

Shuaa Capital

Annuity business; the untold story – Overweight (V), target price AED12.6

- ▶ **Shuaa benefiting from buoyant UAE market. Further regional expansion and focus on fees business add to appeal**
- ▶ **We believe the annuity business is not priced in; trading at a low 2009e PE of 6.5x and a 2008-12e CAGR of 22%**
- ▶ **Initiating with a AED12.6 target price, indicating potential total return of 68%, and thus an Overweight (V) rating**

Overweight (V)

Target price	12.6
Share price	7.5
Potential total return (%)	68%

	2007e	2008e	2009e
HSBC EPS	0.79	0.82	0.87
HSBC PE	9.4	9.0	8.5
Performance	1M	3M	12M
Absolute (%)	10.6	15.8	71.6
Relative [^] (%)	4.5	1.5	26.6

Note: (V) = volatile (please see disclosure appendix)

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Shuaa Capital started life in UAE in 1979 as an investment firm handling only principal investments. In 2000, it repositioned itself as fully integrated financial services firm, also focusing on the fees business. Since 2005, it has expanded regionally. The main drivers of future value are a strategic focus on the annuity business and regional expansion.

Given its expansion in buoyant regional markets, we project an impressive 2006-12e CAGR of 44% in fee revenues (versus principal investment revenue at 20%). We expect the fee business to contribute 58% of revenue in 2012e, versus 30% in 2006.

Shuaa is benefiting from the UAE growth story, and we expect its brokerage market share there to increase slightly to 5.5% by 2012e. We also project that AUM will rise to USD8bn by 2012e (2.5x). Shuaa should continue to benefit from the lucrative UAE IPO market. Foreign competition poses the main risk to this story.

Saudi Arabia is a major opportunity for the company (c60% of regional trading volumes), as is Qatar, through one of its associates. Shuaa recently acquired effective control of five brokerage licences in Egypt, Kuwait, Syria, Jordan and Turkey. For regulatory reasons, full details of the deal are unavailable, and thus not reflected in our numbers. However, it is another value driver, reflecting commitment to the annuity business.

In our view, the market has yet to price in Shuaa's annuity business. It is trading on a 2009e PE of 6.5x with 22% 2008-12e CAGR (EFG-Hermes is on 11.6x for the same rate), and on a 2009e P/BV of 1.4x with 2009e ROE of 17.0% (EFG-Hermes: 2.1x for 17.4%).

We value the company using an SOTP model, and the annuity business (64% of value) by discounting net fee earnings. Principal investments (36% of value) are valued at 1.0x. The resulting target price of AED12.6 indicates 68% potential return of. We therefore initiate coverage with an Overweight (V) rating.

In the company's shareholder structure the 49% cap for foreign investors has already been reached. However, the current convertible bond owned by Dubai Banking Group will be converted in November 2008, opening 125m shares (worth cUSD300m) to foreign investors. This should boost the liquidity of this stock.

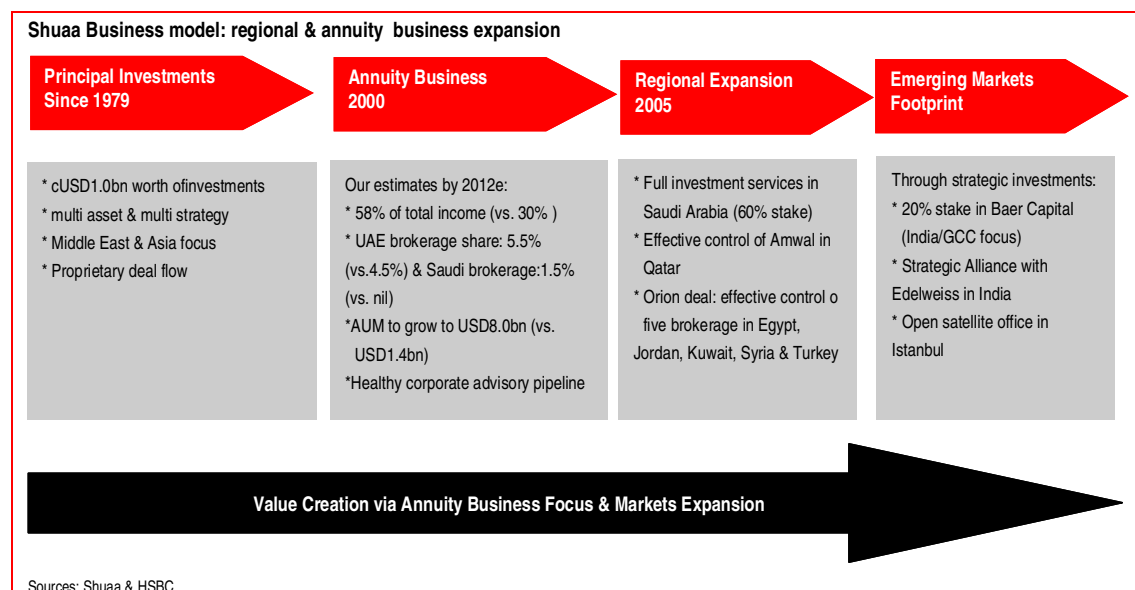
Index [^]	DFM
Index level	5,805
RIC	SHUA.DU
Bloomberg	SHUAA UH

Source: HSBC

Enterprise value (AEDm)	2,414
Free float (%)	50%
Market cap (USDm)	1,124
Market cap (AED)	4,125

Source: HSBC

Investment Summary



Valuation: Overweight (V) rating, target price AED12.6, total potential return of 68%

We initiate coverage on Shuaa Capital with a target price of AED12.6, indicating a potential total return of 68%. We are therefore initiating with an Overweight (V) rating.

We use a sum-of-the-parts valuation model to calculate the value of the annuity business plus principal investments. We have valued the annuity business by discounting net investment fees (net associated costs and taxes), and principal investments at a NAV multiple of 1.0x

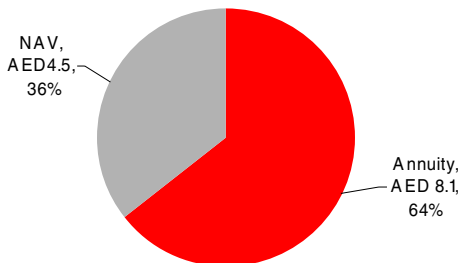
Shuaa SOTP valuation

	AEDm
Explicit value (2009-2012)	1,817
Terminal value	4,671
Annuity business	6,488
Add:	
Principal investment at 1.0x	3,586
Equity value	10,074
Outstanding shares m*	800
Value per share AED	12.6
Price	7.5
Total potential return	68%

Source: HSBC estimates * post bond conversion

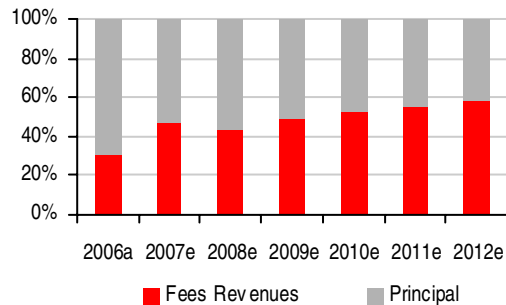
On our estimates, the annuity business accounts for 64% of the company value.

Annuity business contributes AED8.1 (64% of our TP)



Source: HSBC estimates

Fee business to jump to 58% of revenues in 2012e

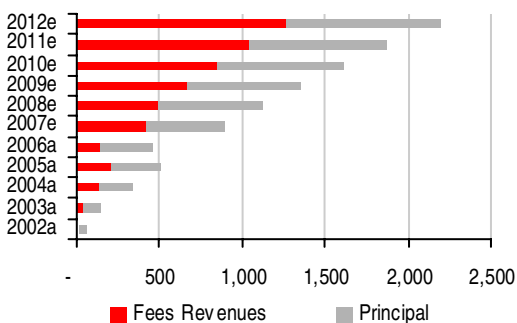


Source: Shuaa & HSBC

Business model: greater focus on annuity business...

Shuaa Capital started life in UAE in 1979 as an investment firm focused solely on principal investments. In 2000, it repositioned itself as fully integrated financial services firm, extending its focus to the fees business. Since 2005, management has been expanding regionally. The main drivers of future value are the strategic focus on annuity business and regional expansion.

Shuaa: increasing focus on the annuity business (AEDm)



Source: Shuaa and HSBC estimates

On our estimates, the annuity business should grow at a 2006-12e CAGR of 44% (net fees at 39%), versus 20% for the principal investment business. By 2012, we believe fee revenues could account for up to 58%, from 30% in 2006.

...whose growth is not priced in

We have compared the valuation of Shuaa's annuity business with those of some global peer. In our view, the stock, which is trading at a market-implied 2009e PE of 6.5x, at a 2007-09e CAGR of 23%, is cheap compared with global players (average 2009e PE of 13.5x at a lower 2007-09e CAGR of 17%).

