

To Yield or Not To Yield

Examining the Potential of Yield Stocks

May 2008

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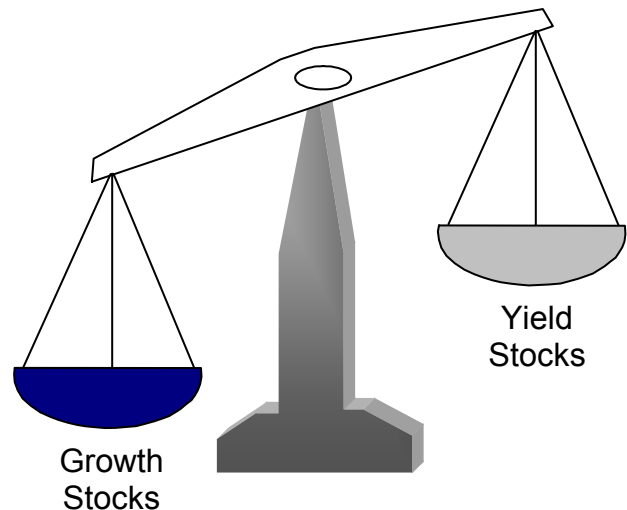
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Theory tells us that stock returns are composed of capital appreciation and dividends. Gulf Co-operation Council Countries (GCC) companies are generous when it comes to doling out dividends (both cash and stocks) as implied by the high dividend payout ratio. High dividend payout need not necessarily result in high dividend yield due to market price fluctuations. Companies may seem to enjoy high dividend yield more due to sharp deceleration in their share price than sharp acceleration in dividend payout and vice-versa.

The key question is: As an investor, do I bet on dividend yield to enhance overall portfolio return? Our research shows that companies that offered high dividend yield suffered from poor stock market valuation and hence had low total return. On the contrary, companies that had low dividend yield provided higher total return due to capital appreciation. Interestingly enough, yield stocks (stocks with high dividend yields) had some characteristics that were uniform for the group viz., small sized, poorly traded, poorly valued with high performance measure. Similarly growth companies (companies with low dividend yields) were generally large companies, well traded, well valued but with performance measures a shade lower than yield stocks. We adopted a portfolio construction approach to these groups in order to ferret out the merit of betting on dividend yields.

Portfolio managers and investors could do well to chase returns in the form of capital appreciation than bet on dividend yields. The vote, at least for the time being, is in favor of growth stocks.

1. Stock Characteristics

Objective: To dissect GCC stocks (those included in MSCI GCC Investible Index) into "Yield Stocks" and "Growth Stocks" and examine the performance differential

Study Period: Jan 2006-March 2008 (27 months)

Universe: 93 stocks

Definition: Yield stocks are those that rank high in terms of dividend yield; "Growth Stocks" are those that rank low in terms of dividend yield.

Table 1: Stock Characteristics

Characteristics	Yield Stocks	Growth Stocks
1. Number of Companies Analyzed	20	15
2. Liquidity		
Average Turnover Ratio	0.62	1.41
Average Value Traded (USD)	851,714,891	2,855,550,392
3. Size		
Average Market Capitalization (USD)	3,662,781,500	6,418,853,433
4. Valuation		
Average P/E	10.06	19.23
Average P/B	1.83	2.93
5. Business Performance		
Average Return on Equity %	23.02	17.38
6. Average Dividend Payout Ratio	82%	30%

Stocks are classified as Yield stocks and growth stocks

Yield stocks have lower size, liquidity and market valuation

Yield Stocks: In general we found that yield stocks as a group suffer from low liquidity (implied by low average turnover ratio), are typically small in size (low average market cap), suffer from low valuation (both P/E and P/B) but generate solid performance (high return on equity). There is more of a downside risk to these numbers due to the presence of some large caps in this list, especially Industries Qatar (USD 26.6 bn) and Saudi Telecom (USD 35.2 bn). If we remove them from our analysis, the average size of the group falls from \$3.6 billion to \$0.6 billion. However, the major attraction for Yield stocks is the dividend yield, due to high dividend payout ratio (82%) (Table 1)

