03 February 2009

Initial Coverage

Aabar Investments PJSC

Rating: Outperform

Current Price	1.31	
AED/Share	Price	*Upside*
Bear-Case	1.69	*29%*
Base-Case	2.10	*60%*
Bull-Case	2.46	*88%*

Note: Current price as of previous close (Feb. 2)

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AL MAL CAPITAL

A "No-Brainer;" Initiating Coverage With Outperform

Initiating coverage with a "special situation" Outperform, AABAR could generate 29-60% upside by 11/30/2009. AABAR's compelling investment case has fallen under most investors' radar. Thus, we consider this report timely as we think AABAR is an interesting opportunity for investors looking for a favorable risk/reward profile in regional equities.

Buying AABAR makes sense, in our view. (1) Our **"bear-case"** scenario yields a fair value/share of AED1.69, which ascribes *no value* for AABAR's investments since Nov. 2008. (2) Indeed if we consider these investments at very heavy discounts to fair/market prices as we do in our **"base-case,"** we could envision AABAR trading up to AED2.10.

Risks to the AABAR story remain, but are overstated. With AABAR trading at 23% discount to even its "bear-case" fair value of AED1.69, investors seem to be factoring in significant risks. We outline the key risks and our arguments against them below:

Risk I: IPIC, slated to become the majority shareholder, could significantly modify the convertible terms hurting minority shareholders; we think this is highly unlikely. Investors could be concerned that IPIC or International Petroleum Investment Co. alters the terms as follows: (1) lowers the conversion price significantly from AED3 per share and/or (2) pushes out the conversion date beyond 11/30/2009. The most recent and significant modification of terms took place with Dubai Banking Group's convertible bonds in SHUAA. In that case, DBG's AED1.5bn bond was supposed to convert into a 32% stake in SHUAA at AED6/share by 10/31/2008, while SHUAA stock was trading at less than 50% of the conversion price at the time. As a result, DBG and SHUAA agreed to extend the date of conversion to 1-2 years beyond 10/31/2008 while leaving the conversion price unaltered at AED6/share (pending shareholder approval). Our analysis reveals that AABAR/IPIC scenario is markedly different from the SHUAA/DBG case: (1) Unlike DBG's investment in a 32% minority stake in a volatile financial services company (SHUAA stock is trading at AED1.10 currently), IPIC gains a controlling majority 71% stake in AABAR. (2) