

# The Sultan Center

## A Homegrown Retailer



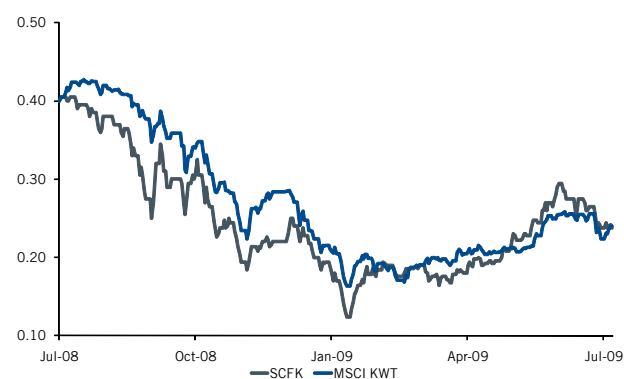
July 21, 2009

### Key Data

<b>Current Price*</b>	<b>Avg. Value Traded per Day</b>
KD 0.240	KD 0.5 million
<b>52-Week High</b>	<b>Market Cap</b>
KD 0.405	KD 139 million
<b>52-Week Low</b>	<b>Current Number of Shares</b>
KD 0.124	578.8 million
<b>Reuters</b>	<b>Bloomberg</b>
SCFK.KW	SULTAN KK
<b>Ownership Structure</b>	
Privately Held: 44%	Public: 56%

\* Price as of close on July 20, 2009. Sources: Zawya and NBK Capital

### Rebased Performance



Sources: MSCI, Reuters, and NBK Capital

### Key Ratios

	2008 a	2009 f	2010 f	2011f	2012f
Adj. P/E*	nmf	15.5	13.1	13.6	13.3
Adj. EV/ EBITDA*	12.3	8.4	7.4	7.2	7.4
EBITDA Margin	5%	6%	6%	6%	6%
EBITDA Growth	-3%	41%	14%	2%	-2%
Dividend Yield	0.0%	0.0%	0.6%	0.7%	0.9%
<b>4Q2008 EBITDA a</b>		<b>2Q2009 EBITDA f</b>			
KD (0.6) mln		KD 4.7 mln			
<b>1Q2009 EBITDA a</b>		<b>3Q2009 EBITDA f</b>			
KD 4.3 mln		KD 5.8 mln			

\* Refer to page 30. a = actual, f = forecast. Sources: Reuters and NBK Capital

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### Highlights

**12-Month Fair Value: KD 0.330**

**Recommendation: Buy-Risk Level\*\*: 4**

**Reason for Report: Initiation of Coverage**

- Sultan Center is a grocery retail player with operations in four MENA countries. Sultan Center has successfully become a dominant player in each of its markets due to its high-quality service and ability to understand the needs of each market.
- Kuwait, the largest grocery operation for Sultan Center (as Kuwait accounts for 55% of the company's grocery sales), has several elements that favor retailing: a young population, a high GDP per capita, and a zero personal income tax environment. In addition, Sultan Center has confirmed its grip on the markets in which the company has expanded and is poised to reap the benefits of such acquisitions.
- Sultan Center's total revenue increased at double-digit growth rates over the past two years, driven mostly by growth in grocery, while the company's EBITDA has been declining. This drop in EBITDA is a result of an escalation of SG&A costs, which were negatively affected by the integration expenses of the new assets acquired in Lebanon in 2008.
- We forecast that Sultan Center's total revenue will increase at a CAGR of 10%, with 2009 having the strongest showing with 23% growth. Our forecasts incorporate a drop in trading revenue due to the anticipated withdrawal of U.S. troops from Iraq. We expect Sultan Center's EBITDA margin to improve from 5.3% in 2008 to an average of 6% over our forecast horizon because of cost-cutting initiatives. Our forecasts for Sultan Center's net income exclude the group's share of results from associates and any other investment gains or losses.
- The fact that 42% of Sultan Center's assets are locked into non-core assets has led to a high volatility in net income. This was felt in the performance in 2008 when Sultan Center posted a net loss of KD 5.4 million compared to a net income of KD 16.9 million in 2007. However, Sultan Center reported strong levels of cash flow from operations of KD 31 million and KD 34.1 million in 2007 and 2008, respectively.
- From a valuation standpoint, using the discounted cash flow (DCF) method, we believe that the fair value of Sultan Center's share is KD 0.330, representing a 37.5% upside potential from the July 20, 2009, close. Hence, we recommend a "Buy" on the stock. From our subjective criteria for risk, we have assigned Sultan Center a risk rating of 4 on a scale of 1 to 5.

\*\* Please refer to page 35 for recommendations and risk ratings.

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## EXECUTIVE SUMMARY

Sultan Center is Kuwait's largest independent grocery retailer, with operations in other lines of business, most notably fashion retail, restaurants, and trading. Today, Kuwait represents 46% of the company's total revenue following Sultan Center's successful expansion in Oman, Jordan, and Lebanon, which started in 1999. Sultan Center quickly confirmed its grip on these new markets and became one of the dominant players in the grocery arena. In addition, Sultan Center is one of the major suppliers used by Agility to procure food-related items for the U.S. Armed Forces in Iraq.

Sultan Center's total revenue has been increasing at double-digit growth rates over the past two years, driven mostly by growth in grocery retail revenue. Sultan Center's EBITDA has been moving in the opposite direction of the company's revenue growth, which raises a concern since the gross profit margin has been relatively consistent. This is a result of an escalation of SG&A costs due to nonrecurring expenses to integrate the new assets in Lebanon.

We forecast that Sultan Center's total revenue will increase at a CAGR of 10%, with 2009 having the strongest showing with 23% growth. Those forecasts reflect our strong view of Kuwait's retail potential in general, our favorable outlook on Sultan Center's grocery operations in other countries, as well as Sultan Center's ability to expand sales per square meter of retail space. However, our forecasts incorporate a drop in trading revenue due to the anticipated withdrawal of American troops from Iraq. We expect Sultan Center's EBITDA margin to improve from 5.3% in 2008 to an average of 6% over our forecast horizon.

Sultan Center began expanding outside its core business in 1995 when the company acquired a 25% stake in National Real Estate Company (NREC) (which has increased to 31% since then). Today, 42% of the total assets of Sultan Center are classified as investment properties, available-for-sale investments, or investments in associates, which has led to a high volatility in net income. This was mainly felt in the performance in 2008 where Sultan Center posted a net loss of KD 5.4 million compared to a net income of KD 16.9 million in 2007. Our forecasts for Sultan Center's net income exclude the group's share of results from associates and any other investment gains or losses. NREC is currently an EBITDA negative company, with its income reliant on NREC's share in Agility. Though we have explicit forecasts for Agility, the fact that NREC has two major projects in the pipeline prevents us from extrapolating NREC's bottom line.

From a valuation standpoint, using the discounted cash flow (DCF) method, we believe that the fair value of Sultan Center's share is KD 0.330, representing a 37.5% upside potential from the July 20, 2009, close. Hence, we recommend a "Buy" on the stock. From our subjective criteria for risk, we have assigned Sultan Center a risk rating of 4 on a scale of 1 to 5.

## VALUATION

The purpose of this valuation exercise is to arrive, using fundamental analysis, at a fair value estimate of the share price that should prevail for Sultan Center in the next 12 months. This does not represent a guarantee that this value is achievable within that time frame, as a wide range of variables and market dynamics affect the market price of an asset.

Each investor must use his or her favored mix of fundamental research, technical analysis, and market intelligence to arrive at an investment decision that matches his or her objectives and tolerance for risk.

We arrived at a 12-month fair value for Sultan Center of KD 0.330 per share using only the discounted cash flow (DCF) method. While it is our standard practice to use at least two valuation methods to reach our fair value estimate, very few retailers are listed on the MENA markets. In addition, the select few that are listed are not covered by research houses, which prevents us from using forward P/E-to-Growth (PEG) multiples for valuation. Our 12-month fair value of KD 0.330 per share represents a potential upside of 37.5% relative to the July 20, 2009, close, and we are initiating coverage on Sultan Center with a “Buy” recommendation.

## DISCOUNTED CASH FLOW

Our DCF valuation (Figure 1) is based on forecast financial results through 2014. DCF valuation is a function of the following major variables, which have been estimated using our models:

- Future net operating profit less adjusted taxes (NOPLAT), which is driven primarily by expectations of revenues and operating expenses
- Future changes in working capital
- Future net expenditures on fixed assets
- The weighted average cost of capital (WACC), which is a weighted average of our estimated cost of equity and the after-tax cost of debt
- The long-term expected growth rate in NOPLAT and the expected rate of return on net new invested capital (RONIC)

From the forecast financial results, we extracted the free cash flows that were used in our valuation. We discounted those cash flows to a point in time that is 12 months into the future to obtain an estimate of the value of the company's operations. After subtracting net debt and minority interest and adding the value of non-operating assets, we arrived at a total equity value of KD 171 million. Concerning the valuation of Sultan Center's investments and investment in associates, we used the latest balance sheet value for all except NREC, for which we used the last month average market value.

To estimate the value of Sultan Center's operations, we incorporated a varying WACC into our model. Our selection of a cost of equity of 13% is based mainly on interest rate levels and the operating environment; the selection of 7% for the cost of debt is based on historical norms.

Figure 1 DCF Valuation

Figures in KD Millions*	Forecast				
	2010	2011	2012	2013	2014
<b>Fiscal Year Ends December</b>					
<b>Net Operating Profit after Tax</b>	14	14	14	16	19
Add: Depreciation and Amortization	8	8	8	8	7
<b>Gross Cash Flow</b>	<b>22</b>	<b>22</b>	<b>22</b>	<b>24</b>	<b>26</b>
(Incr.)Decr. in Working Capital	(2)	(6)	(6)	(1)	(1)
(Incr.)Decr. in Operating Fixed Assets	(9)	(4)	(3)	(2)	(2)
<b>Free Cash Flow from Operations</b>	<b>10</b>	<b>13</b>	<b>14</b>	<b>21</b>	<b>23</b>
<b>Terminal Value</b>					199
<b>Value of Operations in 12 Months</b>	<b>195</b>				
Add: Excess Cash	10				
Add: Value of Long-Term Investments	24				
Add: Value of Other Long-Term Assets	92				
Less: Total Debt	(150)				
Less: Minority Interest	(0)				
<b>Value of Equity in 12 Months</b>	<b>171</b>				
<b>Per Share Value in KD</b>	<b>0.33</b>				

Using the DCF valuation method, we arrived at a fair value per share of KD 0.330

\*Except per-share values. Source: NBK Capital

### Sensitivity Analysis

We performed a sensitivity analysis (Figure 2) on the two key inputs of our DCF valuation model: the cost of equity and the perpetual growth rate used in computing the terminal value.

Figure 2 DCF Sensitivity

		Growth				
		4.50%	4.75%	5.00%	5.25%	5.50%
Cost of Equity*	12.3%	KD 0.36	KD 0.36	KD 0.37	KD 0.37	KD 0.37
	12.8%	KD 0.35	KD 0.35	KD 0.35	KD 0.35	KD 0.35
	13.3%	KD 0.33	KD 0.33	<b>KD 0.33</b>	KD 0.33	KD 0.33
	13.8%	KD 0.32	KD 0.32	KD 0.32	KD 0.32	KD 0.32
	14.3%	KD 0.30	KD 0.30	KD 0.30	KD 0.30	KD 0.30

\*Variations in the cost of equity result in variations in the WACC. Source: NBK Capital

### PEER GROUP COMPARISON

Sultan Center is one of the few listed retail companies on the Gulf Cooperation Council (GCC) equity markets, even after expanding our universe to retailing in general—not just focusing on mass grocery retail. In Figure 3, we have compiled a list of companies—which are traded on various exchanges in the GCC—that derive a significant portion of their revenues from retailing operations. However, these companies are not covered by research houses, which prevents us from using forward P/E-to-Growth (PEG) multiples for valuation purposes. Thus, Figure 3 is to be looked upon as a reference for trading multiples for other GCC retailers.

**Figure 3 Trading Multiples of GCC Retailers**

Company	Market Cap* (USD Millions)	Trading Multiples (TTM)	
		PE Ratio**	EV/EBITDA
Jarir Marketing Company	1,059	11.6	11.1
Abdullah Al Othaim Markets Company	267	18.9	14.6
Fawaz Abdulaziz Alhokair and Company	477	11.1	9.2
Bahrain Duty Free	118	7.5	4.6
Fitaihi Group Holding Company	274	71.3	31.7

\*As of July 14, 2008, \*\*Earnings adjusted to exclude investment gains (losses). Sources: Zawya and NBK Capital

### Risks

- The fact that 37% of Sultan Center's total assets are classified as investment properties or investments in associates may lead to high fluctuations in the company's bottom line.
- Net debt levels for Sultan Center have increased substantially over the last two years. Since Sultan Center has a net debt-to-EBITDA of 9.8x and an interest coverage ratio (EBITDA over interest expense) of just 1.7x, we consider Sultan Center's debt level to be on the high side.
- Through the trade segment, Sultan Center has become one of the major suppliers used by Agility for food orders for the U.S. Armed Forces in Iraq. Accordingly, Sultan Center relies on this single client for a considerable portion of the company's revenue. Since the U.S. government has announced a plan to withdraw troops from Iraq by 2011, we believe that the loss of this client is bound to have a substantial impact on the company's performance.
- Acquisitions do not always achieve their stated objectives and may result in unforeseen integration costs. Therefore, we cannot be sure that the integration of the assets acquired in Lebanon in 2008 will go as smoothly as planned.
- Because Sultan Center's presence is in the Middle East, the company is exposed to both the political and economic uncertainties of the region. The political risk in the region is without a doubt higher than normal, but the risk also varies greatly among countries in the region. In addition, most of the GCC countries are net exporters of oil, which makes their economic growth highly correlated with the price of oil.