Growth Stocks: These are large, liquid companies enjoying high valuation. However, their fundamental performance (in terms of RoE) has not matched that of yield stocks though they are not bad by absolute standards. Like Yield stocks, even growth stocks suffer from the impact of outliers, especially on the liquidity issue. For e.g., while the average turnover ratio for growth stocks is 1.41, removing two outliers (Saudi Pharmaceutical and Aseer) would bring that down to 0.59. Similarly, the influence of heavy weights like Samba, Al Rajhi Bank and NBAD is so high that excluding them from the analysis would result in the average market capitalization falling from \$6.4 b to \$2.5 b. (Table 1)

2. Yield Stocks

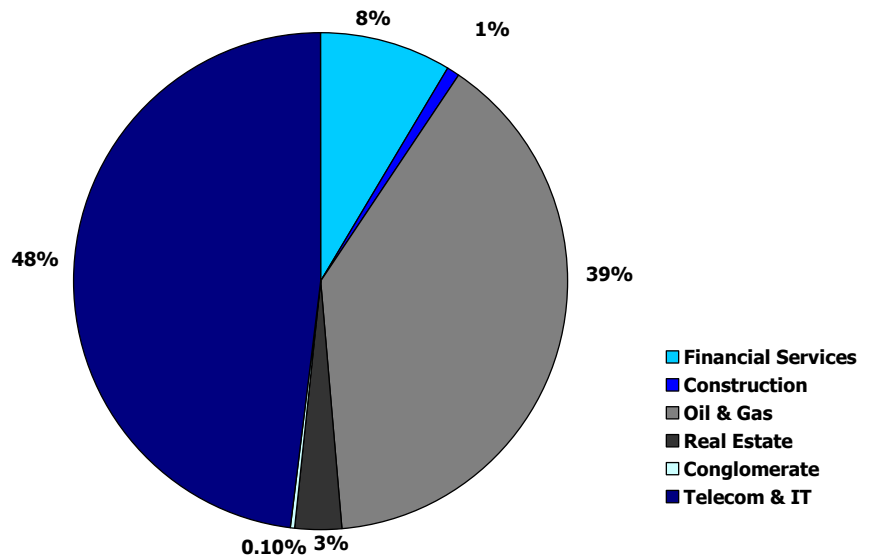
As explained in the earlier chapter, our Yield stocks comprise of companies that are high on dividend yield. However, they are typically small companies with low liquidity and low valuation. However, their fundamental performance has been good as revealed by their return on equity.

The Yield Stocks are heavily skewed in favor of Kuwait, with 14 out of the 20 stocks being Kuwaiti companies

Yield Portfolio: Our yield stock portfolio would comprise of the top 10 yielding stocks (ranked on monthly basis) among the universe of 93 stocks comprised in MSCI GCC Investible Index (Annexure-3). This portfolio is equally weighted. While there are many companies that visited the top 10, the companies that stayed the most in this category are presented in Appendix 1 and they number 20. Surprisingly, 70% of them are from Kuwait.

In terms of sector bias for the group, 50% of Yield Stocks operate in the Financial Services sector in terms of number of companies. However in terms of market capitalization weight; Oil & Gas and Telecom dominate due to the large capitalization of those companies, namely Industries Qatar and Saudi Telecom, which have market capitalizations of USD 26.6 bn and USD 35.2 bn, respectively. (Figure1),

Figure 1: Yield Stocks Sector Breakdown by Market



50% of Yield stocks are in the Financial Services sector, though they do not score high on value due to their small size

Impact of Outliers: As explained earlier, our list of Yield stocks are skewed by the presence of a few outliers. Removing these outliers produces considerably different results than otherwise. (Table 2) The difference is especially noticeable in terms of size and liquidity where removing the outlier companies produces drastically different and lower result.

