Global Research

Equity

Kuwait

September 2006

Aerated Concrete Industries Co. - KSC

Venturing into New Businesses...

Global

بيت الاستثمار العالمي

Global Investment House

Global Investment House KSCC
Sector Research
Souk Al-Safat Bldg., 2nd Floor
P.O. Box 28807 Safat
13149 Kuwait
Tel: (965) 240 0551
Fax: (965) 240 0661
Email: research@global.com.kw
http://www.globalinv.net

Global Investment House stock market indices can be accessed
from the Bloomberg page GLOH
and from Reuters Page GLOB

Omar M. El-Quqa, CFA
Executive Vice President
omar@global.com.kw
Phone No:(965) 2400551 Ext.104

Shailesh Dash, CFA
Head of Research
shaileshdash@global.com.kw
Phone No:(965) 2400551 Ext.196

Raghu Sarma
Senior Financial Analyst
rsarma@global.com.kw
Phone No:(965) 2400551 Ext.273

Chandresh Bhatt
Senior Financial Analyst
cbhatt@global.com.kw
Phone No:(965) 2400551 Ext 270

Faisal Hasan, CFA
Senior Financial Analyst
fhasan@global.com.kw
Phone No:(965) 2400551 Ext.304

Table of Contents

Investment Summary 1

Company Background 4

Management 6

Business Overview 7

Industry Overview 12

Growth Strategy 23

Future Growth Drivers 24

Financial Performance 26

SWOT Analysis 29

Valuation & Recommendation 31

Aerated Concrete Industries Company - KSC

Initial Research Report

Reuters Code
ACIC.KW

September, 2006

Listing
Kuwait Stock Exchange

Recommendation
BUY

Current Price (As on September 2, 2006)
KD 0.500

Investment Summary

- Aerated Concrete Industries Company (ACICO) was established in June 1990 as a Kuwait Shareholding Closed Company (KSCC) under license from Hebel International Germany. The company is involved in the production of reinforced and non-reinforced Autoclaved Aerated Concrete (AAC) of all types and sizes, and supplementary material for construction. The company is a leading producer and marketer of AAC products in the region. The construction using AAC products has many advantages over conventional reinforced concrete construction (RCC).

- The company started with production and distribution of aerated concrete, diversifying into construction contracting and real estate along the way through its subsidiaries. In 2005, aerated concrete contributed over 31% to the total revenues of the ACICO Group. While revenues from housing development contributed about 20% to the total revenues, contracting has become the leading activity for the Group, with a contribution of about 49% to the total revenues of the Group in 2005.

- On the back of lesser third party revenues, the Group had total revenues of KD34.0mn in 2005, down 22.3%, while its net profit was KD7.9mn, down 31.5%, on a year-on-year (y-o-y) basis. Despite the de-growth in 2005, however, the revenues and net profit of the Group have grown at a CAGR of 8.0% and 30.3% respectively during 2002-'05. The company had revenue of KD17.9mn in the first six months of 2006, up 2.9% y-o-y, while its net profit during the period of KD3.6mn was down 15.5% y-o-y.

- The Group has a healthy order book at present, involving construction orders from the Group's real estate subsidiaries for a range of projects in residential, commercial and hospitality sectors.

- The Group's AAC products are used by the Group companies as well as by third-party consumers. Similarly, it carries out contracting projects both for Group companies as well as for third-party entities. The real estate subsidiaries of the Group, however, develop and manage real estate projects only for the Group companies at the moment. Thus, it has de-risked its business model to a large extent against business concentration risk.

- Moving forward, the Group has plans to venture into new businesses, notably the hospitality sector, in an attempt to further diversify its revenue streams and to cash in on the high growth potential in this sector. It has a couple of hotel projects lined up in UAE. The first of the commercial complexes being developed by the company in Dubai should start adding to its revenues as early as by the end of 2006 itself. These new businesses are likely to drive the company's growth, going forward.

- The Group has consistently paid dividends in the past. It has also been rewarding its shareholders with stock dividends year after year over the last three years.

- The Group also has a few financial engineering activities planned out in the times ahead. Part of this strategy involves hiving-off its fully-owned housing subsidiary Al Masaken, and merging the existing subsidiaries ACICO International and KUPS with the parent company ACICO. These moves are expected to unlock value for its shareholders.

- Overall, the ACICO Group would seem to have a sound business model, with diversified, high-growth potential revenue streams, which should, in turn, translate into healthy growth in both revenues and profits in the near-medium term.

- The ACICO stock is currently trading at KD0.500, at 7.9x its 2005 earnings and 10.0x 2006 (P) earnings. The liquidity of the stock at the Kuwait Stock Exchange (KSE) has been low this year so far. The stock is also listed at the Dubai Financial Market (DFM).

- We have arrived at the share valuation of ACICO by two methods : DCF valuation and relative valuation. The weighted average share value of the company by these two valuation methods is KD0.661 per share. This implies a good upside from its current price levels. The company's moves to unlock value for its shareholders going forward are likely to only further add to this upside. We, therefore, initiate our coverage of the ACICO stock with a 'BUY' recommendation.

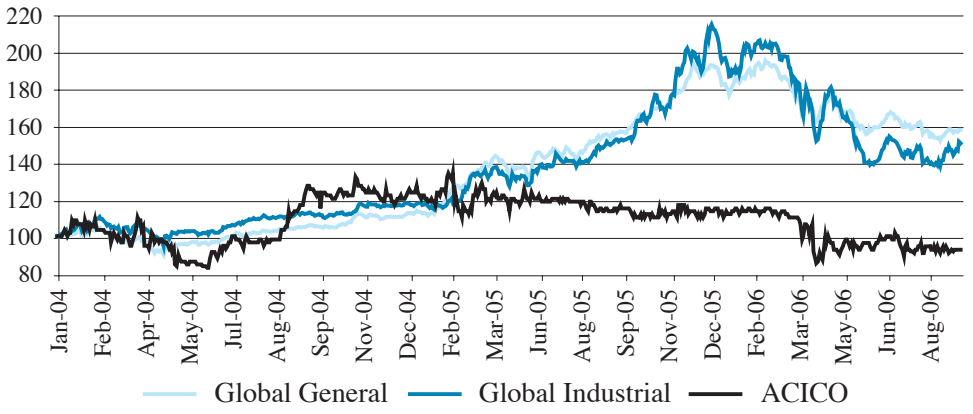
Table 1 : Investment Indicators for ACICO

CMP (KD)		Shares in Issue (mn)		M-Cap (KDmn)		52-Week Hi/Lo (KD)	
	0.500		146.84		73.42	0.630	0.460
Year	Gross Profit (KDs '000)	Net Profit (KDs '000)	EPS (fils)	BVPS (fils)	ROAE (%)	P/E (x)	P/BV (x)
2007 F	25,196	8,789	60	344	17.6	8.4	1.5
2006 F	17,824	7,323	50	337	16.0	10.0	1.5
2005 A	13,246	7,907	63	338	19.5	9.6	1.8
2004 A	12,464	11,540	100	326	37.5	6.4	2.0

*Source : Company's Annual Reports & '**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 Kuwait Stock Exchange as on September 2, 2006.

Chart 1 : Relative Performance of ACICO vs. Global's Indices



ACICO - Company Background

Aerated Concrete Industries Company (ACICO) was established in June 1990 as a Kuwait Shareholding Closed Company (KSCC) under license from Hebel International Germany. The company is involved in the production of reinforced and non-reinforced Autoclaved Aerated Concrete (AAC) of all types and sizes, and supplementary material for construction. The company is a leading producer and marketer in the GCC region of AAC products, viz., reinforced aerated concrete building units, lintels and stairs, as well as the tongue and groove blocks. The construction using AAC products has many advantages over conventional reinforced concrete construction (RCC). The company is also involved in import and export of materials and tools for building and construction.

The company started with production and distribution of aerated concrete, diversifying into construction contracting and real estate development through its various subsidiaries. Today, aerated concrete contributes over 31% to the total revenues of the ACICO Group. While revenues from housing development contribute about 20% to the total revenues, contracting has become the leading activity for the Group, with a contribution of about 49% to the total revenues of the Group.

The Group had total revenues of KD34.0mn in 2005, down 22.3% over 2004, while its net profit was KD7.9mn, down 31.5% over the previous year. The revenues and net profit of the Group have grown at a CAGR of 8.0% and 30.3% respectively during 2002-‘05.

The Group employed about 950 employees at the end of 2005.

Shareholding

As for shareholding pattern of the company, various members of the Al Khaled family have sizeable holdings in the company. The Board of Directors of the company consists of the Al Khaled family members.

Shareholder	Shareholding
Ghassan Ahmed Saud Al Khaled	15.83%
Ahmad Ghassan Ahmad Saud Al Khaled	11.80%
Other Ghassan family members	7.37%
Investment companies	17.00%
Public	48.00%

Source: Zawya.com, Company.

Dividend History

The company has been consistently paying dividends to its shareholders. In 2002, 2003, 2004 and 2005 the company paid cash dividends of 36%, 35%, 45% and 50% respectively. Besides, it has also rewarded its shareholders with bonuses continuously since 2003, announcing stock dividends of 5% in 2003, 2004 and 2005 respectively.

Rights Issue

The company has also issued rights shares in March 2006 in the proportion of one share for every eight shares held at a face value of 100 fils and a premium of 300 fils each, collecting KD6.25mn through the issue. This will help the company partly meet the capital expenditure laid out by it for its various ongoing projects.

Listing & Trading

ACICO was listed in the Kuwait Stock Exchange in 1997, under the ticker 'ACICO'. The company's shares have enjoyed healthy liquidity in the past. The average daily volume traded of the stock was 0.42 million shares, with a stock turnover of 82.3%, during 2005. However, the stock liquidity has suffered in the current year so far, with the average daily volume traded having been about 0.19 million shares, less than half its level in the previous year. The stock closed at KD0.500 on September 2, 2006, with a 52-week high/low of KD0.630/KD0.460.

The company is also listed on the Dubai Financial Market (DFM).

Table 2 : ACICO on the KSE

Year	Volume (mn shares)	Turnover	Price (KD) at end of Period	Market Cap (KDmn) at end of Period
2004	94.7	79.6%	0.640	76.2
2005	102.9	82.3%	0.612	76.5
2006 *	28.9	19.7%	0.500	73.4

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

** Till September 2, 2006.*

Management

Mr. Ghassan Ahmad Saoud Al Khalid is the Chairman and Managing Director of the Group. The day-to-day management of the Group is carried out by Eng. Ghosson Ghassan Al Khaled, who is the Deputy General Manager of the company. She is assisted by managers and other senior officials heading different line and support functions in the company.

Management Style

The company has grown at a good pace over the past many years, diversifying from the production and marketing of AAC into real estate development and construction contracting, while spreading across geographies at the same time. Starting from the Kuwait market, the Group has striven to establish its presence in two of the high potential markets in the region of Saudi Arabia and UAE. These two markets between themselves account for about 79% of the total investments in civil construction sector in the GCC. The company management, thus, has attempted to partly offset the restricted market for its AAC products with business and geographic diversification.

Besides, the management has also striven to reduce the Group's direct exposure to the real estate market by taking the fund route to investing in this market. By investing in the volatile real estate market through its Ee'mmar & Estethmar Fund, the ACICO Group has managed to take an unleveraged exposure to the real estate market.

The company management has also shown the foresight to now further diversify into the hospitality industry, and development and management of commercial complexes, with a string of projects fast coming up in the booming UAE market. These new businesses should contribute handsomely to its revenues and profits going forward, besides de-risking its business model against the uncertainties of the real estate and construction markets.

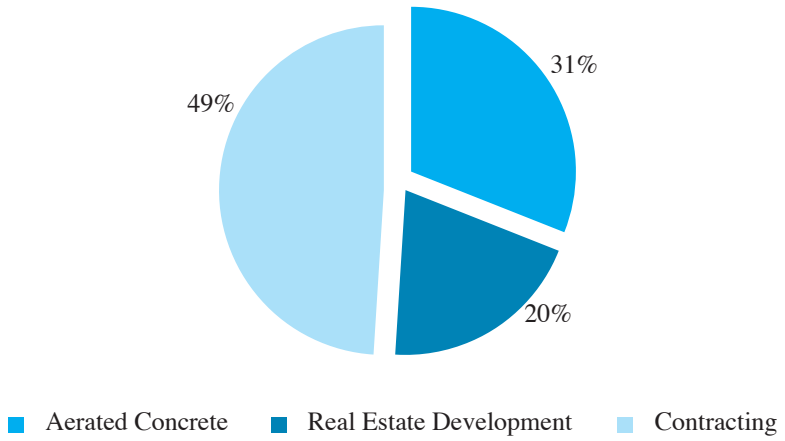
The company also seems to be planning a few financial engineering moves aiming at better value-unlocking for its shareholders in the years ahead.

