

FALCOM
SAUDI EQUITY EXCHANGE TRADED FUND
FINANCIAL STATEMENTS
For the year ended 31 December 2014
together with the
INDEPENDENT AUDITORS' REPORT



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License No. 46/11/323 issued 11/3/1992

INDEPENDENT AUDITORS' REPORT

To: **The Unit holders**
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 2014 and the related statements of income, cash flows and changes in net assets attributable to unit holders 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 2014 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



Khalil Ibrahim Al Sedais
License No. 371

Date: 10 Jumada'II 1436H
Corresponding to: 30 March 2015

FALCOM SAUDI EQUITY EXCHANGE TRADED FUND
BALANCE SHEET
As at 31 December 2014
(Amounts in Saudi Arabian Riyals)

	<i>Note</i>	<u>2014</u>	<u>2013</u>
<u>ASSETS</u>			
Cash balance		218,230	227,557
Held for trading investments	7	<u>26,741,171</u>	<u>26,800,978</u>
TOTAL ASSETS		26,959,401	27,028,535
<u>LIABILITIES</u>			
Accrued liabilities		80,537	87,657
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS		<u>26,878,864</u>	<u>26,940,878</u>
Units in issue (<i>numbers</i>)		<u>925,000</u>	<u>900,000</u>
Net assets value - per unit		<u>29.06</u>	<u>29.93</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 2014
(Amounts in Saudi Arabian Riyals)

	<i>Notes</i>	<u>2014</u>	<u>2013</u>
INCOME			
Trading (loss) / gain, net	8	(2,939,261)	11,582,732
Dividend income, net		841,523	2,427,176
		<u>(2,097,738)</u>	<u>14,009,908</u>
EXPENSES			
Fund management fee	9&10	142,309	258,868
Other expenses	9	142,309	258,868
		<u>284,618</u>	<u>517,736</u>
NET (LOSS) / INCOME		<u>(2,382,356)</u>	<u>13,492,172</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 2014
(Amounts in Saudi Arabian Riyals)

	<u>2014</u>	<u>2013</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) / income	(2,382,356)	13,492,172
<i>Adjustment for:</i>		
Trading (loss) gain on held for trading investments (<i>note 8</i>)	2,939,261	(11,582,732)
	556,905	1,909,440
Changes in operating assets and liabilities:		
Held for trading investments	(631,868)	(1,483,396)
Accrued liabilities	(7,120)	(80,515)
Net cash (used in) / generated from operating activities	<u>(82,083)</u>	<u>345,529</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Creation of units	126,662	--
Redemption of units	(53,906)	(464,478)
Net cash generated from / (used in) financing activities	<u>72,756</u>	<u>(464,478)</u>
Net decrease in cash and cash equivalents	(9,327)	(118,949)
Cash and cash equivalents at beginning of the year	<u>227,557</u>	<u>346,506</u>
Cash and cash equivalents at end of the year	<u><u>218,230</u></u>	<u><u>227,557</u></u>
SUPPLEMENTAL NON CASH INFORMATION		
Net increase / decrease in held for trading investments	<u>572,061</u>	<u>38,573,352</u>
In-kind creation of units	<u>10,914,288</u>	<u>--</u>
In-kind redemption of units	<u>(8,666,702)</u>	<u>(53,124,876)</u>

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

FALCOM SAUDI EQUITY EXCHANGE TRADED FUND
STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS
For the year ended 31 December 2014
(Amounts in Saudi Arabian Riyals)

	2014		2013	
	<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	900,000	26,940,878	2,925,000	67,038,060
Net (loss) / income for the year	--	(2,382,356)	--	13,492,172
Changes from unit transactions				
Creation of units	300,000	11,040,950	--	--
Redemption of units	(275,000)	(8,720,608)	(2,025,000)	(53,589,354)
Net change	25,000	2,320,342	(2,025,000)	(53,589,354)
At the end of the year	925,000	26,878,864	900,000	26,940,878

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 2014

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 2013, 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”).

