Global Research

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September 2006

UAE

Arabtec Holding PJSC

A Regional Construction Giant in the Making...

Global

بيت الاستثمار العالمي

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Arabtec Holding PJSC

Initial Research Report

Reuters Code:
ARTC.DU

September 2006

Listing:
Dubai Financial Market

Recommendation:
BUY

Current Price (As on September 3, 2006):
AED 4.38

Investment Summary

- Arabtec Holding PJSC (Arabtec), formerly known as Arab Technical Construction Company, is a Public Joint Stock Limited Liability Company registered in Dubai, UAE, in July 2004. The company's primary objective is to invest in the contracting sector through acquiring and owning shares in existing contracting companies in the UAE.

- In January 2005, Arabtec acquired Arabtec Construction LLC, a leading contracting company established in the UAE in 1975. Arabtec Construction has had an impressive track record of constructing some of the most prestigious projects in UAE. Some of these projects include the renovation and expansion of Dubai Airport's Terminal I, construction of the 21st Century Tower – the world's tallest residential building, several phases of Emaar's Emirates Living project, the new Abu Dhabi Investment Authority (ADIA) headquarters, and the interior designs for Burj Al-Arab.

- Arabtec today is a leading construction company in the highly dynamic and competitive UAE construction market. It is one of the biggest construction companies in the Middle East. The company is primarily engaged in the construction of high-rise towers, buildings and residential villas, in addition to the execution of various related services through its three wholly-owned subsidiaries – Arabtec Construction, Austrian-Arabian Ready Mix Concrete and Arabtec Precast, all based in Dubai, UAE.

- The company's total operational revenues was AED2.57bn for the period September 20, 2004 - December 31, 2005. The net profit during the period was AED165.9mn. The company had revenue of AED1.41bn in the first six months of 2006, up 23.2 per cent year-on-year (y-o-y). Net profit during the period of AED113.5mn was more than double that in the corresponding period of 2005.

- The company has a healthy order book at present, involving some big ticket construction projects currently being developed by the leading property developers of UAE. Some of the future projects of Arabtec include the Burj Dubai project, Dubai Light Railway project, construction of villas for the Mohammad Bin Rashid Housing Programme, the Dubai Pearl Hotel project, villas in Arabian Ranches, construction of Tiara Residence towers, etc.

- Although, Arabtec's activities are presently focused in Dubai, it has plans to enter other regional markets as well. The company plans to explore opportunities in other emirates (in Abu Dhabi, to start with), and other GCC countries, such as Qatar and Saudi Arabia, in the near-medium term. It is also open to M&A to scale-up its operations.

- In its first full year of operations in 2005, the company did not declare any cash dividend. However, it declared 30 per cent stock dividend for the year.

- Overall, Arabtec would seem to have a sound business model, with high-growth potential revenue streams emanating from its construction activities, which should, in turn, translate into healthy growth in both revenues and profits in the near-medium term. The company seems well on its way to becoming a regional construction giant.

- The Arabtec stock closed at AED4.38 on September 3, 2006, trading at 10.6x its 2005 earnings and 9.5x 2006 (E) earnings. The stock saw high turnover at the Dubai Financial Market (DFM) in 2005. The year 2006 so far has seen relatively lower turnover, perhaps in keeping with the prevailing sentiments on the DFM.

- We have arrived at the share valuation of Arabtec by two methods : DCF valuation and relative valuation. The weighted average share value of the company by these two valuation methods is AED5.75 per share. This implies a good upside from its current price levels. We, therefore, initiate our coverage of the Arabtec stock with a 'BUY' recommendation, with a medium-term perspective.

Table 1 : Investment Indicators for Arabtec

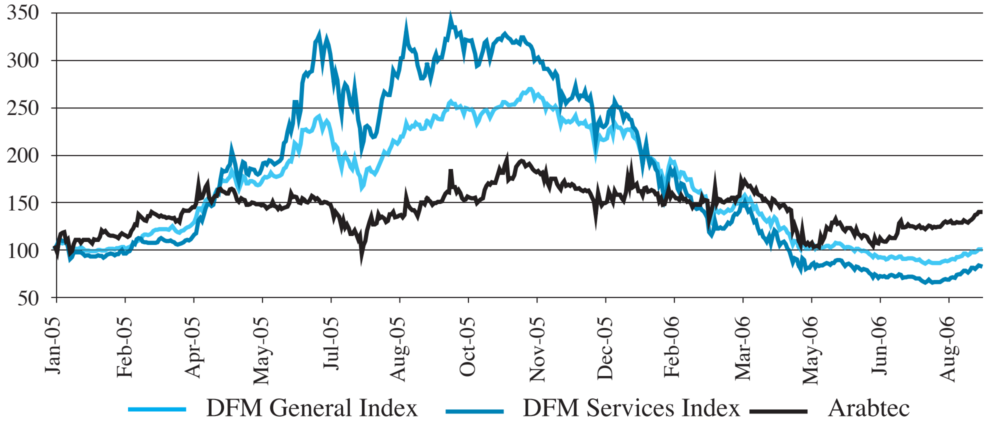
CMP (AED)	Shares in Issue (mn)	M-Cap (AEDmn)	52-Week Hi/Lo (AED)	
4.38	520.00	2,277.60	6.12	3.21

Year	*Gross Profit (AEDs '000)*	*Net Profit (AEDs '000)*	*EPS (AED)*	*BVPS (AED)*	*ROAE (%)*	*P/E (x)*	*P/BV (x)*
2007 F	431,721	277,749	0.53	1.62	35.8	8.2	2.7
2006 F	365,756	240,928	0.46	1.37	37.5	9.5	3.2
2005 A	232,169	165,857	0.41	1.43	28.9	11.4	3.3

*Source : Company's Annual Report & '**Global**' Research.*

Historical P/E & P/BV multiples based on respective year-end prices, while those for future years are based on current market price in the Dubai Financial Market as on September 3, 2006.

Chart 1 : Relative Performance of Arabtec vs. DFM Indices



*Source : Reuters, **Global** Research.*

Arabtec Holding - Company Background

Arabtec Holding PJSC (Arabtec), formerly known as Arab Technical Construction Company PJSC (ATCC), is a Public Joint Stock Limited Liability Company registered in Dubai, UAE, in July 2004. The company's primary objective is to invest in the contracting sector through acquiring and owning shares in existing contracting companies in the UAE.

In January 2005, Arabtec acquired Arabtec Construction LLC, a leading contracting company established in the UAE in 1975, and providing construction services to a variety of government and private clients, including, but not limited to, high rise developments, hotel interiors, residential complexes, office blocks, commercial and industrial projects, major airport developments, offshore oil & gas installations, and cinemas & entertainment facilities.

Arabtec Construction has had an impressive track record of constructing some of the most prestigious projects in UAE. Some of these projects, such as the renovation and expansion of Dubai Airport's Terminal I; and construction of the 21st Century Tower, the world's tallest residential building on Sheikh Zayed Road, Dubai; several phases of Emaar's Emirates Living project; the Abu Dhabi Conference Palace; the new Abu Dhabi Investment Authority (ADIA) headquarters; the Fairmont Hotel; the Emirates Triple Bay Hanger & Engineering Facility; the Sharjah Art Gallery; the interior designs for Burj Al-Arab; and a number of palaces for the ruling family in Abu Dhabi, are considered landmarks in UAE. The company was recently awarded the contract to build the prestigious Burj Dubai, slated to be the tallest building in the world.

Arabtec today is a leading construction company in the highly dynamic and competitive UAE construction market. It is one of the biggest construction companies in the Middle East. The company is primarily engaged in the construction of high-rise towers, buildings and residential villas, in addition to the execution of related services such as drainage, electrical and mechanical works through its three wholly-owned subsidiaries:

- Arabtec Construction LLC, Dubai, UAE
- Austrian-Arabian Ready Mix Concrete LLC, Dubai, UAE
- Arabtec Precast LLC, Dubai, UAE

While Austrian-Arabian RMC is involved in the manufacture and transportation of ready mix concrete products, Arabtec Precast specialises in pre-cast buildings and contracting. Arabtec Construction, however, is the backbone of Arabtec. The subsidiary contributed 97.4 per cent of the holding company's revenue and almost an identical share of its profit in 2005.

The company has also entered into a joint venture recently with two other partners to establish 'House of Equipment', a company specialized in managing, selling, and leasing building equipment.

Although, Arabtec's activities are presently focused in Dubai, it has plans to enter other regional markets as well. The company plans to explore opportunities in other emirates (in Abu Dhabi, to start with), and other GCC countries, such as Qatar and Saudi Arabia, in the near-medium term.

The company's total operational revenues was AED2.57bn for the period September 20, 2004 – December 31, 2005. The net profit during the period was AED165.9mn. The company had operational revenues of AED1.41bn in the first six months of 2006, up 23.2% year-on-year (y-o-y). Net profit during the period of AED113.5mn was more than double that in the corresponding period of 2005.

In April 2006, Arabtec increased its capital from AED400mn to AED520mn through a 30% bonus share issue.

The Group employed over 20,000 employees at the end of 2005.

Shareholding

About 55 per cent of Arabtec's shares are held by the public, while the remaining 45 per cent is owned by the founders of the company. Abraaj Capital is the second largest shareholder controlling 10 per cent of this balance, after the largest single individual share at 19 per cent, held by Mr. Riad Burhan Kamal, who is the Managing Director of the company.

