Earnings overshadowed by uncertainties

Expert View

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The third-quarter earnings season ended last week, with the reported earnings for the major companies broadly meeting or exceeding the market expectations.

However, better earnings were overshadowed by regional uncertainties emanating from Saudi Arabia as they announced an anti-corruption drive on November 4. Resultantly, the equity markets remained on edge and have since then generally declined, with weakness being more pronounced in Dubai (-5.5 per cent), Abu Dhabi (-4.2 per cent), and Kuwait (-4.4 per cent), while Saudi Arabia was down marginally by 0.8 per cent and Oman increased by 1.1 per cent.

The regional credit markets also witnessed selling pressure, translating into a general widening across the sovereign curves with Saudi curve being wider by 13 bps (basis points), while Abu Dhabi and Kuwait widened by 12 bps and 13 bps, respectively. Oman curve widened by 22 bps during this time, further pressured by the S&P downgrade, while Bahrain widened by 28 bps — partly due to its announcement of seeking financial assistance from the Gulf allies amid falling foreign currency reserves.

Looking ahead, we expect the volatility in the regional markets to persist and markets to be primarily driven by the news flows from the Kingdom in the short-term. In addition, equity flows will also be dictated by the expectations on Saudi Arabia 2018 budget announcement (expected late December), and the UAE IPO pipeline, with Emaar Development pricing on November 22 and Adnoc Distribution IPO offering commencing on November 26.

The UAE companies' reported, in general, third-quarter earnings in line and/or ahead of the markets, with DFM index companies reporting an estimated cumulative sequential bottomline growth of 14 per cent (+21 per cent year on year) while Abu Dhabi index companies reported a broadly flat quarter sequentially (+6 per cent year on year). Within Dubai market, all the major banks and Emaar Properties reported earnings ahead of the market expectations, while Damac Properties' earnings came 8 per cent below market expectations and DSI reported a huge unexpected loss. The market however was driven by the evolving geopolitical framework and Emaar Development IPO, which was priced at September 2017 NAV of Dh6.03 compared to the IPO price range of Dh5.7 and Dh6.9. Emaar Development IPO's total proceeds were Dh4.8 billion, which will be utilised by the parent, Emaar Properties, to pay a special dividend to its shareholders.

The IPO allocation to the retail investors was 6.2 per cent of the total offering, compared to the maximum planned 10 per cent allocation, and translates into a total retail subscription of Dh300 million.

Emaar Development targets to distribute at least $1.7 billion in dividends (Dh6.2 billion) up to December 2020, which translates into an annual (2018-20) nominal yield of 8.6 per cent at the IPO price, compared to Damac Properties' 2017 estimated dividend yield of 7.1 per cent. Since Nov 2, Damac Properties share price has declined by around 13 per cent compared to 5.5 per cent decline in the benchmark index (DFMGI) and Emaar Properties decline of 6.5 per cent.

Looking ahead, we continue to prefer Emaar Properties over Damac on better risk-reward proposition and further supported by a one-off dividend from the IPO proceeds and a special dividend of Dh3.9 billion to Emaar Properties, with one-off yield of over 15 per cent. Additionally, amid broader weakness in the regional market and upcoming Adnoc Distribution IPO, we anticipate that the short-term gains on Emaar development may be restrained to high single-to low double digits. Within the construction space, DSI reported a significant third quarter loss of Dh318 million, which further underscores our view that the share price outperformance since Oct 3 recapitalisation of Dh500 million (stock up 14 per cent, after going up by as high as 42 per cent) is unwarranted.

Within the Abu Dhabi market, the third-quarter earnings were broadly in line with market expectations, with ADCB and Aldar reported better numbers than the street expectations. The market however will now be focused on the announced IPO from Abu Dhabi National Oil Company for Distribution (Adnoc Distribution).

Saudi Arabia's index (SASEIDX) companies reported a cumulative sequential bottomline growth of 25 per cent during the third-quarter (year on year growth: 14 per cent).

The announced earnings were generally ahead of the market expectations. However, it didn't translate into enhanced global (and regional investors) appetite for equities as the focus was hijacked by the anti-corruption drive, resulting into a total net outflows from the GCC (and foreign) investors of $620 million (Dh2.28 billion) in the past two weeks ending November 17. Looking ahead, we see underlying near-term fundamental expectations to be partly driven by anticipations on 2018 fiscal budget, expected late December.

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