Equity | M East & Africa

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Mena Strategy

Time to revisit the Mena region?

We take a closer look at stock markets in the Mena region against the current backdrop of political unrest and conclude there are still attractive investment opportunities, especially in the GCC-4 countries, from both a top-down and bottom-up perspective. We highlight our preferred stocks.

Three preferred stocks

	Rec	Current price	Target price	Potential upside/ downside	2011F EV. EBITDA (x)	2011F P/E (x)
Dana Gas	Buy	Dh0.66	Dh0.90	36%	3.9	8.0
Commercial Bank of Qatar	Buy	QR72.50	QR102.40	41%	n/a	9.0
Mobily	Buy	SR52.00	SR76.16	46%	6.2	7.7

Priced at close of business 13 April 2011.
Source: Company data, RBS forecasts

We see attractive investment opportunities across the region

Against a backdrop of political unrest across the region, the GCC-4 countries (Saudi Arabia, Kuwait, Qatar and the UAE) seem relatively stable and in fact benefiting from higher oil prices and a boost in public spending (at least in Saudi Arabia). This, combined with continued strong economic growth in Qatar (GDP +15.7% in 2011, IMF), reasonable growth in other countries in the region (Saudi Arabia +4.5% with upside potential from increased public spending) and a gradual recovery in the UAE, makes stock markets in these countries attractive, in our view, especially following two years of underperformance and given current valuations.

Time to revisit Abu Dhabi and Dubai

The UAE stock markets are some of the cheapest globally, with the economy hit by debt issues in Dubai and a real estate market under pressure. While the country still needs to do a lot to regain investor confidence, we believe this is a good time to revisit investing in Abu Dhabi and Dubai as: 1) we think Dubai's risk is coming down (albeit it still exists - we expect a further decline in UAE house prices in 2011 and about US$31bn of GRE debt due in 2011-12); 2) we might see an upgrade to MSCI emerging market status in June; and 3) the two states' economies should recover gradually in 2011 (GDP +3.3%); 4) the Dubai CDS spread has come down from 455bp at the beginning of March to 370bp currently, suggesting to us the discount rate could come down by up to 1%, thus supporting higher valuations.

Our top picks from a bottom-up perspective

We highlight some of our top Buy recommendations from our coverage universe that also fit into a more top-down macro or sector view. We forecast strong earnings momentum for **Dana Gas** driven by elevated energy prices, capital expenditure recuperation and production growth from new projects. We view a resolution between the Kurdistan Region of Iraq and the Iraqi governments, which would result in payment for ongoing and completed work, as a key catalyst for the stock. **Mobily** is in a strong position to benefit from the overall telecoms growth in Saudi Arabia and we consider it ahead of the curve in terms of its broadband ambitions relative to its peers, but it is still trading at an unjustified (in our view) discount to its peers on our 2011F PE. **Commercial Bank of Qatar** has one of the strongest commercial banking platforms in the Middle East and should be a beneficiary of the substantial volumes of infrastructure spending in Qatar going forward. In our view, the current valuation does not reflect the company's earnings potential.

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Diversity across the region

Although 2011 is likely to be overshadowed by the region's crisis, we note some good news from higher oil prices for the GCC countries and recovering economies. We see the UAE and Qatar as safe havens in a landscape of turmoil.

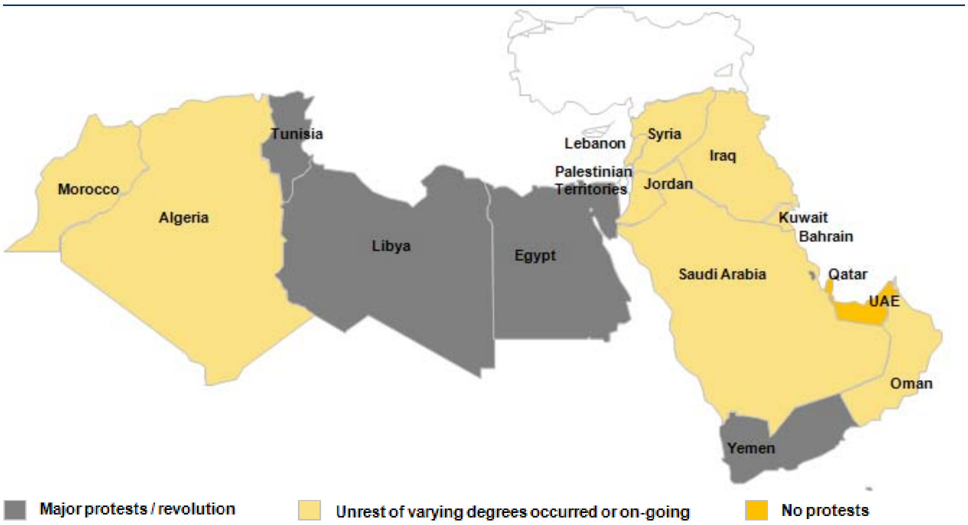
Revolution domino effect

GCC countries likely to benefit from the turmoil and higher oil prices

Following the regime changes in Tunisia and Egypt, revolts and protests continue in Libya, Yemen and (increasingly) Syria. In the Gulf, there has been unrest in Bahrain and Oman in particular and to a lesser extent in Saudi Arabia and Kuwait, but the latter two have given socio-economic benefit packages to the population in an attempt to avoid an escalation of the unrest. In the case of Saudi Arabia, these incentives have been large and we believe the prospect of a political crisis in the country is low.

The GCC-4 countries (Saudi Arabia, UAE, Qatar and Kuwait) are now relatively quiet, in particular, Qatar and the UAE, where no demonstrations have occurred to date. On the contrary, their hydrocarbon-driven economies should benefit from a rising oil price per barrel and it seems some sectors in Dubai have received a short-term shot in the arm, such as a larger number of tourists that would otherwise have gone to Tunisia and Egypt. It is possible that Dubai and Qatar could receive a boost in the number of entrants to their tax-free, independently regulated financial centres.

Figure 1 : Unrest has spread across the region from December 2010 to date



Source: Rasmala

Gap between rich and poor countries widening, Qatar and UAE seen as safe havens

Against this political backdrop, we believe there are still attractive investment opportunities across the region. However, the region's crisis has not only taken its toll on the stock markets in 2Q11, but has also resulted in a widening of the economic gap between the Mena region's poor and rich countries:

- On the one hand, the oil-rich GCC countries, where hydrocarbons have represented 66-86% of GDP average from 2000-09, according to the IMF, are benefiting from a higher oil price, amidst relative political stability, and economic growth should benefit from higher spending by governments to appease the population (in particular, Saudi Arabia).
- On the other hand, most North African and Levant countries, which are net importers of oil and/or food (Egypt, Jordan, Syria, Tunisia, Lebanon and Morocco are net oil importers), tend to be poorer than the oil-driven economies in the region (see the next table) and unemployment rates are high. These countries suffer from the higher commodity prices and/or political instability, affecting economic growth. Furthermore, the events in Egypt and Tunisia have resulted in a delay in investments into these countries.

Table 1 : Mena statistics, 2010

Country / Territory	Population	GDP/capita (US$)	Unemployment rate	Urbanisation	Population growth (2010-2015)
Egypt	79,781,000	2,789	9.7%	43%	2.0%
Iran	75,078,000	4,741	14.6%	71%	1.7%
Sudan	43,192,000	1,705	13.7%	40%	2.6%
Algeria	34,300,000	4,435	9.9%	66%	1.5%
Morocco	32,060,000	3,249	9.8%	58%	1.0%
Iraq	31,467,000	2,564	15.3%	66%	2.3%
Saudi Arabia	27,136,977	16,996	10.8%	82%	2.1%
Yemen**	22,492,035	1,282	15.7%	32%	3.0%
Syria	20,926,000	2,877	8.3%	56%	2.5%
Tunisia	10,439,600	4,200	14.0%	67%	1.0%
Libya **	6,546,000	11,314	20.7%	78%	n/a
Jordan	6,472,000	4,500	13.4%	79%	2.3%
United Arab Emirates**	4,707,000	59,717	4.2%	84%	3.0%
Lebanon	4,255,000	10,044	7.0%	87%	1.3%
Palestinian territories*	3,935,249	1,485	25.7%	72%	n/a
Kuwait	3,051,000	36,412	3.1%	98%	2.0%
Oman	2,694,094	18,657	n/a	73%	3.2%
Qatar	1,696,563	76,168	0.5%	96%	4.0%
Bahrain	807,000	20,475	3.6%	89%	2.0%

*Palestinian territories data as of 2008
**Unemployment rate for UAE, Yemen, Libya as of 2009
Source: CIA, IMF, Government Statistics

Enough positive factors, but sufficient to make markets more attractive to foreign investors?

In this note, we highlight a number of positive factors that should benefit some of the regional stock markets, in particular the ones in the GCC: 1) return to economic growth in the GCC; 2) higher commodity prices; 3) a possible upgrade of the UAE and Qatar to emerging markets status from frontier market status and 4) a boost in public sector infrastructure spending.

Outside the GCC, we still see attractive investment opportunities in Egypt, which still faces many political and economic challenges. However, as we discuss in our previous note on Egypt ('*Egypt – the challenge*', 21 February 20110), if the country makes the right decisions, we believe Egypt could well end up with a structurally stronger economy, and an even more interesting place for FDI and capital market investors than before.

Higher commodity prices support the GCC countries

Higher oil prices give a boost to GCC-4... for now

The recent sharp increase in prices of commodities such as oil, petrochemicals, grains and steel (oil and petrochemical prices in particular), is positive for the Gulf countries predominantly. However, Egypt and other countries continue to suffer high inflation as a result, and it remains to be seen how sustainable higher oil prices are when they start affecting global growth and, hence, demand. In the meantime, higher oil prices will help Saudi Arabia to fund its spending spree (announced in March) and according to press articles, the Institute of International Finance (IIF) recently estimated that the fiscal breakeven oil price for the country could go up to US$115/bbl. The higher petrochemical prices are also supportive for the Saudi petrochemical industry, which constitutes more than 30% of the Tadawul Index.

Economic growth good, but not that exciting in a global perspective

GCC economic growth from a global perspective looks generally positive – higher than developed markets, but below growth in China and India – with the exception of Qatar, which is still boosted by LNG expansions. The IMF forecasts real GDP growth of 15.7% for Qatar in 2011, 4.5% for Saudi Arabia and 3.3% for the UAE, all in all a significant improvement on 2010. Fundamentals for the region are still looking positive: governments in the GCC are still committed to diversification of the economies (and oil prices are at supportive levels for this), and the resulting large amounts of public spending remain a strong driver for economic growth. In the GCC, government spending has been a key driver to get economic growth back on track in 2010.

Economic growth also boosted by continued public infrastructure spending

Construction market has been lacklustre, but expansion of necessary infrastructure continues

However, despite these commitments, new contract awards in the past two years have been lacklustre. Whereas construction (real estate) spending was down sharply in 2010, investments in the industrial, metals, gas production, petrochemicals, power and water sectors were all stable or actually up on the previous year. Saudi Arabia is now the largest market for projects planned or under way (worth about US$664bn, according to MEED Projects), and the latest announcements on further spending will likely lift these figures. The UAE is still large (US$638bn), whereas Qatar follows in third place at US$227bn. The recently announced Qatar National Development Strategy 2011-2016, a detailed document highlighting many aspects for Qatar's future development, confirms Qatar's ambitious spending plans, but the large amounts of government expenditure that the press has highlighted are already mostly included in projects planned. In countries outside the GCC, where political unrest dominates, many projects are likely to be cancelled or delayed.

Time to revisit Abu Dhabi and Dubai

Risk is still there, but another look at the UAE is worthwhile

The UAE stock markets are among the cheapest globally, but the country still needs to do a lot to regain investor confidence. Nevertheless, we believe that with Dubai risk decreasing (but remaining with a real estate market still under pressure and US$31bn of GRE debt due over 2011-2012) and the possible upgrade to MSCI emerging market from frontier market status in June and a gradual recovery in the economy in 2011, this appears to be a good time to revisit investing in Abu Dhabi and Dubai. Also, the Dubai CDS spread has come down from a recent high of about 455bp at the beginning of March to 370bp currently, which suggests the discount rate could come down by as much as 1%, thus boosting valuations. Our Buy recommendations in the UAE are Dana Gas, Abu Dhabi Islamic Bank, First Gulf Bank, National Bank of Abu Dhabi, Drake & Skull, Emaar and Etisalat.

Upgrade of Qatar and the UAE to emerging market status would be a positive

Upgrade could be beneficial for the whole region

Both Qatar and the UAE are one step closer to MSCI upgrade: the Abu Dhabi and Dubai stock exchanges are moving to a 'delivery versus payment' settlement mechanism on 28 April, following Qatar on 11 April. This is a key requirement to be upgraded to secondary emerging market status by MSCI. The upgrade could be a major boost, as it will help make the stock markets more attractive to institutional investors, lift trading volumes and lower investors' risk perception of the exchanges. However, the country still needs to improve regulations and lift restrictions on foreign ownership of listed stocks (UAE up to 49%, Qatar 25% of freefloat). Our Buy recommendations in Qatar are Commercial Bank of Qatar, Qatar National Bank, Qatar Telecom and Vodafone Qatar.

Currently, there are only two Mena countries from the region in the MSCI EM Index (Egypt and Morocco); two more will improve investor's appetite for the region, in our view, particularly in light of the current political unrest. Headlines on Dubai's fortunes and misfortunes over the past few years, despite its relatively small size in terms of both the stock market and the economy, have dominated the press. On another note, it is possible the MSCI may give Syria and Iraq frontier market status, which would be another positive development, in our view.

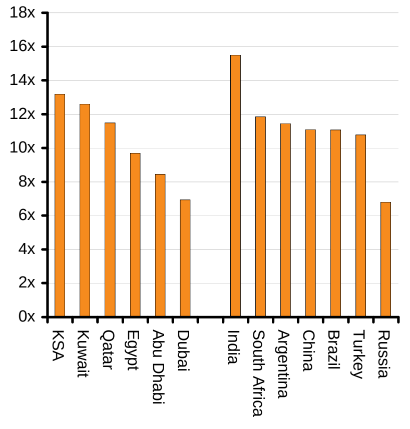
Valuation

Attractive valuations

Comparing market 2011F P/E ratios to other emerging markets, most of the Mena markets look relatively attractive, particularly Qatar and Saudi Arabia given the rosy outlook for their economies and earnings growth. However, the UAE markets remain among the cheapest markets globally at 8.5x and 6.9x respectively, based on Bloomberg consensus estimates. Following consensus downgrades, Egypt is now trading at 9.7x, not necessarily cheap in relation to more stable comparable countries such as Turkey at 10.8x.