## BULLS VS. BEARS

### BULLS

- Sultan Center is a dominant grocery retail player, with market-leading positions in each of the four markets it operates in.
- Sultan Center differentiates itself from the competition by offering a high level of customer service.
- Sultan Center has positioned its stores in prime locations next to highly populated areas with ease of access. This is also true in Kuwait. Although in Kuwait only co-ops are permitted to operate in residential areas, Sultan Center has been able to position its stores in high-traffic commercial areas that are adjacent to highly populated neighborhoods.
- The four types of store formats that have been adopted by Sultan Center to cater to different customer segments are a reflection of its ability to address the needs of local consumers. For example, Sultan Center has successfully adopted the hard-discount-store format in Oman to cater to the needs of the large low-income segment of the population.
- Sultan Center imports a large range of products that are not readily available in the markets the company operates in, which allows the company to offer an extensive product line. Accordingly, Sultan Center is known for carrying select goods that are not available at other stores.
- Sultan Center recognizes that logistics is a key success factor for the company's business and accordingly handles all supply chain operations in-house. This allows the company to offer consistent high-quality service to customers.
- Sultan Center has high brand awareness in the company's home country with the power behind that brand starting to spread elsewhere in the MENA region.
- Sultan Center aims to enhance its relationship with customers by offering a customer loyalty program and some free value-added services.
- Sultan Center has reported strong levels of cash flow from operating activities of KD 31 million and KD 34.1 million in 2007 and 2008, respectively.
- The expansion undertaken by Sultan Center to new markets allows it to negotiate better deals for private label products and many non-grocery products.
- Sultan Center is one of the few listed retail companies in the MENA region. The presence that Sultan Center has in several countries in the MENA region positions the company as a unique opportunity for equity investors to get exposure to the retail sector of this region.
- We believe there is some hidden value in the balance sheet of Sultan Center in relation to freehold land, which is reported at cost of KD 37 million. Real estate value has increased at a CAGR of 21.6% over the period from 2001 to 2006 in Kuwait, which reflects that the value of these assets on Sultan Center's books could be materially understated.

**BEARS**

- We consider the expansion plan that relates to organic growth, which has been laid out by Sultan Center's management, to be reasonable and would protect and enhance the company's market share.
- About 37% of the total assets of Sultan Center are classified as investment properties or investments in associates, which have resulted in a high volatility in earnings.
- The trade segment is poised to see a significant decline in revenues if the plan set by the U.S. government for troop withdrawal from Iraq is adhered to. Further exposure to the number of U.S. troops is through Sultan Center's 31% ownership in NREC, which in turn owns 22.4% of Agility—the prime vendor of food-related products for the U.S. Armed Forces in Iraq.
- Net debt levels for Sultan Center have increased substantially over the last two years. Since Sultan Center has a net debt-to-EBITDA of 9.8x and an interest coverage ratio (EBITDA over interest expense) of just 1.7x, we consider Sultan Center's debt level to be on the high side.
- The EBITDA margin has been declining over the past few years due to a rise in SG&A costs. In 2008, most of the decline in the EBITDA margin was attributed to integration costs related to the assets acquired in Lebanon. We are comforted by the fact that management has started a cost-cutting initiative in 2009, which should lead to improvements in the EBITDA margin.

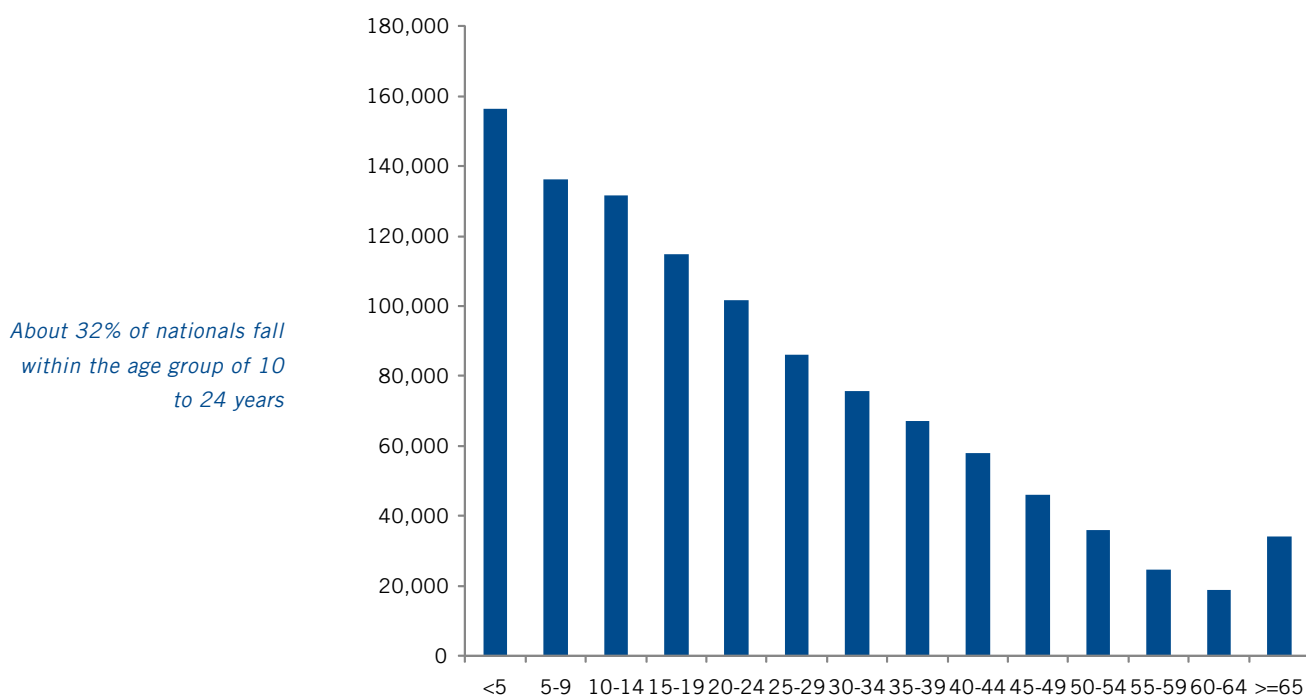
## FUNDAMENTAL FACTORS IN FAVOR OF RETAILING IN KUWAIT

Some of the major factors that drive growth in the retail industry include a stable and growing economy, a growing customer base, and the general purchasing power of the consumer. Though Kuwait is considered one of the smaller countries in the world, all the factors that are in favor of the retail industry are present in this small country. Below is a discussion of some of the fundamental factors that favor the retail industry in Kuwait.

### YOUNG POPULATION

A growing consumer base plays a vital role when assessing the strength of the outlook for the retailing industry in any given country. By examining anticipated changes in demographics, one is able to formulate an outlook regarding their impact on the consumer base. Naturally, a young population will yield high future growth in the consumer base as more people become productive members of society. According to numbers based on the 2007 census, the population of Kuwait stands at 3.3 million people, of whom only a million are Kuwaiti nationals. The segment of the population that is composed of nationals is characterized as being relatively young, with 32% of nationals falling within the age group of 10 to 24 years. As nationals have a significantly higher purchasing power than expatriates, the nationals' young population means that, as time passes, that young segment will start setting up households and will act as an important driver for growth in retail sales in Kuwait. Therefore, it is expected that the aforementioned group will become the most active consumer segment within the Kuwaiti population. Figure 4 below breaks down the population of Kuwaiti nationals by age groups to illustrate how the population is tilted toward the younger generation.

**Figure 4 Kuwaiti Nationals Age Demographic**



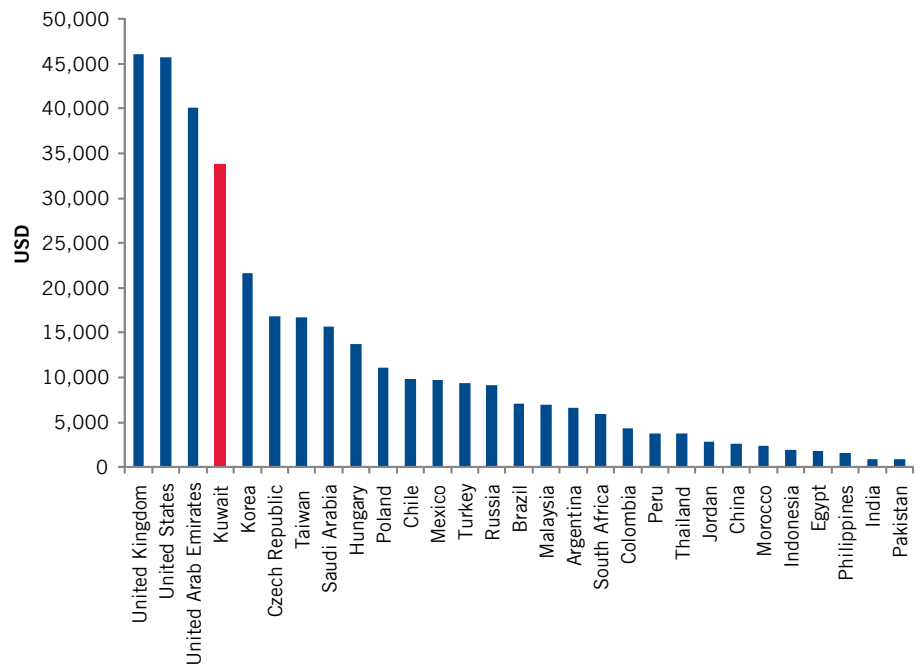
Source: Public Authority for Civil Information

**HIGH GDP PER CAPITA**

Unsurprisingly, purchasing power plays a key role in the retailing industry, as the ability to spend money to buy goods is considered the backbone of the retailing industry. Purchasing power is usually assessed by examining personal disposable income levels; however, reliable figures for disposable income are not available for Kuwait. Accordingly, we looked at GDP per capita as a proxy for the general level of wealth in Kuwait. Figure 5 illustrates Kuwait's GDP per capita compared to various emerging and advanced countries. With a GDP per capita close to that of the advanced world, it is safe to say Kuwait ranks high in that category. In our opinion, the fact that Kuwait is a zero personal tax environment as well as a nation with a high GDP per capita is an indication that the personal disposable income in the country is relatively high.

**Figure 5 GDP per Capita**

*Kuwait has a high GDP per capita when compared to both developing and developed nations*



Sources: IMF and NBK Capital

## COMPANY BACKGROUND

Established in 1976, Sultan Center is Kuwait's largest independent grocery retailer. Sultan Center currently operates in various lines of business, most notably grocery retail, fashion retail, restaurants, trading, telecommunications, security, and investments. Originally a hardware store established in 1981, Sultan Center did not enter its major line of business until 1986 when the company ventured into the grocery business with the introduction of the company's first grocery store in Kuwait. Sultan Center began expanding outside its core operations in 1995 when it acquired a 25% stake in National Real Estate Company. In 1997, Sultan Center became a public company after it was listed on the Kuwait Stock Exchange. The first regional expansion made by Sultan Center was undertaken in 1999 when the company launched its first outlet in Oman. This was followed by the 2003 acquisition of Safeway's operation in Jordan. In 2007, Sultan Center expanded its restaurant business when the company acquired Good Food Company, which propelled Sultan Center's restaurant operations in the Middle East. Finally, the acquisition of Admic's grocery retail assets in Lebanon in 2008 marked Sultan Center's entry into its fourth grocery retail market. Sultan Center currently operates more than 100 locations in six countries with a diverse service offering. Figure 6 presents a time line chronicling Sultan Center's emergence to its current form.

