June 11, 2009

Research Update

AL MAL CAPITAL

A New Phase? – Adjusting Our Equity Risk Premium

- **Investor perception about risk in GCC equities is on the wane; we are adjusting our equity risk premium down by 100bps.** Last year's correction in the global equity markets was exacerbated in the MENA region due to the region's: (1) strong linkage with oil prices; and (2) over-reliance on external funding to fuel the rocket propelled growth of the local economies in the last 5 years. Consequently, back in 4Q08, we had adjusted the equity risk premium higher by 200bps to around 7% for most of the stocks in our universe. However, we have seen a resurgence of investor interest in these markets from early-February and the strong outperformance of several beaten down sectors, such as real estate, construction and banking. Thus, we believe that investor perception about the riskiness of regional equities has improved and as a result, we are reducing the equity risk premium in our models by ~100bps (more details below).

- **With GCC equity markets enjoying a buoyant 4-month run, institutional investor interest has clearly returned.** With volumes picking up significantly across the region (for example, the DFM Index volumes grew 314% to 9.74bn shares for the month of May '09 from 2.35bn shares in December 2008), oil prices trading near $70/b, government support and a return of liquidity into the system, we believe the markets in the region have entered a new phase of the investment cycle. Considering the above factors, we are adjusting our equity risk premium downwards by 100bps across the board for companies in our coverage universe. We note that our modelled risk-free rate remains unchanged at ~7% (approximate yield of the Qatar 30-year bond). The resulting change reduces our cost of equity and leads our target prices across our coverage universe to be higher by 13% (see Table 1 on Page 2). We believe this change better reflects our on the ground view of equities across the region.

- **While the worst may be behind us, given strong gains so far we feel there is room for pullback/consolidation in the near-term.** We do note that the regional markets are attractive relative to other markets, trading at TTM P/E's of 9x (DFM and ADX). In comparison, the US (S&P500), China and Brazil trade at 15x, 28x and 22x. However, given its recent pace of gains, we are of the view that the markets in the region could remain volatile over the upcoming months. We do believe that valuations have somewhat run ahead of fundamentals and that going forward, much will depend on the: (1) continuance of the perception that "the worst is behind us" globally; (2) strength in oil prices; (3) continued strong government support; and (4) next couple of quarterly earnings performance, especially in the real estate/construction/banking sectors. *Net-net, given the strong gains seen thus far, we suspect that the market could remain volatile in the near-term as investors' book profits in especially real estate, construction and energy stocks.* We have seen evidence of such volatility over the last few trading sessions and we expect this to continue in the near-term.

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Lowering Equity Risk Premiums

We are adjusting our equity risk premium downwards by ~100bps across the board for companies in our coverage universe. We note that our modelled risk-free rate remains unchanged at ~7% (approximate yield of the Qatar 30-year bond). The resulting change reduces our cost of equity and leads our target prices across our coverage universe to be higher by 13%. We believe this change better reflects our on the ground view of equities across the region.

Table 1: Introducing Our New Price Targets

Banking

				Previous		New		
Ticker	Company	Recommendation	Current price	Cost of equity	Target Price *	Cost of Equity	Target Price	Upside
NBAD UH	NATIONAL BANK OF ABU DHABI	Outperform	9.81	14.7%	10.25	13.6%	11.60	18%
UNB UH	UNION NATIONAL BANK/ABU DHAB	Market Perform	3.73	15.8%	2.74	14.4%	4.00	7%
ADCB UH	ABU DHABI COMMERCIAL BANK	Market Perform	2.09	15.3%	1.93	14.1%	2.20	5%
FGB UH	FIRST GULF BANK	Market Perform	12.80	15.1%	10.07	13.9%	11.60	-9%
EMIRATES UH	EMIRATES NBD PJSC	Market Perform	3.75	15.5%	3.45	14.3%	3.96	6%
Samba AB	SAMBA FINANCIAL GROUP	Market Perform	47.80	12.5%	55.50	12.0%	55.20	15%
RIBL AB	RIYAD BANK	Market Perform	24.40	13.6%	23.00	11.9%	27.50	13%
SABB AB	SAUDI BRITISH BANK	Outperform	51.50	13.0%	63.40	12.4%	69.10	34%
Rjhi AB	AL RAJHI BANK	Outperform	68.25	12.9%	62.60	11.8%	80.40	18%
ARNB AB	ARAB NATIONAL BANK	Outperform	43.00	13.9%	37.40	13.1%	50.30	17%

