

UAE Transportation Sector – June 2023

Prefer Aramex due to the strong growth in the GCC e-commerce sector

Sector Weighting:
MARKET WEIGHT

We prefer Aramex over Air Arabia in the transportation sector. Global air passenger demand is nearing the pre-pandemic level however, the Middle East passenger grew faster and exceeded the pre-pandemic level. Air Arabia benefited from this surge in passenger traffic. We expect passenger traffic is also expected to soften given the slowdown in the world economy which is expected to decline from 3.4% in 2022 to 2.8% and 3.0% in 2023 and 2024, respectively. In addition, we are seeing capacity addition from the major regional airlines which is expected to pressurize yield and profitability in the aviation sector. On the other hand, Aramex is providing end-to-end services from courier and freight to warehousing, giving the company a competitive advantage in the logistics and supply chain business. Despite a global decline in shipment volumes among competitors, Aramex outperformed the industry with its domestic and cross-border expertise, as well as air, land, and sea freight services. The Company is expanding its business through air and sea charters and increasing its focus in the UAE and KSA region, which will benefit the Freight Forwarding business. The acquisition of MyUS added additional volumes in the international express business segment. Aramex is investing in automation and AI to drive the business in a fully integrated manner which will further help to deliver resilient performance.

Stock	Target P	CMP	Gain	Rating	P/E ¹	EV/EBITDA ¹	Dividend Yield ¹
Air Arabia (AED)	2.75	2.65	3.8%	HOLD	9.1	3.9	6.0%
Aramex (AED)	4.35	3.01	44.5%	BUY	24.1	6.5	3.1%

Source: FABS Estimate

¹Data refers of FY2023

Key Developments in the Transportation Sector

Global air passenger demand was near the pre-pandemic level, Middle East traffic exceeded

Dubai welcomed 4.1 Mn tourists in 1Q23 as compared to 3.4 Mn in 1Q22. The occupancy rate for hotels in Dubai stood strong at 83% in 1Q23 whereas the average room rate declined 6% YOY in 1Q23 as compared to 1Q22 mainly due to supply addition. Likewise, the occupancy rate of hotels in Abu Dhabi stood at 74% in 1Q23, 5% lower as compared to 1Q22. Abu Dhabi recorded 34% YOY growth in hotel guests to 1.2 Mn in 1Q23. According to IATA, the carriers in the Middle East fully recovered and exceeded the international passenger traffic above the 2019 pre-Covid levels. Global passenger demand increased in terms of revenue passenger kilometres (RPKs) rose 39.1% YOY in May 2023 reaching 96.1% of the pre-pandemic levels in 2019. International RPKs for the Middle East rose 30.8% YOY in May 2023 and rose 17.2% YOY as compared to May 2019 levels. The Middle East combined load factor (domestic and international) stood at 79.9% in May 2023 recording the highest growth among all the regions. Passenger traffic from the Middle East to Europe, Asia, and Africa witnessed a solid surge.

Volatility in crude oil prices is expected to pressurize the transportation sector

OPEC+ reduced its oil output starting from May 2023. However, OPEC+ voluntarily extended its production cut until the end of 2024 to support the oil prices. Saudi Arabia voluntarily agreed to reduce oil production by 500,000 barrels per day (bpd) until the end of 2024. Likewise, Iraq extended its production cut by 211,000 barrels per day (bpd), while the UAE agrees to cut production by 144,000 bpd until the end of 2024. Additionally, Oman also extended the oil production cut by 40,000 bpd until the end of 2024. On the other hand, worries over Chinese demand further increased the volatility of crude oil prices. Lower oil prices in 1Q23 benefitted the transportation sector while ongoing volatility in the oil prices is expected to pressurize of the transportation sector.

Saudi Arabia recorded over 32% annual growth in e-commerce in Q1 2023

The e-commerce industry in Saudi Arabia experienced robust growth of 32% YOY in 1Q23. The number of commercial registers issued increased to 4,093 in 1Q23 from 3,499 in 1Q22. Riyadh recorded the highest number of commercial registers issued at 13,195, followed by Makkah and the Eastern Region. The growth of e-commerce aligns with the objectives of Saudi Arabia's Vision 2030 and the National Transformation Program. The country recognizes the significance of e-commerce in enhancing the national economy and provides support for entrepreneurs transitioning to online trade through various services and platforms. The Saudi E-Commerce Council aims to strengthen e-commerce reliability, boost its contributions to the economy, and stimulate its development.