Business Overview of ACICO

Aerated Concrete Industries Company (ACICO) was established in June 1990 as a Kuwait Shareholding Closed Company (KSCC) under license from Hebel International, Germany.

The company started with production and distribution of aerated concrete, diversifying into construction contracting and real estate along the way. Today, aerated concrete contributes over 31% to the total revenues of the company. While revenues from housing development contribute about 20% to the total revenues, contracting has become the leading activity for the company, with a contribution of about 49% to the total revenues of the company.

Chart 2 : Segmental Revenues of ACICO - 2005



Source: Company Annual Report for 2005.

Contracting Services

ACICO entered construction contracting services basically to promote its AAC products and to be able to better use its AAC capacity, and to diversify its revenue streams. It was also a natural extension to its AAC manufacturing activities. Beginning then, contracting has become the leading revenue earner for ACICO in recent years. The contribution of contracting to the company's overall revenues have been steady at about 49% in 2004 and 2005. In this business segment, the company offers construction services for housing and other public building projects, but not for infrastructure projects. The contribution of this segment to the company's overall revenues has been increasing over the years. From KD13.0mn in 2002, the revenues from contracting services gradually increased to KD21.4mn in 2005, a compounded annual growth of 18.1%. Net profit from this business segment correspondingly increased from KD0.92mn in 2002 to KD1.78mn in 2005, a compounded annual growth of 24.8%. The year 2005, however, saw a decline of 11.7% in the revenues and 28.6% in the net profit of this segment.

The contracting activities of ACICO are managed by its subsidiary Ghassan Ahmad Al Khaled & Co. (GAK).

Ghassan Ahmad Al Khaled & Company

The company has also added a contracting company to its business, by acquiring 75% of

Ghassan Ahmad Al Khaled & Company (GAK). The acquisition allows ACICO to benefit from GAK's long experience in the field of contracting, particularly in using AAC systems in construction.
GAK is a Class 'A' contractor. This enables the company to bid for projects of any size, and, thus, widens its scope of business and assures its future growth. GAK carries out contracting projects for ACICO Group subsidiaries as well as for third-party entities, including for government projects. On an average, about 40% of GAK's contracts are sourced from third-party entities.

The company has a healthy order book at present, involving construction orders from the Group's real estate subsidiaries for a range of projects in healthcare, hospitality and industrial sectors.

Autoclaved Aerated Concrete

ACICO is involved in the production of reinforced and non-reinforced Autoclaved Aerated Concrete (AAC) of all types and sizes, and supplementary material for construction. The company occupies a leading position in the GCC in the production of reinforced aerated concrete building units, including ceiling and wall panels, lintels and stairs, as well as tongue and groove blocks. It produces all ancillary materials related to the Hebel Construction System.

The company operates under license from Hebel International, Germany, a leading company in the global aerated concrete industry. ACICO was established under license from Hebel in 1990, prior to Iraq's invasion of Kuwait. Due to this, the company was not able to begin production until 1994, when its plant was included as a member of the 45 plants of Hebel International worldwide. Since then, ACICO has become a leading agent for Hebel in the GCC region, producing Hebel heat-insulated aerated concrete of all types and sizes with state-of-the-art technology. ACICO has the exclusive right in the production of Hebel construction material in Kuwait. It is a leading exporter of such material to other GCC countries.

The contribution of this segment to the company's overall revenues has been increasing over the years. From KD5.9mn in 2002, the revenues from AAC gradually increased to KD13.6mn in 2005, a compounded annual growth of 32.3%. Net profit from this business segment correspondingly increased from KD2.0mn in 2002 to KD5.8mn in 2005, a compounded annual growth of 43.6%. The year 2005 saw an increase of 29.9% in the revenues, with a decline of 33.5% in the net profit from this segment.

The company commands a share of about 45-50% in the Kuwait AAC market, the balance belonging to National Industries Group (NIG), the other producer of AAC in the country. ACICO supplies its AAC products to the Group subsidiaries as well as to third-party entities, including to government projects. Among its roster of third-party companies which use its AAC products are well-known contractors in Kuwait, such as Ahmadiah, Burhan, KFH Contracting and Sheikh Waled, to name but a few.

Features of AAC

The construction using AAC products has many advantages over conventional reinforced concrete construction (RCC). These advantages emanate from the many qualities that AAC products have over conventional concrete. Broad features of AAC include:

- Lightweight building material
- Prefabricated building units
- Quickly and easily installed.
- Uses less manpower to complete the construction.
- Low construction cost.
- Excellent thermal insulator
- Environmentally safe building material
- Excellent fire resistance
- Longer life

Many of the above features of AAC can only be achieved in traditional systems through the combination of different materials.

Use-based classification of AAC
AAC can be classified on the basis of its uses as follows:

- Products Related to the Traditional Skeleton System
- Products Related to the Integrated Load Bearing Walls Aerated Concrete System

Subsidiaries
The company also has a number of subsidiaries, including AAC plants in Qatar, Saudi Arabia and UAE.

E-ACICO
ACICO has set-up Emirates Aerated Concrete Industries Company (E-ACICO) for the production of AAC in the Jebel Ali Industrial Area of Dubai, United Arab Emirates (UAE). The plant is owned entirely by ACICO and began trail production in April 2005. The company has signed several contracts with a local contracting company in UAE for the design of large housing projects using E-ACICO's blocks and aerated concrete panels. Under these contracts, the company would supply for approximately 666 houses belonging to the Ministry of Defense.

S-ACICO
ACICO also has a 45% stake in Saudi Aerated Concrete Industries Company (S-ACICO) for the production of insulated blocks and reinforced panels of AAC in Al Jubail, the eastern region of the Kingdom of Saudi Arabia (KSA). S-ACICO is a joint venture of ACICO, Zamil Industrial Investment Company and Hamed A. Al Zamil & Bros. Company in KSA. The company, with a paid-up capital of SR300mn (US$80mn), is headquartered in Dammam. ACICO strategically chose the location of the production capacity of the plant to tactically cater to the growing demand of the eastern region of KSA, with the objective of exporting surplus production to Kingdom of Bahrain via the King Fahad Causeway. This joint venture, therefore, is expected to meet the increasing demand for AAC materials in KSA and the vicinity. The project is in the erection stage and is expected to begin trial production by the fourth quarter of 2006. Once fully operational, the plant will be equipped to produce both reinforced and non-reinforced AAC materials.

Q-ACICO

ACICO also has a 49% stake in Qatar Aerated Concrete Industries Company (Q-ACICO) for the production of reinforced and non-reinforced AAC. Q-ACICO is a joint venture with Nasser Bin Khaled Al Thani & Sons Holding Co WLL. The company recently acquired land for the project. Trial production at the plant is expected to begin in the first quarter of 2008.

Kuwait United Company for Pre-cast Concrete Systems

ACICO has a 75% equity stake in Kuwait United Company for Pre-cast Concrete Systems (KUPS), a Kuwaiti Shareholding Company established in 1976. It is a leading company that produces pre-cast concrete in Kuwait. The company is classified by the Central Tender Committee as a second category company whose business includes civil, mechanical and electrical engineering works. The company is capable of producing more than 1,200 m3 of concrete per day. Among the projects where the pre-cast units of KUPS have been used are pedestrian bridges, multipurpose buildings for car parking lots, school buildings, housing projects, service buildings, multi purpose convention halls and commercial compounds, etc. in Kuwait.

ACICO plans to prepare this company to be listed.

Real Estate Development

The company entered housing development activities in 1998 to promote its AAC products as well as to diversify its revenue streams. However, irrespective of the booming real estate markets in Kuwait and the neighbouring countries, the contribution of this segment to the Group's overall revenues has been declining over the years. From KD18.2mn in 2002, the revenues from housing development gradually declined to KD8.7mn in 2005, a compounded annual decline of 21.7%. Net profit from this business segment correspondingly declined from KD0.94mn in 2002 to KD0.83mn in 2005, a compounded annual decline of 4.1%. The year 2005 saw a decline of 44.8% in the revenues and 18.5% in the net profit of this business.

The housing development activities of ACICO Group are managed by two companies – Al Masaken Real Estate Development Company and ACICO International Real Estate Development Company.

The ACICO Group has decreased its exposure to the real estate market over the years, as a strategy, by floating a mutual fund – the Ee'mmar & Estethmar Fund. Most of the real estate assets of the Group have been shifted from the Al Masaken Real Estate Development Company to the fund. The fund also owns some of the new real estate assets of the Group.

Al Masaken Real Estate Development Company

In order to expand the size of its business and to diversify down-stream, ACICO entered the real estate sector by setting up Al Masaken Real Estate Development Company (KSCC) in 1998, with ACICO owning 25% of its capital. The primary goal of the company is ownership, development and sale of real estate mainly in Kuwait. Al Masaken became a fully-owned subsidiary of ACICO when it was taken over by the latter in 1999. The company develops real estate exclusively for ACICO Group. The company also manages the Ee'mmar & Estethmar Fund, to which most of its real estate assets have been transferred in recent years.

ACICO has plans to hive-off Al Masaken in the not too distant future, with an aim to list it soon thereafter.

ACICO International

ACICO International Real Estate Development Company (ACICO International) was established in 2005 as a Kuwait Shareholding Company. It has a capital of KD25mn (approximately $85mn); with a 53% contribution from ACICO. ACICO International's core businesses include real estate development, acquisitions, property management, leasing, and corporate real estate services both within and outside of Kuwait.

With the aim of taking advantage of the booming real estate sector, ACICO International has bought several plots of land in UAE to set up different projects.

ACICO plans to merge this company with itself going forward.

Ee'mmar & Estethmar Fund

ACICO has teamed up with Bayan Investment Company in creating Ee'mmar & Estethmar Fund. The Fund invests in real estate inside and outside Kuwait besides stock market and treasury investments. It enables the ACICO Group to have unleveraged exposure to the real estate market. The assets under management of the fund at present are about KD7mn. The funds' investments are managed by Al Masaken.

The fund had paid a dividend of 25% in 2005 and 7.5% on June 30, 2006. The NAV of the fund at the end of June 30, 2006 was KD1.111.

Value Proposition of ACICO

The value proposition of ACICO Group emanates from the following:

- The Group has interests in the AAC, real estate and construction businesses, which provide it with diversified revenue streams.

- The construction sector is benefiting from huge investments in real estate sector all across the GCC, riding on high oil prices-driven liquidity, exacerbated by high population growth rates and resultant housing shortages. This benefits all the business lines of the Group.

- Going forward, the Group is also foraying into the high-potential hospitality industry, and development and management of commercial complexes, which are expected to boost its revenues and profits from as early as the end of 2006.

- Two of the major business lines for the Group – AAC and, going forward, its planned new businesses – are relatively high margin businesses.

- The Group also plans a string of financial engineering moves in the times ahead, which should see the Group transform itself into a leaner, more efficient and better focused Group, while unlocking value for its shareholders.

Industry Overview

1. The Construction Industry in Kuwait

Kuwait's construction market has in recent times been driven by the real estate market which is riding on the back of high growth in population and the record levels of liquidity. All regions in the country have experienced healthy activity and price appreciation. With interest in real estate in the local market surmounting, the real estate and construction sectors have become vital to the health of the local economy. Preliminary figures point to the fact that the majority of real estate is owned by individuals and not by companies. Companies are estimated to own only 2% of total tradable real estate land. The rise in property prices have shot up returns on property investments.

