



US\$8.96bn Market cap	56.9% Free float	US\$14.20mn Avg. daily volume
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Target price	64.90	35.2% over current
Consensus price	58.00	20.8% over current
Current price	48.00	as at 10/3/2010

Underweight	Neutral	Overweight
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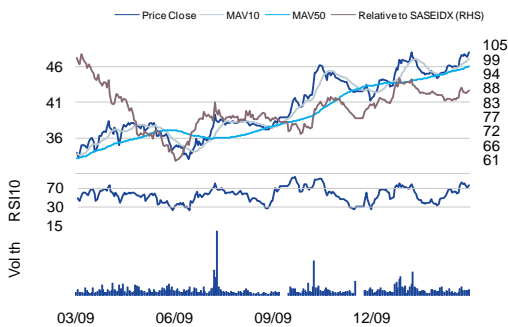
Key themes

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 broadband, 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

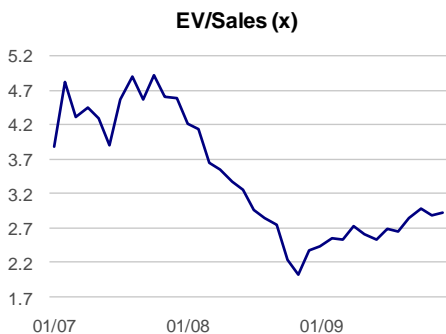


Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	13,058	14,895	16,735	18,171
Revenue Growth	21.0%	14.1%	12.4%	8.6%
EBITDA (SARmn)	4,837	5,640	6,309	6,905
EBITDA Growth	27.5%	16.6%	11.9%	9.4%
EPS	4.31	5.04	5.66	6.12
EPS Growth	16.8%	16.9%	12.2%	8.3%

Source: Company data, Al Rajhi Capital

Valuation



Source: Company data, Al Rajhi Capital

Mobily

Still our top pick in KSA telecoms

Mobily remains our favourite in the Saudi telecoms market. The launch of 21Mbps service should reinforce its dominance of the surging mobile broadband market. Recent regulatory developments are unlikely to affect the company severely. We expect strong Q1 results and believe that these will be a catalyst for renewed share price performance. We remain Overweight with an unchanged target price of SAR64.9, implying 35% appreciation potential.

Mobily launches 21Mbps mobile broadband. Ahead of its rivals, Mobily has recently launched 21.6Mbps mobile broadband service based on HSPA+ technology. The new service is being widely advertised on the streets of Riyadh. As yet Mobily has released no information about expected take-up. However, we believe that the new service will be very competitive compared to existing fixed-line DSL service. We believe that mobile broadband accounts overtook DSL accounts in Saudi Arabia late last year, and expect mobile broadband to continue to grow faster. This should reinforce Mobily's dominance of the market.

Impact of recent regulatory developments. There have been two recent adverse regulatory developments for Mobily and the other Saudi telecoms operators. Firstly, the CITC, the Saudi telecoms regulator, appears to have confirmed a ban on free overseas roaming offers. Secondly, the Saudi authorities appear to be considering closing down the BlackBerry Messenger service in the kingdom for security reasons. In our view, both developments are negative for the operators, but not greatly so. While free roaming offers are a strong marketing tool, we doubt that the majority of Saudi mobile users roam abroad very regularly. Likewise, we do not expect the majority of BlackBerry users to cancel their subscriptions even if the Messenger service is withdrawn.

We predict strong Q1 results. Mobily achieved strong growth in mobile data accounts in Q4 2009. It seems clear that mobile data service carries higher margins than mobile voice service. This robust accounts growth should help drive further expansion in revenues and – more importantly – EBITDA in Q1 2010. We expect strong EBITDA to drive year-on-year net profit growth of 20% in Q1. We do not see slightly disappointing sales growth in Q4 2009 as a sign of impending slowdown; we think this largely reflected a weak Hajj season. We think strong Q1 results will be a catalyst for renewed share price performance.

Valuation reasonable. Using long-run discounted economic profit valuation, we estimate fair value per share for Mobily at SAR64.9; this remains our target price. Despite strong share price performance over 2009, Mobily is not yet expensive for a fast-growing telecoms operator on a 2010 EV/sales ratio of 2.7x, an EV/EBITDA ratio of 7.0x and a PE of 9.5x. The 2009 dividend yield is 2.6%, which is low compared to 6-7% for STC but far from negligible.

Stock rating and conclusion: We think that the Saudi mobile market still has growth potential despite high penetration, and expect Mobily to be the key beneficiary of demand for mobile broadband service. Mobily also owns fixed-line assets which should help it to enhance its service range over the medium term. We retain our Overweight rating and our price target implies 35% upside. The key risk to our assumptions for Mobily is pressure on mobile voice prices.



Corporate summary

Etihaq Etisalat (Mobily) is the second-placed telecoms operator in Saudi Arabia, with a market value of US\$9bn. 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\$) 33.60bn / 9.00bn
52-week range 32.80 - 48.00
Daily avg volume (US\$) 14.20mn
Shares outstanding 700.0mn
Free float (est) 56.9%

Performance: 1M 3M 12M
Absolute 7.6% 16.5% 46.3%
Relative to index 2.1% 6.2% -12.2%

Major Shareholder:
Emirates Telecoms Corp. 27.4%
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	14,895	16,735	18,171
EBITDA (SARmn)	4,837	5,640	6,309	6,905
Net Profit (SARmn)	3,014	3,527	3,959	4,285
EPS (SAR)	4.31	5.04	5.66	6.12
DPS (SAR)	1.25	1.38	1.58	1.90
EPS Growth	16.8%	17.0%	12.2%	8.3%
EV/EBITDA (x)	8.5	7.0	5.9	5.1
P/E (x)	11.1	9.5	8.5	7.8
P/B (x)	2.7	2.3	1.9	1.6
Dividend Yield	2.6%	2.9%	3.3%	4.0%

Source: Company data, Al Rajhi Capital

We predict strong Q1 results

Mobily is due publish its Q1 2010 results within the first three weeks or so of April. The table below shows our current forecasts. We anticipate strong results featuring year-on-year net profit growth of 19.9%. Strong results will, we believe, act as a catalyst for renewed share price performance.

Figure 1. Mobily: estimates for Q1 2010 results

(SAR 000s)	Q1 FY09	Q1 FY10E	% chg	Comment
Subscriptions (000s)	15,400	18,959	23.1%	Estimates. Mobily does not release subscriptions data on a quarterly basis.
Subscriptions market share (%)	40.9%	40.0%	-0.9pp	As above.
Revenues	2,810,455	3,244,925	15.5%	Q4 sales growth of 13.8% was weak. But we expect a slightly stronger Q1.
Cost of Services	-1,193,797	-1,411,543	18.2%	
Gross profit	1,616,658	1,833,383	13.4%	N/a
				We expect rising mobile broadband accounts to drive further margin expansion.
EBITDA	908,015	1,087,050	19.7%	Mobile data service does seem to carry higher margins than mobile voice.
EBITDA margin (%)	32.3%	33.5%	1.2pp	As above.
Amortisation	-130,892	-130,400	-0.4%	N/a
Depreciation Expense	-243,914	-311,085	27.5%	Effective depreciation rate has been falling, but this may not continue.
Net Operating Profit	533,209	645,565	21.1%	Should be pushed up by strong EBITDA.
Net financial costs	-75,135	-54,950	-26.9%	This reflects steadily declining net debt.
Other Income	23,246	0	-100.0%	N/a
Net Profit Before Taxes/Zakat	481,320	590,615	22.7%	This should reflect strong EBITDA and falling financial costs.
Tax / Zakat Provision	-1,158	-14,765	1175.1%	N/m
Net Profit After Taxes or Zakat	480,162	575,849	19.9%	This should reflect strong EBITDA and falling financial costs.
Capex	907,274	713,836	-21.3%	We expect rising network capacity needs to prevent capex from falling sharply.
Capex/sales ratio (%)	32.3%	22.0%	-10.3pp	As above.
Net debt	7,915,923	6,604,323	-16.6%	We forecast strong operating cash flow for Q1.
Net debt/EBITDA (x)	2.2	1.5	n/m	This is a healthy gearing level.

Source: Company data, Al Rajhi Capital

Positive impact of strong growth in mobile data accounts should continue from Q4 into Q1

Growth in mobile broadband accounts should boost margins

Mobily achieved very strong growth in 3.5G mobile broadband service in the second half of 2009: as reported, mobile broadband accounts rose from 0.6mn at the end of Q2 to 1.0mn by the end of Q4. It seems clear that mobile data service carries higher margins than mobile voice service. In our view, this is partly because price competition is lower in data service than in voice (although we do expect current mobile broadband pricing to decline); another reason is that advertising and promotional costs appear to be lower. The positive impact of strong growth in mobile broadband accounts should continue from Q4 into Q1, helping to drive further expansion in revenues and – more importantly – EBITDA and EBITDA margin. Over the three years from 2007 to 2009, Q1 was the weakest quarter for Mobily in margin terms, and this is why we forecast an EBITDA margin of 33.5% for Q1 after 43.0% in Q4 (the strongest quarter over each of the past three years). Nevertheless, we predict 19.7% year-on-year growth in EBITDA in Q1, and a 1.2 percentage point increase in the EBITDA margin; and our assumptions could well prove conservative.