Name	Type	Country	Holding
Riad Burhan Kamal	Private	Jordan	19.00%
Abraaj Capital (via Abraaj Real Estate Fund)	Corporate	UAE	10.00%
Sheikh Butti Al Maktoum	Private	UAE	5.00%
Thomas Patrick Barry	Private	Ireland	2.50%
Sheikh Sultan bin Saqer Al Qassimi	Private	UAE	1.25%
Anis Al Jallaf	Private	UAE	1.25%
Hussein Jassim Al Nuwais	Private	UAE	1.25%
Sheikh Nawaf bin Nasser Al Thani	Private	Qatar	1.25%
Ahmed Ali Khalfan Al Dhahiri	Private	UAE	1.25%
Al Mazroui Holding Company	Corporate	UAE	1.25%
Grigoris C Christofides	Private	Greece	0.50%
Rajah Hani Ghanma	Private	Jordan	0.50%
Public		UAE	55.00%

Source: Zawya.com.

Dividend History

The company commenced its operations in September 2004. In its first full year of operations in 2005, the company did not declare any cash dividend. However, it declared 30% stock dividend for the year.

Listing & Trading

Arabtec is listed in the Dubai Financial Market (DFM) since January 2005, under the ticker 'ARTC'. The stock had enjoyed healthy liquidity in 2005. The average daily volume traded of the stock was 7.72 million shares, with a stock turnover of over 575 per cent, during 2005. The turnover levels of the stock in 2006 so far have been relatively more sedate, perhaps in keeping with the prevailing sentiments on the DFM. The average daily volume traded was lower at 4.81 million shares, with a stock turnover of about 186 per cent, so far in 2006. The stock closed at AED4.38 at the end of trading on September 3, 2006, with a 52-week high/low of AED6.12/AED3.21.

Table 2 : Arabtec on the DFM

Year	Volume (mn shares)	Turnover	Price (AED) at end of Period	Market Cap (AEDmn) at end of Period
2005	2,300.2	575.1%	4.72	1,886.2
2006*	966.4	185.8%	4.38	2,277.6

*Source: Reuters, **Global** Research.*

** Till September 3, 2006.*

Management

Sheikh Butti Bin Maktoum Bin Juma Al Maktoum is the Chairman and Mr. Hussein Jassim Al Nuwais is the Vice Chairman of the Board of Directors of the company.

The day-to-day management of the Group is carried out by Mr. Riad Burhan Kamal, who is the Managing Director of the company. Mr. Kamal, a founding shareholder, is said to have extensive experience in the contracting business, and has overseen, since 1975, the development of several construction projects in Dubai and Abu Dhabi, many of which are considered landmarks in the UAE. He is assisted by heads of various departments, and managers heading different line and support functions in the company.

Management Style

The company has grown at an aggressive pace since its inception in September 2004. The management has remained highly focused on the construction business. It has managed to net construction contracts in some of the most prestigious and well-known projects in UAE, continuing the well-established track record of its main subsidiary – Arabtec Construction. The company has also expanded inorganically by acquiring another subsidiary – Austrian-Arabian Ready Mix Concrete Co. LLC, in Dubai, UAE, in the first 15 months of its operations. While Arabtec Construction is involved in civil construction and related works, Austrian-Arabian RMC is involved in the manufacture and transportation of ready mix concrete products. Continuing to expand aggressively, Arabtec set up Arabtec Precast LLC, a wholly-owned subsidiary specialising in pre-cast buildings and contracting, in Dubai in the second quarter of 2006. Going forward, the company seems open to more M&A to expand its business.

Thus, the company management has shown the enterprise to expand aggressively to establish its presence across a substantial part of the construction chain, while remaining focused on construction as the core activity of the Group. As a result of its sustained efforts over the last year-and-a-half, the company today has a presence in civil construction, ready mix concrete products and pre-cast buildings and contracting segments. This has strengthened its position in the high-potential construction market in Dubai and other Emirates. The company is also looking at establishing its presence in the high-potential Qatar market by announcing its plans to set up two companies in that country in the fields of construction and ready mix. The company is also looking at business possibilities in the lucrative Saudi construction market.

The company management is likely to stay focused on construction as the core business of the company in the near-term. It may not diversify into other related activities, such as real estate development, in the near-term, though it is likely to go on to provide value-added services, such as design services, to its clients. It may also not backward-integrate into cement or aggregate production, etc., in the foreseeable future. The company, thus, is likely to benefit from its scaled-up operations and geographic diversification in the years ahead.

The company management has also shown its willingness to share the company's wealth with the shareholders by offering 55 per cent of the paid-up share capital to public subscription. In its first full year of operations in 2005, the company did not declare any cash dividend. However, it declared 30 per cent stock dividend for the year. The company is expected to adopt a dividend policy which will be consistent with its net income, subject to bank financing, working capital and capital expenditure requirements, in future.

Business Overview of Arabtec

The main activity of Arabtec Holding, the holding company, is to invest in the construction sector through acquiring and owning shares in existing contracting companies in the UAE.

Arabtec Holding has, at present, equity shareholding in the following companies:

Arabtec Construction LLC

Arabtec Construction LLC, a leading contracting company established in the UAE in 1975, provides construction services to a variety of government and private clients, including, but not limited to, high rise developments, hotel interiors, residential complexes, office blocks, commercial and industrial projects, major airport developments, offshore oil & gas installations, and cinemas & entertainment facilities.

Arabtec Construction has had a strong track record of constructing prestigious projects. Some of these projects are the renovation and expansion of Dubai Airport's Terminal I; construction of the 21st Century Tower, the world's tallest residential building, on Sheikh Zayed Road, Dubai; construction of several phases of Emaar's Emirates Living project, the Abu Dhabi Conference Palace, the new Abu Dhabi Investment Authority (ADIA) headquarters, the Fairmont Hotel, the Emirates Triple Bay Hanger & Engineering Facility, the Sharjah Art Gallery, the interior designs for Burj Al-Arab, and a number of palaces for the ruling family in Abu Dhabi. Many of the above are considered Dubai's landmarks. The company, along with its JV partners, has also been awarded the contract to build the prestigious Burj Dubai, slated to be the tallest building in the world.

Arabtec Construction is reported to have already completed and handed over in the last three years over 3,700 villas, including 3,132 villas for Emaar at Emirates Hills, Emirates Lakes, Meadows, Springs and Arabian Ranches, and 560 villas for Dubai Silicon Oasis along the Emirates Road.

The company is fully-owned by Arabtec Holding, which paid an amount of AED330mn to acquire the company with effect from January 1, 2005. Arabtec utilized part of the proceeds from the Initial Public Offering, in addition to the contribution of the founders, to acquire Arabtec Construction.

Arabtec Construction contributed AED2,558mn to the Group's revenue and AED160mn to the Group's profit for the year 2005.

Austrian-Arabian Ready Mix Concrete LLC

Austrian-Arabian RMC is involved in the manufacture and transportation of ready mix concrete products. On September 24, 2005, Arabtec and Arabtec Construction LLC (100 per cent owned by Arabtec) acquired 100 per cent of the issued share capital of Austrian-Arabian Ready Mix Concrete for cash consideration of AED86.98mn.

The company is expected to supply Arabtec Construction with about one-third of its annual requirements of ready mix concrete. The daily production capacity of Austrian-Arabian RMC is about 3,000 cubic metres of ready concrete, with a capacity to enhance the output to 1.5 million cubic meters per year. The acquisition of Austrian-Arabian RMC is expected to complement the activities of Arabtec Construction and, therefore, support the activities of the Group in the regional construction sector.

The company contributed approximately AED7mn in revenue from third parties (excluding sales to Group companies of AED11.4mn) and AED755,158 loss to the Group's results for the period between the date of acquisition till end of 2005.

Arabtec Precast LLC

Arabtec has set up Arabtec Precast LLC, a wholly-owned subsidiary specialising in the production and installment of prefabricated buildings, in Dubai in the second quarter of 2006. The new company's paid up capital is AED0.3mn.

Other Ventures

The company has also entered into a joint venture recently with two other partners to establish 'House of Equipment', a company specialized in managing, selling, and leasing building equipment. Each of the companies' stake will be 33.3% of the total paid up capital of the company, which is AED0.3mn.

Arabtec Construction has been the backbone of Arabtec. The subsidiary contributed 97.4 per cent of the holding company's revenue and almost an identical share of its profit in 2005. Moving ahead, Arabtec Construction is likely to continue to be the main driver for the growth of Arabtec, with its strong pipeline of big-ticket projects in the UAE market.

A strong pipeline of big ticket and prestigious projects should see a healthy and sustainable growth in the company's revenues and profits in the near-medium-term. Going forward, the company also seems open to pursuing M&A as a growth strategy. Thus, the company seems well on its way to becoming a regional construction giant.

Value Proposition of Arabtec

The value proposition of Arabtec Group emanates from the following:

- The size, track record and leading position of the company in the UAE construction market, which gives it a pre-eminent position to bid for all projects on offer, besides giving it the benefits of economies of scale.

- The high cash generation levels of the company, which, so far, has obviated the need for the company to resort to large debt financing to meet its capital expenditure or day-to-day operations.

- The company currently has an impressive pipeline of projects, being developed by some of the leading property developers in the country, which are likely to ensure a healthy growth in its revenue and profit going forward.

The UAE Construction Sector

The UAE construction sector, riding on huge investments into the real estate and infrastructure sectors, has been witnessing a boom since 2001. Over the past four years, the contribution of the construction sector to both nominal GDP and non-oil GDP has risen significantly. From a share of 8.2% in the non-financial sector GDP in 2001, the contribution of the construction sector rose to 8.6% in 2004, the latest year for which detailed break-up of GDP is currently available, at a CAGR of 18.4% during 2001-'04. This coincided with a CAGR of 16.2% in the non-financial sector GDP and 15.0% in the overall GDP during the same period.

