

FALCOM  
SAUDI EQUITY EXCHANGE TRADED FUND

FINANCIAL STATEMENTS  
For the year ended 31 December 2012  
Together with the  
INDEPENDENT AUDITORS' REPORT



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## INDEPENDENT AUDITORS' REPORT

To: **The Unitholders**  
**FALCOM Saudi Equity Exchange Traded Fund**  
**Riyadh**  
**Kingdom of Saudi Arabia**

We have audited the accompanying financial statements of **FALCOM Saudi Equity Exchange Traded Fund** (the "Fund") managed by FALCOM Financial Services (the "Fund Manager") which comprise the balance sheet as at 31 December 2012 and the related statements of income, cash flows and changes in net assets attributable to unitholders for the year then ended and the attached notes (1) through (14) which form an integral part of the financial statements.

### *Fund Manager's responsibility for the financial statements*

The Fund Manager is responsible for the preparation and fair presentation of these financial statements in accordance with generally accepted accounting standards in the Kingdom of Saudi Arabia and for such internal control as the Fund Manager determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The Fund Manager has provided us with all the information and explanations that we require relating to our audit of these financial statements.

### *Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with generally accepted auditing standards in the Kingdom of Saudi Arabia. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Fund Manager, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.



**Opinion**

In our opinion, the financial statements taken as a whole present fairly, in all material respects, the financial position of the Fund as at 31 December 2012 and the results of its operations and its cash flows for the year then ended in accordance with generally accepted accounting standards in the Kingdom of Saudi Arabia appropriate to the circumstances of the Fund.

**For KPMG Al Fozan & Al Sadhan**

Abdullah H. Al Fozan  
License no. 348

Riyadh on 18 Jumada I 1434H  
Corresponding to: 30 March 2013



**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**BALANCE SHEET**  
As at 31 December 2012  
(Amounts in Saudi Arabian Riyals)

	<i>Note</i>	<u>2012</u>	<u>2011</u>
<b><u>ASSETS</u></b>			
Cash balance		346,506	209,619
Held for trading investments	7	66,859,726	79,146,196
<b>TOTAL ASSETS</b>		<u>67,206,232</u>	<u>79,355,815</u>
<b><u>LIABILITIES</u></b>			
Accrued liabilities		168,172	190,565
<b>NET ASSETS ATTRIBUTABLE TO UNITHOLDERS</b>		<u>67,038,060</u>	<u>79,165,250</u>
Units in issue ( <i>numbers</i> )		<u>2,925,000</u>	<u>3,825,000</u>
<b>Net assets value - per unit</b>		<u>22.92</u>	<u>20.70</u>

The accompanying notes 1 through 14 form an integral part of these financial statements.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**STATEMENT OF INCOME**

For the year ended 31 December 2012  
(Amounts in Saudi Arabian Riyals)

	<i>Note</i>	<u>2012</u>	<u>2011</u>
<b>INCOME</b>			
Trading gain / (loss), net	8	6,880,045	(4,875,842)
Dividend income, net		2,802,830	2,535,723
		<u>9,682,875</u>	<u>(2,340,119)</u>
<b>EXPENSES</b>			
Fund management fee	9	348,828	361,200
Other expenses	9	348,827	361,200
		<u>697,655</u>	<u>722,400</u>
<b>NET INCOME / (LOSS)</b>		<u>8,985,220</u>	<u>(3,062,519)</u>

The accompanying notes 1 through 14 form an integral part of these financial statements.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**STATEMENT OF CASH FLOWS**  
For the year ended 31 December 2012  
(Amounts in Saudi Arabian Riyals)

	<u>2012</u>	<u>2011</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income / (loss)	8,985,220	(3,062,519)
<i>Adjustment for:</i>		
Trading (gain) / loss on held for trading investments	(6,880,045)	4,875,842
	<u>2,105,175</u>	<u>1,813,323</u>
<b>Changes in operating assets and liabilities:</b>		
Held for trading investments	(1,772,035)	(2,165,410)
Accrued liabilities	(22,393)	56,198
<b>Net cash generated from (used in) operating activities</b>	<u>310,747</u>	<u>(295,889)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Creation of units	100,341	461,362
Redemption of units	(274,201)	(277,720)
<b>Net cash (used in) / generated from financing activities</b>	<u>(173,860)</u>	<u>183,642</u>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<u>136,887</u>	<u>(112,247)</u>
Cash and cash equivalents at beginning of the year	209,619	321,866
<b>Cash and cash equivalents at end of the year</b>	<u>346,506</u>	<u>209,619</u>
<b>SUPPLEMENTAL NON CASH INFORMATION</b>		
Net decrease / ( increase) in held for trading investments	<u>14,058,505</u>	<u>(29,236,930)</u>
In-kind creation of units	<u>12,645,259</u>	<u>61,748,913</u>
In-kind redemption of units	<u>(33,583,809)</u>	<u>(31,133,980)</u>