Contribution to GDP

The real estate & construction segments continues to rapidly expand and additional funds are pumped into these sectors, they become pivotal to the health of the local economy. In growth terms, both construction and real estate were able to improve their value added to GDP. Construction sector GDP showed a yearly growth of 13.2% during 2005 (having grown at a CAGR of 12.3% over the previous 5 years), while real estate GDP grew at 3.8% during the year (at a CAGR of 13.1% over the previous 5 years). Combined, the sectors accounted for 6.6% of Kuwait's economy during 2005, as compared to 10.8% and 8.3% in 2002 and 2004 respectively. Separately, real estate accounted for 4.7% of GDP in 2005, slightly below its 5-year average of 6.7%. Similarly, construction sector accounted for 1.9% of GDP during the year, as compared with its 5-year average of 2.5%. However, this does not indicate that either real estate or construction activities have been diminishing; instead, this is due to a brisk growth in oil & gas sector contribution to Kuwait's economy (a CAGR of 18.0% over the previous 5 years).

Table 3 : GDP by Economic Activity (at Current Prices)

Sector (KDmn)	2000	2001	2002	2003	2004	2005
Oil & Gas	5,543.9	4,586.5	4,409.2	5,797.8	7,822.1	12,828.1
Mining and Quarrying	0.5	0.5	13.8	17.0	22.5	24.5
Agriculture and Fishing	41.1	47.7	59.9	64.9	70.9	78.4
Manufacturing of which :	800.1	678.8	907.3	1,127.0	1,455.9	1,756.7
Refined Products Industry :	501.6	374.4	430.6	572.4	795.5	1,003.8
Electricity, Gas and Water	245.5	253.1	275.3	299.4	306.9	316.6
Construction	**255.2**	**262.6**	**312.0**	**349.3**	**401.9**	**455.2**
Wholesale and Retail Trade	603.7	617.5	822.5	890.2	950.2	989.7
Restaurants and Hotels	92.4	97.9	123.7	174.2	157.6	165.6
Transport, Storage and Communications	552.1	613.1	594.1	799.9	1,045.1	1,294.0
Financial Instituitions	604.1	676.9	760.4	1,171.7	1,486.5	1,790.3
Insurance	12.8	15.8	22.7	64.9	61.9	63.7
Real Estate	**871.8**	**872.7**	**982.4**	**1,062.0**	**1,095.4**	**1,137.0**
Business Services	52.2	54.7	159.0	186.6	227.2	264.7
Community, Social and Personal Services	2,293.3	2,327.6	2,540.8	2,726.4	2,924.6	3,085.9
GDP at Producer's Price	**11,968.6**	**11,105.4**	**11,983.1**	**14,731.3**	**18,028.7**	**24,250.4**
Imputed Banks Service Charges	(475.6)	(489.3)	(495.5)	(612.9)	(724.2)	(810.7)
Imports Duties	77.0	83.9	96.9	135.1	161.5	148.3
GDP at Purchaser's Price Value	**11,570.0**	**10,700.0**	**11,584.5**	**14,253.5**	**17,466.0**	**23,588.0**
GDP Growth Rate		-7.5%	8.3%	23.0%	22.5%	35.1%

Source: Ministry of Planning, Statistical and Information Sector, Central Statistical Office.

Public Expenditure

The budgeted figures for the fiscal year 2005-06 envisioned another deficit, however a contracting one, which was projected to reach KD2.62bn. Expenditures were estimated to be higher by 10% compared to the previous budget and 14.5% above actual expenditures. This increase in budgeted expenditures includes increase in salaries to reach KD1.943bn. Other salient expenditure increases include construction and land acquisition to KD939mn, transport equipment to KD90mn and transfers and miscellaneous expenditures to KD3.182bn. Thus, budgeted expenditures on capital projects picked up by 52.54%, although the government has historically spent only around 50% of its projected budget in this category.

Table 4 : Economic Classification of Public Expenditure

KD mn	2000/01	2001/02	2002/03	2003/04	2004/05A	2005/06A
Current	2,248.0	3,399.8	3,428.1	3,823.7	2,698.8	3,020.0
Capital	23.9	24.1	23.7	40.5	59.0	90.0
Construction	**214.4**	**323.2**	**413.4**	**521.5**	**825.0**	**758.0**
Land Acquisition	**-**	**83.2**	**48.0**	**48.0**		**181.0**
Other	701.8	916.2	1,014.2	1,089.1	2,993.5	3,182.0
Total	**3,188.1**	**4,746.5**	**4,927.4**	**5,522.8**	**6,576.3**	**7,231.0**

A: Budgeted

Source: Ministry of Finance & Central Bank of Kuwait

For the FY 2005/06, the government has budgeted increasing share of total capital expenditures to reach a new record of 14.23% of total expenditures. Budgeted construction and land acquisition expenditures stood at new level (KD939mn) that is 38.4% and 13.8% above last year actual and budgeted levels. It is important to note that, the burdens of construction spending are still relayed to some extent onto the shoulders of the private sector, through the use of Build Operate Transfer (BOT) method. On another front, as the private sector continues to take a larger role in solving the housing dilemma in Kuwait, the government is to uphold its downward spending on the sector. However, this will not affect the health of the sector as the private sector has the resources and the know how to drive the sector forward.

Domestic Credit Facilities

The balance of utilized cash credit facilities extended by local banks to the different economic sectors hiked to a new high of KD11.83bn by the end of 2005, or 19.9% higher than in 2004. Aided by the increased economic activity and ample liquidity, the real estate and construction sectors have been the forerunners of those receiving credit facilities in 2005. Credit to the real estate sector accounted for 21.5% of the total credit extended by banks during 2005, which is the second largest share after personal facilities. Further, the sector has consistently expanded, with banks increasing facilities to the sector by 10.5% and 41.5% in 2003 and 2004 respectively, followed by 25.1% in 2005.

The construction sector saw expanding credit growth during 2003, with banks increasing facilities to the sector by 39.3% to stand at KD632.6mn. However, during 2004, construction activity witnessed the first trough in loans since 2001. Entering 2005, loans to the sector rebounded again to stand at a new landmark of KD769.8mn by the end of the year, or 30.1% growth over 2004. Combined, the two inter-dependant sectors amounted a substantial share of 28% of the total credit facilities. We should note that the two sectors share has been

increasing since 2000, when it stood at over 24%. This could also be reflected from the high CAGRs for real estate and construction sectors at 24.3% and 12.7% respectively over the five-year period 2000-'05.

Table 5 : Balance of Domestic Facilities by Sector

KD mn	2000	2001	2002	2003	2004	2005	5-yr CAGR
Trade	783.6	811.9	1,021.9	1,072.2	1,276.2	1,371.2	11.8%
Industry	318.1	394.3	465.5	441.7	447.1	467.9	8.0%
Construction	**422.9**	**356.4**	**454.1**	**632.6**	**591.5**	**769.8**	**12.7%**
Agri. & Fishing	10.6	13.9	20.1	48.7	22.8	19.1	12.5%
Non-bank FI's	306.9	612.5	538.1	650.2	781.0	932.8	24.9%
Personal Facilities	1,887.3	2,307.7	2,627.9	3,442.6	4,169.1	5,139.5	22.2%
Real Estate	**853.8**	**1,165.3**	**1,298.4**	**1,434.3**	**2,029.5**	**2,538.5**	**24.3%**
Crude Oil and Gas	78.2	45.0	66.6	73.0	54.7	49.5	-8.7%
Public Services	0.8	0.5	0.4	1.2	0.1	4.8	43.1%
Other	567.5	319.5	360.5	622.9	494.9	534.3	-1.2%
Total	**5,229.7**	**6,027.0**	**6,853.5**	**8,419.4**	**9,866.9**	**11,827.4**	**17.7%**

Source: Central Bank of Kuwait

Government Regulations & Decisions

Although the real estate market is the only economic sector not organized or regulated by a government authority, the Kuwaiti government still holds a key position in stimulating or hindering growth within the market. Decisions taken by related government ministries or authorities –especially municipality- often times prompt increased activity in certain areas or induces a sell-off in others. Such decisions may vary to include among other things approving; building permits, higher buildings, transforming permits from one segment to another, granting land or allowing foreign ownership. All such decisions have more of impact, which can boost or hinder the real estate market. To hit the point home, we shall look at some decisions and their effect on the respective areas, which they affected.

Many times the government can take initiatives to drive the real estate market forward. One of such decisions was the cabinet's approval for the municipality decision to transform the rest of Salem Al Mubarak Street from investment to commercial. Land prices zoomed after the decision from KD200/sqm up to KD300/sqm overnight. Another similar decision was the transformation of the eastern portion of the area behind Al Hamraa complex from residential to investment property, due to its unattractive location for villas. The transformation led to increased activity and rising prices in the area, also spilling over into neighboring areas.

Regarding built-up area and number of floors, Kuwait Municipality paved the way for higher building structures during 2004, approving the first 50-storey tower for the Secretariat of Al-Awqaf. Following ahead, the plot height restrictions were relaxed even more during 2005, as Kuwait Municipality has decided to allow the construction of buildings with 100 floors in Kuwait City provided their height does not exceed 400 meters and have 9,000 square meters of area. The year 2006 is expected to witness the approval of the Liberation City project that involves the construction of one of the tallest skyscrapers in the world with a height of 1,100m containing 250 floors and named Kuwait Tower. This new trend would mean sustained construction activity in the country.

Spiraling Price of Building Materials

The rising prices of building materials have negatively impacted the market, although not curbing the activity altogether. This is seen as a global trend, resulting primarily from an increase in China's steel consumption in preparation for the 2008 Olympics. The increase in prices of building materials is estimated to have resulted in rise of construction cost by 50% over the last 3 years.

However, the Kuwait government was prompted to temporarily raise subsidies for building materials, especially cement and steel. According to the latest available data published by the Ministry of Commerce and Industry for 2005, average steel subsidies stood at KD41/ton, or almost 30% subsidy. As for cement, average subsidies were at KD0.44/bag, or about 40% subsidy. This was mainly to control prices and prevent inflationary pressures being built-up in the real estate sector.

The total government subsidies for building materials reached KD7.43mn for 2005, up 3.7% over KD7.16mn in the previous year. Out of the total subsidies, cement subsidies comprised the highest share of 54.2%, with the balance 45.8% for steel subsidies; there were almost no brick subsidies. The government has also banned the export of cement and steel, which are in short supply locally, to check their spiraling prices in the local market. There is also a decision to ban the export of bricks from Kuwait to meet the high local demand. These decisions, along with the government initiative to support prices of building materials, have resulted in some price stability in the local market. But, the price of steel is still considered high owing to strong international demand. On another front, a shortage of cranes and other equipments too has affected the local construction market.

Construction Activity in Kuwait

Construction activity was brisk starting 2003, as reflected in the rising real estate prices across categories and low vacancy levels. Further, enabling government regulations, low-medium interest rates, high level of liquidity, rising demand due to expanding population – especially the working-age population, along with influx of expatriates into the economy have further fuelled the demand for real estate. This has led to the boom in the construction market during 2004 and 2005.

Building permits, as a proxy for construction activity in the economy, has shown signs of picking up in 2005 after a drop in 2004. There has been a 7.6% growth in the number of permits issued during 2005, reaching 4,116 permits as compared to 3,824 permits in the previous year. It is important to note that 2005 data excludes permits for the governorate of Jahra because of non-availability, impacting the 2005 performance as compared with that in the previous year. In general, 2005 witnessed more new construction permits issued for all segments, except investment and commercial segments which declined by 21.9% and 5.5% respectively. The highest growth was seen in the industrial category, climbing 37.1% with 85 new permits in 2005, as compared to 62 new permits in 2004. Activity in the residential category increased as well by 16.8% to 3,058 permits, thus representing 78.3% of new construction permits. It could be noted that over the years, the growth in issuance of new building permits has come from the investment property segment that increased its share in new construction permits from 2.4% in 2000 to 18.2% in 2005. This was at the expense of residential segment's share that declined from 95.7% to 78.3% during the period. As for renovation permits, it increased by 18.1% to 209 in 2005. Though there has been an

increase over 2004, the issuance of renovation permits had a major drop compared to the corresponding period in 2003.