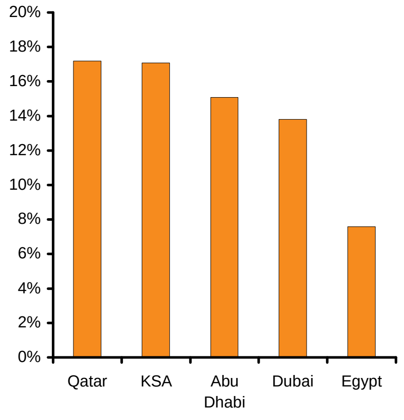
Consensus Bloomberg forecasts suggest strong EPS growth, particularly in Qatar and Saudi Arabia, but also for the UAE, supporting a recovery in valuation for the latter in particular. As expected, consensus EPS growth for Egypt has come down from 20%-plus last month to currently c8% and we see further downside here.

Chart 1 : Consensus global PE ratios, FY11



Source: Bloomberg

Chart 2 : Consensus EPS growth, FY11



Source :Bloomberg

Headwinds and key risks to investing in the Mena region

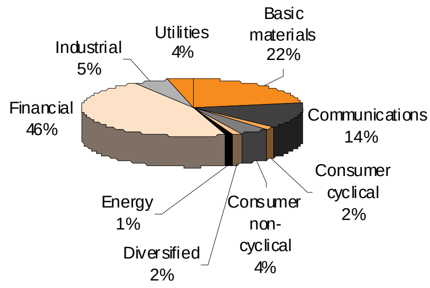
Despite some positive fundamentals that should make the region attractive for investors, we see a number of risks:

- The political situation in the GCC-4 seems stable, but any escalation in Saudi Arabia, in particular, would be detrimental to the investment case.
- Dubai is not out of the woods yet: the real estate market needs more time to recover and the amount of debt due by GREs in Dubai amounts to US$31bn for 2011-12, according to the IMF.
- Debt levels are high, in particular in the real estate sector, which could lead to rights issues and other forms of capital increases.
- The IPO market has been lacklustre over the past year and few new IPOs have been announced. Currently, some of the markets are heavily skewed towards financials and real estate, and diversification would help the investor appetite.
- Following the sharp fall in trading volumes, liquidity in some of the markets is low. Upgrades of the UAE and Qatar markets to emerging market status would help.

View on key sectors and preferred stocks

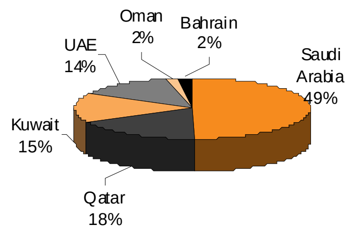
Out of our coverage universe across the Mena region, we highlight Dana Gas (UAE), CBQ (Qatar) and Mobily (Saudi Arabia) as key Buy recommendations, with potential upside based on valuation and near-term catalysts.

Chart 3 : Bloomberg GCC 200 Index, split by sector*



* % of total market cap, as at close of 13 April 2011.
Source: Bloomberg

Chart 4 : Bloomberg GCC 200 Index, split by country*



* % of total market cap, as at close of 13 April 2011.
Source: Bloomberg

Financials (including real estate), telecoms and petrochemicals are key sectors in the region. In the GCC, these sectors account for about 83% of the Bloomberg GCC200 Index. We discuss our view on specific sectors below.

Qatari banks – a rosy outlook, but some hurdles

Public sector spending the main driver of loan growth

Things are certainly quite rosy for the Qatari banks at the moment. Public sector spending is expected to push loan growth above 20% for much of the next five years and with this as a backdrop competition is likely to be limited and profitability should be high. It is not all positive though, particularly for those banks less-exposed to public sector expansion failing to benefit from the current expansionary fever. In addition, regulatory volatility has taken its toll. Islamic lending for conventional banks was recently banned, and the conventional banks have aimed to convert or replace these Islamic loans with conventional ones. In addition, there have been two major reviews of retail lending. The first limited the amount and scope of retail lending, the second constrained this further and imposed limits on pricing. Finally there has been significant intervention in the balance sheets of the banks, with capital being injected into the banks, but with liquidity being removed. All this amounts to significant volatility in the banking landscape. Overall though, it is the strong growth potential which is driving valuations, and ultimately, it will be the sustainability of that growth that drives further progress.

UAE banks – lack of return to growth already reflected in valuations

Gradual recovery

The UAE banking sector has had a slow dawn emerging for much of the last two years. We expected a clean-up of the balance sheet in late 2010, and this has been delayed. Nevertheless, a resolution of the big issues – Dubai-related GREs – by 3Q11 looks realistic. At the same time, the banking sector has been addressing the issue of its liquidity shortage gradually, with the banking sector as a whole moving into liquidity surplus around the year end. Now, the banks are beginning to ease liquidity constraints, and are moving back to making progress on lending. However, we have yet to see whether there is demand, beyond the public sector. In contrast to Qatar, public sector related lending has not taken off, perhaps due to more limited public sector spending and that has meant minimal growth. So far, the banks have been happy to focus on rebuilding profitability, and stabilising the balance sheets. However, the lack of growth may be a greater issue going forward. With valuations clustered around 1x BV though, prices well reflect that.

UAE real estate – not out of the woods yet

We expect a further decline in UAE house prices

We believe UAE house prices are likely to decline by an additional 25-30% (nominal terms) after a peak-to-date 45-55% drop largely due to the '3D' challenge of depopulation, deleveraging and deliveries. We believe equity valuations largely account for systemic challenges, but in the absence of significant catalysts – including consolidation, privatisation, banking and immigration reforms – we expect the UAE property sector to remain range-bound in the foreseeable future. Moreover, we believe market valuations and stock performance will be driven first by balance sheet metrics and second by earnings growth. Companies with higher self-financing capacity and access to capital (with the ability to manage free cash flow within a predictable and consistent range), and diversified revenue streams will likely drive market premiums, and lead in both fundamental and risk-driven equity rallies.

Mena telecoms – safe haven, investment case for broadband growth intact

Broadband to drive growth in telecoms sector

We maintain that broadband demand will continue to drive the region's telecommunications sector growth. This is because most of the countries that we expect to witness the 'sweet spot' in broadband penetration are essentially oil-driven economies that have either low or moderate exposure to the political rebellion in the area. In the short term, we believe the environment favours defensive sectors, particularly telecoms. We also believe the telecommunications sector in the Mena region provides one of the safest havens in light of current and ongoing events, owing to the mass population's increasing awareness of the Internet's power as a tool for communication and the inherent, defensive nature of the industry.

For Egypt in particular, we also see strong investment opportunities in the telecoms sector (for a more in-depth analysis of the impact of the revolution on the Egyptian economy, see our notes '*Egypt – Implications of the turmoil'*, 1 February 2011, and '*Egypt – The challenge*', 21 February 20110) owing to:

- the population's increasing awareness of the internet's power as a tool for communication (Facebook was the underlying application behind the rise of the Egyptian revolution);
- the fact that none of the major shareholders of the existing Egyptian telecoms companies have been implicated to have had ties with the former regime;
- the inherent, defensive nature of the industry; and
- the average dividend yield for both Telecom Egypt and Mobinil of about 7.5% on their respective last closing prices, which looks attractive to us and would become more attractive if share prices were to fall further.

Key stock recommendations

Dana Gas (Buy, TP AED0.90)

High oil price beneficial to Dana Gas

Dana Gas is the only listed oil and gas company in the Mena region with exploration concessions in Egypt and Iraq. It offers energy asset exposure in a period of inflated energy prices and to a region with some of the world's largest energy reserves. We forecast strong earnings momentum in 1Q 2011 and over the next 24 months, driven by elevated energy prices, capital expenditure recuperation in both Egypt and Iraq, and production growth as planned projects are brought on-stream. The key catalyst for the stock, in our view, is a resolution between the Kurdistan Region of Iraq and the Iraqi governments which would result in payment for ongoing work and work completed. They key risk to our thesis is continued non-payment in Kurdistan which, over the longer term, may result in key asset sales or an equity issuance.

