

Short-Term Rec.: Reduce
Long-Term Rec.: Sell

Current Price*: AED 1.97
LT Fair Value : AED 1.46

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• The continuing delay in the company's key Iranian gas deal has meant that Dana Gas reported 3Q2007 results significantly below our expectations. Revenues (net of royalties) came in at AED138 million, flat Q-o-Q, and were driven solely by the company's Centurion business. While SG&A expenses were lower than expected, interest expenses rose 42% Q-o-Q to AED27 million and resulted in net profit of AED22 million for the quarter, down 24.1% Q-o-Q.

• Given that 3Q2007 results are below our expectations and that the Iranian gas deal has not yet materialized, our estimates for the full year are now too high. Also, we had previously expected that Dana Gas would make an acquisition in Pakistan as part of the Pakistan government's privatization plan, however, this deal now looks highly unlikely to occur, after the government put the privatization process on hold in the wake of political unrest.

• While we still expect the Iranian gas deal to materialize, given the significant capital outlay already committed by both parties, we now anticipate the start of this contract at the beginning of 2008. Therefore, taking into account the impact of removing both the Iranian gas deal for 2007 and the Pakistan transaction throughout the whole projection period, we downgrade our revenue forecasts by 67% and 53% for 2007 and 2008, while top line estimates fall by around 53% thereafter. Meanwhile, our estimates for net income decline by 70% and 43% for 2007 and 2008, and then by around 45% for subsequent years.

• Meanwhile, Dana Gas has issued a USD1 billion Sukuk to help to finance the company's future projects/acquisitions. The convertible bond matures in 2012 and has a fixed coupon payment of 7.5%. With the strike price to be set nine months after the issuance date, we believe the terms of this bond to be particularly favourable to bond holders, and with the greater likelihood of bond holders converting to equity, could be materially dilutive to existing shareholders.

• In light of our forecast downgrades, we also revisit our DCF analysis. Our new long term fair value estimate falls to AED1.46, down 18.9% from the previous LTFV of AED1.80. Since our LTFV is 26% lower than the current share price of AED1.97, we reduce our LT recommendation to Sell from Neutral. However, in the short term we are mindful of the positive sentiment that would follow from the announcement of the long awaited Iranian gas deal and our ST rating therefore moves to Reduce from Neutral.

December year end	2006a	2007e	2008e	2009e
Operating Income (mn)	(16.4)	161.3	637.4	708.8
Net Attrib. Income (mn)	235.4	94.8	307.0	356.2
ROE	3.5%	3.9%	7.6%	8.1%
EPS	0.04	0.02	0.05	0.06
EPS Growth	-65.8%	-59.7%	223.7%	16.0%
PER	50.2	124.6	38.5	33.2
DPS	N/A	N/A	N/A	N/A
Dividend Yield	0.0%	0.0%	0.0%	0.0%
BVPS	1.14	1.15	1.20	1.26
P/BV	1.73	1.71	1.64	1.56
CFPS (Operating CF)	0.04	0.05	0.10	0.11
P/CF	44.3	36.8	20.0	17.7
EBITDA (mn)	15.1	387.3	921.7	1,021
EBITDA Margin	26.3%	71.7%	37.2%	36.8%
EV/EBITDA	596.5	35.4	15.1	14.1
Net Debt/(Cash) (mn)	(2,839)	1,873	2,134	2,533
Net Debt/(Cash) / BV	-42%	27%	30%	33%
Net Debt/(Cash) /Mkt Cap	-24%	16%	18%	21%

Fig in AED unless otherwise stated



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Estimate Changes					
(AED mn)	2006a	2007e		2008e	
		Old	New	Old	New
Revenue	57.3	1,657	540.0	5,229	2,480
EBITDA	15.1	889.0	387.3	1,246	921.7
EBITDA Margin	26.3%	53.6%	71.7%	23.8%	37.2%
Net Attrib. Income	235.4	312.8	94.8	537.2	307.0

Stock Data:

Last Ex-Div Date	N/A
Mkt. Val. (GDR mn)	AED11,820
Shares (mn)	6,000
Av. Mthly Liqd. (mn)	AED799.7
52-Week High / Low	AED2.33 / 1.30
Bloomberg / Reuters	DANA.UH / DANA.AD
Est. Free Float	35%

*prices as of 27 November 2007

I. REVIEW OF FINANCIALS

A. 3Q2007 RESULTS - BELOW EXPECTATIONS

Dana Gas reported 3Q2007 results significantly below our expectations. This was mainly due to the fact that the company's cornerstone Iranian gas deal has failed to materialize this year, while we had forecast it to contribute to earnings in 2H2007. Revenues (net of royalties) came in at AED138 million, were flat Q-o-Q, and reflected the sole contribution from Dana Gas' Centurion business and, more specifically, its Egyptian operations. The gross margin came in at 93% for the quarter and 89% for 9M2007 vs. our expectation of 60% for FY2007.