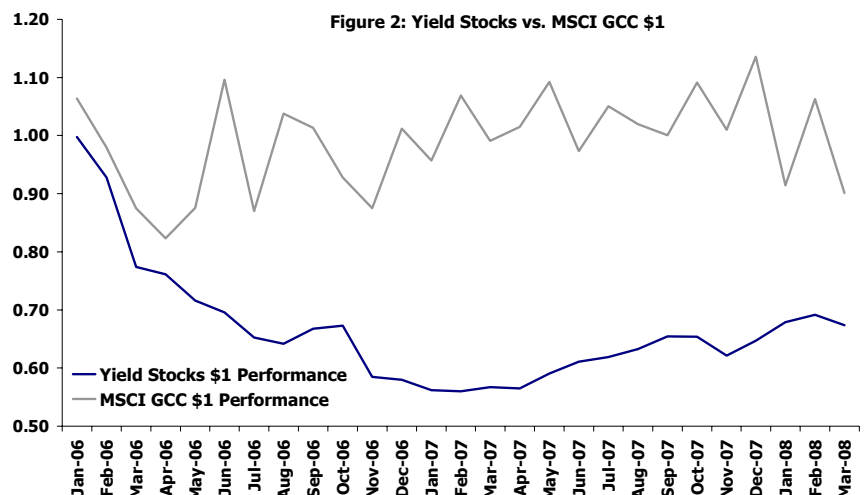
Outliers significantly impact the result of our Yield stock analysis, most notably in terms of size and liquidity

Table 2: Impact of Outliers on Yield Stocks			
Parameters	Including Outliers	Excluding Outliers	Extent of Deviation
Turnover Ratio	0.62	0.47	-25%
P/E	10.06	8.90	-12%
P/B	1.83	1.43	-22%
ROE %	23.02	21.05	-9%
Value Traded (USD)	851,714,891	273,358,721	-68%
M cap (USD)	3,662,781,500	632,146,317	-83%

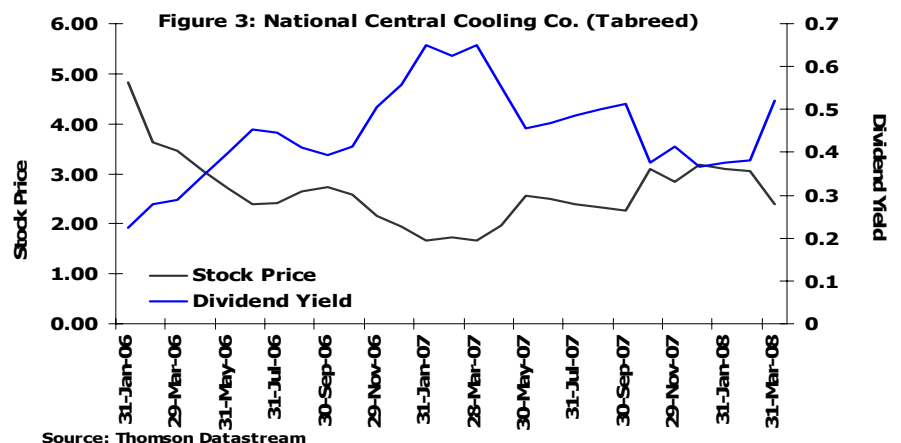
Source: Markaz Research

Portfolio Performance: An equally weighted portfolio comprising the top 10 yield stocks on a monthly basis underperformed the MSCI GCC Index. \$1 invested at the beginning of the period turned into \$0.67 by March 2008 as against \$0.90 for MSCI GCC index (Figure 2). This is due to sharp deceleration in their share prices which severely undermines the contribution of dividend yield in the total return. A case in point is provided in Figure 3.

The Yield stock portfolio underperformed the benchmark due to the deceleration in the share prices of underlying stocks



Source: Thomson Datastream Markaz Research



Source: Thomson Datastream

3. Growth Stocks

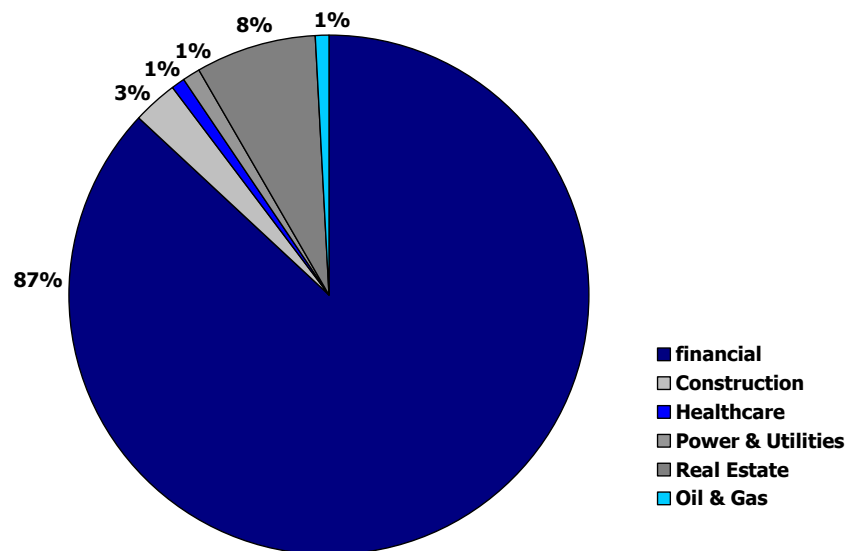
The Growth stocks are not heavily skewed to any one country, however, Saudi companies account for 46% of Growth stocks, with 7 companies in the group of 15 stocks.