**Figure 6 Time Line for Sultan Center**

Year	Milestone
1976	The Sultan Center (TSC) is established
1981	First retail outlet - Hardware store
1986	First "one stop shop"
1995-1996	TSC acquires 25% stake in National Real Estate Company
1997	TSC is listed on the Kuwait Stock Exchange
1998	TSC opens first warehouse store
1999	First TSC store outside Kuwait opens in Oman
2003	TSC acquires Safeway retail company in Jordan
2006	TSC opens fashion stores in UAE
2006-2007	TSC undergoes major reorganization project with consultants
2007	TSC acquires Good Food company
2007	TSC opens fashion stores in Bahrain
2008	TSC acquires the leading grocery retailer in Lebanon
2009	100 locations in 6 countries in addition to other services

*Sultan Center opened its first grocery retail outlet in 1986*

Source: Sultan Center

## BUSINESS SEGMENTS

### RETAIL

#### Kuwait

##### Competitive Landscape

The grocery retail sector in Kuwait is dominated by local players with co-operative societies, which benefit from government support, having the largest stronghold in the market. Sultan Center and City Center are two local players that have been successful in establishing themselves as leading grocery retail chains by differentiating their product offering from the majority of the co-op stores. The recent entry of Lulu Hypermarket (Emke Group) and Carrefour represents the first set of foreign players that have expanded to Kuwait. The number of international players has recently increased following the opening of the first Geant in Kuwait. Other players in the grocery retail market are a large number of fragmented small stores that are spread throughout the country. The following is a brief summary of the major players in Kuwaiti mass grocery retail (excluding Sultan Center):

##### *Local Co-ops*

Together, the government-funded co-ops represent the largest grocery retailing group in Kuwait, with approximately a 60% market share. The government has granted them the exclusive right to operate in residential areas, which gives the government-funded co-ops a major competitive advantage over their privately owned rivals. Each residential area in Kuwait has its own co-op, although it is common to find two areas sharing a co-op. In addition, local co-ops are considered a Kuwaiti institution or tradition of sorts as they have local area elections and give back to the community through dividends, much like a rewards program. The co-ops do not operate like a chain, as their stores tend to vary significantly in terms of size, quality of service, and product line. The co-ops have stores that range in size from small supermarkets to larger stores.

##### *City Center*

City Center Kuwait is a local brand hypermarket that operates two stores in Kuwait and is credited with being the first to introduce the hypermarket concept in Kuwait. City Center started its operation in Kuwait with a hypermarket in Shuwaikh in 1999, which was followed by another hypermarket in Salmiya in 2003.

##### *Carrefour, Geant, and Lulu Hypermarket*

Lulu Hypermarket and Carrefour are the first two foreign players to establish operations in Kuwait. Both players have opted to set up a single store following the hypermarket format. Carrefour is located in the Avenues Mall, which is the largest shopping mall in Kuwait. Casino has recently started operations in Kuwait by opening the company's first hypermarket under the Geant brand in the 360 Mall in the second half of 2009.

##### **Sultan's Setup in Kuwait**

Sultan Center is the largest independent grocery retailer in Kuwait, with an estimated market share of 15%. Sultan Center operates 12 major retail outlets in Kuwait, in addition to another 12 small-scale stores that are categorized as convenience stores. Sultan Center differentiates itself in the Kuwaiti retail market by offering customers a large and diverse product line and a superior level of customer service. Sultan Center's product line is not limited to procurements made from local distributors and manufacturers, as it imports a variety of products from international markets. Sultan Center has adopted three types of store formats in Kuwait. The following is a brief summary of each concept:

***Service Stores***

A service store is a customer-friendly, “one-stop shop,” self-service retail store that caters to medium-to-high-income customers. A service store offers customers a unique and enjoyable shopping experience whatever their needs may be. Sultan Center has seven service stores in Kuwait, located in Ahmadi, Al Kout Mall, Fahaheel, Hawally, Salmiya, Salwa, and Sharq. In Kuwait, the service stores operate under the TSC brand. Service stores tend to carry an extended product line that sets them apart from the competition.

***Wholesale Stores***

A wholesale store is designed to cater to low-to-medium-income customers by offering a variety of products at low prices. The setup of the wholesale stores is simple, with no fancy interior designs, to drive down operating costs. Another method of reducing costs implemented in these stores is that the store is essentially a hybrid between a grocery store and a warehouse. Therefore, shelf space is used to store the products in addition to displaying them. Wholesale-store customers tend to buy in bulk, though this is not a necessary condition for purchase. Five wholesale stores are operated in Kuwait and are located in Dhajeej, Jahra, Mangaf, Shuwaikh, and Sulaibiyah. Wholesale stores are operated in Kuwait under the TSC Wholesale brand.

***Convenience Stores***

A convenience store is designed to offer a limited product range that is intended for quick and easy shopping. Location is extremely important for the convenience store, as it has to be easily accessible. In Kuwait, Sultan Center has selected locations that make the group’s convenience stores easily accessible from highways by customers who are heading to the southern beaches of Kuwait. Currently, Sultan Center has 12 convenience stores in Kuwait that operate under the TSC Express brand.

**Oman****Competitive Landscape**

The grocery retail market in Oman is highly fragmented with foreign players dominating the hypermarket scene and local players accounting for most of the supermarket stores. According to data from Planet Retail, the largest player in the Omani grocery retail market is Emke Group through its Lulu Hypermarket chain, with an approximate market share of 13%. In addition to Sultan Center, Carrefour is the only other foreign player in the market operating a hypermarkets-type store, though Carrefour has two locations. Supermarkets constitute an important aspect of the Omani retail scene with a presence in inner-city locations. Local players in the supermarket segment include Khimji and Al-Jadeeda while international players include Al Safer and Al Fair (part of the UAE Spinneys Group). The local retailers outnumber their foreign counterparts in the supermarket segment and focus on low-income consumers with a product offering that does not embrace fresh foods.

**Sultan’s Setup in Oman**

Sultan Center’s presence in Oman represents the group’s first operation outside Kuwait, and the entry into the Omani market was 100% organic. Sultan Center operates eight stores in Oman, of which only one is classified as a service store. Two other stores are set up as wholesale stores, while the remaining five are set up as hard-discount stores. The hard-discount store is a store category that so far has been successfully adopted by Sultan Center in Oman. This store format offers a limited product range that revolves around basic needs with a focus on Sultan Center’s private labels. Based on the store formats that have been adopted by Sultan Center in Oman, it is evident that the strategy of the group is to focus on the low-income consumer.

## Jordan

### Competitive Landscape

Over the past five years, the grocery retail market in Jordan has been seeing some structural changes following the introduction of new large-store formats. Safeway, Sultan Center's operation in Jordan, operates warehouse stores, while Carrefour operates hypermarkets. Supermarket stores remain the most common store formats with Safeway and C-Town leading the way in this category, both of which focus on the high-income consumer. Independently owned supermarket stores are on the rise with many operating modern stores located in urban centers.

### Sultan's Setup in Jordan

Sultan Center has been following a proactive approach in managing the company's operation in Jordan under the Safeway brand. Sultan Center has implemented the same store concepts in Jordan as those in Kuwait, as Sultan Center currently operates 14 service stores, two wholesale stores, and six convenience stores in Jordan. Service and wholesale stores operate under the Safeway brand, while the convenience stores use the Safeway X-press brand. The estimated market share of Sultan Center in Jordan is around 20%.

## Lebanon

### Competitive Landscape

The Lebanese grocery sector has been seeing investments from foreign players in addition to expansions made by some of the local players. The foreign players with a dominant position in the grocery retail segment in Lebanon are Spinneys and Sultan Center, both of which operate large stores that fall in the hypermarket or superstore category in prominent city locations. Bou Khalil, a local player, operates a chain of nine stores that fall in the hypermarkets and supermarkets category that are scattered in various locations in the country. The Co-ops are a chain of approximately 50 supermarkets that are dispersed in several areas with a general focus on the low-income consumer. Another strong local player in the Lebanese grocery retail market is Le Charcutier Aoun, which operates 11 supermarkets across the country. In addition to these chains, smaller retailers that operate one to two supermarkets tend to have a strong presence in the neighborhoods in which the supermarkets are located.

### Sultan's Setup in Lebanon

Sultan Center's acquisition of six stores from Admic marked the entry of the Kuwaiti retailer in the Lebanese market in mid-2008. These stores used to operate under the Monoprix and Geant brands, but the Sultan Center acquisition did not include the franchise rights for these brands. Following the acquisition, the five service stores were rebranded as TSC Plus while the hypermarket store was branded TSC Mega. This acquisition by Sultan Center guaranteed it a leading position in the Lebanese grocery market with stores situated in prime locations. The original setup of these stores was a perfect fit for the store format template that has been adopted by Sultan Center, especially since the five service stores were set up to focus on medium- to high-income customers.

## SPECIALTY FASHION GROUP

The Specialty Fashion Group is the fashion division of Sultan Center that currently operates 27 stores in Kuwait, the UAE, and Bahrain. The Specialty Fashion Group develops and manages franchises and license partnerships with international clothing brands. Some of the brands that are managed by Sultan Center include Jaeger, Rampage, Bedo, and Ocean Pacific. In addition to the 27 stores that are currently managed by Sultan Center, the retailer has an aggressive expansion plan for 26 stores spread across Kuwait, the UAE, Bahrain, Lebanon, Jordan, and Egypt.

**Figure 7 Sultan Center's Fashion Stores by Country**

*Sultan Center is planning to increase the number of its fashion stores to 53, with most of the expansion in the UAE*

Country	Operational stores	New store openings	Expected Total
Kuwait	9	-	9
UAE	9	15	24
Bahrain	9	-	9
Jordan	-	5	5
Egypt	-	4	4
Lebanon	-	2	2
<b>Total</b>	<b>27</b>	<b>26</b>	<b>53</b>

Source: Sultan Center

### GOOD FOOD COMPANY

Good Food Company is Sultan Center's restaurant division that currently operates 17 outlets, of which nine are in Kuwait, that are a mix of franchise and internally developed concepts. Good Food Company plans to add 28 new outlets in the GCC. Good Food Company focuses on three distinct market segments: premium convenience, premium and midmarket casual dining, and specialist fine dining. Below is a list of the restaurants that are operated by Good Food Company:

- Jeans Grill Restaurant
- Chi-Chi
- Tumbleweed Southwest Grill (master franchise in the MENA region)
- Entrecote Café De Paris
- Wasabi
- Ruby Tuesday (master franchise in Bahrain, Oman, Lebanon, and Jordan)
- Karam Beirut (master franchise in Kuwait and Egypt)
- Au Bon Pain (master franchise in the MENA region)

**Figure 8 Sultan Center's Restaurants by Country**

*Sultan Center is planning to increase the number of its restaurants to 45*

Country	Operational stores	New store openings	Expected Total
Kuwait	11	10	21
UAE	4	7	11
Bahrain	-	2	2
Oman	1	-	1
Egypt	-	6	6
Jordan	1	3	4
<b>Total</b>	<b>17</b>	<b>28</b>	<b>45</b>

Source: Sultan Center

### TRADING

In addition to the retailing business, Sultan Center is a supplier of food, non-food, and industrial products. It has established several partnerships with many companies that own reputable brands in the fast-moving consumer and durable goods sector. Some of the major brands that are supplied by Sultan Center include Black & Decker, LEGO, and Ocean Spray. Also, Sultan Center acts as a supplier of meats and perishables to the catering and hospitality sector. This segment accounts for 16.6% (1Q2009) of Sultan Center's total revenue; however, this is mostly due to Sultan Center being one of the major suppliers being used by Agility. Agility is the prime vendor for food-related items for the U.S. Armed Forces in Iraq and recently won an extension on that contract until the end of 2010.

### TELECOM AND SECURITY

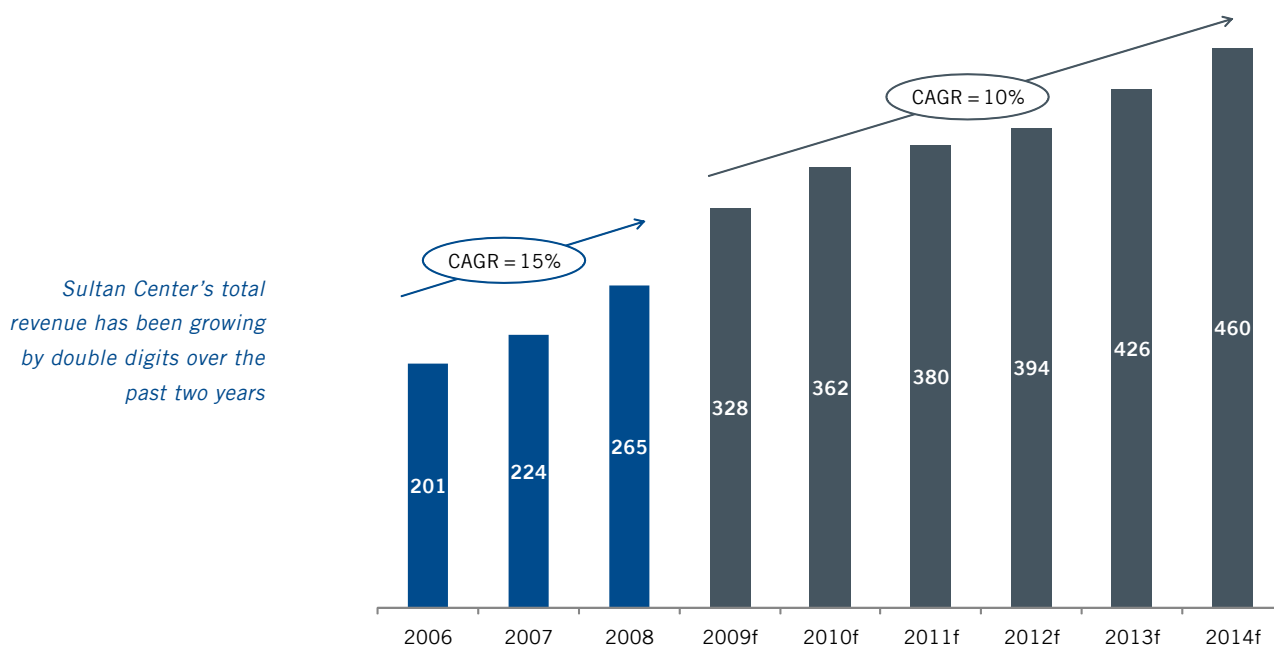
Sultan Center runs a telecommunications business that accounts for 4% of the company's total revenue. This particular segment operates as a supplier and contractor for optical fiber transmission networks, as well as radio and television broadcasting. Sultan Center currently carries out telecommunication services in Kuwait, Oman, Bahrain, the UAE, Syria, and Yemen. In addition to telecommunications, Sultan Center has branched out into the security market. This business segment began as an in-house security exercise to monitor Sultan Center assets and has since grown to offer services to external clients. This segment currently accounts for 1.4% of revenue. Sultan Center's security arm currently acts as a security equipment supplier, installer, and maintainer of advanced security command and control systems. Sultan Center also provides security staff and services for various locations across Kuwait. Although both of these segments account for a small percentage of revenue, they are both very self-sufficient entities that require minimal interference from upper management.