Table 3 : UAE - Gross Domestic Product at Basic Prices by Economic Sectors

Economic Indicators	2001	*% Share*	2002	2003	2004 *	*% Share*	*CAGR*
(1) Non-Financial Sectors	213,614	*100.0%*	231,348	274,873	335,234	*100.0%*	*16.2%*
– Agriculture, Livestock and Fishery	8,862	*4.1%*	9,105	9,152	10,100	*3.0%*	*4.5%*
– Mining	75,687	*35.4%*	73,277	92,901	124,089	*37.0%*	*17.9%*
– Crude Oil & Natural Gas	74,990	*35.1%*	72,552	92,136	123,261	*36.8%*	*18.0%*
– Quarries	697	*0.3%*	725	765	828	*0.2%*	*5.9%*
– Manufacturing	35,132	*16.4%*	37,710	42,215	50,159	*15.0%*	*12.6%*
– Electricity, Gas and Water	4,890	*2.3%*	4,930	6,009	6,720	*2.0%*	*11.2%*
– Construction	**17,446**	***8.2%***	**21,478**	**26,072**	**28,971**	***8.6%***	***18.4%***
– Wholesale, Retail Trade and Repairing Services	22,838	*10.7%*	28,894	35,460	43,458	*13.0%*	*23.9%*
– Restaurants and Hotels	5,435	*2.5%*	6,025	6,525	7,343	*2.2%*	*10.5%*
– Transport, Storage and Communication	19,595	*9.2%*	21,742	24,692	27,263	*8.1%*	*11.6%*
– Real Estate and Business Services	19,662	*9.2%*	22,524	25,355	30,018	*9.0%*	*15.1%*
– Social and Personal Services	4,067	*1.9%*	5,663	6,492	7,113	*2.1%*	*20.5%*
(2) Financial Corporation Sector	16,845	*100.0%*	17,314	19,902	23,374	*100.0%*	*11.5%*
(3) Government Services Sector	27,029	*100.0%*	27,864	30,737	32,463	*100.0%*	*6.3%*
– Household Services	1,940	*7.2%*	2,030	2,065	2,126	*6.5%*	*3.1%*
Less : Imputed Bank Services Charges	5,192	---	5,700	5,825	6,662	---	*8.7%*
TOTAL	**254,236**	---	**272,856**	**321,752**	**386,535**	---	***15.0%***
Total Non-Oil Sectors	179,246	---	200,304	229,616	263,274	---	*13.7%*

Source : Ministry of Economy and Planning.

Figures in AED million, at current prices.

** Estimates.*

The high level of activity over the past four years in the construction sector has led to robust asset creation in the economy. Gross Fixed Capital Formation (GFCF) grew by a CAGR of 10.5 percent during 2001-'04.

Table 4 : UAE - Expenditure on Gross Domestic Product

Expenditure	2001	2002	2003	2004 *	*CAGR*
Final Consumption	160,363	184,647	204,104	249,153	*15.8%*
– Public Consumption	41,700	41,818	46,057	48,850	*5.4%*
– Private Consumption	118,663	142,829	158,047	200,303	*19.1%*
Gross Fixed Capital Formation	**60,178**	**62,404**	**73,105**	**81,255**	***10.5%***
Variation in the Inventory	2,792	2,870	2,950	4,505	*17.3%*
Net Exports of Goods and Services	32,075	25,365	44,989	55,569	*20.1%*
Net Indirect Taxes	(1,172)	(2,430)	(3,396)	(3,947)	*49.9%*
Gross Domestic Product at Basic Prices	254,236	272,856	321,752	386,535	*15.0%*

Source : Ministry of Economy and Planning.
Figures in AED million, at current prices.
** Estimates.*

Construction Sector Growth Drivers

Some of the factors driving the high level of investments into the real estate/infrastructure sectors in UAE in recent years are:

- Need for UAE to grow out of oil-dependence.
- Infrastructure spending a necessity now, especially due to high population growth rates in the recent years.
- Leveraging the geographic position of UAE to make it a one-stop tourist destination and leading financial/commercial centre in the region.
- High liquidity in the system.
- High returns from real estate and attractive real estate valuations.
- Eagerness to attract FDI.
- Availability of easy and cheap credit.

Obviously, the above factors drive the growth in the UAE construction sector as well.

The UAE Construction Sector

For long, the construction contracts in the UAE were dominated by public sector infrastructure development and oil and gas projects, mostly initiated by the governments of various emirates. The last few years have, however, seen more and more contracts being awarded in non-oil projects, such as residential, commercial and mixed use developments, and infrastructure projects. Besides, the government is no longer the main investor in these projects; it has been briskly overtaken by the private sector as the leading investor.

While Dubai has taken the lead as the main destination of choice for most of the construction projects in the initial years, other emirates, such as Abu Dhabi, Ras Al Khaimah and Sharjah, too have joined the construction bandwagon in recent months.

In the year 2004, the total number of buildings completed in Dubai totaled 2,119, of which 68 per cent were villas & residential complexes, 19 per cent were Multi-storey Commercial Buildings and 13 per cent were Industrial, Recreational, & Services Buildings. The number of under construction buildings totaled 4,852 in the year 2004 of which villas and residential complexes represented 74 per cent.

The main construction activities are – site preparation (which includes wrecking & demolition, land draining and civil exploiting), contracting of civil engineering work (which includes contracting of civil engineering, building contracting and steel construction contracting), building installation (which includes air conditioning system contracting, lifts & escalators contracting, etc.), and building completion (which includes, concrete work, painting, insulation, etc.). In Dubai, contracting of civil engineering works are estimated to represent 45 per cent of all construction companies working in the sector followed by the building completion with 33 per cent.

Construction sector is considered one of the major employers in UAE. It is estimated that over 15 per cent of the total number of workers in the country are employed in the construction sector alone.

Market Players

The UAE construction sector is very fragmented in terms of the number of contractors operating in the market, estimated at 5,938 companies in Dubai alone, according to Dubai Chamber of Commerce and Industry (DCCI) statistics. The extent of fragmentation can be gauged by the fact that over 96 per cent of these companies employ less than 250 employees; over 75 per cent employing less than 20 each. The market is dominated by local players, with advantages of local expertise and the ability to employ a large labor force. Many of these contractors also possess the required experience and technical know-how to manage small-to-medium sized projects on their own.

There are now quite a few international project contracting firms too in the local market. Among them are companies from Britain, Australia, Germany, Italy and France. Among the Asian players, Japanese and South Korean companies are the leaders, while Chinese and Indian companies too have presence in the market. Constrained by the inability to engage a large local workforce, the international firms are mostly limited to technical advisory roles. Often, the international contractors form consortia with local firms to bid for large projects. In a few cases, joint ventures have been formed between local and international firms. The resulting synergies between the local partners’ local knowledge and the foreign firm’s technical capabilities have led to the JV bagging mega projects.

Consolidation is expected to continue to be the buzzword in the construction sector going forward. Large contractors are expected to gradually corner an increasing share of the construction market, not only due to the increasing size, scope and sophistication of the new projects but also because of the imposition of tougher pre-qualification criteria, such as management experience, technical know-how, financial strength, track record, etc., for bidding for new projects.

Table 5 : UAE - Civil Projects Under Development With Major Contractors

Contractor	Projects
Al Habtoor Engineering	10,343
Al-Jaber Group	1,095
Al-Naboodah Group	7,017
Arabian Construction Co.	3,106
Arabtec	6,571
Belhasa Six Construct	4,323
Consolidated Contractors International Co.	2,315
Khansaheb Co.	1,450
Total	36,220

*Source: Sentinel Market Intelligence, **Global** Research.*
Figures in US$ million.
Figures include projects both on stand-alone basis as well as in alliances/consortia with other contractors, at various stages of bidding/construction.

Listed Construction Companies in GCC

Arabtec is the only listed construction company in UAE. It is, in fact, one of the three listed civil construction companies in all of GCC, the other two being Combined Group Company for Contracting (CGCC), Kuwait, and Al Hassan Engineering Company (AHEC), Oman.

The three companies compare as under:

Table 6 : Listed Civil Construction Companies in GCC

Company	Country	Main Activity	2005			CMP	P/E (x)
			Revenues	Net Profit	EPS		
Combined Group Company for Contracting	Kuwait	General contractors engaged in the construction of roads, motorways and buildings; agents of concrete and asphalt products; supply fleet of heavy equipment.	240.9	17.7	0.30	2.39	8.1
Al Hassan Engineering Company	Oman	Electrical, mechanical, instrumentation and civil contracting in the oil and gas sectors.	77.7	2.1	0.31	7.44	23.7
Arabtec Holding	UAE	Investment in the construction sector through acquiring and owning shares in existing contracting companies in the UAE.	540.2	34.9	0.07	1.09	16.2
Weighted Average P/E							13.8

*Source: Zawya.com, **Global** Research.*
Revenues & Net Profits in US$mn. EPS & CMP in US$.
CMP as on August 20, 2006.
Arabtec financials for 2005 annualized from figures available for 20 Sep '04 - 31 Dec '05.

As can be seen from the above Table, Arabtec is quoting at a trailing P/E of 16.2x, which is in between those for its other two peers CGCC and AHEC respectively. It is also more than the weighted average trailing P/E for the three listed companies of 13.8x.

