

# Etiad Etisalat Company

Telecoms – Mobile

EEC AB: Saudi Arabia

26 October 2010

الراجحي المالية  
Al Rajhi Capital



**US\$10.17bn** Market cap  
**55.3%** Free float  
**US\$8.28mn** Avg. daily volume

Target price **75.40** 38.3% over current  
Consensus price **67.80** 24.4% over current  
Current price **54.50** as at 24/10/2010

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Underweight

Neutral

Overweight

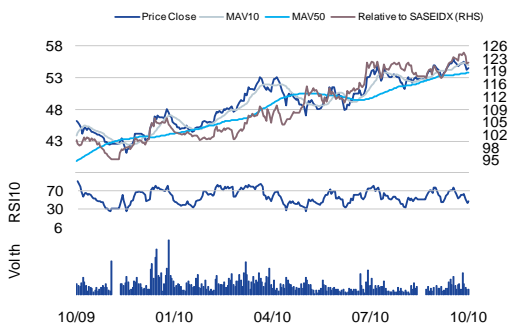
## Key themes

We expect mobile to continue to outperform fixed-line telecoms in Saudi Arabia over the next few years. Mobily has taken a clear lead in 3.5G mobile data, which is the fastest-growing segment of the market. While Mobily's strong focus on mobile is a clear positive, it is also making selective investments in fixed-line service.

## Implications

Our preferred stock in the Saudi telecoms sector is Mobily, which we rate as Overweight. Mobily is performing well operationally and offers strong growth in the near term at a reasonable valuation.

## Performance

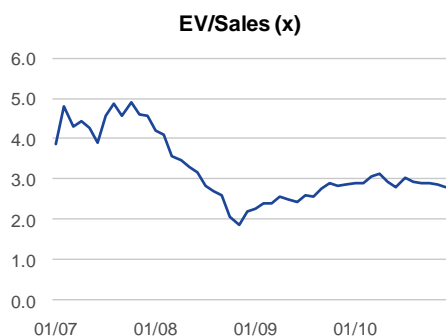


## Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (mn)	13,058	15,646	18,086	20,115
Revenue Growth	21.0%	19.8%	15.6%	11.2%
EBITDA (mn)	4,837	5,944	6,754	7,442
EBITDA Growth	27.5%	22.9%	13.6%	10.2%
EPS	4.31	5.64	6.38	6.97
EPS Growth	16.8%	31.1%	13.0%	9.3%

Source: Company data, Al Rajhi Capital

## Valuation



Source: Company data, Al Rajhi Capital

# Mobily Still leads the pack

*This report follows our Flash View of 18th October. We remain Overweight in Mobily as the leader in the surging Saudi mobile broadband market. Mobily's results for Q3 2010 were again excellent, but differed from our expectations: sales growth was weak, but expansion in profits and margins was remarkable. We regard the weakness in sales growth as temporary, but conversely expect profits growth to moderate from now on. We have modestly raised our overall forecasts, and have a set a new target price of SAR75.4, implying 38% upside.*

**Weakness in sales growth probably temporary:** After rising by 27% year-on-year in Q1 and by 24% in Q2, sales rose by 14% in Q3. We think the main reason for the slowdown was weak handset sales. Sales of smartphones should pick up from now on since 1) Blackberry service has not been banned, and 2) Mobily has just started to sell i-phone 4. More importantly, we expect a strong Hajj season in Q4 after a relatively weak Hajj season in Q4 2009. On this basis we predict a recovery in sales growth to 16% in Q4 2010, with similar growth in 2011.

**Gross profit and EBITDA remarkably strong in Q3:** Mobily staged a major promotion on international calls in Q1 and a similar but less aggressive promotion in Q3. In Q1, the promotion boosted call volumes and thus revenues, but weighed heavily on gross profit. In Q3, by contrast, cost of sales was well below our estimate, so that Mobily achieved a gross margin of 57.9%, compared to our estimate of 54.5%. We think that the key factor behind strong gross profitability was further expansion in high-margin mobile broadband service: data revenues seem to have reached 18-19% of the total for Mobily in Q3.

Not only was cost of sales below our estimate, but also SG&A costs fell by 6% year-on-year. In consequence, EBITDA surged by 29% to SAR1,648bn, while the EBITDA margin expanded from 36.4% to 41.3%. This was far above our estimate of a margin of 35.0% and was a truly impressive outcome. The strong growth in EBITDA fed directly through to a 41% increase in net profit.