Commercial Bank of Qatar (Buy, TP QR102.4)

CBQ has the right platform to benefit from infrastructure spending

So far, CBQ has not been the primary beneficiary of public sector lending, which, together with the fallout from the Islamic Banking laws, has pushed the company into a discount valuation. Nevertheless, with one of the strongest commercial banking platforms in the Middle East and the strength to take its share of public sector business, we believe it should be a beneficiary of the substantial volume of infrastructure spending going forward. Profitability is challenged by low levels of gearing in the short term, but we believe the bank's deal structuring capability should stand it in good stead. We expect returns to improve over time, particularly if the two large associates are spun off, or more fully integrated. We believe the discount valuation does not reflect the earnings potential.

Mobily (Buy, TP SR76.16)

Strong growth at discount valuation

Given our growth expectations for data demand in the region, we believe Mobily is in a strong position to benefit from the overall telecoms growth in Saudi Arabia. Furthermore, we consider it ahead of the curve in terms of its broadband ambitions relative to its peers. We forecast an 11% EPS CAGR for 2011-15 and, based on our forecasts, we see upside potential of about 46% for Mobily. Furthermore, the stock is trading favourably compared to its peers, at a discount of about 40% on our 2011F PE.

Table 2 : Current stock coverage recommendations and target prices

Stock	Country	Ticker	Sector	Rating	Curr	Current price	Target price	Up/ downside	EV/ EBITDA 2011F (x)	P/E 2011F (x)
Abu Dhabi Islamic Bank	UAE	ADIB UH	Financials	Buy	AED	3.07	3.65	19%	n/a	6.3
ADCB	UAE	ADCB UH	Financials	Hold	AED	2.61	2.32	-11%	n/a	8.2
Aldar	UAE	ALDAR UH	Real Estate	Hold	AED	1.60	1.40	-13%	16.0	3.8
Arabtec	UAE	ARTC UH	Construction	Hold	AED	1.51	1.45	-4%	3.9	8.9
Dana Gas	UAE	DANA UH	Oil & Gas	Buy	AED	0.66	0.90	36%	4.4	7.3
Drake & Scull	UAE	DSI UH	Construction	Buy	AED	1.08	1.10	2%	8.0	10.8
Du	UAE	DU UH	Telecoms	Hold	AED	3.16	2.86	-9%	6.7	21.1
Dubai Islamic Bank	UAE	DIB UH	Financials	Sell	AED	2.16	2.04	-6%	n/a	7.7
Emaar	UAE	EMAAR UH	Real Estate	Buy	AED	3.32	3.10	-7%	9.8	8.7
Emirates NBD	UAE	EMIRATES UH	Financials	Hold	AED	3.65	3.41	-7%	n/a	5.7
Etisalat	UAE	ETISALAT UH	Telecoms	Buy	AED	10.35	12.89	25%	8.3	11.8
First Gulf Bank	UAE	FGB UH	Financials	Buy	AED	17.50	18.78	7%	n/a	6.1
NBAD	UAE	NBAD UH	Financials	Buy	AED	11.05	13.20	19%	n/a	6.3
Sorouh	UAE	SOROUH UH	Real Estate	Hold	AED	1.39	1.15	-17%	10.6	9.9
Mobily	Saudi Arabia	EEC AB	Telecoms	Buy	SR	52.00	76.16	46%	6.2	7.7
National Shipping Co of Saudi Arabia	Saudi Arabia	NSCSA AB	Shipping	Hold	SR	14.90	16.33	10%	11.0	20.4
Zain Saudi	Saudi Arabia	ZAINKSA AB	Telecoms	Sell	SR	7.00	7.75	11%	50.7	n/a
Commercial Bank of Qatar	Qatar	CBQK QD	Financials	Buy	QR	72.50	102.40	41%	n/a	9.0
Doha Bank	Qatar	DHBK QD	Financials	Hold	QR	53.20	63.33	19%	n/a	9.0
Nakilat	Qatar	QGTS QD	Shipping	Hold	QR	19.58	18.50	-6%	12.4	12.0
Qatar Islamic Bank	Qatar	QIBK QD	Financials	Hold	QR	83.60	86.62	4%	n/a	12.3
Qatar National Bank	Qatar	QNBK QD	Financials	Buy	QR	149.40	161.14	8%	n/a	10.7
Qatar Telecom	Qatar	QTEL QD	Telecoms	Buy	QR	150.00	187.58	25%	4.8	9.4
Vodafone Qatar	Qatar	VFQS QD	Telecoms	Buy	QR	8.07	8.86	10%	n/a	n/a
Wataniya	Kuwait	NMTC KK	Telecoms	Buy	KWD	1.82	2.10	15%	3.8	11.4
Jordan Telecom	Jordan	JTEL JR	Telecoms	Sell	JOD	5.70	5.09	-11%	6.9	16.3
Nawras	Oman	NWRS OM	Telecoms	Buy	RO	0.76	0.83	9%	4.8	8.5
Omantel	Oman	OTEL OM	Telecoms	Hold	RO	1.11	1.21	9%	4.1	8.5
Mobinil	Egypt	EMOB EY	Telecoms	Buy	EGP	140.64	172.02	22%	5.3	13.7
Telecom Egypt	Egypt	ETEL EY	Telecoms	Buy	EGP	17.01	20.15	18%	5.1	9.6

Priced at close of business 13 April 2011.
Source: Company data, Rasmala forecasts

Markets have suffered from regional unrest

Mena markets generally underperformed global markets in 2010 and this trend continued into 2011 as a result of the region's crisis. Following a drop in trading volumes in 2009 and again in 2010, 1Q 2011 volumes increased, but driven by only Qatar and Saudi Arabia.

Mena markets were out of favour in 2010

The year 2010 was bad for Mena equities. A more positive macroeconomic backdrop of a recovery in growth and higher oil prices could not offset global concerns about economic recovery and European sovereign debt. This was exacerbated by regional concerns regarding debt restructurings, sharply deteriorating real estate markets, corporate governance unease and liquidity. All Mena markets, except Qatar (+25% in 2010), Morocco (+21%) and Tunisia (+19%) underperformed global emerging markets in 2010 – the MSCI Emerging Markets Index increased by 16%, the S&P500 by 13% and the FTSE100 by 9%. Even Qatar's performance was lacklustre until the country won the bid to host the 2022 World Cup at the back-end of last year.

The region's crisis taking its toll in 2011

As a result of the unrest in the region, ytd performance has been even worse, with all stock markets in the region down. So far this year, the Egyptian EGX 30 is down 23%, making Egypt the worst performing market. The best performing markets ytd are Saudi Arabia (-0.7%) and Qatar (-1%).

Average traded volumes were down 40% in both 2009 and 2010, but the biggest drops were on the UAE stock markets, with the DFM down 60% and the ADX 50% in 2010. The good news is that volumes are up by an average 21% in 1Q 2011, but driven mainly by Saudi Arabia and Qatar, whereas volumes in Dubai, Abu Dhabi and Kuwait have been down once again.

