



EFG - Hermes

Dana Gas Pipe Dream

02 August 2006

UAE | Utilities

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ST Rec. : Neutral
LT Rec. : Neutral

Current Price*: AED 1.80
LT Fair Value : AED 1.75

• Dana Gas, a Sharjah-based natural gas resource enterprise, was established in June 2005. Dana comprises of strategic assets and contractual entitlements to considerable natural gas supplies in the Gulf. The company has two wholly owned subsidiaries and an affiliate which is a subsidiary of the well-established Crescent Petroleum.

• Dana Gas's operations span across gas ownership, processing and distribution, with current contracts including access to gas supplies from Iran, as well as end-user agreements to distribute gas to industrial clients and government-owned utilities across the UAE. Its future strategy includes making acquisitions and/or entering into partnerships, with the view to operating across all stages of the gas value chain.

• With both economic and population growth driving increases in demand for energy and in particularly demand for natural gas, in the GCC, gas consumption is expected to more than double from 7.8 trillion in 2002 to 17.1 trillion cubic feet by 2025.

• Dana's contract with the National Iranian Oil Company (NIOC) gives the company access to gas which, in addition to its other two contracts and an anticipated acquisition, are the basis of our financial projections. However, given the lack of guidance, we have not included further contracts/acquisitions in our estimates. From 2007 to 2012, we forecast sales and profits CAGRs of 42.9% and 19.6% respectively.

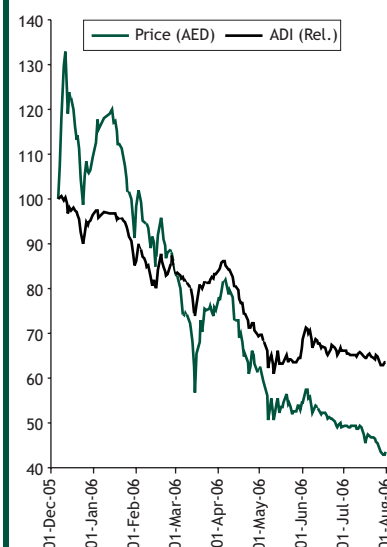
• The company faces the risk that the Iranian gas contract will not be completed, although we believe this to be highly unlikely. We are also mindful that this uncertainty and the lack of transparency regarding Dana's future strategy will likely lead to investors applying a discount to the company's growth potential.

• Due to limited guidance on the company's future projects, coupled with its current low returns and rich near-term valuation, we find it hard to be positive on the stock at this stage of its development, and believe the company has much to prove. Furthermore, our DCF model suggests an estimated Fair Value of AED1.75 per share, which is below the current share price. Thus, we initiate coverage with a ST/LT Neutral recommendation.

December year end	20/11/05 31/03/06	2006e	2007e	2008e
Operating Income (mn)	-5.0	-16.4	108.5	289.5
Net Attrib. Income (mn)	689.0	228.0	239.7	346.9
ROE	10.3%	3.3%	3.3%	5.0%
EPS	0.11	0.04	0.04	0.06
EPS Growth	N/A	-66.9%	5.1%	44.7%
PER	15.7	47.4	45.1	31.1
DPS	-	-	-	-
Dividend Yield	0.0%	0.0%	0.0%	0.0%
BVPS	1.11	1.15	1.19	1.25
P/BV	1.61	1.56	1.51	1.44
CFPS (Operating CF)	0.11	0.04	0.08	0.12
P/CF	15.7	41.6	23.4	15.3
EBITDA (mn)	(5.0)	15.1	331.0	650.5
EBITDA Margin	N/A	35%	40%	22%
EV/EBITDA	N/A	988.3	63.1	33.8
Net Debt (Cash) (mn)	(4,750)	(2,468)	906	1,514
Net Debt (Cash) / BV	-71%	-36%	13%	20%
Net Debt (Cash) / Mkt Cap	-44%	-23%	8%	14%

Fig in AED unless otherwise stated

Estimate Changes					
(AED mn)	20/11/05 31/03/06	2006e		2007e	
		Old	New	Old	New
Revenues	-	N/A	57.3	N/A	959.5
EBITDA	(5.0)	N/A	15.1	N/A	331.0
EBITDA Margin	N/A	N/A	26.3%	N/A	34.5%
Net Attrib. Income	689.0	N/A	228.0	N/A	239.7



Stock Data:

Last Ex-Div Date	N/A
Mkt. Val. (mn)	10,800
Shares (mn)	6,000
Av. Mthly Liqd. (mn)	AED227.4
52-Week High / Low	AED 5.87 / 1.73
Bloomberg / Reuters	DANA UH / DANA.AD
Est. Free Float	35%

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*As at 01 August 2006

KINDLY REFER TO THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGE 19.

EXECUTIVE SUMMARY

Dana Gas is a natural gas enterprise operating in the UAE as well as the broader Gulf region. The company comprises of two wholly owned subsidiaries, Sajaa Gas Private Ltd Co. (SajGas) and United Gas Transmissions Co. Ltd (UGTC) and it also owns a 35% stake in Sharjah-based Crescent Petroleum's subsidiary, Crescent National Gas Co. Ltd (CNGCL). Dana Gas came to the market in late 2005, raising AED2.06 billion. The resulting shares account for 34.3% of the company's capital.

Through SajGas, the company has access to a gas sweetening and sulphur recovery facility. UGTC gives Dana ownership of an entire gas transmission facility comprising of a gas receiving platform and an 80 km transmission pipeline that connects with Crescent Petroleum's Mubarak gas field. Meanwhile, Dana's ownership in CNGCL gives it access to natural gas supplies, underpinned by a 25-year agreement between CNGCL and the National Iranian Oil Company (NIOC), with Iran being the second largest gas resource-holder in the world.

Natural gas consumption is becoming a more important source of energy consumption in the Middle East, with demand expected to more than double from 7.8 trillion cubic feet in 2002 to 17.1 trillion by 2025. In the GCC, proven natural gas reserves are estimated at 1,534 trillion cubic feet which is 25% of the world's total reserves, while natural gas production currently stands at 6.9 trillion cubic feet or 10% of the world's total. Therefore, there is a considerable opportunity for increased supply, production and export of gas from within the region.

We believe the company will generate revenues from its three current projects, the UGTC contract in partnership with Emarat (from 4Q2006); the Iranian contract (from 1Q2007) - which we are confident will be completed despite current pricing issues, particularly given the level of capital already committed to the project by both parties; and the smaller Oman Petrochemicals contract (from 1Q2008). In addition to these projects, we have assumed that Dana Gas will be successful in acquiring the Pakistani Sui Southern Gas Company next year, for two-times book value, with contributions from this company expected to start in 2008.

Over the longer term, we think that the company will expand into upstream exploration and also increase the provision of natural gas for the operations of the power and water industries. However, we have not included this in our current forecasts given the lack of information and/or guidance on future projects.

Dana's longer term contract-based revenue profile lends itself to a DCF valuation framework. We have assumed a WACC equivalent to the company's cost of equity of 10.3%, given its net cash position. Our perpetual growth rate of 4.0% is based on our assumptions that Dana will grow revenues in line with underlying gas demand at 3-4% p.a. beyond 2010. This gives us a Fair Value of AED1.75 per share, which is 3% lower than the current share price.

Given the lack of directly listed comparables within the region, we have chosen to value Dana Gas against a selected number of a number of gas companies from across the globe. Against these, Dana's valuation multiples look high, although the company's price to book ratio is towards the lower end of the peer group, a reflection of its relative youth.

With Dana aiming to be the region's leading gas operator across the whole gas value chain, we believe there is much for the company to go for in the medium term and therefore expect positive news flow over the next few years. However, our estimated fair value, arrived at through a DCF, is slightly lower than the current share price and this, coupled with current low returns and high valuations, means that we initiate coverage with a ST/LT Neutral recommendation.