Market Dynamics

Besides, the strong pipeline of new projects, a higher level of size, scope and sophistication of these projects, and increasing demand for tighter completion schedules put a lot of pressure on the construction sector contractors. This also means that only the accomplished, experienced and proven contractors, who are capable of managing projects within the given cost/time schedules could survive in the long run. This is also precipitated by the fact that only large-size contractors with strong track records, access to large and skilled labor force and having the necessary expertise and experience can bid for large-scale projects in joint ventures/consortia with international firms.

A tender for a large-sized project normally attracts 5-6 bidders at the pre-qualification stage. At the technical qualification stage, however, not more than 2-3 remain in the running. These are the bidders who have the necessary technical expertise, the experience and proven track record, and the necessary wherewithal to develop and manage the project within its assigned parameters. Based on further negotiations, the project is finally awarded to the chosen contractor. The construction market is becoming more of a contractors' market. The contractors are now more selective in bidding for the projects. This also translates into lower bidding expenses.

On the revenue side, the major projects are priced on a lump-sum basis, with payments being released upon reaching specific milestones. On the cost side, however, the big contractors normally hedge against the rise in raw material prices through long-term contracts and quantity discounts, negotiating against their project order book and taking advantage of their ability to carry large inventories at any point in time. Large-sized contractors, therefore, benefit from economies of scale. Site offices in large projects also lead to better logistics for these contracting companies. Added to all this is the prevailing regime of low interest rates (even though increasing of late) and abundant liquidity in the market, which enables them to access financing from banks at reasonable cost.

Construction Costs

During the last few years most of the construction materials have witnessed fluctuations in their production, consumption and prices due to different reasons.

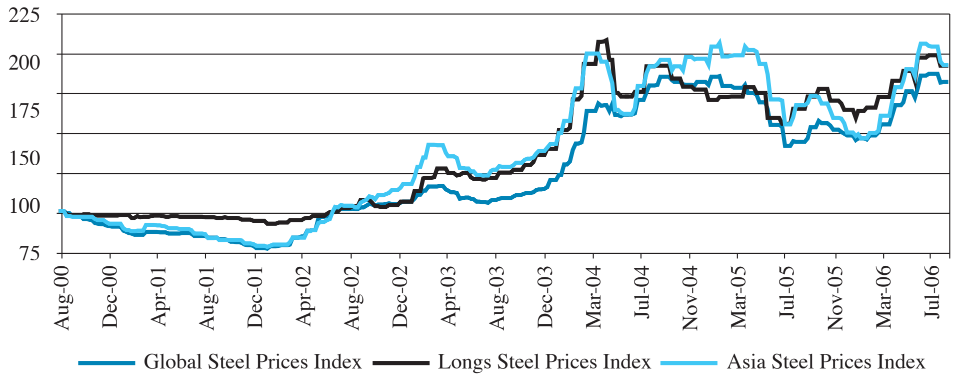
Steel

Steel is major part of the material costs and, therefore, the direct costs incurred in construction. Reinforcing and prestressing steel are used in both the foundation and the superstructure in any construction project. As such, steel prices significantly impact the costs and margins of any construction company.

The production of steel in the Middle East increased by 6.4 per cent in 2005 to 14.9 million tonnes (mt) from 14.0mt in 2004, while the consumption of steel increased by 13.4 per cent to 34.7mt in 2005 from 30.6mt in 2004. The steel production and consumption showed CAGRs of 6.6 per cent and 12.0 per cent respectively during 2000-'05. The shortage of steel – which grew by 19.3 per cent to 19.8mt in 2005 from 16.6mt in the previous year, growing at a compounded rate of 17.3 per cent over the five-year period ended 2005 – was met by imports. The two main regions from where the Middle East sourced its steel imports in 2004 were countries in the former USSR and Europe.

The price of steel in the local market has risen due to the increase in global demand and a decline in supply of raw materials from major source markets. Prices of almost all the steel products that are used in the construction market rose over the last five years. UAE, in general, and Dubai, specifically, witnessed fluctuations in the price of steel during the period 2000-'04.

Chart 2 : Global Steel Prices Trends



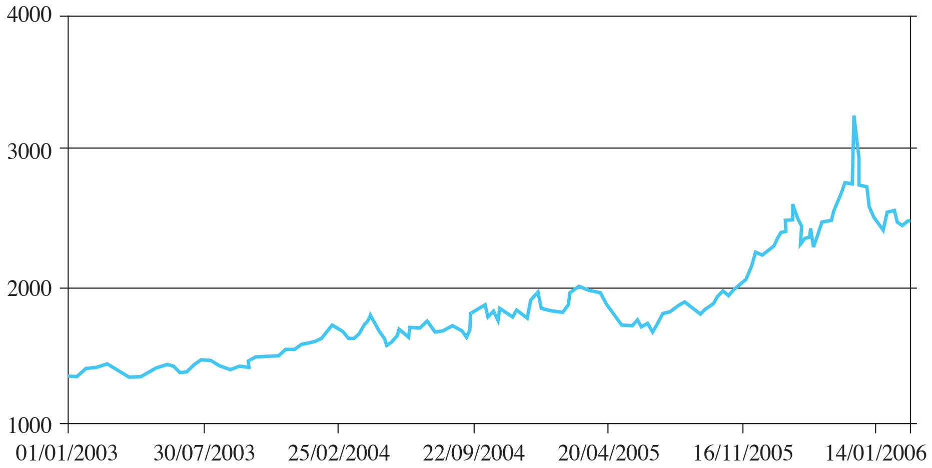
Source: CRUspi.com, ***Global*** *Research.*

Aluminum

Aluminum is used primarily as door and window frames in the construction industry and is a minor component of the direct costs of a construction company.

The Middle East aluminum production remained low, although increasing from 1.18mt in the year 2000 to 1.315mt in the year 2004, an increase of 11.4 per cent during the period at a CAGR of 2.7 per cent. The region is a minor player in the international aluminum market. The global supply shortages have exerted upward pressures on prices, which have also been felt in the Middle East.

Chart 3 : Aluminum Prices (US$/tonne)



Source: London Metal Exchange.

Aluminum represents a major extraction and processing industry for Dubai. Dubai Aluminum Company (Dubal) has been a major player in the GCC aluminum industry. In 2005, Dubal's annual production capacity was 0.761mt. By the end of 2006, the company's annual production capacity is likely to exceed 0.871mt. The steep increase in international aluminum prices since 2003 have benefited UAE, in general, and Dubai, in particular, as Dubal is a major exporter of the metal. More than 92 per cent of the company's total production is exported to global markets – from China to North America. Other key markets include the Far East, Europe, the ASEAN region, the Middle East, the Mediterranean region and North America.

Cement

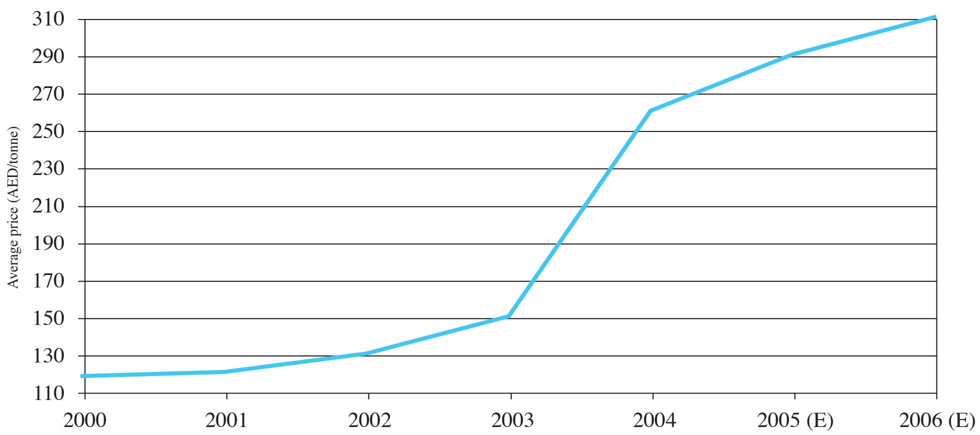
Cement is used in the making of concrete and plaster in a construction project, and is a significant contributor to the direct costs of a construction company.

In 2005, cement production in the Middle East was estimated at 117.8mt, up 1.1 per cent over 2004, while the consumption was estimated at 120.2mt, up 2.2 per cent over the previous year. The GCC countries, however, faced a robust cement demand, which caused steep price hikes over the previous three years. During the year, cement production in the GCC was estimated at 44.1mt, up 7.5 per cent over 2004, while the consumption was estimated at 48.8mt, up 10.6 per cent over the previous year. The strong demand in GCC was primarily due to a strong pipeline of projects, which include projects in buildings, leisure & entertainment, and transportation infrastructure. Added to this was large investments in other sectors of the economy as well. A large chunk of these investments were in UAE.

The cement production in the UAE was estimated at about 12.6 million tonnes, while the consumption was estimated at about 14.6 million tonnes, in 2005. This high consumption is due to the construction boom in the country as a whole, and in Dubai, in particular, which led to a steep hike in cement prices since 2003. Riding on the strong cement prices, the concrete mix prices too have ruled at high levels in the last three years.

Civil infrastructure projects worth $312bn are estimated to be currently underway in UAE. A bulk of these are known to be in Dubai. Most cement companies in the country have resorted to capacity expansions to meet the expected high local demand of cement in the near-medium term.