Hajj was weaker in 2009 than in 2008

Apparent weakness of Q4 revenues not a great concern

As we noted in our recent major report *Saudi Telecoms Sector: we prefer jam today* (25th January, 2010), Mobily's revenue performance in Q4 2009 was slightly disappointing. Revenue growth of 13.8% year-on-year was slightly below our forecast, and Q4 showed the lowest increase of the year; revenue growth exceeded 20% over each of the first three quarters. However, the strongest quarter of the year for the Saudi telecoms operators is the quarter which includes the Eid al-Adha festival, which is the time when the annual Hajj pilgrimage to Mecca takes place (since the pilgrimage generates strong additional telecoms traffic). Over the past three years the Hajj has fallen in Q4. While the Hajj season was very strong in 2008, with around 3.0mn visitors, this number dropped to around 2.5mn in 2009.

The table below shows that Q4 accounted for 28.6% of Mobily's annual revenue in 2007, and for 28.8% in 2008. If all other factors were equal, Q4 would generate 25% of annual revenue for the company each year. For 2007 and 2008, we calculate the "excess" revenue in Q4 – that is to say, the excess over 25% of annual total revenues – at SAR301-411mn. We believe that this excess revenue is largely explained by additional telecoms traffic generated during the Hajj season. By contrast, in 2009, Q4 accounted for 27.1% of total revenues for the year, and the excess revenue in Q4 was lower, at SAR273mn.

Figure 2. Impact on Mobily of Hajj season

(SAR mn)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	FY07	FY07	FY07	FY07	FY08	FY08	FY08	FY08	FY09	FY09	FY09	FY09
Revenues	1,877	2,029	2,125	2,411	2,308	2,544	2,834	3,109	2,810	3,199	3,511	3,537
% of revenues generated in each quarter	22.2%	24.0%	25.2%	28.6%	21.4%	23.6%	26.3%	28.8%	21.5%	24.5%	26.9%	27.1%
Estimated "normalised" quarterly revenues (25% of annual total)	2,110	2,110	2,110	2,110	2,699	2,699	2,699	2,699	3,265	3,265	3,265	3,265
Shortfall or excess of revenues over normalised total	-234	-82	14	301	-391	-155	135	411	-454	-65	247	273

Source: Company data, Al Rajhi Capital

If the Hajj season had been as strong in 2009 as in 2008, we think Q4 revenue growth could have been over 18%

If the Hajj season had been as strong in 2009 as in 2008, we think that Mobily would have generated around SAR140mn of additional revenue in Q4. If so, then it would have achieved revenues for that period of at least SAR3,677mn rather than the reported figure of SAR3,537mn. On this basis, year-on-year revenue growth in Q4 would have been 18.3% rather than the reported 13.8%.

While the Hajj is not the only factor involved, we expect a pick-up in revenue growth to 15.5% in Q1

In our view, other factors probably did contribute to the slowdown in revenue growth in Q4. We think that intensifying pressure on mobile voice prices in particular was one of these factors. Nevertheless, the relatively weak Hajj season almost certainly was the key reason for Mobily's disappointing revenue performance in that period. Given that growth in mobile broadband should help to compensate for pressure on voice prices, we regard our estimate of year-on-year revenue growth of 15.5% for Mobily in Q1 2010 as realistic. We expect revenue growth to slow down gradually after Q1, but to be boosted in Q4 by a stronger Hajj season (partly reflecting the recovering global economy, which should encourage tourist visits). On this basis we predict revenue growth of 14.1% for Mobily for 2010 as a whole.

We think that recent reports of two adverse regulatory developments are essentially correct

Modest impact from recent regulatory developments

Two recent regulatory developments will have some impact on Mobily and the other Saudi operators. Firstly, the CITC, the Saudi telecoms regulator, has reportedly confirmed a ban on free overseas roaming offers; see, e.g., the report from *Okaz* news service cited by Bloomberg on 17th February. To be precise, our understanding is that the CITC has recently reaffirmed a ban which had been in place for a year or so. Secondly, there have been various reports (see, e.g., the report from *Arab News* cited by Bloomberg on 5th March) that the Saudi authorities are considering closing down the BlackBerry Messenger service in the kingdom for security reasons. While we await official confirmation of these reports from the CITC, we believe that the reports are essentially correct.

