

# Etiad Etisalat Company

Telecoms – Mobile

EEC AB: Saudi Arabia

24 April 2010

الراجحي المالية  
Al Rajhi Capital



**US\$9.50bn** Market cap  
**55.3%** Free float  
**US\$14.20mn** Avg. daily volume

Target price **67.80** 32.9% over current  
Consensus price **61.50** 20.6% over current  
Current price **51.00** as at 21/4/2010

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Underweight

Neutral

Overweight

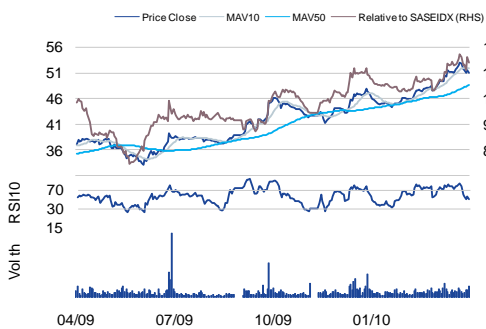
## Key themes

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

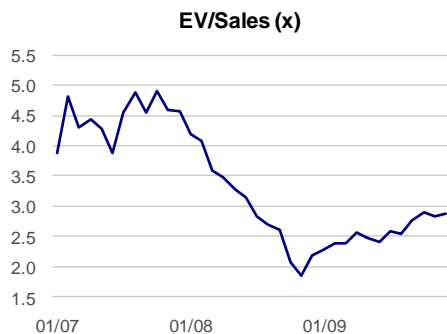


## Earnings

Period End (SAR)	12/09A	12/10E	12/11E	12/12E
Revenue (SARmn)	13,058	15,317	17,182	18,910
Revenue Growth	21.0%	17.3%	12.2%	10.1%
EBITDA (SARmn)	4,837	5,691	6,458	7,186
EBITDA Growth	27.5%	17.7%	13.5%	11.3%
EPS	4.31	5.05	5.70	6.26
EPS Growth	16.8%	17.2%	12.9%	9.9%

Source: Company data, Al Rajhi Capital

## Valuation



Source: Company data, Al Rajhi Capital

# Mobily

## Sparkling revenue growth the key

*In stark contrast to STC, Mobily announced another set of impressive results for Q1 2010, featuring year-on-year sales growth of 27% and net profit growth of 49%. We are surprised by market talk that this sparkling performance was disappointing. While we expect growth to moderate from now on, we predict net profit growth of 17% for 2010 as a whole. We remain Overweight and have raised our target price by 4% to SAR67.8, implying 33% appreciation potential.*

**Revenues up by 27% year-on-year:** The most important feature of Mobily's Q1 2010 results was year-on-year revenue growth of 27%. This was truly impressive and far exceeded our estimate of an increase of 15%. The driving force behind this growth is burgeoning demand for mobile broadband service; we estimate that Mobily ended Q1 with 1.2mn broadband accounts, and that data service now accounts for 16-17% of revenues. Strong growth in mobile broadband is entirely consistent with our overall view on the telecoms market, as explained in our comprehensive sector report *We prefer jam* today of 25 January. According to Mobily, expansion in higher-value postpaid accounts also helped to boost the top line. This is a promising sign, and we expect Mobily to continue to gain share in the postpaid and corporate segments of the mobile market.

**Pressure on gross margin easily contained:** Mobily carried out an aggressive promotion on international calls over Q1, featuring a rate of 1 halala (SAR0.01) per second. This weighed heavily on gross profit, which rose by only 13% year-on-year, with the result that the gross margin shrank from 57.5% to 51.0%. However, due to firm control of SG&A costs (down 8% year-on-year), EBITDA increased by 30% year-on-year. With depreciation under control and financial costs declining, this fed through to a 49% increase in net profit.