## FINANCIAL ANALYSIS

### REVENUE ANALYSIS

Sultan Center's total revenue has been increasing at double-digit growth rates over the past two years, driven mostly by growth in grocery retail revenue. As highlighted in Figure 9, total revenue increased by 12% and 18% in 2007 and 2008, respectively. The growth achieved in 2007 was mainly internal growth, as the company added eight stores (two wholesale stores and six convenience stores). The story for 2008 is slightly different, as annual revenues increased 18%, with a considerable portion of the increase in revenues for 2008 a result of the acquisition that was made in Lebanon. In our opinion, if Sultan Center had not acquired the six stores in Lebanon, the company's revenues for 2008 would have increased by 11%. Thus, we can still say that Sultan Center continued to show signs of strong organic growth in 2008. Growth in total revenue in 2006 was at a low level of 2% due to a 25% drop in trading revenue. In 1Q2009, total revenue increased by 25%, but if we exclude the revenue from Lebanon, the growth in total revenue would be 10%. As for our forecast horizon, we are expecting total revenue to increase at a CAGR of 10%, with 2009 having the strongest showing with 23% growth. The growth rates for total revenue in 2011 and 2012 do not properly reflect the growth in revenues for the individual segments due to the anticipated drop in trading revenue, which we reflected in our forecasts.

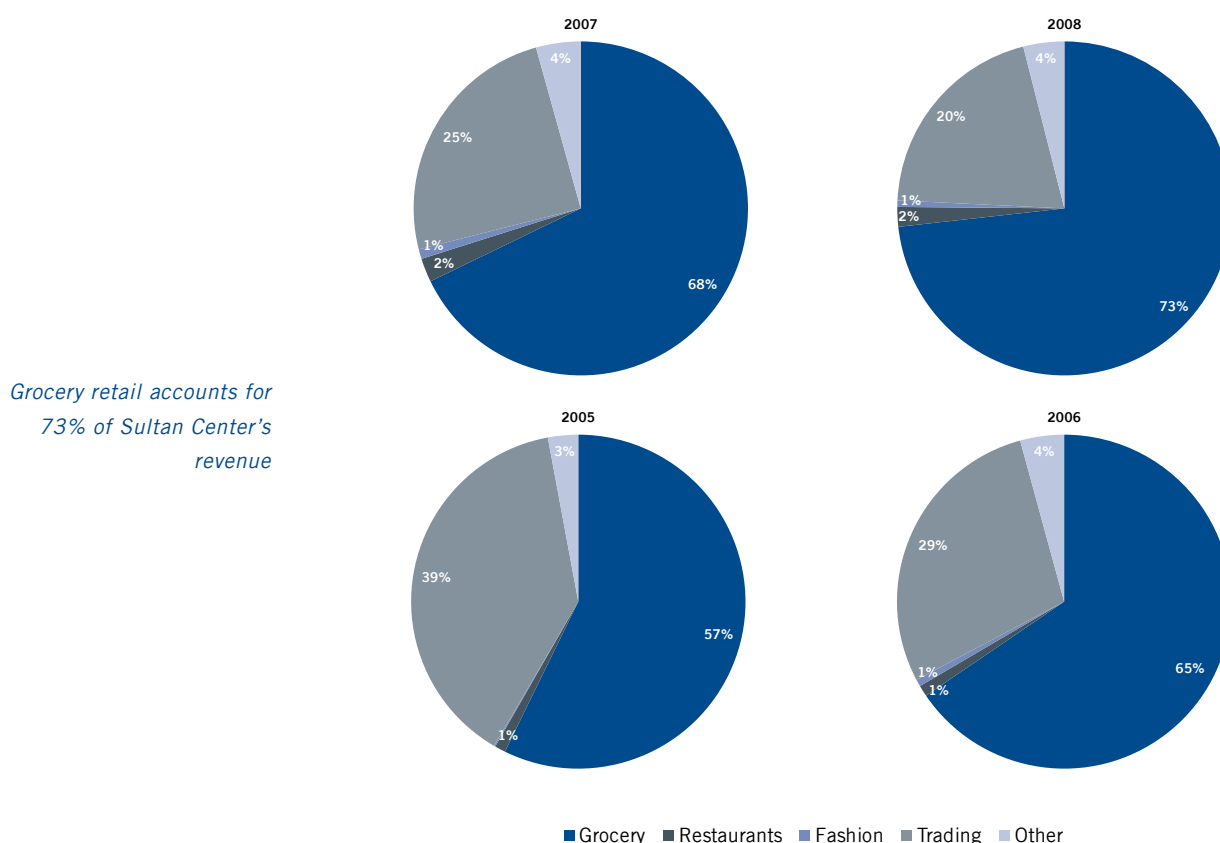
**Figure 9 Sultan Center's Total Revenue**



Source: Sultan Center and NBK Capital

Figure 10 shows the various segments' contributions to Sultan Center's total revenue for the past four years. In 2005, trade generated 39% of revenue, but in 2008 that share dropped to 20%. At the same time, the contribution of grocery retail services increased from 57% in 2007 to 72% in 2008. The change in the distribution of revenue by segments is largely due to two factors: a) the growth in retail revenue due to organic and inorganic expansion and b) the 30% decline in trade revenue from 2005 levels. Moving forward, we expect this trend to continue with a high probability of a significant drop in trade revenue in 2011 if the plan for the withdrawal of U.S. troops from Iraq is adhered to.

Figure 10 Revenue by Segments



Grocery retail accounts for 73% of Sultan Center's revenue

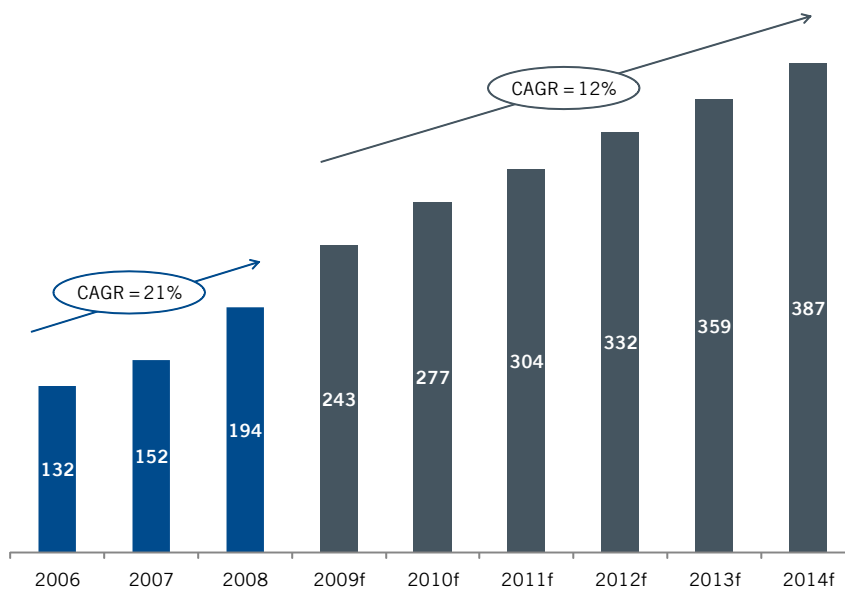
Sources: Sultan Center and NBK Capital

**Grocery Retail Revenue**

Sultan Center has been posting strong increases in grocery sales over the past four years. This performance has been a result of expansion, both organic and inorganic, and a general increase in revenue per square meter of retail space across the countries in which the group is present. In 2008, grocery retail sales increased by an impressive 28%; however, this was buoyed by the acquisition in Lebanon in 3Q2008. If we were to exclude the effect of the acquisition in Lebanon, the increase in sales in 2008 would have been around 17%—which is in line with the trend from the past two years. Grocery sales registered 32% growth in 1Q2009; however, when we exclude sales from Lebanon, the growth decreases to 11%. Our forecasts for grocery sales reflect growth at a CAGR 12% from 2009 to 2014. Our forecasts are based on the confirmed expansion plans that have been laid out by management in each of the markets in which Sultan Center is present. We did not include the possibility of Sultan Center entering new markets.

Figure 11 Grocery Retail Revenue

*Sultan Center has been posting strong growth in grocery retail revenue over the past three years*

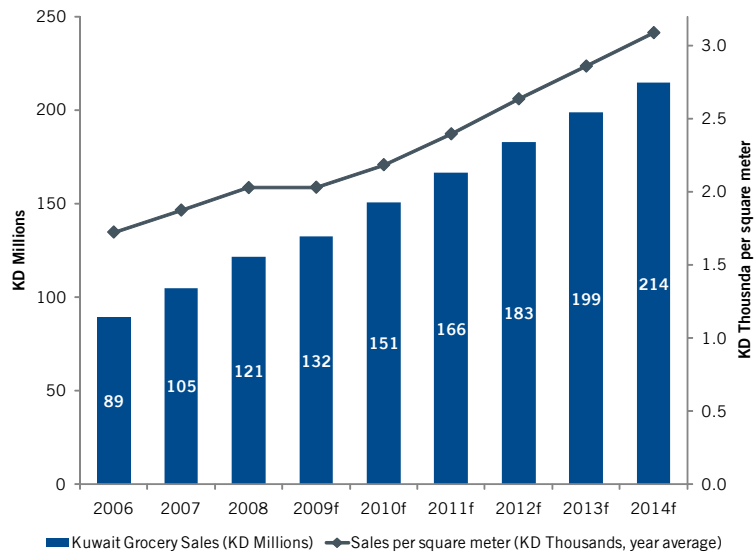


Sources: Sultan Center and NBK Capital

Sultan Center's grocery retail sales in Kuwait have grown at a CAGR of 16% over the past three years. This increase has been partially driven by the expansion the company had during that period by adding eight stores (one warehouse store and seven convenience stores) and essentially raising the total number of grocery stores in Kuwait to 23 by the end of 2008. These additions resulted in just a 16% increase in retail floor area, due to the small size of the convenience stores. A more impressive result is the increase in sales per average square meter of retail space from KD 1.7 thousand in 2006 to KD 2 thousand in 2008. Since we do not have same-stores figures, we consider this improvement in sales per average square meter to be a good indication of improved sales among the same stores. In 1Q2009, Sultan Center opened a new service store in Hawali with a floor area of 5,170 square meters, thereby increasing Sultan Center's floor area in Kuwait by 8%. This is not the only expansion that is set for Kuwait, as Sultan Center plans to open two service stores and three convenience stores before the end of 1Q2010. The two planned service stores are expected to open in 4Q2009 and 1Q2010 with a floor area of 1,700 square meters each. All these store openings are reflected in our forecasts. Due to the size of the expansion in Kuwait, we were conservative in our estimates concerning the productivity of the new stores, as we assumed a productivity level of 60% in the first year of operation of new stores compared to existing stores. We incorporated a modest growth of 3.5% in sales per square meter, for existing stores, in 2009 to reflect the weak economic conditions. However, we expect sales per square meter to pick up by 10% in 2010 in light of an expected economic rebound coupled with relatively high inflation. Our forecasts for grocery sales in Kuwait reflect growth at a CAGR of 10% over our forecast horizon.

Figure 12 Grocery Retail Sales in Kuwait

Grocery retail sales in Kuwait have increased at a CAGR of 16% over the past three years

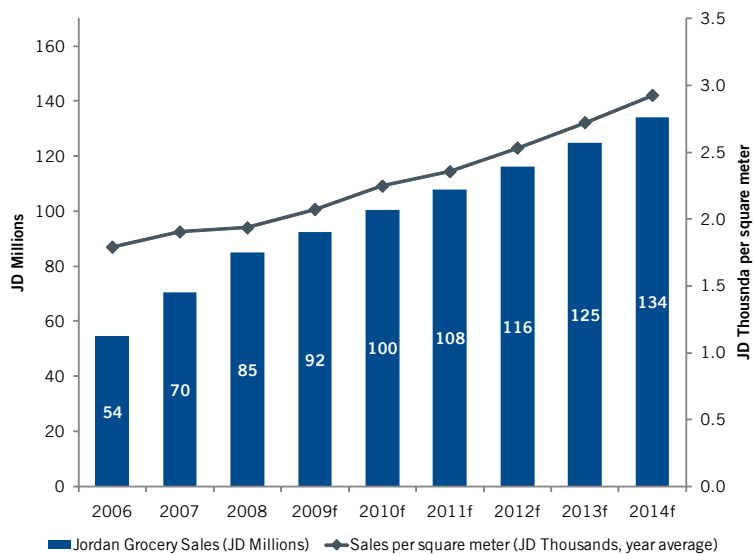


Sources: Sultan Center and NBK Capital

Grocery sales in Jordan have been rising at an impressive CAGR of 26% over the past three years. The story in Jordan is similar to Kuwait: five stores (one warehouse store and four convenience stores) were added during a three-year period, which raised the number of stores to 14 by the end of 2008. These stores led to a 46% increase in retail space to 44,237 square meters by the end of 2008. An examination of sales per average square meter in Jordan shows a gently rising trend, which is comforting considering the size of the expansion that Sultan Center undertook in Jordan. In 2009, Sultan Center’s operation in Jordan is set to see a small expansion consisting of three convenience stores, of which one has already opened in 1Q2009. In our forecasts for Jordan, we expect that most of the sales growth will come from increases in sales per average square meter. Accordingly, our forecasts for grocery sales in Jordan reflect a CAGR of 8%, though we did not include major additions to the number of stores.

