

Key themes

Healthcare sector sees rerating due to strong 2023 earnings and positive outlook...

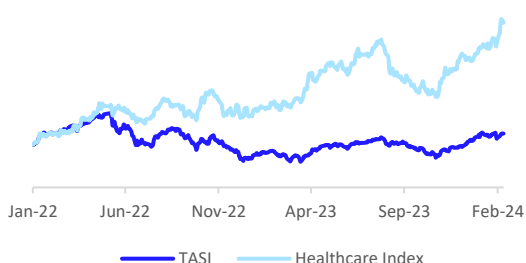
...valuations expand from 40.3x at the start of 2023 to 45.6x currently and trading at 39.0x (2024E)

Hospitals benefited from improved utilization, but 2024-2026 could be challenging phase given the influx of capacity

Caution advised on possibility of rising competition, cannibalization due to new capacity, pre-operating cost pressures

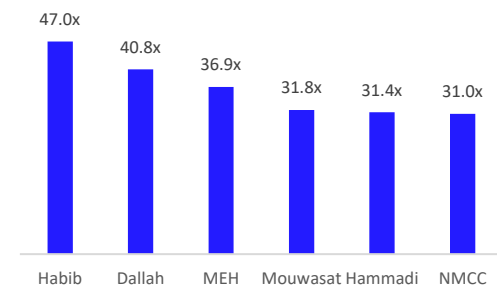
Care, Habib, Mouwasat, and Hammadi relatively better positioned with minimal downside risks

Healthcare vs TASI (Rebased to 100)



Source: Bloomberg, Al Rajhi Capital.

Blended forward P/E* on current market price



Source: Bloomberg, Al Rajhi Capital. Forward P/E is calculated based on CMP upon average of FY24/25E EPS from ARC estimates.

Saudi Healthcare

Target prices raised, but advise caution

Given the strong growth in 2023 earnings and bright medium-term prospects, the healthcare sector continues to rerate. Sector valuations have expanded (trailing) from 40x at the start of 2023 to 46x currently (2023E). On a 2024E basis, the sector is now trading at 39x. We acknowledge that there are structural drivers in place such as rising private employment (mandatory private insurance), limited investments in public hospitals, growing awareness of insurance benefits (new table of benefits), etc. Further, sentiments towards the hospital sector is also very positive given recent acknowledgement from the Minister of Health, that the Kingdom seeks to increase the private sector's contribution to healthcare to 50% in 2030, versus 38% currently. In the last two years, the hospitals witnessed not only topline growth, but also margin expansion as they benefitted from improved utilization levels at the existing facilities. There was hardly any new major hospital entering the market, and the capacity that entered the market was mainly through ramp-up or expansion of the existing facilities. Thus, the benefits of operating leverage helped the margins. Further, the topline drivers were a mix of both volume and better yield as the recovery in insured lives in 2022 was led by Saudi nationals (spending on cosmetics, surgeries, etc.), new table of benefits were introduced, and some hospitals negotiated prices with insurance and some got MoH accreditations. These developments improved the patient mix, and higher yield aided both the topline as well as margins. Further, the hospitals became very active in terms of improving their utilization by actively admitting more MoH patients.

However, as we enter a phase of strong influx of capacity (listed players to bring additional 34% of their current capacity over the next 3 years) we could see rising competition limiting upward price revisions and existing hospitals facing the impact of cannibalization, thus the benefits of operating leverage will be absent. Coming to 2024 in particular, the positive catalysts are limited. First, the insured lives in 2023 were flattish, that could curb the growth in patients flows in 2024, second the receivables spiked mainly for hospitals with higher MoH exposure, thus the ECL provisions could go up this year, and the growing possibility that rate cuts will happen in H2 2024, thus benefits would reflect only in 2025. Moreover, Q4 2023 would not see the strong sequential improvement that we saw in Q4 2022, and Q4 typically is cost heavy as the hospitals recognize the investment costs done for additional hiring/beds and also recognize the ECL provisions and interest costs fully.

