

Al-Arafa Holding

3Q11/12 margin recovered on cost control

Al-Arafa Holding [AIVC] showed an improved operational performance in 3Q11/12, ended October 2011, compared to the first two quarters of this year. On a YoY basis, top line grew 2.5% whilst EBITDA margin remained almost flat in 3Q11/12. That said, net earnings doubled in 3Q11/12 to USD2.3mn (30% below CI Capital Research estimates of USD3.3mn) due to high non-opex booked in 3Q10/11. The deviation from our estimates came mainly from higher taxes in 3Q11/12. AIVC currently trades on a 2012/13E PER of 8.2x, vs. a peer average of 11.4x. In light of continuing economic uncertainties (especially in Europe), we have trimmed our top line and earnings estimates over the forecast period. This, in addition to accounting for higher tax rate and risk-free rate in some of the Egyptian operations, drove our LTFV 8% lower to USD0.8/share. We have also cut our target price 19% to USD0.56/share. Though this leaves AIVC with 40% upside potential, (which necessitates a Strong Buy rating as per our matrix), we still keep our Buy recommendation in view of market volatility.

Sustainable top line growth in 3Q11/12: AIVC reported a 2.5% YoY growth in top line reaching USD71.8mn (10% above CI Capital Research estimates of USD65.3mn). This came largely as a result of a 31% growth in the Apparel & Tailoring segment (42% of sales in 3Q11/12) – itself driven by an increasing size of manufacturing business to international brands such as Zara and Massimo Dutti through its Portugal-based subsidiary, **Egyptian Portuguese Co.** Challenges in the UK market and impacts of devaluation of the EGP vs. USD on translation of EGP statements of Concrete's retail arm to USD led to a 1% YoY lower retail revenues in 3Q11/12.

Margins almost maintained YoY, yet earnings doubled: EBITDA grew 0.8% YoY to USD5.1mn (77% above our estimates), while EBITDA margin remained stable at 7.2% in 3Q11/12. However, compared to the previous quarter (2Q11/12), EBITDA margin improved by 280bps due to continuous cost rationalization and the removal of sales discounts in Concrete (AIVC's local retail arm). Due to lower non-opex recorded below the line compared to 3Q10/11, AIVC reported a +100% increase in 3Q11/12 net earnings to USD2.3mn vs. USD1.1mn a year ago.

Valuation and recommendation: While we remain cautious of the global macro scene, we still believe in AIVC's potential, given the growing contribution of the high-margin luxury-wear manufacturing business – whose demand remained so far relatively sheltered from the economic headwinds. The penetration of shirts manufacturing (jointly with a well-known Italian brand and another one with Zegna), the start of made-to-measure business in Concrete, further devaluation of the EGP vs. USD (the reporting currency) with some of industrial expenses denominated in EGP should all provide a soft landing for AIVC in the coming period. Yet, given global uncertainties besides the higher risk free rate and tax rate factored in, we have cut our LTFV and TP to USD0.8/share and USD0.56/share, respectively. Our Buy rating is maintained.

US\$ mn	Jan-10 A	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P
Revenues	332.4	283.3	289.0	299.7	321.9
Growth rate	NM	-14.8%	2.0%	3.7%	7.4%
EBITDA	3.2	17.9	18.8	26.5	35.5
Growth rate	NM	467.3%	4.8%	40.7%	34.2%
EBITDA margin	1.0%	6.3%	6.5%	8.8%	11.0%
Net income	11.5	23.1	10.5	15.3	21.2
Growth rate	-56.8%	101.3%	-54.6%	46.1%	38.2%
Net margin	3.5%	8.2%	3.6%	5.1%	6.6%
PER	10.9x	5.4x	12.0x	8.2x	5.9x
P/BV	0.6x	0.6x	0.6x	0.6x	0.5x
EV/EBITDA	80.5x	16.3x	14.8x	9.1x	6.2x
Net debt/EBITDA	40.8x	9.4x	8.1x	4.4x	2.7x
Dividend yield	N/A	5.0%	2.3%	3.9%	6.3%

* Jan-09A financials represented a transitional 10-month period. NM = Not Meaningful.

Source: Company reports and CI Capital Research estimates

BUY (MAINTAINED)
LT FAIR VALUE | USD0.80 (DOWNGRADED)
TARGET PRICE | USD0.56 (DOWNGRADED)

COMPANY SYNOPSIS

Established in 2006, Al-Arafa for Investment and Consultancies [AIVC] is a vertically integrated, large-scale textile and garment manufacturer, exporter and retailer. The Group has currently three consumer-based sectors: (i) Casual-wear market, with production planned to be fully carried out in Beni Suef, targeting big US retailers such as JC Penny, Macy's and GAP, (ii) Formal wear market, a great portion of AIVC's production supplies its British retail arm, BMB, which holds 12% market share in the UK formal suits market, and the (iii) Luxury market with AIVC producing high quality suits for Concrete and other luxury brands. Furthermore, AIVC has exposure to the high-end local market through its 47 retail stores of Concrete.

International revenue stream made almost 89% of AIVC's revenue in 2010/11. Exports are mainly directed to customers in Europe, particularly the UK and the US. Customers include chain retailers and department stores such as JC Penny, Macy's, Massimo Dutti, as well as international fashion brands such as Valentino, Jaeger and Haggard. AIVC owns brands such as John Langford and Bonner in the UK. With a 35% stake, AIVC is the largest shareholder of the prestigious Italian company, Forall Confezioni, the owner of brand Pal Zileri.

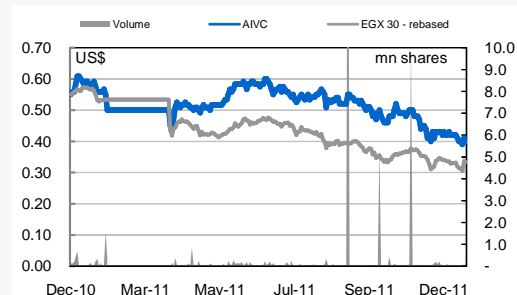
SHAREHOLDER STRUCTURE

Alaa Arafa	25.27%
Samaa Ragab	16.47%
Sherine Arafa	7.08%
Ashraf Arafa	11.90%
Free float	39.28%

STOCK DATA

Reuters; Bloomberg	AIVC.CA ; AIVC EY
Recent price as of 26-Dec-11	US\$0.40
No. of O/S shares	313.5 mn
Market cap	US\$125 mn
52-wk high / low	US\$0.62/ US\$0.39
Avg. daily volume / turnover	0.27 mn / US\$0.13 mn