Chart 4 : Average Cement Prices in UAE (2000-'06)



*Source: Industry Sources & **Global** Research.* *2006 (E) price as at end of July 2006.*

Labour

Contractors are also under pressure from higher wages and salaries. Firstly, the rapid increase in the demand for construction services and the tight delivery schedules for new projects call for the extensive hiring of fresh expatriate labor. Secondly, there is pressure on the general level of wages in Dubai to meet the rising cost of living, especially housing rents.

The combined effect of the above is that Dubai has become the most expensive location in the region in terms of construction cost per square foot, now estimated to be in the range of AED250-350 (US$68-95) per square foot, depending on the type of project.

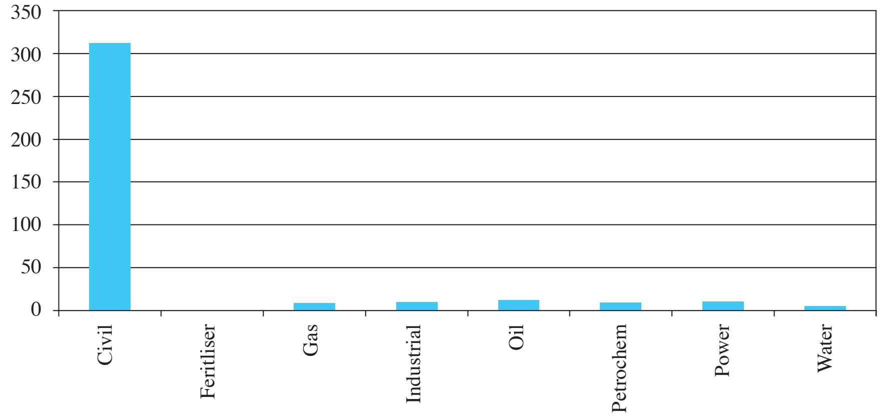
Profit Margins

As a result of the rising costs, the construction margins could be under pressure going forward. Construction gross margins are currently in the range of 9-12 per cent, depending on the mix of projects. We expect the margins to soften going forward, based on the likelihood of construction commodity prices ruling firm in the near-medium term, riding on the back of sustained strong global demand. Despite the big-ticket projects currently under development, the healthy projects pipeline and the abundant liquidity in UAE, the intense competition in the construction market could keep the margins under pressure for some time to come. This is notwithstanding the proven track record and technological credentials of the leading contractors which could provide them with strong negotiation and lobbying power.

Outlook for the UAE Construction Sector

The strong upward trend in construction activity witnessed in UAE in 2004 and 2005 is expected to continue in the near-term due to expectations of sustained high oil prices and abundant liquidity. This liquidity is expected to continue to be directed to development of massive real estate and infrastructure projects. In addition, UAE's strong population growth requires massive real estate and infrastructure investments.

Chart 5 : UAE : Break-Up of Investment Projects (August 2006)



*Source: Sentinel Market Intelligence, **Global** Research.* *Figures in $ billion.*

The construction projects in UAE are a good mix of residential, commercial, retail, multi-use and hospitality projects in Dubai, Abu Dhabi, and in other emirates. Projects worth an estimated $312bn are said to be at various stages of development at present.

Table 7 : UAE - Category-Wise Break-Up of Civil Construction Projects

Buildings	
Commercial	6,340
Education	3,895
Healthcare	712
Hotels	8,326
Mix	225,924
Others	6,583
Residential	24,537
Retail	1,623
Buildings - Sub-Total	**277,940**
Leisure & Entertainment	
Mix	3,853
Sports Facilities	589
Theme Parks	3,402
Leisure & Entertainment - Sub-Total	**7,844**
Transport	
Airports	7,154
Bridges	1,486
Ports	3,140
Railways	6,292
Roads	8,888
Transport - Sub-Total	**26,960**
Total - UAE - Civil Construction Projects	**312,744**

*Source: Sentinel Market Intelligence, **Global** Research.*

Amounts in $ million.

However, a general slowdown in real estate activity due to an anticipated correction in the Dubai property market could adversely impact the fortunes of the construction companies, going forward. It might also lead to a delay in the launch or scrapping altogether of some of the proposed projects. But, the construction sector is at different stages of maturity in the different emirates at present. While the Dubai market could be approaching its peak, the Abu Dhabi and Ras Al Khaimah markets have just about started picking up. This is likely to support the construction market players, especially those who have geographically diversified portfolios within UAE and beyond, for some time to come. Thus, the pipeline of projects lined-up should indeed see continued buzz in the construction market in UAE in the near-medium-term.

Growth Strategy of Arabtec

In keeping with its core operations of investing in construction, contracting and related services, Arabtec plans to expand its business by acquiring and owning shares of UAE-based construction companies. Diversification into other areas of construction will not only support its core activity but also help to increase efficiency by achieving cost synergies. The highly fragmented nature of UAE’s construction sector provides the company an ideal ground to implement this strategy.

Arabtec’s subsidiary, Austrian-Arabian Ready Mix Concrete supplies its other subsidiary Arabtec Construction with around one-third of its annual requirements of ready mix concrete. As of now, the daily production capacity of the Austrian-Arabian factory is around 3,000 cubic meters of ready mix concrete. Arabtec is planning to increase the concrete capacity of Austrian-Arabian RMC this year to support its expanding activities.

With the establishment of Arabtec Precast LLC, a wholly-owned subsidiary of Arabtec which specialises in pre-cast buildings and contracting, the company seems to have established its presence across a substantial part of the construction chain, while remaining focused on construction as the core activity of the company.

Although, Arabtec’s activities are presently focused in Dubai, it has plans to enter other regional markets as well. The company plans to explore opportunities in other emirates (in Abu Dhabi, to start with), and other GCC countries, such as Qatar and Saudi Arabia in the near-medium term. The company is looking at establishing its presence in the high-potential Qatar market by announcing its plans to set up two companies in that country in the fields of construction and ready mix. Other markets such as Iraq have also been short-listed for entry, once the geo-political situation there stabilizes. These measures are likely to drive the company’s growth moving forward.

The company management is likely to stay focused on construction as the core business of the company in the near-term. It may not diversify into other related activities, such as real estate development, in the near-term, though it is likely to go on to provide value-added services, such as design services, to its clients. It may also not backward-integrate into cement or aggregate production, etc., in the foreseeable future. The company, thus, is likely to benefit from its scaled-up operations and geographic diversification in the years ahead.

A strong pipeline of big ticket and prestigious projects should see a healthy and sustainable growth in the company’s revenues and profits in the near-medium-term. Going forward, the company also seems open to pursuing M&A as a growth strategy. Thus, the company seems well on its way to becoming a regional construction giant.

Future Growth Drivers for Arabtec

Arabtec has a strong pipeline of construction projects. Its leadership position in the highly dynamic, highly competitive and high-potential construction market in UAE has enabled it to net some prestigious and lucrative contracts in recent months. These contracts are expected to drive its growth in the near-medium term.

Some of the forthcoming projects of Arabtec Construction include:

- a deal with Asteco Development Management LLC on behalf of Zabeel Investments to develop the AED2.1bn lifestyle development – the Tiara Residence. Construction on the Tiara, which consists of seven 15-storey residential towers situated on the Palm Jumeirah, is expected to begin shortly with scheduled handover by the end of 2007.

- the AED487mn contracts to design and construct 594 villas known as Palmera (District 7) at Arabian Ranches to be completed in phases by June 30, 2007, and 88 villas known as Hattan (District 6A), also at Arabian Ranches to be completed by May 1, 2007.

- the US$220mn luxury residence buildings – Jumana and Dana Towers – in the AED5.9bn (US$1.6bn) Dubai Pearl Development – a self-contained multi-use development of more than 10 million square feet of built-up area situated within Dubai Media City.

- the Dubai Pearl Hotel contract to build a high-rise hotel at the Dubai Pearl Development. The 287-metre, 60-storey, 760-room, five-star hotel is a partnership between Dubai Pearl Inc and Kingdom Hotel Investment Group. The AED485mn project is likely to be completed by December 2006. The hotel will be managed by the Swiss hospitality chain Movenpick.

- two 60-storey tower projects through Asteco Development Company.

- Dubai Municipality's prestigious "Contract DS170 for House Sewage Connections and Miscellaneous Works”, worth AED63.78mn.

- the construction of the approximately AED1bn project, comprising of Palazzo Versace Hotel and the D1 Tower in the recently announced Culture Village in Dubai Creek. Arabtec Construction have entered the joint venture as equal partners with Emirates Sunland Project Management LLC – which is a venture between Australia-based Sunland Group and Emirates International Holdings.

- the design and construction of 544 villas and associated infrastructure works for the Mohammad Bin Rashid Housing Programme. The total value of the contract is likely to be about AED575mn, with the work expected to be completed in phases over the coming two years. The order brings the total number of villas currently under construction by Arabtec to 2,514, including 558 villas for Dubai Properties; 1,412 villas for Emaar; and 544 villas for Mohammad Bin Rashid Housing Programme.

- a contract of AED472mn signed with DIFC in September 2005 for the construction and maintenance of 10 commercial buildings.

- the construction and maintenance of the car tunnel inside the DIFC. Expected to be completed in 20 months starting from November 2005, the contract is worth AED386.5mn.

- successful pre-qualification as part of a consortium for the proposed Dubai Light Railway Project. The anticipated value of the project is US$4bn. The consortium, collectively known as "Metro One", comprises Arabtec (Dubai), Bombardier (Canada), Odebrecht (Brazil), Guris (Turkey), Ghella Group (Italy) and Parsons (USA). The company views this as a significant opportunity to develop the company's growth strategy into complex heavy engineering.