**Margins may slip, but profits growth should stay robust:** We do not view the very high profit margins of Q3 as sustainable. Mobily makes almost no profit on handset sales, so as handset sales pick up margins should slip. We also expect promotional activity in mobile voice service to continue. Then again, the rising importance of data to Mobily is positive for margins. We also expect a strong Hajj season in Q4 to support profit growth in what is traditionally Mobily's best quarter. For 2010 as a whole we thus predict an EBITDA margin of 38.0% (versus 37.0% in 2009), but we expect a drop to 37.3% in 2011. In absolute terms we predict an increase in EBITDA of 23% in 2010, followed by 14% in 2011.

**Balance sheet strengthens further:** Net debt was SAR6.53bn at the end of Q3, down from SAR7.13bn at the end of Q2. Higher EBITDA and lower debt pushed the net debt/EBITDA ratio down to 1.0x at the end of Q3, versus 1.8x one year ago. This is the lowest level of gearing in Mobily's history and below the level for STC. With its finances very healthy, Mobily can continue to invest for growth.

**We remain positive:** Mobily dominates the surging mobile broadband market in Saudi Arabia. While in the near term trends in mobile will drive the company, Mobily's GED ("Growth, Efficiency and Differentiation") strategy should prepare it for a future of likely greater fixed and mobile integration. Following the results, we have raised our target price by 6% to SAR75.4, implying 38% upside.



### Corporate summary

Etiihad Etisalat (Mobily) is the second-placed telecoms operator in Saudi Arabia, with a market value of US\$10bn. Mobily has a market share of mobile accounts of about 40%, although its revenue share is lower at 31%. Mobily has at least 50% of mobile broadband subscriptions; this is the fastest-growing segment of the Saudi telecoms market. Mobily's presence in fixed-line service is very limited, but should expand due to selective acquisitions. Mobily is an affiliate of Emirates Telecoms Corp., which owns 27% of its shares.

### Share information

Market cap (SAR/US\$) 38.15bn / 10.17bn  
52-week range 41.20 - 56.00  
Daily avg volume (US\$) 8.28mn  
Shares outstanding 700.0mn  
Free float (est) 55.3%

Performance: 1M 3M 12M  
Absolute -0.9% 2.8% 18%  
Relative to index 1.2% 1.0% 22.1%

Major Shareholder:  
Emirates Telecoms Corp. 27.5%  
Gen. Organisation for Social Insc. 11.2%

Source: Bloomberg, Al Rajhi Capital

### Valuation

Period End	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	13,058	15,646	18,086	20,115
EBITDA (SARmn)	4,837	5,944	6,754	7,442
Net Profit (SARmn)	3,014	3,951	4,466	4,880
EPS (SAR)	4.31	5.64	6.38	6.97
DPS (SAR)	1.25	1.40	1.64	1.97
EPS Growth	16.8%	31.1%	13.0%	9.3%
EV/EBITDA (x)	9.3	7.4	6.1	5.2
P/E (x)	12.7	9.7	8.5	7.8
P/B (x)	3.1	2.5	2.0	1.7
Dividend Yield	2.3%	2.6%	3.0%	3.6%

Source: Company data, Al Rajhi Capital

## Q3 2010: an unusual quarter but no change to our overall stance

Below we discuss Mobily's results for Q3 2010 and our revised assumptions in greater detail.

### Weakness in sales growth probably temporary

After rising by 27% year-on-year in Q1 and by 24% in Q2, revenues rose by 14% in Q3. Revenues of SAR3,989mn thus fell 2% below our estimate of SAR4,057mn. While this outcome looks disappointing, we think the main reason was weak handset sales, caused in part by concern about whether Blackberry terminals – very popular in Saudi Arabia – would be banned or not. Sales of smartphones should pick up from now on since 1) Blackberry service has not been banned, and 2) Mobily has just started to sell i-phone 4. More importantly, we expect a strong Hajj pilgrimage season in Q4 after a relatively weak Hajj season in Q4 2009. On this basis we predict a recovery in sales growth to 16% in Q4, with similar growth in 2011.

### Gross profit and EBITDA remarkably strong in Q3

Mobily staged a major promotion on international calls in Q1 and a similar but less aggressive promotion in Q3. In Q1, the promotion boosted call volumes and thus revenues, but weighed heavily on gross profit. In Q3, by contrast, cost of sales was well below our estimate, so that Mobily achieved a gross margin of 57.9%, compared to our estimate of 54.5%. In absolute terms, gross profit increased by 17% year-on-year to SAR2,310mn; this was well above the growth in revenues. While Mobily states that it carefully designed its promotions to minimise international interconnection costs, we assume that the key factor behind strong gross profitability was further expansion in mobile broadband service, which recent experience demonstrates carries higher margins than mobile voice. Data seems to have reached 18-19% of total revenues for Mobily in Q3, which in our view represents the highest proportion among the three Saudi operators. In our view Mobily remains the clear leader in mobile broadband; see our report *Saudi Telecoms Sector: Mobily still our favourite* of 13th October for further details.