Table 6 : Building Permits

Permit Type	Full Year						% Change
	2000	2001	2002	2003*	2004	2005**	2005
New Construction	3,013	3,234	5,560	5,606	3,647	3,907	7.13%
Commercial	15	25	46	178	55	52	-5.45%
Investment	71	220	524	712	912	712	-21.93%
Industrial	45	63	103	198	62	85	37.01%
Residential	2,882	2,926	4,887	4,518	2618	3058	16.81%
Additions	5,580	6,346	6,949	7,022	n/a	n/a	-
Renovations	1,942	2,297	1,584	1,956	177	209	18.08%
Total	**10,535**	**11,877**	**14,093**	**14,584**	**3,824**	**4,116**	**7.64%**

** Annualized*

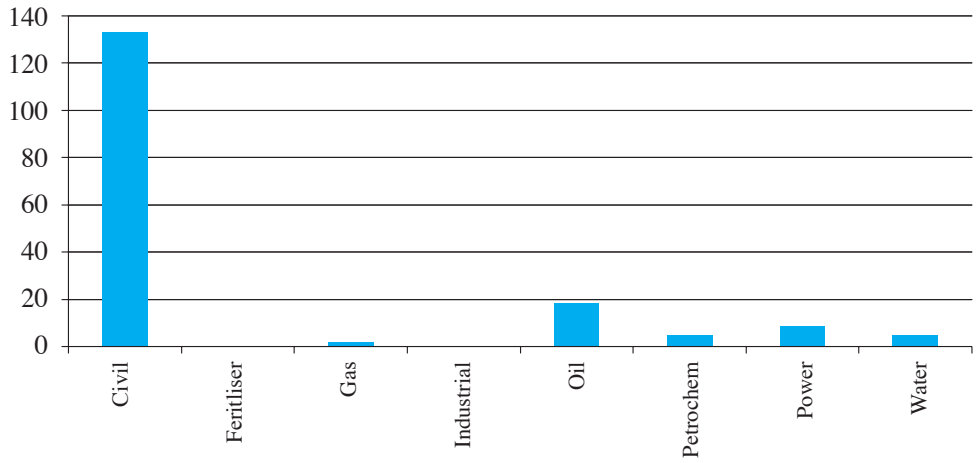
*** Excluding Jahra Governorate*

*Source: Kuwait Municipality & **Global** Research*

Industry Outlook

Looking forward, the construction industry is expected to benefit from a strong pipeline of construction projects in Kuwait, estimated at present at about $172bn, over the next five years. Prominent among these are the Failaka Island Project, the Kuwait University Project, the Al Khiran Residential City, the Arifjan Residential Project, the Silk City Project, various Ring Road Projects, the Bubiyan Island Project and Project Kuwait, etc. Mega Projects Agency (MPA), a division of the Ministry of Public Works, is charged with overseeing the development of the state's two most important infrastructure projects, Failaka and Bubiyan. Such projects are bound to impact the real estate market in Kuwait.

Chart 3 : Kuwait - Break-Up of Investment Projects (June 2006)



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

Civil construction projects are believed to be worth over $133bn, or over 77%, of the total projects of $172bn. These consist of $127bn worth of buildings projects (about 95% of the total civil construction projects), $0.7bn worth of leisure & entertainment projects (0.5%), and $6bn worth of transport infrastructure projects (4.5%).

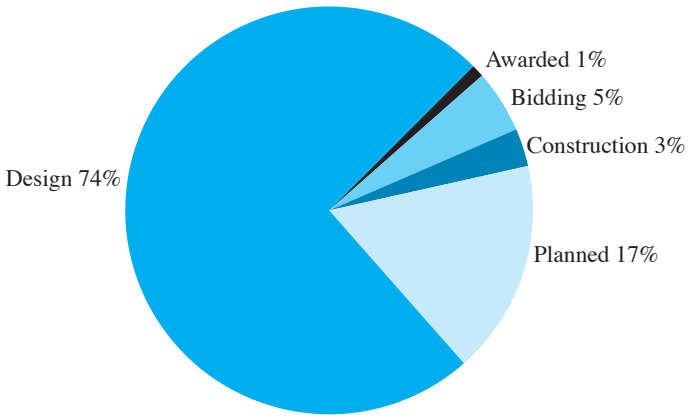
Table 7 : Kuwait - Category-Wise Break-Up of Civil Construction Projects

Buildings	
Commercial	1,041
Education	2,614
Healthcare	575
Hotels	207
Mix	119,433
Others	1,133
Residential	759
Retail	787
Buildings - Sub-Total	**126,549**
Leisure & Entertainment	
Mix	325
Sports Facilities	274
Theme Parks	100
Leisure & Entertainment - Sub-Total	**699**
Transport	
Bridges	3,000
Ports	1,375
Roads	1,716
Transport - Sub-Total	**6,091**
Total - Kuwait - Civil Construction Projects	**133,339**

*Source: Sentinel Market Intelligence, **Global** Research.*
Amounts in $ million.

A vast majority (74%) of the civil construction projects are in the design stage, while planned projects constitute about 17% of the projects and projects at the bidding stage about 5%.

Chart 4 : Kuwait - Break-Up by Stages of Civil Construction Projects



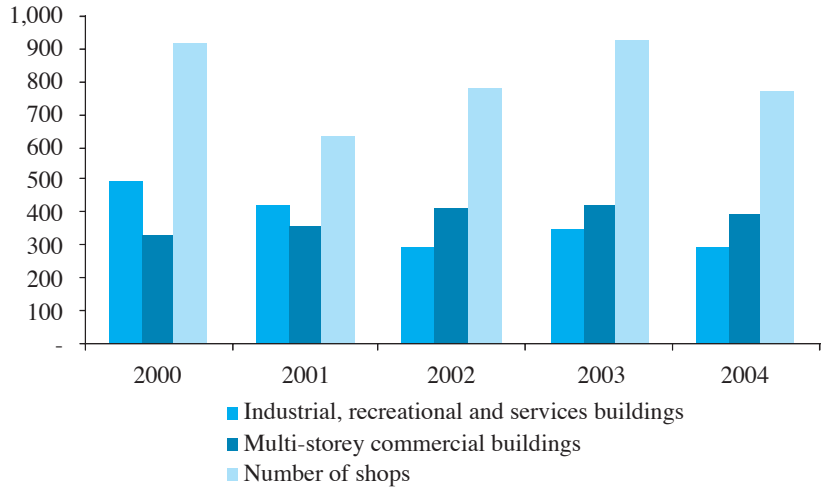
*Source: Sentinel Market Intelligence, **Global** Research.*

Such a strong pipeline of projects is expected to have positive implications for the real estate and construction sectors in Kuwait. With stable current political and economic conditions, it is expected that the boom in the domestic real estate and construction sectors would continue to be sustained in the near-medium terms. This, in turn, is bound to benefit the markets players, who are expected to see a sustained growth in revenues and bottomlines in the years to come.

2. The Non Residential Property Segment in Dubai

In Dubai, as in the case of the residential property segment, supply of the property in the commercial and industrial segments too saw inconsistent patterns in the period 2000-2004. Fewer buildings in the industrial, recreational and services segments were supplied in 2003 and 2004, possibly due to the developers concentrating on other more lucrative segments.

Chart 5: Supply of Property in Dubai for Non-Residential Segments



Source: Dubai Municipality

As can be seen in the chart, supply of multi-storey commercial buildings has seen an increasing trend in the period 2001-2003. However, supply of industrial, recreational and services building have been more or less subdued. It could be seen that the year 2004 saw lower supply across the non-residential segment. As in the case of the residential segment in Dubai, we would expect a major increase in the supply of non-residential property in the years to come, due to the economic health that the region is currently in and the associated capital investments.

Big Projects to be Delivered Soon

Dubai being positioned as the financial hub of the Middle East encouraged developers to invest in office property. Likewise, the focus on tourism naturally attracted investments not only in hotels, but also large scale retail developments. Most of the large scale mixed use investments would be delivered in the next few years.

Table 8 : Major Projects Investing into Non-Residential Segments

Development	Developer	Investment (AED bn)	Year of Completion	Expected Supply
Burj Dubai	Emaar Properties	10	2008	Hotels, retail and office, 150 floors
Business Bay	Dubai Properties	30	2010	Expected to attract MNCs
Dubailand	Dubai Properties	18	2015	Retail and entertainment
Dubai Pearl Development	Omnix Group	5	2007	1,500 hotel rooms

Source: Company websites, Ventures Middle East, Industry Sources.

Residential supply associated with these projects are not mentioned above.

Most of these large scale developments would result in a substantial increase in the supply of office property in the market. All of them are set to provide high-end office space, which are in high demand currently. Apart from the ones mentioned above, more commercial and office space is slated to come into the market through projects such as Burj Dubai, Business Bay, International City and Dubai Festival City.

Further Escalation in Rents in the Short-Term

Rental yield for commercial segment in Dubai is as high as 15%, higher than the residential segment. For example, property at internet city, which was sold at US$4200/sq.m, is rented out at US$600/sq.m/yr. Annual rents for class A range from US$405-US$625 per sqm, while those of class B range from US$175-US$380 per sqm. Class A office space continues to be at very high demand and is in short supply. We expect status-quo to be maintained for some more time. However, a supply surplus scenario could evolve by 2010.

The story is not that different in Abu Dhabi, the demand supply gap resulted in a sudden upsurge of rents. Office space, which was available at a rent of US$135/sq.m earlier, is now available at about US$320/sq.m.

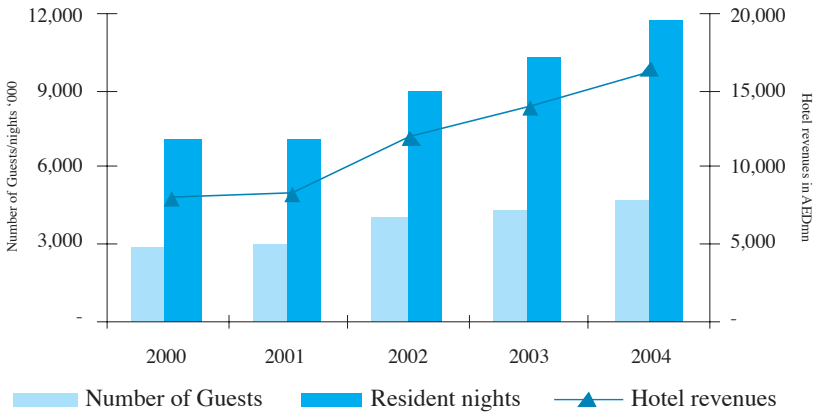
Business Hub to Attract More Companies

Dubai is developing into the financial capital of Middle East. Its location almost equidistantly between Japan and London, its business culture and the supply of highest quality developments make it an ideal location for multinational companies to set up their hub for Middle East business. Barclays Capital, banking arm of Merrill Lynch, Alliance Re, Credit Suisse, and Ansbacher are examples of international entities, which have already won the licence to operate from Dubai International Financial Centre (DIFC). More are expected to come and this would generate a lot of demand for high end office space in Dubai.

The Hotel Industry in Dubai

The rapid increase in tourist flow has rendered hotels in acute short supply, especially in Dubai. The number of hotels increased to just 276 hotels in 2004 up from 265 hotels in 2000, while number of tourists almost doubled during the same period, as outlined earlier. As expected, the tourism boost led to a 14% CAGR of hotel guests and 13% CAGR of the resident nights during the period 2000-'04.

Chart 6 : Number of Hotel Guests, Resident Nights & Hotel Revenues



Source: Department of Tourism and Commerce Marketing

The increase in the number of guests was combined with a marginal increase in the average length of stay in the hotels. Average length of stay in 2004 was 2.6 nights compared to 2.5 nights in 2000. The supply-demand mismatch led to a steady increase of occupancy levels to levels beyond the global norms. The same trend is seen in the bed occupancy rates too, which increased to 77% in 2004 from 58% in 2000. Increase in occupancy rates allowed hotels to hike the room rates, boosting their revenues. Along with the lodging revenues, which increased at a CAGR of 23%, other revenues too increased by a CAGR 17% in the period 2000-'04, possibly a result of increasing proportion of high spending guests from the western world.

A large increase in supply is warranted to match the projected increase in demand in the next few years. Occupancy levels in Dubai hotels for the first nine months of 2005 was estimated at 86% by Deloitte and Smith Travel Research, while that in the last quarter is believed to be even higher, according to industry sources. Rough calculations show that Dubai would require an additional 30,000 rooms by 2010 to limit the occupancy at 80% and around 32,000 to keep it at a reasonable rate of 75%. This is based on an assumption that the number of tourists visiting Dubai would continue to grow at past levels.