Meanwhile, SG&A expenses came in at AED19 million for 3Q2007 (down 34.5% Q-o-Q), which led to SG&A expenses for 9M2007 of AED60 million. Interest costs rose 42% Q-o-Q to AED27 million, and meant that net profit for the quarter came in at AED22 million, a decline of 24.1% Q-o-Q.

Table 1.1: Summary of 3Q2007 Results

(AED mn)	3Q06a	FY06a	1Q07a	2Q07a	3Q07a	Q-o-Q	9M07a	FY07e Old Est.	FY07e New Est.
Revenue			202	241	276	14.5%	719	2,113	996
Less Royalties			(79)	(103)	(138)	34.0%	(320)	(456)	(456)
Net Revenue			123	138	138	0.0%	399	1,657	540
Cost of Sales			(18)	(17)	(10)	-41.2%	(45)	(664)	(65)
Gross Profit			105	121	128	5.8%	354	993	475
Gross Profit Margin			85%	88%	93%		89%	60%	88%
SG&A	(6)	(36)	(12)	(29)	(19)	-34.5%	(60)	(86)	(70)
EBITDAX	(6)	(36)	93	92	109	18.5%	294	907	405
Exploration Expenses	0		(14)	(5)	(1)	-80.0%	(20)	(18)	(18)
EBITDA	(6)	(36)	79	87	108	24.1%	274	889	387
EBITDA Margin			64%	63%	78%		69%	54%	72%
Depreciation & Depletion	0		(54)	(60)	(56)	-6.7%	(170)	(359)	(226)
Net Operating Profit	(6)	(36)	25	27	52	92.6%	104	530	161
NOP Margin			20%	20%	38%		26%	32%	30%
Non-operating Income		29	13	1	1	0.0%	7	0	0
Gain in FV of Inv. Property			59	59	36	-39.0%	154	0	154
Net Interest Income (Expense)	52	820	(46)	(19)	(27)	42.1%	(84)	(25)	(45)
Earnings before Taxes	46	814	51	68	62	-8.8%	181	505	270
Income Taxes	0	0	(30)	(39)	(40)	2.6%	(109)	(192)	(176)
Net Profit after Unusual Items	46	814	21	29	22	-24.1%	72	313	95

Source: Dana Gas Financials, EFG-Hermes estimates

OTHER NEWS AND DEVELOPMENTS

New USD1 billion Sukuk

Dana Gas issued a USD1 billion Sukuk on 31 October to help the company finance future projects and/or acquisitions. The convertible bond matures in 2012 and has a fixed coupon payment of 7.5%. This issue follows on from the company's failed attempt to raise money through the debt markets earlier in the year.

Political Instability in Kurdistan

In 1H2007, Dana Gas signed a strategic alliance with the Kurdistan Regional Government of Iraq. Under the terms of the strategic alliance, Dana Gas was appointed, on a service contract basis, to develop, process, and transport natural gas from the Khor Mor Gas field and to provide natural gas supplies to fuel domestic electric power generation plants currently under construction near Erbil and Suleymaniya. More recently, Dana Gas has opened its new Suleymaniya office in the Kurdistan region of Iraq. The Khor Mor project is now 60% complete with production scheduled for early 2008.

Given the lack of details that Dana Gas has provided regarding this agreement - i.e. what potential production levels will be, and therefore subsequent revenue and profit expectations, we have chosen not to include this project in our forecasts at this stage. Moreover, with the recent political instability in the Kurdistan region of Iraq, we believe that there is a risk of possible delays to the project. Therefore, we have chosen to wait until we have more visibility, before including the potential upside from this agreement in our estimates for next year and beyond.