**Revenues up versus Q4 too:** Q1 is always the weakest quarter for Mobily; Q4 is the strongest, since this includes the Hajj season which generates substantial additional revenue. However, Q1 sales of SAR3,581m were 1.2% higher than in Q4 2009; this is the first time that Mobily has achieved revenue growth in Q1 on a quarter-on-quarter as well as a year-on-year basis. We are surprised by talk in the stock market that Mobily's Q1 results were disappointing because net profit fell by 32% versus Q4; no one should have been expecting a stronger outcome.

**Rest of year set to be tougher:** While Mobily's Q1 performance was robust, we expect the rest of 2010 to be more challenging. Both STC and Zain KSA seem to be making greater efforts in the broadband mobile segment. Similarly, the strong pressure (stimulated in part by Mobily's own competitive action) on international call prices in Q1 serves as a reminder that price pressure in general is probably the biggest risk in the Saudi mobile market. While the Q1 results were well above our forecasts, we have therefore trimmed our forecasts for Q2 and Q3 and continue to predict net profit growth of 17% for 2010 as a whole.

**Valuation and conclusion:** While our near-term profit forecasts are little changed, stronger sales growth and a minor reduction in our estimated WACC have boosted our long-run discounted economic profit valuation of Mobily. Our new estimate of long-run fair value is 4% higher at SAR67.8. We have set this as our new target price; it implies potential appreciation of 33% from the current share price. With its clear focus on domestic mobile and solid near-term growth prospects, Mobily remains our preferred stock in the Saudi telecoms sector.



Corporate summary	Share information	Valuation
Etiihad 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.	<p>Market cap (SAR/US\$) 35.70bn / 9.50bn</p> <p>52-week range 33.10 - 53.00</p> <p>Daily avg volume (US\$) 14.20mn</p> <p>Shares outstanding 700.0mn</p> <p>Free float (est) 55.3%</p> <p>Performance: 1M 3M 12M</p> <p>Absolute 6.9% 9.2% 45.7%</p> <p>Relative to index 6.8% 3.7% 12.6%</p> <p>Major Shareholder:</p> <p>Emirates Telecoms Corp. 27.5%</p> <p>Gen. Organisation for Social Insc. 11.2%</p>	<p>Period End 12/09A 12/10E 12/11E 12/12E</p> <p>Revenue (SARmn) 13,058 15,317 17,182 18,910</p> <p>EBITDA (SARmn) 4,837 5,691 6,458 7,186</p> <p>Net Profit (SARmn) 3,014 3,532 3,988 4,384</p> <p>EPS (SAR) 4.31 5.05 5.70 6.26</p> <p>DPS (SAR) 1.25 1.38 1.58 1.90</p> <p>EPS Growth 16.8% 17.2% 12.9% 9.9%</p> <p>EV/EBITDA (x) 8.8 7.4 6.2 5.2</p> <p>P/E (x) 11.8 10.1 9.0 8.1</p> <p>P/B (x) 2.9 2.4 2.0 1.7</p> <p>Dividend Yield 2.5% 2.7% 3.1% 3.7%</p> <p>Source: Company data, Al Rajhi Capital</p>

## Details of Q1 results: another strong performance

Below we present the key details of Mobily's Q1 2010 results, together with our comments.