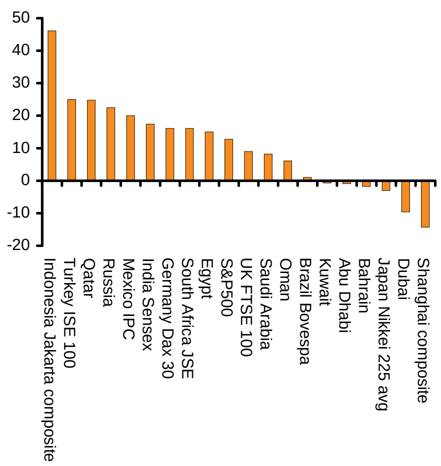
IPO activity has been very low and recent interest has been more on the debt capital market side than in equity capital markets. Nawras was the biggest offering during the year, at just under US$500m. Axiom would have been the first IPO in the UAE in two years, but was cancelled because of concerns about market conditions.

Table 3 : Average daily traded volumes for major Mena markets and % change, US$m

Market	2008	2009	2010	1Q 2011	2009	2010	1Q 2011
Saudi Arabia	2,074	1,348	813	1,102	-35%	-40%	36%
Egypt	274	195	142	167	-29%	-27%	18%
Kuwait	540	307	178	122	-43%	-42%	-31%
Qatar	184	100	74	128	-46%	-26%	73%
Dubai	338	189	76	46	-44%	-60%	-39%
Abu Dhabi	254	76	38	32	-70%	-50%	-16%
Oman	40	23	13	17	-43%	-43%	31%
Total	**3,704**	**2,238**	**1,334**	**1,614**	**-40%**	**-40%**	**21%**

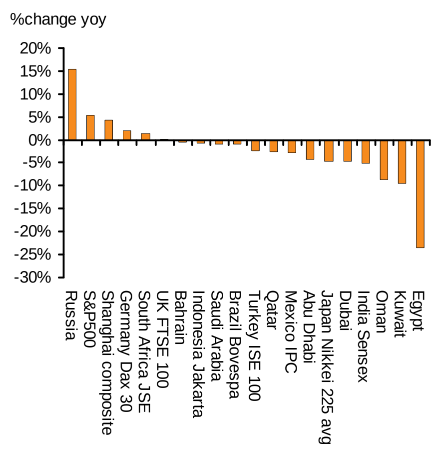
Source: Bloomberg

Chart 5 : Stock market performance, 2010



Source: Bloomberg

Chart 6 : Stock market performance 1Q



Source: Bloomberg

Infrastructure spend – another boost?

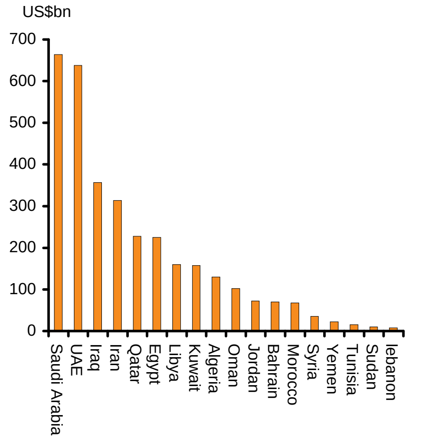
Infrastructure spending remains a large driver for long-term economic growth, as governments are committed to economic diversification. However, new contract awards in 2010 have been lacklustre and in Egypt, we believe some projects will be delayed.

In the GCC, government spending has been a key driver to get economic growth back on track in 2010. Whereas construction (real estate) spending was down sharply, investments in the industrial, metal, gas production, petrochemicals, power and water sectors were all stable or up on the previous year.

Saudi Arabia and the UAE are the largest construction markets in the region

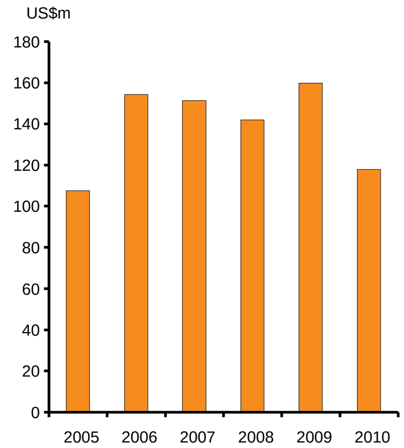
Saudi Arabia is now the largest market for projects planned or underway (about US$664bn according to MEED Projects) and the latest announcements on further spending will likely lift these figures. The UAE is still a large market (US$638bn), whereas Qatar follows in third place at US$227bn. The recently announced Qatar National Development Strategy 2011-2016 document highlights many aspects of Qatar's planned development. However, the large amounts of government expenditure that the press has highlighted are already mostly included in projects planned, whereas the economic impact of investments for the FIFA World Cup 2022 is likely to be modest over the 2011-2016 period. Egypt is also significant in terms of projects planned or underway, but some of these may be delayed as a result of the recent developments in the country. However, we believe Egypt will ramp up infrastructure spending as a means of giving something to the people.

Chart 7 : Projects planned or underway in the Mena region



Source: MEED Projects

Chart 8 : New contact awards in the GCC



Source: MEED Projects

Qatar National Development Strategy 2011-16

Recently, Qatar published its strategy for the next five years, the Qatar National Development Strategy 2011-2016 (QNDS). The report looks at four pillars of Qatar's National Vision 2030, focused on human, social, economic and environmental development. One of the features that attracted most media attention was Qatar's spending plan of QAR820bn (US$225bn) for 2011-2016, half of which might come from the non-hydrocarbon sector. The report estimates that of the QAR820bn, public investment accounts for about QAR347bn.

Play Qatar's infrastructure theme through the banks

While these numbers are large, we note that:1) they include spending on projects already announced (see table below); 2) not the whole amount may materialise, depending on oil prices and other factors; and 3) playing an infrastructure spending theme in the region is not straightforward; the same holds for Qatar, where there are no listed construction companies and there are a limited number of materials companies, so the most obvious way for investors to get exposure to Qatar's spending plans would be through the financials sector.

Table 4 : Qatar major ongoing projects

Project name	Industry	Amount (US$m)
Qatar Railways Development Company – Qatar Rail Network Program	Infrastructure – Railways	42,900
Gulf Cooperation Council – GCC Rail Network	Infrastructure – Railways	30,000
QP – Qatar North Gas Field Development	Oil and Gas – Exploration & Production	20,000
QP/Qatar Shell GTL – Pearl GTL	Oil and Gas – GTL	18,000
UDC – The Pearl Qatar	Real Estate - Community Development	14,000
Qatargas 2 – LNG Complex	Oil and Gas – LNG	12,800
NDIASC – New Doha International Airport	Infrastructure - Airports	11,000
QP/ExxonMobil – Barzan Gas Development	Oil and Gas - Exploration & Production	8,600
The New Doha Port Steering Committee – New Doha Port	Infrastructure – Ports	7,000
QP/Shell – Ras Laffan Petrochemical Complex	Petrochemicals - Olefins & Aromatics	6,000

Source: Zawya

We see the recent announcements as touching the financial service sector directly in four ways: infrastructure and other investment, property market and immigration, SME and Qatar Financial Centre. The most important of these is the investment, in our view, which includes key developments such as infrastructure spend of US$65bn, the largest element of which is likely to be the Metro, real estate projects of QAR100bn, energy projects of QAR88bn and other Q-company projects of QAR30bn, including particularly health and education. All these will need to be financed and, while there was some slack in our forecasts for unidentified investment financing, the scale of projected investment is still above the level we have been anticipating.

The second key element has been the comments about incentivising business and key labour market participants. The result of this is likely to be solid support for immigration, and indirectly this labour market support should have a positive effect on the property market.

Finally, while the ancillary banking areas, such as SME lending, asset management and reinsurance, are unlikely to become primary drivers of business for the banks, the strong support they are given in the document may well suggest greater opportunities in this area, particularly as the GCC searches for its commercial/ financial capital.