Most Saudi mobile users are probably not great roamers

In our opinion, both developments are negative for the Saudi operators, but not greatly so. The Saudi operators have used free international roaming offers as a tool to help attract new customers; this has been particularly true of Zain KSA, whose "One network" offer takes advantage of its membership of the Zain group with a presence in many different countries. However, we doubt that the majority of the Saudi operators' customers roam widely except for very high-end customers, who are likely to be less concerned about roaming prices.



The BlackBerry's popularity in KSA is unlikely to reflect the Messenger service alone

Regarding the BlackBerry Messenger service, Research in Motion's BlackBerry handset has proved very popular in Saudi Arabia, winning wide acceptance among ordinary consumers as well as business users. Although we cannot confirm this, we believe that the BlackBerry may be the single most popular mobile handset in Saudi Arabia; one source has suggested to us that there are around 250,000 BlackBerry devices in the kingdom. While the BlackBerry Messenger service appears to be widely used, we doubt that the majority of customers are using the BlackBerry simply for that service, or that they will cancel their subscriptions if it is no longer available. With larger user bases, we suspect that STC and Mobily would be slightly more affected by closure of the service than Zain KSA, which appears to have the smallest BlackBerry user base – albeit a rapidly growing one.



2009 saw sales growth of 21% and expansion in the EBITDA margin from 35% to 37%

Rising earnings give scope to boost dividend

Growth rates set to moderate in 2010, but to remain high

Mobily offers solid value, especially on EV/sales and PE

Income Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Revenue	10,795	13,058	14,895	16,735	18,171
Cost of Goods Sold	(4,766)	(5,512)	(6,224)	(7,079)	(7,632)
Gross Profit	6,028	7,547	8,671	9,656	10,539
Government Charges					
S.G. & A. Costs	(2,234)	(2,710)	(3,031)	(3,347)	(3,634)
Operating EBIT	2,496	3,208	3,799	4,256	4,532
Cash Operating Costs	(7,000)	(8,221)	(9,255)	(10,426)	(11,266)
EBITDA	3,794	4,837	5,640	6,309	6,905
Depreciation and Amortisation	(1,298)	(1,629)	(1,841)	(2,054)	(2,373)
Operating Profit	2,496	3,208	3,799	4,256	4,532
Net financing income/(costs)	(438)	(204)	(181)	(195)	(137)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	41	-	-	-
Other Expenses	-	-	-	-	-
Minority Interests	-	-	-	-	-
Net Profit Before Taxes	2,099	3,045	3,617	4,060	4,395
Taxes	(7)	(31)	(90)	(102)	(110)
Net Profit	2,092	3,014	3,527	3,959	4,285
Dividends	-	(875)	(963)	(1,107)	(1,328)
Transfer to Capital Reserve	-	-	-	-	-
	12/08A	12/09A	12/10E	12/11E	12/12E
Adjusted Shares Out (mn)	523.0	700.0	700.0	700.0	700.0
CFPS (SAR)	5.98	6.63	7.67	8.59	9.51
EPS (SAR)	3.69	4.31	5.04	5.66	6.12
DPS (SAR)	0.000	1.250	1.375	1.581	1.898
	12/08A	12/09A	12/10E	12/11E	12/12E
Growth					
Revenue Growth	27.9%	21.0%	14.1%	12.4%	8.6%
Gross Profit Growth	29.7%	25.2%	14.9%	11.4%	9.1%
EBITDA Growth	17.2%	27.5%	16.6%	11.9%	9.4%
Operating Profit Growth	13.1%	28.5%	18.4%	12.0%	6.5%
Net Profit Growth	51.6%	44.1%	17.0%	12.2%	8.3%
EPS Growth	39.8%	16.8%	17.0%	12.2%	8.3%
	12/08A	12/09A	12/10E	12/11E	12/12E
Margins					
Gross profit margin	55.8%	57.8%	58.2%	57.7%	58.0%
EBITDA margin	35.1%	37.0%	37.9%	37.7%	38.0%
Operating Margin	23.1%	24.6%	25.5%	25.4%	24.9%
Pretax profit margin	19.4%	23.3%	24.3%	24.3%	24.2%
Net profit margin	19.4%	23.1%	23.7%	23.7%	23.6%
	12/08A	12/09A	12/10E	12/11E	12/12E
Other Ratios					
ROCE	15.2%	17.2%	17.9%	17.7%	16.8%
ROIC	16.8%	16.2%	16.9%	17.0%	16.2%
ROE	26.7%	27.4%	26.1%	24.4%	22.4%
Effective Tax Rate	0.3%	1.0%	2.5%	2.5%	2.5%
Capex/Sales	27.4%	25.2%	21.5%	21.0%	20.5%
Dividend Payout Ratio	0.0%	29.0%	27.3%	28.0%	31.0%
	12/08A	12/09A	12/10E	12/11E	12/12E
Valuation Measures					
P/E (x)	13.0	11.1	9.5	8.5	7.8
P/CF (x)	8.0	7.2	6.3	5.6	5.0
P/B (x)	2.6	2.7	2.3	1.9	1.6
EV/Sales (x)	3.3	3.2	2.7	2.2	1.9
EV/EBITDA (x)	9.3	8.5	7.0	5.9	5.1
EV/EBIT (x)	14.2	12.9	10.4	8.7	7.8
EV/IC (x)	1.7	1.9	1.6	1.4	1.2
Dividend Yield	0.0%	2.6%	2.9%	3.3%	4.0%