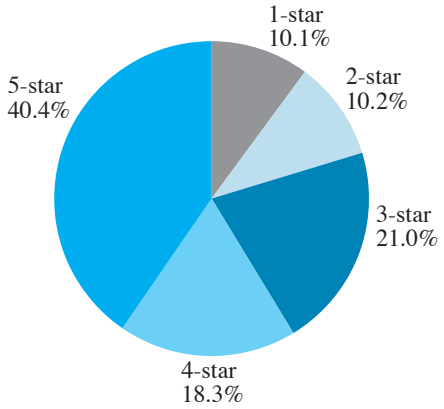
Table 9 : Required Supply of Hotel Rooms by 2010

	2005	2010P
Number of tourists (in '000)	6,159	11,666
Number of guests (in'000)	5,294	10,149
Resident nights (in'000)	13,375	26,388
Room occupancy (%)	71%	75%
Average room occupany	21,189	47,979
Number of rooms	29,808	63,971

*Source: **Global** Estimates.*

While there is a perceived difficulty in obtaining hotel rooms across the emirates, it should be noted that tourists are left with little choice other than four/five star hotels or low end hotels in the unorganised segment. There is a clear cut gap, which would provide an opportunity for the organised budget hotels to come in, especially as increased tourist inflow would bring down the proportion of business travellers in Dubai.

Chart 7 : Mix of Guests Across Different Categories of Hotels in 2004



Source: Department of Tourism and Commerce Marketing

Major plans in the economy segment are already planned out by majors like Holiday Inn and Rotana Group in the brand names Express and Centro. Rotana Group has a target of 25 Centro Properties across the region within two years. Another hotel group to follow the low cost model is the Accor Group, which has announced 200,000 new rooms over the next four years, half of which falls in the economy segment. However, economy segment would still have to make do with the fact that the market is service-driven rather than price-driven. Another trend catching up fast is the emergence of regional hotel groups in the region. Kingdom Holding owned by Prince Walid Bin Talal of Saudi Arabia leads the way along with Jumeirah International and the Kuwait based IFA Hotels and Resorts.

UAE Real Estate Market Outlook

The outlook for the UAE real estate market is different across emirates and across different segments of the market. Dubai has been by far the largest emirate in terms of real estate activity, and has also witnessed the highest escalation in rents, and prices. We believe that current prices still guarantee decent margins for developers and investors in Dubai in the residential and the commercial segments, with higher yields in the commercial segment. Currently, demand is huge and supply is not enough to cover this demand in the residential and commercial segments considering the economic boom, the high growth of employment, the regularity at which foreign companies are setting up base in the country, and the huge inflow of expatriates.

Margins for developers would depend on whether the developer got the land as a grant. Furthermore, with the risk of an oversupply situation in the long term, developers have to concentrate on cost-control and providing differentiated service levels in order to encourage people to buy off-plan, and secure their returns. Although, the Dubai property market is crowded with several number of mega projects in the pipeline signalling an expected oversupply situation, most of the projects in the pipeline are due for completion two or three years from now. Furthermore, constant delays in the delivery of new property has fuelled the demand for available property, and hence led to more appreciation in rents and prices. We do not foresee any stabilization in rents and prices in the near term. However, we expect this stabilization to occur once these projects come into completion.

The recently announced property law allowing foreign ownership of property in Dubai has boosted investor confidence in the market, and is expected to sustain the boom in the market. The new property law is also expected to trigger activity in home financing segment. We believe that the pent-up demand in the residential and commercial segments in Abu Dhabi would require enormous supply to be satiated, which implies a more secure story for developers in this emirate, built on latent demand rather than external demand as in the case, to a certain extent in Dubai.

The rapid increase in tourist flow has rendered hotels in acute short supply, especially in Dubai. We expect that, hotels would continue to be in short supply in the medium term, and the high current occupancies would be maintained. The situation is pretty much similar in Abu Dhabi too, where tourism is expected to pick up once the major developments in the investment zones are completed. At present, hotels in Abu Dhabi too are facing a supply deficit situation. Similarly, Ras Al Khaimah too is marketed as a tourist destination and would offer plenty of opportunities for more hotel developments.

Activity has also picked up in the Northern emirates of the UAE as well, especially Sharjah and Ras Al Khaimah. Going forward, we expect these emirates to continue to offer good value proposition for investments considering the relatively low entry price. Ras Al Khaimah, Umm Al Qaiwan and Sharjah would be relatively more attractive among these emirates in that order. However, in terms of the scale and the number of developments, opportunities would fade in comparison to that in Dubai and Abu Dhabi. We see a steady evolution of these emirates into higher levels of activity, but there are no signals foreboding a sudden shift of activity from the bigger emirates.

However, any slowdown in real estate activity due to an anticipated correction in the Dubai property market could adversely impact the fortunes of the construction and real estate companies, going forward. It might also lead to a delay in the launch or scrapping altogether of some of the proposed projects. But, while the Dubai market could be approaching its peak, activities in Abu Dhabi, Ras Al Khaimah and other emirates are likely to support the real estate market in UAE in the near-medium-term.

Growth Strategy of ACICO

ACICO's growth strategy involves the expansion of its AAC business in the Middle East. It has installed AAC plants locally and overseas, keeping pace with the increasing demand for heat-insulated construction material and continuing to grow as one of the leading construction manufacturing companies in the region. As a part of this strategy, ACICO has set-up companies in various GCC countries. For example, it has set-up Emirates Aerated Concrete Industries Company (E-ACICO) in UAE and Saudi Aerated Concrete Industries Company (S-ACICO) in Saudi Arabia, while it is on way to set up Qatar Aerated Concrete Industries Company (Q-ACICO) in Qatar. Through this, the company hopes to cash in on the prevailing real estate boom in those respective markets.

The company's foray into construction contracting was as much a move for diversification as for popularizing its AAC products. GAK's long experience in the field of contracting, particularly in using AAC systems in construction, enables the Group to have an in-house expertise in the field of construction using AAC.

Through Al Masaken Real Estate Development Company, ACICO has diversified further downstream into real estate development.

The growth of the Group over the past few years has been led by its AAC and contracting subsidiaries, with the real estate's share gradually declining in the overall revenues and profits of the company. The Group has decreased its exposure to the real estate market over the years, as a strategy, by floating a mutual fund – the Ee'mmar & Estethmar Fund. Most of the real estate assets of the Group have been shifted from the Al Masaken Real Estate Development Company to the fund. The fund also owns some of the new real estate assets of the Group. Thus, the ACICO Group has managed to have unleveraged exposure to the real estate market through the fund.

Future Growth Drivers for ACICO

AAC

AAC has been the mainstay of the company, and is expected to continue to be so in the future as well. The future growth in the revenues and profit from this business line is expected to be driven, among others, by the increasing number of land plots that the Kuwaiti government is expected to release for low-cost housing every year (about 10,000 land plots are expected to be released in the near-medium term, which will be open for bidding by the construction companies).

Contracts

GAK has a healthy order book at present, involving construction orders from the Group's real estate subsidiaries for a range of projects in residential, hospitality and commercial sectors. These construction contracts are slated to be completed in the near-term. Most of the projects are for ACICO International and are located in Kuwait and UAE.

Among the prominent construction projects that the company currently has are:

- Two plots of land in Dubai Healthcare City, Dubai, to set up a commercial-cum-medical complex covering up to 7,000 square meters. The project is likely to be completed by September 2006.

- A plot of land on the coast of Fujairah, with an estimated total area of 29,605 square meters. A five star, 180-room beach resort is expected to be developed at this location, which is going to be managed by Nikko Hotels, a subsidiary of JAL, Japan, and expected to be launched by January 2007.

- A commercial complex at Port Saeed, opposite the Dubai Airport, slated for completion by the middle of 2007.

- Two plots of land on Shaikh Zayed Road, Dubai, with a total estimated area of 3,700 square meters. It will be composed of one 52-storey, 550-room five-star hotel and one multipurpose office-cum-residential tower. The residential-cum-commercial complex is likely to open by October 2008, while the hotel could be launched by January 2009.

The company is also trying to establish construction companies in Bahrain, Qatar and Saudi Arabia to cash in on the construction boom in those countries. The company status of a Class 'A' contractor enables it to get projects of any size, and, thus, widens its scope of business and assures its future growth. This business line, therefore, is expected to see strong growth in the years ahead, which could gradually taper once the real estate market in the region plateaus.

Real Estate Development

The contribution of this sector to the Group's overall revenues and profits could be expected to decline moving ahead with the gradual plateauing of the real estate market in the region expected in the near-medium term. Besides, the Ee'mmar & Estethmar Fund is expected to continue to invest in some of the new real estate assets for the Group.

New Businesses

A number of new businesses that the company is planning to enter in the coming years are likely to drive its growth going forward. We project that these new businesses – broadly categorized into hospitality and commercial complexes – will contribute about 34% of the Group's overall revenues in the year 2009. While all the existing businesses, except real estate development, are projected to grow in absolute terms going forward, their share in the overall pie is likely to shrink, giving way to the new businesses. The new businesses are also likely to de-risk its business model to a certain extent against the uncertainties of the real estate and construction markets.

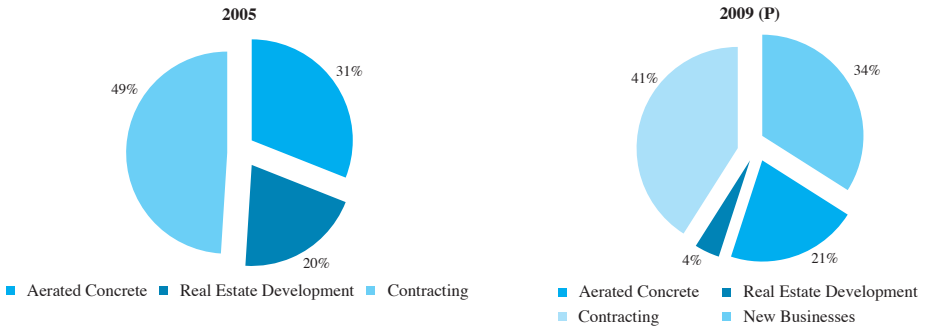
Hospitality

This is a new line of business for the company and is a part of the company's strategy to further diversify its revenue streams and to cash in on this high-growth, though highly competitive, sector. It has a few hotel projects lined up which should start adding to its revenue streams as early as by the end of 2006 itself. The company is slated to enter the hospitality sector with the commissioning of the beach resort in Fujairah for which the company has entered into a management contract with Nikko Hotels, a subsidiary of JAL, Japan. The Group will bolster its presence in this sector further with the commissioning of the five-star hotel on Shaikh Zayed Road, Dubai, by January 2009. This is, thus, a sunrise business for the company; with the occupancy levels in the regional hospitality industry expected to rule at the current high levels of 85-90% in the near-medium term as well, this business holds promise of good growth moving forward. Simultaneously, this business is likely to contribute to an increasing share of the Group's overall operational revenues in the years ahead.

Management of Commercial Complexes

This is another new line of business for the company, under which the company plans to cash in on the prevailing high demand for quality commercial space in Dubai. The company is at present developing three commercial complexes – the first of these is expected to be ready for occupation in Dubai Healthcare City by September this year. The Port Saeed Commercial Complex, opposite the Dubai Airport, is likely to be commissioned by the middle of 2007, while the complex on the Sheikh Zayed Road, Dubai, is likely to be commissioned by October 2008. The revenue streams from these complexes are expected to bolster the overall earnings of the company going forward.

Chart 8 : Segmental Revenues of ACICO in 2005 & 2009 (P)



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

The company is also likely to venture into other related businesses going forward.

Financial Performance of ACICO

Financial Performance in 2005

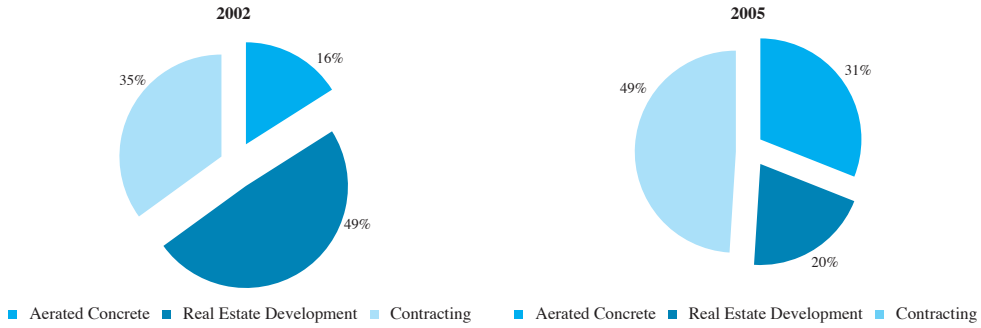
Revenue

The company's total operational revenues was KD34.0mn for the year ended December 2005, a decline of 22.3% from KD43.8mn in the previous year. Prior removing minority interest and inter-company transactions, the total revenue of the company was KD43.7mn in 2005, down 13.4% from KD50.5mn in 2004. The total revenues in 2005 were lower than in the previous year because there were lesser third party revenues during the year.