Not only was cost of sales well below our estimate, but also total SG&A costs fell by about 6% year-on-year. In consequence, EBITDA surged by 29% to SAR1,648bn, or 16% above our estimate of SAR1,420mn, while the EBITDA margin expanded from 36.4% to 41.3%. This was far above our estimate of a margin of 35.0% and is a truly impressive outcome. The strong growth in EBITDA fed directly through to a 41% increase in net profit.

### Margins may slip, but profits growth should stay robust

We do not view the very high profit margins of Q3 as sustainable. Mobily essentially makes no money on handset sales, so as handset sales pick up margins should slip. We also expect promotional activity in mobile voice service to continue. On the other hand, the rising importance of data to Mobily is positive for margins. We also expect a strong Hajj season in Q4 to support profit growth in what is traditionally Mobily's best quarter. Accordingly we predict an EBITDA margin of 42.1% in Q4, up slightly quarter-on-quarter but down from

Concern about the Blackberry weighed on handset sales in Q3. Recovering smartphone sales and a strong Hajj season should boost sales from now on

We see further expansion in mobile broadband service as the key reason for strong profit margins in Q3



43.0% in Q4 2009. This translates into an EBITDA margin of 38.0% for 2010 as a whole (versus 37.0% in 2009), but we expect a drop to 37.3% in 2011. In absolute terms we predict an increase in EBITDA of 23% in 2010, followed by 14% in 2011.

We expect Mobily to have net cash by 2013

### Balance sheet strengthens further

Net debt was SAR6.53bn at the end of Q3, down from SAR7.13bn at the end of Q2. Higher EBITDA and lower debt pushed the net debt/EBITDA ratio down to 1.0x at the end of Q3, versus 1.8x one year ago. We believe that this is the lowest level of gearing in Mobily's history and below the level for its great rival STC (for which the ratio was 1.3x at the end of Q2 2010). With its finances very healthy, Mobily can continue to invest for growth. Despite continuing substantial investment and our expectation of steady dividend increases from now on, we expect Mobily to have net cash by 2013.

Slightly higher EBITDA estimates and a marginally lower WACC boost our fair value by 6% to SAR75.4

### We raise target price by 6%

Taking account of the revisions to our assumptions described above, our revenue forecasts are little changed from previously. However, we have raised our estimates of EBITDA for each of 2010, 2011 and 2012 by 3-4%. These upgrades to EBITDA feed through to upgrades in net profit compared to our previous forecasts of between 6% and 11% over those three years. We have also updated Beta in our WACC calculation, and have ended up with a marginally lower WACC of 8.3%. As a consequence of these revisions, we have raised our long-run discounted economic profit (DEP) valuation for Mobily by 6%, from SAR71.0 to SAR75.4 per share. Our long-run DEP fair value remains our target price. Accordingly Mobily offers 38% theoretical appreciation potential from its current share price. Mobily remains our preferred stock in the Saudi telecoms sector and we remain Overweight.



We predict 20% sales growth in 2010, in line with our previous assumption, but have raised our EBITDA forecasts by 3-4%

Rising earnings give scope to boost dividend

Growth rates set to moderate from now on, but to remain high

We predict an EBITDA margin of 38.0% for 2010, with a drop to 37.3% in 2011

Mobily achieves returns well above cost of capital

Mobily offers solid value, notably on EV/sales and PE; it also has a tangible prospective dividend yield of 2.6%

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
<b>Revenue</b>	<b>10,795</b>	<b>13,058</b>	<b>15,646</b>	<b>18,086</b>	<b>20,115</b>
Cost of Goods Sold	(4,766)	(5,512)	(7,014)	(8,146)	(9,152)
<b>Gross Profit</b>	<b>6,028</b>	<b>7,547</b>	<b>8,632</b>	<b>9,940</b>	<b>10,962</b>
Government Charges					
S.G. & A. Costs	(2,234)	(2,710)	(2,688)	(3,186)	(3,520)
<b>Operating EBIT</b>	<b>2,496</b>	<b>3,208</b>	<b>4,143</b>	<b>4,637</b>	<b>5,066</b>
Cash Operating Costs	(7,000)	(8,222)	(9,702)	(11,332)	(12,672)
<b>EBITDA</b>	<b>3,794</b>	<b>4,837</b>	<b>5,944</b>	<b>6,754</b>	<b>7,442</b>
Depreciation and Amortisation	(1,298)	(1,629)	(1,801)	(2,117)	(2,376)
<b>Operating Profit</b>	<b>2,496</b>	<b>3,208</b>	<b>4,143</b>	<b>4,637</b>	<b>5,066</b>
Net financing income/(costs)	(438)	(204)	(154)	(70)	(61)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	41	41	-	-
Other Expenses	-	-	-	-	-
<b>Net Profit Before Taxes</b>	<b>2,099</b>	<b>3,045</b>	<b>4,029</b>	<b>4,568</b>	<b>5,005</b>
Taxes	(7)	(31)	(79)	(102)	(125)
Minority Interests	-	-	-	-	-
<b>Net profit available to shareholders</b>	<b>2,092</b>	<b>3,014</b>	<b>3,951</b>	<b>4,466</b>	<b>4,880</b>
Dividends	-	(875)	(980)	(1,147)	(1,376)
Transfer to Capital Reserve	-	-	-	-	-
	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Adjusted Shares Out (mn)	700.0	700.0	700.0	700.0	700.0
CFPS (SAR)	5.98	6.63	8.22	9.40	10.37
EPS (SAR)	3.69	4.31	5.64	6.38	6.97
DPS (SAR)	0.000	1.250	1.400	1.638	1.966
<b>Growth</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Revenue Growth	27.9%	21.0%	19.8%	15.6%	11.2%
Gross Profit Growth	29.7%	25.2%	14.4%	15.2%	10.3%
EBITDA Growth	17.2%	27.5%	22.9%	13.6%	10.2%
Operating Profit Growth	13.1%	28.5%	29.1%	11.9%	9.3%
Net Profit Growth	51.6%	44.1%	31.1%	13.0%	9.3%
EPS Growth	39.8%	16.8%	31.1%	13.0%	9.3%
<b>Margins</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Gross profit margin	55.8%	57.8%	55.2%	55.0%	54.5%
EBITDA margin	35.1%	37.0%	38.0%	37.3%	37.0%
Operating Margin	23.1%	24.6%	26.5%	25.6%	25.2%
Pretax profit margin	19.4%	23.3%	25.8%	25.3%	24.9%
Net profit margin	19.4%	23.1%	25.2%	24.7%	24.3%
<b>Other Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
ROCE	15.2%	17.2%	19.2%	18.5%	17.6%
ROIC	16.8%	16.2%	19.5%	19.1%	18.1%
ROE	26.7%	27.4%	28.7%	26.2%	23.6%
Effective Tax Rate	0.3%	1.0%	2.0%	2.2%	2.5%
Capex/Sales	27.4%	25.2%	21.2%	21.0%	20.5%
Dividend Payout Ratio	0.0%	29.0%	24.8%	25.7%	28.2%
<b>Valuation Measures</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
P/E (x)	14.8	12.7	9.7	8.5	7.8
P/CF (x)	9.1	8.2	6.6	5.8	5.3
P/B (x)	3.9	3.1	2.5	2.0	1.7
EV/Sales (x)	3.4	3.5	2.8	2.3	1.9
EV/EBITDA (x)	9.7	9.3	7.4	6.1	5.2
EV/EBIT (x)	14.8	14.1	10.6	8.9	7.7
EV/IC (x)	2.3	2.2	1.8	1.5	1.3
Dividend Yield	0.0%	2.3%	2.6%	3.0%	3.6%

Source: Company data, Al Rajhi Capital



We expect Mobily to have net cash by 2013

Annualised net debt/EBITDA was 1.0x at the end of Q2 2010; this is a very healthy gearing level