When we refer to annuity PE, we mean the company's enterprise value (market cap minus principal investment value) over its clean earnings (fees minus fee costs minus taxes).

Shuaa clean earnings multiple in context

Company	Ticker	CAGR 07-09	PE 2009e
T Rowe Price*	TROW US	14%	17.3
Janus Capital*	JNS US	25%	15.0
Federated*	FII US	17%	14.3
Franklin Resources*	BEN US	8%	11.9
Blackrock*	BLK US	18%	18.0
Aberdeen AM	ADN LN	15%	9.5
F&C	FCAM LN	15%	15.5
Schroders	SDR LN	6%	8.7
Ashmore	ASHM LN	34%	11.1
Average		17%	13.5
Shuaa @ market	SHUAA UH	23%	6.5
Shuaa Implied	SHUAA UH	23%	17.6

(ADN LN, OW, TP 220p versus 140p) (FCAM LN, UW, TP 170p versus 180p) (SDR, OW, TP 1,350p vs. 920p) (ASHM LN, OW, 410p vs. 270p)

Source: HSBC estimates *Consensus from Bloomberg

Shuaa versus EFG-Hermes: a valuation call

Based on our estimates, the market-implied valuation for Shuaa's annuity business is at much lower multiples than EFG-Hermes, although they have the same growth potential. Shuaa's business is trading at a 2009e PE of 6.5x compared with 11.8x for EFG-Hermes.

Likewise, despite similar ROEs, Shuaa seems to be trading at a lower 2009e P/BV: 1.4x versus 2.1x for EFG-Hermes.

Shuaa multiples are relatively low

	Shuaa	EFG-Hermes
PE 2009e*	6.5	11.8
Net Fees CAGR 2008-12e	22.0%	22.1%
PE 2009e implied valuation*	17.6	15.2
Discount rate	10.5%	12.5%
PE 2009e (bottom line)	8.6	12.9
Net Income CAGR 2008-12e	18%	21%
P/PV 2009e	1.4x	2.1x
ROE 2009e	17.0%	17.4%

Source: HSBC estimates *based on net service income

Orion deal: adds more markets, increases focus on annuity business

In early 2008 Shuaa acquired a 20% stake in Orion Holding, a Dubai-based financial services firm that specialises in brokerage and clearing, and financial IT solutions. In addition, Shuaa will gain effective control of five Orion brokerage companies in Kuwait, Jordan, Egypt, Syria and Turkey.

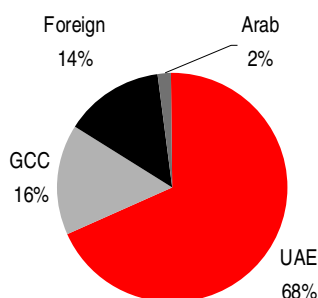
We have not factored this deal into our numbers for several reasons. First, regulatory approval is still pending in the countries concerned. Second, according to management, the transaction is worth USD52.5m but the payment method – whether by cash or a share swap – has not been disclosed. Third, Shuaa has not announced the size of its stake in the brokerage companies.

Although we have not included it in our valuation, we view the deal as a clear manifestation of Shuaa's commitment to the expansion of the fee business

New shares open to foreign investors by November 2008

The company's shareholder structure has already reached the 49% ceiling on non-UAE investors to the Dubai market. However, in late 2007, Dubai Financial Group (70% owned by Dubai Holding) subscribed to a convertible bond/debt worth cUSD457m, 32% of Shuaa equity. The strike date is November 2008, after which 125m share will become available to non-UAE investors.

Shareholder structure post bond conversion: 125m more shares open to investors



Source: Shuaa and HSBC

Currently, Shuaa Capital has paid-up capital of AED550m, representing 550m shares with a face value of AED1 per share. Currently, c53% of the co-holding is with UAE shareholders, including the Al- Ghurair family (11.5%), NBK Trustees Services (7.9%) and the Al Sager Family (5.7%).

The bond conversion will increase paid-up capital to AED800m, by issuing 250m more shares.

Risks

The main risks to our valuation are:

- ▶ Poorer-than-expected performance across the company's markets and business lines owing to increasing competition from global players who

are building their capabilities in the Middle East – specifically in UAE and Saudi Arabia;

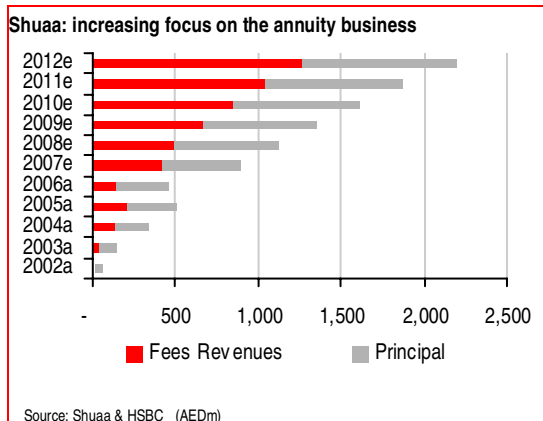
- ▶ Management's inability to create an organisational structure appropriate for running multi-market, multi-business operations;
- ▶ Shuaa's strong private equity corporate culture might slow development in its annuity business, which requires a different mind set.
- ▶ Escalation of cost beyond the levels we factored into our forecast.

Growth at a value price

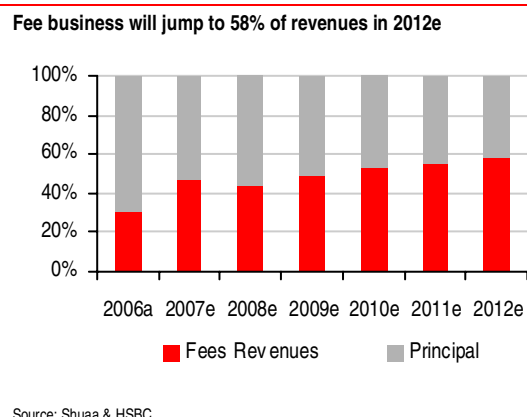
- ▶ Regional expansion and annuity business the key growth drivers. UAE to remain strong, Saudi a big opportunity – more to follow
- ▶ Annuity business is not priced in. On our numbers, it trades at a 2009e PE of 6.5x, for a 2008-12e CAGR of 22%
- ▶ Our target price of AED12.6 implies a potential total return of 68%

Business model: greater focus on the annuity business

Shuaa Capital started out as a pure principal and proprietary investment firm. In 2000, the company repositioned itself as an integrated investment services firm, combining fee-based business and principal investment. The move aimed to fully tap the booming GCC financial markets.



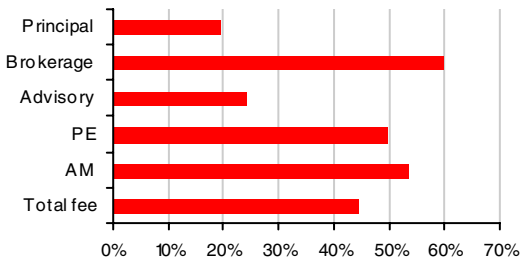
On our estimates, fee revenues will contribute 58% of revenue by 2012e, compared with 30% in 2006.



Well positioned to exploit the regional opportunity

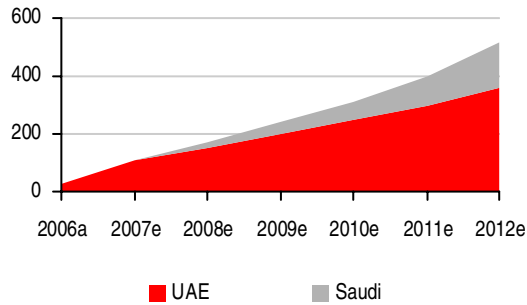
Shuaa is well positioned to benefit from regional opportunities. We argue that the Middle East equity story – particularly in the GCC – is very attractive given its strong economic fundamentals, ample liquidity, attractive valuation and relatively low correlation with global markets. The company's base in the UAE places it close to the GCC markets, clients and, potentially, foreign inflow.

Shuaa revenue CAGR 2006-12e



Source: Shuaa and HSBC estimates

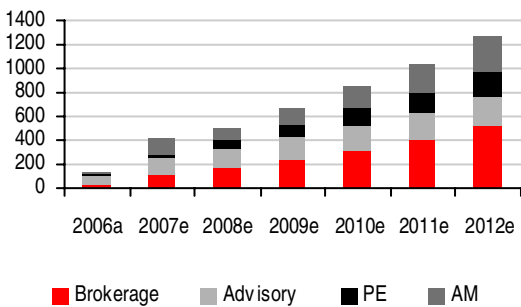
UAE still a major contributor; Saudi Arabia a good addition (AED)



Source: Shuaa and HSBC estimates

Coming from a low base, brokerage should be the main growth driver followed by asset management and private equity.

