



# Dubai Financial Market

## Equity Research

## Initiation Coverage

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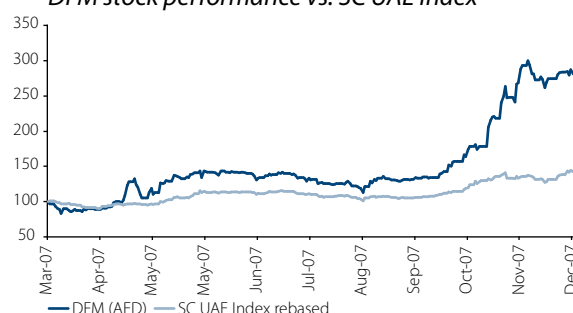
<b>Current Price:</b>	AED 6.85	<b>Country:</b>	United Arab Emirates
<b>Fair value Target:</b>	AED 4.01	<b>Sector:</b>	Financial Exchange
<b>Recommendation:</b>	SELL	<b>Exchange:</b>	Dubai Financial Market

- The Dubai Financial Market (DFM) commenced operations in March 2000 as the operator of the first regulated electronic exchange in the UAE. It was later listed in March 2007 to become the first listed exchange in the GCC. The DFM's vision today is to strengthen its position as a regional hub for the GCC capital market activity and to position itself as one of the key exchanges in emerging markets today. The establishment of Bourse Dubai as the holding company for the Government of Dubai's stake in both the DFM and the DIFX is a recent key development, with significant implications for DFM shareholders.
- We anticipate continuing strong growth in the size of the equity market in Dubai, on the back of both price appreciation and significant new listings, which should continue to drive trading volumes on the DFM higher. The DFM's revenue model is currently driven purely by trading volumes of equities on the exchange, and is underpinned by very high operating margins. We expect net income to grow by 50% in 2007 to reach AED 1.2 bn, and AED 1.3 bn in 2008 and at a CAGR of 14.2% for the remainder of our forecast period.
- The DFM is currently trading at a significant premium to global peer average multiples which indicates very lofty expectations for growth. Even with the significant anticipated growth in listings, the current market value of the exchange is unjustifiably higher than almost any other listed global exchange indicating exaggerated expectations. The current price does not seem to account for increasing domestic competition in a fragmented market with potential pressure on high exchange fees and restrictive regulatory environment.
- We initiate coverage on DFM with a Sell recommendation based on a target value of AED 4.01 per share implying a downside of 41% to the current market price of AED 6.85 per share. The target value was based on a sum of parts valuation which includes a discounted cash flow (DCF) valuation and a relative valuation utilizing a meaningful peer group with comparable market and growth prospects.

Year	Net Profit (AED '000')	BV (AED '000')	EPS (AED)	BVPS (AED)	RoAE (%)	P/E (x)	P/B (x)
Dec 09E	1,258,939	10,491,448	0.16	1.31	12.29	43.53	5.22
Dec 08E	1,307,330	9,987,872	0.16	1.25	13.44	41.92	5.49
Dec 07E	1,201,760	9,464,941	0.15	1.18	20.66	45.60	5.79
Dec 06	797,591	2,170,472	0.10	0.27	45.42	68.71	25.25

<b>Current Price</b>	6.85
<b>52-week range (AED)</b>	1.96-7.05
<b>Number of Shares ('000)</b>	8,000,000
<b>Free Float (%)</b>	20
<b>Market Cap (AED'000)</b>	54,800,000
<b>Market Cap (USD'000)</b>	14,923,747
<b>Div. Yld 2006 (%)</b>	0

DFM stock performance vs. SC UAE Index



## Investment Highlights

- The Dubai Financial Market (DFM) commenced operations in March 2000 as the operator of the first regulated electronic exchange in the UAE. It was later listed in March 2007 to become the first exchange in the GCC region to be traded on a financial exchange. At present government of Dubai owns 80% of DFM via Bourse Dubai.
- DFM's vision is to strengthen its position as a regional hub for the GCC capital market activity and to position itself as one of the key exchanges in emerging markets today. In an effort to achieve this, the government announced the establishment of Bourse Dubai as the holding company for its stake in DFM and DIFX. Eventually, the goal is to merge both exchanges under one coherent strategy and operation with compelling and complete collective service offering. However, private shareholders are currently only exposed to the performance of one component, the DFM.
- With the difference in listing requirements between the DIFX, it is becoming evident that once DIFX achieves critical mass, it will be in a position of competitive advantage against DFM, rather than a complementary one. Additionally, Bourse Dubai has emerged as the sole acquiring entity, meaning that acquisitions and consolidation events are likely only to occur on the holding company level.
- The UAE is expected to exhibit brisk growth of 60% in its market capitalization to reach AED 882 bn by year end 2007. This growth includes DFM's substantial capitalization increase of 65%. Going forward we assumed price appreciation on Dubai markets to be in-line with nominal GDP growth and to record 16% in 2008. The market in Dubai also enjoyed a record year in terms of equity offerings, with AED 24 bn worth of deals executed during 2007. In the upcoming year, we expect close to AED 95 bn worth of new capitalization originating from IPOs to be listed in Dubai and expected that to grow at a CAGR of 28% from 2008 onwards on the back of underrepresented sectors on the market. We allocate 50% of the new formed market capitalization to the DFM.
- The DFM's revenue model is currently driven purely by trading volumes of equities on the exchange, and is underpinned by very high operating margins. We expect net income to grow by 50% in 2007 to reach AED 1.2 bn, out of which 0.47 bn are non-recurring IPO related returns, meaning that operating profits for the year will be effectively flat. We expect earnings to grow to AED 1.3 bn in 2008 and at a CAGR of 14.2% for the remainder of our forecast period. However, we anticipate ROAE levels to witness downward pressure, not due to any pressure on margins, or lack of growth, but rather due to a situation of excess capitalization from funds raised in 2007, without any clear avenue for capital expenditure.
- The DFM is currently trading at a significant premium to global peer average multiples which indicates very lofty expectations for growth. Even with the significant anticipated growth in listings, the current market value of the exchange is unjustifiably higher than almost any other listed global exchange indicating exaggerated expectations. The current price does not seem to account for increasing domestic competition in a fragmented market with potential pressure on high exchange fees and restrictive regulatory environment.
- We initiate coverage on DFM with a Sell recommendation based on a target value of AED 4.01 per share implying a downside of 41% to the current market price of AED 6.85 per share. The target value was based on a sum of parts valuation which includes a discounted cash flow (DCF) valuation and a relative valuation utilizing a meaningful peer group with comparable market and growth prospects.

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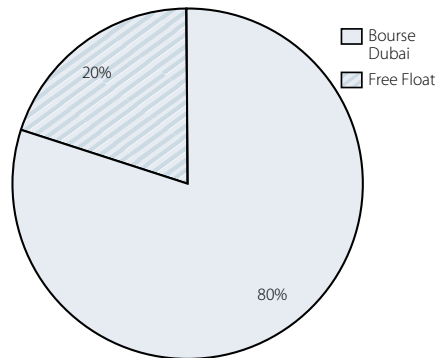
## Overview of DFM