Figure 1. Mobily: key features of Q1 2010 results

(SAR mn)	Q1'09 actual	Q4'09 actual	Q1'10 actual	% chg y-y	Q1'10 ARCe	Comment
Subscriptions (000s)	15,400	18,200	18,959	23.1%	18,959	Not published for Q1; Q1 numbers are ARC estimates
Subscriptions market share (%)	41.2%	40.2%	40.1%	-1.1pp	40.1%	As above
Broadband subscriptions (000s)	433	1,000	1,200	177.1%	1,200	As above
<b>Revenues</b>	<b>2,810</b>	<b>3,537</b>	<b>3,581</b>	<b>27.4%</b>	<b>3,244</b>	Sparkling growth year-on-year, and first time that Q1 sales have exceeded those of the preceding Q4
Gross profit	1,613	2,115	1,827	13.3%	1,833	Much weaker than sales growth due to aggressive promotions on international calls
Gross margin	57.4%	59.8%	51.0%	-6.5pp	56.5%	Margin fell sharply due to international promotions
<b>EBITDA</b>	<b>908</b>	<b>1,521</b>	<b>1,180</b>	<b>29.9%</b>	<b>1,087</b>	Remarkably strong given weakness of gross profit; SG&A costs fell by 8% year-on-year
EBITDA margin (%)	32.3%	43.0%	32.9%	0.6pp	33.5%	EBITDA margin increased slightly; we had expected a stronger outcome
Depn. & amortisation	-375	-436	-417	11.2%	-442	Downward trend in effective depreciation rate seems to be continuing
<b>Operating profit</b>	<b>533</b>	<b>1,085</b>	<b>763</b>	<b>43.1%</b>	<b>646</b>	Reflects strong EBITDA and lower depreciation than our forecast
Financing cost	-75	-40	-40	-46.7%	-55	Interest costs are falling as financial position strengthens
Other	23	6	6	-75.5%	0	N/m
Net income before tax	481	1,051	729	51.4%	591	Reflects strong EBITDA, control of depreciation and lower financial expenses
Tax and zakat	-1	1	-14	n/m	-15	N/m
<b>Net profit</b>	<b>480</b>	<b>1,052</b>	<b>714</b>	<b>48.8%</b>	<b>576</b>	Reflects strong EBITDA, control of depreciation and lower financial expenses. The 32% decline in net profit versus Q4 is immaterial due to seasonality of results
Capex	-907	-902	-730	-19.5%	-714	Close to our forecast. Network coverage is now very high, but we think capacity needs will prevent capex from falling significantly in the near term
Capex/sales (%)	32.3%	25.5%	20.4%	-11.9pp	22.0%	As above
Net debt	7,916	7,062	6,682	-15.6%	6,604	Very close to our forecast
Net debt/annualised EBITDA (x)	2.2	1.2	1.4	n/m	1.5	This is a very healthy gearing level

Source: Mobily Q1 results release on Tadawul website, Al Rajhi Capital

## Outlook and adjustments to our estimates

We have trimmed our forecasts for Q3 and Q4 2010

While Mobily's Q1 results significantly exceeded our forecasts, we have actually trimmed our profit forecasts for Q2 and Q3 2010. This is largely because we expect continuing strong growth in mobile broadband service to be partly offset by further pressure on mobile voice prices – following the example of the severe pressure on international call prices seen in Q1. By contrast, we have left our profit forecasts for Q4 2010 little changed, mainly because we are currently assuming a stronger Hajj season in 2010 than in 2009. The net outcome is that our overall forecasts for 2010 are also little changed, and we continue to predict net income growth for this year of around 17%.

But we have raised our estimate of fair value by 4% to SAR67.8

Despite price pressures, we believe that Mobily will achieve solid growth in both 2010 and 2011 (for which we predict net profit growth of 13%). Impressive top-line growth helps to support our long-run discounted economic profit valuation of the company. Another factor boosting the long run-valuation is a slight reduction in our estimated WACC from 8.7% to



8.5%; this reflects an updating of assumptions about risk-free rate, cost of equity, long-run gearing target and related factors. We have accordingly raised our estimate of long-run fair value by 4%, from SAR64.9 to SAR67.8; we have set this estimate as our new target price. With 33% implied appreciation potential from the current share price to our target, we retain our Overweight rating on Mobily and it remains our preferred stock in the Saudi telecoms sector.



We have raised our estimate of revenue growth for 2010 from 14% to 17%

Rising earnings give scope to boost dividend

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

Mobily offers solid value, especially on EV/sales and PE; it also has a tangible prospective dividend yield of 2.7%