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.

FALCOM SAUDI EQUITY EXCHANGE TRADED FUND
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2014

5. BASIS OF PREPARATION (CONTINUED)

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 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 expenses 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 2014
(Amounts in Saudi Arabian Riyals)

7. HELD FOR TRADING INVESTMENTS

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

<u>Description</u>	<u>2014</u>	<u>2013</u>
Al Rajhi Bank	3,358,259	4,136,472
Saudi Basic Industries Corporation	3,083,136	3,941,748
SAVOLA Group	1,826,792	1,276,335
Jabal Omar Development Company	1,620,045	843,062
Saudi Telecom Company	1,228,539	963,000
Alinma Bank	1,208,520	855,022
Etihad Etisalat Company	1,128,426	2,108,430
Jarir Marketing Company	958,300	789,912
Saudi Arabia Fertilizers Company	953,018	1,019,754
Al Marai Company	914,529	601,020
National Industrialization Company	897,398	1,081,782
Bank Al Bilad	721,137	546,840
Saudi Cement Company	717,504	730,800
Saudi Arabian Mining Company (Ma'aden)	674,843	548,208
Saudi Electricity Company	616,605	576,704
Fawaz Abdulaziz Al Hokair Company	611,129	410,328
Al – Tayyar Travel Group Holding Company	594,405	412,164
Bank Al Jazira	570,851	561,744
Yanbu National Petrochemical Company	568,320	849,600
Saudi International Petrochemical Company	519,598	594,151
Makkah Construction Development Company	493,210	397,062
Dar Al Arkan Real Estate Development Company	489,717	564,523
Yamama Cement Company	477,744	548,226
Arabian Cement Company	420,006	265,995
Yanbu Cement Company	419,256	439,749
The National Shipping Company of Saudi Arabia	402,560	322,834
Southern Province Cement Company	367,845	357,210
Advanced Petrochemical Company	355,762	346,637
Sahara Petrochemical Company	336,330	423,403
Mobile Telecommunication Company (Zain KSA)	207,387	288,263
Total	<u>26,741,171</u>	<u>26,800,978</u>

- 7.1 The Fund invests in the component securities of Benchmark Index in the same weight 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.

- 7.2 As at 31 December 2014, cost of the above mentioned held for trading investments amounted to SAR 29.785 million (31 December 2013: 21.25 million).

FALCOM SAUDI EQUITY EXCHANGE TRADED FUND
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2014
(Amounts in Saudi Arabian Riyals)

8. TRADING GAIN / (LOSS), NET

	<u>2014</u>	<u>2013</u>
Realised gain on held for trading investments	105,349	6,038,484
Unrealised (loss) / gain on held for trading investments	(3,044,610)	5,544,248
	<u>(2,939,261)</u>	<u>11,582,732</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% (2013: 0.50%)
Other expenses:	
Administration fee	0.17% (2013: 0.17%)
Custodial charges	0.15% (2013: 0.15%)
Index fee	0.10% (2013: 0.10%)
Tadawul listing and basic registration fee	Up-to 0.08% (2013: 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 and primary market maker) is considered to be a related party of the Fund.

Related party transactions for the year ended 31 December 2014 and balances arising thereof are described as under:

Related party	Nature of transactions	Amount of transaction during the period		Closing balance	
		<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
FALCOM Financial Services	Fund management fee	142,309	258,868	40,269	43,829

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.

FALCOM SAUDI EQUITY EXCHANGE TRADED FUND
NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2014

11. RISK MANAGEMENT (CONTINUED)

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 at bank and held for trading investments; its financial liabilities consist of other liabilities, which represent liabilities towards Fund Manager and custodian to the Fund.

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 2014 (2013: 31 December 2013).

14. AUTHORIZATION

These financial statements were authorized for issue by the Fund Board on 10 Jumada'II 1436H (corresponding to 30 March 2015).