Construction & Building Materials

				Previous		New		
Ticker	Company	Recommendation	Current price	Cost of equity	Target Price *	Cost of Equity	Target Price	Upside
ARTC UH	ARABTEC HOLDING CO	Market Perform	3.08	14.0%	2.65	13.7%	3.38	10%
DSI UH	DRAKE & SCULL INTERNATIONAL	Outperform	0.92	14.2%	0.96	13.6%	1.08	17%
UCC UH	UNION CEMENT CO	Underperform	2.09	14.0%	1.65	13.0%	1.83	-12%
RAKCC UH	RAS AL KHAIMAH CEMENT CO	Market Perform	1.45	14.0%	1.35	13.0%	1.56	8%
ARKAN UH	ARKAN BUILDING MATERIALS CO	Underperform	4.82	14.0%	2.01	13.0%	2.29	-52%

Telecommunications

				Previous		New		
Ticker	Company	Recommendation	Current price	Cost of equity	Target Price *	Cost of Equity	Target Price	Upside
ETISALAT UH	EMIRATES TELECOM CORPORATION	Outperform	10.80	13.3%	15.57	12.4%	17.11	58%
DU UH	EMIRATES INTEGRATED TELECOMM	Market Perform	2.97	12.8%	2.84	12.4%	3.00	1%
STC AB	SAUDI TELECOM CO	Outperform	53.50	11.7%	75.42	11.3%	86.84	62%
EEC AB	ETIHAD ETISALAT CO	Outperform	34.70	12.3%	49.62	11.9%	54.14	56%
ZAIN KK	MOBILE TELECOMMUNICATIONS CO	Market Perform	1140.00	14.2%	1042.00	13.6%	1114.00	-2%
NMTC KK	NATIONAL MOBILE TELECOMMUNI	Market Perform	1620.00	12.2%	1562.00	12.8%	1470.00	-9%

Real Estate, Oil & Gas

				Previous		New		
Ticker	Company	Recommendation	Current price	Cost of equity	Target Price *	Cost of Equity	Target Price	Upside
ALDAR UH	ALDAR PROPERTIES PJSC	Market Perform	4.69	15.2%	3.57	14.0%	5.13	9%
EMAAR UH	EMAAR PROPERTIES PJSC	Market Perform	3.93	16.0%	2.68	14.7%	4.14	5%
SOROUH UH	SOROUH REAL ESTATE COMPANY	Market Perform	3.44	15.1%	2.81	14.0%	3.68	7%
UPP UH	UNION PROPERTIES PJSC	Market Perform	1.15	14.9%	0.80	13.8%	1.09	-5%
DANA UH	DANA GAS	Outperform	1.18	15.1%	1.20	14.0%	1.51	28%
TAQA UH	ABU DHABI NATIONAL ENERGY CO	Outperform	1.83	16.9%	2.20	15.5%	2.44	33%

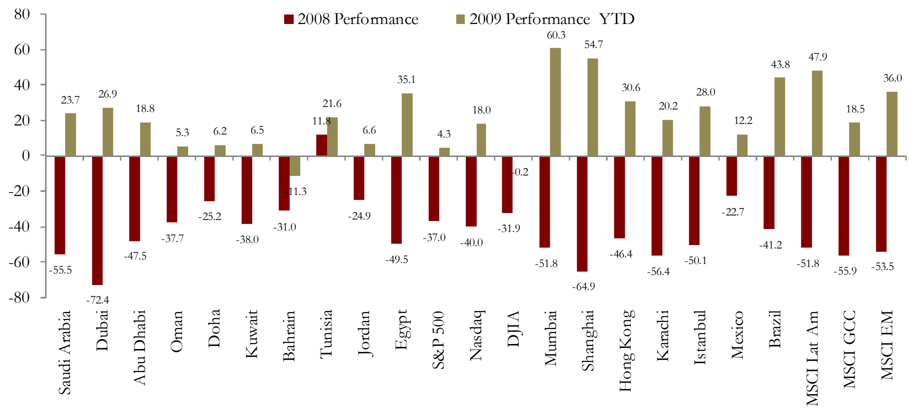
** price is adjusted for corporate actions (bonus shares, buybacks etc.) and may differ from market price reflected on last revised report*

Source: Al Mal Capital Research

Most Regional Markets Have Bounced Back

While the Dubai market underperformed all major stock markets last year, we have seen good gains thus far this year. We detail major world equity performances in 2008 and YTD in the below figure and discuss the UAE and Saudi markets in the next sections.