II. CHANGES TO FORECASTS

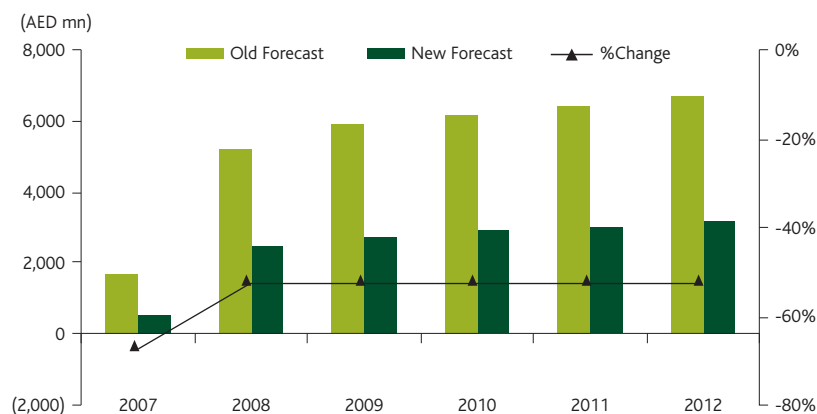
Given that these third quarter results are significantly below our expectations and that the Iranian gas deal has not yet materialized, our estimates for full year 2007 are now too high. While we still believe the Iranian deal will happen (given the capital already committed by both parties), and now anticipate the start of this contract at the beginning of 2008, we need to revisit our forecast assumptions to reflect the negative impact from this delay on our earnings estimates this year.

Moreover, we take this opportunity to look at our forecast assumptions beyond 2007. We had previously expected that Dana Gas would acquire Pakistan's Sui Southern Gas Company Limited as part of Pakistan government's privatization plan. However, this deal now looks highly unlikely to happen after the Pakistan government decided to put on hold its privatization process at least until the new government takes over. These combined changes will have a material impact to our forecasts for 2007 and beyond as follows:

REVENUE

Our previous revenue forecasts were based on the Iranian contract coming on stream in 2H2007 and contributing AED960 million to total revenues for FY2007. However, due to the on-going delay in the contract, we now reduce our forecasts significantly for 2007. We also now assume that Dana Gas will not purchase Pakistan's Sui Gas company, and therefore reduce our top line forecasts by 67.4% in 2007 and by 52.6% in 2008 to reflect both these changes. Beyond this, our revenue forecasts decline by around 53% per annum across our forecast horizon, as shown in Figure 2.1.

Figure 2.1: Changes in Revenue Forecasts



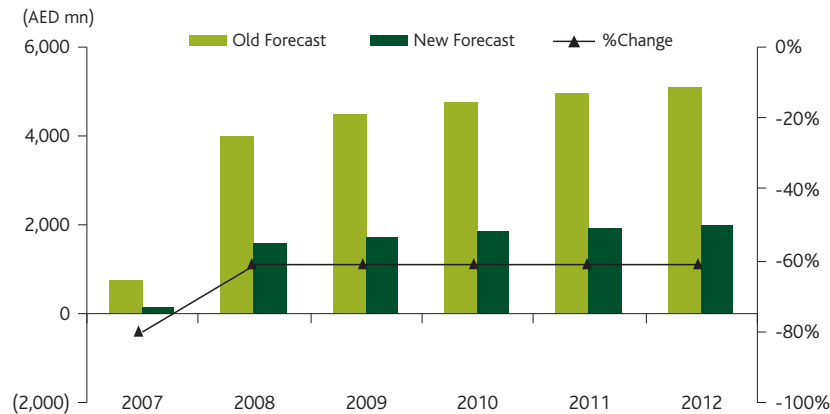
Source: EFG-Hermes estimates

OPERATING COSTS

We go on to reduce our forecasts for Dana Gas' operating costs accordingly. Our previous estimates included costs associated with the Pakistani acquisition. However, as we now exclude this from our numbers, we reduce our operating costs for 2007 by 80% and our subsequent forecasts by 61% per annum.

This reduction in our operating costs results in an increase in our gross profit margin estimates, increasing them from 60% to 88% in 2007 (reflecting Centurion operations only) and from just under 31% to just under 44% thereafter.