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I. SECTOR OVERVIEW

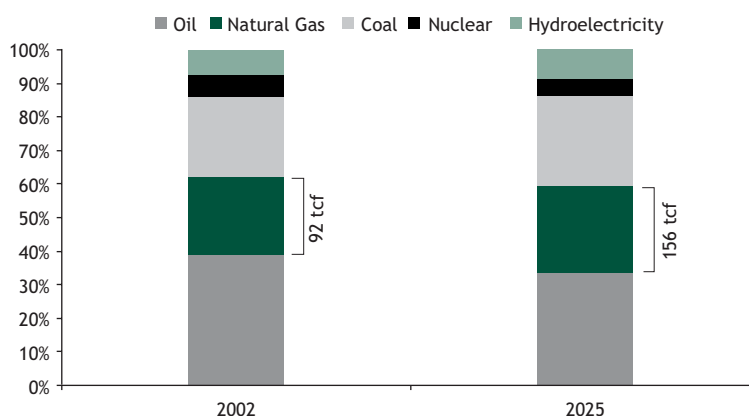
A. World Energy Consumption and Natural Gas Usage

World energy consumption is expected to more than double by 2025, reaching a level of 645 quadrillion British thermal units (Btu) according to the Energy Information Administration (EIA). While oil will remain the predominant source of energy in the future, natural gas and hydroelectricity are becoming increasingly important and are taking a greater share.

Natural gas is the fastest growing energy source

Natural gas is the fastest growing energy source according to recent Energy Information Administration (EIA) reports. Consumption of natural gas is expected to increase by nearly 70% between 2002 and 2025, reaching 156 trillion cubic feet, with the greatest demand expected to stem from the emerging economies of the Middle East and Asia.

Figure 1.1: World Energy Consumption by Resource 2002-2025



Source: EIA International Energy Outlook 2005

Natural gas is increasingly becoming a highly sought-after source of energy due to decreasing oil reserves, consumer demand for alternative sources of energy, greater use of gas as a supply for electric power generation and industrial usage, as well as for other environmental benefits such as low carbon content.

There has been a large increase in production of natural gas

Furthermore, due to its high usability and lower cost of production, there has been a large increase in production of natural gas specifically in Asia and the Middle East. Indeed, production in these emerging economies is expected to rise almost 64%, from 24 trillion cubic feet in 2002 to 65 trillion cubic feet in 2025.

B. Middle East Natural Gas Usage Patterns: Consumption, Reserves and Production

Consumption

With rising populations, booming economies and increasing demand for power, the Middle East has seen large increases in energy consumption from 7.8 quadrillion Btu in 1990 to 13.2 quadrillion Btu in 2002 (growth of 69%) and is further expected to rise to 23.3 quadrillion Btu by 2025, implying growth of 77%. Within the GCC specifically, natural gas consumption is expected to double between 2002 and 2025, with the proportion of natural gas, in terms of total energy consumption, slated to rise from 39% in 2002 to 45% in 2025.

Demand for natural gas is being driven by increases in industrial consumption of gas

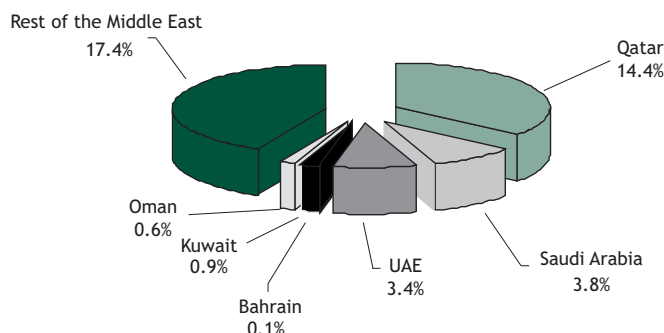
Demand Drivers

Demand for natural gas is being driven by a number of factors. First, increased usage of natural gas for the operation of power plants and as a transportation fuel is encouraging the industrial consumption of gas. Second, GCC governments are undertaking large-scale projects to reduce dependency on oil by exploring natural gas reserves. Moreover, with investments in natural gas pipelines and gas distribution networks, as well as efforts to deregulate natural gas and other energy sectors, new players and therefore greater competition are being encouraged. And third, technological improvements in gas-turbine and combined-cycle technologies have lowered the costs of transporting natural gas and hence increased the potential of suppliers to reach an increased customer base. Finally, reduced carbon dioxide emissions from natural gas result in significant environmental benefits.

Reserves

With almost 41% of the world's natural gas reserves in the Middle East, the GCC, (primarily Qatar, Saudi Arabia and the UAE), has approximately 25% of the world's reserves. The majority of these are concentrated in a small number of super giant fields. There are ten such fields in the GCC, out of twenty such fields in the world.

Figure 1.2: Distribution of Natural Gas in the Middle East-2005



Source: BP Statistical Review of World Energy 2005

The Middle East has not fully exploited its production potential

Production

Despite huge reserves of natural gas, the Middle East has not fully exploited its production potential, given that it currently produces only 10% of the world's total natural gas, with Saudi Arabia, Qatar and the UAE accounting for almost 6% of this production alone. However, efforts are underway across the GCC to undertake large-scale exploration projects, construct pipelines and networks, in an attempt to increase production facilities and distribution capacity.

C. UAE Natural Gas Sector: Consumption, Production and Reserves

Consumption

In terms of consumption, the UAE has experienced increased demand of natural gas from commercial, industrial as well as residential sectors in the past decade. This growth has been driven by the growing consumption of electricity and demand from the petrochemical industry which has spurred the use of natural gas. In Abu Dhabi for example, natural gas consumption has doubled over the last ten years and currently stands at 4 billion cubic feet per day. Meanwhile, due to rapid industrial expansion and a switch to the use of natural gas by its power plants, Dubai's consumption of natural gas has been growing at nearly 10% per annum over the last few years, with current demand averaging 810 million cubic feet per day.

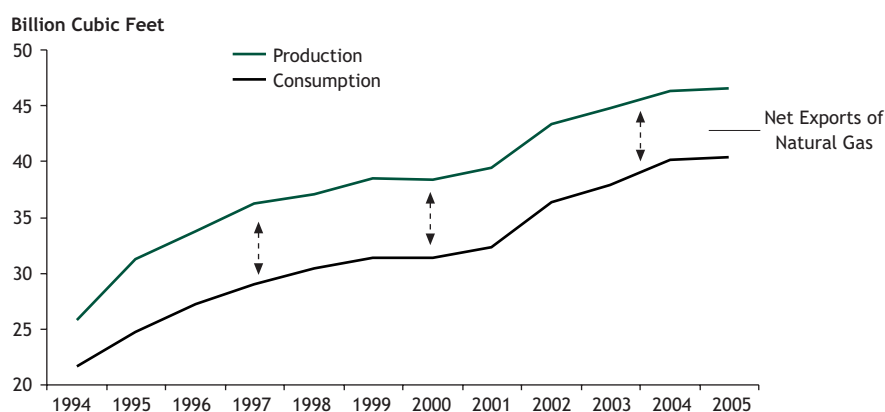
The UAE has embarked on massive multi-billion dollar investments in natural gas sector over the last few years

Production

The past few years have seen the UAE embark on massive multi-billion dollar investments in natural gas sector, including both exploration and production facilities. Some of these projects have involved switching power plants from using coal and oil to natural gas, developing a natural gas-based industrial zone (in Taweelah commercial district), and also some larger-scale and ambitious projects, namely the Dolphin project to interconnect natural gas grids across Qatar, the UAE and Oman.

It is interesting to note however that this increased gas production has not only satisfied the UAE's consumption needs, but has also meant that the country has been able to export excess supply, largely to Japan, South Korea and Spain.