- the contract to build Burj Dubai, set to be the tallest building in the World, in a joint venture with Samsung Corporation of Korea and Six Construct of Belgium (Besix). Both Samsung and Besix are experienced in the construction of skyscrapers. While Samsung has previously completed the two tallest towers in the world – The Petronas Tower in Kuala Lumpur and the Trade Centre Tower in Taipei, Besix has the Emirates Towers in Dubai to its credit. Work commenced on Burj Dubai in January 2005 with completion scheduled in December 2008. Estimated cost of the project is AED4bn.

These projects add up to about US$2.9bn, with scheduled completion during 2006-'09. In addition to these, the company is at various stages of bidding for some other projects in UAE. Overall, the total quantum of projects currently with Arabtec, both on stand-alone basis as well as in alliances/consortia with other contractors, at various stages of bidding/construction, is estimated at over US$6.5bn. This pipeline of projects is expected to drive the revenues of the company in the near-medium-term.

Financial Performance of Arabtec

Financial Performance in 2005

The year 2005 was the first full year of operations for the company. The company released its consolidated financial statements for the entire period since the commencement of business on September 20, 2004 till the end of December 2005 in April 2006.

Income

The company's total operational revenues was AED2.57bn for the period ended December 2005. Revenue from construction contracting constituted about 97.4 per cent of the total revenue for the period, whereas revenue from the sale of ready-mix concrete to third parties fetched about 0.3 per cent of the total revenue, with miscellaneous contracting services constituting the remaining 2.3 per cent of the total revenues for the period.

Direct Costs

Direct costs for the period were AED2.33bn. About 97.7 per cent of this amount pertained to construction contracting, with the balance emanating from the other activities.

Gross Profit

Gross profit for the period amounted to AED232.2mn. The gross profit margin was 9.0 per cent.

Other Operational Expenses

The salaries and employees' benefits constituted AED51.0mn, while the general & administrative expenses amounted to AED30.6mn. The company had over 20,000 employees at the end of 2005.

Operating Profit

The operating profit during the period was AED131.3mn, with an operating profit margin of 5.1 per cent.

Non-Operating Income & Expenses

Interest income, earned on other financial assets, including short-term deposits, amounted to AED5.9mn, while profit from sale of equity investments was AED20.4mn. Interest expenses on non-current retentions payable amounted to AED5.8mn, while miscellaneous income, including service charges and other income, amounted to AED15.0mn.

Net Profit

The net profit during the period was AED165.9mn, with a net profit margin of 6.5 percent.

Dividends

The company did not declare any cash dividend during the period. However, it declared 30 per cent stock dividend during the period.

Assets and Liabilities

The total assets of the company were AED1.89bn at the end of 2005. While the current assets were AED1.21bn at the end of the year, trade & other receivables amounted to AED874.7mn

(62 receivable-days). Simultaneously, inventories totaled AED95.4mn (7 inventory-days). Advances paid amounted to AED61.5mn, while financial assets, including short-term bank deposits, amounted to AED77.0mn at the end of the year. Intangible assets, arising from the take-over of Arabtec Construction and Austrian-Arabian Ready Mix Concrete amounted to AED101.0mn, while goodwill from the above two transactions was AED88.9mn. Non-current retentions receivable were AED128.6mn. Net fixed assets amounted to AED331.5mn at the end of the year.

On the liabilities side, the trade & other payable totaled AED919.4mn (72 payable-days). Advances received amounted to AED298.2mn. Non-current retentions payable were AED57.1mn. The owners' equity, including a 30% stock dividend, added up to AED574.0mn at the end of the year.

Financial Performance in the First Half of 2006

The company had operational revenues of AED1.41bn in the first six months of 2006, up 23.2 per cent year-on-year (y-o-y). The total direct costs of AED1.24bn were up 19.1 per cent y-o-y. The lower growth in the direct costs caused a steeper growth in the gross profit, which was AED174.2mn, up 62.0 per cent y-o-y, for a gross profit margin of 12.3 per cent, against 9.4 per cent a year ago. Net operating costs of AED60.8mn were up 26.7 percent y-o-y, leading to an operating profit margin of 8.0 per cent, against 4.9 per cent a year ago. The company's net profit during the period of AED113.5mn was more than double that in the corresponding period of 2005.

The total assets of the company were AED2.05bn at the end of June 2006. While the current assets were AED1.42bn at the end of the period, trade & other receivables amounted to AED951.2mn (121 receivable-days). Simultaneously, inventories totaled AED73.5mn (11 inventory-days). Other financial assets amounted to AED22.9mn at the end of the period. Intangible assets amounted to AED95.4mn, while goodwill remained at AED88.9mn. Non-current retentions receivable were AED53.6mn. Net fixed assets amounted to AED371.1mn at the end of the period. On the liabilities side, the trade & other payable totaled AED1.26bn (140 payable-days). Non-current retentions payable were AED60.1mn. Owners' equity was AED682.0mn at the end of the period.

SWOT Analysis

Strengths/Opportunities

- The company is a leading construction contractor in the lucrative yet competitive UAE market, associated with some of the most prestigious projects currently being developed by some of the leading property developers in the country.

- The UAE construction market is benefiting from huge investments in real estate sector being made in the country, riding on high oil prices-driven liquidity, exacerbated by high population growth rates and resultant housing shortages. This benefits the company immensely.

- The company currently has an impressive pipeline of projects, proposed to be developed by some of the leading property developers in the country. These projects are at various stages of development. This entails visible growth of revenues for the company going forward.

- The company is also looking at geographic diversification to reduce business concentration risk. The company plans to explore opportunities in other emirates (in Abu Dhabi, to start with), and other GCC countries, such as Qatar and Saudi Arabia, in the near-medium term. It is also open to M&A to scale-up its operations.

- The UAE construction market is highly fragmented. This provides a good opportunity for the company to grow by acquisitions going forward. The company is expected to generate healthy levels of cash going forward, which could make such acquisitions financially viable.

- Moving forward, the high levels of cash generation are also expected to obviate the need for the company to raise any debt to meet its capital expenditure or for its operations.

- The company works with some of the major property developers in the country, which ensures timely receipt of outstanding payments. Going forward, its continued association with leading property developers is likely to continue to enable it to efficiently manage its receivables.

Weaknesses/Threats

- Any slow-down in the economic growth and/or decline in liquidity levels going forward could adversely impact the ongoing construction activity in the region, impacting, thereby, the revenues of the company.

- The current uptrend in the prices of all construction-related commodities, such as steel, aluminum, cement, etc., could adversely impact the company's profit margins. The near-term outlook on the prices of these commodities indicates a continuous margin downtrend for the company moving forward.

- A general slowdown in real estate activity due to an anticipated correction in the Dubai property market could adversely impact the fortunes of the company, going forward. It might also delay the launch of some of the proposed projects with which the company is likely to be involved in future. Sustained growth in the company's future revenues and profits in such an eventuality, therefore, is likely to depend on its ability to geographically diversify its activities, scale-up its operations, and backward/forward integrate in the construction value chain.

Valuation & Recommendation

Earnings Outlook

We have made the following assumptions in our earnings projections for the company till 2009:

1. The projections for 2006 have been made based on the financial results for the first half of the year, assuming a continuation of the growth momentum seen during the period.

2. The capital expenditure too has been projected for future years based on the capital expenditure incurred in the first half of 2006.

3. The cost of operations has been projected assuming a continuous uptrend in the prices of all construction-related commodities, such as steel, aluminum, aggregates and cement, till 2008, with prices projected to be marginally softening in later years.

4. Among the operating expenses, expenses under all account heads have been projected for 2006, as also for the subsequent years, keeping in mind the projected growth in the company's businesses.

5. Average depreciation has been assumed at 10 per cent on the new fixed assets acquired in 2006 and thereafter.

6. The operating profit margin is projected to decline from 2006 to 2008 due primarily to high staff and depreciation expenses. Thereafter, the company is expected to benefit from enhanced economies of scale, leading to gradually improving operating profit margins.

7. The company has been projected to maintain minimum cash levels in line with its expanding operations. The surplus cash has been projected to be invested in short- and long-term investments.

8. Other income, interest income and investment income have been assumed at appropriate levels each year.

9. Cash dividend rate has been projected to steadily go up from 20 per cent in 2006 to 50 per cent in 2009, with the corresponding payout ratio increasing from 43.2 per cent in 2006 to 72.2 per cent in 2009.

10. Transfers to statutory reserve has been assumed at 10 per cent of the net profit every year, with a cap on the reserve of 50 per cent of the paid-up equity.

The corresponding movements in the net profit, ratios, earnings per share and book value per share have been shown in the Table below.

Table 8 : Arabtec - Earnings and Valuation Ratios

	2005	2006 (P)	2007 (P)	2008 (P)	2009 (P)
Net profit (AEDmn)	165.9	240.9	277.7	306.0	360.1
GPM (%)	9.0	12.3	11.2	10.6	11.0
OPM (%)	5.1	7.8	6.9	6.4	6.6
NPM (%)	6.5	8.1	7.2	6.6	6.8
ROAA (%)	8.8	11.6	11.6	11.4	12.1
ROAE (%)	28.9	37.5	35.8	34.2	35.9
EPS (AED)	0.4	0.5	0.5	0.6	0.7
BVPS (AED)	1.4	1.4	1.6	1.8	2.0

*Source: **Global** Research.*

Valuation

DCF Method

In order to compute the cost of equity for the Discounted Cash Flow (DCF) method, we have used the Capital Asset Pricing Model (CAPM).