Expanding Aviation Industry in the Middle East Drives Growth and Connectivity

In the Middle East, the aviation industry is experiencing significant developments and expansion plans. Emirates Airlines is considering new orders for Airbus A350, Boeing 777X, and 787 jets to meet future demand. On the other hand, Air Arabia aims to double its current fleet capacity by June 2024 to meet Abu Dhabi's growing tourism market. Additionally, Saudi Arabia's new airline, Riyadh Air, is in talks with Airbus and Boeing to acquire a substantial number of narrow and wide-body jets. These initiatives align with the respective countries' visions for economic diversification and increasing global connectivity. Air Arabia is contributing to the remarkable growth of Abu Dhabi's tourism market by catering to the growing demand for low-cost travel. A record 15.9 Mn guests travelled in 2022 through Abu Dhabi, nearly threefold the number of visitors 5.26 Mn in 2021, Abu Dhabi aims to attract 23 million tourists annually by 2030. The airline follows a strategic approach, diversifying its business and investing in innovative services to enhance customer experience. Despite ongoing challenges, the global aviation industry is experiencing strong growth as travel restrictions ease and passenger demand increases.

Contraction in air Cargo demand is showing signs of improvement since start of the year

Globally, demand for air cargo fell 5.2% YOY in May 2023, while capacity increased 14.5% YOY in May 2023. The global air cargo demand is showing sustained improvement since start of the year when it witnessed double-digit decline in demand at the start of 2023. The annual decline in cargo tonnes kilometres narrowed from 16.8% in January 2023 to 9.0% year-to-date in May 2023. The contraction in demand is driven by the lower demand in US and Europe due to higher inflation in these countries. The decline is also led by supply chain disruption due to pandemic and war in Ukraine which significantly impacted the demand in Europe. Meanwhile, Middle Eastern carriers experienced a decline in cargo volumes which fell 3.1% YOY in May 2023. African airlines also saw a decline in demand by 2.4% YOY in May 2023 driven by a slowdown in the growth on the Africa to Asia trade route. Cargo volumes for Middle Eastern carriers declined 6.8% YOY in April 2023, indicating a 5.5% decrease in performance compared to the previous month. Factors such as a contraction in global

manufacturing demand and challenges in global goods trade influenced the decline in demand. However, improvements are expected in the second half of the year as inflation moderates which is expected to stimulate economic activity. Available cargo capacity, measured by available cargo tonne-kilometers (ACTKs), increased by 14.5% YOY in May 2023, mainly due to the recovery of belly capacity as passenger demand improves. Furthermore, capacity surpassed pre-pandemic levels, with a 5.9% increase compared to May 2019.

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2Q23 Preview: Air Arabia

Addition of a new route to boost the top-line

Current Price AED 2.65	Target Price AED 2.75	Upside/Downside (%) +3.8%	Rating HOLD
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2Q23 Estimate

Air Arabia's (The Company/ AIRARABIA PJSC) net profit is forecasted to more than double from AED 160 Mn in 2Q22 to AED 336 Mn in 2Q23 primarily due to an expected increase in revenue and finance income partially offset by a hike in selling, marketing, and G&A expenses along with increase in direct cost. The company's revenue is likely to grow 25.1% YOY to AED 1,393 Mn in 2Q23. The company's direct cost is anticipated to increase 14.8% YOY to AED 1,005 Mn in 2Q23. Thus, gross profit is estimated to rise 63.1% YOY to AED 389 Mn in 2Q23 with a gross profit margin of 27.9%. Moreover, the Company's selling and marketing expenses is predicted to increase 33.8% YOY to AED 22 Mn in 2Q23 while G&A expense is expected to grow 21.3% YOY to AED 74 Mn in 2Q23. Therefore, EBITDA is likely to grow 38.6% YOY to AED 440 Mn in 2Q23 whereas, EBITDA margin is anticipated to grow 307 bps YOY to 31.6%. The company's operating income is likely to increase 82.0% YOY to AED 293 Mn in 2Q23. Moreover, finance income is expected to increase from AED 17 Mn in 2Q22 to AED 40 Mn in 2Q23, while the finance cost is anticipated to decline 1.2% YOY to AED 28 Mn in 2Q23. While other income is predicted to rise marginally 0.6% YOY to AED 31 Mn in 2Q23.