Figure 1.3: UAE Natural Gas Net Exports 1994-2005



Source: BP Statistical Review of World Energy 2006

Reserves

The UAE is home to natural gas reserves of 214.4 trillion cubic feet, which are the world's fifth largest reserves after Russia, Iran, Qatar and Saudi Arabia. These reserves have facilitated greater natural gas production. About 90% of these reserves are located in Abu Dhabi, but are extracted concurrently with oil and hence consist of less pure "associated gas".

D. Natural Gas Consumption and Production by Emirate

There is a capacity gap in the UAE

Abu Dhabi

Abu Dhabi has long been an exporter of LNG, meeting its own needs for gas with supplies mostly from Sharjah

While the UAE's natural gas industry is sectioned by emirate, there is some degree of sharing of supplies between them. With most of Abu Dhabi's gas coming from oil fields, it tends to be of lower-quality (known as "associated gas"), but is easier to convert into LNG. Therefore, Abu Dhabi has long been an exporter of LNG, meeting its own needs for gas, both for residential and commercial use, with supplies mostly from Sharjah. Moreover, since Abu Dhabi is the leading producer of oil in the UAE, the emirate has made considerable investments in projects, using a process of injecting natural gas, to boost oil production.

The two main players in the Abu Dhabi natural gas industry include two subsidiaries of Abu Dhabi National Oil Company (ADNOC), namely Abu Dhabi Liquefaction Limited (ADGAS) and Abu Dhabi Gas Industries (GASCO). In May 2001, GASCO completed the construction of a pipeline connecting the Maqta'a Jebel Ali Gas Pipeline with Dubai, allowing supplies of natural gas to begin flowing between Abu Dhabi and Dubai. However, given that Abu Dhabi's reserves of associated gas are limited, the emirate has established the Dolphin project.

The USD3.5 billion Dolphin Project aims to facilitate the flow of natural gas from Qatar to the UAE and beyond. This project, being undertaken by Abu Dhabi-based Dolphin Energy Limited (DEL), will involve the production and processing of natural gas from Qatar's North Field, which will then be transported via pipeline to the UAE. These gas supplies are expected to largely satisfy Abu Dhabi's rising gas consumption needs. Additionally, the emirate has plans to use gas in the production of petrochemicals and also to supply gas for industrial zones.

Dubai

Dubai has 2% of the UAE's total gas reserves (via its Margham gas field). This field has a capacity of 140 million cubic feet per day (cfpd), which is substantially lower than Dubai's demand of circa 810 million cfpd. As a result, up until 2001, Dubai obtained all its gas supplies from Sharjah. The Maqta'a Jebel Ali Gas Pipeline from Abu Dhabi to Dubai, which was mentioned earlier and has a design capacity of 900 million cubic feet a day, has provided supplies of 300 million cubic feet per day to Dubai. When the Dolphin Project was commissioned, Dubai signed an MoU with DEL, allowing it to purchase 200-700 million cfpd, thereby helping to meet its rising natural gas needs.

Sharjah

Sharjah accounts for 5% of the UAE's total gas reserves, mostly non-associated gas, which is higher in quality than that of Abu Dhabi's and can therefore be used for residential and commercial purposes directly/ more easily. Its fields are located both offshore (i.e. the Mubarak field) and onshore (Sajaa, Move and Kahaif fields). The main operators of these gas fields include Amoco Sharjah Oil Co (AMOCO) - which is a subsidiary of British Petroleum (BP), Crescent Petroleum, and Sharjah LPG Company (SHALCO). While Amoco and Crescent are suppliers of natural gas to Sharjah and other Northern Emirates, Shalco processes natural gas to supply Liquefied Petroleum Gas (LPG) to both Sharjah and Dubai.

Other Emirates

In terms of the other emirates, Fujairah currently imports natural gas from Oman. Similarly to Dubai, in order to meet increasing demand, Fujairah has signed an MoU with Dolphin Energy to obtain Qatari gas supplies via Oman. Ras Al Khaimah is also undertaking projects to explore its gas fields and hence increase production.

Pricing

It is our understanding that most of the companies in the UAE that operate in the natural gas sector are wholly, or partially government owned. Hence fluctuations in energy prices as well as cost increases due to supply shortages are most likely to be met by the respective government utilities, or the government itself. For example, if natural gas prices rise, the Government of Sharjah will absorb the increased costs as opposed to passing on the rise to consumers. This approach was evident in 2005, when Sharjah Electricity and Water Authority (SEWA) standardised rates for both residential and commercial consumers, to ensure fair supply and moderate prices, actually reducing prices for industrial users within the emirate, at a time when the price of gas was rising.

Opportunities within the UAE Gas sector

Given the aforementioned growth drivers and the fact that there is limited competition in the UAE natural gas sector, we believe there are considerable opportunities across the entire gas value chain. Furthermore, given its large but not necessarily always usable reserves, the UAE's need for greater gas supply from abroad, over the next few years, is clear. On its own, the Dolphin project may not be sufficient to meet demand across the whole of the UAE and therefore, additional gas supplies would have to be imported. The Dolphin project has also set a strong example for regional co-operation over energy and we believe that with natural gas becoming a more coveted source of energy, there are further opportunities in the sector that can strengthen both the energy and political environment in the region.

Cost increases in energy prices are most likely to be met by UAE government

There are considerable opportunities across the entire gas value chain

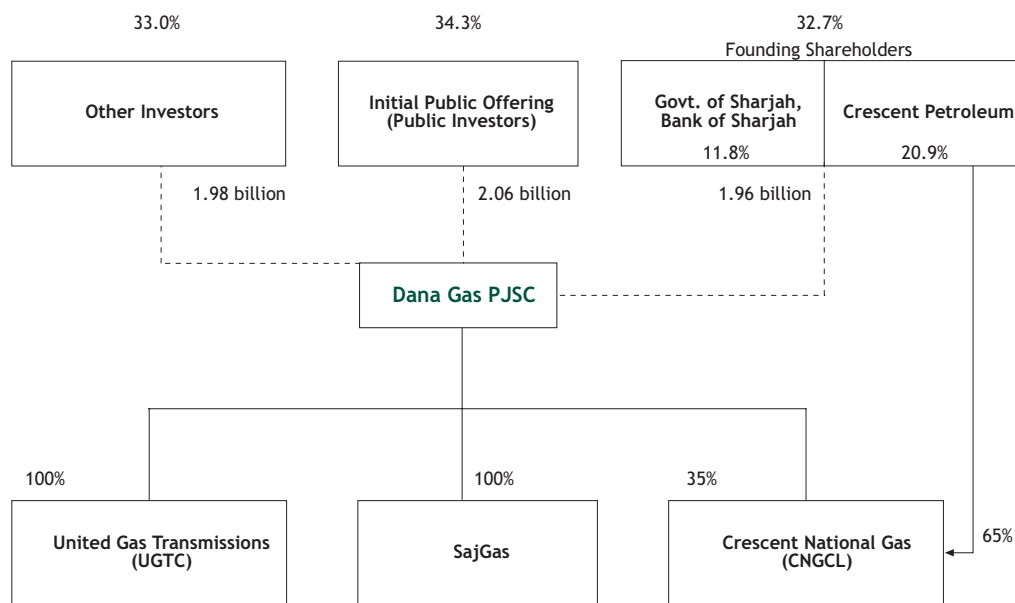
II. COMPANY PROFILE

A. Historical Overview

Dana Gas was listed on the Abu Dhabi Stock Exchange (ADSM) after its initial public offering in November 2005. It was established as a private sector gas resource company with a focus on becoming a leading player in the growing natural gas sector in the UAE and the wider Gulf region. Dana has operating assets at various levels of the gas value chain, including established interests in gas supply, transportation, processing and marketing.