Sales of aerated concrete contributed KD13.6mn in 2005 (up 29.9% from KD10.5mn in 2004), contributing to over 31% of the total revenues during the year. Revenues from housing development contributed KD8.7mn in 2005 (down 44.8% from KD15.8mn in 2004), contributing to about 20% of the total revenues during the year. Lastly, revenues from contracting contributed KD21.4mn in 2005 (down 11.7% from KD24.2mn in 2004), contributing to about 49% of the total revenues during the year. Thus, while contracting remained the major revenue earner for the company, with a share of about 49% in the overall revenues in 2004 and 2005, there has been a switch between the shares of the other two business segments, namely aerated concrete and housing development, in the total revenues during the two years.

The total revenues of the company grew at a CAGR of 8.0% during 2002-'05.

Chart 9 : Segmental Revenues of ACICO in 2002 & 2005



Source: Company's Annual Reports.

Cost of Production

The total cost of production of the company was KD20.8mn for the year ended December 2005, 33.7% lower than in the previous year.

Gross Profit

The gross profit increased by 6.3% to KD13.2mn in 2005 from KD12.5mn in 2004. As a result of a steeper fall in the cost of sales, the gross profit margin increased to 38.9% in 2005 from 28.5% in 2004.

Other Operational Expenses

The salaries and employees' benefits increased by 30.9% during the year – from KD2.8mn in 2004 to KD3.7mn in 2005 – even as the staff strength went up by 10% during the period

– from about 865 employees at the end of 2004 to about 950 employees at the end of 2005. As a percentage of the operational revenues, the staff expenses increased to 10.7% in 2005 from 6.4% in 2004.

The selling & general expenses increased by 58.6% during the year – from KD0.6mn in 2004 to KD0.9mn in 2005. As a percentage of the operational revenues, the selling & general expenses increased to 2.6% in 2005 from 1.3% in 2004. This was due to high transportation costs incurred in exporting AAC products to Abu Dhabi during the year.

General & administrative expenses saw an increase of 2.2% to KD0.97mn in 2005 from KD0.95mn in the preceding year. As a percentage of the operational revenues, these expenses increased from 2.2% in 2004 to 2.8% in 2005.

Operating Profit

At the operating level, the operating profit decreased by 3.9% to KD7.2mn in 2005 from KD7.4mn in 2004. The operating profit margin increased to 21.0% in 2005 from 17.0% in 2004.

Net Profit

The land costs and interest expenses were higher during the year than in the previous year. Besides, while income/gains/profit from investments rose to KD1.0mn in 2005, from (-) KD0.04mn in the previous year, gains from/change in fair value of investment property yielded KD1.5mn in 2005, 83.4% lower than KD8.9mn in 2004. As a result, the net profit of the company declined by 31.5% to KD7.9mn in 2005 from KD11.5mn in 2004. The net profit margin simultaneously decreased from 26.4% in 2004 to 23.2% in 2005. The EPS fell to 63.5 fils in 2005 from 99.6 fils in the previous year.

Dividends

The company has proposed 50% cash dividend and 5% bonus in 2005, with a dividend payout ratio of 79.0%. In 2004, the company had paid 45% cash dividend and 5% bonus with a dividend payout ratio of 46.4%.

Assets and Liabilities

The total assets of the company rose by 11.9% to KD80.3mn at the end of 2005. While the current assets declined by 1.9% during the year, accounts receivable witnessed a rise of 37.1% to KD10.2mn at the end of the year (95 receivable-days in 2005 from 42 in 2004). Trade receivables increased by 13.9% to KD8.1mn at the end of 2005. Simultaneously, inventories increased by 26.9% to KD2.6mn at the end of the year (41 inventory-days in 2005 from 25 in 2004). Increase in fair value boosted the value of investments held for trading to KD1.6mn at the end of 2005 from KD0.05mn at the end of 2004. Lands under development declined by 30.6% to KD9.4mn at the end of 2005. There was an investment of KD11.2mn in ACICO International for Real Estate Development (an unconsolidated subsidiary) during the year. Investment properties declined by 81.8% to KD4.0mn at the end of 2005 from KD22.0mn at the end of the previous year, thanks to lower additions and higher transfers to projects under construction and disposals during the year. Work-in-progress more than trebled during the year to KD14.1mn from KD4.6mn at the end of 2004, due to higher transfer from investment property and despite a higher transfer to the fixed assets portfolio of the company. The net fixed assets increased by 50.9% to KD15.8mn in 2005 on the back of high additions and transfers from the projects under construction during the year.

On the liabilities side, the accounts payable increased by 36.2% during the year (102 payable-days in 2005 from 56 in 2004). Long-term loans saw a rise of 44.1% to KD7.5mn from the end of the previous year. The average cost of debt firmed up to 6.4% in 2005 from 4.5% in the previous year. The owners' equity rose during the year by 8.7% to KD42.2mn, on the back of, among others, a 5% stock dividend declared in 2004.

Financial Performance in the First Half of 2006

The company had revenue of KD17.9mn in the first six months of 2006, up 2.9% year-on-year (y-o-y). The total cost of operations of KD12.3mn was up 2.5% y-o-y. Prior to eliminating the inter-company transactions, the AAC segment registered a revenue growth of 15.1%, real estate revenue saw a de-growth of 60.7% and contracting witnessed a revenue growth of 181.9% on a y-o-y basis during the period. The gross profit of KD5.6mn was up 3.7% y-o-y, with a gross profit margin of 31.3%, as against 31.0% in first half of 2005. General and administrative expenses during the period of KD0.9mn were down 12.9% y-o-y, while selling expenses of KD0.5mn were down 15.4% y-o-y. Investment income of KD0.5mn (nil in 1H 2005) consisted of KD0.4mn of unrealized gains on investments. On the other hand, gain on sale of investment property was nil during the period, against KD1.1mn in the corresponding period of the previous year. Finance charges of KD1.0mn were up 31.2% y-o-y, though loans outstanding of KD30.9mn were up 13.6% vis-à-vis a year ago. The company's net profit during the period of KD3.6mn (after minority interest) was down 15.5% y-o-y.

The total assets of the company of KD86.4mn were up 7.6% from the end of 2005. Accounts receivable rose by 27.4% during the period. Trading investments rise by 162.5% during the period. The work-in-progress of KD18.4mn was higher by 30.5% from that at the end of 2005. On the liabilities side, bank loans went up by 4.7% to KD30.9mn at the end of the period. Accounts payable of KD9.3mn were up 38.8% during the period. The period also saw the share capital of the company rising with the addition of the 5% stock bonus of the previous year. The company has also issued rights shares in March 2006 in the proportion of one share for every eight shares held at a face value of 100 fils and a premium of 300 fils each, collecting KD6.25mn through the issue. This will help the company partly meet the capital expenditure laid out by it for its various ongoing projects. Post the bonus and rights issues, the paid-up capital of the company stood at KD14.7mn at the end of June 2006. While the share premium account swelled to KD16.2mn after the rights issue, the owners' equity increased to KD44.2mn, up 4.7% from the end of 2005.

SWOT Analysis

Strengths/Opportunities

- The Group has interests in the AAC, real estate and construction businesses, which provide it with diversified revenue streams.

- The Group is a leading producer and marketer in the GCC region of AAC products based on technology sourced from Hebel, a world leader in patented AAC technology. AAC products, with their many advantages over traditional concrete products, are expected to be increasingly preferred in construction in the future.

- The Group has a share of about 45-50% in the Kuwait AAC market. The Group has also established presence in UAE, and is establishing its presence in other GCC countries, such as Qatar and Saudi Arabia. UAE and Saudi Arabia together have the largest proportion (79%) of civil construction projects among the six GCC countries. Together with Kuwait and Qatar, the company, thus, plans to have a presence in about 91% of the civil construction market in the region. In terms of buildings projects, this is about 65-70% of the total civil construction market in the region.

- The construction sector is benefiting from huge investments in real estate sector all across the GCC, riding on high oil prices-driven liquidity, exacerbated by high population growth rates and resultant housing shortages. This benefits all the business lines of the Group.

- A good chunk of the Group's business comes from the sale of its AAC products and construction services to third-party players, which de-risks its business model against business concentration risk.

- The Group is also foraying into the high-potential hospitality industry with a couple of hotel projects in UAE. Besides, it is also developing commercial complexes in that country, which are expected to boost its revenues and profits from as early as the end of 2006 itself. These moves are aimed at cashing in on the high growth potential in these sectors, moving forward.

- The Group also plans a string of financial engineering moves in the times ahead, which should see the Group transform itself into a leaner, more efficient and better focused Group, while unlocking value for its shareholders.

- The Group does not see more players entering the AAC industry moving forward. It, thus, along with NIG, has a duopoly in the Kuwait AAC market.

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 company's AAC products cannot be used for heavy-load applications, such as public infrastructure projects. The company, thus, cannot benefit from a sizeable part of the ongoing big-ticket construction projects in the region.

- The proposed foray into hospitality and management of commercial complexes is expected to take the Group into a totally new and highly competitive territory, from its current construction-related businesses. This is likely to test the management acumen of the Group afresh.

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. In keeping with the expansion plans of the company, the DHCC commercial-cum-medical complex is expected to be operational from September 2006, the Fujairah beach resort from January 2007, the Port Saeed commercial complex from mid-2007, the Sheikh Zayed Road commercial complex from October 2008, and the Sheikh Zayed Road hotel from January 2009. Capital expenditure of the company has accordingly been projected for these years.

3. The revenues of the Group have been projected for the future years to include business from these new business segments.

4. The cost of operations too has been projected keeping in view the expanded business in the future years. A declining gross profit margin (GPM) has been assumed, in line with our expectations of intensified competition in all the business segments in which the company is expected to operate going forward.

5. 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.

6. Average depreciation has been assumed at 10% on the new fixed assets acquired in 2006 and thereafter.

7. The operating profit margin is projected to marginally improve from 2006 to 2008 due to economies of scale.

8. Average cost of debt has been assumed to firm up going forward, in keeping with the hardening interest rates. From 6.4% in 2005, it is expected to touch 7.0% in 2006, continuing to increase by 50bp every year thereafter in 2007 and 2008. From 2009, it has been assumed at a steady 7.5% per year.

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

10. The company is projected to raise both long-term and short-term debt to meet its enhanced capital expenditure going forward. The debt/equity ratio is expected to rise from 0.7x at the end of 2005 to a high of 2.1x in 2008, before coming down in later year due to re-payments.

11. Cash dividend rate is assumed to go up from 50% in 2005 to 62% in 2009, with the corresponding payout ratio decreasing from 79.0% in 2005 to 74.7% in 2009.

12. Transfers to statutory reserve has been assumed at levels indicated in the company's audited financial statements for 2005.

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

Table 10 : ACICO - Earnings and Valuation Ratios

	2004	2005	2006 (P)	2007 (P)	2008 (P)	2009 (P)
Net profit (KDmn)	11.5	7.9	7.3	8.8	9.0	12.2
GPM (%)	28.5	38.9	38.3	38.9	39.1	40.0
OPM (%)	17.0	21.0	19.3	20.6	20.8	21.7
NPM (%)	26.4	23.2	15.7	13.6	11.4	13.0
ROAA (%)	18.6	10.4	7.9	7.0	5.6	6.9
ROAE (%)	37.5	19.5	16.0	17.6	17.7	22.9
EPS (fils)	100	64	50	60	61	83
BVPS (fils)	326	338	337	344	350	374

*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 ACICO.

1. A risk-free rate of 6.25%, equal to the current CBK discount rate, has been assumed.

2. A market risk premium of 8.0% has been assumed, to factor in the increased riskiness of the real estate and construction markets going forward.