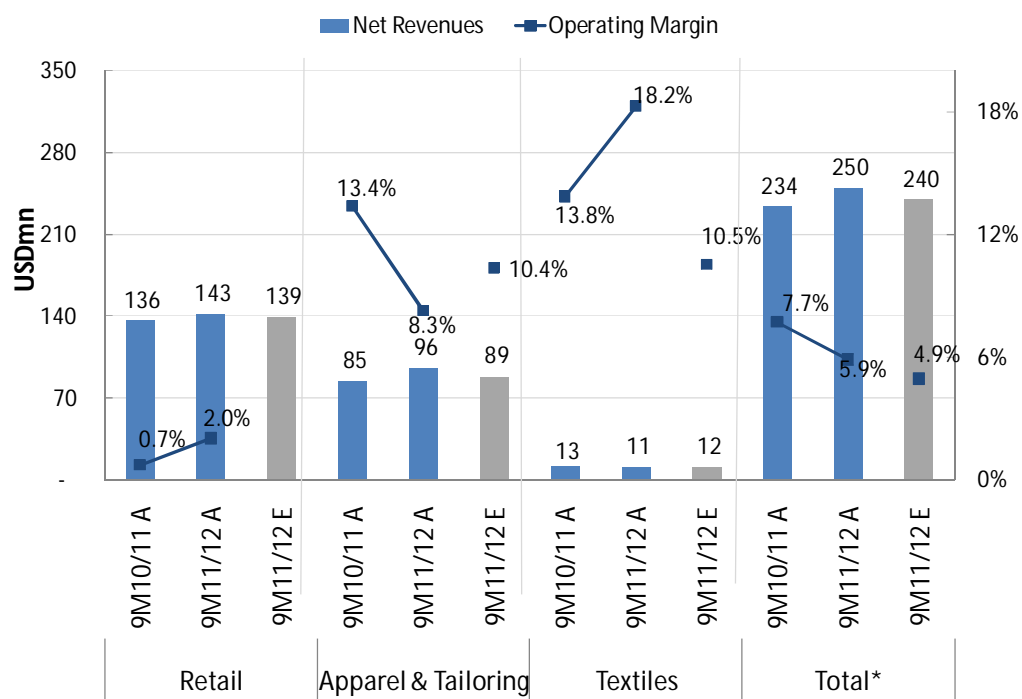
STOCK PERFORMANCE | 52 WEEKS



*Size of volume traded on August 28, 2011 reached 22.9mn shares as one of the family members sold 50% of her stake.

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Figure 1 | Revenues & Operating Margin by segment (Actual vs. Estimates)


*Total revenues include intercompany sales

A=Actual E= Estimate

Source: CI Capital Research estimates and company reports

Figure 2 | Summary of Actual vs. Estimated Results (3Q11/12 vs. 3Q10/11)

(USDmn)	3Q10/11A	2Q11/12A	3Q11/12A	QoQ	YoY	3Q11/12F	Variance
Net Revenues	70.0	71.8	71.8	0.0%	2.5%	65.3	10.0%
EBITDA	5.1	3.1	5.1	64.4%	0.8%	2.9	76.8%
EBITDA Margin	7.3%	4.4%	7.2%	280.2bps	-11.9bps	4.5%	270.4bps
Net Profit	1.1	3.0	2.3	-23.1%	104.9%	3.3	-30.5%
Net Profit Margin	1.6%	4.1%	3.2%	-95.8bps	159.3bps	5.0%	-185.6bps

A=Actual F=Forecast

Source: CI Capital Research estimates and company reports

What has changed from our previous update?

Lowering top line estimates: In view of prevalent global economic uncertainties, we have fine-tuned our top line estimates lower over FY12/13-FY14/15 period by an average of 8%. This came mainly after revising lower revenues of the Retail and the Apparel & Tailoring segments. In our forecasts, we still account for the following: (i) the commercial operation of the new shirts factory which started its operation in 2Q11/12, and (ii) the new made-to-measure business by Concrete in 2012.

Lower revision of top line estimates

Margins are lowered, but to improve annually: Continuous promotions offered to enhance sales of the UK retail arm coupled with lower prevailing utilization rates of the Apparel & Tailoring segment (given the lower-than-expected demand) drove us to lower our 2011/12 EBITDA margin estimate by 181bps, and onwards by an average of 104bps compared to our previous update. Going forward, EBITDA margin is expected to improve annually mainly on the back of the company's increased contribution of the high-margin luxury wear manufacturing business and an expected market recovery.

Revising EBITDA margin lower over the forecast period

Thus, earnings estimates are cut: Based on the above in addition to accounting for the higher tax rate, we have lowered our year-end earnings estimates by 45% to USD10.5mn. We have also revised down our earnings estimates over the coming three years by an average of 34%.