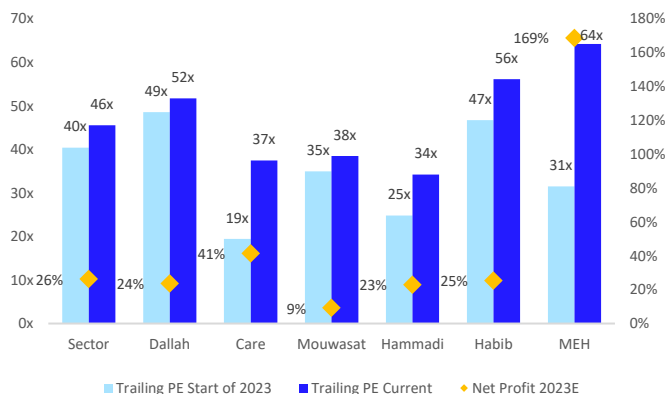
With the sector trading at 39x on 2024E, the valuations are pricing in all the positives and ignoring any sort of risks. We raise our target prices as we roll forward our valuations to 2024/2025E (average EPS) but advise caution. Among our covered names, we find Care, Habib, Mouwasat and Hammadi to be relatively better positioned and exposed to minimal downside risks.

Figure 1 Summary of our ratings

Stock	Current Rating	Previous Rating	New TP	Old TP	CMP	Upside/Downside
Dallah	Neutral	Neutral	164.0	143.0	176.0	-6.8%
Mouwasat	Neutral	Neutral	128.0	108.0	123.4	3.7%
Care	Neutral	Neutral	199.0	143.0	193.8	2.7%
Hammadi	Neutral	Neutral	64.0	57.0	66.6	-3.9%
Habib	Neutral	Neutral	301.0	267.0	314.6	-4.3%
MEH	Neutral	Neutral	113.0	71.0	123.0	-8.1%

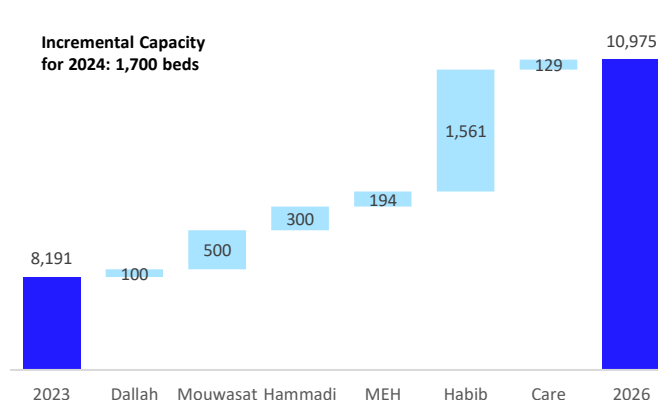
Source: Bloomberg, Al Rajhi Capital estimates. CMP is considered as of 11th February close.

Figure 1 Valuations have seen expansion



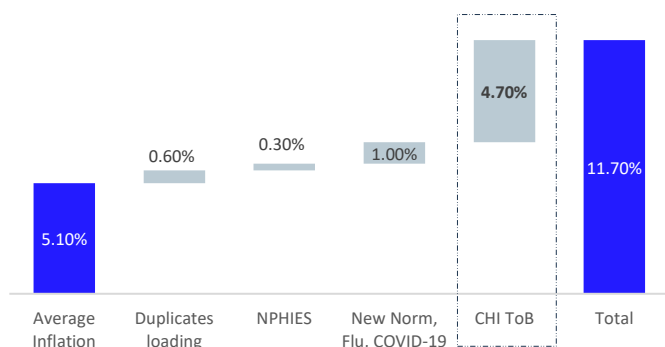
Source: Company Data, Al Rajhi Capital.

Figure 2 Strong influx of bed capacity



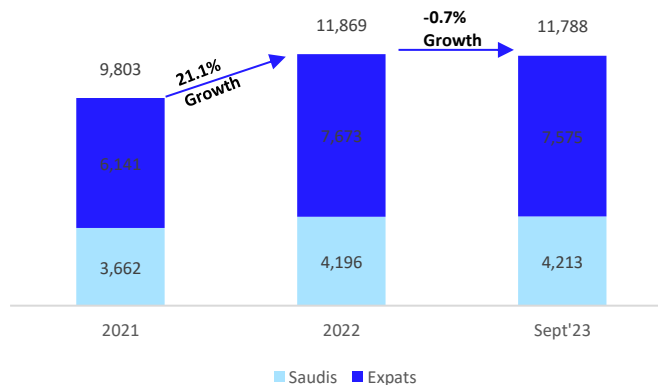
Source: Argaam, Company Data, Al Rajhi Capital. Note: Dallah's 100 beds at Namar and Care's 129 beds at CNH are expansion at existing facilities.