Fee revenue breakdown (AEDm)



Source: Shuaa and HSBC estimates

Brokerage: UAE volume growing, and Saudi Arabia is a useful addition

We expect Shuaa to benefit from foreign inflows to the UAE market as well as from its local retail base. We believe its market share will increase only slightly to 5.5% by 2012e, but on higher volume.

Saudi Arabia is also a helpful addition to the company's brokerage business. Given the competitive nature of the market, we expect Shuaa's market share to be low, at 1.5% by end-2012e. We expect it to benefit more from its Saudi asset management and corporate advisory operations.

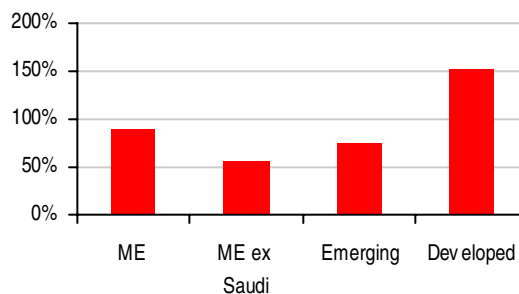
The brokerage is a volume business

	2007e	2008e	2009e	2010e	2011e	2012e
UAE						
Market share	4.50%	5.00%	5.25%	5.50%	5.50%	5.50%
Volume growth	35%	40%	30%	25%	25%	25%
Spread	0.20%	0.18%	0.17%	0.16%	0.16%	0.15%
Saudi						
Market share	0.0%	0.50%	0.75%	1.00%	1.25%	1.50%
Volume growth	-50%	40%	30%	25%	25%	25%
Spread	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%

Source: Shuaa and HSBC estimates

The, seemingly high, volume growth detailed above is supported by the fact that the Middle East (ex Saudi Arabia) is trading at a lower turnover/market cap than emerging and developed markets. We expect higher volumes in Saudi Arabia given higher liquidity, a retail trading mentality and foreign access to the market.

ME market turnover*, ex Saudi Arabia, below peer levels



Source: WFE, HSBA *trading volume/market cap

International firms to push volumes higher

We expect competition to rise as international players build capacity in the Middle East – particularly in UAE and Saudi – and these new entrants will push trading volumes higher. Despite increasing rivalry in the markets, we expect Shuaa to slightly increase its market share by 2012 (from 4.5% to 5.5%) as we expect more retail investors who divested after the market crash in early 2005 to return to the market. In addition, we believe its active IPOs will support the company’s brokerage business and increase its client base.

Orion deal: not reflected in our numbers, but a firm step toward expansion of the fee business

In early 2008, Shuaa acquired a 20% stake in Orion Holding, thereby confirming its horizontal expansion plans. Orion is a Dubai-based financial service firm, which specialises in brokerage and clearing, and financial IT solutions.

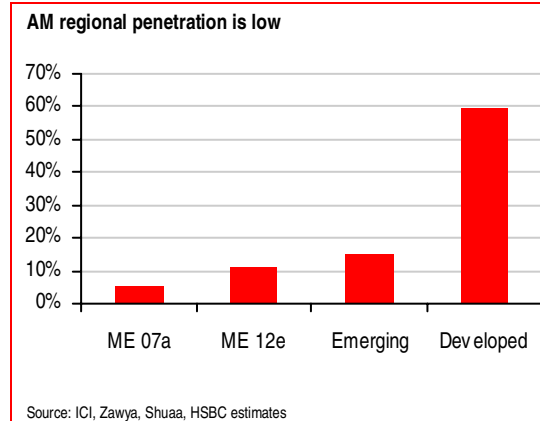
Under the agreement Shuaa will also obtain controlling stakes in five Orion Brokers subsidiaries for USD52.5m (possibly with cash or/and share swap), which cater for the markets of Kuwait, Jordan, Egypt, Syria and Turkey. According to management, this deal should broaden Shuaa Capital’s brokerage execution capabilities, giving it direct access to these markets on a hybrid (online and offline) platform. Pending approval of the deal in the countries concerned no further details have been given, and we therefore opted not to incorporate this into our numbers

Asset management and private equity also growth drivers

Asset management: good track record and low market penetration

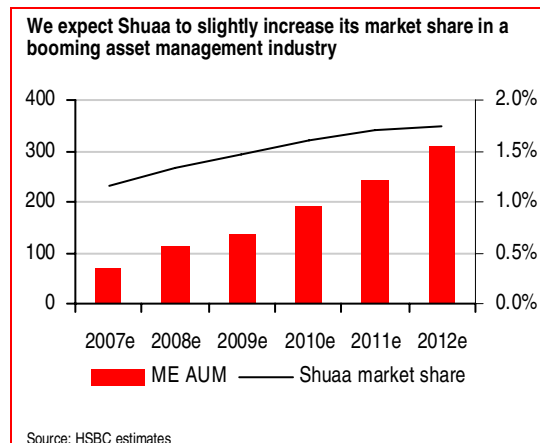
The asset management industry in the Middle East is still in its infancy. The region has a low penetration rate (AUM/market cap) of 6%. We estimate that by 2012, penetration should have reached 11%, which is still below averages of 16% for emerging and 60% for developed

markets. We estimate that AUM will exceed USD300bn by 2012e.



Shuaa, like EFG-Hermes, is among a handful of asset managers who can claim a good track record in the region. We estimate that Shuaa could slightly increase its market share to 1.8%, from 1.2% currently.

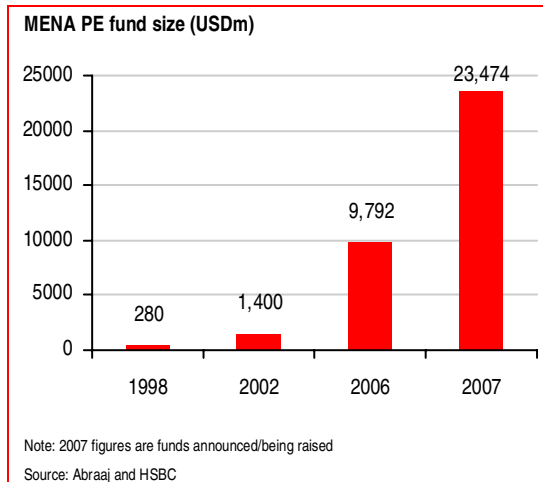
We expect net management fees on equity funds to hover around 70-80bps. Performance incentives should push fees to 170bps.



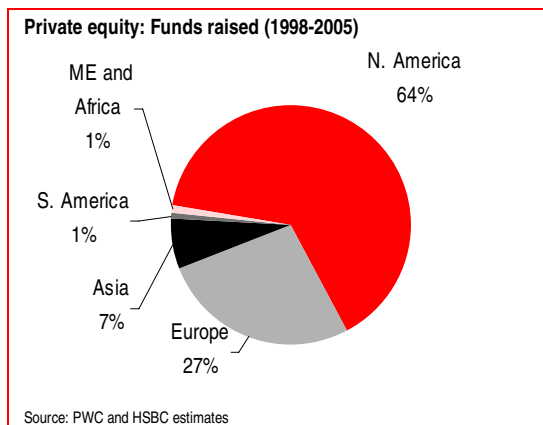
Private equity to grow from a small base

We believe private equity investment in the Middle East is poised for substantial growth, mainly spurred by petrodollar liquidity, surplus wealth and privatisation efforts. The Gulf Venture Capital Association estimates that the GCC countries raised private equity worth USD10bn in

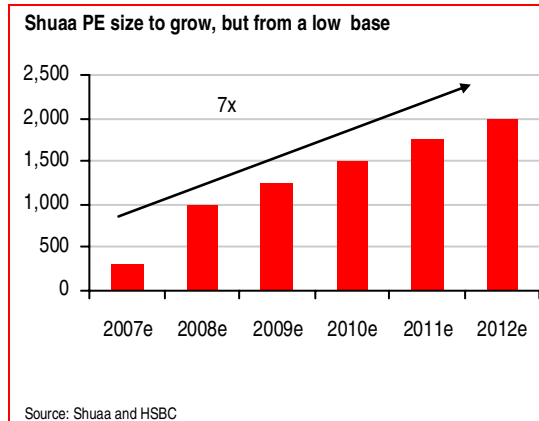
2006, compared with USD5.7bn in 2005 (up 75% y-o-y). It also estimated funds managed by regional private equity firms at USD18bn in 2006 and forecast that they would reach USD25bn by 2007e (y-o-y growth of 47%).



The private equity industry forms only a small share of the global industry. PWC estimates that Middle East and Africa accounted for 1% of total private equity money raised from 1998-2005.