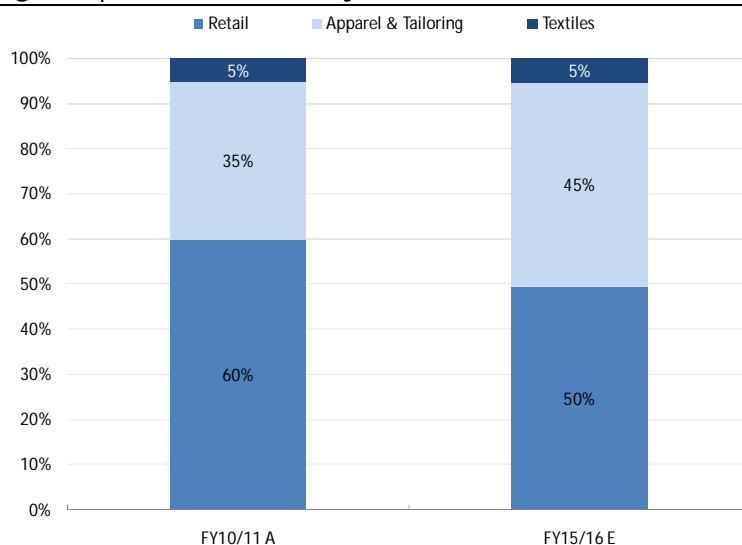
Reducing earnings estimates over the forecast period

Figure 3 | New vs. Old Earnings Estimates

	Jan 2012e			Jan 2013e			Jan 2014e			Jan 2015e		
	Old	New	Chg.	Old	New	Chg.	Old	New	Chg.	Old	New	Chg.
Revenues (USD mn)												
Retail	205	202	-1%	216	204	-6%	224	212	-6%	232	219	-6%
Apparel & Tailoring	122	131	7%	149	142	-5%	186	161	-14%	207	181	-13%
Textiles	17	17	0%	19	19	0%	22	22	0%	23	23	0%
Net Revenues (USD mn)	288	289	0%	318	300	-6%	352	322	-9%	373	342	-8%
EBITDA (USD mn)	24	19	-22%	32	26	-18%	42	36	-15%	49	41	-15%
EBITDA Margin %	8.3%	6.5%	-181bps	10.2%	8.8%	-134bps	11.9%	11.0%	-82bps	13.0%	12.1%	-97bps
Retail Segment	3.4%	2.2%	-115bps	4.6%	2.9%	-169bps	5.9%	5.1%	-89bps	6.7%	5.9%	-79bps
Apparel & Tailoring	11.9%	8.7%	-321bps	13.0%	12.1%	-97bps	13.4%	13.1%	-30bps	14.2%	13.4%	-73bps
Textiles	15.0%	17.3%	231bps	15.3%	17.2%	187bps	15.8%	17.2%	144bps	16.2%	17.3%	112bps
Net Income (USD mn)	19.0	10.5	-45%	23.6	15.3	-35%	30.9	21.2	-31%	29.6	18.9	-36%

Source: CI Capital Research estimates

Figure 4 | Revenue mix in a 5 years' time



Source: Company reports & CI Capital Research estimates

Changes to our Valuation

LTFV cut 8%: We have lowered our sum of the parts valuation (SoTP) by 8% to USD0.8/share, down from the adjusted LTFV of USD0.87/share in our previous note dated July 14, 2011.

LTFV cut to USD0.8/share

This resulted mainly from higher outstanding net debt besides revising lower our valuation of key business segments due to the following:

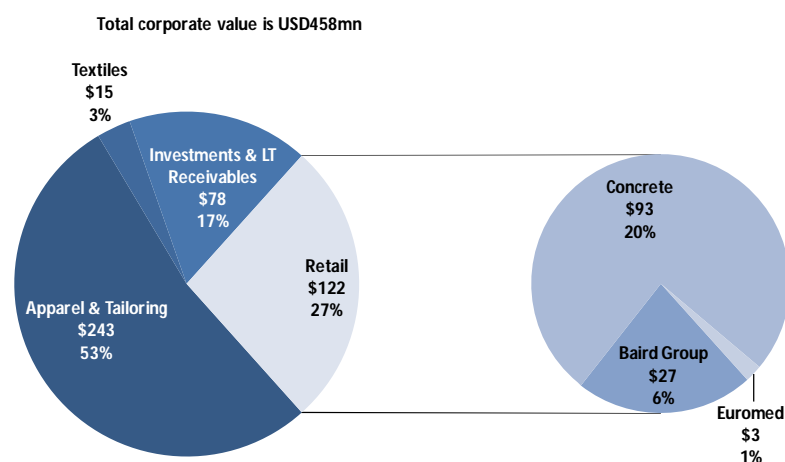
- (i) Trimming top line and margin forecasts of the Retail and the Apparel & Tailoring segments due to cautious outlook for international clothing demand in the coming period.
- (ii) Accounting for the higher income tax rate and risk-free rate in the valuation of Egyptian operations.