The following assumptions have been made in order to arrive at the DCF value of Arabtec.

1. A risk-free rate of 5.95 per cent has been assumed. We have arrived at this rate by applying the differential between the total risk premiums of UAE and Kuwait to the current CBK discount rate of 6.25 per cent. The total risk premiums have been sourced from the data provided by Prof. A Damodaran on the website of the NYU – Stern School of Business.

2. A market risk premium of 7.0 per cent has been assumed, to factor in the increased riskiness of the construction markets going forward.

3. Beta has been assumed at 1.0, since sufficient historic data does not exist, as the company was listed only in January 2005.

4. The cost of equity derived from the above assumptions using the Capital Asset Pricing Model (CAPM) is 12.95 per cent.

5. The cost of debt has been assumed at 8.0 per cent, in anticipation of a further firming up of interest rates going forward.

6. Based on the above assumptions, and a target debt/equity ratio of 0.25, the Weighted Average Cost of Capital (WACC) works out to 12.0 per cent.

7. Terminal growth rate of 3.0 per cent has been assumed, as it is expected to follow the long-term GDP growth in the region.

Based on our future earnings projections and the above assumptions for DCF computations, the DCF value of Arabtec is AED6.22 per share.

Table 9 : DCF Valuation of Arabtec

	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Years	0.33	1.33	2.33	3.33
Free Cash Flow	231.4	174.3	217.6	276.8
Discount Factors	0.96	0.86	0.77	0.69
Discounted Cash Flows	222.8	149.9	167.2	189.9
WACC	12.0%			
Terminal Growth Rate	3.0%			
Primary Value	729.9			
Terminal Value	2,183.4			
Investments	27.7			
Cash	298.2			
Enterprise Value	3,239.2			
Debt	4.0			
Equity Value	3,235.2			
No. of Equity Shares Outstanding (mn)	520.0			
Per Share Value (AED)	**6.22**			

*Source: Company's unaudited financial statements for 1H 2006, **Global** Research.*

All figures in AEDmn, unless stated otherwise.

Values of cash, investments and debt as at end of June 2006.

Sensitivity Analysis

A sensitivity analysis for different estimated long-run future growth rates and cost of capital is provided as below. The table provides estimated fair values for Arabtec's shares based on a range of varying inputs. The shaded area at the center shows the most probable range of alternatives.

Table 10 : Sensitivity Analysis of Arabtec

		Terminal Growth Rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
WACC	10.0%	6.44	7.04	7.81	8.84	10.28
	11.0%	5.86	6.33	6.92	7.67	8.68
	12.0%	5.39	5.76	6.22	6.79	7.53
	13.0%	5.00	5.30	5.67	6.12	6.68
	14.0%	4.66	4.92	5.22	5.57	6.01

*Source: **Global** Research.*

Relative Valuation Method

The peer group valuation is performed to compare the intrinsic value of Arabtec arrived at using the DCF calculation. In order to value Arabtec using this method, we have used the weighted average price-to-earnings (P/E) multiple for a basket of comparable companies, which make up the peer set for Arabtec. The price-earnings multiple of a stock is a reflection of various factors, such as the expected profitability of the company, its growth potential as perceived by the market, predictability and sustainability of its revenues, the quality of its earnings and the quality of its management, among others.

To arrive at the peer-set P/E multiple, we have computed the average sector P/E of the listed construction companies in GCC, based on their current market prices and projected earnings for 2006. The weighted average forward P/E for the construction sector, thus arrived at, is 8.4x.

On the basis of the weighted average forward P/E for the sector and Arabtec's projected 2006 earnings, the company's stock valuation comes to AED3.87 per share.

However, as the price-earnings multiple varies with time and is dependent on several factors, such as market sentiment and other qualitative factors, we have provided a lower weightage of 20 per cent to the peer valuation method, and 80 per cent weightage to the value arrived at using the DCF method.

Weighted Average Share Value

The value of Arabtec's shares derived from the weighted average of the DCF and relative valuation methods is AED5.75 per share. The stock closed at AED4.38 on the DFM at the end of trading on September 3, 2006, which implies that the weighted average value of Arabtec's shares is at a premium of 31.3 per cent to the share's current market price. At their current price, Arabtec's shares are trading at a P/E multiple of 10.6x the 2005 earnings, and forward multiples of 9.5x and 8.2x the projected 2006 and 2007 earnings respectively. We, therefore, recommend a 'BUY' on the Arabtec stock at its prevailing price levels with a medium-term perspective.

Table 11 : Weighted Average Share Value of Arabtec

	Weightage	Fair Value
As per DCF Method	80%	6.22
As per Relative Valuation	20%	3.87
Weighted Average Share Value		**5.75**

*Source: **Global** Research*

Fair Value in AED per share.

Recommendation

Arabtec today is a leading construction company in the highly dynamic and competitive UAE construction market. It is one of the biggest construction companies in the Middle East. The company has a healthy order book at present, involving some big ticket construction projects currently being developed by the leading property developers of UAE. Some of the future projects of Arabtec include the Burj Dubai project, Dubai Light Railway project, construction of villas for the Mohammad Bin Rashid Housing Programme, the Dubai Pearl Hotel project, etc. Overall, Arabtec would seem to have a sound business model, with high-growth potential revenue streams emanating from its construction activities, which should, in turn, translate into healthy growth in both revenues and profits in the near-medium term. It is also planning to expand its activities into other emirates/countries in the region. Moving forward, the high levels of cash generation are also expected to obviate the need for the company to raise any debt to meet its capital expenditure or for its operations. Based on the composite share valuation of the company, we see a good upside in its share price from its current levels. We, therefore, initiate our coverage of the Arabtec stock with a 'BUY' recommendation, with a price target of AED5.75, implying a potential upside of 31.3 per cent, with a medium-term perspective.

BALANCE SHEET

Amounts in AED	ARABTEC HOLDING PJSC				
	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Assets					
Bank & cash equivalents	44,736,763	94,181,172	96,265,571	122,066,277	127,753,664
Trade & other receivables	874,693,919	941,858,702	1,057,250,406	1,162,975,447	1,266,163,086
Advances paid	61,500,738	73,194,259	79,293,780	88,809,034	97,753,373
Inventories	95,405,616	103,394,066	111,737,522	119,062,539	128,546,894
Financial assets	76,996,226	116,996,226	126,996,226	126,996,226	126,996,226
Due from related parties	29,576,492	35,143,981	42,696,651	47,576,268	53,919,771
Other current assets	32,012,789	35,214,068	38,735,475	42,609,022	46,869,924
Total Current Assets	1,214,922,543	1,399,982,474	1,552,975,631	1,710,094,813	1,848,002,938
Available for sale investments	11,659,723	141,246,922	169,800,733	178,508,463	212,301,691
Intangible assets	101,040,097	89,926,758	78,813,419	67,700,080	56,586,741
Goodwill	88,896,366	91,563,257	94,310,155	97,139,459	100,053,643
Retentions receivable (Non-current)	128,629,676	70,287,963	82,953,493	95,152,537	110,376,942
Loan to a related party	-	2,000,000	2,100,000	2,205,000	2,315,250
Other non-current assets	13,140,145	13,797,152	14,487,010	15,211,360	15,971,928
Gross fixed assets	440,889,284	610,889,284	810,889,284	1,010,889,284	1,235,889,284
Less: Accumulated depreciation	109,405,119	168,877,874	247,963,269	348,173,517	470,635,130
Net fixed assets	331,484,165	442,011,410	562,926,015	662,715,767	765,254,154
Total Assets	**1,889,772,715**	**2,250,815,936**	**2,558,366,456**	**2,828,727,479**	**3,110,863,288**
Liabilities					
Trade & other payables	919,391,410	1,069,593,783	1,192,492,877	1,292,678,995	1,395,837,490
Advances received	298,235,973	335,139,385	356,808,892	379,866,196	402,520,578
Short-term loans	-	5,000,000	-	-	-
Due to related parties	9,066,453	4,000,000	4,200,000	4,410,000	4,630,500
Total Current Liabilities	1,226,693,836	1,413,733,168	1,553,501,769	1,676,955,191	1,802,988,568
Retentions payable (non current)	57,080,473	71,306,252	84,507,369	96,383,960	110,368,546
Employee Indemnity Provision	32,041,556	49,404,974	66,615,594	87,199,495	111,282,660
Minority interest	-	6,000,000	12,916,999	20,536,605	29,504,644
Owners' Equity:					
Paid-up equity capital	400,000,000	520,000,000	520,000,000	520,000,000	520,000,000
Bonus shares	120,000,000	-	-	-	-
Statutory reserve	16,585,671	40,678,434	68,453,372	99,049,599	135,060,403
Fair value adjustment reserve	8,100,140	3,000,000	3,150,000	3,307,500	3,472,875
Retained earnings	29,271,039	142,105,908	236,080,343	303,446,389	367,543,625
Unrealized gain on investment	-	4,587,199	13,141,010	21,848,740	30,641,968
Total Shareholder's Equity	573,956,850	710,371,542	840,824,725	947,652,228	1,056,718,871
Total Liabilities & Owners' Equity	**1,889,772,715**	**2,250,815,936**	**2,558,366,456**	**2,828,727,479**	**3,110,863,288**