Companies that generated the lowest dividend yields are classified as growth stocks. These companies are typically larger in size than our Yield Stocks; the average turnover ratio for this group is at 1.41 due to the presence of some heavily traded small companies such as Saudi Pharma and Aseer. Growth stocks also enjoy high valuations with good fundamental performance in terms of return on equity.

Growth Portfolio: Our growth stock portfolio would comprise of the bottom 10 yielding stocks (ranked on monthly basis) among the universe of 93 stocks comprised in MSCI GCC Investible Index. This portfolio is equally weighted. While many companies drifted in and out of the bottom 10, the companies that were most prevalent in this category are presented in Appendix 2 and they number 15.

In terms of sector bias (Figure 4), the group of Growth Stocks is comprised, almost entirely, of companies operating in the Financial Services sector; 9 of the 15 stocks in this group are financial institutions. In terms of market capitalization, financial institutions make up 87% of the total market capitalization for Growth Stocks. Real Estate is a distant second with 8% of the Growth Stocks market cap and is represented by just one company, AIDar Properties, with a market capitalization of USD 7.3 bn.

Figure 4: Growth Stocks Sector Breakdown by Market



Growth Stocks are dominated by the Financial Services sector, which makes up 87% of the total market capitalization of the group.

Impact of Outliers: As with Yield stocks, our group of Growth stocks are skewed by the presence of a few outliers. Removing these outliers produces vastly different results than otherwise. (Table 3) The difference is especially noticeable in terms of size, liquidity, and return on equity.

Similar to yield stocks, outliers impacted the composition of growth stocks as well

Table 3: Impact of Outliers on Growth Stocks			
Parameters	Including Outliers	Excluding Outliers	Extent of Deviation
Turnover Ratio	1.41	0.59	-58%
P/E	19.23	17.48	-9%
P/B	2.93	2.62	-11%
ROE	17.38	21.2	22%
Value Traded (USD)	2,855,550,392	1,297,056,017	-55%
Mcap (USD)	6,418,853,433	2,518,374,142	-61%

Source: Markaz Research

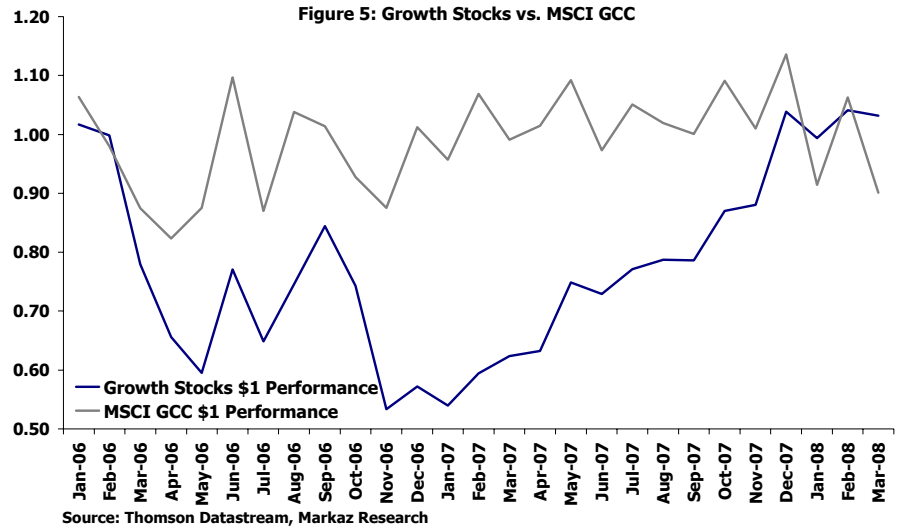
Growth Stocks have higher turnover levels than the Yield Stocks, which implies higher liquidity. The average turnover ratio for this group is 1.41; however, this group contains two outliers in the form of Saudi Pharmaceutical & Industrial Corporation and Aseer, which have very high turnover ratios of 7.55 and 5.81, respectively. If we exclude the effects of these two companies, average turnover ratio reduces to 0.59, which is more in line with the remainder of the companies in the group.