Figure 5 | Summary of SoTP Valuation

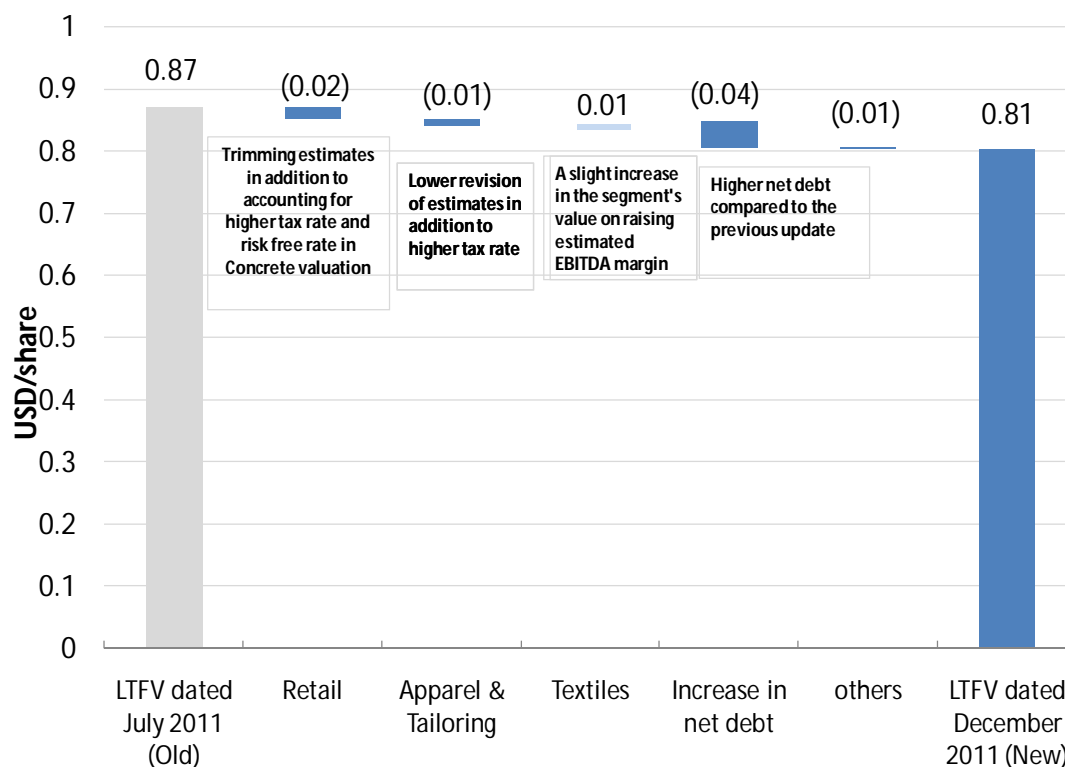
Subsidiary	Country	WACC	Perpetual growth	Corporate value	Net Debt (Debt-Cash)	Equity [EV-Net Debt]	AIVC's stake	Al-Arafa's share of equity Dec 2011 (New)	%age of total value	Al-Arafa's share of equity Jul 2011	% change	
US\$ mn												
1. Retail segment												
Baird Group	UK	6.8%	2.0%	\$34	0.2	\$34	79.5%	\$27	5.9%	\$27	0.6%	
Concrete	Egypt	14.1%	3.0%	\$98	(2.6)	\$101	91.6%	\$93	20.2%	\$100	-7.2%	
Euromed	Egypt	14.1%	2.0%	\$3	(0.1)	\$3	99.2%	\$3	0.6%	\$2	72.9%	
Retail segment shareholders' value									\$122	26.8%	\$128	-4.6%
2. Apparel & Tailoring segment												
Swiss Garments Company & Egyptian Tailoring Co.												
	Egypt	10.2%	3%	\$258	13.4	\$245	99.2%	\$243	53.1%	\$247	-1%	
3. Textiles segment												
Goldentex & White Head												
	Egypt	13.2%	3%	\$32	(1.7)	\$34	43.6%	\$15	3.2%	\$13	14%	
Book value of investments								\$43	9.3%	\$43	-2%	
Receivables due from acquirers								\$35	7.7%	\$35		
Total EV								\$458	100.0%	\$466	-2%	
Less net debt/(net cash)								\$206		\$193	7%	
Total shareholders' value								\$252		\$273	-8%	
no. of outstanding shares (mn)								314	0%	314		
FV/share								US\$/share	0.80	0.87	-8%	