Figure 1: After A Poor 2008, Most World Equity Markets Have Put In A Positive Performance This Year

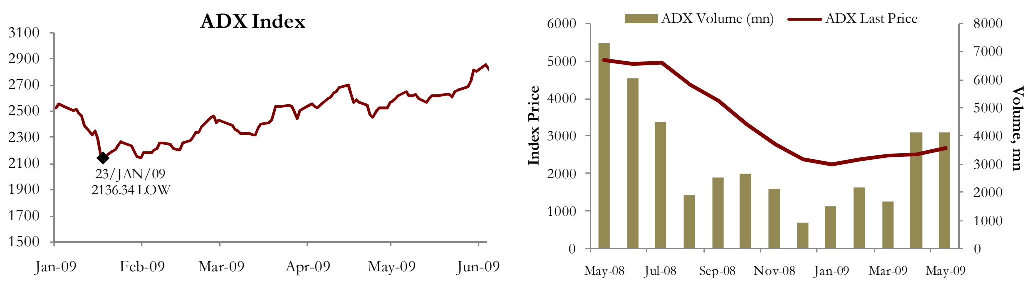


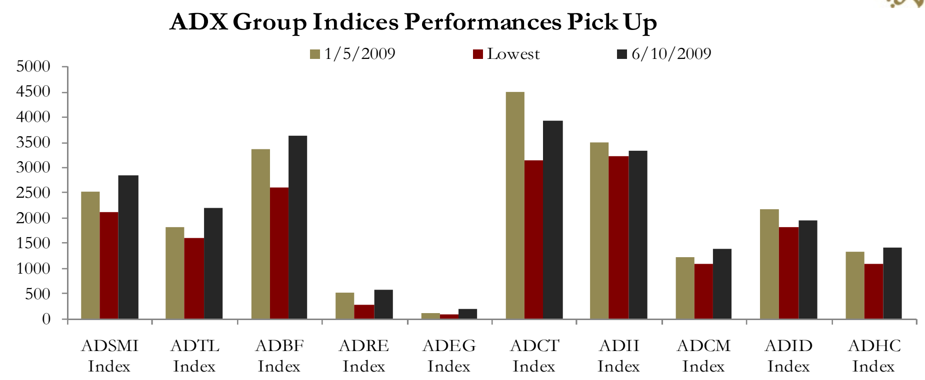
Source: Bloomberg

ADX Has Rebounded Strongly Since Late Jan.; We Expect Volatility Going Forward

The Abu Dhabi stock market is up ~33% since January 23; going forward, we could see a period of volatility in the near-term as investors' book profits. By sectors under coverage: (1) Energy and Real estate have been clear outperformers, up 118% and 96% from their lows; while (2) banking & financials, telecoms and construction have somewhat lagged at 40%, 36% and 25% gains from their lows. In terms of overall market volumes, we have seen trading volumes increase 342% since their December lows (930mm shares) to 4.1bn shares as of the month of May. *Given the strong gains seen thus far, we suspect that the market could remain volatile in the near-term as investors' book gains in especially energy and real estate stocks.*