### History

**DFM is the first listed exchange in the GCC region**

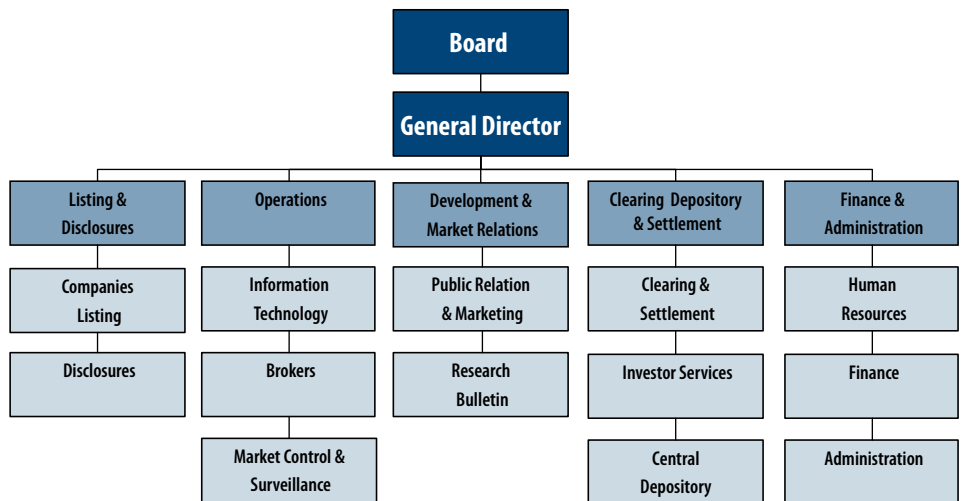
The Dubai Financial Market (DFM) commenced operations in March 2000 as the operator of the first regulated electronic exchange in the UAE for trading of securities. In December 2005, DFM, fully owned by the Dubai Government, was restructured as a public joint stock company in preparation for privatization which took place in 2006 through a 20% public offering. The DFM was listed in March 2007 (on the DFM) to become the first exchange in the GCC region to be traded on a financial exchange. Today, there are 56 companies listed on the DFM with a total market capitalization of AED 440 bn making the exchange third in terms of market capitalization among GCC peers. It is open to all international investors with a 49% maximum foreign ownership limit for most listed stocks.

### DFM ownership structure



Source: DFM

At present, the government of Dubai owns 80% of DFM via Bourse Dubai, a holding company established in August 2007, in which the government stakes in the DFM and the Dubai International Financial Exchange (DIFX) are retained.



Source: DFM

### Regulatory Structure

**DFM is regulated by both ESCA and the UAE Ministry of Economy**

The DFM is collectively regulated by the Emirates Securities and Commodities Authority (ESCA) and the UAE Ministry of Economy. ESCA was established in 2000 as an independent federal authority responsible for regulating the securities market in the country, and reports to the ministry of economy. Its responsibilities include regulating: 1) the exchanges, 2) clearing and settlements 3) ownership transfers, and 4) licensing. The Ministry of Economy's direct influence over the capital market's stems from it being the enforcer of the federal company's law.

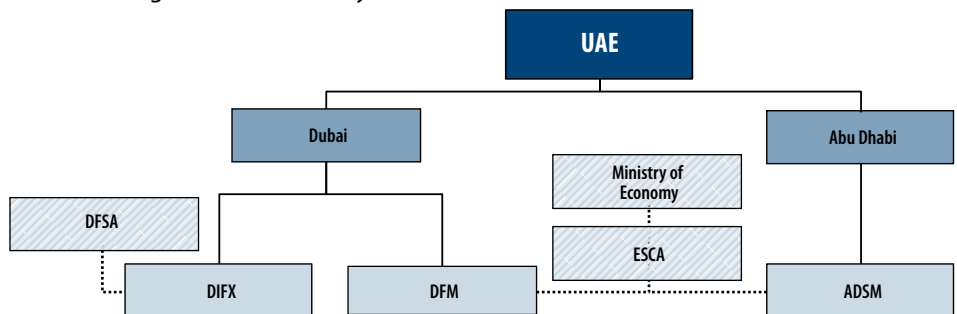
**Strategy to position itself as a key exchange in emerging markets**

**Company Strategy**

DFM's vision is to strengthen its position as a regional hub for the GCC capital market activity and to position itself as one of the key exchanges in emerging markets today. Its strategy is to integrate the regional opportunities to consolidate its capabilities and expand the geographical reach – rendered more relevant by increasing trend of consolidation among global exchanges.

On the operational side, DFM is determined to further develop the cash equity market through attracting more institutional investors, encouraging new primary issuances and new listings and giving impetus to the privatization drive being steered by the Government Of Dubai. The exchange anticipates significant potential for growth in listings going forward both from private issuers as well as the government, as impediments towards listing are cleared, and as key sectors in the economy that have hereto been significantly underrepresented in the market, begin to come to market. On the trading side, DFM currently uses a continuous order driven automated system, tightly coupled with the depository system, validating sell orders against depository inventory prior to trading thus enhancing transparency. However, DFM aims to enhance its technical abilities by transforming into a hybrid market. A hybrid market offers the technical capability of facilitating trading through two platforms: electronic trading and traditional floor broker system. Alongside, DFM would like to enhance the regulatory framework to be able to serve the market a wider range of products including futures and options through the creation of a derivatives market and exchange traded funds (ETFs). A derivatives market should enhance market maturity and depth, giving investors new tools for speculation and hedging.

**Three Exchanges for one economy**



Source: DFM

**DIFX is anticipated to witness a number of new listings over the next year**

Unlike most emerging markets of similar scale, the UAE houses three securities exchanges: the DFM, the Abu Dhabi Securities Market (ADSM) and the DIFX. The DIFX was established in 2005 as a global platform to bridge key global markets, and become the entry point for international companies looking at executing primary issuance to bring Gulf liquidity into play. The DIFX is regulated by a different regulator than the other two “domestic” exchanges and uses advanced market technology provided by its recent collaboration with Nasdaq. The DIFX initially suffered from a slow start, as it was bogged down by a lack of clarity regarding its role, and due to an absence of anchor listings. However, the recent exclusive listing of DP World (the largest IPO in the Gulf region ever) on the DIFX represented a key development for the exchange and provided the elusive anchor listing. The success of the offering has driven new life into the exchange which is anticipated to witness a number of new listings over the next year.

**Recently established Bourse Dubai...to be the acquiring vehicle for DFM and DIFX**

In an effort to streamline the existence of multiple exchanges in Dubai, the Government of Dubai in August 2007 announced the establishment of Bourse Dubai as the holding company for its stake in both the DFM and the DIFX. The new entity, which currently owns 100% of DIFX and 80% of DFM will enable both exchanges to explore joint synergies and opportunities for further development of capital markets in Dubai. Apparently, Bourse Dubai will be the acquiring vehicle for both exchanges as has been signalled by the pending 28% stake uptake in London Stock Exchange (LSE) and the anticipated deal with Nasdaq. Bourse Dubai, upon completion of the Nasdaq deal, will sell its shares in OMX in return for a 19.9% stake in Nasdaq. The deal also entails that Nasdaq acquires a 33% stake in DIFX, rebranding the latter Nasdaq-DIFX.

**...goal to merge both exchanges  
under one coherent strategy...  
but private shareholder's are  
only exposed to the performance  
of one component**

**New law amendments...  
but are they applicable?**

**...it is becoming evident that DIFX  
will be in a position of competitive  
advantage against DFM**

**DIFX and Bourse Dubai to have  
an effect on DFM's organic and  
inorganic growth prospects**

Eventually, the government's goal is to merge both exchanges under one coherent strategy and operation, through which the full capital market opportunity available to Dubai as a financial center is realized, and bottle necks and impediments towards such development are addressed. In other words, between the distinct strengths of the DFM and the DIFX, the collective service offering should be compelling and effectively complete. The only problem with this strategy is that private shareholders are only exposed to the performance of one component of this combined entity at this stage.

#### ***Evolving regulations... addressing bottlenecks for new listings***

In order to address the reluctance of family owned businesses to float the majority of their shares in the event of a public offering, the regulator recently amended the listing requirement on the DFM and ADSM for such businesses to a minimum offering size of 30% of outstanding shares, down from a highly restrictive 55%. However, for the amendment to be valid, the same family should have owned the business for at least three generations which is a very difficult condition to meet given the relative youth of the UAE economy. This restricts the applicability of the new amendment, setting back the desired build up in IPO activity on domestic exchanges. The 55% minimum requirement remains in place for all other non-family owned businesses, although an amendment to reduce that to 45% is said to be imminent. On the same level, the Company Law was amended transferring the regulation of IPO activity from the ministry of economy to ESCA which could eventually result in the practice of book building. The practice is currently not allowed for domestic offerings in the UAE, while being allowed for offerings on the DIFX.

#### ***The resulting tradeoff: DFM vs. DIFX***

With the regulatory bottle necks and restrictions that are currently imposed by the regulator on the domestic exchanges, it is becoming evident that once the DIFX achieves critical mass, it will be in a position of competitive advantage against DFM, rather than a complementary one.