The accompanying notes 1 through 14 form an integral part of these financial statements.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**INTERIM STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS**

For the year ended 31 December 2012

(Amounts in Saudi Arabian Riyals)

	2012		2011	
	<i>Number of units</i>	<i>Net assets value</i>	<i>Number of units</i>	<i>Net assets value</i>
At the beginning of the year	3,825,000	79,165,250	2,425,000	51,429,194
Net income / (loss) for the year	--	8,985,220	--	(3,062,519)
<b>Changes from unit transactions</b>				
Creation of units	525,000	12,745,600	2,975,000	62,210,275
Redemption of units	(1,425,000)	(33,858,010)	(1,575,000)	(31,411,700)
Net change	(900,000)	(21,112,410)	1,400,000	30,798,575
<b>At the end of the year</b>	<b>2,925,000</b>	<b>67,038,060</b>	<b>3,825,000</b>	<b>79,165,250</b>

The accompanying notes 1 through 14 form an integral part of these financial statements.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**NOTES TO THE FINANCIAL STATEMENTS**  
For the year ended 31 December 2012

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**1. THE FUND AND ITS ACTIVITIES**

- 1.1** FALCOM Saudi Equity Exchange Traded Fund ("the Fund") is an exchange traded mutual investment fund created through an Agency (Wakala) contract between FALCOM Financial Services (the Fund Manager) and the Investors established by virtue of the approval of Capital Market Authority on 30 Rabi Al-Awwal 1431H corresponding to 16 March 2010. The objective of the Fund is to passively invest in the listed Saudi equities in order to achieve the results that correspond to the performance of F30 FALCOM Saudi Equity Index, the "Benchmark Index", which is a free-float market capitalization based index that tracks the performance of top 30 (by free float market capitalization) Shariah compliant Saudi equities (the "Component Securities") listed on Tadawul.

In June 2012, the Fund appointed HSBC Saudi Arabia Limited to act as the custodian and Saudi Fransi Capital as the second market maker (previously FALCOM Financial Services). However, Falcom Financial Services continued to act as the primary market maker.

**2. REGULATING AUTHORITY**

The Fund is governed by the Investment Fund Regulations ("the Regulations") issued by Capital Market Authority (CMA) on 3 Dhul Hijja 1427H (corresponding to 24 December 2006) detailing requirements for all funds within the Kingdom of Saudi Arabia.

**3. PRIMARY MARKET OPERATION (CREATION AND REDEMPTION OF UNITS)**

The primary market operation is only carried out between Fund Manager and the authorized Market Maker. The Creation and Redemption activities are done on the basis of blocks of exchange traded fund (ETF) units only (*one block equals 25,000 ETF Units*), referred as Creation Unit and Redemption Unit respectively. The process of creation and redemption of ETF Units is on in-kind basis whereby Fund Manager and Market Maker inter-exchange ETF Units and the Basket of shares, through custodian, for the purpose of creation and redemption of ETF Units.

**4. VALUATION OF THE FUND**

The value of the Fund's portfolio is determined on the valuation day. The net asset value of the Fund for the purpose of purchase or sale of units is determined by dividing the net value of assets (fair value of fund assets *minus* fund liabilities) by the total number of outstanding fund units on the end of the day.

**5. BASIS OF PREPARATION**

**5.1 Statement of compliance**

The accompanying financial statements have been presented in accordance with the general accepted accounting standards in the Kingdom of Saudi Arabia issued by the Saudi Organization of Certified Public Accountants (the "SOCPA").



**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**NOTES TO THE FINANCIAL STATEMENTS**  
For the year ended 31 December 2012

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**5. BASIS OF PREPARATION (CONTINUED)**

**5.2 Basis of measurement**

These financial statements have been prepared under the historical cost convention using accrual basis of accounting and the going concern concept, except for the measurement of held for trading investments at fair value.