Dana Gas's operational activities currently include the effective ownership of natural gas through long-term supply arrangements; onshore/ offshore gas transmission; gas processing; sale of dry gas to government-owned utilities and other large industrial natural gas consumers; and sale of associated petroleum liquids and other related products in the international markets.

Figure 2.1: Structure of Dana Gas



Sources: Company prospectus and EFG-Hermes

B. Existing Assets & Operating Subsidiaries

Crescent Petroleum is one of the UAE's oldest, independently-owned, upstream oil and gas producing companies

Crescent National Gas Company Limited (CNGCL)

CNGCL is a subsidiary of Crescent Petroleum, which is one of the UAE's oldest, independently-owned, upstream oil and gas producing companies. Crescent Petroleum began operations in the 1970s and owns drilling, construction and pipeline facilities, with extensive operational experience in a range of large projects. The company's focus has primarily been on the purchase, processing and sale of gas in the Middle East. This is complemented by regional experience across North Africa, the Caspian Sea and South Asia. When Dana Gas was created, it received a 35% stake in CNGCL, with Crescent Petroleum maintaining the balance. In exchange, Crescent Petroleum received a 20.9% stake in Dana Gas.

Crescent Petroleum, along with the government of Sharjah and others, invested in SajGas to build and operate a gas sweetening plant in the Sajaa area of Sharjah. The Sajaa plant processes gas, supplied from Crescent's Mubarak field, and upon processing, the resultant gas is delivered to Crescent and other end users. Dana has also entered into an 'umbrella agreement' with Crescent Petroleum, who will be providing the company with operational and technical assistance to the extent where Dana can become self-sufficient. Moreover, there is a mandatory clause in the agreement between the two firms, which stipulates that Crescent and Dana will share knowledge of potential deals with one another.

SajGas

SajGas is a limited liability company which was set up in June 2004. The company owns and operates a gas sweetening and sulphur recovery plant in the Sajaa area of Sharjah. The SajGas plant is fully operational and will earn its revenues from the supply of sweetened gas to CNGCL.

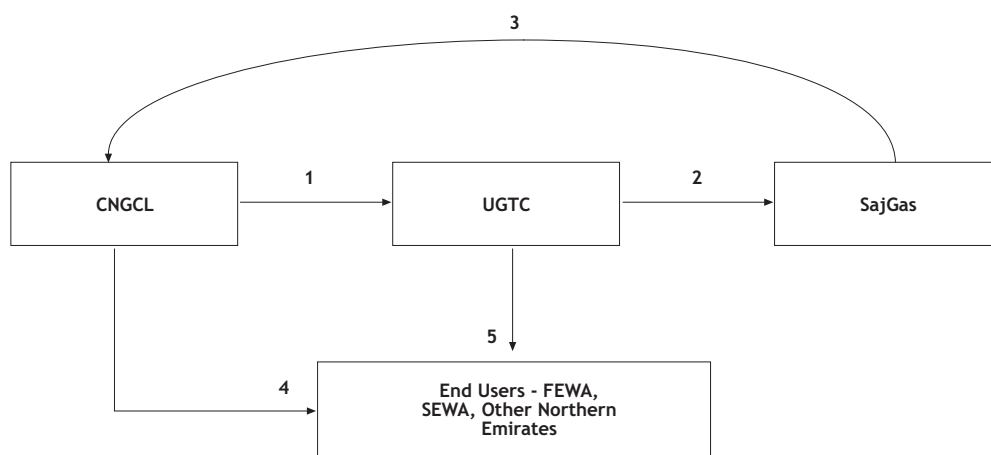
United Gas Transmissions (UGTC)

UGTC is a limited liability company that was established in Sharjah in October 2004, with a principal focus on the transportation, storage and distribution of natural gas. UGTC is undertaking a major project which involves the construction of a new 52 km pipeline from an off-shore gas receiving platform to the shore at Hamriyah and then another 30 km pipeline onshore, leading to the SajGas sweetening plant. This pipeline network will transport gas supplied by CNGCL to the SajGas plant at Sajaa, Sharjah for sweetening. Once further processing has been completed, the dry gas will be sold to Fujairah FEWA, SEWA and other end users. UGTC derives its revenues from the transmission of gas to CNGCL and other end users.

C. Details of Operations

Dana Gas's operations, as we have previously mentioned in this note, are conducted through its subsidiaries and affiliates and is best explained by the following diagram:

Figure 2.2: Flow of Operations of Dana Gas and its Subsidiaries



Source: EFG-Hermes

Their operations are layered in the following way:

1. CNGCL has gas reserves located in its Mubarak field which it transports through a pipeline to UGTC;
2. Once UGTC's receiving platform receives the gas, it then transports it onwards to SajGas's sweetening facility;
3. After Sajgas completes the gas processing phase, the natural gas is sent back to CNGCL;
4. CNGCL then distributes the processed natural gas back to UGTC and end users such as government owned utilities, as well as others;
5. UGTC also has the ability to deliver processed natural gas to FEWA as well as SEWA under-pinned by a 25 year contract with CNGCL.

D. Current Projects

Dana Gas's current contracts include a 25-year USD1 billion contract with National Iranian Oil Company (NIOC) to import and transport natural gas between Iran and the UAE, an AED670 million gas project signed with Emarat Petroleum, and a smaller project with Oman Petrochemicals (OPCL).

Iranian contract

The NIOC project is the larger of Dana's contracts and we believe this was the basis for the financial projections in its prospectus last year. This contract is between Dana's affiliate CNGCL and a leading gas supplier in Iran, NIOC, to transport Iranian sour natural gas to the UAE. After the gas is exported from Iran's Salman field, transported to UGTC's receiving facility and on to SajGas for sweetening, Dana Gas will allow CNGCL to transmit the sweetened gas to end-users such as FEWA and SEWA.

The Iranian project has run into delays, with disagreements relating to price...

However, this project has run into delays over the past few months, with disagreements relating to the price at which NIOC is willing to sell the gas, because gas prices have risen significantly since the contract was first agreed upon. Moreover, there are other aspects of the contract that are causing delays to the original anticipated start date of 2Q2006. Since the project's construction is almost complete, management believes that gas supplies will begin shortly. Also, as a result of negotiations between the Energy Committee of Iran and the Sharjah government, Dana believes that any sticking points will soon be resolved.

At this point, we believe it is worth exploring a more negative argument i.e. that the Iranian contract does not come to fruition. In this case, Dana Gas would be forced to seek alternative supplies from sources such as Qatar or other gas-rich countries. Indeed, it may be possible for supply to come via the Dolphin Energy project, which intends to deliver gas from Qatar to Abu Dhabi. This pipeline could then in theory be extended from Abu Dhabi to Sharjah to supply Dana Gas, but would have obvious cost and time implications for the company. In turn, NIOC could find an alternative recipient for its gas, who would be willing to meet its terms. Further still, NIOC may even be able to use the existing infrastructure, which is almost complete, to supply its gas to another company in the UAE.

...however, given the capital already committed by both parties, we believe the project will go ahead

We note that the above scenario assumes the worst possible outcome for Dana Gas and as such is highly unlikely. In the event that Dana does not receive any supply of gas from NIOC, the company's operations and hence future revenues would stall until alternative gas supplies are arranged, which would take time. However, we believe given the capital already committed by both parties to the project, this negative scenario is highly improbable.

It is important to note that the Iranian project is Dana Gas's claim to gas supplies and will add further capacity in the UAE, in addition to the gas expected to be imported from Qatar via the Dolphin project. Moreover, obtaining the natural gas from Iran will allow Dana to meet its contractual agreements signed with SEWA, FEWA and DEWA, as well as with Oman Petrochemicals.