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>15,317</b>	<b>17,182</b>	<b>18,910</b>
Cost of Goods Sold	(4,766)	(5,512)	(6,754)	(7,274)	(7,942)
<b>Gross Profit</b>	<b>6,028</b>	<b>7,547</b>	<b>8,562</b>	<b>9,908</b>	<b>10,968</b>
Government Charges					
S.G. & A. Costs	(2,234)	(2,710)	(2,872)	(3,450)	(3,782)
<b>Operating EBIT</b>	<b>2,496</b>	<b>3,208</b>	<b>3,765</b>	<b>4,228</b>	<b>4,652</b>
Cash Operating Costs	(7,000)	(8,222)	(9,626)	(10,724)	(11,724)
<b>EBITDA</b>	<b>3,794</b>	<b>4,837</b>	<b>5,691</b>	<b>6,458</b>	<b>7,186</b>
Depreciation and Amortisation	(1,298)	(1,629)	(1,926)	(2,231)	(2,534)
<b>Operating Profit</b>	<b>2,496</b>	<b>3,208</b>	<b>3,765</b>	<b>4,228</b>	<b>4,652</b>
Net financing income/(costs)	(438)	(204)	(152)	(138)	(156)
Forex and Related Gains	-	-	-	-	-
Provisions	-	-	-	-	-
Other Income	41	41	6	-	-
Other Expenses	-	-	-	-	-
Minority Interests	-	-	-	-	-
<b>Net Profit Before Taxes</b>	<b>2,099</b>	<b>3,045</b>	<b>3,619</b>	<b>4,090</b>	<b>4,497</b>
Taxes	(7)	(31)	(87)	(102)	(112)
<b>Net Profit</b>	<b>2,092</b>	<b>3,014</b>	<b>3,532</b>	<b>3,988</b>	<b>4,384</b>
Dividends	-	(875)	(963)	(1,107)	(1,328)
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	7.80	8.88	9.88
EPS (SAR)	3.69	4.31	5.05	5.70	6.26
DPS (SAR)	0.000	1.250	1.375	1.581	1.898
<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%	17.3%	12.2%	10.1%
Gross Profit Growth	29.7%	25.2%	13.5%	15.7%	10.7%
EBITDA Growth	17.2%	27.5%	17.7%	13.5%	11.3%
Operating Profit Growth	13.1%	28.5%	17.4%	12.3%	10.1%
Net Profit Growth	51.6%	44.1%	17.2%	12.9%	9.9%
EPS Growth	39.8%	16.8%	17.2%	12.9%	9.9%
<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%	55.9%	57.7%	58.0%
EBITDA margin	35.1%	37.0%	37.2%	37.6%	38.0%
Operating Margin	23.1%	24.6%	24.6%	24.6%	24.6%
Pretax profit margin	19.4%	23.3%	23.6%	23.8%	23.8%
Net profit margin	19.4%	23.1%	23.1%	23.2%	23.2%
<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%	17.2%	16.9%	16.5%
ROIC	16.8%	16.2%	17.6%	17.2%	16.8%
ROE	26.7%	27.4%	26.0%	24.3%	22.4%
Effective Tax Rate	0.3%	1.0%	2.4%	2.5%	2.5%
Capex/Sales	27.4%	25.2%	21.2%	21.0%	20.5%
Dividend Payout Ratio	0.0%	29.0%	27.2%	27.8%	30.3%
<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)	13.8	11.8	10.1	9.0	8.1
P/CF (x)	8.5	7.7	6.5	5.7	5.2
P/B (x)	3.7	2.9	2.4	2.0	1.7
EV/Sales (x)	3.2	3.3	2.7	2.3	2.0
EV/EBITDA (x)	9.2	8.8	7.4	6.2	5.2
EV/EBIT (x)	14.0	13.3	11.1	9.5	8.1
EV/IC (x)	2.2	2.1	1.7	1.5	1.2
Dividend Yield	0.0%	2.5%	2.7%	3.1%	3.7%