3. Beta has been assumed at 1.0, since the beta as at June 30, 2006, based on the previous 60 months' returns, is 0.845.

4. The cost of equity derived from the above assumptions using the Capital Asset Pricing Model (CAPM) is 14.25%.

5. The cost of debt has been assumed at 8.0%, 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 13.0%.

7. Terminal growth rate of 3.0% 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 ACICO is KD0.709 per share.

Table 11 : DCF Valuation of ACICO

	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Years	0.33	1.33	2.33	3.33
Free Cash Flow	(21.6)	(25.2)	(10.5)	21.9
Discount Factors	0.96	0.85	0.75	0.67
Discounted Cash Flows	(20.8)	(21.4)	(7.9)	14.6
WACC	13.0%			
Terminal Growth Rate	3.0%			
Primary Value	(35.5)			
Terminal Value	150.1			
Investments	19.8			
Cash	0.7			
Enterprise Value	135.0			
Debt	30.9			
Equity Value	104.1			
No. of Equity Shares Outstanding (mn)	146.8			
Per Share Value (KD)	**0.709**			

Source: Company's audited financial statements for 1H 2006, ***Global*** *Research.*
All figures in KDmn, 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 ACICO's shares based on a range of varying inputs. The shaded area at the center shows the most probable range of alternatives.

Table 12 : Sensitivity Analysis of ACICO

		Terminal Growth Rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
WACC	11.0%	0.750	0.880	1.042	1.251	1.529
	12.0%	0.625	0.729	0.856	1.015	1.220
	13.0%	0.522	0.607	0.709	0.833	0.989
	14.0%	0.436	0.506	0.589	0.689	0.811
	15.0%	0.363	0.422	0.491	0.572	0.670

Source: ***Global*** *Research*

Relative Valuation Method

The peer group valuation is performed to compare the intrinsic value of ACICO arrived at using the DCF calculation. In order to value ACICO 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 ACICO. 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 weighted average P/E of the listed companies in Kuwait and UAE in the three main business segments of the company

at present – contracting services, real estate development and building materials – based on their current market prices and 2006 (Projected) earnings. The weighted average P/Es for each of the segments were then weighted with the contribution of each of these segments in the company's projected revenues in 2006 to arrive at the composite weighted average forward P/E. The composite weighted average forward P/E for the peer set, thus arrived at, is 9.4x.

On the basis of the composite weighted average forward P/E for the peer set and ACICO's projected 2006 earnings, the company's stock valuation comes to KD0.470 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% to the peer valuation method, and 80% weightage to the value arrived at using the DCF method.

Weighted Average Share Value

The value of ACICO's shares derived from the weighted average of the DCF and relative valuation methods is KD0.661 per share. The stock closed at KD0.500 on the KSE at the end of trading on September 2, 2006, which implies that the weighted average value of ACICO's shares is at a premium of 32.2% to the share's current market price. At their current price, ACICO's shares have a P/E multiple of 7.9x the 2005 earnings, and forward multiples of 10.0x and 8.4x the projected 2006 and 2007 earnings respectively. We, therefore, recommend a 'BUY' on the ACICO stock at its prevailing price levels with a medium-term perspective.

Table 13 : Weighted Average Share Value of ACICO

	Weightage	Fair Value (in KD per share)
As per DCF Method	80%	0.709
As per Relative Valuation	20%	0.470
Weighted Average Share Value		**0.661**

*Source: **Global** Research.*

Recommendation

The company has presence in the contracting, real estate and AAC businesses, with the contracting business contributing close to half of its overall revenues at present. The company has almost half the market share in its AAC business segment. AAC has many positive features for being used in real estate construction. Its real estate and construction contracting subsidiaries consume a substantial part of its AAC output, though the company also caters to the AAC demand of other consumers in the region. Going forward, the company is moving into the hospitality sector too, by developing hotel properties in the lucrative Dubai market. It has two hotel/resort properties in Dubai, which are at various stages of development at present. It is also developing commercial complexes in Dubai. These segments are expected to contribute to an increasing share of its revenues going forward, especially after the growth in its real estate and contracting businesses slackens, with these markets gradually reaching saturation in the near-medium term. The Group also has a few financial engineering activities planned out in the times ahead. Part of this strategy involves hiving-off its fully-owned housing subsidiary Al Masaken, and merging the existing subsidiaries ACICO International

and KUPS with the parent company ACICO. These moves are expected to unlock value for its shareholders. 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 ACICO stock with a 'BUY' recommendation, with a price target of KD0.661, implying a potential upside of 32.2%, with a medium-term perspective.

BALANCE SHEET

Amounts in KD	AERATED CONCRETE INDUSTRIES CO. KSC						
	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Assets							
Bank & cash equivalents	946,107	201,067	498,051	438,432	900,751	778,462	909,560
Account receivables	2,645,304	7,465,928	10,235,393	14,669,082	17,408,372	20,716,694	25,254,310
Other Receivables	8,263,777	4,546,459	3,030,262	3,826,717	4,440,911	5,179,173	6,055,880
Inventories	2,218,685	2,071,760	2,629,170	3,149,017	4,127,023	5,259,906	6,339,615
Investment Portfolios (Trading)	202,968	45,955	1,561,376	2,112,450	2,581,883	3,000,567	3,383,618
Lands under development	18,688,576	13,535,135	9,394,807	9,864,547	10,357,775	10,875,664	11,419,447
Total Current Assets	32,965,417	27,866,304	27,349,059	34,060,245	39,816,714	45,810,466	53,362,430
Investment available for sale	-	2,000,000	2,460,598	2,859,614	3,160,626	3,322,709	3,493,105
Investment in associates	-	483,910	644,658	644,658	644,658	644,658	644,658
Investment in unconsolidated subsidiary	-	-	11,215,260	178,053	178,053	178,053	178,053
Investment Property	-	21,967,102	4,000,000	4,101,266	4,205,095	4,300,787	4,398,655
Goodwill	-	2,705,446	3,158,661	3,158,661	3,158,661	3,158,661	3,158,661
Right of utilization of leasehold	4,687,757	1,683,301	1,574,074	1,471,759	1,376,095	1,286,649	1,203,017
Work in Progress	4,120,224	4,602,963	14,138,870	34,098,870	40,698,870	42,898,870	1,500,000
Gross fixed assets	16,741,586	17,763,876	24,565,195	34,605,195	68,005,195	95,805,195	139,705,195
Less: Accumulated depreciation	6,081,948	7,310,952	8,789,472	10,948,869	14,876,671	21,012,984	29,865,682
Net fixed assets	10,659,638	10,452,924	15,775,723	23,656,326	53,128,525	74,792,211	109,839,513
Total Assets	**52,433,036**	**71,761,950**	**80,316,903**	**104,229,453**	**146,367,297**	**176,393,063**	**177,778,092**
Liabilities							
Accounts payable	4,759,359	4,920,783	6,700,036	9,053,424	10,643,374	12,360,780	13,606,978
Short-term loans	22,243,037	21,249,318	21,997,484	10,428,305	53,750,000	85,050,000	85,050,000
Due to unconsolidated subsidiary	-	-	169,726	506,476	506,476	506,476	506,476
Dividends payable	46,463	90,203	225,556	300,238	392,411	447,308	487,973
Total Current Liabilities	27,048,859	26,260,304	29,092,802	20,288,442	65,292,261	98,364,565	99,651,427
Long-term loan	1,750,005	5,202,989	7,495,441	31,957,977	26,957,977	21,957,977	16,957,977
Employee Indemnity Provision	285,527	421,942	547,920	575,316	604,082	634,286	666,000
Minority Interest	676,822	1,023,627	959,312	1,868,548	2,959,907	4,078,948	5,592,908
Owners' Equity:							
Paid-up equity capital	9,446,211	11,902,226	12,497,337	14,684,371	14,684,371	14,684,371	14,684,371
Share Premium	5,577,639	11,528,752	11,558,752	16,245,253	16,245,253	16,245,253	16,245,253
Statutory reserve	1,324,147	2,518,992	3,313,780	4,046,036	4,924,965	5,826,188	7,045,459
Treasury Shares	(96,169)	(96,169)	(96,169)	(500,000)	(500,000)	(500,000)	(500,000)
Gain on sale of treasury shares	2,458,046	2,458,046	2,458,046	2,458,046	2,458,046	2,458,046	2,458,046
Retained earnings	3,961,949	10,541,241	12,029,084	11,745,850	11,579,809	11,320,721	13,483,545
Cumulative changes in fair value		-	460,598	859,614	1,160,626	1,322,709	1,493,105
Total Shareholder's Equity	22,671,823	38,853,088	42,221,428	49,539,170	50,553,070	51,357,288	54,909,780
Total Liabilities & Owners' Equity	**52,433,036**	**71,761,950**	**80,316,903**	**104,229,453**	**146,367,297**	**176,393,063**	**177,778,092**

PROFIT & LOSS ACCOUNT

Amounts in KD	AERATED CONCRETE INDUSTRIES CO. KSC						
	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Operational Revenue	27,786,195	43,792,363	34,028,533	46,558,392	64,837,305	78,766,596	94,059,419
Cost of Production	(19,186,520)	(31,328,744)	(20,782,821)	(28,734,779)	(39,641,137)	(47,996,646)	(56,438,036)
Gross Profit	8,599,675	12,463,619	13,245,712	17,823,613	25,196,168	30,769,950	37,621,383
General & Administrative Expenses	(684,177)	(946,551)	(966,939)	(1,396,752)	(2,107,212)	(2,678,064)	(3,423,763)
Staff Costs	(1,999,489)	(2,793,266)	(3,655,143)	(4,917,995)	(5,789,464)	(6,505,041)	(7,309,064)
Distribution Expenses	(354,178)	(552,113)	(875,891)	(1,629,544)	(2,593,492)	(3,229,430)	(3,762,377)
Provisions	(115,295)	(59,427)	(63,133)	(279,350)	(324,187)	(315,066)	(376,238)
Amortization	(299,010)	(299,010)	(109,227)	-	-	-	-
Depreciation	(340,868)	(369,103)	(420,142)	(591,704)	(1,026,104)	(1,638,104)	(2,355,104)
Operating Profit	4,806,658	7,444,149	7,155,237	9,008,268	13,355,709	16,404,243	20,394,838
Other Income	180,757	1,243,129	897,149	600,000	648,373	787,666	846,535
Gain on sale of investment property	-	-	1,171,508	-	-	-	-
Unrealized gain from investments	-	-	486,000	551,074	469,433	418,684	383,051
Dividend income	-	-	500,000	541,917	309,000	308,502	296,908
Interest expenses	(661,561)	(1,141,919)	(1,785,094)	(2,515,772)	(4,616,035)	(7,508,638)	(7,838,098)
Profit on disposal of investments	-	(39,724)	-	11,000	10,715	9,049	6,600
Interest income	-	-	-	304,363	-	-	-
Forex gain / (loss)	266,260	(17,350)	(7,410)	(12,694)	25,000	50,000	75,000
Change in the fair value of investment property	-	8,857,287	300,000	101,266	103,830	95,691	97,869
Contractual commitment expenses	-	(3,750,000)	-	-	-	-	-
Board of Directors remuneration	(75,000)	(85,000)	(85,000)	(85,000)	(85,000)	(85,000)	(85,000)
Contribution to KFAS	(38,626)	(107,536)	(74,231)	(76,636)	(84,844)	(86,976)	(117,391)
NLST	(71,350)	(215,718)	(181,597)	(195,992)	(255,530)	(261,956)	(353,633)
Profit before Minority Interest	4,407,138	12,187,318	8,376,562	8,231,793	9,880,652	10,131,266	13,706,679
Minority Interest	(300,323)	(647,126)	(469,508)	(909,236)	(1,091,359)	(1,119,041)	(1,513,960)
Net Profit	**4,106,815**	**11,540,192**	**7,907,054**	**7,322,557**	**8,789,292**	**9,012,226**	**12,192,719**
P&L Appropriation Account:							
Opening Balance of Retained Earnings	3,661,365	3,961,949	10,541,241	12,029,084	11,745,850	11,579,809	11,320,721
Adjustments	-	-	339,911	-	-	-	-
Net Profit for the year	4,106,815	11,540,192	7,907,054	7,322,557	8,789,292	9,012,226	12,192,719
Transfer to Statutory Reserve	(429,179)	(1,194,845)	(824,788)	(732,256)	(878,929)	(901,223)	(1,219,272)
Proposed Cash Dividend %	*35.0%*	*45.0%*	*50.0%*	*55.0%*	*57.0%*	*60.0%*	*62.0%*
Proposed Cash Dividend	(3,377,052)	(3,293,744)	(5,339,223)	(6,248,669)	(8,076,404)	(8,370,091)	(8,810,623)
Proposed Stock Dividend %	*5.0%*	*5.0%*	*5.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Proposed Stock Dividend	-	(472,311)	(595,111)	(624,867)	-	-	-
Closing Balance of Retained Earnings	3,961,949	10,541,241	12,029,084	11,745,850	11,579,809	11,320,721	13,483,545