Source: Company data, Al Rajhi Capital



We expect Mobily to have net cash by 2013

Annualised Q409 net debt/ EBITDA was 1.3 at end-2009; this is a healthy gearing level

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

Balance Sheet (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Cash and Cash Equivalents	2,314	2,000	3,778	6,106	7,920
Current Receivables	3,389	5,029	5,647	6,025	6,541
Inventories	108	132	242	251	273
Other current assets	4,200	1,416	1,416	1,416	1,416
Total Current Assets	6,621	8,577	11,083	13,798	16,150
Fixed Assets	8,117	10,370	12,256	14,238	16,112
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,923	10,450	9,928	9,407	8,885
Total Other Assets	-	-	-	-	-
Total Non-current Assets	20,570	22,349	23,714	25,175	26,527
Total Assets	27,192	30,926	34,797	38,972	42,677
Short Term Debt	3,148	3,235	3,235	3,235	3,235
Trade Payables	7,523	7,978	9,196	10,376	10,902
Dividends Payable	-	875	963	1,107	1,328
Other Current Liabilities	78	100	100	100	100
Total Current Liabilities	10,749	12,189	13,494	14,818	15,566
Long-Term Debt	6,642	6,425	6,425	6,425	6,425
Other LT Payables	-	-	-	-	-
Provisions	46	70	70	70	70
Total Non-current Liabilities	6,688	6,495	6,495	6,495	6,495
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	2,754	5,243	7,808	10,659	13,617
Total Shareholders' Equity	9,754	12,243	14,808	17,659	20,617
Total Equity	9,754	12,243	14,808	17,659	20,617
Total Liabilities & Shareholders' Equity	27,192	30,926	34,797	38,972	42,677
Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Net Debt (SARmn)	7,476	7,660	5,882	3,554	1,740
Net Debt/EBITDA (x)	1.97	1.58	1.04	0.56	0.25
Net Debt to Equity	76.6%	62.6%	39.7%	20.1%	8.4%
EBITDA Interest Cover (x)	8.7	23.7	31.1	32.3	50.3
BVPS (SAR)	18.65	17.49	21.15	25.23	29.45
Cashflow Statement (SARmn)	12/08A	12/09A	12/10E	12/11E	12/12E
Net Income before Tax & Minority Interest	2,099	3,045	3,617	4,060	4,395
Depreciation & Amortisation	1,298	1,629	1,841	2,054	2,373
Decrease in Working Capital	(40)	(974)	491	793	(12)
Other Operating Cashflow	189	547	(90)	(102)	(110)
Cashflow from Operations	3,546	4,246	5,858	6,805	6,646
Capital Expenditure	(2,952)	(3,292)	(3,205)	(3,514)	(3,725)
New Investments	(1,050)	448	-	-	-
Others	(1,580)	(44)	-	-	-
Cashflow from investing activities	(5,583)	(2,889)	(3,205)	(3,514)	(3,725)
Net Operating Cashflow	(2,037)	1,357	2,653	3,290	2,921
Dividends paid to ordinary shareholders	(250)	(525)	(875)	(963)	(1,107)
Proceeds from issue of shares	2,000	-	-	-	-
Increase in Loans	836	(1,162)	-	-	-
Effects of Exchange Rates on Cash	-	-	-	-	-
Other Financing Cashflow	12	-	-	-	-
Cashflow from financing activities	2,598	(1,687)	(875)	(963)	(1,107)
Total cash generated	561	(331)	1,778	2,328	1,814
Cash at beginning of period	703	2,314	2,000	3,778	6,106
Implied cash at end of year	1,264	1,983	3,778	6,106	7,920
Ratios	12/08A	12/09A	12/10E	12/11E	12/12E
Capex/Sales	27.4%	25.2%	21.5%	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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