Figure 3 4.7% growth coming from CHI ToB



Source: Bupa Presentation, Al Rajhi Capital.

Figure 4 Insured lives have been flattish (in '000)



Source: Bupa Presentation, Al Rajhi Capital

Figure 5 Valuations (SAR/share)

Dallah	Multiples
Forward P/E	38.0x
2024E/2025E EPS	4.3
Fair value	164.0
CMP	176.0
Upside/Downside	-6.8%

MEH	Multiples
Forward P/E	34.0x
2024E EPS	3.3
Fair value	113.0
CMP	123.0
Upside/Downside	-8.1%

Habib	Multiples
Forward P/E	45.0x
2024E EPS	6.7
Fair value	301.0
CMP	314.6
Upside/Downside	-4.3%

Mouwasat	Multiples
Forward P/E	33.0x
2024E/2025E EPS	3.9
Fair value	128.0
CMP	123.4
Upside/Downside	3.7%

Hammadi	Multiples
Forward P/E	30.0x
2024E EPS	2.1
Fair value	64.0
CMP	66.6
Upside/Downside	-3.9%

Care	Multiples
Forward P/E	30.0x
2024E EPS	6.2
Care Existing + Jiwar	187.0
CC*	10.4
CC* (Expansion)	1.7
Fair Value	199.0
CMP	193.8
Upside/Downside	2.7%

Source: Al Rajhi Capital estimates, *CC: Chronic Care

Dr. Sulaiman Al Habib Medical Services Group

All eyes on ramp of new hospitals

Habib is positioned for strong profitability growth, leveraging its brand strength and minimal exposure to MoH patients. New hospitals in Riyadh and Jeddah tap lucrative markets, while medical centers increase catchment areas

Earnings can potentially double in the next five years despite conservative assumption on margins.

Target price of SAR 301/share, neutral recommendation at current levels

Outlook and view: Among all the names, we believe Habib is the best positioned hospital operator to see secular growth in its profitability as we believe strong brand image should help the company to manage the ramp up of its upcoming hospitals and limit the impact of pre-operating costs on margins. Further, minimal exposure to MoH patients eliminates the risk of downward price revisions or rejection of claims. Its upcoming 500 bed hospital in North of Riyadh, that is scheduled to open in H1 2024, is a state-of-the-art hospital, located in an upmarket neighborhood of affluent Saudi Nationals. Moreover, its two new hospitals in Jeddah allow it to enter a market that has limited Class A operators and consists of very high expat population. At the same time, its strategy of opening medical centers should help to increase the catchment area, reduce overcrowding at the main hospitals thus improving the wait time and patient experience. Moreover, Habib's growth strategy is not dependent on price hikes from insurance companies, rather it focuses on gaining more patient flows through improving patient experience led by digitization, tele consultations, and offering more specialties under one roof.

Valuations: With no major price hike and flattish margin assumptions (even after ramp up), we see the potential of earnings doubling in the next five years. We value the company at a forward P/E of 45x on 2024/2025E EPS and arrive at our new target price of SAR 301/share, that implies a downside of around 4% from the current levels. We remain neutral on the stock but see potential for upward revision in the target price if we notice any signs of quicker than expected ramp up at the upcoming hospitals.

Dallah Healthcare Co.

Valuations fully price in all the positives

Dallah's strategic acquisitions in 2020/2021, notably Kingdom Hospital, have enhanced its portfolio without impacting its balance sheet. Utilization improvements at Namar and Nakheel hospitals are expected to bolster revenue and margins.

Valuations pricing in all the positives, target price of SAR 164/share at 38x P/E on 2024/2025E

Key risk: Upcoming Habib's 500 beds hospital on King Fahd Road

Outlook and view: Dallah's inorganic strategy has played out well so far given the timing of its acquisitions in 2020/2021, when the company acquired a premium hospital located in the Northern part of the Riyadh city, Kingdom Hospital. The company acquired 58.64% stake in Care Shield Holding Company, that owns Kingdom Hospital, for SAR 322mn paid through a mix of shares (SAR 186mn paid through shares) and cash. The company had paid SAR 186mn through shares by issuing 3.74 mn shares, implying a share price of about SAR 50/share versus the current market price of SAR 170/share. Thus, without impacting its balance sheet the company acquired a premium asset that has scope to improve its pricing given the location of the hospital. Moreover, recently, the company has been successful in terms of improving its utilization at its Namar facility by admitting more MoH patients. Going forward, we expect its Namar facility to aid the topline as it plans to open another 100 beds, while improving utilization at its flagship Nakheel hospital will continue to offset margin pressure from the expansion.

