.1%	16.8%
Saudi Cable Co	Building & Construction	0.26	46,971	2,265	36.3	1.8	18.5%	15.9%	33.5%	21.0%
Basic Chemical Industries Ltd	Industrial Investment	0.77	29,346	869	21.9	2.9	16.9%	NA	NA	13.4%
Zamil Industrial Investment Co	Building & Construction	0.05	10,537	2,700	14.5	2.4	14.7%	28.8%	25.3%	23.4%
United International Transport Co	Transport	0.43	17,825	1,276	15.2	3.6	18.2%	NA	NA	25.5%
Alinma Bank	BFSI	0.29	411,086	21,000	53.8	1.3	8.8%	NA	NA	NA
Weighted Average		0.31	53,757	6,188	23.7	2.8	8.9%	15.1%	18.3%	19.3%

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Name	SALES GROWTH			Net Income Margin			Dividend Pay Out			Dividend Yield	
	2006	2007	2008	2006	2007	2008	2006	2007	2008		TTM
Arabian Pipes Co	23.5%	8.8%	27.7%	13.2%	19.6%	14.4%	NA	37.6%	0.0%	0.0%	0.0%
Al Abdullatif Industrial Investment Co	15.2%	23.9%	6.8%	22.3%	18.8%	17.7%	NA	NA	0.0%	0.0%	0.0%
Filing & Packing Materials Manufacturing	6.6%	9.6%	22.6%	9.3%	10.0%	9.9%	NA	23.7%	0.0%	0.0%	0.0%
Al Khaleej Training and Education Co	NA	NA	14.9%	NA	12.4%	11.9%	NA	0.0%	12.1%	30.4%	2.1%
Almarai Co Ltd	28.5%	36.7%	33.4%	16.9%	17.7%	18.1%	43.0%	40.8%	41.9%	35.8%	2.3%
EtiHAD Etisalat Co	272.1%	36.5%	27.9%	11.3%	16.3%	19.4%	NA	18.1%	0.0%	17.5%	2.1%
Saudi Chemical Co	6.3%	21.3%	25.0%	14.6%	9.1%	13.0%	42.7%	56.6%	0.0%	0.0%	0.0%
Saudi Paper Manufacturing Co	10.6%	21.3%	14.0%	18.8%	18.6%	16.7%	17.5%	21.8%	35.5%	34.0%	1.5%
Al Babbain Power & Telecommunication Co	23.7%	24.3%	21.2%	11.2%	11.5%	12.9%	NA	56.2%	20.6%	30.9%	1.9%
Saudi Arabian Amiantit Co	6.7%	16.6%	29.8%	0.8%	2.1%	5.8%	0.0%	NA	24.5%	31.8%	2.2%
Saudi Cable Co	51.2%	107.8%	11.4%	6.7%	9.0%	6.1%	NA	20.2%	26.9%	91.3%	1.4%
Basic Chemical Industries Ltd	NA	NA	16.5%	NA	11.4%	8.0%	NA	0.0%	0.0%	34.7%	1.7%
Zamil Industrial Investment Co	21.0%	28.4%	23.6%	6.7%	5.6%	4.9%	NA	32.7%	30.0%	36.3%	1.5%
United International Transportation Co	NA	NA	19.1%	NA	19.5%	17.8%	NA	35.5%	38.2%	38.2%	3.3%
Alinma Bank	NA	NA	NA	NA	NA	NA	NA	NA	NA	0.0%	0.0%
Weighted Average	102.8%	25.8%	20.6%	9.6%	11.8%	12.9%	10.1%	19.7%	12.3%	19.6%	1.5%

Source: Bloomberg, Al Rajhi Capital Research



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