Figure 13 Grocery Retail Sales in Jordan

Grocery sales in Jordan have been rising at an impressive CAGR of 26% over the past three years

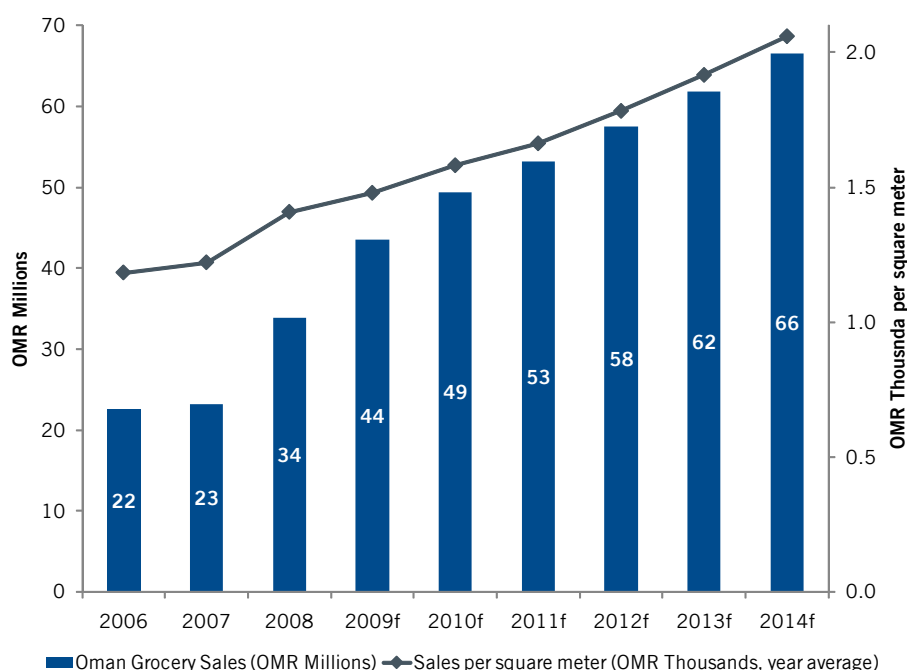


Sources: Sultan Center and NBK Capital

Oman’s grocery sales reflect an impressive jump of 46% in 2008, which comes on the back of the opening of six new stores (one warehouse store and five hard-discount stores). As we can see in Figure 14, the new stores led to improved sales per average square meter of retail space. The sales figures for Oman in 2008 are a good indication that the strategy adopted by Sultan Center to focus on the medium-to-low-income consumer has merits and can lead to growth in sales. Our forecasts for Oman reflect the opening of a new service store in 4Q2009 and a hard-discount store in 2Q2010. In the years that follow, we have incorporated the addition of five convenience stores, but the effect on the total available floor area is limited due to their small space. Accordingly, our forecasts for the grocery sales in Oman reflect growth at a CAGR of 12% over our forecast horizon.

**Figure 14 Grocery Retail Sales in Oman**

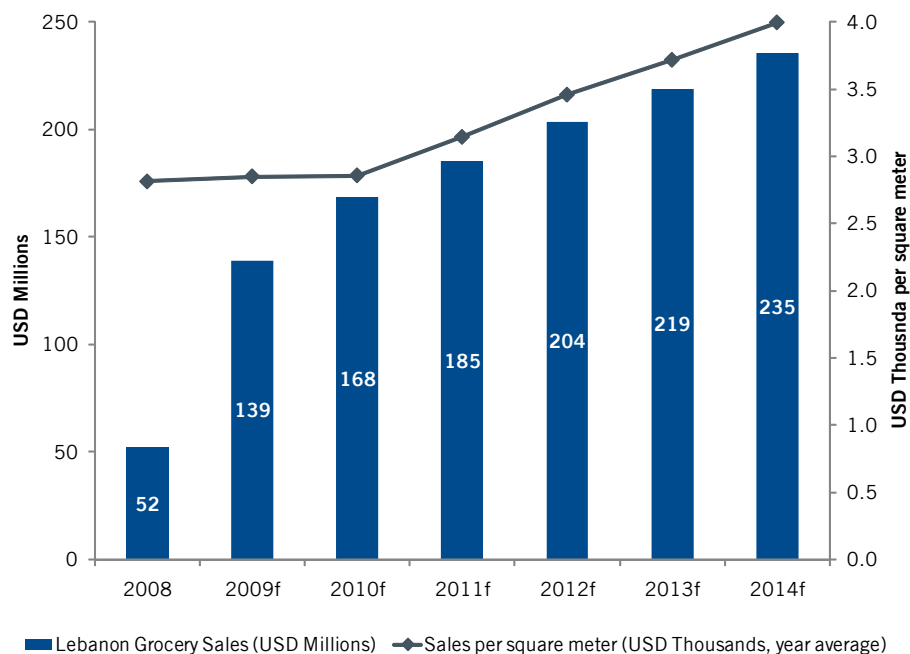
*Grocery sales increased by 46% in Oman in 2008*



Sources: Sultan Center and NBK Capital

In 3Q2008, Sultan Center began operating in Lebanon after the company had acquired six stores from Admic. Accordingly, the sales figures for Lebanon in 2008 represent only a partial year of operation; however, we used the average sales per square meter for that period as the basis of our forecast. Though it might seem that Sultan Center has a small expansion strategy set for Lebanon by adding one service store and expanding the floor area of another, the additional area from these two expansions is very large. The service store, which is set to open in 4Q2009, is expected to have a floor area of 5,500 square meters, while the expansion, which is set for 2Q2009, has a floor area of 9,000 square meters. Thus, in one year Sultan Center will increase its floor area in Lebanon by 33%, from 44,410 square meters to 58,910 square meters. We assumed a 60% productivity rate for the additional space in the first 12 months of operation. We did not include any store expansions in 2011 and 2012, but we factored in a 10% increase in sales per average square meter for both years. This increase in sales per average square meter is based on our opinion that Sultan Center will have gained enough experience operating in this new market, thus propelling the company’s sales activity in Lebanon.

Figure 15 Grocery Retail Sales in Lebanon



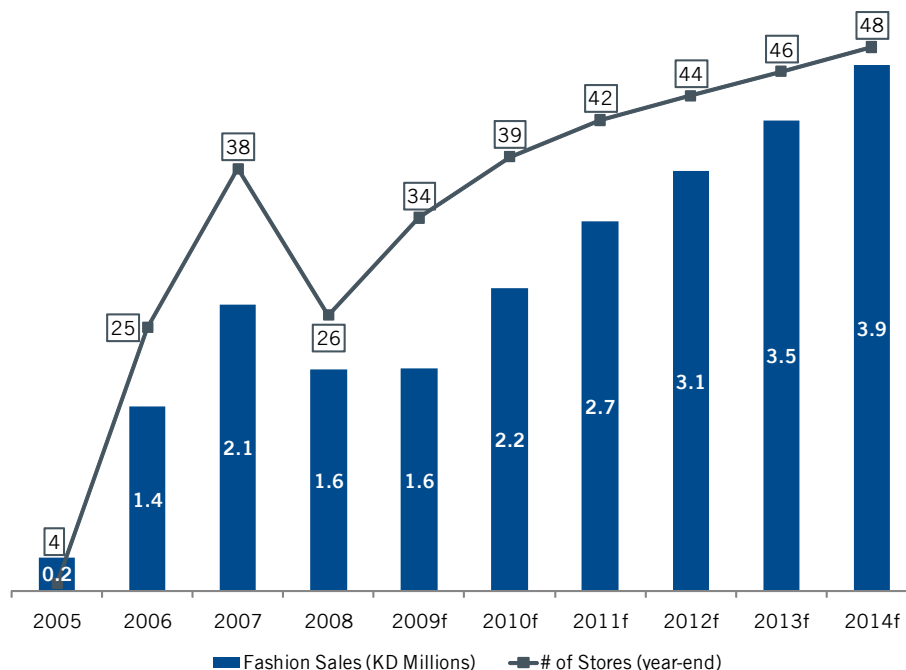
Sources: Sultan Center and NBK Capital

### Fashion Retail Revenue

Sultan Center entered the fashion retailing business in 2005 with four stores. The number of stores increased to 26 and 38 by the end of 2006 and 2007, respectively. However, Sultan Center has been scaling back its fashion stores, as the number of stores fell to 26 and 22 by the end of 2008 and 1Q2009, respectively. Figure 16 shows that fashion retail sales have been rising and falling along with the number of stores being operated. According to management, some stores were closed because their locations proved to be unfavorable while others were closed due to weak performance by their brands. Sultan Center plans to add 26 fashion stores spread over four countries. Figure 16 shows that our forecasts for fashion sales are based on an increase in the number of stores to 34 by the end of 2009 (up from 22 by the end of 1Q2009). In addition, we incorporate the addition of five stores in 2010, followed by two in each of the remaining years in our forecast horizon. Therefore, we forecast that fashion sales will show growth at a CAGR of 15.5% over our forecast horizon, due to a combination of store additions and improved sales per store.

Figure 16 Fashion Retail Sales

*Fashion retail sales have been rising and falling along with the number of stores*

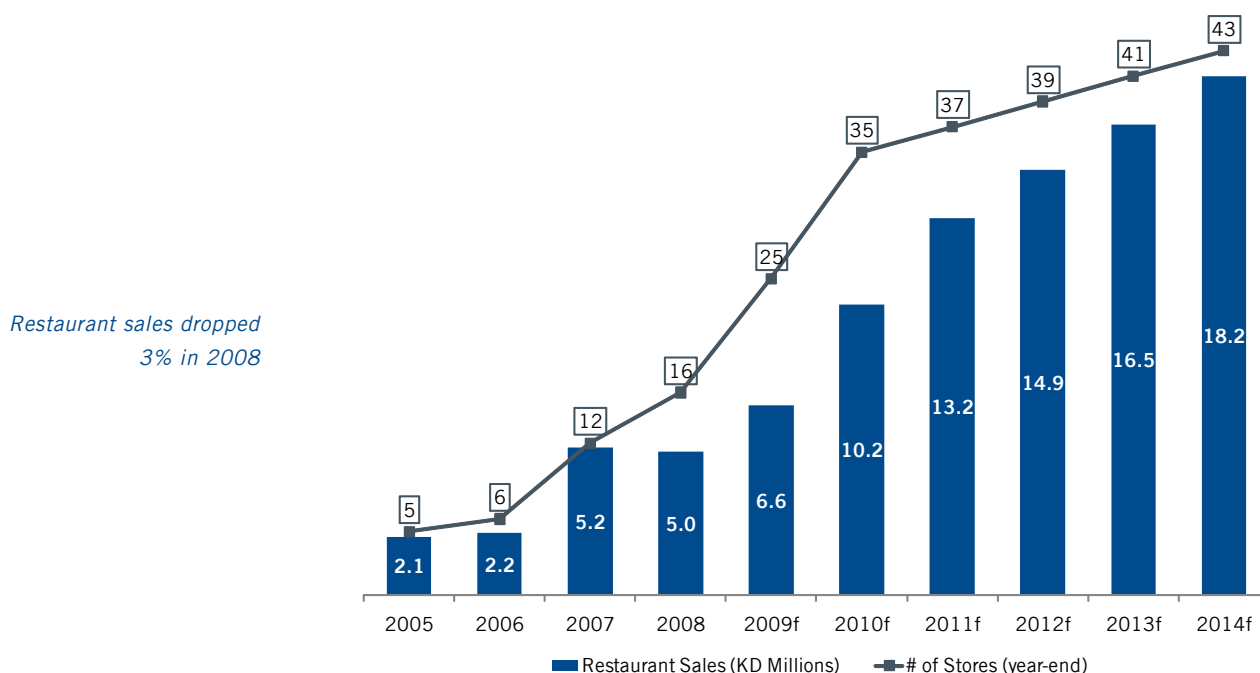


Sources: Sultan Center and NBK Capital

**Restaurant Revenue**

The acquisition of Good Food Company in December 2006 by Sultan Center is behind the increase in restaurant revenue in 2007. In 2007, the number of restaurants operated by Sultan Center increased from 6 to 12, with revenue increasing 140% to KD 5.2 million. Though the number of restaurants increased in 2008 to 16, Sultan Center saw a 3% drop in restaurant revenue in that year. According to management, three restaurants opened late in 2008, and one of its major outlets (Wasabi) was adversely affected by road construction activity in the restaurant’s proximity. Similar to the fashion segment, Sultan Center plans to more than double its number of restaurants by adding 21 restaurants in five countries. We based our forecasts for restaurant revenue on the expansion plan that has been set by management for that segment. Based on the expected increase in the number of restaurants operated by Sultan Center, we project that restaurant revenue will increase at a CAGR of 24% over our forecast horizon, making restaurants the highest-growing segment among our forecasts.