Source: CI Capital Research estimates

Figure 6 | Estimated enterprise value by segment (USD mn)



Source: CI Capital Research estimates

Figure 7 | Changes in SoTP Valuation (USD/share)


Source: CI Capital Research estimates

Target Price set at USD0.56/share: Based on 2012E composite PER average of 11.4x for international peers, we have set our target price at USD0.56/share, 19% lower than our previous target price of USD0.69/share.

Figure 8 | 2012E PER of International Peers

Company name	Country	PER 12e
Retail		
Casual Male Retail Group	US	9.7
French Connection Group	GB	6.3
MQ Holding Ab	SW	6.3
Average		7.4x
Weight		23%
Apparel & Tailoring		
Oxford Industries	US	15.9
Philips-Van Heusen	US	11.4
Average		13.7x
Weight		65%
Textiles		
TEXWINCA HOLDINGS LTD	HK	8.3
PACIFIC TEXTILES HOLDINGS	HK	6.4
Average		7.4x
Weight		13%
Composite Peer Average		11.4x

Source: Bloomberg

Valuation and recommendation: AIVC's improving operational performance in 3Q11/12 – despite challenging conditions in Europe- proved a strategic success for the management. While we remain cautious of the global macro scene, we still believe in the company's potential given the growing contribution of the high-margin luxury-wear manufacturing business – for which demand remains so far relatively sheltered from the economic headwinds. The penetration of shirt manufacturing jointly with a well-known Italian brand (kicked off in 2Q11/12) and another one with Zegna (estimated to start operations next year), besides a made-to-measure business by Concrete in the local market, and the full operation of the new Beni Suef casual production lines should lend support to AIVC's top line and margins. Moreover, further devaluation of the EGP vs. USD (the reporting currency) will help AIVC since some of the industrial expenses are denominated in EGP and a USD stock provides a shield for foreign investors. Yet, given global uncertainties besides the higher risk free rate and tax rate factored in, our LTFV and TP are cut to USD0.8/share and USD0.56/share, respectively. Our Buy recommendation is maintained.

Risks to our Recommendation

- Slowdown in foreign markets.
- Intense competition from nations known for low-cost manufacturing such as Vietnam, Bangladesh and China.
- Depreciation of the UK pound.
- Elimination of the government's export-incentive program.
- Prolonged political instability.

Catalysts

- Egypt is a key sourcing hub for major markets due to its low-cost environment and proximity to major markets.
- Egyptian textiles' tariff-free access to the US and Europe.
- The increasing contributions from AIVC's manufacturing arm.
- Vertically-integrated operations, which ensures timely delivery of customer demands, a guaranteed market for its products, and better cost management.