**5.3 Functional and presentation currency**

These financial statements are presented in Saudi Arabian Riyals (SAR) which is the functional currency of the Fund. All financial information presented has been rounded to the nearest SAR.

**5.4 Use of estimates and judgments**

In the ordinary course of business, the preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in future periods affected.

**6. SIGNIFICANT ACCOUNTING AND RISK MANAGEMENT POLICIES**

The accounting policies set out below have been applied consistently throughout the periods presented in these financial statements.

**6.1 Investments held for trading**

Investments are classified as "Held for trading" as these are purchased for the purpose of resale in the short term. Investments held for trading are initially recorded at cost which includes the purchase price plus all expenditures made by the Fund for the purpose of acquiring securities. Subsequent to initial recognition, investments held for trading are measured at fair value and resulting gains or losses are recognised in the statement of income. Realised gains or losses at disposal and unrealised gains or losses are determined on average cost basis.

**6.2 Revenue recognition**

The realized gain or loss from a held for trading investments is calculated as the difference between its carrying amount at the beginning of the reporting period, or transaction price when purchased in the current reporting period and its sale price.

The unrealized gain or loss is calculated as the difference between the carrying amount of a held for trading investment at the beginning of the reporting period, or transaction price when purchased in the current reporting period and its carrying amount at the end of the reporting period.

Dividend income is recognised when the right to receive is established.

**6.3 Fund management fee, custodian & fund administration fees and other expenses**

Fund management fee, custodian & fund administration fees and other expenses are charged at agreed rates with the Fund Manager. These charges are calculated and accrued on each valuation day at an annual percentage of the Fund's net assets value at each valuation day and are payable quarterly. These expenses are charged to the statement of income.

**6.5 Zakat / income tax**

Zakat / income tax is the obligation of the Unitholders and is not provided for in the accompanying financial statements.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**  
**NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2012  
(Amounts in Saudi Arabian Riyals)

**7. HELD FOR TRADING INVESTMENTS**

The composition of held for trading investments by-investee is summarized as follows:

<i>Description</i>	<u>2012</u>	<u>2011</u>
Saudi Basic Industries Corporation	10,490,249	14,358,094
Al Rajhi Bank	9,338,940	12,664,499
Etihad Etisalat Company	5,584,176	4,899,825
Saudi Arabia Fertilizers Company	3,277,638	3,581,424
National Industrialization Company	2,900,606	4,539,556
SAVOLA Group	2,634,840	2,406,323
Saudi Telecom Company	2,527,984	2,513,300
Al Inmaa Bank	2,396,499	2,220,214
Saudi Cement Company	2,245,230	2,159,136
Al Marai Company	1,879,664	2,150,874
Yanbu National Petrochemical Company	1,798,583	2,127,312
Saudi Arabian Mining Company (Ma'aden)	1,777,885	1,769,001
Jabal Omar Development Company	1,765,062	1,392,354
Saudi Electricity Company	1,721,444	2,271,316
Jarir Marketing Company	1,671,111	1,874,862
Dar Al Arkan Real Estate Development Company	1,532,817	1,088,174
Yamamah Saudi Cement Company	1,489,410	1,852,830
Bank Al Bilad	1,175,441	1,047,782
Saudi International Petrochemical Company	1,159,809	1,522,121
Yanbu Cement Company	1,120,509	1,247,180
Southern Province Cement Company	1,053,000	1,157,904
Emaar The Economic City	1,018,684	-
Bank Al Jazira	952,754	785,785
Sahara Petrochemical Company	938,527	1,384,956
Makkah Construction & Development Company	840,785	958,545
Mobile Telecommunication Company (Zain KSA)	793,974	798,201
Advanced Petrochemical Company	729,565	870,784
The National Shipping Company of Saudi Arabia	712,495	576,275
Arabian Cement Company	672,750	--
Qassim Cement Company	659,295	--
Saudi Kayan Petrochemical Company	--	2,393,315
Saudi Industrial Investment Group	--	1,726,758
Rabigh Refining & Petrochemical Company	--	807,496
<b>Total</b>	<u>66,859,726</u>	<u>79,146,196</u>

7.1 The Fund invests in the component securities of Benchmark Index in the same weights and proportions while keeping adequate amount of cash to account for the Fund expenses and liabilities on ongoing basis.