The recent listing of DP World on the DIFX indicates the government's keenness to revitalize the exchange and level it out with DFM. We anticipate future Dubai government related entities, out of which Emirates Airlines is a leading candidate, may also opt for a listing on the DIFX, with the possibility of a secondary listing on the DFM.

The difference in listing requirements between DIFX, currently at a minimum float of 25%, and the DFM at 55%, implies that many companies including family businesses may be enticed to list on the DIFX rather than the DFM. An example is family owned DEPA United Group, a Dubai based interiors contracting company, which has recently announced its intention to perform a primary issuance on the DIFX. Also supportive is the recently marketed practice entailing that companies wishing to list on the DIFX can create a fully owned, DIFC domiciled special purpose vehicle (SPV), which can take full ownership of the underlying economic interest and then be floated on the DIFX, in the process bypassing ESCA's more restrictive requirements. Further, the exchange fees imposed by DIFX at 0.085% are lower than the 0.1% charged by the DFM. These two factors indicate a possible scenario in which DFM's share of new listings decreases, in the process diluting market development and shifting away trading volumes. As for the creation of a derivatives market, we expect some delay considering the current regulatory complications and anticipate the development of derivatives on the DIFX, with DFM listed securities as the underlying.

#### ***The verdict***

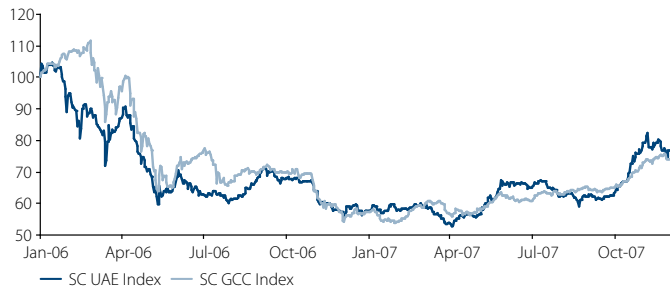
Investors need to be aware of the innate competition the DIFX and Bourse Dubai could represent. We believe that the DIFX, with its more attractive terms, and Bourse Dubai, as the sole acquiring entity, will have an effect on DFM's organic and inorganic growth prospects going forward. The value proposition is that Bourse Dubai may leave shareholders of the DFM in the cold if the economic interests of minority shareholders are not aligned with the holding company's. One way this can be achieved is through an effective merger between the DFM and the DIFX, in which economic interest in the DIFX is retained by equity holders in the DFM.

## UAE Capital Market Review

**SC UAE index added 43% after having lost 42% in 2006**

The year 2007 witnessed positive performance for all GCC equity markets recovering from the severe losses incurred during 2006. The UAE witnessed resurgence during the year, as the SC UAE index added 43% after having lost 42% in 2006. Strong economic growth, solid earnings growth, soaring liquidity due to high oil prices, and foreign investor interest were the primary drivers behind the market's upturn. The UAE market outperformed the SC GCC Index which gained 36% YTD.

SC UAE Index versus SC GCC Index



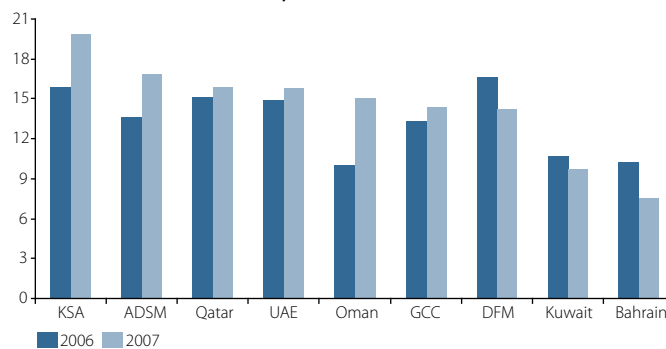
Source: SHUAA Capital

### Market Valuation

**UAE high growth market trading at low growth valuation.. key at attracting foreign institutional and foreign interest**

Even with the strong performance of GCC stock markets this year, the region has maintained relatively low valuation levels throughout 2007, with an average 2007E PE multiple of 14.2. The market in the UAE trades at a 2007E PE of around 14.5 times almost on par with levels at which the market was trading at in 2006. This reflects the compatibility of earnings growth with that of the index. The fact that the UAE market has proven to be a high growth market trading at low growth valuations has been key at attracting foreign institutional interest into the market. As the market continues to develop into a conventional emerging equity market, the level of foreign institutional interest and activity is likely to both increase and become a more permanent component of activity on the market.

GCC valuation: PE Multiple 2006 - 2007E



Source: SHUAA Capital  
PE 2007E as of prices November 28, 2007

### Market Capitalization

The GCC region is set to report a significant increase in market capitalization by around 43% by end 2007, originating from both an appreciation in stock prices and from increased IPO activity. Year to date, the SC GCC index appreciated by 36%, while total size of new listings through IPO activity reached AED 203 bn (USD 55 bn) up from AED 76 bn (USD 21 bn) in 2006.

**UAE's market capitalization to reach AED 882 bn by year end 2007**

The UAE is expected to exhibit brisk growth of 60% in its market capitalization to reach AED 882 bn by 2007-end. This growth includes DFM's substantial capitalization increase of 65% on the back of solid price gains and significant IPO activity: 36% appreciation in the index accompanied by a AED 19 bn increase by market cap originating from a AED 5.9 bn

worth of equity issues. It is worth noting that AED2.5 bn of the new listing were raised in 2006 yet were actually listed in 2007 and therefore are reflected in 2007's market capitalization.

**With DP World..DIFX witnessed significant revival**

We should note the increased presence of the DIFX which reported an unprecedented growth as a result of the government's actions to revitalize the platform through DP World floatation and a resultant total market capitalization of AED 90 bn. On the other hand, ADSM market capitalization will grow by around 50% driven almost entirely by the appreciation in the index as only one new company was listed during the year. On a regional level, Saudi Arabia will continue to be the largest market in the GCC with a dominant market capitalization of AED 1,462 bn at year end 2007 depicting growth of 19%.

In our analysis, we breakdown the drivers for growth in market capitalization into

- 1) Price appreciation of the index
- 2) New listings (IPOs).

**Index Price Appreciation**

Unlike the preceding year, 2007 witnessed significant price gains by listed stocks in the UAE, rendered attractive by a steep correction in 2006. The SC UAE index appreciated by 43%; while the DFM and ADSM reported growth of 36% and 50%, respectively.

Indices Growth YTD

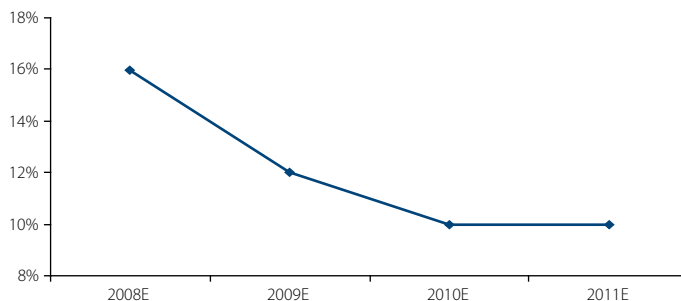
Index	Index Growth
SC KSA	32.72%
SC Qatar	42.85%
SC UAE	42.80%
DFM	36.32%
ADSM	50.28%
SC Oman	61.56%
SC Kuwait	36.88%
SC Bahrain	14.99%

Source: SHUAA Capital  
As of December 10, 2007

**Price appreciation in-line with GDP growth**

Going forward we assume price appreciation to be in-line with nominal GDP growth and have conservatively assumed that the SC UAE index will grow by 16% in 2008 following the growth forecast for UAE GDP. This assumption is likely to be significantly exceeded by the actual performance of the market over the short-term, but should reflect performance more reasonably over the longer term.