Source: Company data, Al Rajhi Capital



We expect Mobily to have net cash by 2013

Annualised Q409 net debt/ EBITDA was 1.4x at the end of Q1 2010; this is a 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	2,883	4,714	7,237
Current Receivables	3,389	5,481	6,212	6,731	6,902
Inventories	108	132	245	266	284
Other current assets	4,200	1,277	1,655	1,655	1,655
<b>Total Current Assets</b>	<b>6,621</b>	<b>8,577</b>	<b>10,996</b>	<b>13,365</b>	<b>16,078</b>
Fixed Assets	8,117	10,370	12,416	14,323	16,194
Investments	-	-	-	-	-
Goodwill	1,530	1,530	1,530	1,530	1,530
Other Intangible Assets	10,923	10,450	9,922	9,394	8,865
Total Other Assets	-	-	-	-	-
<b>Total Non-current Assets</b>	<b>20,570</b>	<b>22,349</b>	<b>23,868</b>	<b>25,246</b>	<b>26,589</b>
<b>Total Assets</b>	<b>27,192</b>	<b>30,926</b>	<b>34,863</b>	<b>38,611</b>	<b>42,667</b>
Short Term Debt	3,148	2,147	2,103	2,103	2,103
Trade Payables	7,523	9,831	10,790	11,513	12,292
Dividends Payable	-	-	-	-	-
Other Current Liabilities	78	211	(0)	0	0
<b>Total Current Liabilities</b>	<b>10,749</b>	<b>12,189</b>	<b>12,894</b>	<b>13,617</b>	<b>14,395</b>
Long-Term Debt	6,642	6,448	7,018	7,018	7,018
Other LT Payables	-	-	-	-	-
Provisions	46	47	52	52	52
<b>Total Non-current Liabilities</b>	<b>6,688</b>	<b>6,495</b>	<b>7,069</b>	<b>7,069</b>	<b>7,069</b>
Minority interests	-	-	-	-	-
Paid-up share capital	7,000	7,000	7,000	7,000	7,000
Total Reserves	2,754	5,243	7,900	10,925	14,203
<b>Total Shareholders' Equity</b>	<b>9,754</b>	<b>12,243</b>	<b>14,900</b>	<b>17,925</b>	<b>21,203</b>
<b>Total Equity</b>	<b>9,754</b>	<b>12,243</b>	<b>14,900</b>	<b>17,925</b>	<b>21,203</b>
<b>Total Liabilities &amp; Shareholders' Equity</b>	<b>27,192</b>	<b>30,926</b>	<b>34,863</b>	<b>38,611</b>	<b>42,667</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	6,238	4,407	1,884
Net Debt/EBITDA (x)	1.97	1.46	1.10	0.68	0.26
Net Debt to Equity	76.6%	57.7%	41.9%	24.6%	8.9%
EBITDA Interest Cover (x)	8.7	23.7	37.5	46.9	46.1
BVPS (SAR)	13.93	17.49	21.29	25.61	30.29

<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	3,619	4,090	4,497
Depreciation & Amortisation	1,298	1,629	1,926	2,231	2,534
Decrease in Working Capital	(40)	(388)	(531)	184	589
Other Operating Cashflow	189	(40)	(72)	(102)	(112)
<b>Cashflow from Operations</b>	<b>3,546</b>	<b>4,246</b>	<b>4,941</b>	<b>6,402</b>	<b>7,507</b>
Capital Expenditure	(2,952)	(3,288)	(3,240)	(3,609)	(3,877)
New Investments	(1,050)	450	300	-	-
Others	(1,580)	(51)	-	-	-
<b>Cashflow from investing activities</b>	<b>(5,583)</b>	<b>(2,889)</b>	<b>(2,940)</b>	<b>(3,609)</b>	<b>(3,877)</b>
<b>Net Operating Cashflow</b>	<b>(2,037)</b>	<b>1,357</b>	<b>2,001</b>	<b>2,793</b>	<b>3,630</b>
Dividends paid to ordinary shareholders	(250)	(525)	(875)	(963)	(1,107)
Proceeds from issue of shares	2,000	-	-	-	-
Increase in Loans	836	(1,162)	524	-	-
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>(351)</b>	<b>(963)</b>	<b>(1,107)</b>
Total cash generated	561	(331)	1,650	1,831	2,523
Cash at beginning of period	703	2,314	1,533	2,883	4,714
<b>Implied cash at end of year</b>	<b>1,264</b>	<b>1,983</b>	<b>3,183</b>	<b>4,714</b>	<b>7,237</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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