Shuaa currently manages around USD300m in private equity, with more funds in the pipeline. We expect the figure to reach 2.0bn by 2012e.



Corporate advisory: well positioned in the lucrative UAE IPO market

Investment banking is booming in the region. IPOs are increasing in size and number, as a result of demand for new equity ideas, privatisations and family businesses tapping the market.

IPOs are increasing, particularly in Dubai and Saudi Arabia

	Deal Size USDm		No of deals	
	2007	2006	2007	2006
UAE	6,559	1,753	3	5
Saudi Arabia	4,814	2,785	26	10
Egypt	1,045	92	3	1
Qatar	389	1,355	2	2
Oman	210	54	2	na
Kuwait	120	-	na	0
Bahrin	70	1,036	1	3
Total	13,207	7,075	37	21

Source: Zawya and HSBC

UAE and Saudi are the most lucrative IPO markets in terms of deal numbers and size. Shuaa performed extremely well in UAE in 2007, and we expect the corporate advisory business to report double-digit growth; nonetheless, it is unwise to extrapolate 2007 year fees into the future.

Lucrative UAE IPO market gives Shuaa the edge in 2007

Deal numbers	3
Deal size USDbn	2.8
UAE market share (rank)	100% (1)
Regional market share (rank)	23% (2)

Source: Zawya and HSBC

Given the impressive list of names floated by Shuaa, we believe it is very close to UAE's

corporate community. Deal sizes are increasing substantially year on year. According to Zawya, announced and speculated IPOs in the region could number between 30 and 35 by 2010, most of them in the GCC.

Impressive IPO record in UAE

Deal	Time	Size USDm
Al Qudra Holding	2008 expected	997
DP World*	2007	4,963
Deyaar Development*	2007	883
Air Arabia	2007	713
Gulf navigation	2006	252
Islamic Arab Insurance	2005	55
Aramex*	2005	152
Arabtec	2004	60
Amlak Finance	2004	112

Source: Zawya and HSBC *co-lead manager

M&A activity is also increasing on the back of the boom in private equity funds raised. This activity is supported by cross-regional corporate expansion.

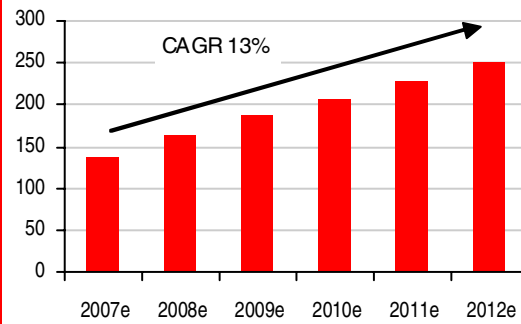
MENA – M&A deal size is increasing exponentially

	2007	2006	2005	2007/05
Size (USDm)	50,889	31,968	12,855	4.0x
Number	365	321	272	1.3x

Source: Thomson and HSBC

We expect Shuaa to retain a substantial market share in the IPO market, but expect no massive jump in its M&A deals

Shuaa corporate advisory: increase from a high base (AEDm)

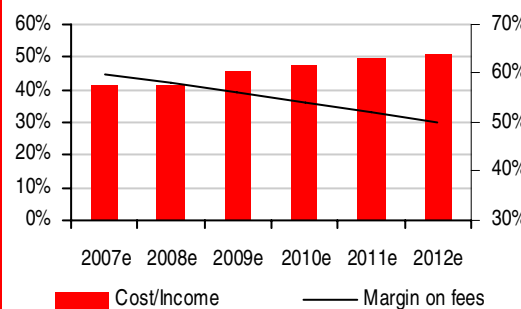


Source: Shuaa and HSBC

Margins could fall to international levels

Shuaa's margins may come under pressure from the scarcity of experienced investment professionals and other inflationary pressures in the region. We expect the margin on fees to stabilise at 50% and the total cost to total revenues ratio at 52% by 2012e.

Costs to rise, margins to fall

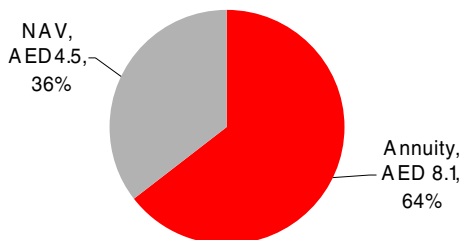


Source: Shuaa and HSBC (LHS: Cost/income, RHS: fee margins)

Valuation: annuity business not priced in

We have valued Shuaa using sum-of-the-parts, as we believe its value is derived from the sum of two components: the annuity business and principal investments.

Annuity business contributes AED8.1 (64% of our TP)



Source: HSBC estimates

Annuity business: clean earnings are what really matters

For the annuity business, we discount the company's clean earnings, which we define as investment-services fees (brokerage, corporate advisory, asset management and private equity) less operating costs.

Annuity business is deeply discounted at a 2009e PE of 6.5x...

On our estimates, the company's annuity business is trading at a 2009e PE of 6.5x, which we view as very cheap in absolute and relative terms.

We define annuity PE as the company's enterprise value (market cap minus principal investment value) over its clean earning (fees minus fee costs minus taxes). Being based in Dubai, Shuaa is not subject to corporate taxes, which gives it an advantage over other non-GCC players.

Market versus HSBC implied valuation for annuity business

	PE 2009e	CAGR 2008-12e
Market implied price	6.5x	22%
HSBC implied valuation:		
Asset management	18.3x	31%
Other investment services	17.0x	18%
Total investment services	17.6x	22%

Source: HSBC estimates

...and our estimates would put it at an implied PE 2009e of 17.6x, in line with global peers

Our implied valuation puts Shuaa at a 2009e PE of 17.6x, which we view as justified by our expectation of higher-than-peer growth potential.

Shuaa: clean earnings multiple in context

Company	Ticker	CAGR 2007-09e	PE 2009e
T Rowe Price*	TROW US	14%	17.3
Janus Capital*	JNS US	25%	15.0
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Source: HSBC estimates *Consensus from Bloomberg

Principal investment: valued at 1.0x NAV (36% of value)

To value the principal investment business, we have used the NAV reported in the company's financial statements at 31 December 2007. This division accounts for 36% of the company's value on our estimates.

We value Gulf Finance at AED558

We have used our own estimates to value Gulf Finance, a consumer finance company that is fully owned by Shuaa.

Gulf Finance company valuation

AEDm	2008e	2009e	2010e	2011e	2012e
Interest income	62	78	97	121	152
Interest exp	22	27	34	42	53
G&A	10	13	17	23	32
Net earnings	31	38	46	55	67
Y-o-y % change	25%	23%	21%	20%	20%
DCF @ 10.5%	28	31	34	37	41
Explicit value	171				
Perpetuity value	387				
GFC value (AEDm)	558				

Source: HSBC estimates

Regional exposure warrants much higher valuation multiples

Despite much higher potential growth rate, the market values Shuaa almost on a par with global investment firms (Shuaa at 8.6x for 27% growth, compared with global firms at 7.9x for a mere 7% growth – see table in next column).

In our view, this PE ratio and the company's growth potential imply that Shuaa's stock price is unjustifiably deeply discounted.

Shuaa: low bottom-line multiples unjustified

Company	Ticker	CAGR 07-09	2009	Rating
GS	GS US	-3%	7.7	Neutral
Lehman Brothers	LEH US	2%	7.3	Neutral
Morgan Stanley	MS US	15%	6.4	
Merrill Lynch	MER US	na	9.4	Overweight
UBS	UBSN VX	na	6.6	Overweight
Bear Stearns	BSC US	28%	8.3	
JP Morgan	JPM US	2%	9.3	
Lazard	LAZ US	14%	10.9	
Deutsche	DBK GR	-4%	6.8	Neutral
Credit Suisse	CSGN VX	1%	6.5	Overweight
Average		7%	7.9	
Shuaa @ Market *	SHUAA UH	27%	8.6	
Shuaa @ Implied *	SHUAA UH	27%	14.5	

Source: Source: Consensus from Bloomberg *Bottom line diluted EPS (earnings include principal investments)

What if?

We have tested some of our main assumptions in an adverse situation entailing much lower trading volumes where Shuaa is unable to increase its market share because of foreign competition. In this scenario, we also assumed no growth in the asset management business. We also valued the principal investments at a P/NAV of 0.75x, rather than 1.0x. Even under such adverse conditions, we still

Shuaa Summary of our SOTP valuation

31 of March	2008e	2009e	2010e	2011e	2012e	CAGR08-012e
Fees Income	494	659	844	1033	1268	27%
Less exp	207	290	388	496	634	32%
Net Fees	287	369	456	537	634	22%
Of which						
AM+PE	84	154	147	190	243	31%
Others	203	215	309	347	391	18%
Discounted earnings @ 10.5%	287	334	373	398	425	
Explicit AM + PE (2008-2012)	647					
Explicit others (2008-2012)	1,170					
Terminal AM + PE	2,175		Terminal @	3%		
Terminal Others	2,496		Terminal @	0%		
Value from Operations	6,488	64.5%				
Add:						
Net Cash	-241	-2.2%				
Gulf finance	558	5.5%				
Investments in associates	829	8.3%				
Investment securities	1,963	19.5%				
Investment for sale	477	4.4%				
Equity Value	10,074	100.0%				
Outstanding Shares (m)*	800					
Value Per share (AED)	12.6					
Price (AED)	7.5					
Potential	68%					

Source: HSBC estimates * PostDebt Conversion

obtained a respectable potential return of 27%.