**Expected Price Appreciation**



Source: Shuaa Capital

**IPOs..Source of Inorganic Growth**

Total IPO activity for most GCC markets slowed down marginally in 2007 with the distinct exception of the UAE which, enjoyed a record year in terms of offering size (if not in terms of number of offerings) with AED 24 bn worth of deals executed during 2007, representing an increase of 205% over the previous year. The DIFX was the main contributor with 76% of funds raised originating from the DP World IPO which

**DFM contributing 24% of total funds raised in 2007 versus 71% in 2006**

raised AED 18 bn. Listings on the DFM accounted for the rest, with only two offerings contributing 24% of total funds raised. In 2006, DFM supplied 71% of the UAE's total IPO activity with four new listings, inclusive of the DFM IPO, for an aggregate of AED 6 bn. However, and despite the decline in DFM's share of total offerings in the market in 2007, total offering size on the DFM grew by 5.4% for the year.

**UAE IPO Log 2006**

Exchange	Company	IPO size (AED)
DFM	Tamweel	560,861,280
	Du	2,423,409,840
	Gulf Navigation	927,987,840
	DFM	1,647,626,400
<b>DFM Total</b>		<b>5,559,885,360</b>
ADSM	Arkan Building Materials	878,746,320
DIFX	Kingdom Hotel Investments	1,458,665,280
<b>UAE Total</b>		<b>7,897,296,960</b>

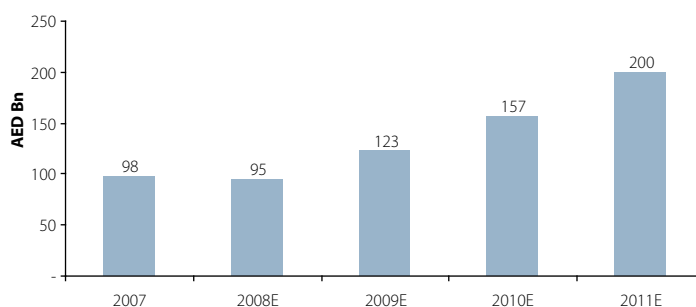
**UAE IPO Log 2007**

Exchange	Company	IPO size (AED)
DFM	Air Arabia	2,618,246,160
	Deyaar	3,240,870,480
<b>DFM Total</b>		<b>5,859,116,640</b>
DIFX	DP World	18,225,604,800
<b>UAE Total</b>		<b>24,084,721,440</b>

Source: Zawya

Although regulatory bottlenecks and listing delays cloud the IPO pipeline, we expect close to AED 95 bn worth of new capitalization originating from IPOs taking place in Dubai in the upcoming year and have assumed a CAGR of 28% from 2008 onwards.

**Dubai Market Capitalization increase through funds raised**



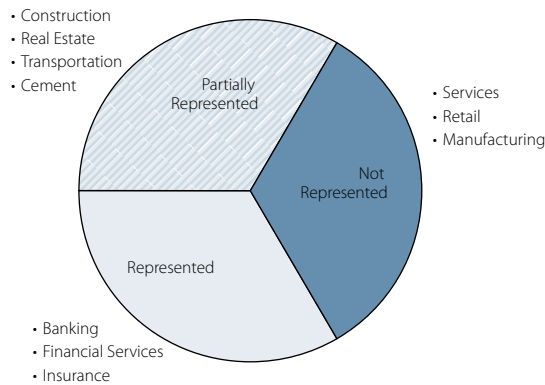
Source: SHUAA Capital

**Expected Increase in sector representation driving AED 95 bn of new capitalization in 2008**

**Increased sector representation:**

Our forecast hinges on the lack of sufficient representation on the exchange of major sectors that contribute heavily to Dubai's economy. For instance, services, manufacturing and construction contribute to more than 80% of real domestic production. However, the services sector, mainly made up of the trade, hospitality and transportation activities among many others, is effectively absent from the market. Construction companies are also conspicuous in their absence, as Arabtec is the sole listed company representing the sector. With marked increase in industrial activity, particularly in the Jebel Ali area of Dubai, more manufacturing companies are also expected to tap the market. Dubai Aluminium, one of the largest smelters in the world, is worthy of mention in this context. Furthermore, major real estate developers such as Nakheel, are also likely to pursue a listing in the near future. A major IPO is expected in the transportation sector, as Emirates Airlines has recently announced plans to complete its primary issuance in 2008. Should the airline

float its shares, it could contribute over AED 100 bn (USD 30 bn) in additional market capitalization.

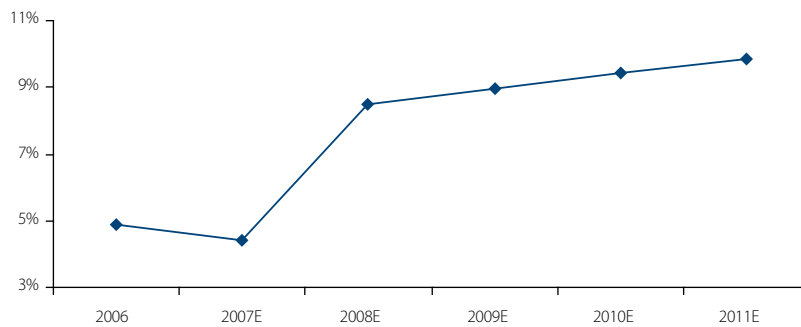


Source: SHUAA Capital

**DFM to be allocated 50% of new formed market capitalization... with formation yields reaching 9.8% by 2011**

Notwithstanding Dubai's promising primary issuance pipeline, the share that will end up listing on the DFM vs. the DIFX remains speculative. We allocate 50% of the new formed market capitalization to DFM and maintain our assumption at this level going forward. Hence, we expect that market formation yield (Market Capitalization Increase through Funds raised/ market capitalization) on the DFM to show positive growth increasing from its current levels at 4.4% to reach 9.8% by year end 2011.

**DFM: Formation Yield**

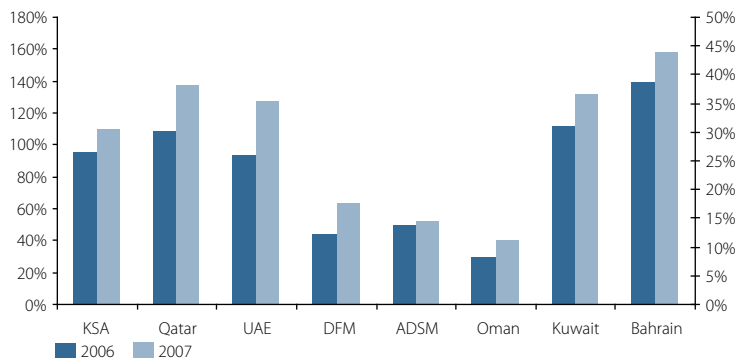


Source: SHUAA Capital

**Market Cap/GDP**

Market Capitalization/GDP for the UAE is expected to cross the 100% mark by 2007 end, reflecting index appreciation coupled with the fund raising activity. Overall, we see most markets in the region witnessing growth in market cap to their respective GDPs following suit with emerging market trends.

**Mkt Cap/GDP 2006 - 2007**



Source: SHUAA Capital  
Ratio of DFM and ADSM based on UAE GDP

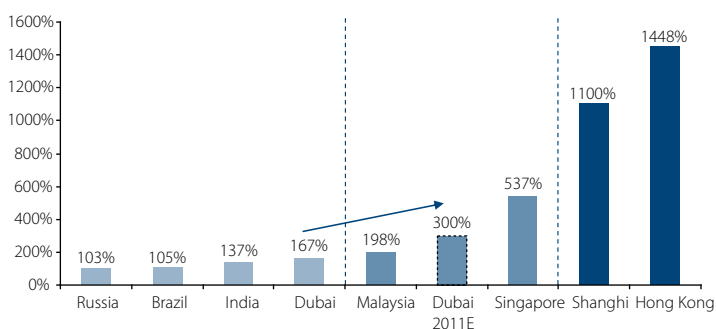
In the course of our analysis, we have calculated total market capitalization in Dubai vs. its own GDP with an estimate that the latter constitutes 45% of the country's whole

production after accounting for the residual GDP coming from the neighbouring emirates. The ratio currently stands at 167% utilizing a Dubai market cap of AED 519 bn, of which AED 440 bn is contributed by DFM, on a Dubai GDP of AED 311 bn.