Estimates and valuations: We estimate revenues to grow by 9% each in 2024E and 2025E, while net income to grow by 15% and 17% supported by better operating margins, improving associate income and benefits from lower interest rates. We value the stock at a forward P/E of 38x on 2024/2025E EPS, 15% premium to Mouwasat (33x) for being a Riyadh focused operator and arrive at our new target price of SAR 164/share, that offers downside of about 7%, implying Neutral recommendation on the stock. **Key risk:** Habib's 500 beds hospital on King Fahd Road impacting patient volumes for Dallah's Nakheel hospital.

Al Hammadi Holding Co. Growth to resume in 2026

Near term growth to be modest, but strong growth from 2026 once Olaya hospital is ready

Strong balance sheet and some margin expansion key positives

Operating income growth in 2024 to see limited benefits due to normalized ECL provisions (2023 saw reversals)

Until its Olaya hospital is ready in 2026, Hammadi's topline is expected to grow by mid-single digit supported by price hikes (negotiations with insurance) as well as continuous improvement in the utilization level at the Suweidi hospital. However, given that there were reversals in 2023 (related to ECL provisions for insurance) and 2024 could see normalized ECL provisions, operating income growth in 2024 would be minimal. Post 2025, we are expecting revenues to grow by double digit led by the Olaya hospital (300 beds and 120 clinics). Currently, the stock is trading at a forward P/E of 32x on 2024/2025E EPS. Given the rerating in the sector and Hammadi being a key beneficiary of growth in the private insurance, that is expected to be driven by class B category, current valuations are partly justified. Due to mid to low single digit growth expectations over the next two years, we value the stock at a P/E of 30x on 2024/2025E EPS and arrive at our new target price of SAR 64/share. At these valuation levels, we are neutral on the stock.

Middle East Healthcare Co. Valuations pricing in the growth

Saudi German Hospital has shown strong profit growth in 2023 led by ramp up at Dammam and strong demand at Makkah hospital

2024 could see further growth on capacity addition at the existing hospitals

However, concerns arise from high receivables, a stretched balance sheet, and potential risks from MoH exposure.

Possibility of spike in ECL provisions due to high exposure to MoH and long receivable days

Key risk is competition coming in Jeddah

Downgrade to Underweight on expensive valuations

We acknowledge that the company has shown strong growth in profits in 2023 due to low base in 2022 and better capacity utilization at Makkah and Dammam. The incremental gross margins have been strong led by the ramp up at Dammam facility. Following the strong growth, the company, during its recently held investor day, announced its plan to increase the capacity of Dammam by another 100 beds (need to get approval as license is to operate only 150 beds) and open another 100 beds at Makkah. Further, the expectations of receiving HIMS accreditation at both these hospitals can improve the pricing. The company has guided for double digit growth in revenues and EBITDA margins of over 20%.

2024 view: During the investor day, the company also guided that they would be investing for the additional capacity at Dammam and Makkah, thus bottom-line in Q4 2023 would be below the quarterly run rate of 9M 2023. For 2024, we estimate revenues to grow by 15% in 2024 and EBITDA margins to improve to 20.7% from 19.5% in 2023E. We would cautiously watch the ramp up at Habib's new hospitals in Riyadh and Jeddah (H2 should see the impact) and see it as a potential risk to Saudi German's patient flow. However, the impact would be more noticeable in H2 2024 and 2025 given the delay in the opening of these hospitals. For now, we are not considering any impact from the rising competition in its core markets.

Key concerns: In addition to competition, we see its stretched balance sheet as a major concern. The current receivables (9M23) are at over 290 days, the highest in the industry. Although the company has received some cash in Q4 2023, given its high MoH exposure and Q4 being seasonally strong in terms of topline, we do not see any notable improvement in the receivable days. Considering that MoH plans to become more corporatized, we could see efficiency kicking in, that raises the risk of prices being revisited (MoH prices are higher than insurance). Moreover, MoH also has a history of higher rejection of claims from private hospitals. Given the high receivable period, the impact of rejection is visible with a lag. Another risk we see is ECL provisions rising for the company in 2024E, currently the ECL provisions are below the industry average.