Figure 17 Restaurant Sales



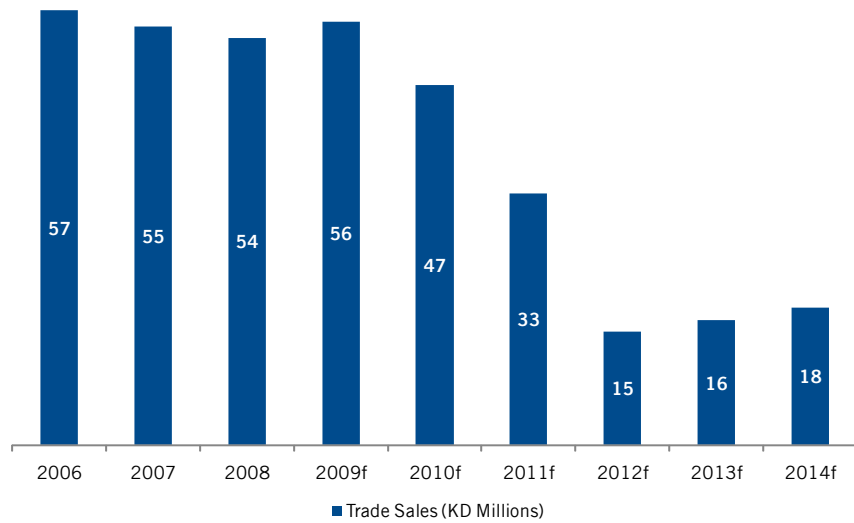
Sources: Sultan Center and NBK Capital

**Trade Revenue**

Trade revenue saw a 25% drop in 2006, after trade revenue peaked at KD 76 million in 2005. The majority of the revenue of this segment is related to Sultan Center’s role as one of the suppliers used by Agility to procure food-related items for the U.S. Armed Forces in Iraq. Accordingly, we expect this drop in revenue to be directly related to a drop in either Agility’s sourcing through Sultan Center or a general decline in quantities ordered by the U.S. Army. Over the past three years, the performance of this segment has been almost stagnant, a reflection of the maturity of this service. However, our forecasts for this segment show a huge drop in revenue over the next few years. The reason behind these numbers is that we assume that the withdrawal plan for American troops in Iraq that has been announced by the U.S. government will be adhered to. According to this plan, the number of troops will decline from an estimated 140,000 to 50,000 (at most) by August of 2010. A complete troop withdrawal is expected to take place by the end of 2011. Thus, we felt it is prudent to include the potential effects of this troop withdrawal plan in our forecasts for trading revenue, which resulted in a 15%, 30%, and 55% drop in trade revenue in 2010, 2011, and 2012, respectively.

Figure 18 Trade Sales

Over the past three years, trade sales have been in gentle downward trend



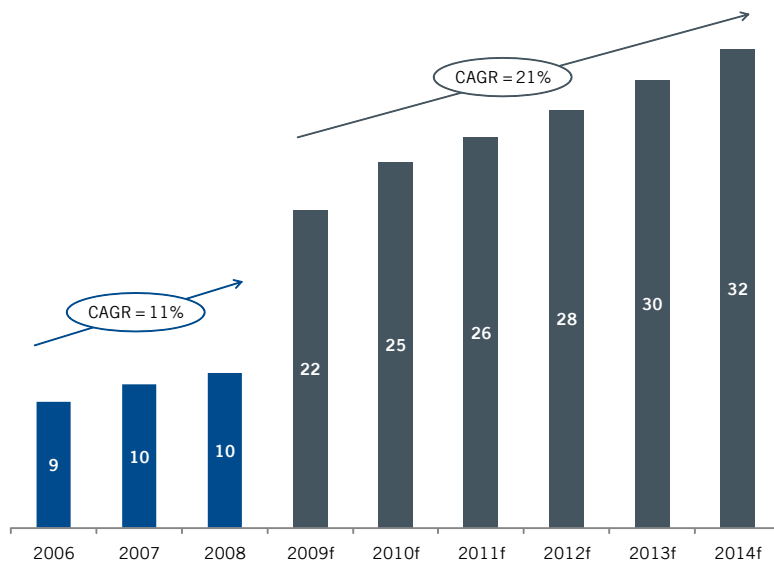
Sources: Sultan Center and NBK Capital

Telecom and Security Revenue

Combined, telecom and security services achieved sales of KD 10.5 million in 2008 and accounted for 4% of Sultan Center’s total revenue. Revenue from telecom and security services saw a 46% increase in 2006, which was followed by a 12% and 8% increase in 2007 and 2008, respectively. The performance of these two segments has been very strong in 1Q2009 as they have recorded growth in revenues of 126%, attributed mostly to new contracts. Accordingly, our forecasts reflect a growth at an impressive CAGR of 21% for telecom and security revenue over out forecast horizon.

Figure 19 Telecom and Security Sales

Due to new contract wins, trade and security sales are set to spike in 2009

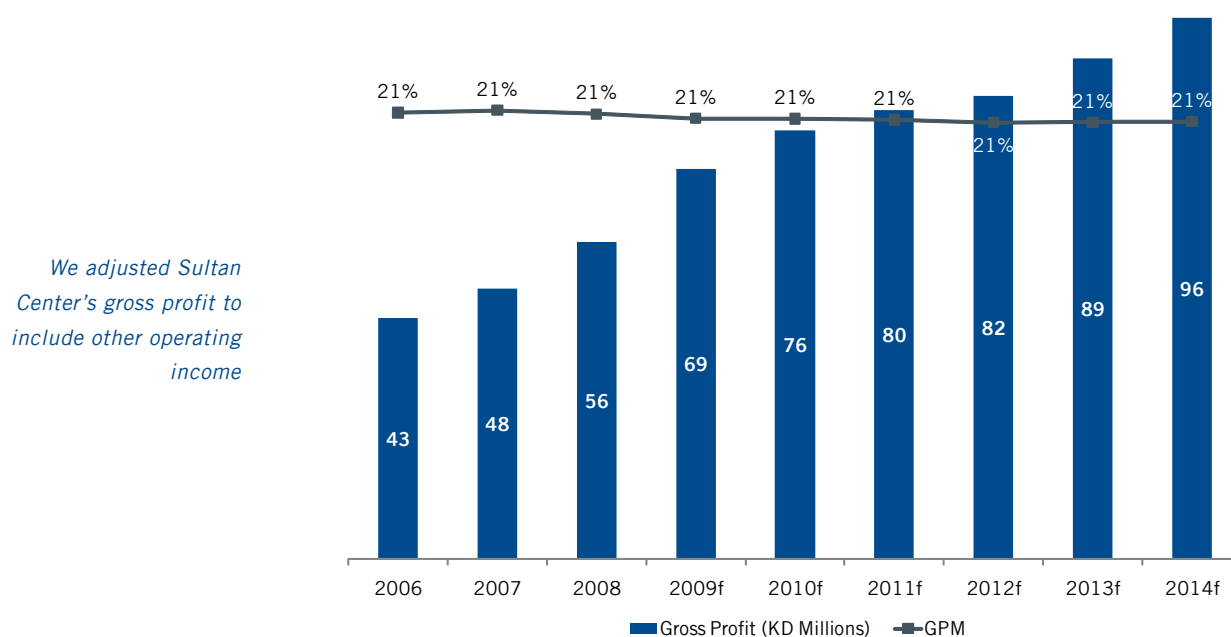


Sources: Sultan Center and NBK Capital

**GROSS PROFIT: ADJUSTED TO INCLUDE OTHER OPERATING INCOME**

In our analysis of the gross profit of Sultan Center, we adjusted the gross profit figure that is reported on the income statement by adding other operating income. Other operating income relates mostly to rebates and discounts received from suppliers. The reason other operating income is not included in the gross profit on the income statement is due to the timing of some of the discounts received from suppliers. According to our discussion with management, suppliers in Kuwait tend to offer the discount up front while in other countries of operation some suppliers offer the discount afterwards, which ends up showing as other operating income on the income statement. Thus, by including other operating income in the gross profit, we are better able to analyze trends in the gross profit margin. Figure 20 shows the adjusted gross profit and adjusted gross profit margin since 2006 and over our forecast horizon. The adjusted gross profit for Sultan Center has been growing at a pace that generally matched the growth in revenues, which has led to a relatively consistent adjusted gross profit margin. Sultan Center does not provide gross profit margins by segments, but management indicated that fashion and restaurant sales have the highest gross profit margins. In addition, according to management, trade revenue has a gross profit margin that is close to the average of the group. Accordingly, we forecast that the decline we are expecting to see for the trade segment, once U.S. troops start their withdrawal from Iraq, will not alter the group's gross profit margin.

**Figure 20 Adjusted Gross Profit Margin**



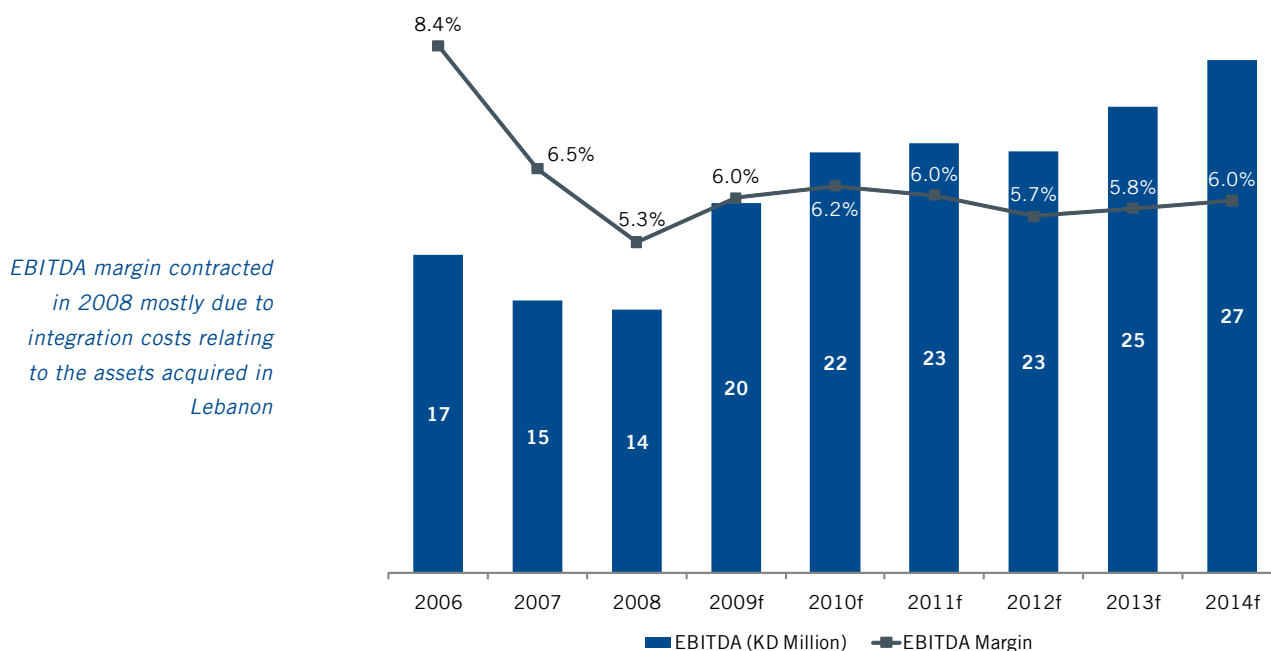
Sources: Sultan Center and NBK Capital

**EBITDA**

Sultan Center's EBITDA has been moving in the opposite direction of the company's revenue growth, which raises a concern since the gross profit margin has been relatively consistent. Figure 21 shows that Sultan Center's EBITDA has been declining over the past three years and that the group's EBITDA margin has been contracting over that period. This outcome has been driven by an escalation of SG&A costs, which increased by 31% and 23% in 2007 and 2008, respectively. In 2008, the damage was done in the fourth quarter as almost 40% of the SG&A

expenses occurred in the fourth quarter and led to the group achieving a negative EBITDA for that quarter. According to management, the spike in SG&A costs that occurred in 4Q2008 is related to the acquisition in Lebanon, as Sultan Center incurred some nonrecurring expenses to integrate the new assets. We started to see some improvement in the EBITDA margin in 1Q2009, as Sultan Center posted an EBITDA margin of 5.8% for that quarter, and based on feedback we received from management, this situation is expected to further improve during the year. Sultan Center has started several cost-cutting initiatives to enhance operational efficiency, which is why we are expecting the EBITDA margin to improve in 2009 to 6% and to 6.2% in 2010. In 2011 and 2012, we expect that the EBITDA margin will see some contraction due to the fall in trade revenue. The reason behind this contraction is that we expect the trade segment to have a higher EBITDA margin than that of the group, and this will lead to a decline in the group's EBITDA margin. Our forecasts reflect that EBITDA will grow at a CAGR of 12% over our forecast horizon.