2023 Forecast

Air Arabia's net profit is anticipated to rise 11.2% YOY to AED 1,359 Mn in 2023 mainly due to growth in revenue and finance income partially offset by a hike in selling and marketing expenses. Air Arabia's revenue is expected to grow 11.4% to AED 5,837 Mn in 2023. The company's direct cost is likely to grow 11.2% YOY to AED 4,237 Mn in 2023. Thus, gross profit is forecasted to increase 11.8% YOY to AED 1,600 Mn in 2023. Selling and marketing expense is estimated to rise significantly 37.2% YOY to AED 93 Mn in 2023. G&A expense is forecasted to incline marginally 3.9% YOY to AED 298 Mn in 2023. Thus, EBITDA is anticipated to increase 12.6% to AED 1,925 Mn in 2023 whereas, EBITDA margin is likely to grow 35 bps YOY to 33.0%. The company's operating income is expected to incline 12.2% YOY to AED 1,209 Mn in 2023. Further, finance income is forecasted to rise 44.5% YOY to AED 128 Mn in 2023. While finance cost is also expected to increase 12.9% YOY to AED 130 Mn in 2023. While other income is estimated to grow 11.9% YOY to AED 152 Mn in 2023.

1Q23 Outturn

Air Arabia's revenue rose 26.6% YOY to AED 1,429 Mn in 1Q23 due to a rebound in passenger traffic and the addition of nine routes across its global network. The Company served 3.9 Mn passengers in 1Q23 as compared to 2.4 Mn passengers in 1Q22 whereas the seat load factor rose from 79% in 1Q22 to 85% in 1Q23. On the other hand, Air Arabia's direct cost rose 31.5% YOY to AED 1,032 Mn in 1Q23. Thus, gross profit rose 15.5% YOY to AED 398 Mn in 1Q23 with a gross profit margin of 27.8% in 1Q23 as compared to 30.5% in 1Q22. Furthermore, the company's selling and marketing expenses rose 47.7% YOY to AED 20 Mn in 1Q23 whereas G&A expenses rose significantly 52.4% YOY to AED 76 Mn in 1Q23. While operating profit rose 7.3% YOY to AED 301 Mn in 1Q23. The Company's finance income more than doubled to AED 41 Mn in 1Q23 from AED 15 Mn in 1Q22 due to higher benchmark rates in the economy whereas finance cost declined 5.6% YOY to AED 26 Mn in 1Q23 due to a reduction in lease liabilities and bank borrowings. Air Arabia's other income more than doubled to AED 26 Mn in 1Q23 up from AED 12 Mn in 1Q22.

Target price and rating

We revise our rating from BUY to HOLD on Air Arabia with a target price of AED 2.75. The Company's share price inclined 23.8% since our last rating on 27 April 2023. During 1Q23, the aviation industry experienced a notable recovery, driven primarily by a rebound in passenger demand. Air Arabia total number of passengers rose from 2.4 Mn in 1Q22 to 3.9 Mn in 1Q23. This substantial growth highlights the airline's success in attracting more passengers during the period. The Company reported strong growth in seat load factor which rose 8% YOY to 85% in 1Q23. Air Arabia continued to expand its global network and added nine new routes across the world during 1Q23 from its seven strategic hubs including UAE, Morocco, Egypt, Armenia, and Pakistan. The Company operated 68 aircraft in service including 59 Airbus A320 and 9 Airbus A321 at the end of 1Q23. Further, Air Arabia ordered 120 Airbus A320 family aircraft whose delivery will start in 2025, strengthening its market positioning going forward. Additionally, Air Arabia's management is committed to improving its operational efficiency and undertaking cost-control measures will enhance the company's performance. The company's management is providing special attention to active fleet management to ensure healthy growth supported by the adoption of new technologies. A rise in fuel price affected the company's profitability in 1Q23 but we expect softness in energy prices to drive profitability going forward. Moreover, the company's reported a strong financial position with a net cash balance of AED 5.1 Bn 1Q23 supported by a steady free cash flow from its operating activities. Air Arabia's management approved a 15% cash dividend distribution equivalent to a dividend per share of 15 fils in 2022 with a dividend yield of 6.9%. Thus, based on our analysis, we recommend a HOLD rating on the stock.