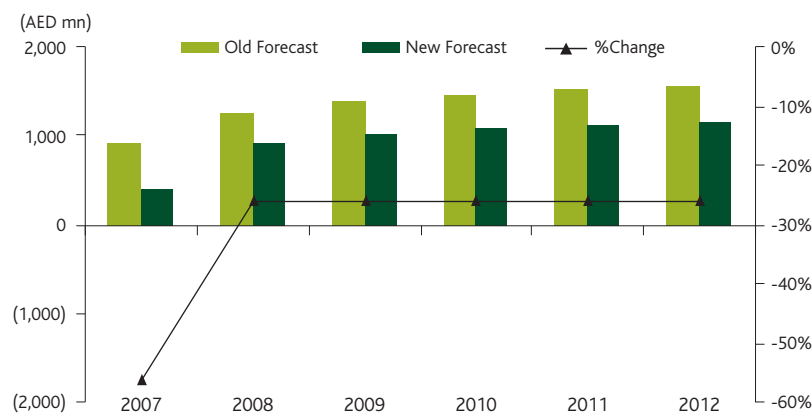
Figure 2.2: Changes in Total Operating Cost Forecasts



Source: EFG-Hermes estimates

The combined effect of these changes to our top line forecasts and cost assumptions means that our estimates for EBITDA fall by 56.4% in 2007 and by just over 26% in 2008 and beyond. However, our EBITDA margin increases from our old estimate of 54% to 72% in 2007 and from just under 23% to 37% thereafter.

Figure 2.3: Changes to EBITDA Forecasts



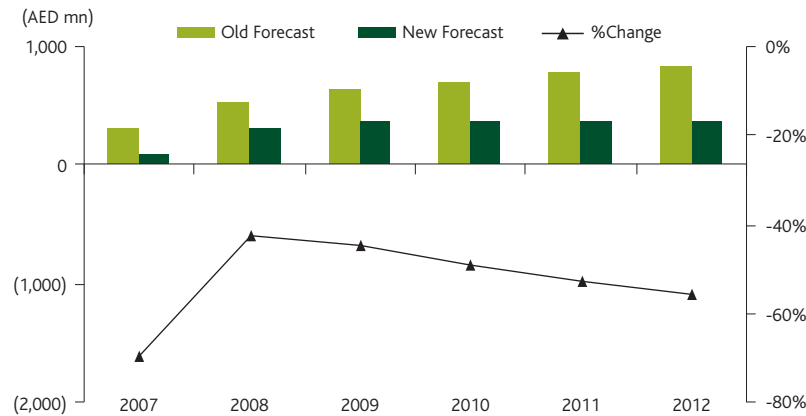
Source: EFG-Hermes estimates

NET INCOME

Furthermore, we make downward adjustments to our depreciation and amortization expenses going forward, again a reflection of the fact that we have now excluded the Pakistani Sui Gas company from our estimates.

Meanwhile, our forecasts for interest expenses increase to reflect the coupon payments due from the company's recent Sukuk issue. The combined effect of all these changes is that our net income forecasts fall by 69.7% and 42.8% in 2007 and 2008, and decrease further than 45% thereafter, as in Figure 2.4.

Figure 2.4: Changes in Net Income Forecasts



Source: EFG-Hermes estimates

Our new net income forecasts and EPS estimates show declines against our previous estimates across our forecast horizon, as in Table 2.5. It is worth noting that the significant increase to earnings from 2007 to 2008 (of 224%) for our new earnings estimates is a reflection of our assumption that the Iranian gas deal starts to contribute from the beginning of 2008.

Table 2.5: Changes in Earnings Forecasts

AED (mn)	2007e	2008e	2009e	2010e	2011e	2012e
Old Net Income	312.8	537.2	648.9	708.7	772.8	832.8
Old Number of shares (millions)	6,000	6,000	6,000	6,000	6,000	6,000
Old Earnings Per Share	0.052	0.090	0.108	0.118	0.129	0.139
Growth in EPS	37.2%	71.7%	20.8%	9.2%	9.0%	7.8%
New Net Income	94.8	307.0	356.2	358.1	362.4	366.6
New Number of shares (mn)	6,000	6,000	6,000	6,000	6,000	6,000
New Earnings Per Share	0.016	0.051	0.059	0.060	0.060	0.061
Growth in EPS	-59.5%	223.7%	16.0%	0.5%	1.2%	1.2%

Source: EFG-Hermes estimates

CHANGES TO DEBT AND EQUITY

Issuance of Convertible Sukuk - Potential Negative Impact on Existing Shareholders

Dana Gas has issued a USD1 billion Sukuk to help the company finance future projects and/or acquisitions. The convertible bond matures in 2012 and has a fixed coupon payment of 7.5%. The strike price, to which an exchange premium of 10% will apply, will be set nine months after the issuance date (4 October 2007).

