



US\$78.20bn Market cap **24.8%** Free float **US\$133.2mn** Avg. daily volume

Target price **131.2** 34.2% over current
 Consensus price **131.9** 34.9% over current
 Current price **97.75** as at 6/8/2011

Research Department

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Underweight

Neutral

Overweight

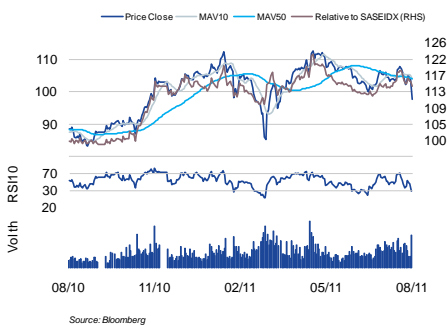
Key themes

We expect Saudi petrochemicals suppliers to outperform global rivals with margins driven by cheap feedstock costs and strong demand coming from Asia. We believe that SABIC (majority-owned by the Saudi government) with firm oil prices and large scale capacity additions, is well-positioned to capitalise on growth opportunities in the global petrochemicals sector.

Implications

The sector giant's diverse petrochemicals portfolio, proximity to its main target markets and high-capex driven growth are key catalysts for the stock. We rate SABIC Overweight.

Performance

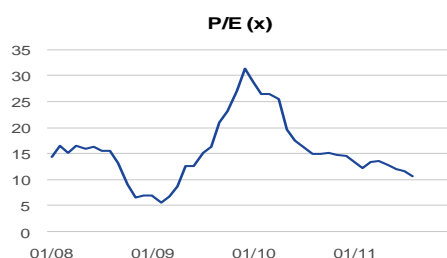


Earnings

Period End (SAR)	12/10A	12/11E	12/12E	12/13E
Revenue (mn)	151,714	189,836	207,879	214,473
Revenue Growth	47.2%	25.1%	9.5%	3.2%
EBITDA (mn)	48,238	62,760	64,694	65,414
EBITDA Growth	63.1%	30.1%	3.1%	1.1%
EPS	7.20	10.14	9.58	9.37
EPS Growth	173.5%	45.3%	-5.5%	-2.2%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

SABIC

Robust Q2 performance, volatile future ahead

SABIC reported a 61.5% year-on-year growth in Q2 2011 net earnings driven by a rise in product prices, higher sales volume and improved operating efficiencies. Considering the recent global economic concerns (US rating downgrade and European sovereign debt crisis) and a sharp drop in oil prices last week, we are conservative about the petrochemical prices for the remainder of the year. Despite these headwinds, we believe that SABIC will continue to deliver solid performance given its feedstock advantage, scale, proximity to key growth markets such as China and India. We reiterate our Overweight rating on SABIC and maintain our target price of SAR131.2.

Strong top-line growth: SABIC posted a 26.3% year-on-year growth in revenues to SAR49.09bn in Q2 2011 (vs. our estimate of SAR45.59bn and consensus of SAR46.67bn). Revenues jumped 9.4% quarter-on-quarter in Q2 2011, led by a strong revenue growth in petrochemicals segment (+7.4% sequentially). This robust increase is attributable to higher prices for most of the company's products and an increased capacity utilisation at Sharq and Tianjin complexes. Our price estimates were conservative due to macro concerns (monetary tightening and inflation) in the emerging markets.

Huge jump in net earnings: SABIC recorded a net profit of SAR8.1bn for Q2, up by 61.5% year-on-year and by 5.4% sequentially (vs. our estimates of SAR6.1bn). This discrepancy can be mainly attributable to our conservative view on the product prices and volumes during Q2. We had also overestimated the impact of the two month salary bonus declared by the company. Moreover, the higher net earnings were supported by lower tax and interest expenses, which were below our estimates. SABIC declared cash dividends of SAR6bn (SAR2 per share) for H1 2011, in-line with our estimates. Sitting on huge cash reserves, SABIC has also repaid SAR3bn sukuk in July 2011.

Robust top-line performance to continue in the remainder of 2011: With continued expansion plans (additional production from Kayan), SABIC is expected to witness volume growth in the near term. Prices of petrochemicals (ethylene, propylene etc.) came under pressure in July and we expect the prices to be subdued in H2 2011. However, we believe SABIC's fixed price contracts (estimated at 50% of contracts) will provide a partial cushion against a decline in spot prices. Accordingly, we estimate revenue of SAR47bn and SAR48.9bn for Q3 & Q4 2011 respectively. However, we might have to revise our price estimates in the event of major negative macroeconomic developments in the US or Europe, affecting oil prices severely.

Valuation and conclusion: SABIC reported better-than-expected results in Q2, reinstating our conviction in the strong fundamentals of the Saudi petrochemicals industry. We have raised our revenue estimate by 3% for 2011 and revised our cost assumptions based on Q2 results. Consequently, our EBITDA estimates increased by about 7.2% for 2011. Considering the macroeconomic concerns in the US and Europe, we have raised the market risk premium, which resulted in an increase in WACC to 10% from 9.4% earlier. We retain our Overweight rating with a target price of SAR131.2, implying a 34.2% upside from the current levels.



Corporate summary

Established in 1976, SABIC is the largest listed company in the GCC. It is 70% owned by the Saudi government, giving it solid financial and regulatory backing. SABIC has grown from producing 6mtpa of petrochemicals in the 1980s to over 60mtpa currently, and it accounts for over 80% of Saudi Arabia's output. SABIC has seen solid revenue growth over the last 5 years while the EBITDA margin has averaged 35% over the same period, significantly higher than the global average of 15%.

Share information

Market cap (SAR/US\$)	293.3bn / 78.20bn		
52-week range	83.25 - 112.5		
Daily avg volume (US\$)	133.2mn		
Shares outstanding	3,000mn		
Free float (est)	24.8%		
Performance:	1M	3M	12M
Absolute	-7.4%	-11.7%	10.8%
Relative to index	0.8%	-2.6%	14.4%
Major Shareholder:			
Public Investments Funds (PIF)	70%		
GOSI	5.2%		

Source: Bloomberg, Al Rajhi Capital

Valuation

Period End	12/10A	12/11E	12/12E	12/13E
Revenue (SARmn)	151,714	189,836	207,879	214,473
EBITDA (SARmn)	48,238	62,760	64,694	65,414
Net Profit (SARmn)	21,585	30,410	28,727	28,113
EPS (SAR)	7.20	10.14	9.58	9.37
DPS (SAR)	3.50	3.75	3.75	5.06
EPS Growth	173.5%	40.9%	-5.5%	-2.1%
EV/EBITDA (x)	9.3	6.9	6.4	6.2
P/E (x)	13.6	9.6	10.2	10.4
P/B (x)	2.4	2.1	1.9	1.7
Dividend Yield	3.6%	3.8%	3.8%	5.2%

Source: Company data, Al Rajhi Capital

SABIC: Expansion continues

Focus on higher performance & speciality chemicals to add value to the petrochemical exports

Expanding chemical segment: SABIC is expanding its basic chemicals line to produce high performance chemicals. The company has finalized strategic agreements with Mitsubishi Rayon, Montefibre, Exxon Mobil, Lurgi and Asahi, to produce methyl methacrylate (250ktpa), polymethylmethacrylate (40ktpa), carbon fiber (3ktpa), elastomers, and sodium cyanide. We believe that the focus on higher performance & speciality grades chemicals will add value to the Saudi petrochemicals exports. The company also plans to invest in a joint venture with China Petroleum & Chemical Corporation (Sinopec) to produce polycarbonate (260ktpa) in China from 2015.

Earnings contribution from Saudi Kayan expected from Q4 2011: With visibility on the launch of commercial production (company guidance of 1st October 2011) at Saudi Kayan (35% owned by SABIC), we have revised cracker utilisation rate for Saudi Kayan. Accordingly, we expect SABIC to benefit from higher production and sales of petrochemicals products like ethylene (total capacity of Saudi Kayan of 1.48mtpa), propylene (0.63mtpa) and their derivatives in Q4 2011. We anticipate Saudi Kayan to account for 6% of the company's total revenues and 8% of net earnings for the year 2012.

Economic growth in emerging markets to support demand for petrochemicals in the medium term

Rising Saudi petrochemicals exports: According to the Saudi Ports Authority, petrochemicals exports from Saudi Arabia rose to 12.6mn tons in the first five months of 2011 from 11.8mn tons a year earlier on growing demand from Asia, mainly China and Singapore. Petrochemicals exports grew by 39.1% year-on-year in the month of May to SAR4.8bn despite a decline in export volume by 3.4% year-on-year basis (source: Bloomberg), indicating a significant jump in product prices. According to the Gulf Petrochemicals and Chemicals Association, the total petrochemicals production of the Gulf States is expected to increase 46% from the current production of 105mtpa to 155mtpa by 2015 to serve growing demand, with Saudi Arabia accounting for more than 50% of the total petrochemicals production.