Solid upside even in a very adverse scenario

	Base Case	Adverse
UAE Brokerage Volume CAGR 06-12	25%	10%
UAE Market Share in 2012e	5.5%	4.5%
Saudi market volume CAGR 06-12	10%	0%
Saudi Market Share in 2012e	1.5%	1.0%
Asset Management Perpetuity Growth	3%	0%
Principal investment valued at P/NAV of	1.00x	0.75x
Target Price AED	12.6	9.5
Current Price AED	7.5	7.5
Potential total return	68%	27%

Source: HSBC estimates

Shuaa versus EFG-Hermes: boils down to valuation

Shuaa fee business is not priced in

On our estimates, Shuaa is trading at deep discount to EFG-Hermes. Whereas we estimate that the net fees of both companies will grow at net fees CAGR08-12e of 22%, Shuaa's annuity business is trading at a 2009e PE of 6.5x, versus 11.8x for EFG-Hermes.

The valuation implied by our target price would place Shuaa at higher PE of 17.6x, compared with 15.2% for EFG-Hermes. Despite having the same expected growth rate, Shuaa's discount rate (mainly GCC) is c200bps lower than that of EFG-Hermes (average for Egypt and GCC).

Shuaa's multiples are relatively low

	Shuaa	EFG-Hermes
PE 2009e*	6.5	11.8
Net Fees CAGR 2008-12e	22.0%	22.1%
PE 2009e implied valuation*	17.6	15.2
Discount rate	10.5%	12.5%
PE 2009e (bottom line)	8.6	12.9
Net Income CAGR 2008-12e	18%	21%

Source: HSBC estimates *based on net service income

And Shuaa currently trades at a lower P/BV despite having the same ROE

On our numbers, Shuaa, post debt conversion, would trade at a lower 2009e P/BV, of 1.4x versus 2.1x for EFG-Hermes, despite having more or less the same ROE.

Shuaa trades at a lower P/BV despite similar ROE*

	Shuaa	EFG-Hermes
P/BV 2009e	1.4	2.1
ROE 2009e	17.0%	17.4%

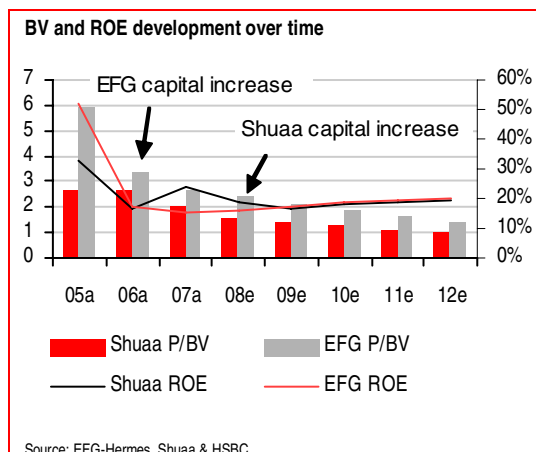
Source: HSBC estimates * average equity

Capital increase places more pressure on EFG-Hermes's ROE...

The following graph shows the development of the B/PVs of Shuaa and EFG-Hermes against their respective ROEs. From 2009 and beyond, the companies show the same ROE, yet Shuaa is trading at a lower P/BV.

The massive capital increase undertaken by EFG-Hermes in 2006 (9x its equity) places more pressure on its ROE, which fell from 52% in 2005 to 15.4% in 2007.

After the debt conversion in October 2008, we expect Shuaa's ROE to come under pressure, falling from 24% in 2007e to 18.6% in 2008e. However, this pressure will be less extreme than in the case of EFG-Hermes, as Shuaa's capital will be increased by less than 2x.



Source: EFG-Hermes, Shuaa & HSBC

DuPont analysis: it's all about leverage – and is reversible for EFG-Hermes

The following DuPont analysis shows the decomposition of ROE over time for both companies. It is clear that the main contributor to the pressure on EFG-Hermes's ROE is much lower leverage. As long as we expect margins to remain healthy, the ROE could be pushed higher through leverage – but how could this come about? Either by leveraging the balance sheet and making an acquisition or by giving cash back to shareholders. This equity base is not needed to support the fee business operations.

Du Pont Analysis: low gearing puts pressure on ROE

	2005a	2006a	2007a	2008e	2009e
Shuaa					
Margin	73%	57%	51%	52%	54%
Revenue / Assets	0.21	0.13	0.15	0.18	0.20
Assets /Equity	1.51	2.26	2.94	1.61	1.57
ROE*	24%	17%	22%	15%	17%
EFG-Hermes					
Margin	46%	59%	53%	58%	57%
Revenue / Assets	0.34	0.13	0.20	0.20	0.21
Assets /Equity	2.84	1.26	1.41	1.43	1.49
ROE*	45%	10%	15%	16%	18%

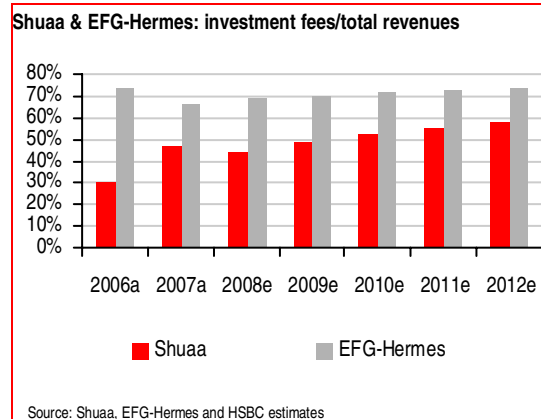
Source: EFG-Hermes & HSBC estimates *year end equity

And it is all linked to their business model: annuity versus principal

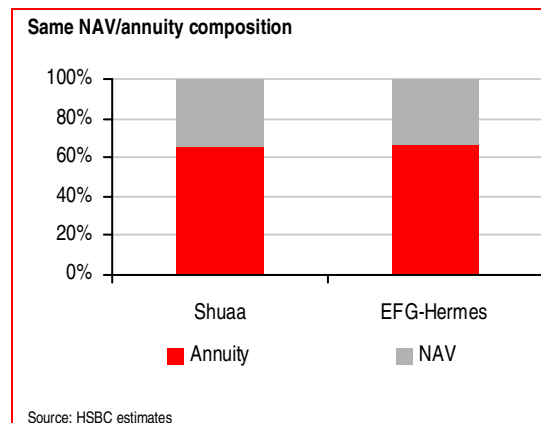
It is interesting to see how the two companies are changing their strategies over time.

- ▶ Shuaa, historically a pure private play, is repositioning itself to focus on the annuity business. If it succeeds, it should be able to trade on a higher multiple than at present.
- ▶ EFG-Hermes, historically a pure fee-based firm, now holds principal investments. It is still pursuing a universal banking model, combining investment and commercial banking operations. Meanwhile, it is not using its capital base efficiently.

On our numbers, EFG-Hermes would generate higher investment fee income, but Shuaa's fees/total revenues ratio is increasing significantly.



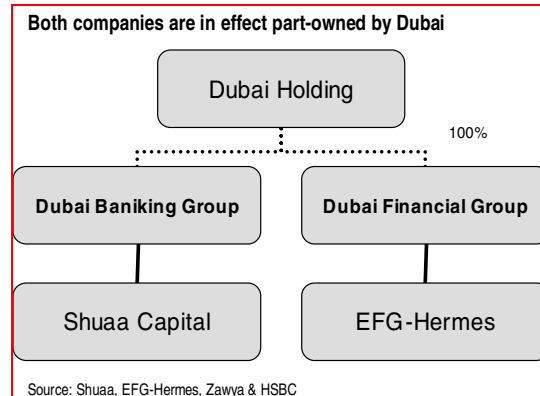
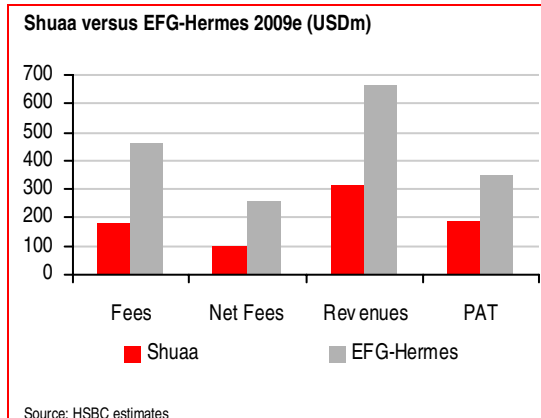
And on our numbers, both have more or less the same NAV to annuity valuation split.