Figure 21 EBITDA



*EBITDA margin contracted in 2008 mostly due to integration costs relating to the assets acquired in Lebanon*

Sources: Sultan Center and NBK Capital

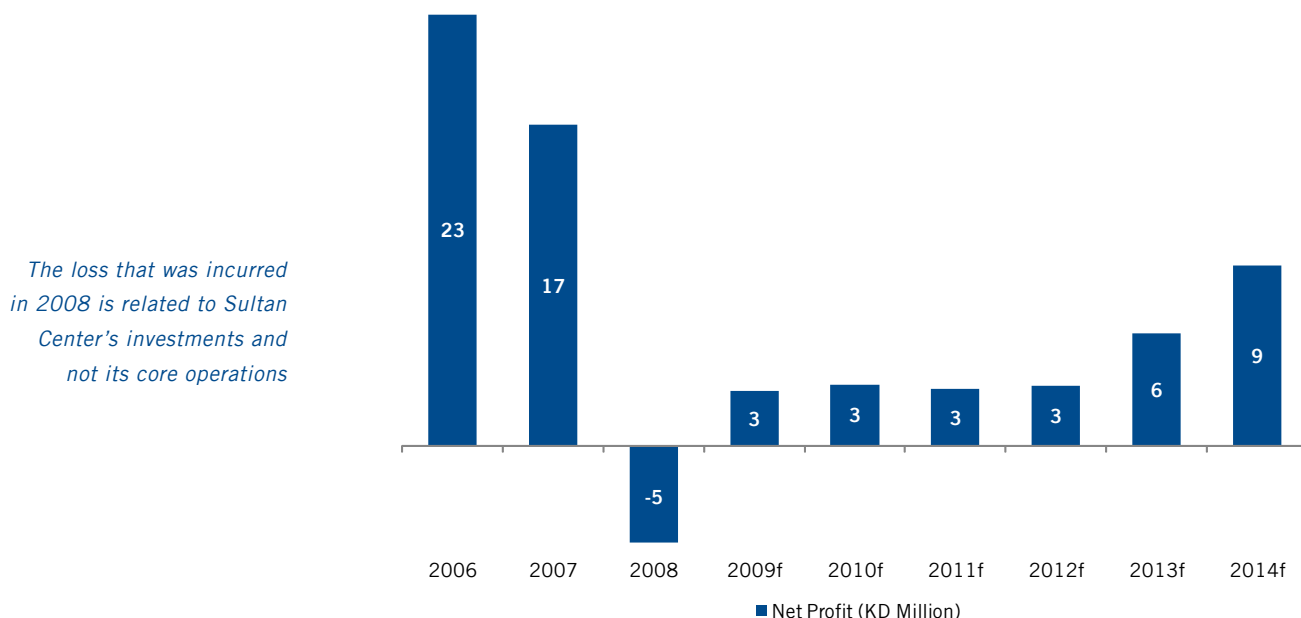
NET INCOME

Though Sultan Center's major lines of business are generally considered relatively stable operations, the group's significant exposure to investments (including investments in associates) has led to high volatility in the company's bottom-line results. This was mainly felt in the performance in 2008 when Sultan Center posted a net loss of KD 5.4 million compared to a net income of KD 16.9 million in 2007. The group's result in 2008 actually reflects an escalation in operating expenses, but that is not the reason for Sultan Center posting a loss in 2008. Sultan Center recorded an operating profit of KD 8.6 million, down just 10% from KD 9.5 million in 2007. This highlights that most of the damage that was done in 2008 did not relate to core operations. In fact, Sultan Center incurred KD 9.4 million in investment losses along with KD 1.9 million in losses from changes in fair values of investment properties in 2008. The level of investment losses taken through the income statement in 2008 was reduced following the group's reclassification of its investment portfolio from "held-for-trading" to "available-for-

sale” in accordance with the changes in IAS 39. A total of KD 3.6 million relating to changes in the fair value of available-for-sale investments was taken directly to equity in 2008. In addition, the group’s share of results from associates declined from KD 12.4 million in 2007 to KD 5.6 million in 2008. This decline in the share of results from associates is largely due to the 53% decline in the net income of National Real Estate Company (NREC). (Please refer to the appendix for more on NREC’s performance in 2008.) Interest expense remained relatively stable at KD 8.2 million compared to KD 8 million in 2007. The performance in 1Q2009 was much better than the last two quarters of 2008, as Sultan Center was able to record KD 2.2 million in net income.

Our forecasts for Sultan Center’s net income exclude the group’s share of results from associates and any other investment gains or losses. Usually when the share of results from associates is small compared to the company’s core operation, analysts tend to forecast that line item based on historical trends. However, this is not the case with Sultan Center as the share of the group’s results from associates is substantial, due to the investment in NREC. In 2008, the group’s share of results from associates was equal to 65% of Sultan Center’s operating income, and in 2007, the share was equal to 130% of Sultan Center’s operating income. Accordingly, forecasts for the group’s share of results from associates should be based on forecasts for NREC (which we do not have enough visibility on). NREC is currently an EBITDA negative company, with its income reliant on the company’s share in Agility. Though we have explicit forecasts for Agility, the fact that NREC has two major projects in the pipeline prevents us from extrapolating NREC’s bottom line. Hence, we opted not to include the share of results from associates in our forecasts. This decision will not have an impact on valuation, as we use the latest balance sheet and market prices to value Sultan Center’s investments in associates. In addition, this will have no tax implications, as taxes in Kuwait (contribution to KFAS, zakat, and National Labor Support Tax) are calculated after the share of income from associates is deducted to avoid double taxation.

**Figure 22 Net Income**



Sources: Sultan Center and NBK Capital

## BALANCE SHEET ANALYSIS

### Current Ratio

Sultan Center has a trend of having a low current ratio that reached 0.3x by the end of 2008. This has been affected by the group's policy of having the majority of the company's debt in the form of short-term borrowing. Excluding short-term borrowing would raise the current ratio to 0.9x.

### Fixed Assets and Intangibles

As of the balance sheet on December 31, 2008, Sultan Center carried KD 124 million in fixed assets and intangibles, which represents 46.5% of total assets. Included in fixed assets is freehold land with a book value of KD 37 million. The ownership of the majority of this freehold land goes back several years with its value on Sultan Center's balance sheet being recorded at cost. Land prices for commercial properties in Kuwait increased at an impressive CAGR of 21.6% between 2001 and 2006, which reflects that these assets could be significantly undervalued on Sultan Center's books. In addition, considering that the group has buildings with a net book value of KD 19 million, we think that Sultan Center's balance sheet may have some hidden value that relates to the company's freehold land and building. If the company were to undertake a sale-and-leaseback transaction in relation to these assets, Sultan Center would most likely realize some considerable gains.

### Investment in Associates

As of the latest available balance sheet, investments in associates account for 35% of Sultan Center's total assets. These investments represent a minority shareholding in six companies (five in Kuwait and one in Bahrain) with the 31% stake in NREC comprising 86.5% of the balance sheet value of these investments. These investments are accounted for using the equity method, and in the case of NREC, the carrying value has grown exponentially since Sultan Center acquired the majority of its share in that company in 1996. NREC is a real estate company that built Souq Sharq in 1998, which was a prominent shopping location in Kuwait at that time. One of Sultan Center's service stores is located in that mall, and thus Sultan Center's investment in NREC was considered strategic when initially made. What led to the ballooning increase in the recorded value of NREC on Sultan Center's books is the 22.4% ownership that NREC has in Agility—a company that grew exponentially from a small warehousing company into a global logistics player due to the company's contracts with the US Army over the last decade. The carrying value of the NREC investment on Sultan Center's books is KD 103.5 million, while the value of that investment based on the latest market value of NREC's stock price is KD 79 million. This shows that the market value of NREC is below the carrying value on Sultan Center's balance sheet; however, the market valuation does not account for control premium. For more information on NREC, please refer to the appendix at the end of this report.

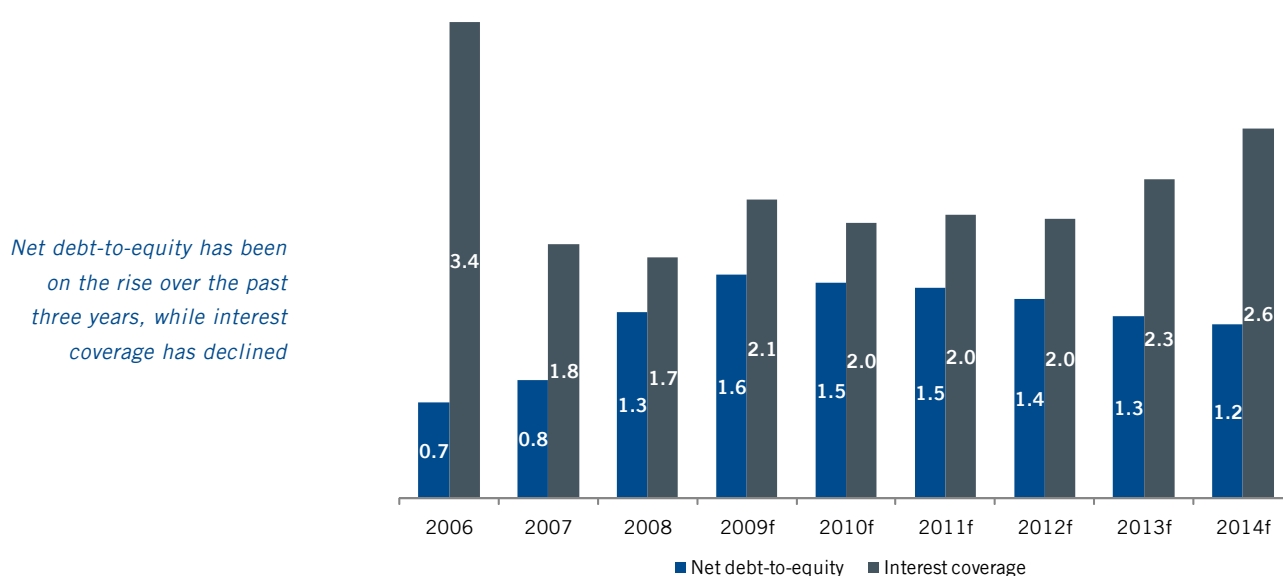
### Investments

Though the level of investments has been dwindling, following the investment losses in 2008, investments still represent 7% of total assets and 22% of equity. Investment assets appear in two categories on the balance sheet, available-for-sale and investment properties. Investment properties, with a balance sheet value of KD 6.2 million, are properties that are held by the group for either capital appreciation or generation of rental income. Gains and losses from changes in fair value of investment properties are taken to the income statement. Investments classified as available-for-sale, amounting to KD 17.4 million, include both quoted and unquoted equity securities. In 2008, Sultan Center implemented amendments to IAS 39 that allowed the company to reclassify KD 19.8 million in investments held-for-trading to available-for-sale, which allowed the group to take losses relating to changes in fair value directly to equity rather than passing them through the income statement.

### Capital Structure

Sultan Center’s capital structure has been drifting more toward debt over the past few years due to two major reasons: a) financing the group’s expansion and b) investment losses and changes in associates’ equity led to a 21% decline in the group’s equity balance in 2008. By the end of 2008, Sultan Center had a net debt-to-equity of 1.4x, which represents a major jump from the 0.7x mark in 2006, as we can see in Figure 23. Also visible in Figure 23 is a declining interest coverage ratio (EBITDA divided by interest expense) from 3.4x in 2006 to just 1.7x in 2008. It is important to note that the majority of Sultan Center’s debt is in the form of short-term borrowing; however, management has informed us that they plan to move a large portion of the debt to longer maturities.

**Figure 23 Net Debt-to-Equity and Interest Coverage**



Sources: Sultan Center and NBK Capital

### CASH FLOW

Sultan Center reported impressive cash flow from operating activities in 2007 and 2008 of KD 31 million and KD 34.1 million, respectively. This represents a big improvement from the level that was achieved in 2006, when cash flow from operating activities stood at just KD 4.3 million. This improvement is attributed to enhanced working capital management, which actually was the main reason behind the low level of cash flow from operating activity in 2006.

### ADJUSTMENT TO TRADING MULTIPLES

As we highlighted earlier in the report, Sultan Center investments (including associates) represent 42% of the group’s total assets. Accordingly, these investments have a material impact on Sultan Center’s bottom line and valuation. To calculate trading multiples (P/E Ratio and EV/EBITDA) that reflect the core business of Sultan Center, we had to adjust the inputs of these trading multiples by stripping the effect of non-core operations from the market cap value, debt, and interest expense.

## APPENDIX: NATIONAL REAL ESTATE COMPANY

In this appendix, we present an overview of National Real Estate Company (NREC) that we prepared with the help of our real estate analysts. We did not meet with the management of NREC, and the following analysis is based on data that we gathered from publicly available sources.