Petrochemical prices to face near term headwinds from global macro environment

Uncertain global macro-economic environment: Since the start of 2011, the global macro-economic environment continued to remain uncertain as developed countries struggled to achieve growth. However, the recent developments such as an escalation of European sovereign debt crisis (from Greece to potentially Spain and Italy) and a credit rating downgrade for US by S&P (from AAA to AA+) has clouded the global economic recovery. The MSCI World index and WTI crude dipped by 9% each last week fuelling concerns about a second financial crisis. We expect these developments to create near term headwinds for the petrochemical industry, especially for the product prices. We currently expect a moderate decline in the product prices for H2 2011; however, we will closely monitor the macro-economic developments and will come out with another update note if required.



We expect prices to remain strong in H2 2011, but slightly lower as compared to H1 2011.

Pricing pressure to impact H2 performance: During Q2 2011, blended prices of the key products of SABIC grew by about 28% on a year-on-year basis. Average price of ethylene (+37.8% year-on-year), polyethylene (+19.1%), ammonia (+45.6%) and urea (+65.6%) rose sharply in Q2 2011. However in July, average prices of ethylene and polyethylene declined 16% (at US\$1,284/mt) and 7% (at US\$1,358/mt) respectively as compared to average price in Q2 mainly due to weaker demand and uncertain global economic outlook. We expect average prices to decline moderately in H2 2011.

Currently, we estimate average price of ethylene and polyethylene to decline by 11% and 5% respectively in Q3. We estimate the average blended price for petrochemicals to decline by 5.8% in Q3. Thus, we expect SABIC to report revenues and net profit of SAR47bn and SAR7.43bn respectively, a decline of 4.3% and 8.3% quarter-on-quarter. In Q4 2011, we expect the blended price to decline further by 0.5% quarter-on-quarter, however, the revenues and net profit are estimated to increase owing to additional production from Kayan.

Government spending and strong demand to drive growth for steel segment

Improving demand for steel and fertilizers bodes well for growth: The steel segment is expected to witness a strong demand on the back of fast-growing real estate and construction industry in Saudi Arabia and continuous growth from the government backed massive infrastructure projects (US\$400bn over the next five years, source: zawya). Higher demand and soaring steel prices is expected to support top-line growth of Saudi steel producers, including SABIC. On the other hand, high price environment dented the sales of fertilizers in Q2 2011. We expect fertilizer segment to recover in the coming quarters with an improvement in demand, mainly from emerging markets. The International Fertilizer Industry Association (IFA) expects demand for urea to grow at 3.8% annually to 175mtpa by 2014, due to increased demand for fertilizers as well as industrial applications of urea. Moreover, IFA expects the Middle East to become the world's largest exporting region of urea, as capacity of the region is estimated to reach 23mtpa by 2014.

Scheduled maintenance at three MEG plants not to impact sales in H2: SABIC is planning to shut its three MEG (mono-ethylene glycol) plants (total capacity of 1.5mtpa) for maintenance from mid-September. The company has delayed this maintenance plan from its original schedule of H1 2011 due to inadequate inventory level to cater to MEG demand. The shutdown at two plants is scheduled for 10 days each in Q4, while the third plant maintenance will start in mid September and last for 35 days. We have reduced MEG plant utilisation to 97% and 93% for Q3 and Q4 respectively from our earlier estimates of 100%. We do not expect any significant impact of plant shutdown on the H2 earnings, as the company has reported that it has sufficient inventory levels. Additionally, Saudi Kayan will also contribute to MEG production from Q4.

Figure 1. SABIC: Q2 and Q3 results (actual and our estimates)

(SAR mn)	Q2 2010 actual	Q1 2011 actual	Q2 2011 ARC est	Q2 2011 actual	% chg y-y	Q3 2010 actual	Q3 2011 ARC est	% chg y-y
Revenues	38,862	44,873	45,594	49,086	26.3%	37,877	46,992	24.1%
Gross profit	14,502	18,187	17,554	19,265	32.8%	14,128	18,609	31.7%
Gross margin	37.3%	40.5%	38.5%	39.2%	193 bps	37.3%	39.6%	230 bps
EBITDA	11,795	15,270	13,450	16,046	36.0%	11,616	15,507	33.5%
EBITDA margin (%)	30.4%	34.0%	29.5%	32.7%	234 bps	30.7%	33.0%	233 bps
Operating Profit	9,138	12,508	10,597	13,276	45.3%	8,982	12,622	40.5%
Net profit	5,016	7,689	6,131	8,101	61.5%	5,326	7,431	39.5%
Capex	(2,750)	(2,997)	(5,471)	(3,417)	24.3%	(4,675)	(4,229)	-9.5%
Capex / Sales	7.1%	6.7%	12.0%	7.0%	n/m	12.3%	9.0%	n/m
Net debt	57,540	67,835	69,335	56,824	-1.2%	58,797	52,613	-10.5%
Net debt / Annualized EBITDA (x)	1.2	1.1	1.3	0.9	n/m	1.3	0.8	n/m