The convertible Sukuk can potentially have a negative impact on the value accruing to the company's current shareholders. The Sukuk holders have the option of converting the Sukuk into equity in the future (starting nine months after issuance), or can continue to receive coupon payments until maturity in 2012. This option to convert will potentially have material dilutive effects on existing shareholders.

The extent of the dilution on existing shareholders will depend on two factors; i) the strike price of the Sukuk, which will determine how many shares the sukuk will be converted into and ii) the percentage of the Sukuk holders that will chose to exercise their option to convert.

As for the strike price, which is due to be set in nine months after the issuance date of October 4, we have undertaken an analysis to explore various scenarios and have assumed different strike prices - ranging from 50% upside to 62% downside to the current share price. As is illustrated in Table 2.6, the lower the strike price, the more shares that will need to be issued, resulting in greater dilution to existing shareholders. In this case, equity holders would suffer from a double negative effect; i) the impact of a lower share price and ii) greater dilution. However, if the strike price were to be above our estimated long-term fair value, then we believe the transaction would be accretive for existing shareholders.

Typically, bond holders would only benefit if the underlying share price increases above that of the strike price. However, in this case, given that the strike price has not yet been set, and is due to be set at just a 10% premium to the current share nine months after the Sukuk offering, bondholders will never be hugely out of the money if the price falls. Thus, there is a greater likelihood of bondholders converting to equity. We have therefore assumed that 100% of the Sukuk holders will convert to equity at maturity at the end of 2012.

Table 2.6: Various Scenarios for Conversion of Sukuk

Strike Price (AED)	Shares issued (mn)	New Equity	New No of shares (mn)	New LTFV	Dilution
0.75	4,448	12,087	10,448	1.16	21%
1.00	3,336	12,087	9,336	1.29	11%
1.25	2,669	12,087	8,669	1.39	4%
1.50	2,224	12,087	8,224	1.47	-1%
2.00	1,778	12,306	7,778	1.58	-8%
2.50	1,544	12,612	7,544	1.67	-15%
3.00	1,389	12,917	7,389	1.75	-20%

Source: EFG-Hermes estimates

This Sukuk issue will also impact the company's capital structure going - which will go from 100% equity in 2006 to an expected debt to equity ratio of 1:3 over 2008-2010.

Table 2.7: Movements in Debt and Equity and Interest Cover

	2006e	2007e	2008e	2009e	2010e	2011e	2012e
Net Debt (Cash)	(2,839)	1,873	2,134	2,533	2,838	3,151	3,511
Equity	6,814	6,909	7,216	7,572	7,930	8,293	8,659
Total	3,975	8,782	9,350	10,105	10,768	11,444	12,171
Debt Proportion	0%	21%	23%	25%	26%	28%	29%
Equity Proportion	100%	79%	77%	75%	74%	72%	71%
Debt/EBITDA	N/A	4.8	2.3	2.5	2.7	2.8	3.0
EBITDA/Interest	N/A	8.6	3.3	3.7	3.9	4.0	4.2
Operating profit/interest	N/A	3.6	2.3	2.6	2.7	2.7	2.8

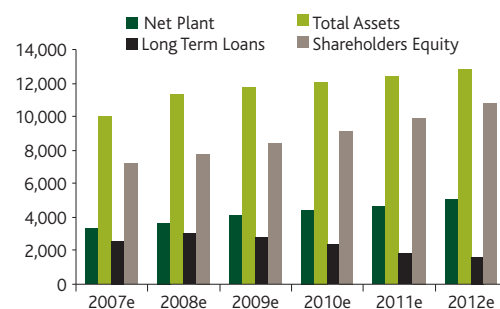
Source: EFG-Hermes estimates

CHANGES TO BALANCE SHEET

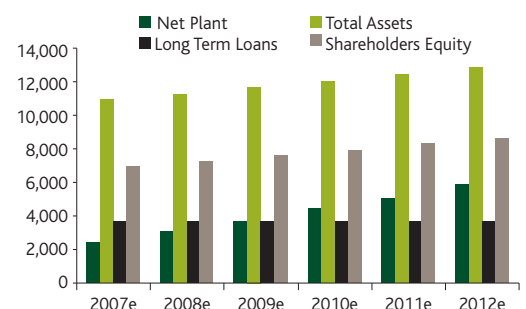
In light of our new assumptions, we have also revisited our balance sheet forecasts. Indeed, the exclusion of the Pakistani Sui Gas company from our numbers, combined with the Sukuk issue, have led to changes in our balance sheet estimates, as in Figures 2.8.