Valuations: On the back of sector rerating and as we roll forward our valuations to 2024/2025E, we value the stock at 34x, mid-single digit discount to peers (Mouwasat and Dallah), and arrive at our new target price of SAR 113/share. However, due to the sharp rally in the stock price in recent weeks, we are neutral on the name.

Mouwasat Medical Services Co.

Margin protection at core

Mouwasat, although has struggled in recent years due to competition in the eastern region, it has a superior historical track record of cost control and has a solid balance sheet. The company has been cautious in terms of ramping up its capacity at Dammam given the rise in competition, thus compromised on growth in the recent quarters but not at the expense of margins. The company's gross margins have remained intact at around 47-48% (9M 2023), the highest in the industry. The company plans to follow a cautious approach in terms of opening additional beds at its existing facilities, Dammam and New Madina. Moreover, any increase in capacity in 2024 would come at existing facilities or in existing cities. Thus, there would be limited negative impact from pre-operating costs. For Old Madina hospital, which the company plans to open in Q1 2024 (waiting for MoH approval), the company sees limited impact on costs as it plans to allocate staff from the existing new Madina hospital till it sees the need for ramp up. The Old Madina hospital will be a standalone 100 beds LTC unit, thus the staffing requirement will also be lower compared to a full-fledged multi-specialty hospital. Moreover, even at Dammam LTC unit, which has total capacity of 200 beds, additional opening of 100 beds would depend on the utilization levels reaching 70-80% for the 100 beds that are already functioning. Thus, the company would continue to maintain its focus on margins than chasing growth at the expense of profitability.

2024 and beyond: An important catalyst for 2024 would be the upward price revision from the insurance companies. The company is in the final stages of negotiation and expects a minimum 10% increase in the pricing. Given that insurance is the major clientele for the company, over 75% exposure, any positive development on that front could increase the overall pricing by mid to high single digit. We have considered staggered impact in pricing, with 4% improvement in each 2024 and 2025. One of the concerns for the market has been the John Hopkins contract, where the terms have changed from per capita to fees for services. As per the company, the new contract was supposed to be implemented in November 2023 for most of its hospitals and it should have a positive impact of 10% increase in revenues per patient. However, we prefer to be skeptical and not considering any positive impact at the moment. Moreover, in 2025 the company's major hospitals, 300 beds hospital in Jeddah and 200 beds hospital in Yanbu will be completed. We anticipate some impact on the gross margins but should be limited as we believe the company will follow a similar approach of gradual opening of the beds and focusing on cost control.

Key concerns: In terms of risks and reason for our cautious view on the stock so far, lack of greenfield projects in Riyadh has been our concern. The company has a relatively smaller project of 120 beds in Qadisiyah (2026 completion), eastern part of Riyadh, and no plans of entering in the Northern part of the city. On one hand, this could work in the company's favor as the Northern part of the city is expected to see notable increase in the capacity in the next few years. However, at the same time, the company could miss on tapping the affluent class of Saudi nationals and growing population. Moreover, the need to revamp its hospitals to improve the patient experience, investments in digitization and the rising competition, we anticipate the margins to come under pressure in the near future, which could offset the growth in the topline to some extent.

Valuations: Based on the above-mentioned catalysts (price hikes from insurance and capacity increase), we estimate the topline to grow by 12% and 17% in 2024 and 2025, respectively, however, operating profits are expected to grow at a relatively lower rate of 11% and 13%, respectively. We assign a P/E multiple of 33x to 2024/2025E EPS and arrive at our new target price of SAR 128/share, offering around 4% upside from the current levels and implying Neutral recommendation on the stock. The key upside risks to our assumptions are price hikes from insurance, no negative impact from change in terms of Aramco contract, etc.

Mouwasat Hospital maintains strong cost control and a solid balance sheet despite regional competition, focusing on cautious capacity expansion at existing facilities to minimize pre-operating costs.

Catalysts for growth include potential price hikes from insurance companies and the completion of major hospitals by 2025, though concerns remain about limited greenfield projects in Riyadh and potential margin pressure.

Target price SAR 128/share implies a Neutral recommendation, with upside risks including insurance price hikes and favorable contract terms.

National Medical Care Co.

Inorganic growth can be the next driver

During 2023, Care's stock has rerated due to improvement in earnings driven by better pricing for its MoH patients, as well as higher utilization of its existing facilities. Further, traction on its inorganic growth strategy, post-acquisition of Jiwar and Chronic Care, also improved sentiments. Now, with the approval for the long pending expansion of 129 beds at the CNH hospital, the revenue growth prospects for 2024 appear bright. Over the years, Care has traded at a lower valuation than its peers mainly on the back of weak growth prospects, unattractive capital structure, and low return on assets. The company is now pursuing a growth strategy driven by both organic and inorganic routes, as well as optimizing the capital structure through leveraging the balance sheet. Despite the strong cash balance of over SAR 700mn as of Q3 2023 (post collection of GOSI receivables), the company has announced plans to lever its balance sheet by borrowing SAR 350mn, of which SAR 250mn is the long-term loan that will be used for growth. Even if we adjust the working capital requirements (SAR 100-150mn) and the acquisition cost for Chronic Care of SAR 193mn, the company will be left with a dry powder of SAR 500mn. Thus, there is a significant possibility of more acquisitions in the near to medium term.

Care's saw a rerating in 2023 due to improved earnings from better pricing for MoH patients and higher facility utilization, alongside traction in its inorganic growth strategy.

Pursuing a growth strategy through organic and inorganic means, Care plans to optimize its capital structure by leveraging the balance sheet

Revenue growth in 2024 (excluding Chronic Care) is estimated at around 19%, driven capacity addition at CNH hospital and higher mix of MoH and GOSI patients

Potential for further acquisitions given a significant cash balance of SAR 700 million.

2024 and beyond: We are estimating revenue growth to be around 19% (ex-Chronic Care) in 2024 driven by the capacity addition at CNH hospital. As mentioned in our note dated [8th October 2023](#), the loss of national guard contract can be a blessing in disguise as the margins on MoH and GOSI patients are higher than NG patients. At the same time, we are also considering the contribution of Jiwar, an emergency services facility, located in a strategic location (Grand Mosque in Makkah) with 66 beds. We are now also considering the impact of 124 beds, that were pending to be commissioned at the CNH for long. The approval was pending for a few years now due to parking issues at the hospital. The capex is already done, thus the beds are ready to be commissioned starting Q1 2024. Moreover, given that the expansion is at the existing facility, it should have limited impact on the operating costs, as the company can open the beds in a phased manner and utilize the existing staff as well as increase the hiring of personnel based on the demand. Between the two hospitals, the CNH hospital has high exposure to insurance clientele. Thus, given the strong demand for healthcare services from insurance client, the company should benefit in terms of quicker ramp up of the additional capacity. Beyond 2024, we are expecting revenues to grow by another high single digit in 2025 as the year will see full benefits of the expansion at CNH. The company's greenfield project in Narjes, 300 beds hospital, is expected to be completed in 2027 that should help the topline to grow by low double digit beyond 2027 for over 3-4 years.

Chronic care: We are estimating revenues from Chronic care to be over SAR 100mn with an EBITDA margin of 21%. We value Chronic Care separately and assign a multiple of 25x to its estimated net profit of SAR 19mn after considering the synergies (5% of sales, higher MoH pricing due to Care's accreditations). We are also considering the possibility of 25 beds of expansion at the Chronic Care facility, which could add another SAR 3mn of profits. Our valuation from Chronic Care is SAR 12/share (including expansion).

Valuations: As we roll forward our valuations to 2024/2025 and consider the rerating in the sector, we value the company (ex-Chronic Care) at 30x P/E on 2024/2025E EPS of SAR 6.25/share, which is 25% premium to its 10-year historical median forward multiple of 24x. The reason for the premium is improving growth prospects coming from inorganic opportunities, and confidence in the execution capabilities of the management. We value Chronic Care and the expansion at 25.0x, lower than the group, due to peak utilization of the facilities and lack of notable exposure to insurance clients. Based on this, our new target price for the company is SAR 199/share, that is around 3% above the current market price, implying neutral recommendation on the stock.