With over 95% of the project complete, and USD1 billion spent by Dana and a further USD1.2 billion by NIOC, the investment/capital already committed to this project is significant enough to prevent either party from walking away from the contract. With this infrastructure in place, we believe any differences over pricing will be reconciled, as this would clearly be in the best interests of both parties.

Since Dana will be supplying this gas for residential use, as well as to feed power plants which are operated by UAE-owned electricity utilities (SEWA, FEWA), we also assume that any differences in the price of the contract will not be passed on to end consumers. With the practice of subsidized utilities in the region, the government is likely to absorb the additional costs to ensure fair tariffs for consumers. It is for this reason that we have assumed that for the first seven years, as stipulated by the contract, there will be no change to the price at which the gas is imported, honouring the original contract and also avoiding the potential waste of the completed infrastructure, which is already in place.

Indeed, our analysis of the contract, based on conversations with experts in the gas industry, suggests that while in all likelihood the contract will be completed, Dana may be compelled to pay a higher price for the gas. This would in turn have obvious implications for anticipated revenues, gross profits and net profit margins. However, given that the contract is broken into two time periods, from 0-7 years and 7 years and beyond, for the first seven years of the deal, we have assumed that the original terms will be honoured. Once the first seven years have elapsed, we are certain that the price at which Dana obtains the gas will change, and therefore so too will its margins. But that thereafter, we expect less favourable terms for Dana, anticipating a price increase for the sale of the gas. We have estimated that the first gas supplies, and hence revenues from this contract, will begin at the start of 2007.

Emarat contract

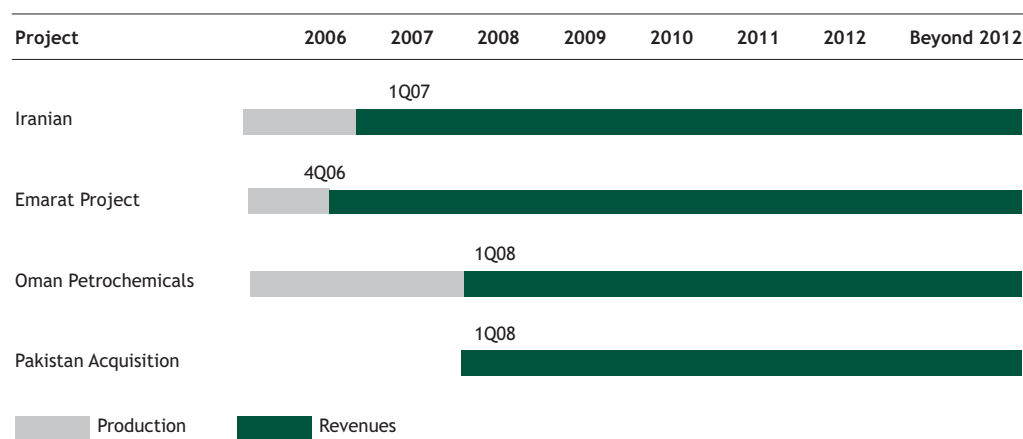
The Emarat project is a contract being undertaken through UGTC, which consists of building, owning and operating a 30 km, 48 inch common-user gas pipeline from the Sharjah gas hub to the Hamriyah Free Zone. Valued at AED670 million, the pipeline is expected to be one of the largest in the UAE with an anticipated capacity of 1 billion cubic feet per day. This contract is valid for 25 years and UGTC and Emarat Petroleum are partners in this venture, sharing equally in profits and costs. The first phase of the project, which connects the existing Emarat Petroleum to the Hamriyah power plant operated by SEWA, has been completed with the rest of the project expected to be completed by late 2006. As part of the first phase, revenues from the sale of gas to end-users are expected to start in 4Q2006.

Hamriyah Free Zone contract

A third, smaller project has been signed by Dana, and includes a 25-year agreement with Muscat-based Oman Chemicals and Pharmaceuticals LLC (OCPL) to supply natural gas, which OCPL will primarily use for its production of ammonia, urea and other petrochemicals. The ammonia plant will be located in the Hamriyah Free Zone in Sharjah and construction is expected to be completed by 2007. Revenues from the supply of feedstock for the ammonia plant, are expected to commence in 1Q2008.

At this time, while Dana Gas has made public its intentions to invest and enter into upstream projects, we do not have any guidance as to what these contracts and/or projects may be and when they may happen. Therefore, for our forecast period (between 2006 and 2012), we believe the company will generate revenues from the above three deals/contracts. However, we also believe Dana will make an acquisition next year, which we expect to contribute to our estimates in 2008.

Figure 2.3: Time-line for Contracts/Projects



Source: EFG-Hermes Estimates

E. Future Projects & Strategy

Dana Gas's long term strategy involves undertaking projects across all stages of the gas value chain including venturing into a range of upstream, midstream and downstream activities as well as providing natural gas to local and regional customers. Specifically by utilizing its access to Iranian gas reserves and existing distribution networks, we think Dana Gas will be able to provide natural gas not only for domestic and GCC usage, but also for the wider Middle East and South Asian region.

We believe Dana Gas will be awarded the bid for the Pakistan's Sui Southern Gas Company

To this effect, we are aware that Dana Gas has put forward a bid for a gas transmission and distribution company, Pakistan's Sui Southern Gas Company Limited. As part of the Pakistan government's privatization process, this majority government-owned company is offering a 51% equity stake, and Dana is waiting to be short listed for this project. Given the strong economic ties that the UAE shares with Pakistan, as well as Dana's strengths as a regional player, with strong leadership and expertise in the gas sector, we believe it is highly probable that Dana will be awarded the bid. We are assuming that Dana Gas will pay twice the current book-value for the company, which amounts to AED1,350 million.

Over the longer term, we expect that Dana Gas will venture into upstream projects and also increase direct gas supplies towards the power industry. With growing usage of natural gas to power gas turbines, which are used to create electricity and desalinate water, there is immense potential for the company to tap into the UAE and regional power market, where consumption is expected to more than double over the next 10 years (according to the Economist Intelligence Unit).

Furthermore, we are aware of other midstream projects in the region that Dana Gas may be interested in, such as pipelines that connect Qatar, Pakistan and India etc. However, there are no specific contracts related to these projects as yet and given the nature of the industry, where project feasibility tends to take 3-4 years, we believe it is highly unlikely that some of these contracts will come to be executed for a few years yet and hence have not included any such deals in our forecasts.

III. FINANCIAL ANALYSIS AND PROJECTIONS

A. Forecasts

Dana Gas generates revenues from three separate stages of the gas value chain: At exploration and production (Crescent), at treatment (SajGas), and at transmission (UGTC). We note that revenues from treatment and transmission are based on a tolling model, which means that, at these two subsidiaries, the company earns a fee on services provided. Currently, SajGas and UGTC are fully consolidated into Dana's financial statements, while it is our understanding that for projects undertaken through CNGCL, profits are also consolidated in proportion with Dana's 35% stake in CNGCL.

We expect revenues to come from Dana's current projects and from the anticipated AED1,350 million acquisition of the Pakistani Sui Southern Gas Company (starting in 2008). We have then also taken into consideration the expected increase in demand for gas in the Middle-East, easy to satisfy given abundant reserves (refer to the first section on the sector overview), and believe this underpins our LT forecasts.