Size matters: EFG-Hermes is growing from a higher base

Our estimates show that both companies should be able to increase their net fees at the same rate (2008-12e CAGR). However, we note that EFG-Hermes's growth is from a much higher base, reflecting the strong track record and aggressive strategy of its fee business.

By comparison, Shuaa's growth is coming from a much lower base and, moreover, its strong private equity culture could, in our view, slow the expansion of the annuity business, which requires a different mind set.



Both maintain financial flexibility: corporate action could be a stock catalyst...

Both Shuaa and EFG-Hermes have low financial gearing and currently enjoy low debt-to-equity ratios (Shuaa at 0.4x and EFG-Hermes at nil for 2008e). The two companies have both expressed their desire to make an acquisition, which could act as a strong catalyst for the share price. Shuaa is explicitly moving to increase its fees business while EFG-Hermes continues to pursue the universal banking model.

...and, effectively, they are part-owned by the government of Dubai

Post bond conversion in November 2008, Dubai Banking Group (70% owned by Dubai Holding) will own 31% of Shuaa. Interestingly, in November 2007, Dubai Financial Group (100% effectively owned by Dubai Holding) bought 25% of EFG-Hermes (sold by Abraaj Capital).

This means that both companies are in effect partially owned by the Dubai Holding, or the government of Dubai. It would be premature to guess at the effects of this development in the short term. However, over the medium to long term, we think that the Dubai government's involvement could help both companies in their acquisitive expansion strategies.

EFG-Hermes valuation and risk

On 6 March 2008, we published a note on EFG-Hermes, in which we raised our target price to EGP75 from EGP55, but downgraded the stock from Overweight (V) to Neutral. Please see *EFG-Hermes: Like the story, not the valuation; Raise TP from EGP55 to EGP75, downgrade rating from Overweight (V) to Neutral*.

EFG-Hermes SOTP valuation

	EGPm
Explicit value (2009-2012e)	6,119
Terminal value	13,049
Annuity business	19,169
Add:	
Principal investment at 1.0x	10,079
Equity value	29,248
Outstanding shares m	388
Value per share EGP	75
Price EGP	64
Total potential return	17%

Source: HSBC estimates

The upside risks to our valuation are:

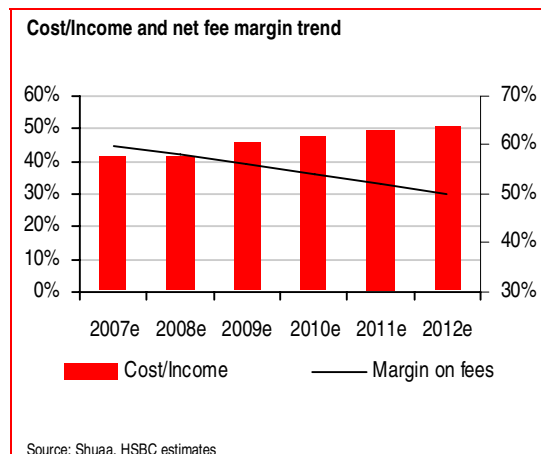
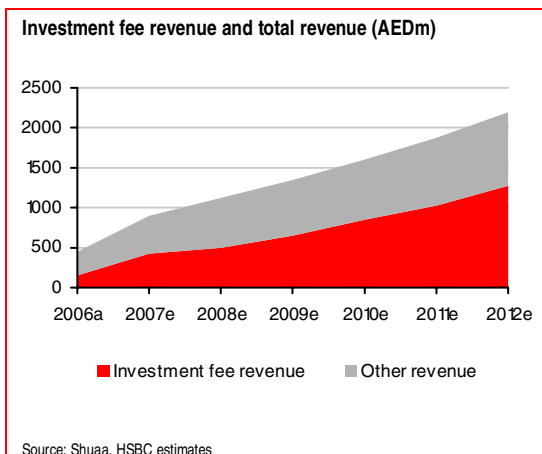
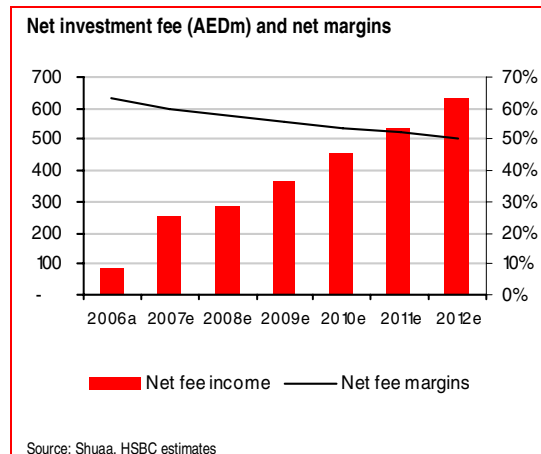
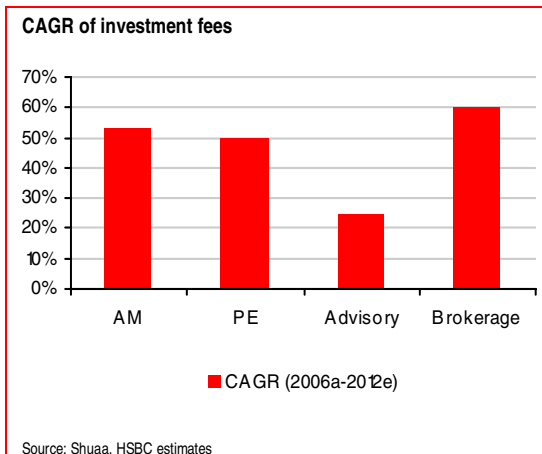
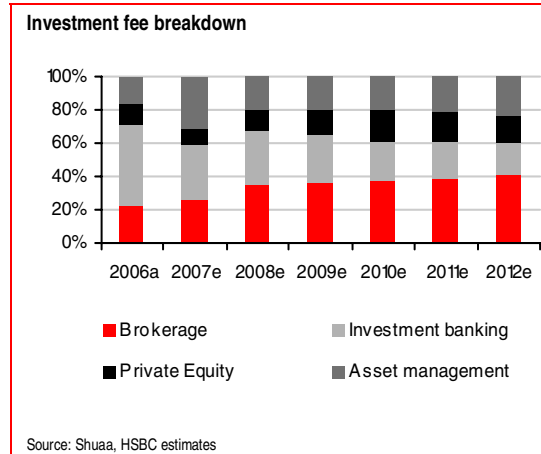
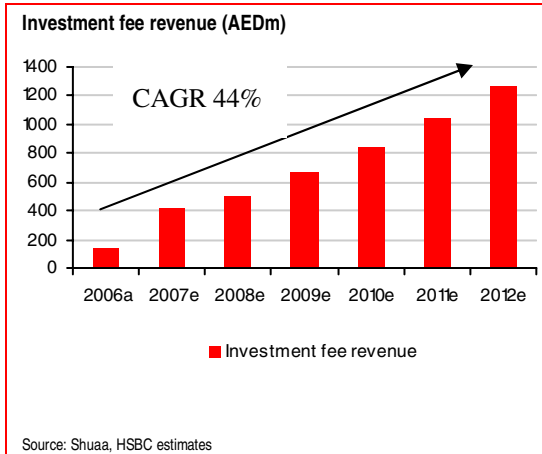
- ▶ Better-than-expected performance in the company's markets, particularly the Saudi market;
- ▶ Better-than-expected performance in the company business lines, particularly the asset management segment;

- ▶ Faster-than-projected deployment of excess cash on the balance sheet in a deal that is significantly value accretive

The downside risks to our valuation are:

- ▶ Weaker-than-expected performance across markets and business lines, particularly in the Saudi operation and asset management;
- ▶ Escalation in costs of human capital and infrastructure above the levels we have factored in;
- ▶ Uncertainties surrounding the deployment of the cash balance.

Financial Forecast



Shuaa Capital Income Statement

AED m (31 March)	2005-06a	2006-07a	2007-08f	2008-09f	2009-10f	2010-2011f	2011-12f
Fee and commission income	202	140	422	494	659	844	1033
Expenses	75	52	169	207	290	388	496
Operating Income	127	88	253	287	369	456	537
Other Income							
Interest income	69	87	118	161	189	218	253
Income from investment securities	66	-13	229	301	325	351	379
Income from investments	53	138	46	29	31	32	34
Income from associates	112	108	83	135	147	159	173
Total Other Income	300	319	477	627	691	760	839
Interest expense	25	71	120	136	85	85	85
Other expenses	35	74	155	193	241	278	305
Total Expenses	59	145	274	329	327	363	391
Profit before tax	368	262	456	584	734	853	986
Tax	0	0	0	0	0	0	0
Profit after tax	368	262	456	584	734	853	986
Minority interest	5	1	23	29	37	43	49
Profit after tax	362	262	433	555	697	810	937

Source: Shuaa, HSBC estimates

Balance sheet of Shuaa Capital

As at 31 March (UAEm)	2005-06a	2006-07a	2007-08f	2008-09f	2009-10f	2010-2011f	2011-12f	2012-13f
Assets								
Cash on hand & bank	70	136	1,763	1,517	1,457	1,402	1,353	1,293
Other deposits	17	-	-	-	-	-	-	-
Investment securities	575	850	1,912	2,007	2,168	2,341	2,529	2,731
Accounts and notes receivable	310	790	450	560	675	802	936	1,099
Instalment credit , loans and advances	554	650	813	975	1,170	1,404	1,685	2,022
Investment available for sale	134	176	185	195	204	215	225	237
Investment in associates	648	774	835	902	978	1,061	1,154	1,257
Fixed assets (net)	9	11	13	14	14	14	13	11
Goodwill(net)	34	95	95	95	95	95	95	95
Total assets	2,351	3,483	6,065	6,266	6,762	7,334	7,990	8,745
Liabilities								
Due to banks	450	690	1,112	912	912	912	912	912
Payable and other credit balance	205	740	777	816	857	900	945	992
Medium term debt	137	505	584	584	584	584	584	584
Additions of convertible bonds from DBG	-	-	1,500	-	-	-	-	-
Total Liabilities	792	1,936	3,973	2,312	2,353	2,395	2,440	2,488
Shareholders' Equity								
Paid – in capital	550	550	550	800	800	800	800	800
Treasury shares	-	-13	-13	-13	-13	-13	-13	-13
Proposed issue of bonus shares /dividend	165	110	110	110	110	110	110	110
Employee stock option plans	90	-175	-	-	-	-	-	-
Statutory reserve	553	553	553	553	553	553	553	553
Retained(losses) earnings	368	513	860	2,443	2,861	3,347	3,909	4,560
Investment revaluation reserve	11	2	3	3	3	3	3	3
Translation reserve	2	2	2	2	2	2	2	2
Total Shareholders' Equity	1,560	1,543	2,065	3,898	4,316	4,802	5,364	6,015
Minority interest	-	5	27	57	93	136	185	242
Total Shareholders' Equity and Liabilities	2,351	3,483	6,065	6,266	6,762	7,334	7,990	8,745

Source: Shuaa, HSBC estimates

Background

- ▶ A leading financial services institution in the UAE with a presence in MENA and GCC countries
- ▶ Market leader in the IPO league, with a 100% share in UAE, and second-largest player in GCC countries
- ▶ Looking for growth in the region through strategic investments

Company Summary

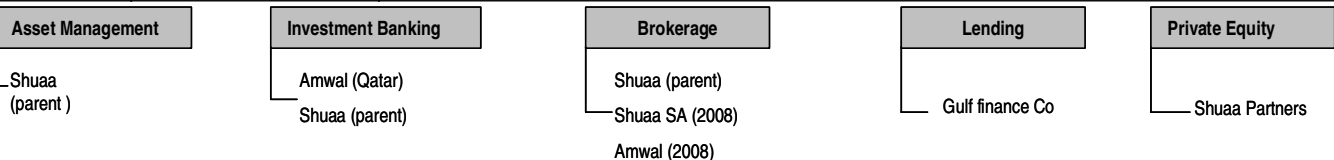
Shuaa Capital is one of the leading financial service institutions based in Dubai. Its main focus is on asset management, private equity, investment banking, principal investment and research. Incorporated in 1979, it is now one of the largest investment banking institution in the UAE. The company's shares are listed in Dubai Financial Market and the Kuwait Stock Exchange. Shuaa's business model consists of five segments, as described below

Assets under management

Shuaa Asset Management was established in 2001 and today manages more than 18 funds with AUM of AED 4.5bn. The company covers 15 organised stock exchanges in the Arab world and GCC countries, providing one of the best routes for foreign investors to invest in the GCC and Arabic regional stock markets. The funds managed include equity funds, debt market funds, conventional and Shariah-compliant products. In FY2007, management fees contributed cAED22m of revenue,

Shuaa major events, time line and companies

Pre 2000	Principal Investments	<ul style="list-style-type: none"> ▶ Managing Shuaa's assets ▶ Established diversified portfolio of global investments
2001	Assets Management	<ul style="list-style-type: none"> ▶ Leading asset management institution in the region, covering different assets classes. ▶ Currently manages more than 13 funds.
2002	Investment Banking	<ul style="list-style-type: none"> ▶ Leader in the GCC IPO market ▶ Activity include ECM, DCM and advisory
2004	Brokerage	<ul style="list-style-type: none"> ▶ Provides access to GCC market plus seven Arab markets in MENA ▶ Top three broker in UAE market share
2005	Private Equity	▶ Closed the first fund in 2005 (USD 200m) and partially closed the second fund (USD 100m) in 2006
2007	Convertible bonds	▶ Issued convertible bonds to DBG for AED1.5bn to be converted into equity share thus making DBG the biggest stakeholder



Source: Shuaa [please correct IPO (all capitals) in 2002 row; add unit to amount mentioned in 2007 row]

which has increased to AED122m for the nine months ending December 2007. We expect fee revenues from AUM to grow at a 2006a-2012e CAGR of c12% to AED295m. This segment currently contributes c16% of the fee revenue

Investment Banking

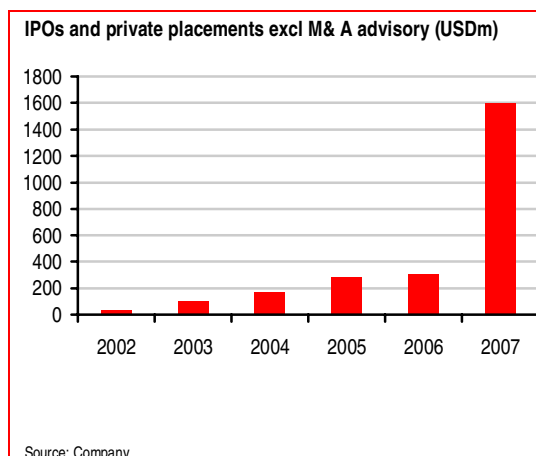
Shuaa provides investment banking services through Shuaa Parents and its associate, Amwal, in Qatar. The main services provided in this segment include private placement, M&A advice, public offerings of equity and debt securities, trade sales, syndication, sales and trading, and structured products. The table below details some of the advisory services handled by Shuaa.

Impressive IPO record in UAE

Deal	Time	Size USDm
Al Qudra Holding	2008 expected	997
DP World*	2007	4,963
Deyaar Development*	2007	883
Air Arabia	2007	713
Gulf Navigation	2006	252
Islamic Arab Insurance	2005	55
Aramex*	2005	152
Arabtec	2004	60
Amlak Finance	2004	112

Source: Zawya & HSBC *co-lead manager

Shuaa holds the No 1 position in the GCC lead managers' IPO league for UAE, with a 100% market share and held second place in the GCC region, with a c25% market share. Advisory fees generated revenue of AED68m in 2007, ie approximately 49% of all fee revenue. HSBC estimates that this segment will grow at a CAGR of c24% by 2012. The table below shows the transaction value of IPOs and private placements handled by Shuaa.



Brokerage

Shuaa provides its client with a common platform for trading in all the GCC markets plus seven Arab markets in the MENA. Its plans for this segment envisage high growth. The company is opening a fully operational brokerage subsidiary in Saudi Arabia (end-2008) to tap into the region's high growth potential. Furthermore, Shuaa has announced the acquisition of a 20% strategic stake in Orion Holding – a Dubai-based prime brokerage firm with a presence in Kuwait, Egypt, Jordan and Turkey. In 2007, brokerage fees contributed c22% ie AED31m, to overall fee revenue. We expect these fees to grow at a CAGR of 60% (2006a -2012e)

Private equity

Shuaa Partners, the private equity arm of Shuaa Capital, invests in selected equity, debt and/or equity investments. It operates two funds: Shuaa Partners Fund I (USD200m) and Frontier opportunity fund I (USD 100m).

Shuaa Partners Fund I: Focuses mainly on investments in private companies and equity-related investments in GCC countries. To date this fund has invested in five companies, namely Air Arabia, Rotana Hotel Management, Drake & Scull, Petrofac and Damas. It has since exited from two of these.