Key Financials

Figure 6 **Dallah**

(SARmn)	2023E	2024E	2025E
Revenue	2,883	3,143	3,420
Revenue growth	15.9%	9.0%	8.8%
Gross profit	1,059	1,138	1,231
Gross margin	36.7%	36.2%	36.0%
Operating profit	463	509	544
Op. margins	16.1%	16.2%	15.9%
Net profit	335	390	452
Net margin	11.6%	12.4%	13.2%
EPS	3.4	4.0	4.6
DPS	2.2	2.6	3.0
Payout ratio	65%	66%	66%
P/E	51.1x	44.1x	38.0x
RoE	16%	18%	20%

Source: Al Rajhi Capital

Figure 7 **Mouwasat**

(SARmn)	2023E	2024E	2025E
Revenue	2,599	2,909	3,388
Revenue growth	11.3%	11.9%	16.5%
Gross profit	1,240	1,367	1,563
Gross margin	47.7%	47.0%	46.1%
Operating profit	747	820	926
Op. margins	28.7%	28.2%	27.3%
Net profit	655	718	833
Net margin	25.2%	24.7%	24.6%
EPS	3.3	3.6	4.2
DPS	1.6	1.8	2.1
Payout ratio	49%	50%	50%
P/E	37.7x	34.4x	29.6x
RoE	21%	21%	22%

Source: Al Rajhi Capital

Figure 8 **Habib**

(SARmn)	2023E	2024E	2025E
Revenue	9,462	12,736	15,788
Revenue growth	13.9%	34.6%	24.0%
Gross profit	3,242	4,124	5,063
Gross margin	34.3%	32.4%	32.1%
Operating profit	2,081	2,366	2,884
Op. margins	22.0%	18.6%	18.3%
Net profit	2,069	2,132	2,555
Net margin	21.9%	16.7%	16.2%
EPS	5.9	6.1	7.3
DPS	4.4	4.5	5.4
Payout ratio	75%	74%	74%
P/E	53.2x	51.6x	43.1x
RoE	34%	32%	35%

Source: Al Rajhi Capital

Figure 9 **Hammadi**

(SARmn)	2023E	2024E	2025E
Revenue	1,178	1,282	1,346
Revenue growth	5.0%	8.8%	5.0%
Gross profit	442	495	524
Gross margin	37.5%	38.6%	38.9%
Operating profit	335	350	362
Op. margins	28.4%	27.3%	26.9%
Net profit	316	333	346
Net margin	26.8%	26.0%	25.7%
EPS	2.0	2.1	2.2
DPS	1.5	1.6	1.3
Payout ratio	75%	75%	60%
P/E	33.7x	32.0x	30.8x
RoE	19%	18%	18%

Source: Al Rajhi Capital

Figure 10 **Care (ex-Chronic Care)**

(SARmn)	2023E	2024E	2025E
Revenue	1,062	1,256	1,345
Revenue growth	15.7%	18.3%	7.1%
Gross profit	357	422	453
Gross margin	33.6%	33.6%	33.7%
Operating Profit	252	283	303
Op. margin	23.8%	22.5%	22.5%
Net profit	240	276	284
Net margin	22.6%	22.0%	21.1%
EPS	5.4	6.2	6.3
DPS	1.0	1.3	1.5
Payout ratio	19%	20%	24%
P/E	36.1x	31.5x	30.6x
RoE	14%	16%	14%

Source: Al Rajhi Capital

Figure 11 **MEH**

(SARmn)	2023E	2024E	2025E
Revenue	2,613	3,009	3,418
Revenue growth	21.1%	15.1%	13.6%
Gross profit	993	1,128	1,251
Gross margin	38.0%	37.5%	36.6%
Operating profit	368	460	501
Op. margins	14.1%	15.3%	14.7%
Net profit	202	277	336
Net margin	7.7%	9.2%	9.8%
EPS	2.0	3.0	3.6
P/E	61.2	40.9	33.7
RoE	13%	16%	17%

Source: Al Rajhi Capital, Note: Our published Q4 2023 estimate for MEH is SAR 58mn, however, company has guided that Q4 could be below the 9M 2023 run rate due to investments for additional beds.

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Contact us

Mazen AlSudairi, CFA, CMT

Head of Research

Tel : +966 11 836 5468

Email: alsudairim@alrajhi-capital.com

Al Rajhi Capital

Research Department

Head Office, King Fahad Road

P.O. Box 5561, Riyadh 11432

Kingdom of Saudi Arabia

Email: research@alrajhi-capital.com

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