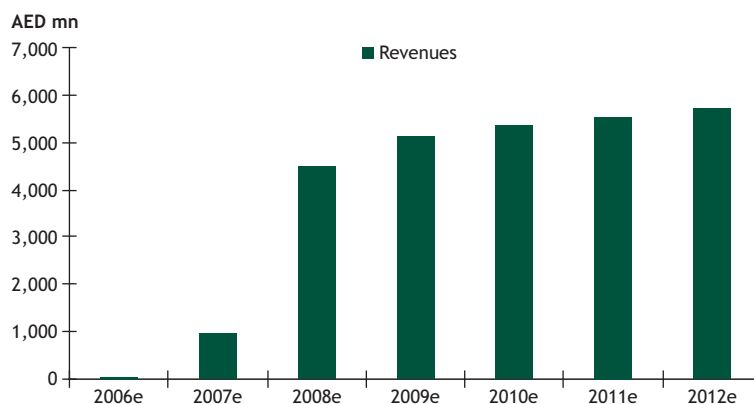
It is worth noting that our forecasts do not reflect any potential future investments (except for the Pakistani acquisition) above and beyond normal capacity expansions to meet the rise in demand. Non-forecast acquisitions/initiatives could lead both to an increase in revenues and a possible increase in interest expenses as a result of rising debt.

B. Revenues

Revenue growth will be driven by the company's project with the Iranian National Gas company and then its acquisition

We forecast strong revenue growth over the next few years, buoyed by the company's large project with the Iranian National Gas company and then by our anticipated acquisition (in 2007) of the Pakistani Southern Sui Gas Company, which is expected to contribute from 2008. Therefore we have estimated a CAGR of 42.9% from 2007 to 2012 for revenues. However, within this, while we expect to see a huge jump in revenues in 2008, beyond 2010, we have estimated more normalised rates of growth (of between 3% and 4% p.a.). Clearly, if Dana Gas were to sign additional contracts and/or make further acquisitions in the meantime, this would have obvious implications for our estimates further out, but currently we have no guidance on this.

Figure 3.1: Forecast Revenues (AED million)



Source: EFG-Hermes Estimates

C. Profitability

Gross Margins

We believe gross margins will improve over the next two years, rising to 39.5% in 2007, at which point we expect the anticipated acquisition to have an adverse effect on group margins (from 2008). Given that we estimate a gross margin of below 15% for the Pakistani Gas Company, we forecast that the group's margin will fall to 21.5% in 2008.

However, we believe gross margins will improve steadily from this point onwards, as the company increases its capacity utilization and production efficiency, and benefits from economies of scale. Given the capital intensive nature of building and establishing a new plant and/or pipeline, margins improve as the plant/pipeline adds additional capacity. Therefore, we forecast margins to grow to 23.5% by 2012.

EBITDA

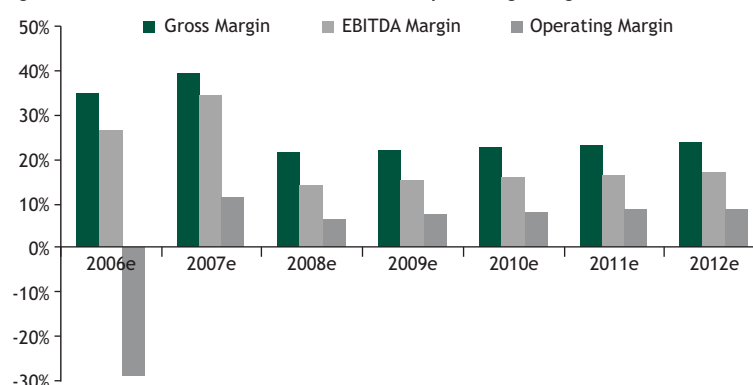
While we expect to see strong growth in EBITDA, forecasting a CAGR of 23.9% from 2007 to 2012, we expect EBITDA margins to follow a similar pattern to that of the company's gross margins; after initial increases over the next two years, we expect margins to fall in 2008, reflecting the group's anticipated acquisition, but then to grow steadily thereafter (towards 17% by 2012).

While EBITDA growth is being driven by strong top line momentum, it is also dependent on the company's SG&A expenses, which we expect to remain well under control while the company grows rapidly. Indeed, given greater economies of scale, with minimal additions to labour costs as additional capacity is added, we expect SG&A as a percentage of sales to fall steadily after 2008.

Operating Margins

We also expect to see a steady increase in operating margins in the medium term, despite anticipating a negative margin for 2006. With strong revenue growth and SG&A expenses falling as a percentage of sales, we expect operating margins to rise from under 6.5% in 2008 to 8.8% by 2012.

Figure 3.2: Forecast Gross, EBITDA and Operating Margins



Source: EFG-Hermes Estimates

We expect to see strong bottom-line progression over the next few years

With significant jumps in revenue anticipated for 2007 and 2008, we expect to see strong bottom-line progression over the next few years. Furthermore, we forecast Dana's net profit margins will be buoyed by contributions from both interest and investment income in 2006 and 2007. While we note that this is a "poor quality" driver for earnings growth, we do not expect to see these contributions beyond 2007. However, we have forecast a contribution from 'other income' from 2008, anticipating this to come from the Pakistani Sui Gas Company's current operations. Therefore, we have forecast a net profit CAGR of 19.6% from 2007 to 2012.

Table 3.3: Forecast Net Profit and EPS

(AED mn)	2006e	2007e	2008e	2009e	2010e	2011e	2012e
Net Profits	228.0	239.7	346.9	437.0	489.4	539.3	587.1
Net Profit Margins	397.8%	25.0%	7.7%	8.5%	9.1%	9.7%	10.3%
Basic Earnings per Share	0.038	0.040	0.058	0.073	0.082	0.090	0.098
Growth in Earnings	-66.9%	5.1%	44.7%	26.0%	12.0%	10.2%	8.9%

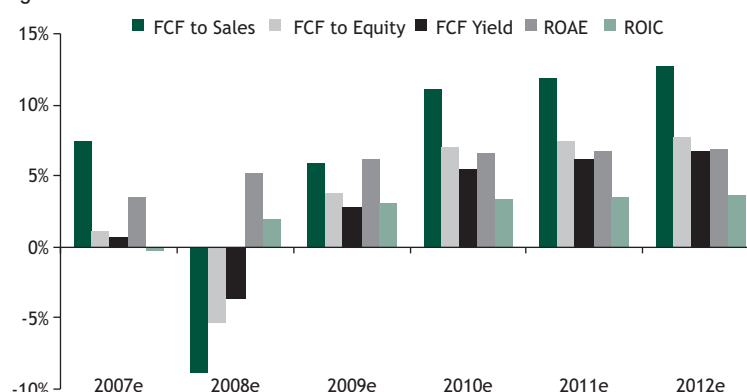
Source: EFG-Hermes Estimates

D. Free Cash Flow and Returns

Cash flows will be muted in the medium term

We believe Dana's ability to produce strong cash flows will be muted in the medium term as the company establishes its current projects and beds in the anticipated AED1,350 million acquisition (of Pakistani Sui Gas Company) over the next few years. However, in the longer term, with a typical contract term of 25 years, we forecast a steady rise in FCF as the company comes through its development phase towards maturity. While Dana's free cash flows rise towards 13% of sales by 2012, its free cash flow yield (at the current share price of AED1.80) increases to 7.6% by 2012. However, it is important to bear in mind that non-forecast acquisitions/expansions would have an impact on the company's free cash flows.

Figure 3.4: Forecast Free Cash Flows and Returns



Source: EFG-Hermes Estimates

Meanwhile, with limited information as to what Dana will invest in, we can only forecast returns from existing operations, as above. Based on these, we believe that Dana's ROAE and ROIC, although rising, are low. The fact that the company is currently in the investment phase of its development (i.e. building/acquiring), and given the nature of its business i.e. 25 year contracts, we expect returns to remain low over the medium term.