Petrofac Exit figures- (USDm)

Exit method	Holding period	Cost realised Investments	Proceeds
Secondary Market	4 months	9.8**	15.6
	Realised gain	Multiple at Cost	Gross IRR
	5.8	1.60x**	400.60%

Source: Company, ** (net of leverage of USD4.9m)

Frontier opportunity fund I: Focuses mainly on private companies and equity-related investments in Syria, Jordan and Lebanon. To date this fund has invested in one company, Syriates.

The company aims to set up two new private equity funds in 2008: Hospitality fund (USD500m) and SPF II fund (USD500m).

Principal Investments

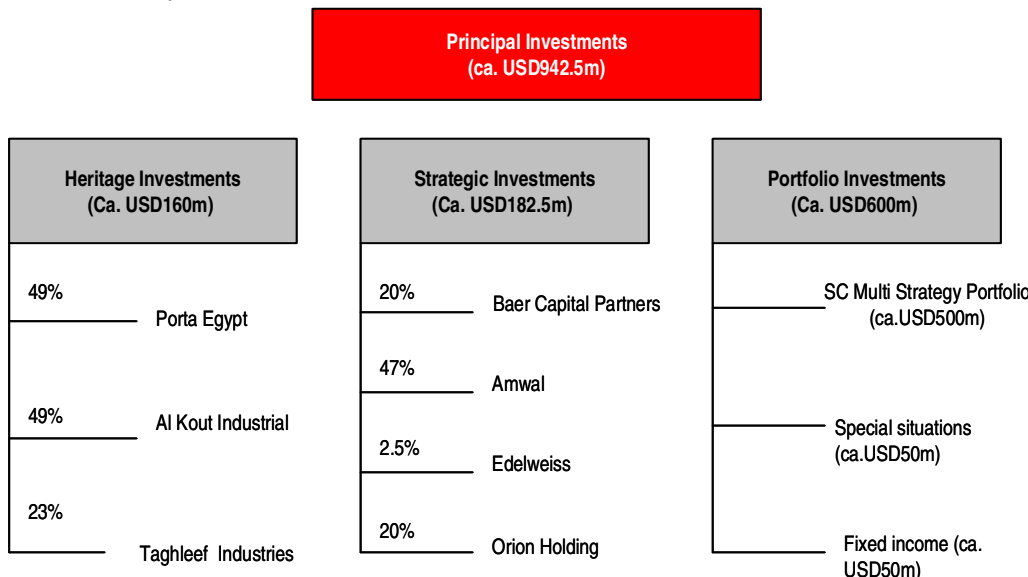
The principal investment division mainly makes strategic, heritage and portfolio investments. Here, the company invests its own funds to enhance shareholder value. Strategic investments are made in companies that operate in the same business line to secure business synergies. Heritage investments are mainly in private companies and their main aim is to achieve capital appreciation at the time of exit, whereas portfolio investments are funds set aside for special purposes and fixed income.

Orion deal

In early 2008, Shuaa acquired a 20% stake in the Orion Holding thereby confirming its horizontal expansion plans. Orion is a Dubai-based financial services firm specialising in brokerage and clearing, and financial IT solutions. The company mainly caters to the markets of Kuwait, Jordan, Egypt and Turkey. This deal will broaden the brokerage execution capabilities Shuaa Capital can offer its clients, providing direct access to these markets on a hybrid (online and offline) platform.

Under the agreement Shuaa has agreed to acquire a 20% strategic stake in Orion Holding as well as controlling stake in five Orion Brokers subsidiaries for USD52.5m. This will assure Shuaa a seat on the Orion board of directors. Orion will also be represented on the board of Shuaa Securities, a brokerage arm of Shuaa Capital that is currently being set up.

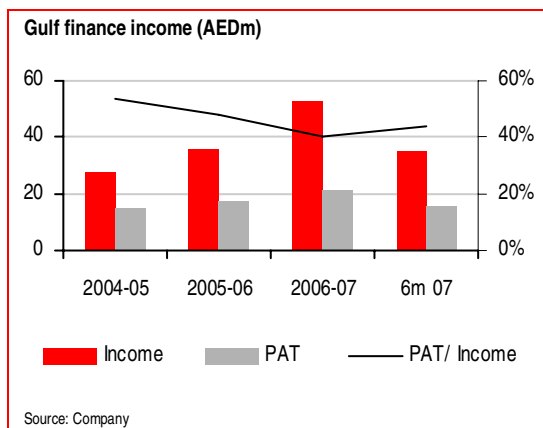
Breakdown of Principal Investments



Source: Company

Gulf Finance: a consumer finance company

Gulf Finance is a 100% subsidiary of Shuaa Capital that concentrates on asset-backed finance. The company's main focus is on auto and construction equipment finance, receivables financing, bill discounting and investments in project companies for up to 7% of their net worth.

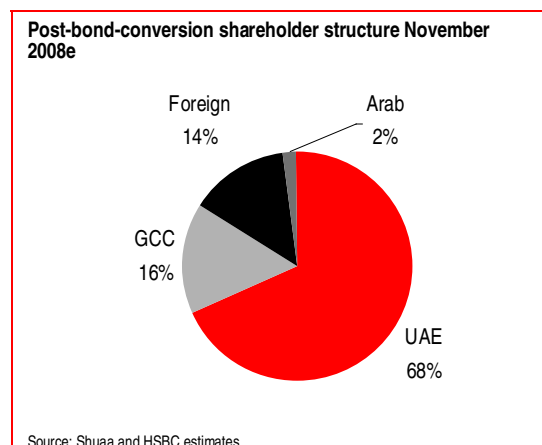
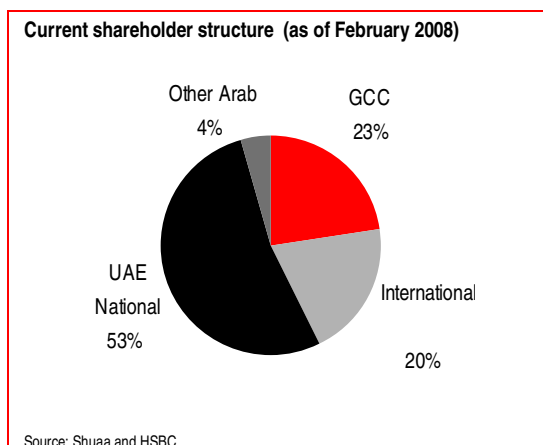


Dubai Banking Group: the major shareholder

To finance the strategic investments of the company and the further expansion of its business, Shuaa's board stroke a deal with Dubai Banking Group (DBG), jointly owned by Dubai Holding (70% stake) and Emmar Properties (30% stake). Under the agreement, DGB subscribed to a AED1.5bn convertible bond to be converted into 250m shares at AED6 per share by end-November 2008. DBG also injected AED176m to retire Shuaa's debt. Post conversion the DBG Group will hold a c32% stake in the company. Shuaa has already earmarked part of the funds, announcing the acquisition of the strategic stake in Orion, for AED193m. The chart below shows the current and post-conversion shareholder structure of Shuaa.

Shareholder Structure

Shuaa Capital has paid-up capital of AED550m representing 550m shares with a face value AED1 per share. Currently, c53% of the company is held by UAE shareholders, including the Al Ghurair family (11.5%), NBK Trustees Services (7.9%) and the Al Sager family (5.7%).



Notes

Notes

Notes

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Wael Orban and Walid Khalfallah

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

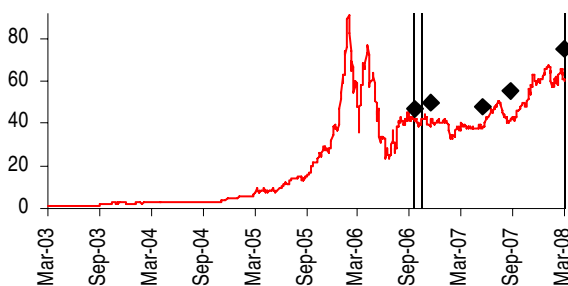
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As of 07 March 2008, the distribution of all ratings published is as follows:

Overweight (Buy)	57%	(22% of these provided with Investment Banking Services)
Neutral (Hold)	29%	(23% of these provided with Investment Banking Services)
Underweight (Sell)	14%	(13% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

EFG Hermes Holding Share Price performance EGP Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Neutral	21 September 2006
Neutral	Overweight (V)	16 October 2006
Overweight (V)	Neutral	06 March 2008
Target Price	Value	Date
Price 1	47.10	22 September 2006
Price 2	50.00	22 November 2006
Price 3	47.99	22 May 2007
Price 4	55.00	29 August 2007
Price 5	75.00	06 March 2008

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
SHUAA CAPITAL	SHUA.DU	7.44	06-Mar-2008	6, 7

Source: HSBC

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