### COMPANY BACKGROUND

With a market capitalization of KD 232 million, NREC stands out as one of the largest Kuwaiti real estate companies. NREC was established in 1973, and was listed on the Kuwait Stock Exchange in 1984. NREC is specialized in developing, trading, and managing commercial and industrial real estate properties, including retail centers, office properties, resorts, and hotels in both Kuwait and the region. The company is primarily a rental player. NREC is also one of the largest shareholders in Agility as NREC owns a 22.4% stake in the logistics services provider.

### COMPLETED PROJECTS

Figure 24 presents a summary of the real estate projects that are currently complete and are being operated by NREC. Among the projects that are presented in Figure 24, the most prominent is the Sharq Market – Waterfront Project, which is considered a landmark in the Kuwaiti capital. Sharq Market is primarily a shopping mall that was completed in 1998 and hosts major international retail brands, restaurants, and cafés. One of Sultan Center's service stores is located in Sharq Market. From Figure 24, we can see that NREC owns properties that are relatively old, with some dating back to the 1970s.

**Figure 24 NREC's Current Operations**

Project	Location	Use	Year of completion	Leasable Area (sq. m)
Mishal Tower	Sharq	Commercial Offices	2008	-
Sharq Market	Sharq	Retail	1998	28,300
El Joan Resort	Juliaa	Resort	-	-
Waty Complex	Qebala	Commercial Complex	1979	11,186
Souq Al Wataniya	Mirqab	Commercial Complex	1978	12,971
Al Wataniya Tower	Kuwait City	Commercial Complex	1989	3,332
Boby Complex	Farwaniya	Commercial Complex	1993	9,916
Dasman Complex	Dasman	Commercial Complex	1979	16,081

Sources: NREC and NBK Capital

### UPCOMING PROJECTS

Figure 25 presents a list of projects that NREC has in the pipeline. NREC recently announced that it has put on hold the majority of these projects due to the current economic situation; however, the two major projects that are still on track (according to an announcement made in the AGM) are Najmat Abu Dhabi, located in Reem Island, and Grand Heights in Egypt. Najmat Abu Dhabi is composed of a mall and four residential towers, with the mall having a gross lettable area of 200,000 square meters, which would make it the largest mall in Abu Dhabi. Construction of the mall is set to begin in the third quarter of 2009 with a target completion in 2012. Grand Heights is a project that covers a total area of 3.7 million square meters composed of residential villas surrounded by a green landscape in 6<sup>th</sup> of October City in Cairo.

Figure 25 Upcoming Projects

Country	Project	Location	Total Area	Use
UAE	Najmat Abu Dhabi	Reem Island	360,000	Commercial Center
	TECOM Dubai	Dubai Media City	26,303	Hotel, Offices
	SHAMS Abu Dhabi	Reem Island	42,132	Hotel, Residential
Iraq	Erbil Mega	Erbil	104,000	Shopping mall, Hotel
Egypt	TELAL	6th of October	3,700,000	Residential Villas
Jordan	Aqaba	AL-Aqaba city	2,000,000	Offices
	Amman	Amman	4,387	Mix Use
Lebanon	Agricola Project	Al Romail	8,000	Residential
	West End Project	Gemmayze	7,800	Commercial Offices
Libya	Palm City Residences	Janzour	160,000	Residential Villas
Pakistan	Canal Residence	Lahore	200,460	Residential Villas

*With the exception of Najmat Abu Dhabi and Grand Heights, all other projects are currently on hold*

Sources: NREC and NBK Capital

#### FINANCIAL PERFORMANCE

- Rental income increased by 10% in 1Q2009, to KD 2.09 million compared to the same period a year before.
- A turning point for NREC's rental income took place in 2007 following the cancellation of a management contract for the Kuwait Free Trade Zone, which led to a 53% drop in rental income in 2007. NREC has appealed against this outcome and is still awaiting a final court ruling on the matter.
- A closer look at the company's real estate-related income (rental income and revaluation gains/losses from real estate properties) reveals that NREC reported losses at the EBITDA level in the past two years. NREC reported negative EBITDA of KD 4.4 million and KD 9.7 million for 2007 and 2008, respectively. This was the trend in 1Q2009 as well.
- NREC's share in the associates' result is entirely due to NREC's share of Agility's profit.
- As of 1Q2009, the proportionate share of NREC in Agility's net profit was more than the company's net profit (KD 8.29 million vs. NREC's reported net profit of KD 5.74), which apparently means that the core real estate operations for NREC are reporting losses. This has been the trend over the past couple of years as well.
- NREC reported a net income of KD 18.3 million in 2008, which represents a 53% decline from KD 39 million in 2007. This decline is mostly due to a drop in investment income and share of profits of associates.
- A quick financial analysis of NREC reflects that its earnings are highly dependent on the performance of Agility, as the core real estate business is not generating enough revenue to cover operating expenses. However, considering the size of the real estate projects that are currently being pursued by NREC, it is expected that this scenario will change once projects that are in progress are completed. As of the latest available balance sheet, 44% of NREC's total assets are classified as capital-work-in-progress

Figure 26 NREC Summary Financial Performance

Income Statement (KD Millions)	2006	2007	2008	CAGR	1Q2008	1Q2009	% Growth
Rental Income	16.3	7.7	8.0	-21%	1.9	2.1	10%
Change in value of investment properties	0.4	(0.4)	(4.7)	-335%	(0.1)	(1.2)	896%
<b>Total Real Estate Related Revenue</b>	<b>16.7</b>	<b>7.2</b>	<b>3.3</b>	<b>-42%</b>	<b>1.8</b>	<b>0.9</b>	<b>-48%</b>
Staff costs	(4.2)	(4.8)	(4.0)	-1%	(1.3)	(1.1)	-15%
General and administrative	(6.3)	(6.8)	(8.9)	12%	(1.2)	(1.5)	23%
<b>EBITDA</b>	<b>6.2</b>	<b>(4.4)</b>	<b>(9.7)</b>	<b>-216%</b>	<b>(0.7)</b>	<b>(1.7)</b>	<b>126%</b>
Depreciation and amortization	(0.7)	(0.2)	(0.4)	-13%	(0.1)	(0.1)	75%
<b>EBIT</b>	<b>5.5</b>	<b>(4.6)</b>	<b>(10.1)</b>	<b>-222%</b>	<b>(0.8)</b>	<b>(1.8)</b>	<b>121%</b>
Share in the associates' results	38.8	36.2	31.5	-7%	8.8	8.3	-6%
Net investment (loss) income	6.8	9.3	3.5	-20%	1.9	(0.0)	-102%
Net interest	(1.2)	(2.4)	0.1	-139%	(1.4)	0.2	-116%
Other income	(1.4)	1.6	(5.6)	58%	1.1	(0.8)	-177%
<b>Net Income before Taxes</b>	<b>48.5</b>	<b>40.0</b>	<b>19.3</b>	<b>-26%</b>	<b>9.6</b>	<b>5.8</b>	<b>-39%</b>
Provision for income taxes	(0.1)	(0.2)	-	-100%	(0.0)	(0.0)	-54%
<b>Net Income after Taxes</b>	<b>48.4</b>	<b>39.8</b>	<b>19.3</b>	<b>-26%</b>	<b>9.5</b>	<b>5.8</b>	<b>-39%</b>
Non-Controlling Interest	0.8	0.8	1.0	7%	0.1	0.1	-32%
<b>Net profit for the year</b>	<b>47.6</b>	<b>39.0</b>	<b>18.3</b>	<b>-27%</b>	<b>9.4</b>	<b>5.7</b>	<b>-39%</b>

Sources: NREC and NBK Capital

*The proportionate share of NREC in Agility's net profit was more than the company's net profit*

## FINANCIAL STATEMENTS

Balance Sheet (KD Thousands)			Forecast					
Fiscal Year Ends December	2007	2008	2009	2010	2011	2012	2013	2014
<b>ASSETS</b>								
Cash	4,128	12,251	22,382	11,350	24,094	8,831	26,515	22,843
Total Receivables, Net	27,204	33,023	39,627	45,571	52,407	60,268	66,295	72,924
Total Inventory	15,948	24,618	28,504	31,417	32,959	34,254	37,043	39,971
<b>Total Current Assets</b>	<b>47,280</b>	<b>69,892</b>	<b>90,514</b>	<b>88,338</b>	<b>109,459</b>	<b>103,353</b>	<b>129,852</b>	<b>135,738</b>
Property/Plant/Equipment, Total - Net	72,706	92,722	95,540	97,591	93,143	88,172	83,165	78,859
Goodwill and Intangibles	14,428	31,317	31,015	30,720	30,430	30,146	29,868	29,595
Long Term Investments	44,312	23,874	23,874	23,874	23,874	23,874	23,874	23,874
Other Long-Term Assets, Total	122,772	115,750	115,750	115,750	115,750	115,750	115,750	115,750
<b>TOTAL ASSETS</b>	<b>301,498</b>	<b>333,554</b>	<b>356,693</b>	<b>356,273</b>	<b>372,656</b>	<b>361,294</b>	<b>382,509</b>	<b>383,816</b>
<b>LIABILITIES &amp; EQUITY</b>								
Accounts Payable	48,408	73,587	85,512	92,824	95,880	99,647	107,761	116,279
Short-Term Debt	93,284	126,583	133,860	123,955	132,773	117,271	123,558	110,252
Other Current Liabilities, Total	469	429	472	520	572	629	692	761
<b>Total Current Liabilities</b>	<b>142,160</b>	<b>200,600</b>	<b>219,845</b>	<b>217,299</b>	<b>229,225</b>	<b>217,546</b>	<b>232,011</b>	<b>227,292</b>
Long-Term Debt	21,896	23,197	23,622	21,874	23,431	20,695	21,804	19,456
Other Liabilities, Total	5,045	5,771	6,348	6,983	7,681	8,449	9,294	10,223
Minority Interest	242	251	264	277	291	305	320	336
<b>Total Liabilities</b>	<b>169,343</b>	<b>229,818</b>	<b>250,079</b>	<b>246,432</b>	<b>260,627</b>	<b>246,995</b>	<b>263,429</b>	<b>257,307</b>
<b>Total Equity</b>	<b>132,155</b>	<b>103,736</b>	<b>106,614</b>	<b>109,841</b>	<b>112,029</b>	<b>114,299</b>	<b>119,080</b>	<b>126,509</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>301,498</b>	<b>333,554</b>	<b>356,693</b>	<b>356,273</b>	<b>372,656</b>	<b>361,294</b>	<b>382,509</b>	<b>383,816</b>

Income Statement (KD Thousands)			Forecast					
Fiscal Year Ends December	2007	2008	2009	2010	2011	2012	2013	2014
Total Revenue	224,295	264,777	328,462	361,976	379,502	393,755	425,940	459,740
Operating expenses	209,772	250,750	308,725	339,548	356,549	371,247	401,070	432,332
Depreciation/Amortization	4,983	5,396	7,414	7,564	8,431	7,847	7,727	7,020
<b>Operating Income</b>	<b>9,540</b>	<b>8,631</b>	<b>12,322</b>	<b>14,864</b>	<b>14,522</b>	<b>14,661</b>	<b>17,143</b>	<b>20,387</b>
Interest Expense	(8,020)	(8,196)	(9,283)	(11,457)	(11,354)	(11,310)	(10,939)	(10,408)
Other, Net	178	(147)	-	-	-	-	-	-
Minority Interest	(22)	(22)	(24)	(27)	(29)	(32)	(35)	(39)
Taxes	(190)	-	(137)	(153)	(143)	(151)	(279)	(449)
<b>Earnings Before Income from Investments</b>	<b>1,485</b>	<b>266</b>	<b>2,878</b>	<b>3,227</b>	<b>2,996</b>	<b>3,168</b>	<b>5,889</b>	<b>9,491</b>
Share of Results from Associates*	12,359	5,606	-	-	-	-	-	-
Net Investment Income*	3,047	(11,298)	-	-	-	-	-	-
<b>Net Income*</b>	<b>16,891</b>	<b>(5,426)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Cash Flow (KD Thousands)			Forecast					
Fiscal Year Ends December	2007	2008	2009	2010	2011	2012	2013	2014
Cash from Operating Activities	30,991	34,122	20,636	20,233	17,000	16,487	23,433	25,496
Cash from Investing Activities	(36,734)	(41,561)	(9,354)	(8,685)	(2,995)	(1,824)	(1,597)	(1,513)
Cash from Financing Activities	6,240	15,562	(1,151)	(22,580)	(1,261)	(29,926)	(4,152)	(27,655)
<b>Net Change in Cash</b>	<b>497</b>	<b>8,123</b>	<b>10,132</b>	<b>(11,033)</b>	<b>12,744</b>	<b>(15,263)</b>	<b>17,684</b>	<b>(3,672)</b>

\* As explained on page 28, our forecasts for Sultan Center exclude the group's share of results from associates and any other investment gains or losses. Sources: Company financials and NBK Capital

## RISK AND RECOMMENDATION GUIDE

Recommendation		Upside (Downside) Potential		
Buy		more than 20%		
Accumulate		between 10% and 20%		
Hold		between -5% and 10%		
Reduce		between -10% and -5%		
Sell		less than -10%		
RISK LEVEL				
Low Risk		High Risk		
1	2	3	4	5

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