Deregulation is more of a double-edged sword. On one hand this is likely to mean greater opportunities for the banks and a lower cost of doing business. On the other, it suggests greater competition as the banking sector has been relatively well protected to date.

Saudi Arabia spending spree

Boost in public spending to appease the population

In response to the spreading of unrest across the Mena region, the Saudi government announced a socio-economic benefit package of SAR140bn (US$37bn) in February, followed by another of SAR350bn in March. Overall, the two packages together amount to about 30% of 2010 GDP.

The first (SAR140bn) package will be used mainly to help lower- and middle-income earners by providing them with affordable housing, unemployment benefits and pay rises to offset inflation. The package also includes an extra allocation of SAR40bn (US$10.7bn) to the Saudi development fund to finance low-income housing and provide other loans.

The second package comprises 21 royal orders, including:

- spending SAR250bn (US$66.7bn) for the construction of 500,000 housing units;
- raising the amount of the upper limit of loans by Real Estate Development Fund from SAR300,000 (US$80,000) to SAR600,000 (US$160,000);
- setting a minimum wage for all categories of Saudi workers to SAR3,000 (US$800) per month;
- payment of SAR2,000 (US$534) per month for job seekers in the public and private sectors;
- providing SAR16bn (US$4.3bn) to the Ministry of Health to implement and expand several medical projects; and
- creating 60,000 military jobs for the Ministry of Interior.

Table 5 : Saudi Arabia major ongoing projects

Project	Industry	Amount (US$m)
Modon – Sudair Industrial City	Real Estate – Industrial Zones	40,000
Gulf Cooperation Council – GCC Rail Network	Infrastructure – Railways	30,000
KHC – Kingdom City	Real Estate – Community Development	27,000
SAGIA – Jazan Economic City	Real Estate – Free Zones/Economic Zones	27,000
SAGIA – King Abdullah Economic City (KAEC)	Real Estate – Free Zones/Economic Zones	27,000
SAGIA – Ras Al Zour Economic City	Real Estate – Free Zones/Economic Zones	25,000
Aramco/Dow Chemical – Petrochemicals Complex	Petrochemicals – Olefins & Aromatics	20,000
Modon – Jazan Industrial City	Real Estate – Industrial Zones	17,000
Saudi Kayan – Jubail Petrochemicals Complex	Petrochemicals – Olefins & Aromatics	12,500
Modon – Sudair Industrial City	Real Estate – Industrial Zones	40,000

Source: Zawya

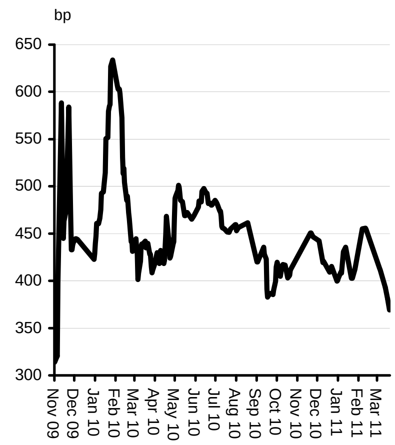
Time to look at the UAE again

We believe that with Dubai risk coming down, the possible upgrade to MSCI emerging market status in June and a gradual recovery in the economy in 2011, this is a good time to revisit investment in the UAE stock markets.

UAE markets should be at a discount to global markets

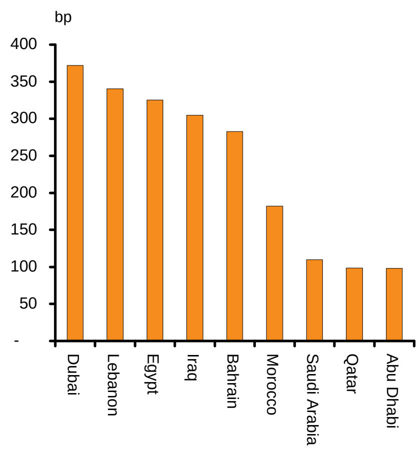
- The Abu Dhabi and Dubai stock markets are justifiably some of the cheapest globally, in our view, given the GRE debt in Dubai and slumping real estate markets in both Emirates. There are still enough reasons to keep the markets at a discount to other emerging markets:
- The real estate markets (in both Dubai and Abu Dhabi) are still suffering from oversupply, making any significant recovery in selling prices and rents unlikely.
- Uncertainty about debt in Dubai's GREs other than Dubai World is high: the IMF estimates that US$31bn of debt is due in 2011-12, including US$5bn in the real estate sector.
- The current unrest in the Mena region could dampen the outlook for the UAE.
- CDS spreads have come down for Dubai, which we believe is justified given the greater visibility on Dubai's debt restructuring, but are still among the highest globally at about 370bp.

Chart 9 : Dubai 5yr CDS – Dubai now perceived as less risky…



Source: Bloomberg

Chart 10 : ... but still the highest in the region*



* As at 13 April 2011.
Source: Bloomberg

However, some rerating justified

However, we believe there are enough positive indications that it could be time to revisit investing in the UAE, as we consider some rerating is justified:

- The Nakheel recapitalisation plan is a positive step forward.
- The lower Dubai CDS spread should result in lower discount rates for the market of about 1%, which should in turn lead to higher valuations for listed stocks.
- The economy is recovering gradually: the IMF expects 3.3% real GDP growth in 2011, with non-oil real GDP growth recovering from 2.2% growth in 2010 and 3.3% in 2011. Not all sectors are performing well yet, in particular real estate and construction, but other crucial sectors for Dubai such as trade have been recovering, tourism numbers are up and air traffic continues to post double-digit growth in passenger numbers.
- Investments have come down in the country, but Abu Dhabi is still one of the largest spenders on infrastructure in the region.
- One step closer to MSCI upgrade: The Abu Dhabi and Dubai stock exchanges are moving to a 'delivery versus payment' settlement mechanism on 28 April, which is a key requirement to be upgraded to secondary emerging market status by MSCI, from frontier market status currently. This could be a major boost, as it will help make the stock markets more attractive to institutional investors, lift trading volumes and lower investors' risk perception of the

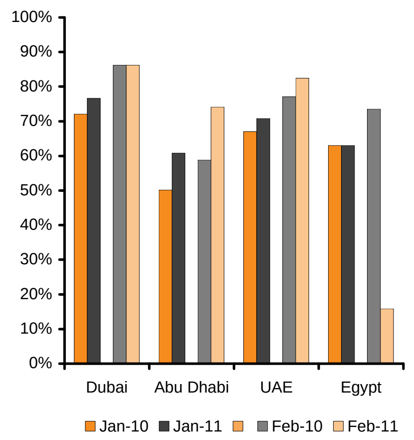
exchanges. However, the country still needs to improve regulations and lift restrictions on foreign ownership of listed stocks.

- Bloomberg consensus forecasts for Dubai and Abu Dhabi suggest EPS growth of 14% and 15% for 2011, and 17% and 12% for 2012, respectively. Consensus forecasts in the region are notoriously unreliable, but even lower growth than predicted makes the markets look cheap at a 2011 consensus P/E of 6.9x and 8.5x respectively, especially when economic growth forecasts give support to earnings growth.

Dubai has historically benefited from misfortunes in other countries in the region. It seems this year has not been different, and the current unrest sweeping around the region provides Dubai with a period of opportunity. But as we see this as a short term phenomenon; there will be a need for political stability and investor confidence in the region to make this sustainable for the longer term.