Figure 2: ADX Statistics Show Strong Performance As Of Late



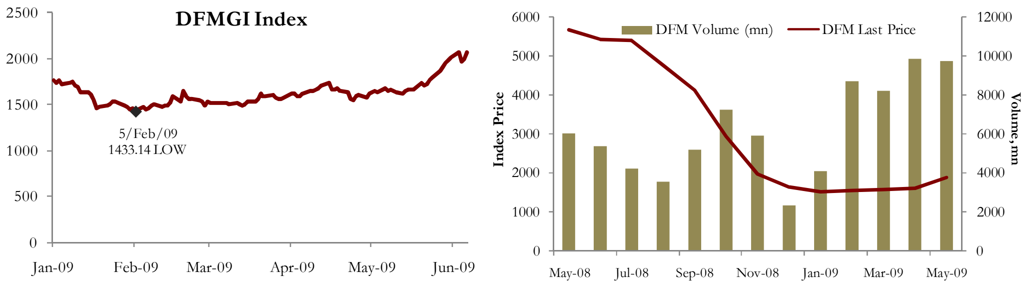


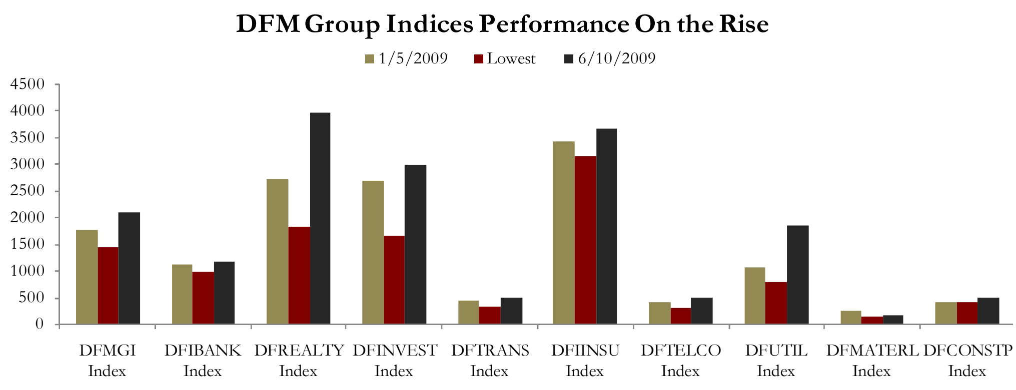
Source: Bloomberg

On a Tear Since Early Feb., DFM Could Also Be Volatile Near-Term

The Dubai stock market is up ~45% since February 5; going forward, we could have choppiness in the market in the near-term. Essentially the catalyst behind this market's upward rise was the Dubai $20bn bond program/Borse Dubai refinancing news announced in February. This allowed investors to rethink their cataclysmic view about Dubai equities and has led to the strong gains we have seen in DFM thus far. By sectors under coverage: (1) Real estate (including construction firms) and telecoms have been clear outperformers, up 120% and 67% from their lows; while (2) banks have somewhat lagged at 18% gains from their lows. In terms of overall market volumes, we have seen trading volumes increase 314% since their December lows (2.4bn shares) to 9.7bn shares as of the month of May. *Given the strong gains seen thus far, we suspect that the market will remain volatile in the near-term as investors' try to lock in profits in sectors such as real estate and construction.*

Figure 3: The Dubai Market Has Outperformed the Abu Dhabi Market Recently



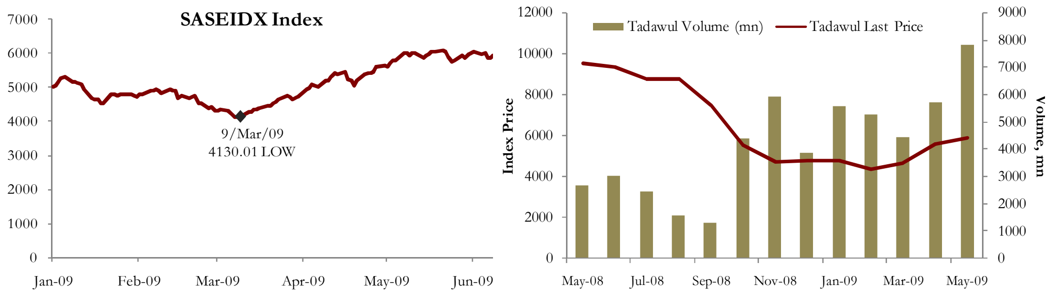


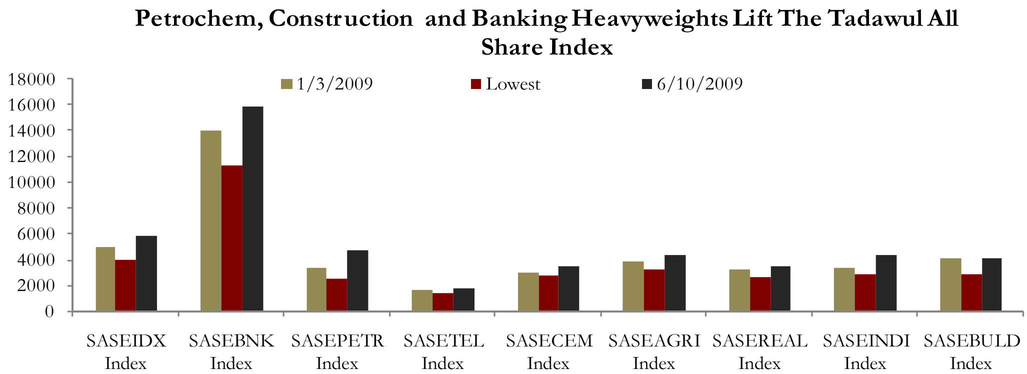
Source: Bloomberg

While Saudi Was The Last To Bottom, It Has Rebounded Strongly Since Then

The Saudi stock market has appreciated ~44% since March 9; our near-term view is a period of increased volatility. Given the strong performance of sectors such as petrochemicals (up 85% from its lows) and banks (up 39%), it is easy to understand TADAWUL's gains thus far. In terms of overall market volumes, we have seen trading volumes increase 101% since December (3.9bn shares) to 7.8bn shares as of the month of May. We have held the view that the Saudi economy is unique for the region in terms of the scale and growth of its consumer population, breadth and liquidity of its equity markets, and capacity of its government to invest through the global downturn. *However, we could experience a period of increased volatility in the near-term given the TADAWUL's strong gains to-date, valuation premium to other regional markets and heavy weighting towards petrochemicals stocks.*

Figure 4: TADAWL Has Appreciated Strongly Off Its Lows





Source: Bloomberg

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