In addition, growth stocks trade at relatively high P/E values, whereby the average P/E for the group is 19.23. This is including the outlier, Tabreed, which is trading at a P/E of 43.65.

In terms of business performance, the Growth Stocks generated an average ROE of 17.38%. However, this parameter contains three outliers which are skewing the average. These outliers are Saudi Pharmaceutical & Industrial Corp., Tabreed, and AABAR Investments, with RoE's of 5%, 5.92%, and -4.60%, respectively. If we remove these outliers from consideration, we arrive at a more attractive ROE of 21.20%.

The performance of growth stock portfolio was better than yield stocks

Portfolio Performance: We applied the same performance methodology to the growth stocks as we did with yield stocks. We constructed an equally weighted portfolio comprising the bottom 10 yield stocks on a monthly basis benchmarked against the MSCI GCC Index. This group of stocks outperformed the benchmark; the \$1 invested at the beginning of the period increased to \$1.03 by March 2008 as against \$0.90 for MSCI GCC index (Figure 5). This return is boosted by the rebound in the performance of some of the underlying stocks which feature in the last three months of the period.



Appendix 1: Yield Stocks

	Name	Country	Sector	Turnover Ratio	P/E (LFY)	P/B (LFY)	ROE (LFY)	Dividend Payout Ratio (LFY)	Value Traded (USD mn)	M cap (USD mn)
1	Saudi Telecom	Saudi Arabia	Telecom & IT	0.22	10.82	3.62	34.32	0.86	7,598	35,246
2	Qatar Industries	Qatar	Oil & Gas	0.10	19.45	7.09	40.29	1.17	2,613	26,630
3	Qatar Shipping Company	Qatar	Oil & Gas	0.14	18.70	1.52	14.98	0.98	256	1,822
4	Al Mazaya Holding	Kuwait	Real Estate	0.43	7.67	2.41	32.08	0.68	521	1,214
5	Commercial Facilities Company	Kuwait	Financial Services	0.25	7.85	1.76	23.64	7.23	278	1,112
6	Bank of Sharjah	UAE	Financial Services	0.01	12.86	1.62	18.39	0.78	14	1,085
7	Kuwait Investment Company (KIC)	Kuwait	Financial Services	0.19	5.04	1.17	25.46	0.59	157	811
8	Kuwait Real Estate Company	Kuwait	Real Estate	3.54	5.34	0.96	19.68	-1.25	2,175	615
9	Kuwait Finance Centre (Markaz)	Kuwait	Financial Services	1.63	5.14	1.04	22.82	0.83	883	543
10	Gulf Investment House	Kuwait	Financial Services	1.26	9.20	1.86	20.46	0.64	667	528
11	Kuwait Finance & Investment Company (KFIC)	Kuwait	Financial Services	1.11	6.08	1.66	28.42	0.58	567	513
12	United Real Estate Company	Kuwait	Real Estate	0.01	11.04	0.93	9.53	0.68	4	474
13	Aerated concrete Industries	Kuwait	Construction	0.47	5.32	1.56	27.90	0.57	206	440
14	Al-Ahleia Insurance Company	Kuwait	Financial Services	0.03	7.14	1.29	19.94	2.50	12	439
15	The International Investor	Kuwait	Financial Services	0.64	9.74	1.37	14.99	0.54	274	430
16	OmInvest	Oman	Financial Services	0.14	9.39	2.41	29.14	0.26	57	422
17	Bayan Investment Company	Kuwait	Financial Services	1.96	11.56	1.05	9.09	-0.50	668	340
18	Umm Al Qaiwain Cement Company	UAE	Construction	0.00	7.69	1.10	16.52	-2.56	0	270
19	Independent Petroleum Group	Kuwait	Oil & Gas	0.31	9.55	1.11	11.60	0.75	74	238
20	National Company for Consumer Industries (NCCI)	Kuwait	Conglomerate	0.01	21.65	1.00	41.22	1.07	1	76
	Average			0.62	10.06	1.83	23.02	82%	851	3,662

Source: Markaz Research

Note: Turnover Ratios, Values Traded, and Market Capitalizations are as of December 31st, 2007.