We expect capex to remain relatively high due to capacity requirements for data

<b>Balance Sheet (SARmn)</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Cash and Cash Equivalents	2,314	1,533	2,748	5,160	7,620
Current Receivables	3,389	5,481	6,238	7,108	7,342
Inventories	108	132	246	281	302
Other current assets	4,200	1,277	1,368	1,368	1,368
<b>Total Current Assets</b>	<b>6,621</b>	<b>8,577</b>	<b>10,601</b>	<b>13,917</b>	<b>16,632</b>
Fixed Assets	8,117	10,370	12,633	14,838	17,112
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,923	10,450	9,963	9,438	8,912
Total Other Assets	-	-	-	-	-
<b>Total Non-current Assets</b>	<b>20,570</b>	<b>22,349</b>	<b>24,126</b>	<b>25,806</b>	<b>27,553</b>
<b>Total Assets</b>	<b>27,192</b>	<b>30,926</b>	<b>34,727</b>	<b>39,723</b>	<b>44,186</b>
Short Term Debt	3,148	2,147	2,147	2,147	2,147
Trade Payables	7,523	9,831	10,835	12,345	13,074
Dividends Payable	-	-	-	-	-
Other Current Liabilities	78	211	60	60	60
<b>Total Current Liabilities</b>	<b>10,749</b>	<b>12,189</b>	<b>13,042</b>	<b>14,552</b>	<b>15,281</b>
Long-Term Debt	6,642	6,448	6,306	6,306	6,306
Other LT Payables	-	-	-	-	-
Provisions	46	47	60	60	60
<b>Total Non-current Liabilities</b>	<b>6,688</b>	<b>6,495</b>	<b>6,367</b>	<b>6,367</b>	<b>6,367</b>
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	2,754	5,243	8,319	11,804	15,538
<b>Total Shareholders' Equity</b>	<b>9,754</b>	<b>12,243</b>	<b>15,319</b>	<b>18,804</b>	<b>22,538</b>
<b>Total Equity</b>	<b>9,754</b>	<b>12,243</b>	<b>15,319</b>	<b>18,804</b>	<b>22,538</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>27,192</b>	<b>30,926</b>	<b>34,727</b>	<b>39,723</b>	<b>44,186</b>
<b>Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Net Debt (SARmn)	7,476	7,062	5,705	3,293	833
Net Debt/EBITDA (x)	1.97	1.46	0.96	0.49	0.11
Net Debt to Equity	76.6%	57.7%	37.2%	17.5%	3.7%
EBITDA Interest Cover (x)	8.7	23.7	38.5	97.0	121.6
BVPS (SAR)	13.93	17.49	21.88	26.86	32.20
<b>Cashflow Statement (SARmn)</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Net Income before Tax & Minority Interest	2,099	3,045	4,029	4,568	5,005
Depreciation & Amortisation	1,298	1,629	1,801	2,117	2,376
Decrease in Working Capital	(39)	(388)	(416)	606	474
Other Operating Cashflow	189	(40)	131	(102)	(125)
<b>Cashflow from Operations</b>	<b>3,547</b>	<b>4,246</b>	<b>5,546</b>	<b>7,189</b>	<b>7,730</b>
Capital Expenditure	(2,954)	(3,288)	(3,312)	(3,796)	(4,123)
New Investments	-	-	-	-	-
Others	(1,580)	(51)	16	-	-
<b>Cashflow from investing activities</b>	<b>(4,533)</b>	<b>(3,339)</b>	<b>(3,297)</b>	<b>(3,796)</b>	<b>(4,123)</b>
<b>Net Operating Cashflow</b>	<b>(987)</b>	<b>907</b>	<b>2,250</b>	<b>3,392</b>	<b>3,607</b>
Dividends paid to ordinary shareholders	(250)	(525)	(875)	(980)	(1,147)
Proceeds from issue of shares	2,000	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	12	-	-	-	-
<b>Cashflow from financing activities</b>	<b>2,598</b>	<b>(1,687)</b>	<b>(1,035)</b>	<b>(980)</b>	<b>(1,147)</b>
Total cash generated	1,611	(781)	1,215	2,412	2,460
Cash at beginning of period	703	2,314	1,533	2,748	5,160
<b>Implied cash at end of year</b>	<b>2,314</b>	<b>1,533</b>	<b>2,748</b>	<b>5,160</b>	<b>7,620</b>
<b>Ratios</b>	<b>12/08A</b>	<b>12/09A</b>	<b>12/10E</b>	<b>12/11E</b>	<b>12/12E</b>
Capex/Sales	27.4%	25.2%	21.2%	21.0%	20.5%

Source: Company data, Al Rajhi Capital



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### Additional disclosures

#### 1. Explanation of Al Rajhi Capital's rating system

Al Rajhi Capital uses a three-tier rating system based on absolute upside or downside potential for all stocks under its coverage except financial stocks and those few other companies not compliant with Islamic Shariah law:

**"Overweight"**: Our target price is more than 15% above the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

**"Neutral"**: We expect the share price to settle at a level between 5% below the current share price and 15% above the current share price on a 6-9 month time horizon.

**"Underweight"**: Our target price is more than 5% below the current share price, and we expect the share price to reach the target on a 6-9 month time horizon.

#### 2. Definitions

**"Time horizon"**: Our analysts make recommendations on a 6-9 month time horizon. In other words, they expect a given stock to reach their target price within that time.

**"Fair value"**: We estimate fair value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

**"Target price"**: This may be identical to estimated fair value per share, but is not necessarily the same. There may be very good reasons why a share price is unlikely to reach fair value within our time horizon. In such a case we set a target price which differs from estimated fair value per share, and explain our reasons for doing so.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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