Currently Dana Gas has no debt and a significant cash pile

Further, it is worth mentioning the company's current capital structure at this point. Currently, Dana Gas has no debt and a cash balance of AED4.75 billion. We have assumed that the company will repay its AED1,950 million convertible note in cash, by the end of 2006, and also expect Dana's cash pile to also help to finance its AED1,350 million acquisition of the Pakistani Gas Company in 2007. Although we forecast that the group will take on some debt as part of this acquisition, we believe that Dana Gas has the ability to retain greater levels debt in the longer-term, in order to finance any further projects and/or acquisitions.

E. Alternative Deal Assumptions

Whilst we have assumed that the Iranian deal will be struck at the original terms of the contract for the first 7 years at least, (which are favourable to Dana), and have reflected this in our current forecasts, we feel that it is worth undertaking a simple exercise, in which we plug in terms of an 'alternative' deal into our financial model.

Under this 'worst case' scenario for Dana, we have assumed that gross margins, for revenues generated from this project, would halve from current forecast levels. This is based on the assumption that the company would have to pay substantially more for the gas (up to 4 times as much), than under the current deal terms. Running this through our model, we find that profits would actually fall by more than half in 2008, growing to only AED253m by 2010 (a profit margin of just 4.7%), which is substantially less than our actual forecasts, of profit of AED489 million for that year.

Tables 3.5: Income Statement Forecasts for Actual and Alternative Scenarios

Alternative scenario forecasts:

Income Statement	2006e	2007e	2008e	2009e	2010e	2011e	2012e
Revenues	57.3	959.5	4,486	5,114	5,360	5,559	5,724
COGS	(37.2)	(580.5)	(3,737)	(4,235)	(4,411)	(4,547)	(4,653)
Gross Profit	20.1	379.0	749.2	879.7	948.8	1,012	1,070
Gross Profit Margin	35.0%	39.5%	16.7%	17.2%	17.7%	18.2%	18.7%
EBITDA	15.1	331.0	435.2	526.8	584.3	639.2	692.6
EBITDA Margin	26.3%	34.5%	9.7%	10.3%	10.9%	11.5%	12.1%
Net Operating Profit	(16.4)	108.5	74.2	145.6	178.7	205.5	228.8
Net Operating Margin	-28.6%	11.3%	1.7%	2.8%	3.3%	3.7%	4.0%
Net Profit	228.0	239.7	148.8	211.2	252.7	293.8	334.3
Net Profit Margins	397.8%	25.0%	3.3%	4.1%	4.7%	5.3%	5.8%

Actual forecasts:

Income Statement	2006e	2007e	2008e	2009e	2010e	2011e	2012e
Revenues	57.3	959.5	4,486	5,114	5,360	5,559	5,724
COGS	(37.2)	(580.5)	(3,522)	(3,989)	(4,154)	(4,280)	(4,379)
Gross Profit	20.1	379.0	964.6	1,125	1,206	1,279	1,345
Gross Profit Margin	35.0%	39.5%	21.5%	22.0%	22.5%	23.0%	23.5%
EBITDA	15.1	331.0	650.5	772.3	841.6	906.1	967.3
EBITDA Margin	26.3%	34.5%	14.5%	15.1%	15.7%	16.3%	16.9%
Net Operating Profit	(16.4)	108.5	289.5	391.1	436.0	472.3	503.5
Net Operating Margin	-28.6%	11.3%	6.5%	7.6%	8.1%	8.5%	8.8%
Net Profit	228.0	239.7	346.9	437.0	489.4	539.3	587.1
Net Profit Margins	397.8%	25.0%	7.7%	8.5%	9.1%	9.7%	10.3%

Source: EFG-Hermes Estimates

IV. VALUATION

A. DCF Valuation

We have arrived at an estimated fair value of AED1.75 using a DCF framework

Given the nature of its longer term contracts, we believe it is appropriate to value Dana using a DCF framework. Based on our analysis, we arrive at an estimated Fair Value of AED1.75 per share.

Methodology

Given that Dana currently has net cash on its balance sheet, our WACC of 10.3% is equal to the company's cost of equity. The cost of equity has been derived from a risk free rate of 5.3% (equal to the 30 year US Treasury bond rate), and an equity risk premium of 5.0% (equal to that assumed for the UAE banking sector and 75bp more than for Taqa).

Our Terminal growth rate of 4.0% is driven by long-term demand expectations

Our perpetual growth rate of 4.0% is driven by our assumption that Dana will expand proportionate capacity and revenues in line with longer term demand of between 3% and 4% per annum, given expected growth rates for gas consumption in the region. This is higher than the 3% perpetual growth rate we have assumed for Taqa, which supplies electricity and water to Abu Dhabi. However, due to the lack of information available from Dana, our forecasts could change should the company choose to invest in additional sectors and/or other projects.

Table 4.1: Discounted Cash Flow (DCF)

(AED mn)	2006e	2007e	2008e	2009e	2010e	2011e	2012e
EBITDA	15	331	651	772	842	906	967
Change in Working Cap	(84)	(233)	(902)	(303)	(70)	(56)	(46)
Capex	(350)	(59)	(121)	(133)	(147)	(164)	(182)
Acquisitions	-	(1,350)	-	-	-	-	-
FCF	(419)	(1,310)	(372)	336	625	686	739
Discount Factor	0.9	0.8	0.7	0.7	0.6	0.6	0.5
Discounted FCF	(380)	(1,077)	(278)	227	383	381	372
Terminal value	11,729						
Perpetual Growth	4.0%						
WACC	10.3%						
PV of Cash Flows 2006-2011	(744)						
PV of Perpetuity	6,513						
Total Firm Value	5,769						
Estimated Net (Debt)/Cash	4,750						
Total Equity Value	10,519						
No. Shares	6,000						
Value/ Share Price (AED)	1.75						

Source: EFG-Hermes Estimates

Our assumption for Dana's future capital expenditure is equal to 0.6x depreciation, which is in line with other gas/energy companies across the region. Clearly, if Dana were to undertake a new project, or acquire an asset, this might have a significant impact on our DCF value.

Table 4.2: Sensitivity Analysis

		Perpetual Cost of Equity				
		9.3%	9.8%	10.3%	10.8%	11.3%
Terminal Growth	3.0%	1.81	1.70	1.60	1.52	1.45
	3.5%	1.91	1.78	1.67	1.58	1.50
	4.0%	2.02	1.88	1.75	1.65	1.55
	4.5%	2.16	2.00	1.85	1.72	1.62
	5.0%	2.35	2.13	1.96	1.81	1.69

Source: EFG-Hermes Estimates

Therefore, our DCF exercise suggests a fair value of AED1.75 per share, which is 3% lower than the current share price. With our assumption of a CAGR of 19.6% in earnings (from 2007 to 2012), our DCF valuation implies the following multiples; a 2008e P/E ratio of 30.3x and a 2008e P/B ratio of 1.4x.

B. Comparable Valuation

Dana Gas is the only listed private sector energy company in the region, as most other operators are either government-owned, or do not concentrate on all areas of the gas value chain. Most operators in the region either develop exploration and production capabilities, or provide transmission and distribution of natural gas, unlike Dana which has/or will soon have operations across the entire gas value chain.

We have looked at a number of gas and power companies from across the globe

Keeping this in mind, we have therefore selected what we deem to be an appropriate peer group. We have looked at a number of gas and power companies from across the globe. These companies are involved in various stages of the gas value chain, some having a greater expertise in exploration and production while others concentrate on transmission and distribution.

We have split the companies into geographical zones. While we are aware of the limitations of this method, all companies selected either produce and/or produce and distribute power/gas services to end users and, as such, are capital intensive and, for that reason, lend themselves well to comparison with Dana.