Appendix 2: Growth Stocks

Company	Country	Sector	Turnover Ratio	P/E (LFY)	P/B (LFY)	ROE (LFY)	Dividend Payout Ratio (LFY)	Value Traded (USD million)	Mcap (USD million)
1 Al Rajhi Bank	Saudi Arabia	Financial Services	0.42	15.93	4.86	29.46	0.28	14,445	34,546
2 Samba Financial Group	Saudi Arabia	Financial Services	0.08	15.24	4.12	29.13	0.20	1,685	20,186
3 National Bank of Abu Dhabi	UAE	Financial Services	0.00	15.97	3.57	24.78	0.23	54	11,329
4 ALDAR Properties	UAE	Real Estate	0.21	14.36	3.24	35.42	0.11	1,513	7,338
5 National Industrialization Company	Saudi Arabia	Financial Services	1.08	28.68	3.20	11.51	0.34	4,835	4,457
6 Saudi Investment Bank	Saudi Arabia	Financial Services	0.19	18.33	2.23	12.88	0.05	836	4,325
7 Saudi Industrial Investment Group (SIIG)	Saudi Arabia	Financial Services	0.57	17.88	2.50	14.49	0.46	2,416	4,205
8 Doha Bank	Qatar	Financial Services	0.33	12.44	3.31	29.01	0.08	1,082	3,292
9 Mabanee Company	Kuwait	Construction	0.29	22.05	5.03	23.16	0.36	559	1,919
10 Aseer Trading Tourism Industrial Agricultural Real Estate and Contracting Company	Saudi Arabia	Financial Services	5.81	11.32	1.22	14.36	0.21	6,471	1,113
11 National Central Cooling Company (Tabreed)	UAE	Power & Utilities	2.08	43.65	2.55	5.92	0.21	1,799	865
12 Saudi Pharmaceutical & Industrial Corporation	Saudi Arabia	Healthcare	7.55	25.07	1.09	5.00	0.57	6,351	841
13 AABAR Investment	UAE	Oil & gas	0.25	13.31	1.61	-4.60	0.47	206	813
14 Union Cement Company	UAE	Construction	0.00	16.45	2.07	12.98	0.75	3	788
15 Qatar Islamic Insurance Company	Qatar	Financial Services	2.20	17.74	3.31	17.25	0.15	571	259
Average			1.41	19.23	2.93	17.38	30%	2,855	6,418

Source: Markaz Research

Note: Turnover Ratios, Values Traded, and Market Capitalizations are as of December 31st, 2007.

Appendix 3: All Stocks

	Company	Country	Dividend Yield % As of March 31, 2008
1	Kuwait Finance & Investment Company	Kuwait	11.63
2	United Real Estate Company	Kuwait	9.26
3	Sharjah Cement & Industrial Development Company	UAE	8.57
4	Commercial Facilities Company	Kuwait	8.47
5	Saudi Telecom	Saudi Arabia	8.47
6	Bank of Sharjah	UAE	8.33
7	Kuwait Investment Projects	Kuwait	8.33
8	Aerated Concrete Industries	Kuwait	8.20
9	Al-Ahleia Holding Company	Kuwait	8.00
10	Gulf Investment house	Kuwait	7.94
11	National Company for Consumer Industries (NCCI)	Kuwait	7.94
12	Agility	Kuwait	7.76
13	First Investment Company	Kuwait	7.70
14	Independent Petroleum Group	Kuwait	7.50
15	Kuwait Investment Company	Kuwait	7.30
16	Kuwait Real Estate Company	Kuwait	7.28
17	National Real Estate Company	Kuwait	7.14
18	Industries Qatar	Qatar	6.95
19	Qatar Industrial Manufacturing	Qatar	6.86
20	Ras Al Khaimah White Cement company	UAE	6.75
21	Sharjah Islamic Bank	UAE	6.72
22	Kuwait Financial Centre (Markaz)	Kuwait	6.66
23	Gulfinvest International	Kuwait	6.46
24	Qatar Shipping Company	Qatar	6.19
25	Qatar Insurance Company	Qatar	6.16
26	International Investment Group	Kuwait	6.15
27	International Investment Projects	Kuwait	6.10
28	Qatar Islamic Insurance	Qatar	6.08
29	The International Investor	Kuwait	6.05
30	Sultan Centre	Kuwait	6.02
31	Burgan Bank	Kuwait	5.88
32	Kuwait & Middle East Financial Investments	Kuwait	5.88
33	Oman Telecom	Oman	5.77
34	Al-Mazaya Holding	Kuwait	5.74
35	Jazan Development	Saudi Arabia	5.63
36	United Development Company	Qatar	5.50
37	Umm Al Qaiwain Cement Industries	UAE	5.42
38	Doha Bank	Qatar	5.28
39	Global Investment House	Kuwait	5.26
40	Oman International Bank	Oman	5.11
41	The Commercial Real Estate Company	Kuwait	5.09
42	Aref Investment Group	Kuwait	5.07
43	Aayan Leasing & Investments	Kuwait	4.84
44	Bahrain Telecom	Bahrain	4.76
45	Abu Dhabi Commercial Bank	UAE	4.67
46	Saudi Cement	Saudi Arabia	4.42
47	National Shipping Company for Saudi	Saudi Arabia	4.35
48	Dubai Islamic Bank	UAE	4.27
49	The National Industries Group (NIG)	Kuwait	4.16

Appendix 3: All Stocks, continued

	Company	Country	Dividend Yield % As of March 31, 2008
50	Gulf Bank of Kuwait	Kuwait	4.16
51	Raysut Cement Company	Oman	4.11
52	Bayan Investment Company	Kuwait	4.10
		Saudi	
53	Riyad Bank	Arabia	4.04
54	The Investment Dar Company	Kuwait	4.03
55	Bank of Bahrain & Kuwait	Bahrain	3.86
56	Boubyan Petrochemicals	Kuwait	3.85
57	The National Bank of Kuwait	Kuwait	3.79
58	Securities Group	Kuwait	3.64
59	Ominvest	Oman	3.63
60	Union Cement Company	UAE	3.59
61	Makkah Construction & Development Company	Saudi Arabia	3.40
62	Qatar Telecom	Qatar	3.06
	Saudi Pharmaceutical & Industrial Development		
63	Company	Saudi Arabia	2.97
64	Shuaa Capital	UAE	2.76
65	SASCO	Saudi Arabia	2.63
66	Mobile Telecommunications Company (ZAIN)	Kuwait	2.57
67	Al Rajhi Bank	Saudi Arabia	2.40
68	SAVOLA Group	Saudi Arabia	2.34
69	Qatar Real Estate Investments	Qatar	2.34
70	Kuwait Pipes & Oil Services	Kuwait	2.30
71	Kuwait Finance House	Kuwait	2.27
72	National Investments Company	Kuwait	2.15
73	SABIC	Saudi Arabia	2.15
74	Banque Saudi Fransi	Saudi Arabia	2.12
75	SIIG	Saudi Arabia	1.89
76	EMAAR Properties	UAE	1.83
77	Aseer	Saudi Arabia	1.75
78	National Bank of Abu Dhabi	UAE	1.74
79	KTINVEST	Kuwait	1.71
80	Kuwait International Bank	Kuwait	1.61
81	AABAR Petroleum Investments	UAE	1.60
82	Arab National Bank	Saudi Arabia	1.53
83	International Financial Advisors	Kuwait	1.52
84	National Industrializations Company	Saudi Arabia	1.40
85	Qatar Islamic Bank	Qatar	1.39
86	ARABTEC Holding	UAE	1.25
87	First Gulf Bank	UAE	1.05
88	ALDAR Properties	UAE	0.97
89	SAMBA Financial Group	Saudi Arabia	0.89
90	Mabane Company	Kuwait	0.85
91	Saudi Investment Bank	Saudi Arabia	0.79
92	National Central Cooling Company (Tabreed)	UAE	0.52
93	National Bank of Oman	Oman	0.18

Source: Markaz Research

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