Source: Company data, Al Rajhi Capital



Global recovery and capacity expansion set to drive strong sales growth over the next three years

We expect growth in the dividend resulting from growth in earnings

Strong Asian demand should drive growth

Income Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue	103,062	151,714	189,836	207,879	214,473
Cost of Goods Sold	(64,851)	(92,766)	(114,564)	(128,634)	(134,046)
Gross Profit	38,211	58,948	75,272	79,246	80,427
Government Charges					
S.G. & A. Costs	(19,407)	(21,104)	(24,608)	(30,526)	(31,586)
Operating EBIT	18,804	37,844	50,664	48,719	48,842
Cash Operating Costs	(73,485)	(103,476)	(127,076)	(143,185)	(149,059)
EBITDA	29,577	48,238	62,760	64,694	65,414
Depreciation and Amortisation	(10,773)	(10,394)	(12,096)	(15,975)	(16,573)
Operating Profit	18,804	37,844	50,664	48,719	48,842
Net financing income/(costs)	(1,529)	(2,034)	(1,265)	(1,315)	(1,856)
Forex and Related Gains					
Provisions	-	-	-	-	-
Other Income					
Other Expenses	(1,181)	-	-	-	-
Net Profit Before Taxes	16,094	35,810	49,399	47,404	46,985
Taxes	(900)	(2,500)	(3,089)	(3,318)	(2,819)
Minority Interests	(7,302)	(11,725)	(15,900)	(15,359)	(16,054)
Net profit available to shareholders	7,892	21,585	30,410	28,727	28,113
Dividends	(4,500)	(10,500)	(11,250)	(11,250)	(15,181)
Transfer to Capital Reserve					
	12/09A	12/10A	12/11E	12/12E	12/13E
Adjusted Shares Out (mn)	3,000	3,000	3,000	3,000	3,000
CFPS (SAR)	8.66	14.57	19.47	20.02	20.25
EPS (SAR)	2.63	7.20	10.14	9.58	9.37
DPS (SAR)	1.50	3.50	3.75	3.75	5.06
Growth	12/09A	12/10A	12/11E	12/12E	12/13E
Revenue Growth	-31.7%	47.2%	25.1%	9.5%	3.2%
Gross Profit Growth	-31.5%	54.3%	27.7%	5.3%	1.5%
EBITDA Growth	-36.6%	63.1%	30.1%	3.1%	1.1%
Operating Profit Growth	-48.6%	101.2%	33.9%	-3.8%	0.3%
Net Profit Growth	-64.2%	173.5%	40.9%	-5.5%	-2.1%
EPS Growth	-64.2%	173.5%	40.9%	-5.5%	-2.1%
Margins	12/09A	12/10A	12/11E	12/12E	12/13E
Gross profit margin	37.1%	38.9%	39.7%	38.1%	37.5%
EBITDA margin	28.7%	31.8%	33.1%	31.1%	30.5%
Operating Margin	18.2%	24.9%	26.7%	23.4%	22.8%
Pretax profit margin	15.6%	23.6%	26.0%	22.8%	21.9%
Net profit margin	7.7%	14.2%	16.0%	13.8%	13.1%
Other Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
ROCE	7.1%	13.9%	17.3%	15.5%	15.4%
ROIC	9.9%	18.1%	21.9%	19.9%	19.2%
ROE	7.5%	18.8%	23.3%	19.3%	17.1%
Effective Tax Rate	5.6%	7.0%	6.3%	7.0%	6.0%
Capex/Sales	23.3%	10.6%	8.4%	12.0%	12.0%
Dividend Payout Ratio	57.0%	48.6%	37.0%	39.2%	54.0%
Valuation Measures	12/09A	12/10A	12/11E	12/12E	12/13E
P/E (x)	37.2	13.6	9.6	10.2	10.4
P/CF (x)	11.3	6.7	5.0	4.9	4.8
P/B (x)	2.7	2.4	2.1	1.9	1.7
EV/Sales (x)	4.3	2.9	2.3	2.0	1.9
EV/EBITDA (x)	15.1	9.3	6.9	6.4	6.2
EV/EBIT (x)	23.8	11.8	8.5	8.6	8.3
EV/IC (x)	2.3	2.1	1.9	1.7	1.6
Dividend Yield	1.5%	3.6%	3.8%	3.8%	5.2%