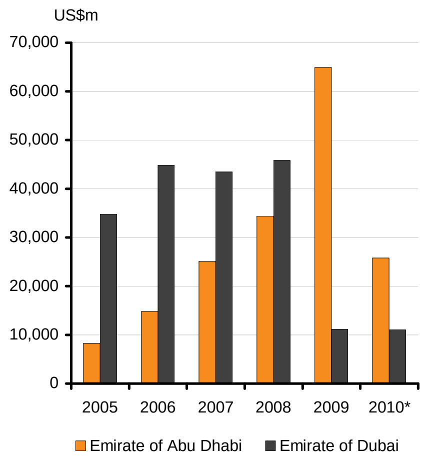
In the key tourism sector for Dubai, January and February hotel occupancy has been the highest in the region, and higher than in the same period last year, despite an increase of almost 8,000 new rooms over the past year, benefiting from the slump in tourism in Egypt and Tunisia. RevPars also increased by 2.7% to US$178, also the highest in the region. Similarly, occupancy rates in Abu Dhabi showed the strongest improvement from 27.3% to 74.1% in February 2011. Unsurprisingly, hotel occupancy rates in Egypt fell almost 80% in February 2011 compared with the same month last year, to about 16% according to STR Global.

Chart 11 : Hotel occupancy rates



Source: STR Global, Rasmala

Chart 12 : New contract awards in Abu Dhabi and Dubai



* As at November 2010.
Source: MEED

Summary of Nakheel's recapitalisation plan

In late March, the Government of Dubai proposed a recapitalisation plan for Dubai World and Nakheel's debt and liabilities: if agreement with creditors can be reached, the Government of Dubai, through the Dubai Financial Support Fund (DFSF), will commit to providing about US$8bn of new money directly to Nakheel to fund operations and settle liabilities. In addition, the DFSF has proposed to convert its existing US$1.2bn debt claim in Nakheel into equity. Ahead of a final agreement on the recapitalisation plan, an initial US$1.5bn of the new funds from the DFSF will be made available as required to Nakheel to fund contractors to continue building near-term development projects.

- Nakheel will use a significant proportion of the funds provided by the DFSF to complete the construction of near-term projects.

- Trade creditors (contractors and suppliers) will be offered 100% recovery of their agreed claims, 40% through a cash payment and 60% in the form of a publicly tradable security at a commercial rate. Each of Nakheel's individual trade creditors will receive a cash payment of up to AED500,000, which means that half of the contractors by number will have their balances settled in full.

- Financial creditors:1) secured bank creditors will receive 100% of principal and accrued interest or profits through a rollover and maturity extension on existing facilities, based on

EIBOR/LIBOR; 2) the 2010 and 2011 Nakheel Sukuk will be paid as they fall due; 3) unsecured bank creditors will receive 100% of principal and accrued interest or profits through a new debt facility with any existing third party credit support remaining in place.

Real GDP growth is recovering gradually

Non-oil GDP recovering

In 2010, the IMF estimates that the UAE's real GDP rose 3.2%, recovering from a 3.2% drop in 2009, the result of a drop in oil prices, the international financial crisis and the significant fall in real estate prices. For 2011, the IMF expects a further gradual recovery of 3.3%, with non-oil GDP growth improving from 2.1% growth in 2010 to 3.3% in 2011 on the back of strong tourism, logistics and trade (with Asia) for Dubai (benefiting from its leading position as a regional hub), as well as large public investment spending in Abu Dhabi. Inflation should remain moderate at c4.5% in 2011, where lower rents should somewhat offset an increase in food prices. Higher oil prices are contributing to a marked improvement in the fiscal position and balance of payments (IMF Article IV, March 2011).

GRE debt is still high

The IMF also highlights a number of risks, including: 1) the large overhang of supply (and uncertainty about the actual size) in the real estate market remains a drag on the economy and will continue to weigh on property prices, investment and growth. 2) Uncertainty about debt restructuring needs of other GREs than Dubai World can translate into higher borrowing costs for Dubai; also, Dubai's strategy to use the earnings of the well-performing GREs to finance the underperforming entities may dampen investment and growth. Dubai continues to face significant rollover risks in the short term and estimates that US$31bn of debt is due in 2011-12, including US$5bn in the real estate sector. 3) The unrest in the Mena region could dampen the outlook for Dubai itself, although the IMF recognizes some benefits for the UAE as well.

The successful restructuring of Dubai World's debt has improved market confidence, allowing top-grade Dubai issuers to regain market access.

Commodities: a double-edged sword

Recent sharp increases in commodity prices can be positive for the region, but predominantly in the Gulf countries. Egypt and other countries continue to suffer high inflation as a result of higher grain prices.

Commodities in pictures

Governments need higher oil prices to balance budgets

The higher oil price so far this year may stoke inflation across the globe and trigger a slowdown in economic activity, but certainly helps oil revenues for the major oil exporters in the GCC countries. It also supports the higher level of government spending announced in the wake of the unrest in other countries. In particular Saudi Arabia needs a higher oil price for its ambitious spending plans that the government announced in March. Recently, the IIF estimated Saudi Arabia's break-even oil price at US $88/bbl for 2011, up from cUS$68/bbl in 2010, and potentially US$115/bbl by 2015.

Table 6 : Price movements of major commodities

	1Q 2011 vs 1Q 2010	1Q 2011 vs 4Q 2010
Brent Crude Oil	37%	23%
Natural gas (Henry Hub)	-18%	10%
Steel rebar	31%	13%
Urea	25%	1%
Ethylene	31%	30%
Methanol	38%	17%
Corn	41%	12%
Wheat	38%	9%

Source: Bloomberg

Producers of commodities set to benefit

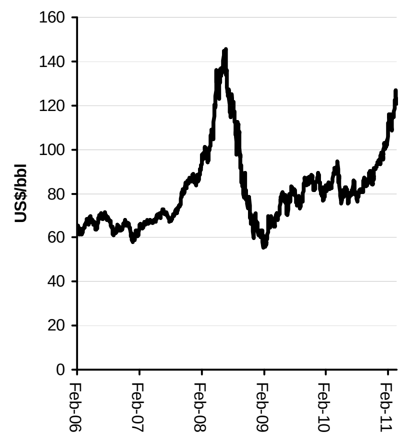
Other commodities have also increased sharply: petrochemicals and fertilizers are of particular relevance for the regional stock markets, as these are increasingly important export commodities for Saudi Arabia and Qatar in particular. The petrochemicals segment constitutes just over 30% of Saudi Arabia's Tadawul All Share Index and more than 20% of the Bloomberg GCC 200 Index (representing the largest and most liquid stocks in the GCC). Ethylene prices have increased by around 30% in 1Q 2011 compared with 1Q and 4Q 2010, whereas urea prices are also up compared with 1Q 2010 (but flat versus 4Q 2010). This should have a direct positive impact on bottom-line earnings for stocks in the sector, given that their cost bases are relatively fixed.

Price increases for basic items have fuelled social unrest

However, the flipside of the coin is that it has also fuelled inflation, and increases in basic items (together with high youth unemployment) have been at the root of the social uprising in Tunisia and Egypt, the latter being the largest wheat importer globally in volume terms.