Figures 2.8: Balance Sheet Forecasts - Old vs New

A. Old Balance Sheet Forecasts



B. New Balance Sheet Forecasts



Source: EFG-Hermes estimates

III. VALUATION

In light of all of these changes to our forecasts, we revisit our DCF analysis. As a result of downgrades to our earnings estimates, our new fair value estimate of AED1.46 per share is 18.9% lower than our previous estimate of AED1.80 per share.

We have also made an adjustment to our WACC calculations for Dana Gas. Our WACC rises to 9.4% from our previous assumption of 9.0%. Although we assume a lower risk free rate of 4.2% (10 year US Treasury bond rate) vs. 4.8% previously and apply a lower discount factor on our free cash flows for 2007 and beyond, to reflect the fact that there is only one month left in the year, we increase our risk premium from 5.0% to 5.8% to reflect greater risk attached to our forecasts, given delays to Dana's key Iranian contract which makes up a significant share of our estimates going forward.

We continue to assume that Dana Gas' future capital expenditure is equal to 0.6x depreciation, which is in line with other gas/energy companies across the region.

Table 3.1: Old Discounted Cash Flow

(AED mn)	2007e	2008e	2009e	2010e	2011e	2012e	2013e
EBITDA	889	1246	1384	1450	1508	1569	1631
Change in Working Cap	(476)	(970)	(191)	(83)	(73)	(73)	(76)
Capex	(596)	(199)	(203)	(224)	(244)	(266)	(277)
Acquisitions	(4,850)	-	-	-	-	-	-
Taxes	(192)	(269)	(289)	(306)	(322)	(337)	(351)
FCF	(5,225)	(192)	701	836	869	892	928
Discount factor	0.9	0.8	0.8	0.7	0.6	0.6	0.5
Discounted FCF	(4,793)	(161)	541	593	565	532	507
Terminal value	18,550						
Perpetual Growth	4.0%						
WACC	9.0%						
PV of Cash Flows 2007-2012	(2,724)						
PV of Perpetuity	11,061						
Total Firm Value	8,337						
Estimated Net (Debt) / Cash	2,468						
Total Equity Value	10,804						
No. of shares	6,000						
Value / Share Price (AED)	1.80						

Source: EFG-Hermes estimates

Table 3.2: New Discounted Cash Flow

(AED mn)	2007e	2008e	2009e	2010e	2011e	2012e	2013e
EBITDA	387	922	1021	1069	1112	1157	1203
Change in Working Cap	(278)	5	(71)	(14)	(11)	(11)	(11)
Capex	(451)	(144)	(160)	(176)	(190)	(204)	(213)
Acquisitions	(3,895)	-	-	-	-	-	-
Taxes	(176)	(240)	(255)	(266)	(276)	(286)	(297)
FCF	(4,412)	543	535	613	635	655	682
Discount factor	0.99	0.91	0.83	0.76	0.69	0.63	0.58
Discounted FCF	(4,372)	492	443	464	439	415	395
Terminal value	12,683						
Perpetual Growth	4.0%						
WACC	9.4%						
PV of Cash Flows 2007-2012	(2,119)						
PV of Perpetuity	8,030						
Total Firm Value	5,911						
Estimated Net (Debt)/Cash - end of 2006	2,839						
Total Equity Value	8,750						
No. shares	6,000						
Value/Share Price (AED)	1.46						

Source: EFG-Hermes estimates

Table 3.3: Sensitivity Analysis

		WACC				
		8.4%	8.9%	9.4%	9.9%	10.4%
Terminal Growth	3.0%	1.53	1.38	1.25	1.14	1.04
	3.5%	1.68	1.49	1.34	1.22	1.11
	4.0%	1.85	1.64	1.46	1.31	1.19
	4.5%	2.08	1.81	1.60	1.42	1.28
	5.0%	2.36	2.03	1.76	1.56	1.39

Source: EFG-Hermes estimates

Our DCF valuation of AED1.46 implies the following multiples; a 2008e P/E ratio of 28.5x, a PBV ratio of 1.2x and an EV/EBITDA ratio of 11.8x, which are still not cheap, particularly given the lack of visibility regarding delivery of the Iranian gas, and therefore uncertainty over our future forecasts.