**...Dubai's market cap to GDP to grow to 300% by end of 2011 on vibrant economy...**

Going forward, we believe that Dubai's market cap to GDP will grow by the end of our projection period to reach 300%, which we believe is realistic given the vibrancy of the Dubai economy, the pace of its development as a financial center, and major anticipated new listings. We have conservatively assumed a target at the medium of the range of the global peer average incorporating key yet significantly under developed emerging financial markets on one end, and recognised emerging financial centers on the other. Dubai, in a role similar to Singapore's, is acting as a financial hub for the GCC and the greater Middle East region with its market activity being generated from domestic sources as well as through major contributions from neighbouring countries coupled with increasing depth and sophistication in the market. Singapore boasts a market cap to GDP of almost 540%, while Hong Kong retains a striking market cap to GDP ratio of 1450%.

**Emerging Exchanges Market Capitalization/GDP**



Source: Exchanges Reports, IMF  
Market Capitalization as of November 2007

**Dubai market capitalization to exceed the AED 1 trillion mark by 2010..**

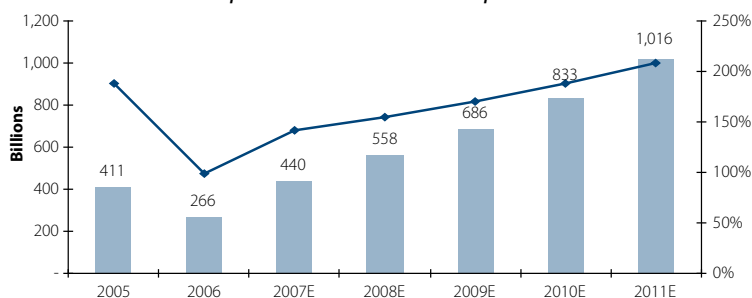
Incorporating a conservative growth in Dubai's nominal GDP similar to that of the UAE, we estimated that the former will grow at a CAGR of 12% throughout our forecast period. Using our generated Dubai Market Cap/Dubai GDP ratio coupled with our projections for Dubai's GDP, we estimate Dubai's market capitalization to reach AED 696 bn by year end 2008 and then grow by a rate of 30% and 27% in years 2009 and 2010 respectively. Utilizing index appreciation no lower than the growth in GDP, we can infer the scale of new listings expected to occur annually.

AED '000	2006	2007E	2008E	2009E	2010E	2011E
Dubai GDP	269,671,680	310,651,200	360,223,200	403,449,984	443,794,982	488,174,481
Dubai Market Capitalization/Dubai GDP	101%	167%	193%	224%	259%	300%
Dubai Market Capitalization	271,706,385	518,547,183	696,207,065	902,834,095	1,149,878,992	1,464,523,442

Source: Shuaa Capital

As previously mentioned, we believe that DFM is entitled to 50% of the increase in Dubai's market capitalization originating from inorganic sources. We have gauged DFM's future market capitalization by applying the same growth in prices coupled with the summation of market capitalization generated from IPOs. We expect the DFM to register a 2008 market capitalization of AED 558 bn, reaching up to AED 1,016 bn by 2011-end.

**DFM Market Cap versus DFM Market Cap/Dubai GDP**



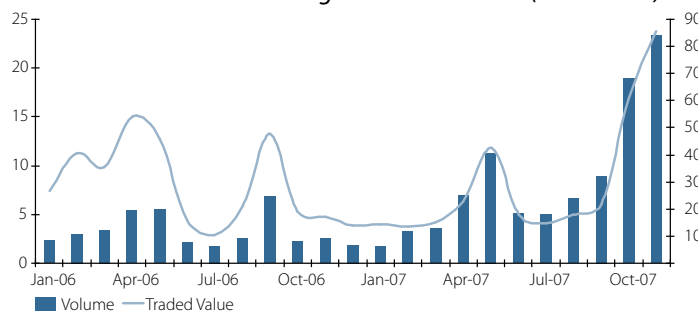
Source: Shuaa Capital

**Market Activity**

Most regional equity markets witnessed a growth in trading values during 2007, with average growth of 31% recorded for the year. After the severe downturn in the GCC stock markets in 2006, turnover picked up in 2007 reflecting the positive economic outlook, new fund flows and the market's inherent upside potential directly affecting volumes and prices.

The UAE has witnessed a significant increase in annual turnover during 2007, driven by international institutional flows and general price appreciation. In particular, the ADSM is expected to report an increase of 43% in trading value for the full year, while the DFM is expected to show a mere 2.7% increase. As indicated from the chart below, trading values on the DFM only started to pick up during the last quarter of 2007.

**DFM: Volume versus Trading Value 2006 - 2007 (AED Billion)**



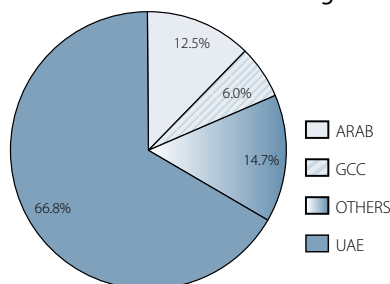
Source: DFM

**Until October, foreign investors held a positive net trading position worth USD 3.1 bn**

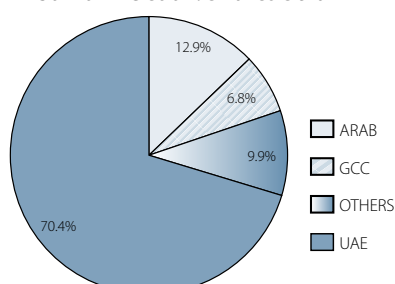
The October and November surge in volumes was primarily the result of increased interest from foreign investors who have developed a very positive stance on the UAE market. Their net position during October reached 8.8% amounting to a hefty USD 1.5 bn. It's worth noting that between January and October, net position held by foreign investors amounted to 4.8% translating to a USD 3.1 bn. Significantly, other investors, Arab, GCC and UAE, held a negative net position at the end of the period, effectively taking profit from the hike in prices witnessed at the end of the period.

At status quo, we do not anticipate foreign investors to retract from the market. In fact, given current market fundamentals, we believe foreign investment will be sustained, if not increased.

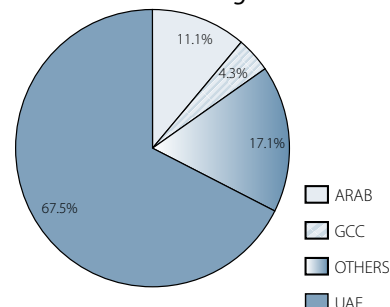
**Jan 07 - Oct 07: Shares Bought**



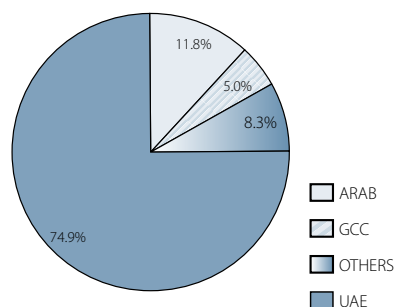
**Jan 07 - Oct 07: Shares Sold**



**Oct 07: Shares Bought**



**Oct 07: Shares Sold**



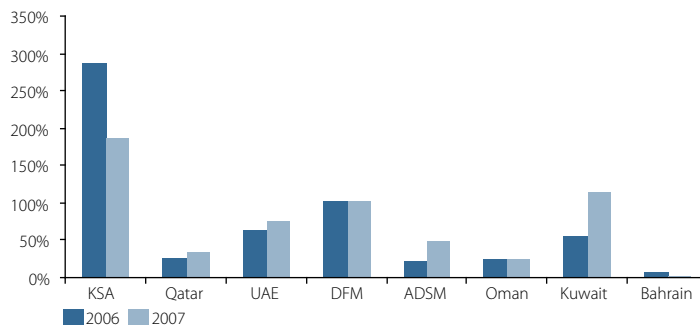
Source: DFM

**UAE trading velocity set at 74% for 2007**

**Trading Velocity**

To eliminate the effect of price appreciation witnessed throughout 2007, we consider the annual trading velocity (traded value/average market capitalization). Traded value/average market cap for the UAE is set to increase from 63% to 74% in 2007 reflecting the increased activity on the country's exchanges. In particular, DFM is expected to report in 2007 velocity similar to that reported in 2006, depicting a steady speed at which the market is trading. Seemingly, the market reaction to the increase in capitalization is being fulfilled with sufficient trading keeping DFM's velocity above the regional average. In the same context, ADSM's velocity is expected to report a growth of 100% due solely to the increase in trading values identified above. On a regional level, Saudi Arabia continues to post higher than emerging market average velocity, standing at 182%; yet the ratio has decreased by more than half on lower trading volumes in 2007.

**GCC Velocity: 2006 - 2007**



Source: SHUAA Capital

**DFM sustained velocity at 90% by the end of our projection period...down from current 100%**

Seasonal impact of highly active months like October and November pushing upwards the year's total turnover is an intrinsic trend on DFM that we expect to see in the future as well. This, coupled with the expected continuing foreign interest; will keep DFM's velocity higher than average regional velocity. We believe that given the current status of the DFM, 90% will prove to be a sustainable velocity for the market, and adopt it as a target for the end of our projection period. However, various factors could negatively affect DFM's velocity going forward, accentuating the decelerating rate. Significant among these are: 1) Marked shift in foreign investment from DFM to DIFX which is expected to witness significant IPO activity, 2) Shift in overall liquidity from the DFM to the DIFX 3) the possible opening of the Saudi market to foreign investment, pulling some of the liquidity currently focused on the DFM. In short, at status quo, we believe that DFM will continue to witness higher than average regional velocity; yet certain developments can alter our assumptions.

**Emerging Exchanges Velocities - 2007**

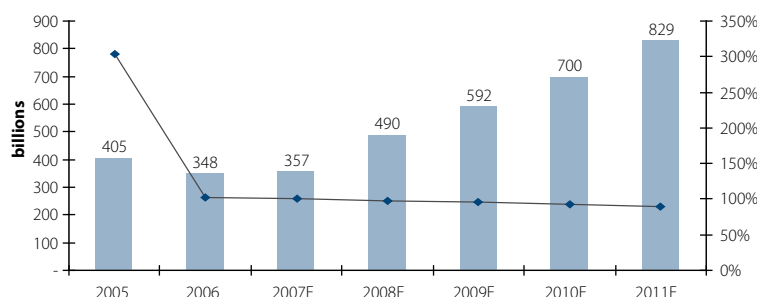
Exchange	Velocity
Singapore	69.4%
Malaysia	52.9%
Hong Kong	92.2%

Source: Exchanges report, SHUAA Capital

**DFM to report a trading turnover of AED 490 bn in 2008 & to grow at 19% CAGR thereafter...**

With an expected DFM market capitalization of AED 558 bn in 2008 coupled with an expected velocity of 98% for the year, we project DFM's annual trading value to reach AED 490 bn (USD 133 bn). Going forward, we expect that turnover will be going to grow at a CAGR of 19%.

**DFM Turnover versus DFM velocity (AED)**



Source: SHUAA Capital

## Overall Analysis and Forecasts

### Business Model

**..very high profitability levels, despite being neither capital nor labour intensive...**

DFM, as a growing securities exchange, represents a key financial infrastructure play that enjoys very high profitability levels, despite being neither capital intensive nor labour intensive. DFM's dominant revenue contributor is exchange trading fees on the cash equity market. Being directly linked to trading levels on the market, DFM's revenue model is a particularly volatile one, highly dependent on market performance and market size as drivers of trading volumes and resultant generated fees.

### Single revenue stream

**..Alternative revenue sources remain absent on the DFM..**

The DFM today retains a very simple revenue model that is driven purely by trading volumes of equities on the exchange. Generally, listed exchanges generate additional revenue lines pertaining to the derivative market, among others, sometimes with significant contribution to gross operating revenues. However, alternative instruments remain absent on the DFM at this stage, while even bond trading remains minimal despite the listing of a small number of bonds on the exchange. While most other listed exchanges dilute the impact of securities trading levels on revenue streams by diversifying revenue sources to include other fees such as listing fees and information vendor fees, as well as trading in other instruments, lack of such fees at the DFM may prove to be a cushioning option in case exchange fees are forced lower in the future. However, we do not foresee any scenario where exchange fees on trading equities is anything short of the dominant revenue line.

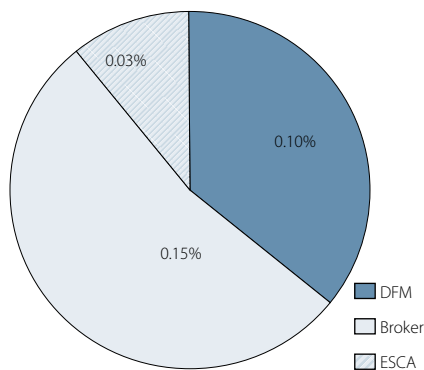
	Operating Revenue			Stable Revenue			
	Cash Market Securities Trading Fees	Derivative Market Contracts Trading Fees	Clearings Clearing, Settlement, Custodian	Listing Fees Primary Issuance	Membership Fees Brokerage Houses	Corporate Action Fees Splits and Dividends	Information System Sale of Market Data
<b>DFM</b>	✓		✓		✓		
<b>International Exchanges</b>	✓	✓	✓	✓	✓	✓	✓

**DFM exchange fees standing at 0.1%..higher than all other regional global peers of similar scale..**

### High exchange fees dominate

During 2006, ESCA cut trading commission on the value of each transaction down to 0.275% from the earlier hefty 0.5%. However, the cut came primarily at the expense of member brokers, with their commissions slashed by 50% down from 0.3% to 0.15% at the time when DFM's fees decreased from 0.15% to 0.1%. Given two sides of each trade, the DFM generates 0.2% of the value of each trade calculated as a percentage of total market traded value.

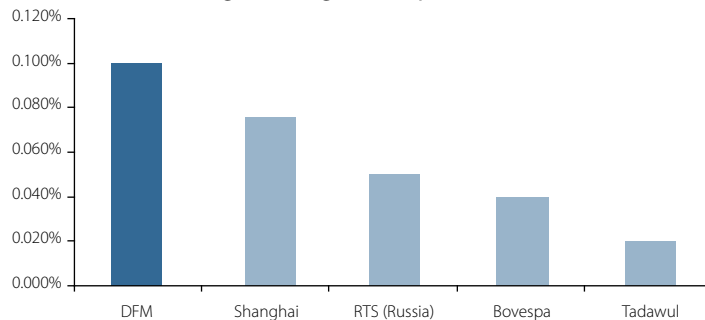
### Trading Commission Segmentation



Despite the 33% reduction in exchange fees in 2006, the DFM (and ADSM) retain among the highest exchange fees in the world, and certainly higher than all other regional and global peers of similar scale. While this may not at the outset seem sustainable, it is likely that fees will prove to be resilient for the foreseeable future, as volumes on the exchange seem not to have suffered, and member brokers seem not to have put up much of a

challenge. However this may no longer be the case if the market begins to retract and volumes begin to decline. This is especially true given the fact that the DFM is not a monopoly exchange in the UAE. In fact, it is not even a monopoly exchange in Dubai, with the alternative exchange in Dubai already charging lower exchange fees.

**Global Exchange Trading Fees (Equities)**



Exchanges websites  
Single side fees including clearing fees

**..exchange fees represent 94% of total operating income..with no change in future trend..**

**Operating Revenue**

For 9M 2007 the DFM witnessed a modest growth in revenues, reporting AED 410 mn, representing around half 2006 full year revenues. Exchange fees represented 94% of total operating revenue stemming from total traded value reported on the DFM during the first three quarters of AED 181 bn, or only 52% of total value traded in 2006. However, October and November reported a significant increase in trading values with a reported combined turnover of AED 146 bn increasing total turnover till end of November 2007 to AED 327 bn. We expect year end turnover to reach AED 357 bn bringing with it DFM's total operating revenue to AED 804 mn of which AED 760 mn will be contributed by exchange fees. Going forward, we expect no change in trend with exchange fees continuing to be the major source of revenue, in direct relation to trading volumes.