OPERATING STATEMENT

Amounts in AED	ARABTEC HOLDING PJSC				
	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Revenue	2,565,510,644	2,968,433,832	3,858,963,982	4,630,756,778	5,325,370,295
Cost of Production	(2,333,341,612)	(2,602,678,205)	(3,427,243,307)	(4,138,840,642)	(4,739,355,197)
Gross Profit	232,169,032	365,755,627	431,720,674	491,916,136	586,015,097
General & Administrative Expenses	(30,597,678)	(59,368,677)	(77,179,280)	(83,353,622)	(95,856,665)
Staff Costs	(50,975,172)	(86,817,090)	(103,263,719)	(123,503,408)	(144,498,988)
Marketing Expenses	(311,715)	(1,484,217)	(1,929,482)	(2,315,378)	(3,195,222)
Other Operating Income	-	35,621,206	46,307,568	50,938,325	55,916,388
Depreciation & Amortisation	(18,981,680)	(21,589,421)	(28,435,571)	(36,435,571)	(44,935,571)
Operating Profit	131,302,787	232,117,429	267,220,190	297,246,481	353,445,039
Interest income	5,882,323	4,849,811	6,099,811	5,714,830	5,079,849
Profit from sale of equity investments	20,390,086	-	-	-	-
Change in fair value of non-current retentions	(1,558,007)	10,554,729	12,767,951	13,160,381	13,417,642
Interest expenses	(5,828,593)	(6,594,336)	(8,367,715)	(9,949,023)	(10,854,507)
Gain on sale of PPE	656,003	-	-	-	-
Miscellaneous income	15,012,111	6,000,000	6,946,135	7,409,211	7,988,055
Minority interest	-	(6,000,000)	(6,916,999)	(7,619,606)	(8,968,038)
Net Profit	**165,856,710**	**240,927,632**	**277,749,373**	**305,962,273**	**360,108,040**
P&L Appropriation Account:					
Opening Balance of Retained Earnings	-	29,271,039	142,105,908	236,080,343	303,446,389
Adjustments	-	-	-	-	-
Net Profit for the year	165,856,710	240,927,632	277,749,373	305,962,273	360,108,040
Transfer to Statutory Reserve	(16,585,671)	(24,092,763)	(27,774,937)	(30,596,227)	(36,010,804)
Proposed Cash Dividend %	*0.0%*	*20.0%*	*30.0%*	*40.0%*	*50.0%*
Proposed Cash Dividend	-	(104,000,000)	(156,000,000)	(208,000,000)	(260,000,000)
Proposed Stock Dividend %	*30%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Proposed Stock Dividend	(120,000,000)	-	-	-	-
Closing Balance of Retained Earnings	29,271,039	142,105,908	236,080,343	303,446,389	367,543,625

CASH FLOW STATEMENT

Amounts in AED	ARABTEC HOLDING PJSC				
	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Operating					
Operating Activities	236,979,799	308,359,265	362,094,625	415,500,818	497,123,365
Net Profit	165,856,710	240,927,632	277,749,373	305,962,273	360,108,040
Depreciation	50,972,755	59,472,755	79,085,395	100,210,249	122,461,613
Amortization of intangible assets	11,000,000	-	-	-	-
Interest income	-	(4,849,811)	(6,099,811)	(5,714,830)	(5,079,849)
Change in fair value of non-current retentions	1,558,007	(10,554,729)	(12,767,951)	(13,160,381)	(13,417,642)
Gain on sale of property, plant and eqpt	(656,003)	-	-	-	-
Minority interest	-	6,000,000	6,916,999	7,619,606	8,968,038
End of service indemnity paid	(1,901,180)	-	-	-	-
Increase in Employee Indemnity Provisions	10,149,510	17,363,418	17,210,620	20,583,901	24,083,165
Working Capital	(75,022,313)	86,423,810	3,859,843	(7,865,055)	(6,187,361)
Dec/(inc.) in receivables	(489,419,613)	(67,164,783)	(115,391,704)	(105,725,041)	(103,187,640)
Dec / (inc) in Inventories	26,398,645	(7,988,450)	(8,343,456)	(7,325,018)	(9,484,355)
Inc/(dec) in accounts payable	401,253,816	150,202,373	122,899,094	100,186,118	103,158,495
Dec/(inc.) in other assets	(13,255,161)	(20,462,289)	(17,173,598)	(18,268,418)	(19,548,743)
Inc/(dec) in other liabilities	-	31,836,959	21,869,507	23,267,304	22,874,883
Total Operating	**161,957,486**	**394,783,076**	**365,954,468**	**407,635,764**	**490,936,004**
Investing					
Capex	(106,589,564)	(170,000,000)	(200,000,000)	(200,000,000)	(225,000,000)
Proceeds from disposal of property	8,654,885	-	-	-	-
Interest income	-	4,849,811	6,099,811	5,714,830	5,079,849
Increase in Other Assets	-	55,684,706	(13,455,388)	(13,028,394)	(16,095,224)
Increase in Other Financial Assets	(49,170,806)	(40,000,000)	(10,000,000)	-	-
Purchase of Intangible Assets	-	11,113,339	11,113,339	11,113,339	11,113,339
Increase in Other Liabilities	-	14,225,779	13,201,117	11,876,591	13,984,586
Changes in Goodwill	-	(2,666,891)	(2,746,898)	(2,829,305)	(2,914,184)
Sale / (Purchase) of investments available for sale	29,521,883	(125,000,000)	(20,000,000)	-	(25,000,000)
Change in fair value of non-current retentions	-	10,554,729	12,767,951	13,160,381	13,417,642

CASH FLOW STATEMENT (Contd.)

Amounts in AED	ARABTEC HOLDING PJSC				
	2005	**2006 (F)**	**2007 (F)**	**2008 (F)**	**2009 (F)**
Investment in subsidiaries	(288,104,391)	-	-	-	-
Fair value adjustment reserve	-	(5,100,140)	150,000	157,500	165,375
Total Investing	**(405,687,993)**	**(246,338,667)**	**(202,870,068)**	**(173,835,058)**	**(225,248,617)**
Financing					
Loan	(39,418,659)	5,000,000	(5,000,000)	-	-
Settlement of current accounts	(72,114,071)	-	-	-	-
Increase in Capital & premium	400,000,000	-	-	-	-
Dividend Paid	-	(104,000,000)	(156,000,000)	(208,000,000)	(260,000,000)
Total Financing	**288,467,270**	**(99,000,000)**	**(161,000,000)**	**(208,000,000)**	**(260,000,000)**
Net Change in Cash	44,736,763	49,444,409	2,084,400	25,800,706	5,687,387
Net Cash at beginning	-	44,736,763	94,181,172	96,265,571	122,066,277
Net Cash at end	44,736,763	94,181,172	96,265,571	122,066,277	127,753,664

RATIO ANALYSIS

	ARABTEC HOLDING PJSC				
	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Liquidity Ratios					
- Current Ratio (x)	1.0	1.0	1.0	1.0	1.0
- Quick Ratio (x)	0.9	0.9	0.9	0.9	1.0
- Inventory stock (days)	15	14	11	10	10
- Receivables outstanding (days)	124	112	95	88	83
- Length of operating cycle (days)	139	126	106	98	93
- Payables outstanding (days)	144	139	120	110	104
- Length of cash cycle (days)	(4)	(14)	(14)	(12)	(11)
Profitability Ratios					
- Total Assets Turnover (x)	1.4	1.4	1.6	1.7	1.8
- Total Net Fixed Assets Turnover (x)	7.7	7.7	7.7	7.6	7.5
- Equity Turnover (x)	4.5	4.6	5.0	5.2	5.3
- Gross Profit Margin (%)	9.0	12.3	11.2	10.6	11.0
- Operating Margin (%)	5.1	7.8	6.9	6.4	6.6
- Net Profit Margin (%)	6.5	8.1	7.2	6.6	6.8
- Return on Average Assets (%)	8.8	11.6	11.6	11.4	12.1
- Return on Average Equity (%)	28.9	37.5	35.8	34.2	35.9
- Return on Common Capital (%)	41.5	52.4	53.4	58.8	69.3
Activity Ratios					
- Inventory Turnover Ratio (x)	24.5	26.2	31.9	35.9	38.3
- Debtor turnover Ratio (x)	2.9	3.3	3.9	4.2	4.4
- Creditors Turnover Ratio (x)	2.5	2.6	3.0	3.3	3.5
Leverage Ratios					
- Current Liability / Equity (x)	2.1	2.0	1.8	1.8	1.7
- Debt / Equity (x)	-	0.01	-	-	-
Ratios Used for Valuation					
- EPS (AED)	0.41	0.46	0.53	0.59	0.69
- Book Value Per Share (AED)	1.43	1.37	1.62	1.82	2.03
- Dividend Payout Ratio (%)	-	43.2	56.2	68.0	72.2
- Market Price (AED) *	4.72	4.38	4.38	4.38	4.38
- P/E Ratio (x)	11.4	9.5	8.2	7.4	6.3
- P/BV (x)	3.3	3.2	2.7	2.4	2.2
- Dividend Yield (%)	-	4.6	6.8	9.1	11.4

** Market price for 2006 and subsequent years on DFM as on September 3, 2006.*

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist

Company	Recommendation	Ticker	Price	Disclosure
Arabtec Holding PJSC	Buy	ARTC.DU	AED 4.38	1,10

1. Global Investment House did not receive and will not receive any compensation from the company or anyone else for the preparation of this report.
2. The company being researched holds more than 5% stake in Global Investment House.
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Global rating	Definition
Buy	Fair value of the stock is >10% from the current market price
Hold	Fair value of the stock is between +10% and -10% from the current market price
Reduce	Fair value of the stock is between -10% and -20% from the current market price
Sell	Fair value of the stock is < -20% from the current market price

Global Research

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