Company Financials [FY10/11A-2015/16P]

Balance Sheet (USD mn)	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
Assets						
Cash & Cash Equivalent	62	64	67	72	76	81
Net Receivables	109	113	97	104	111	119
Total Inventory	113	115	116	117	121	123
Advance Payment	6	7	7	7	7	8
Other Trading Assets						
Other Current Assets	11	8	8	8	4	1
Total Current Assets	303	307	294	308	320	331
Net Plant	101	97	96	94	92	89
Long-Term Investments	45	45	45	45	45	45
Other Non-Current Assets	54	48	42	37	35	37
Other Non-current Assets	2	2	2	2	2	2
Intangibles	40	40	40	40	40	40
Total Assets	545	539	518	525	534	544

Liabilities & Shareholders' Equity

Short-Term Debt	105	111	100	109	138	133
CP of Long Term Debt	24	24	23	23	11	6
Accounts Payable	50	51	52	54	58	60
Accrued Expenses	7	8	8	8	9	9
Down Payments	0	0	0	0	0	0
Taxes Payable	8	8	8	8	8	8
Dividends Payable	6	3	5	8	7	11
Other Current Liabilities	3	4	4	4	4	4
Total Current Liabilities	205	208	200	215	235	231
Total Long-Term Debt	101	82	59	36	11	5
Other Non-Current Liabilities	4	4	4	4	4	4
Total Liabilities	309	294	262	255	250	240
Other Provisions	2	2	2	2	2	2
Minority Interest	26	27	28	30	31	33
Shareholders' Equity	208	216	226	239	251	269
Total Liab. & Equity	545	539	518	525	534	544

Income Statement (USD mn)	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
Revenues	283	289	300	322	342	365
Cost of Revenues	(177)	(182)	(185)	(195)	(206)	(214)
Gross Profit	107	107	115	127	136	151
SG&A	(89)	(88)	(88)	(92)	(95)	(98)
EBITDA	18	19	26	36	41	53
Depreciation & Amortization	(8)	(8)	(9)	(9)	(9)	(10)
EBIT	10	11	18	26	32	44
Interest Expense	(11)	(10)	(9)	(9)	(9)	(7)
Interest Income	4	3	3	3	3	4
Investment Income	0	0	0	0	0	0
Other Non-Operating Income	16	13	12	11	3	3
Other Non-Operating Expenses	(8)	(1)	(2)	(2)	(2)	(2)
EBT	11	15	21	29	27	41
Taxes	(3)	(4)	(5)	(7)	(7)	(10)
NPAT	8	12	16	23	20	30
Minority Interest	6	(1)	(1)	(1)	(1)	(2)
Extraordinary Items	9	0	0	0	0	0
Attributable Profits	23	10	15	21	19	29

A=Actual P=Projected

Source: Company reports and CI Capital Research estimates

Cash Flow (USD mn)	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
NOPAT	4	7	13	20	25	33
Depreciation & Amortization	8	8	9	9	9	10
Gross Cash Flow (COPAT)	13	15	22	29	35	43
Working Investments Change	(48)	(4)	16	(6)	(8)	(7)
Other Current Items	(15)	4	0	0	4	4
Cash After Current Operations	(50)	14	38	23	31	40
Financing Payments	(26)	(34)	(33)	(32)	(32)	(19)
Cash Before Long Term Use	(76)	(20)	5	(8)	(2)	21
Net Plant Change	4	(4)	(8)	(7)	(7)	(7)
FCFF	(46)	11	31	16	24	33
Others	26	21	18	16	6	2
Cash Before Financing	(46)	(3)	16	1	(3)	17
Short-Term Debt	(43)	6	(11)	9	29	(5)
Long-Term Debt	72	5	0	(0)	(14)	0
Networth	(2)	(1)	(1)	(1)	(1)	(2)
Grey Area	(6)	1	1	1	1	2
Dividends	0	(6)	(3)	(5)	(8)	(7)
Change in Cash	(24)	2	2	5	5	5