AED '000	2006	2007 E	2008 E	2009 E	2010 E	2011 E
Operating Income	789,069	804,925	1,104,100	1,334,456	1,578,645	1,869,604
Trading Commission Fees	745,200	760,037	1,042,530	1,260,039	1,490,611	1,765,344
Brokers' Fees	17,547	21,422	29,385	35,515	42,014	49,758
Ownership transfer & mortgage fees	23,010	19,438	26,662	32,225	38,122	45,148
Others fees	3,313	4,027	5,524	6,676	7,898	9,353

Source: SHUAA Capital

**Investment revenue to grow at a CAGR of 16% generating 5.8% yield..**

**Investment Revenue**

DFM also has significant investment revenue streams originating from returns on Islamic deposits, direct investments, and managed investments. Going forward, we expect further reliance on investment revenue to hedge against market volatility. We have assumed a CAGR of 16 % in Islamic deposits for our projection period, generating an average 5.8% yield for 2008 and going forward, reflecting the 25 bps decline in 2007 yields.

AED '000	2006	2007 E	2008 E	2009 E	2010 E	2011 E
Islamic Deposits	889,091	1,957,088	2,309,364	2,424,832	2,909,799	3,491,759
Return on Islamic Deposits	46,142	118,054	123,346	136,869	154,228	185,074

Source: SHUAA Capital

**DFM to relocate to Business Bay by end of 2009**

**Rental Revenue**

By 2009, the DFM is expected to relocate its head quarters from the Dubai World Trade Centre to its new premises at the Business Bay. The Government of Dubai has granted the DFM a 36,153 m2 land on which a building with an approximate cost of AED 800 mn will be constructed. The management didn't specify the area of the building, however, we believe it will occupy 60% of the land's area comprising a four story building, with a built up area of 86,767 m2. Assuming that regular building efficiency averages 60%, we estimate that total usable building space is going to amount to 52,060 m2. The management hasn't yet specified the source of funding but with current cash position, we believe, that the funding is going to be in-house.

**..with an expected rental revenue stream of AED 112 mn translating to a yield of 14%..**

Along with the DFM, the 100 brokers currently operating in the UAE will also be instructed to relocate to the new centre ensuring stable rental revenue for the DMF. We have assumed that 1000 m2 will be utilized by DFM's trading floor and administrative offices leaving rental space of 51,060 square meters. We expect that the rent per square meter to be, on average, around AED 2,200 entailing a rental revenue of AED 112 mn translating to a yield of 14% on investment. We will be accounting DFM's occupied space as fixed assets while rental space will be considered as property investment.

**New DFM Headquarters**



Source: DFM

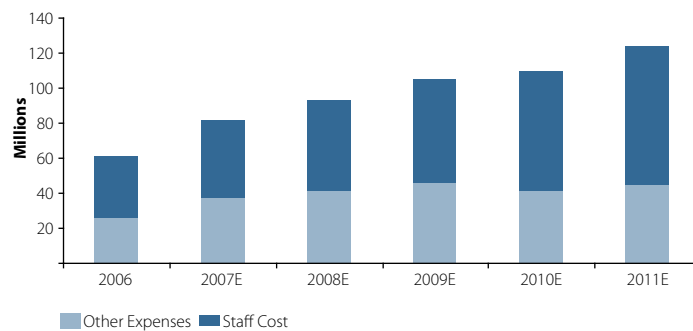
**..Staff related expenses.. major component..**

**Expenses**

DFM reported AED 59 mn in general and administrative expenses for 9M 2007. Staff related costs are the major component of DFM's expenses making up 54% of the total, or AED 32 mn for the same period. We expect total operating expenses for the year 2007 to reach AED 71 mn, of which AED 45 mn will be wages. Going forward, we expect the rise of employee costs to average no higher than 15% at a time when the employee base is expected to grow at 5%.

Post DFM's relocation to the new premises, we expect that general expenses will increase with no significant effect on margins.

**DFM Expenses (AED)**



Source: Shuaa Capital

**..highest operating and net profit margins among relative exchanges..**

**Margins & Multiples**

The DFM manages a unique business that can grow on minimal capital expenditures and general expenses resulting in very high margins and a large accumulation of cash. The DFM has posted significant profitability measures depicted by the high operating margin which is expected to increase from 76.48% in 2007 to reach up to 87.64% by 2011 reflecting the low costs incurred by the exchange.

Bottom line revenue originating from investment and rental income is expected to inflate net income numbers and result in exaggerated above 100% net profitability margins.

	PE Multiple			Profit Margin			Return on Equity			Dividend Yield		
	2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
Singapore	45.8	28.5	24.3	54.0%	58.8%	59.0%	50.8%	58.4%	60.5%	2.7%	3.2%	3.7%
Malaysia	71.0	29.6	26.3	41.2%	53.4%	54.0%	13.4%	32.3%	36.9%	2.9%	4.2%	4.3%
Hong Kong	94.4	39.6	25.8	60.8%	74.1%	80.0%	47.9%	94.3%	105.1%	1.0%	2.2%	3.5%
DFM	-	46	42	101%	149%	118%	45%	21%	13%	-	1.36%	1.48%

Source: Reuters  
Prices as of December 11 2007

**high expected dividend payout ratio..yet low dividend yield..**

Even with the absence of a fixed payout scheme that DFM is going to utilize, we assume a dividend payout ratio of 60% on the back of the high cash position the company retains. Yet with the high trading price DFM is trading at, dividend yields are below emerging market peers.

At the current price of AED 6.75 a share, DFM is trading at a 2008 forward earnings multiple significantly higher than that of its peer average, depicting the relative premium at which the DFM is currently trading at.

**Profit & Return**

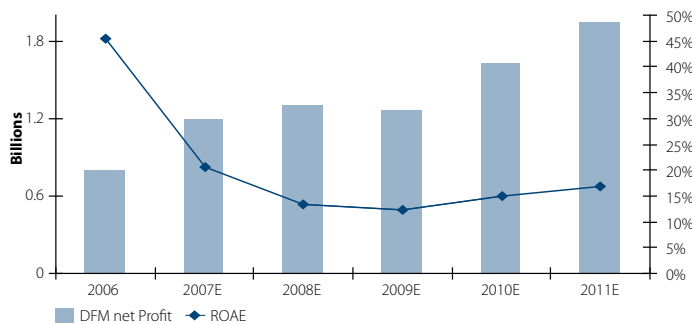
**Net profit inflated by one-off items in 2007 and 2008**

We expect net income in 2007 to grow by 50% to reach AED 1.2 bn of which AED 0.47 bn contributed by the non recurring IPO returns. In 2008, DFM is forecasted to report a net income of AED 1.3 bn with AED 0.28 bn originating from the one-off item representing the land grant. Given the positive outlook for the market coupled with DFM's vision we see net income growing post 2008 at a CAGR of 14.2% over the remainder of our projection period.

**Low RoAE on high capitalization**

Return on average equity is expected to fall from 45.4% in 2006 to 20.7% in 2007 due to the capital increase from the primary issuance in Q1 2007 with the funds raised have not been utilized yet. Given the fact that going forward DFM will not be in the position to perform any acquisition due to the presence of Bourse Dubai, we expect that ROAE will further decline to hit 16.8% by year 2011, which is significantly below the average for peers. However this is not due to any pressure on margins, or lack of growth, but rather due to a situation of excess capitalization without any clear avenue for capital expenditure.

Profit & Return (AED)



Source: Shuaa Capital

## Valuation

**Target price of AED 4.01  
implying a 41% discount on  
current price of AED 6.85**

**DFM current market  
capitalization is close to that of  
LSE and OMX combined implying  
exaggerated expectations  
and significant mispricing**

We initiate coverage on DFM with a Sell recommendation based on a target value of AED 4.01 per share, implying a downside of 41% to the current market price of AED 6.85 per share. The target value was based on a 70%-30% weighted sum of parts valuation which includes a discounted cash flow (DCF) valuation and a relative valuation utilizing a meaningful peer group with comparable market and growth prospects.