Air Arabia – Relative Valuation

(at CMP)	2018	2019	2020	2021	2022	2023F
PE (X)	NA	12.5	NA	17.2	10.1	9.1
PB (X)	2.7	2.2	2.7	2.0	1.8	1.6
EV / EBITDA	10.6	6.7	23.7	6.8	4.5	3.9
Dividend yield (%)	NA	3.4%	NA	3.2%	5.7%	6.0%

FABS estimate & Co Data

Air Arabia - P&L

	2Q22	1Q23	2Q23F	YOY Ch	QOQ Ch	2022	2023F	Change
AED mm								
Revenue	1,114	1,429	1,393	25.1%	-2.5%	5,242	5,837	11.4%
Direct costs	-875	-1,032	-1,005	14.8%	-2.6%	-3,810	-4,237	11.2%
Gross profit	238	398	389	63.1%	-2.2%	1,432	1,600	11.8%
Selling & Mkt expense	-17	-20	-22	33.8%	12.3%	-68	-93	37.2%
G&A expenses	-61	-76	-74	21.3%	-3.1%	-286	-298	3.9%
EBITDA	318	461	440	38.6%	-4.6%	1,710	1,925	12.6%
EBIT	161	301	293	82.0%	-2.9%	1,077	1,209	12.2%
Finance income	17	41	40	141.4%	-1.0%	89	128	44.5%
Finance costs	-28	-26	-28	-1.2%	5.8%	-115	-130	12.9%
Other income	30	26	31	0.6%	19.3%	136	152	11.9%
Share of profit on JVs	-20	0	0	NM	NM	36	0	NM
Profit before NCI	160	342	336	109.8%	-1.7%	1,222	1,359	11.2%
Non-controlling int.	0	0	0	NM	NM	1	0	NM
Profit to shareholders	160	342	336	109.8%	-1.7%	1,222	1,359	11.2%

FABS estimate & Co Data

Air Arabia - Margins

	2Q22	1Q23	2Q23F	YOY Ch	QOQ Ch	2022	2023F	Change
Gross Profit	21.4%	27.8%	27.9%	650	8	27.3%	27.4%	10
EBITDA	28.5%	32.3%	31.6%	307	-69	32.6%	33.0%	35
Operating Profit	14.4%	21.1%	21.0%	657	-9	20.5%	20.7%	16
Net Profit	14.4%	23.9%	24.1%	973	20	23.3%	23.3%	-3

FABS estimate & Co Data

2Q23 preview: **Aramex PJSC**

Increasing shipment volume supports bottom-line

Current Price	Target Price	Upside/Downside (%)	Rating
AED 3.01	AED 4.35	+44.5%	BUY

2Q23 Estimate

Aramex's (The Company/ Aramex) net profit is anticipated to decline 24.3% YOY to AED 34 Mn in 2Q23 due to increase in impairment loss on financial asset, finance cost, selling and market expenses, and cost of services partially offset an expected increase in revenue and decline in administrative expenses. Revenue is predicted to grow 2.9% YOY to AED 1,561 Mn in 2Q23. The Company's cost of services is expected to increase 2.9% YOY to AED 1,171 Mn in 2Q23. Thus, gross profit is estimated to rise 3.1% YOY to AED 390 Mn in 2Q23 with a gross profit margin of 25.0%. Selling and marketing expenses are forecasted to grow 19.8% YOY to AED 78 Mn in 2Q23. While administrative expenses are anticipated to decline 5.4% YOY to AED 222 Mn in 2Q23. However, impairment loss is expected to increase to AED 14 Mn in 2Q23 as compared to AED 5 Mn in 2Q23. Other income is likely to fall 43.1% YOY to AED 6 Mn in 2Q23. Thus, the operating profit is likely to grow 10.5% YOY to AED 70 Mn in 2Q23. As a result, EBITDA is also expected to incline 3.5% YOY to AED 162 Mn in 2Q23, with the EBITDA margin expected to rise 6 bps YOY to 10.4%. Furthermore, finance income is expected to increase from AED 1 Mn in 2Q22 to AED 2 Mn in 2Q23 while finance cost is estimated to incline from AED 15 Mn in 2Q22 to AED 29 Mn in 2Q23 due to higher benchmark rates. Income tax expense is likely to grow 2.0% YOY to AED 9 Mn in 2Q23 impacting profit.

