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AL MAL CAPITAL



Research Note

ARKAN UH Equity

Rating: Under Perform

ARKAN 1Q09 Net Fails to Impress

ARKAN reported 1Q 09 net loss of AED 91.1mn, versus profit of AED 17.2mn in 1Q 08. Results have been disappointing since 4Q 08. Though losses through the exposure to equity investments present a distorted picture of Arkan's operational performance at the net level, the write downs on steel inventory cannot be overlooked as steel is part of the company's core business. Since 2Q 08, steel has led to an overall decline in the company's margins.

Given the lack of earnings for FY 09 and a high PE multiple of 70 based on 2010 earnings estimates, we consider the stock to be expensive and therefore, **retain our previous rating of Under Perform with a target price of AED 2.01.**

Cement revenues declined 7.3% q-o-q while gross margins declined from 59.5% in 4Q 08 to 52.8% in 1Q 09. Though we expected revenues to fall sequentially from 4Q 08, we are surprised at the decline in margins. Arkan has easier access to natural gas and does not suffer from supply disruptions like companies in its peer group. In current market conditions, ARKAN benefits from its strong presence in Abu Dhabi and though we expect margins to face some pressure, we are also convinced that the company can weather the storm relatively better than those in its peer group.

Steel revenues and margins continue to plague the company's performance.

Declining demand and volatile steel prices do not offer any hope of recovery to the steel business in the near term. Steel led to an inventory write down of AED 429mn for FY 08 and though prudent, the company continued to take a provision of AED 50mn for 1Q 09 on the stock available. Market conditions are unlikely to improve until 2010 and we hope the company can reduce exposure to this business segment at least until steel prices find a floor.

The blocks business segment offers some support to the top line and gross margins for the quarter. Revenues (grew 27% q-o-q) and margins (>49% since 4Q08) have improved sequentially since 4Q 08.

Aggressive expansion strategy revisited. AED 68.3mn worth of expenses incurred on Arkan Industrial Park, a 15 sq.km plot of land which was to house many manufacturing units has been written off as the company shelved its plan to develop this park. As per the company guidance, a dry mortar plant under development in the Industrial Park was expected to come online in 2010 to complement existing businesses. However, the detail of what has been written off remains unknown.

Equity Data

Current Price (AED)	4.15
Target Price (AED)	2.01
Upside/downside	-51%
12 Mo. Performance	-21%
Market Cap. (AED bn.)	7.26
Enterprise Value (AED bn)	7.50
RIC	ARKN.AD



Financials	2008A	2009E	2010E	2011E	2012E
Revenues	695	684	749	876	1,098
Gross Margins	40.27%	20.26%	31.26%	34.03%	44.05%
EBITDA	210.74	91.88	189.10	246.23	430.07
EBITDA Margin	28.4%	5.5%	15.8%	20.1%	32.7%
Net Profit	(291.65)	(78.56)	102.96	197.88	412.37
Net Profit Margin	-41.95%	-11.49%	13.74%	22.59%	37.57%
EPS	(0.17)	(0.04)	0.06	0.11	0.24
PE	(24.90)	(92.44)	70.54	36.70	17.61
EV/EBITDA	35.57	81.58	39.64	30.44	17.43

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