The DFM is currently trading at a significant premium to global peer average multiples, which indicates very lofty expectations for growth. While growth going forward will likely be strong in light of the economic boom witnessed in the region, significant anticipated growth in listings and the emergence of Dubai as the pre-eminent financial center in the Gulf, the current market value of the exchange operator is in fact higher than almost any other listed global exchange, which indicates exaggerated expectations and significant mispricing. The current price also does not seem to account for increasing domestic competition in a fragmented market, potential pressure on high exchange fees and the restrictive regulatory environment that may limit growth going forward.

Listed Exchange	Hong Kong Exchange	NYSE Euronext	LSE	Singapore Exchange	Nasdaq	OMX	Bursa Malaysia	DFM
Market Capitalization (USD Mn)	30,241	23,113	10,886	9,351	5,434	4,799	2,174	14,924
Traded Value YTD (USD Mn)	2,521,483	20,388,800	7,486,086	372,515	1,713,100	1,798,594	164,736	89,103
Number of Listed Companies	1275	1246	3208	1036	3270	648	633	56

### Weighted Valuation

Final Valuation	Value per Share	Weight	Value in Target Price
DCF	70%	4.31	3.01
Peer Multiple	30%	3.30	0.99
Final Valuation			4.01

DCF implies a value of AED 4.31 per share

The DCF of DFM was based on four year forecast period and a terminal value. The weighted average cost of capital is equal to the cost of equity of 9.95% as the company is currently un-leveraged. The cost of equity was based on a risk free rate of 4.55%, an equity risk premium of 5% and a beta of 1. To calculate the terminal value we used a terminal growth of 4.5% to reflect UAE's increasing inflation rate.

Our DCF value of AED 4.31 per share implies a downside of 37% from the current price of AED 6.85.

WACC/Perpetual Growth	3.5%	4.5%	5.5%
8.55%	4.42	5.4	7.02
9.55%	3.67	4.31	5.26
10.55%	3.13	3.57	4.2

### Relative Valuation

We have utilized the 2008 forward PE multiples for three comparable emerging market listed exchanges which revealed an average PE multiple of 25.5. Considering DFM's 2008 EPS prior to extraordinary item of 0.128, we arrive at an average value of AED 3.3 per share for DFM after incorporating the land grant into the value.

Exchange	2008 PE
Hong Kong Exchanges and Clearing	25.8
Singapore Exchange	24.3
Bursa Malaysia	26.3
Average	25.5

## Financials

### DFM Balance Sheet - AED '000

Year at December	2006	2007E	2008E	2009E	2010E	2011E
Cash and Bank Accounts	292,722	480,099	22,326	65,384	259,340	494,637
Islamic Deposits	889,091	1,957,088	2,309,364	2,424,832	2,909,799	3,491,759
Prepaid Expenses & Other Receivables	17,495	32,197	44,164	53,378	63,146	74,784
Due from related parties	566,392	785	589	442	331	248
Current Other financial assets	58,777	352,055	369,657	388,140	407,547	427,925
Net PP&E	28,194	32,596	308,004	302,337	297,712	294,097
Investment Property	-	-	392,317	784,633	784,633	784,633
Non Current other financial Assets	498,765	1,123,706	1,179,891	1,238,885	1,300,830	1,365,871
Net Intangible assets (Provisional)	-	5,695,528	5,588,328	5,481,128	5,373,928	5,266,728
<b>Total Assets</b>	<b>2,351,437</b>	<b>9,674,054</b>	<b>10,214,641</b>	<b>10,739,160</b>	<b>11,397,266</b>	<b>12,200,683</b>
Payables & Accrued Expenses	179,824	164,092	185,833	210,372	220,512	247,763
Due to related Party	-	43,650	39,285	35,357	31,821	28,639
Provision for EOSI	1,141	1,372	1,650	1,984	2,385	2,868
<b>Total Liabilities</b>	<b>180,965</b>	<b>209,114</b>	<b>226,768</b>	<b>247,712</b>	<b>254,718</b>	<b>279,270</b>
Share Capital	-	8,000,000	8,000,000	8,000,000	8,000,000	8,000,000
Employees' performance share program	-	55,864	55,864	55,864	55,864	55,864
Net IPO income	-	31,608	31,608	31,608	31,608	31,608
Retained Earnings	2,139,041	1,346,037	1,868,969	2,372,545	3,023,645	3,802,509
Investment Revaluation Reserve	31,431	31,431	31,431	31,431	31,431	31,431
<b>Total Equity</b>	<b>2,170,472</b>	<b>9,464,941</b>	<b>9,987,872</b>	<b>10,491,448</b>	<b>11,142,548</b>	<b>11,921,413</b>
<b>Total Liabilities &amp; Equity</b>	<b>2,351,437</b>	<b>9,674,054</b>	<b>10,214,641</b>	<b>10,739,160</b>	<b>11,397,266</b>	<b>12,200,683</b>

### DFM Income Statement - AED '000

Year at December	2006	2007E	2008E	2009E	2010E	2011E
<b>Operating Income</b>	<b>789,069</b>	<b>804,925</b>	<b>1,104,100</b>	<b>1,334,456</b>	<b>1,578,645</b>	<b>1,869,604</b>
Trading Commission Fees	745,200	760,037	1,042,530	1,260,039	1,490,611	1,765,344
Brokers' Fees	17,547	21,422	29,385	35,515	42,014	49,758
Ownership transfer & mortgage fees	23,010	19,438	26,662	32,225	38,122	45,148
Others fees	3,313	4,027	5,524	6,676	7,898	9,353
Investment Revenue	67,602	118,054	123,346	136,869	154,228	185,074
Other Revenue	1,869	-	-	-	112,333	123,566
<b>Total Revenue</b>	<b>858,541</b>	<b>922,979</b>	<b>1,227,447</b>	<b>1,471,325</b>	<b>1,845,206</b>	<b>2,178,243</b>
G&A Expenses	(60,950)	(82,046)	(92,917)	(105,186)	(110,256)	(123,882)
Ammortization of Intangible Assets	-	(107,200)	(107,200)	(107,200)	(107,200)	(107,200)
<b>Profit from Operations</b>	<b>797,591</b>	<b>733,733</b>	<b>1,027,330</b>	<b>1,258,939</b>	<b>1,627,750</b>	<b>1,947,162</b>
Land Grant	-	-	280,000	-	-	-
IPO returns	-	468,026	-	-	-	-
<b>Net Profit</b>	<b>797,591</b>	<b>1,201,760</b>	<b>1,307,330</b>	<b>1,258,939</b>	<b>1,627,750</b>	<b>1,947,162</b>

## DFM - Key ratios % (unless otherwise stated)

Year at December	2006	2007E	2008E	2009E	2010E	2011E	CAGR 2007-2011
<b>Growth</b>							
Equity	61.80	336.08	5.52	5.04	6.21	6.99	5.94
Total Assets	60.49	311.41	5.59	5.13	6.13	7.05	5.97
Total Liabilities	46.23	15.55	8.44	9.24	2.83	9.64	7.50
Trading Commission Income	(39.67)	1.99	37.17	20.86	18.30	18.43	23.45
G&A Expenses	36.97	34.61	13.25	13.20	4.82	12.36	10.85
Net Profit	(36.39)	50.67	8.78	(3.70)	29.30	19.62	12.82
<b>Liquidity</b>							
CA/CL (times)	10.15	13.59	12.20	11.93	14.43	16.24	
<b>Structure &amp; Efficiency</b>							
Trading Commission Income/Total Income	86.80	82.35	84.93	85.64	80.78	81.04	
Employee Expense/Operating Income	4.49	5.53	4.66	4.45	4.35	4.24	
Cost to Total Income	7.10	8.89	7.57	7.15	5.98	5.69	
Profit Margin	101.08	149.30	118.41	94.34	103.11	104.15	
<b>Return</b>							
RoAA	41.80	19.99	13.15	12.02	14.71	16.50	
RoAE	45.42	20.66	13.44	12.29	15.05	16.88	

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