2023 Forecast

Aramex's net profit is expected to incline 11.7% YOY to AED 185 Mn in 2023 primarily due to an estimated rise in revenue, and an increase in finance income partially offset by a rise in impairment loss and finance cost, owing to the higher benchmark rates. The Company's revenue is forecasted to rise 4.2% YOY to AED 6,173 Mn in 2023. Aramex's cost of services is estimated to increase 1.5% YOY to AED 4,568 Mn in 2023. Thus, gross profit is likely to grow 12.7% YOY to AED 1,605 Mn in 2023. While gross profit margin is anticipated to rise from 24.0% in 2022 to 26.0% in 2023. Selling and marketing expenses are estimated to grow 7.8% YOY to AED 278 Mn in 2023. Similarly, administrative expenses are anticipated to incline 6.8% YOY to AED 969 Mn in 2023. EBITDA is estimated to grow 12.9% YOY to AED 688 Mn in 2023 whereas, EBITDA margin is expected to incline by 87 bps YOY to 11.1% in 2023. Thus, operating profit is estimated to rise 31.3% YOY to AED 322 Mn in 2023. On the other hand, finance income is expected to grow from AED 5 Mn in 2022 to AED 9 Mn in 2023. Finance cost is anticipated to incline from AED 73 Mn in 2022 to AED 118 Mn in 2023 due to higher interest rates. Tax expense is expected to rise from AED 26 Mn in 2022 to AED 38 Mn in 2023.

1Q23 Outturn

Aramex revenue declined 1.2% YOY to AED 1,431 Mn in 1Q23 mainly due to the weakening in the global shipment volume, currency fluctuations, and inflationary pressures. Cost of services declined by 2.8% YOY to AED 1,073 Mn in 1Q23 reflecting the company's initiative in cost optimization through the economic cycle and consistent investment in efficiency maximization. As a result, gross profit rose 4.0% YOY to AED 358 Mn in 1Q23 owing to growth in International Express business especially MyUS acquisition provided a further boost to growth with a gross profit margin of 25.0% in 1Q23 as compared to 23.7% in 1Q22. The improvement is also led by investment in efficiency improvement initiatives and cost optimization. Selling and marketing expenses rose 21.4% YOY to AED 71 Mn whereas administrative expenses declined 2.2% YOY to AED 209 Mn in 1Q23. The overall increase

in SG&A expenses is attributable to the inclusion of MyUS. Net impairment loss on financial assets increased from AED 5 Mn in 1Q22 to AED 13 Mn in 1Q23. Moreover, other income declined from AED 8 Mn in 1Q22 to a loss of AED 1 Mn in 1Q23. Resultantly, operating profit declined 16.0% YOY to AED 63 Mn in 1Q23. EBITDA decreased 9.3% YOY to AED 154 Mn in 1Q23 whereas EBITDA margin declined 95 bps YOY to 10.7% in 1Q23. Finance income rose from AED 1 Mn in 1Q22 to AED 2 Mn in 1Q23 while finance cost increased significantly from AED 13 Mn in 1Q22 to AED 30 Mn in 1Q23 due to the higher rate of interest in the economy. Share of results of joint ventures and associates declined from AED 4 Mn in 1Q22 to AED 0.5 Mn in 1Q23. Income tax expense reduced 44.8% YOY to AED 11 Mn in 1Q23 in line with the decline in profitability.