Fund rebalancing activities are undertaken periodically to ensure proper tracking of performance of the Benchmark Index and to keep adequate cash balance.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND  
NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2012  
(Amounts in Saudi Arabian Riyals)

**7. HELD FOR TRADING INVESTMENTS (CONTINUED)**

7.2 As at 31 December 2012, cost of the above mentioned held for trading investments amounted to SAR 64.19 million (31 December 2011: 80.82 million).

**8. TRADING GAIN / (LOSS), NET**

	<u>2012</u>	<u>2011</u>
Realised gain / (loss) on held for trading investments	4,210,724	(1,378,003)
Unrealised gain / (loss) on held for trading investments	2,669,321	(3,497,839)
	<u>6,880,045</u>	<u>(4,875,842)</u>

**9. MANAGEMENT FEE AND OTHER EXPENSES**

The Fund Manager charges to the Fund on each Valuation Day, management fee at following rates as percentage of the Fund's net assets value:

Management Fee	0.50% (2011: 0.50%)
Other expenses:	
Administration Fee	0.17% (2011: 0.22%)
Custodial Charges	0.15% (2011: 0.10%)
Index Fee	0.10% (2011: 0.10%)
Tadawul Listing and Basic Registration Fee	Up-to 0.08% (2011: Up-to 0.08%)

These charges, in total, will not exceed 1% per annum of the Fund's net assets value.

**10. TRANSACTIONS WITH RELATED PARTIES**

In the ordinary course of its activities, the Fund transacts with the related party. FALCOM Financial Services (being the Fund Manager, custodian up to June 2012 and primary market maker) is considered to be a related party of the Fund.

Related party transactions for the year ended 31 December 2012 and balances arising there-from are described as under:

Related party	Nature of transactions	Amount of transaction during the period		Closing balance Receivable/(Payable)	
		<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
FALCOM Financial Services	Fund management fee	348,828	361,200	84,086	95,283
FALCOM Financial Services	Other expenses	287,511	361,200	59,019	95,283
FALCOM Financial Services	Cash balance	--	--	--	209,619

During the year, FALCOM Financial Services, being the primary market maker, have subscribed and redeemed units amounting to SR 11.62 million (2011: SAR 62.21 million) and SR 33.86 million (2011: SAR 34.41 million), respectively.

**FALCOM SAUDI EQUITY EXCHANGE TRADED FUND**

**NOTES TO THE FINANCIAL STATEMENTS**

For the year ended 31 December 2012

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**11. RISK MANAGEMENT**

*Credit risk*

Credit risk is the risk that one party to a financial instrument may fail to discharge an obligation and cause the other party to incur a financial loss.

The Fund is exposed to credit risk for its cash balance only. The exposure is not significant since the cash balance is maintained with the custodian with sound credit rating.

*Equity price risk*

Equity price risk is the risk that the fair value of equity investments decreases due to general market and as a result of changes in the levels of equity indices and the value of individual stocks. The Fund is exposed to equity price risk arising from its investments in shares.

The Fund Manager endeavors to minimize the risk including the concentration risk through investment in component securities of Benchmark Index and periodic rebalancing to ensure adequate tracking of the Benchmark Index.

*Liquidity risk*

Liquidity risk is the risk that the Fund may encounter difficulty in releasing funds to meet commitments associated with financial liabilities and redemption of units.

The Fund has the mechanism of in-kind redemption of units, hence, not significantly exposed to liquidity risk. Furthermore, the Fund Manager, through periodic Fund rebalancing activities, ensures to keep adequate cash with custodian to meet its financial commitments associated with financial liabilities.

**12. FAIR VALUES OF FINANCIAL INSTRUMENTS**

Fair value is the amount for which an asset could be exchanged, or a liability settled between knowledgeable willing parties in an arm's length transaction. Financial instruments comprise financial assets and financial liabilities.

The Fund's financial assets consist of cash and bank balance and held for trading investments; its financial liabilities consist of other liabilities which represent liabilities towards Fund Manager.

Investments are carried at fair values. The fair values of other financial instruments are not materially different from their carrying values.

**13. LAST VALUATION DAY**

The last valuation day of the period was 31 December 2012 (2011: 31 December 2011).

**14. AUTHORIZATION**

These financial statements were authorized for issue by the Fund Board on 30 March 2013 (corresponding to 18 Jumada I 1434 H).