CASH FLOW STATEMENT

Amounts in KD	AERATED CONCRETE INDUSTRIES CO. KSC						
	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Operating							
Operating Activities	6,576,647	4,317,292	8,558,287	8,908,967	12,944,242	15,465,858	21,806,663
Profit before KFAS & NLST	4,106,815	12,510,572	8,632,390	7,595,185	9,129,666	9,361,157	12,663,743
Depreciation	1,208,773	1,259,933	1,552,022	2,159,397	3,927,802	6,136,314	8,852,698
Amortization	299,010	299,010	109,227	-	-	-	-
Gain on sale of investment property	-	-	(1,171,508)	-	-	-	-
Unrealized gain from investments	-	-	(486,000)	(551,074)	(469,433)	(418,684)	(383,051)
Dividend income	-	-	(500,000)	(541,917)	(309,000)	(308,502)	(296,908)
Change in fair value of investment property	-	(8,857,287)	(300,000)	(101,266)	(103,830)	(95,691)	(97,869)
Gain on sale of property, plant and eqpt	(656)	(1,031,663)	(4,020)	-	-	-	-
Provision for slow-moving inventory	-	-	60,000	-	-	-	-
Gain on sale of land	-	(1,114,038)	(791,031)	-	-	-	-
Gain / loss from Sale of Investments	-	39,724	-	(11,000)	(10,715)	(9,049)	(6,600)
Provision for doubtful debts	115,295	59,427	3,133	-	-	-	-
Increase in indemnity provisions	88,447	152,171	164,403	27,396	28,766	30,204	31,714
Payment for staff indemnity	(14,540)	(15,756)	(38,425)	-	-	-	-
Interest expenses	661,561	1,141,919	1,785,094	-	-	-	-
Interest income received	(51,369)	(1,016)	-	(304,363)	-	-	-
Contribution to KFAS	38,626	-	-	-	-	-	-
Payment for KFAS	(60,000)	(50,704)	(168,626)	(76,636)	(84,844)	(86,976)	(117,391)
Board of Directors fees	75,000	-	-	-	-	-	-
Payment of Board of Directors fees	(50,000)	(75,000)	(85,000)	-	-	-	-
NLST	71,350	-	(203,372)	(195,992)	(255,530)	(261,956)	(353,633)
Change in minority interest	88,335	-	-	909,236	1,091,359	1,119,041	1,513,960
Working Capital	(5,737,352)	228,890	446,611	(3,059,854)	(2,741,540)	(3,462,061)	(5,247,833)
Dec/(inc.) in receivables	1,552,835	119,090	(916,401)	(5,230,145)	(3,353,484)	(4,046,584)	(5,414,323)
Dec / (inc) in Inventories	(336,473)	146,925	(617,410)	(519,847)	(978,006)	(1,132,884)	(1,079,709)
Inc/(dec) in accounts payable	1,330,972	(37,125)	1,980,422	2,353,388	1,589,950	1,717,406	1,246,198
Change in other current assets	(8,284,686)	-	-	-	-	-	-
Change in other current liabilities	-	-	-	336,750	-	-	-
Total Operating	**839,295**	**4,546,182**	**9,004,898**	**5,849,113**	**10,202,703**	**12,003,796**	**16,558,829**

CASH FLOW STATEMENT (Contd.)

Amounts in KD	AERATED CONCRETE INDUSTRIES CO. KSC						
	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Investing							
Purchase of fixed assets	(756,361)	(1,103,058)	(3,096,642)	(10,040,000)	(33,400,000)	(27,800,000)	(43,900,000)
Proceeds from sale of fixed assets	5,503	77,236	63,258	-	-	-	-
Purchase of land	-	(3,416,071)	(3,769,984)	-	-	-	-
Proceeds from sale of land	-	9,683,550	8,701,343	-	-	-	-
Work in progress	(2,600,068)	(3,425,563)	(4,255,850)	(19,960,000)	(6,600,000)	(2,200,000)	41,398,870
Purchase of investment property	-	(10,927,458)	(4,920,548)	-	-	-	-
Proceeds from sale of investment property	-	-	16,387,425	(101,266)	(103,830)	(95,691)	(97,869)
Gain / loss from Sale of Investments	-	-	-	11,000	10,715	9,049	6,600
Unrealized gain from investments	-	-	-	551,074	469,433	418,684	383,051
Right of utilization of leasehold	-	-	-	102,315	95,664	89,446	83,632
Changes in lands under development	-	-	-	(469,740)	(493,227)	(517,889)	(543,783)
Paid for purchase of investment in associates	-	-	(160,748)	-	-	-	-
Investment in unconslidated subsidiary	-	-	169,726	11,037,207	-	-	-
Subscription in unconsolidated subsidiary	-	-	(12,361,000)	-	-	-	-
Interest income received	51,369	1,016	-	304,363	-	-	-
Dividend income received	-	-	160,000	541,917	309,000	308,502	296,908
Change in fair value of investment property	-	-	-	101,266	103,830	95,691	97,869
Purchase of investment avlbl for sale	-	(1,882,711)	(1,029,421)	-	-	0	0
Purchase of investment for trading	-	-	-	(551,074)	(469,433)	(418,684)	(383,051)
Total Investing	**(3,299,557)**	**(10,993,059)**	**(4,112,441)**	**(18,472,939)**	**(40,077,849)**	**(30,110,891)**	**(2,657,773)**
Financing							
Changes in Loan	4,562,547	2,459,265	3,040,618	12,893,356	38,321,696	26,300,000	(5,000,000)
Dividend paid	(3,358,766)	(3,250,005)	(5,203,870)	(6,173,986)	(7,984,231)	(8,315,194)	(8,769,958)
Cash dividend to subsidiary	-	(300,321)	(647,127)	-	-	-	-
Proceeds from treasury shares	-	-	-	(403,831)	-	-	-
Increase in Capital & premium	54,600	7,934,817	-	6,248,668	-	-	-
Interest expenses	(661,561)	(1,141,919)	(1,785,094)	-	-	-	-
Total Financing	**596,820**	**5,701,837**	**(4,595,473)**	**12,564,207**	**30,337,465**	**17,984,806**	**(13,769,958)**
Net Change in Cash	(1,863,442)	(745,040)	296,984	(59,619)	462,319	(122,289)	131,099
Net Cash at beginning	2,809,549	946,107	201,067	498,051	438,432	900,751	778,462
Net Cash at end	946,107	201,067	498,051	438,432	900,751	778,462	909,560

RATIO ANALYSIS

	AERATED CONCRETE INDUSTRIES CO. KSC						
	2003	2004	2005	2006 (F)	2007 (F)	2008 (F)	2009 (F)
Liquidity Ratios							
- Current Ratio (x)	1.2	1.1	0.9	1.7	0.6	0.5	0.5
- Quick Ratio (x)	1.1	1.0	0.8	1.5	0.5	0.4	0.5
- Inventory stock (days)	39	25	41	37	34	36	38
- Receivables outstanding (days)	32	42	95	98	90	88	89
- Length of operating cycle (days)	71	67	136	134	124	124	127
- Payables outstanding (days)	77	56	102	100	91	88	84
- Length of cash cycle (days)	(7)	11	34	34	33	37	43
Profitability Ratios							
- Total Assets Turnover (x)	0.6	0.7	0.4	0.5	0.5	0.5	0.5
- Total Net Fixed Assets Turnover (x)	2.6	4.1	2.6	2.4	1.7	1.2	1.0
- Equity Turnover (x)	1.2	1.4	0.8	1.0	1.3	1.5	1.8
- Gross Profit Margin (%)	30.9	28.5	38.9	38.3	38.9	39.1	40.0
- Operating Margin (%)	17.3	17.0	21.0	19.3	20.6	20.8	21.7
- Net Profit Margin (%)	14.8	26.4	23.2	15.7	13.6	11.4	13.0
- Return on Average Assets (%)	8.4	18.6	10.4	7.9	7.0	5.6	6.9
- Return on Average Equity (%)	18.4	37.5	19.5	16.0	17.6	17.7	22.9
- Return on Common Capital (%)	43.5	108.1	64.8	53.9	59.9	61.4	83.0
Activity Ratios							
- Inventory Turnover Ratio (x)	9.4	14.6	8.8	9.9	10.9	10.2	9.7
- Debtor turnover Ratio (x)	11.6	8.7	3.8	3.7	4.0	4.1	4.1
- Creditors Turnover Ratio (x)	4.7	6.5	3.6	3.6	4.0	4.2	4.3
Leverage Ratios							
- Current Liability / Equity (x)	1.2	0.7	0.7	0.4	1.3	1.9	1.8
- Debt / Equity (x)	1.1	0.7	0.7	0.9	1.6	2.1	1.9
Ratios Used for Valuation							
- EPS (fils)	41.6	99.6	63.5	49.9	59.9	61.4	83.0
- Book Value Per Share (fils)	240.0	326.4	337.8	337.4	344.3	349.7	373.9
- Dividend Payout Ratio (%)	80.5	46.4	79.0	110.3	95.2	97.8	74.7
- Market Price (KD) *	0.539	0.640	0.612	0.500	0.500	0.500	0.500
- P/E Ratio (x)	13.0	6.4	9.6	10.0	8.4	8.1	6.0
- P/BV (x)	2.2	2.0	1.8	1.5	1.5	1.4	1.3
- Dividend Yield (%)	6.5	7.0	8.2	11.0	11.4	12.0	12.4

** Market price for 2006 and subsequent years as on September 2, 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
Aerated Concrete Industries Company - KSC	Buy	ACIC.KW	KD 0.500	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.
3. Global Investment House makes a market in securities issued by this company.
4. Global Investment House acts as a corporate broker or sponsor to this company.
5. The author of or an individual who assisted in the preparation of this report (or a member of his/her household) has a direct ownership position in securities issued by this company.
6. An employee of Global Investment House serves on the board of directors of this company.
7. Within the past year , Global Investment House has managed or co-managed a public offering for this company, for which it received fees.
8. Global Investment House has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
9. Global Investment House expects to receive or intends to seek compensation for investment banking services from this company in the next three months.
10. Please see special footnote below for other relevant disclosures.

Global Research: Equity Ratings Definitions

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

This material was produced by Global Investment House KSCC ('Global'),a firm regulated by the Central Bank of Kuwait. This document is not to be used or considered as an offer to sell or a solicitation of an offer to buy any securities. Global may, from time to time,to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities ('securities'), perform services for or solicit business from such issuer, and/or have a position or effect transactions in the securities or options thereof. Global may, to the extent permitted by applicable Kuwaiti law or other applicable laws or regulations, effect transactions in the securities before this material is published to recipients.

Information and opinions contained herein have been compiled or arrived by Global from sources believed to be reliable, but Global has not independently verified the contents of this document. Accordingly, no representation or warranty, express or implied, is made as to and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. Global accepts no liability for any loss arising from the use of this document or its contents or otherwise arising in connection therewith. This document is not to be relied upon or used in substitution for the exercise of independent judgement. Global shall have no responsibility or liability whatsoever in respect of any inac curacy in or ommission from this or any other document prepared by Global for, or sent by Global to any person and any such person shall be responsible for conducting his own investigation and analysis of the information contained or referred to in this document and of evaluating the merits and risks involved in the securities forming the subject matter of this or other such document.

Opinions and estimates constitute our judgment and are subject to change without prior notice.Past performance is not indicative of future results. This document does not constitute an offer or invitation to subscribe for or purchase any securities, and neither this document nor anything contained herein shall form the basis of any contract or commitment what so ever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person.

Neither this report nor any copy hereof may be distributed in any jurisdiction outside Kuwait where its distribution may be restricted by law. Persons who receive this report should make themselves aware of and adhere to any such restrictions. By accepting this report you agree to be bound by the foregoing limitations.

Global Research

Global Investment House
Tel: (965) 2400551, ext 132 - Fax: (965) 2400661
research@global.com.kw
www.globalinv.net