Target price and rating

We maintain our BUY rating on Aramex with a target price of AED 4.35. Aramex is a renowned logistics player, offering domestic and cross-border expertise as well as freight services through air, land, and sea reported a marginal drop in revenue of 1.2% YOY to AED 1,431 Mn in 1Q23 outperforming the competition despite softening in global shipment volumes of peer. UAE's high internet penetration of more than 90% coupled with favourable government policies adds fuel to the e-commerce sector growth in the region. Consequently, we expect the domestic courier business revenue to be positively driven by the rising digital users in UAE. Developing countries in MENA region like UAE, Saudi Arabia, and Qatar are taking major steps to promote the e-commerce segment to boost the non-oil economy which will in return benefit Aramex's courier services business. The International Express business of the company reported stable growth reflecting additional volumes contributed by MyUS. Aramex management is continuously taking prudent cost-cutting measures and investing in automation and AI to drive the business in a fully integrated manner which will further help to deliver resilient performance, also expect to stabilize and improve the margin in the forthcoming period. Further, Aramex partnered with Abu Dhabi's AD Ports Group to establish a joint venture. The JV will lease or purchase space in shipping container to facilitate the movement of goods for freight forwarding companies. This collaboration aims to strengthen shipping connectivity in the GCC, Indian, and East and West African markets. The Company is expanding its business through air and sea charters and increasing its focus in the UAE and KSA region which will in return benefit the Freight Forwarding business. As the company is also providing end-to-end services from courier and freight to warehousing, gives the company a competitive advantage in the logistics and supply chain business. Aramex is strategically expanding its operations through air and sea charters and strengthening its presence in the UAE and KSA regions. This expansion will greatly benefit its Freight Forwarding business. With a comprehensive range of services, including courier, freight, and warehousing. In addition, the company entered into a joint venture agreement with AD Port to develop and operate a new Non-Vessel Operating Common Carrier (NVOCC) Enterprise to enhance global trade and logistics business. The new JV, in which Aramex has a stake of 49%, will provide customized solutions to all Freight Forwarding industry players, further enhancing and developing shipping connectivity across the GCC and India along with East and West African markets with a short-term goal of 10,000 containers and improved supply chain linkages along important international trade routes. The recent acquisition made by the company with MyUS started contributing to the company's revenue and is expected to provide a further boost in the profitability of the company. Thus, based on our analysis, we maintain our BUY rating on the stock.

Aramex – Relative Valuation

(At CMP)	2018	2019	2020	2021	2022	2023F
PE (X)	8.95	8.86	16.53	19.54	26.65	24.10
PB (X)	1.83	1.68	1.64	1.65	1.76	1.72
EV / EBITDA (x)	5.26	4.68	5.37	5.93	8.05	6.50
Dividend yield (%)	5.4%	5.5%	5.5%	4.3%	4.3%	3.1%

FABS estimate and Co data

Aramex - P&L

	2Q22	1Q23	2Q23F	YOY Ch	QOQ Ch	2022	2023F	Change
AED mm								
Rendering of Services	1,517	1,431	1,561	2.9%	9.0%	5,926	6,173	4.2%
Cost of Services	-1,138	-1,073	-1,171	2.9%	9.1%	-4,502	-4,568	1.5%
Gross profit	379	358	390	3.1%	9.0%	1,424	1,605	12.7%
S&M Expenses	-65	-71	-78	19.8%	9.3%	-258	-278	7.8%
Administrative Expenses	-234	-209	-222	-5.4%	5.8%	-908	-969	6.8%
Net Impairment loss	-5	-13	-14	195.3%	8.9%	-16	-37	130.1%
Other income, net	-11	-1	-6	-43.1%	NM	2	1	-51.7%
Operating profit	64	63	70	10.5%	11.5%	245	322	31.3%
EBITDA	156	154	162	3.5%	5.2%	609	688	12.9%
Finance Income	1	2	2	55.3%	-35.9%	5	9	87.7%
Finance Costs	-15	-30	-29	90.0%	-4.1%	-73	-118	62.3%
Share of results of JV & Asso	4	0	0	NM	NM	9	9	NA
Profit before Income Tax	53	35	43	-20.2%	20.1%	187	223	19.2%
Income Tax Expense	-8	-11	-9	2.0%	-21.8%	-26	-38	47.3%
Profit for the period	45	25	34	-24.3%	38.7%	161	185	14.7%
Profit attributable	45	24	34	-24.3%	40.8%	165	185	11.7%

FABS estimate & Co Data

Aramex - Margins

	2Q22	1Q23	2Q23F	YOY Ch.	QOQ Ch.	2022	2023F	Change
Gross Profit	25.0%	25.0%	25.0%	3	-1	24.0%	26.0%	197
EBITDA	10.3%	10.7%	10.4%	6	-38	10.3%	11.1%	87
Operating Profit	4.2%	4.4%	4.5%	31	10	4.1%	5.2%	108
Net Profit	3.0%	1.7%	2.2%	-78	49	2.8%	3.0%	20

FABS estimate & Co Data

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