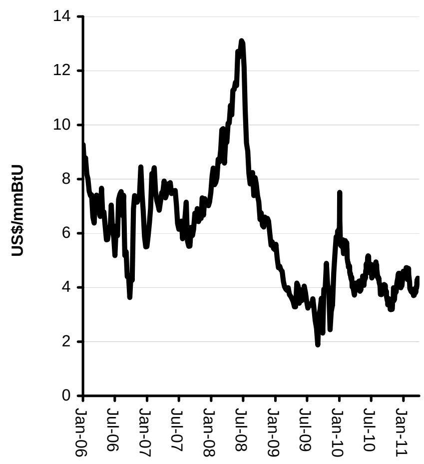
At the end of March, the US Department of Agriculture revealed that inventories of some of the major crops were lower than expected, adding to inflationary pressure around the world. In the year to end of February, corn stocks fell 15%, as demand has been strong in developing countries (China) and for corn-based ethanol in the US. Soybean stocks were down 2%, but wheat stocks increased 5%.The USDA said that the highest prices in 2.5 years were prompting farmers in the US, the world's largest exporter of agricultural commodities, to plan big increases in plantings for corn (+4.5% acres), wheat (+8.2%) and cotton (+15%), but a decrease in soybean acreage of 1%. However, the USDA's extra acreage is unlikely to rebuild stocks to comfortable levels and it expects the current tight supply situation to continue into 2011 and 2012.

Chart 13 : Oil price (Brent)



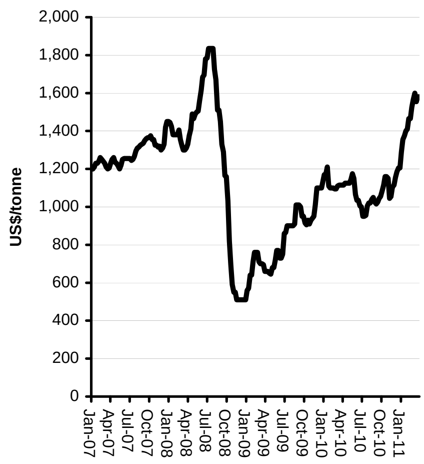
Source: Bloomberg

Chart 14 : Natural gas price (Henry Hub)



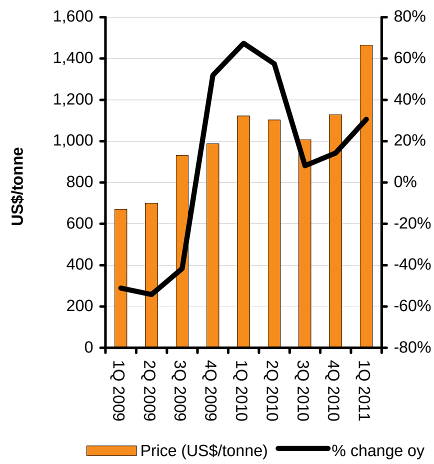
Source: Bloomberg

Chart 15 : Ethylene prices have moved up sharply since its low in 2008



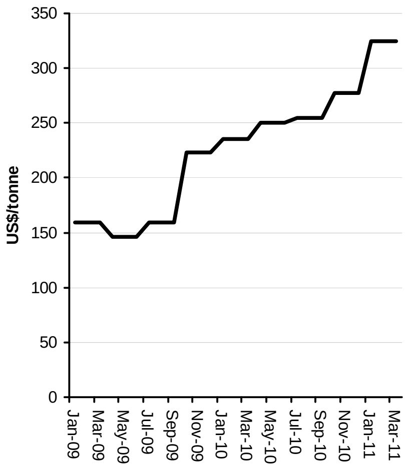
Source: Bloomberg

Chart 16 : The quarterly average ethylene price has risen 31% in 1Q 2011



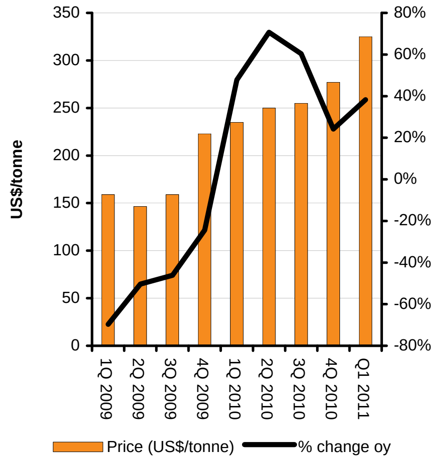
Source: Bloomberg

Chart 17 : Methanol prices continue their upward track



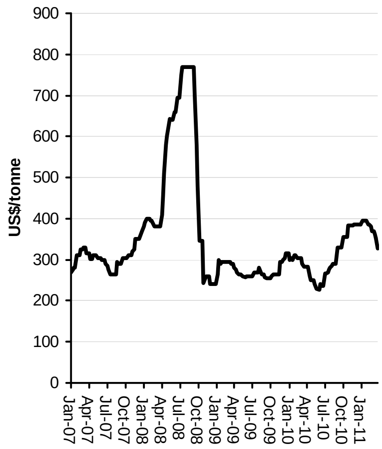
Source: Bloomberg

Chart 18 : Methanol quarterly prices and % change



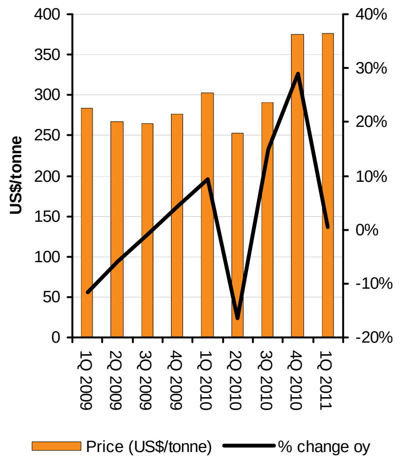
Source: Bloomberg

Chart 19 : Urea Middle East prices have increased 25% versus 1Q10 ...



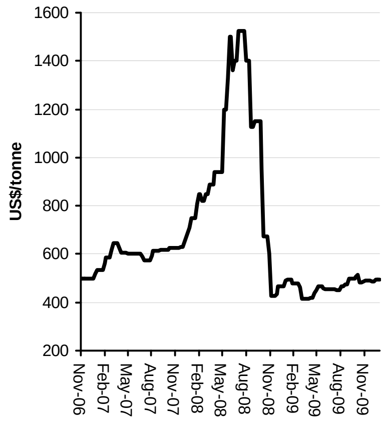
Source: Bloomberg

Chart 20 : ... but are flat against 4Q10



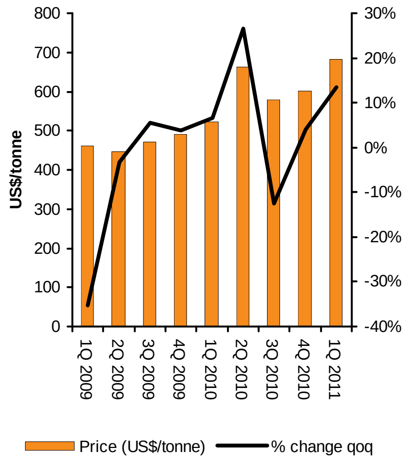
Source: Bloomberg

Chart 21 : Middle East steel rebar prices



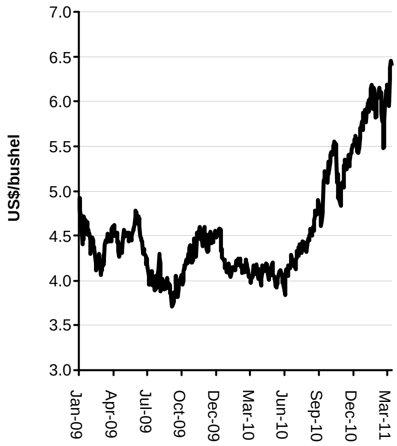
Source: Bloomberg

Chart 22 : Middle East steel rebar prices



Source: Bloomberg

Chart 23 : Corn prices Dec 2011 futures



Source: Bloomberg

Chart 24 : Wheat futures

Source: Bloomberg

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

For a discussion of the valuation methodologies used to derive our price targets and the risks that could impede their achievement, please refer to our latest published research on those stocks at http://research.rbsm.com

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