RECOMMENDATION

Having revisited our forecasts and our DCF assumptions, our new estimated Fair Value of AED1.46 per share is 26% lower than the current share price of AED1.97. Therefore, we reduce our LT recommendation to Sell from Neutral. Furthermore, the shares have had a good run over the last few months (up 20.1% since October 1), with no justification for this performance in our minds. However, in the short term we can foresee positive sentiment from the announcement of the long awaited Iranian gas deal, and therefore, our ST recommendation moves to Reduce from Neutral.

COMPANY NOTE

Financial Statements (December year end)

(AED mn)	20/11/05 30-09/06	2006a	3Q2007a	2007e	2008e	2009e
Balance Sheet						
Cash & Liquid Assets	3,489	2,839	216	1,797	1,536	1,137
Accounts Receivable	1.0	2.0	326.0	347.7	203.9	228.2
Net Accounts Receivable	1.0	2.0	326.0	347.7	203.9	228.2
Inventory	-	-	141.0	168.7	227.1	256.6
Prepaid Expenses	-	-	-	52.5	231.1	258.6
Total Current Assets	3,490	2,841	683	2,366	2,198	1,881
Net Plant	844.0	862	2,293	2,400	3,007	3,723
Net Investments	-	-	231	231	243	255
Total Intangibles	3,140	3,140	5,696	5,900	5,855	5,810
Total Assets	7,474	6,843	8,903	10,897	11,302	11,668
Accounts Payable	42.0	25.0	270.0	284.1	378.5	384.8
Total Payables	42.0	25.0	270.0	284.1	378.5	384.8
Accrued Expenses and Provisions	1.0	4.0	13.0	12.0	13.2	14.5
Dividends Payable	-	-	-	-	-	-
Convertible Note	647.0	-	1,723	-	-	-
Total Current Liabilities	690.0	29.0	2,006	296.1	391.7	399
Loans	-	-	-	3,670	3,670	3,670
Other Liabilities	-	-	20.0	22.0	24.2	26.6
Total Liabilities & Provisions	690.0	29.0	2,026	3,988	4,086	4,096
Shareholder Equity	6,784	6,814	6,877	6,909	7,216	7,572
Income Statement						
Revenue	-	57.3	138.0	540	2,480	2,776
COGS	-	(37.2)	(10.0)	(64.8)	(1,381)	(1,561)
Gross Profit	-	20.1	128.0	475.2	1,099	1,215
Gross Profit Margin	-	35.0%	92.8%	88.0%	44.3%	43.8%
SG and A	(17.0)	(5.0)	(19.0)	(87.9)	(177.3)	(194.3)
EBITDA	(17.0)	15.1	108.0	387.3	922	1,021
EBITDA Margin	-	26.3%	78.3%	71.7%	37.2%	36.8%
Depreciation	-	(31.4)	(56.0)	(226.0)	(239.3)	(267.1)
Amortization	-	-	-	-	(45.0)	(45.0)
Net Operating Profit	(17.0)	(16.4)	52.0	161.3	637.4	708.8
Net Interest Income/(Expense)	171.0	151.8	(27.0)	(45.0)	(208.6)	(221.8)
Non-operating Income (Inc. Investments)	630.0	100.0	37.0	154.0	118.0	123.9
Earnings before Taxes	784.0	235.4	62.0	270.3	546.8	610.9
Income Taxes	-	-	(40.0)	(175.5)	(239.8)	(254.7)
NPAUI	784.0	235.4	22.0	94.8	307.0	356.2
Cash Flow Statement						
Cash Operating Profit after Tax	(801.0)	(32)	165	205	229	235
Change in Working Capital	-	(41)	(25)	(278)	5	(71)
Cash Flow after Change in WC	(27.0)	(73)	140	(73)	234	164
Capital Expenditure	1.0	(229)	(1,646)	(1,757)	(393)	(452)
Free Cash Flow	(827.0)	(302)	(1,506)	(1,830)	(159)	(288)
Non-operating Cash Flow	(211.0)	934	(2,589)	(2,837)	106	112
Cash Flow before Financing	217.0	632	(4,095)	(4,667)	(53)	(176)
Net Financing	(2,021)	2,104	1,575	3,625	(209)	(222)
Change in Cash	(2,842)	2,736	(2,520)	(1,042)	(261)	(398)

Source: Dana Gas, EFG-Hermes estimates

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