Fact Sheet	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
ROE	11.1%	4.9%	6.8%	8.8%	7.5%	10.6%
ROS	8.2%	3.6%	5.1%	6.6%	5.5%	7.8%
ROA	4.2%	1.9%	3.0%	4.0%	3.5%	5.3%
ROIC	1.0%	1.7%	3.3%	4.9%	6.2%	8.2%
Gross Margin	37.6%	37.0%	38.4%	39.5%	39.8%	41.4%
EBITDA Margin	6.3%	6.5%	8.8%	11.0%	12.1%	14.6%
ATO	0.5	0.5	0.6	0.6	0.6	0.7
W/ Sales	79.6%	77.4%	67.2%	62.8%	60.8%	59.6%
ALEV	2.6	2.5	2.3	2.2	2.1	2.0
Liabilities/Networth	1.5	1.4	1.2	1.1	1.0	0.9
Current Ratio	1.5	1.5	1.5	1.4	1.4	1.4

Per-Share Ratios	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
Share Price (as of December 26,2011)	0.40	0.40	0.40	0.40	0.40	0.40
No. of o/s shares (,000)	313,500	313,500	313,500	313,500	313,500	313,500
EPS	0.07	0.03	0.05	0.07	0.06	0.09
DPS	0.02	0.01	0.02	0.03	0.02	0.03
Revenues/Share	0.90	0.92	0.96	1.03	1.09	1.16
BV/Share	0.66	0.69	0.72	0.76	0.80	0.86
Gross Cash Flow/Share	0.04	0.05	0.07	0.09	0.11	0.14
FCFF/Share	(0.15)	0.03	0.10	0.05	0.08	0.11
EBITDA/Share	0.06	0.06	0.08	0.11	0.13	0.17
EV/Share	0.94	0.89	0.77	0.71	0.67	0.60

Multiples	Jan-11 A	Jan-12 P	Jan-13 P	Jan-14 P	Jan-15 P	Jan-16 P
P/E	5.4x	12.0x	8.2x	5.9x	6.6x	4.4x
Dividend Yield	5%	2%	4%	6%	6%	8%
P/ Revenue	0.4x	0.4x	0.4x	0.4x	0.4x	0.3x
EV/ Revenues	1.0x	1.0x	0.8x	0.7x	0.6x	0.5x
P/ COPAT	9.8x	8.3x	5.7x	4.4x	3.6x	2.9x
EV/ COPAT	23.0x	18.4x	11.0x	7.7x	6.1x	4.4x
P/ FCFF	-2.7x	11.6x	4.1x	7.6x	5.3x	3.8x
EV/ FCFF	-6.4x	25.7x	7.9x	13.5x	8.9x	5.7x
P/ EBITDA	7.0x	6.7x	4.7x	3.5x	3.0x	2.4x
EV/ EBITDA	16.3x	14.8x	9.1x	6.2x	5.1x	3.5x
P/ BV	0.6x	0.6x	0.6x	0.5x	0.5x	0.5x

Source: Company reports and CI Capital Research estimates

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In February 2008, CI Capital Research (CICR) launched a new rating system to give analysts more freedom to be market responsive. This is to make one element of our research more dynamic, namely the advertising of target prices and recommendations. What we did not change is our assessment of the Long Term Fair Value (LTFV), nor have we stopped our detailed industry and company research. What we did is change the target price to trade in the balance of where a share should trade and where we think it will trade.

LTFV: As before we continue to estimate a fundamental valuation, largely DCF and/or NAV based.

Target Price: The price, which is not necessarily the LTFV, is where the analyst, given all (qualitative as well as financial) information available, thinks the share price can get to within the next 3-12 months. This can be changed at any time on changing facts and perceptions.

Recommendations: Our new rating system falls out from the total return relating to the share price performance to the target price, and including any distributions may not be included in the target price calculation. This is shown in the table below, and to be BUY must return over 19%, an arbitrary hurdle rate we think reasonable given prevailing interest rates and risks (Please see table below.)

Rating	Potential Upside/Downside
Strong Buy	>30%
Buy	>20%<30%
Hold	>10%<20%
Underweight	>0% <10%
Sell	<0%