Source: Company data, Al Rajhi Capital



SABIC's capacity expansion is expanding the balance sheet

Balance Sheet (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Cash and Cash Equivalents	56,377	50,645	62,127	71,726	65,269
Current Receivables	20,534	29,216	33,242	36,484	37,642
Inventories	23,770	26,240	35,197	37,557	38,749
Other current assets	5,482	10,335	13,078	13,078	13,078
Total Current Assets	106,464	116,436	143,643	158,846	154,738
Fixed Assets	157,539	165,050	169,779	178,750	187,914
Investments	8,299	8,829	9,556	9,556	9,556
Goodwill	21,901	22,263	23,135	23,135	23,135
Other Intangible Assets	-	-	-	-	-
Total Other Assets	2,658	4,636	2,779	2,779	2,779
Total Non-current Assets	190,398	200,778	205,248	214,219	223,383
Total Assets	296,861	317,214	348,892	373,065	378,121
Short Term Debt	6,477	16,621	18,981	18,981	18,981
Accounts Payable	13,382	15,347	19,554	21,461	22,142
Accrued Expenses	13,402	12,804	17,598	19,315	19,928
Zakat Payable	-	-	-	-	-
Dividends Payable	587	625	-	-	-
Other Current Liabilities	-	-	-	-	-
Total Current Liabilities	33,849	45,397	56,133	59,757	61,051
Long-Term Debt	100,538	94,031	90,711	90,711	76,366
Other LT Payables	9,845	11,605	12,295	12,295	12,295
Provisions	-	-	-	-	-
Total Non-current Liabilities	110,382	105,636	103,006	103,006	88,661
Minority interests	44,375	45,342	49,812	52,884	56,094
Paid-up share capital	30,000	30,000	30,000	30,000	30,000
Total Reserves	78,255	90,839	109,941	127,418	142,315
Total Shareholders' Equity	108,255	120,839	139,941	157,418	172,315
Total Equity	152,630	166,181	189,752	210,301	228,409
Total Liabilities & Shareholders' Equity	296,861	317,214	348,892	373,065	378,121

We expect a decline in net debt on account of higher cash flow from operations

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Net Debt (SARmn)	50,637	60,007	47,565	37,966	30,077
Net Debt/EBITDA (x)	1.71	1.24	0.76	0.59	0.46
Net Debt to Equity	33.2%	36.1%	25.1%	18.1%	13.2%
EBITDA Interest Cover (x)	19.3	23.7	49.6	49.2	35.2
BVPS (SAR)	36.08	40.28	46.65	52.47	57.44

Cashflow Statement (SARmn)	12/09A	12/10A	12/11E	12/12E	12/13E
Net Income before Tax & Minority Interest	16,094	35,810	49,399	47,404	46,985
Depreciation & Amortisation	10,773	10,394	12,096	15,975	16,573
Decrease in Working Capital	(461)	(12,837)	(5,398)	(1,979)	(1,055)
Other Operating Cashflow	(393)	(2,878)	(3,204)	(3,318)	(2,819)
Cashflow from Operations	26,012	30,489	52,893	58,082	59,684
Capital Expenditure	(23,988)	(16,027)	(16,020)	(24,946)	(25,737)
New Investments	724	105	(374)	-	-
Others	(1,371)	(4,216)	(1,527)	-	-
Cashflow from investing activities	(24,636)	(20,139)	(17,921)	(24,946)	(25,737)
Net Operating Cashflow	1,377	10,350	34,972	33,136	33,947
Dividends paid to ordinary shareholders	(3,750)	(8,962)	(11,127)	(11,250)	(13,215)
Proceeds from issue of shares	-	-	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	(6,931)	(10,577)	(10,898)	(12,287)	(12,843)
Cashflow from financing activities	3,973	(16,083)	(23,491)	(23,537)	(40,403)
Total cash generated	5,350	(5,732)	11,482	9,599	(6,456)
Cash at beginning of period	51,028	56,377	50,645	62,127	71,726
Implied cash at end of year	56,377	50,645	62,127	71,726	65,269

We expect the capex/sales ratio to stabilize at 12%

Ratios	12/09A	12/10A	12/11E	12/12E	12/13E
Capex/Sales	23.3%	10.6%	8.4%	12.0%	12.0%

Source: Company data, Al Rajhi Capital



Disclaimer and additional disclosures for Equity Research

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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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