Table 4.3: Comparable Valuation Table

Company	Country	Currency	Price*	Market Cap (USD mn)	PE			P/BV			EV/ EBITDA		
					2006e	2007e	2008e	2006e	2007e	2008e	2006e	2007e	2008e
North America, Europe and Australia													
Transcanada	Canada	CAD	34.91	15,041	18.8	17.8	16.7	2.1	2.0	-	9.4	9.5	9.1
Santos Ltd	Australia	AUD	11.40	5,200	9.1	9.9	12.5	2.1	2.0	1.8	4.4	4.3	4.7
Williams Companies Inc	USA	USD	24.25	14,431	24.7	17.3	10.8	2.6	2.2	-	9.1	7.6	-
Repsol YPF SA	Spain	EUR	22.01	34,289	7.9	8.2	8.7	1.4	1.3	1.2	3.5	3.7	3.7
Average					15.1	13.3	12.2	2.1	1.9	1.5	6.6	6.3	5.8
South East Asia													
GAIL India LTD	India	INR	241.9	4,419	8.9	9.0	9.5	-	1.8	1.6	4.6	5.0	5.0
CNOOC	Hong Kong	HKD	6.80	38,322	9.6	10.6	10.6	3.0	2.6	2.2	5.3	5.8	5.6
Pakistan Petroleum	Pakistan	PKR	262.0	2,999	13.0	9.6	8.5	6.0	4.4	3.3	6.8	4.8	4.3
Pakistan Oilfields Ltd	Pakistan	PKR	372.5	1,226	11.8	8.2	-	4.9	3.6	2.8	-	-	-
Average					10.8	9.4	9.5	4.6	3.1	2.5	5.6	5.2	5.0
GCC													
Saudi Electricity	KSA	SAR	21.0	23,348	87.2	-	-	2.6	-	-	26.6	-	-
Taqa	UAE	AED	2.85	3,216	36.1	30.2	24.2	2.0	1.8	1.7	15.5**	14.6**	13.5**
Dana Gas	UAE	AED	1.80	2,936	47.4	45.1	31.1	1.6	1.5	1.4	N/A	63.1	33.8
Dana Gas (Implied by DCF)	UAE	AED	1.75	2,855	46.1	43.8	30.3	1.5	1.5	1.4	N/A	61.5	33.0
Average					43.2	39.7	28.5	1.7	1.6	1.5	21.1	46.4	26.8

*As at 01/08/2006

**EBITDA has been adjusted to take into account Taqa's minority interests

Sources: Reuters Knowledge and Bloomberg

On the basis of cash flow and earnings measures, Dana trades at the upper end of the global and emerging market peer group but trades more in line with its peers within the GCC. However, it is important to bear in mind that Dana does not look expensive on a price to book basis, the result of its relative youth.

Recommendation

With Dana aiming to be the region's leading gas operator across the whole gas value chain, we believe there is much for the company to go for in the medium term and therefore we expect positive news flow over the next few years. However, given a lack of guidance, and the uncertainty of new contracts and/or possible acquisitions or partnerships, we find it hard to be very positive on the stock at this stage of its development, and believe Dana Gas has yet much to prove. Furthermore, our DCF gives an estimated fair value which is slightly lower than the current share price, and coupled with current low returns and high valuations, we initiate coverage with a ST/LT Neutral recommendation.

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Financial Statements (December year end)

(AED mn)	20/11/05 31/03/06	2006e	2007e	2008e	2009e	2010e
Balance Sheet						
Cash & Liquid Assets	4,750	2,468	1,714	1,886	2,074	2,178
Accounts Receivable	2.0	10.1	52.6	245.8	420.4	440.6
Other Receivables	-	17.8	78.9	368.7	420.4	440.6
Net Accounts Receivable	2.0	27.9	131.4	614.6	840.7	881.1
Inventory	-	32.2	127.2	578.9	655.8	682.9
Prepaid Expenses	-	6.7	79.9	373.5	425.8	446.3
Revenues in Excess of Billings	-	-	-	-	-	-
Total Current Assets	4,752	2,534	2,053	3,453	3,997	4,188
Net Plant	786.0	1,289	4,125	4,350	4,597	4,969
Net Investments	-	-	-	-	-	-
Total Intangibles	3,140	3,140	3,690	3,530	3,370	3,210
Total Assets	8,678	6,963	9,868	11,333	11,963	-
Accounts Payable	45.0	25.5	63.6	386.0	437.2	455.2
Other Payables	-	-	-	-	-	-
Total Payables	45.0	25.5	63.6	386.0	437.2	455.2
Accrued Expenses and Provisions	3.0	20.9	28.0	43.0	35.5	11.9
Dividends Payable	-	-	-	-	-	-
Convertible Note	1,941	-	-	-	-	-
Total Current Liabilities	1,989	46.4	91.6	429.0	473	467.1
Loans	-	-	2,620	3,400	3,550	3,470
Total Provisions	-	-	-	-	-	-
Minority Interest	-	-	-	-	-	-
Other Liabilities	-	-	-	-	-	-
Total Liabilities & Provisions	1,989	46.4	2,712	3,829	4,023	3,937
Shareholders' Equity	6,689	6,917	7,157	7,504	7,941	8,430
Income Statement						
Revenues	-	57.3	959.5	4,486	5,114	5,360
COGS	-	(37.2)	(580.5)	(3,522)	(3,989)	(4,154)
Gross Profit	-	20.1	379.0	964.6	1,125	1,206
Gross Profit Margin	-	35.0%	39.5%	21.5%	22.0%	22.5%
SG and A	(5.0)	(5.0)	(48.0)	(314.0)	(352.9)	(364.5)
EBITDA	(5.0)	15.1	331.0	650.5	772.3	841.6
EBITDA Margin	-	26.3%	34.5%	14.5%	15.1%	15.7%
Depreciation	-	(31.4)	(97.6)	(201.0)	(221.1)	(245.6)
Amortization	-	-	(125.0)	(160.0)	(160.0)	(160.0)
Net Operating Profit	(5.0)	(16.4)	108.5	289.5	391.1	436.0
Net Interest Income/(Expense)	190.0	144.4	31.2	(30.4)	(40.0)	(34.1)
Non-Operating Income (Inc. Investments)	504.0	100.0	100.0	118.0	123.9	130.1
Minority Interest	-	-	-	-	-	-
Earnings Before Taxes	689.0	228.0	239.7	377.1	475.0	532.0
Income Taxes	-	-	-	(30.2)	(38.0)	(42.6)
NPAUI	689.0	228.0	239.7	346.9	437.0	489.4
Cash Flow Statement						
Net Operating Profit	689.0	228.0	239.7	346.9	437.0	489.4
Net Interest Income/(Expense) and Investments	(668.0)	(244.4)	(131.2)	(87.6)	(83.9)	(96.0)
Depreciation & Amortization	-	31.4	222.6	361.0	381.1	405.6
Change in Working Investment	(25.0)	(84.3)	(232.6)	(902.4)	(303.3)	(69.7)
Other Current Liabilities	(23.0)	0.3	0.3	0.4	0.4	0.4
Net Cash Flow from Operating Activities	(27.0)	(68.9)	98.7	(281.7)	431.3	729.8
CAPEX	(153.0)	(350.0)	(58.5)	(121)	(132.7)	(147.3)
Acquisitions	-	-	(1,350)	-	-	-
Investments	(3,887)	100.0	100.0	-	-	-
Net cash from Operating and Investing Activities	(4,067)	(318.9)	(1,210)	(402.3)	298.6	582.4
Non-operating Cash Flow	668.0	144.4	83.6	208.0	222.9	236.4
Cashflow before Financing	(3,399)	(174.6)	(1,126)	(194.3)	521.5	818.8
Dividends Paid	-	-	-	-	-	-
Net Financing	4,045	(1,923)	2,574	674.3	3.0	(244.4)
Change in Cash	646.0	(2,098)	1,448	480.0	524.6	574.4

Sources: Dana Gas and EFG-Hermes Estimates

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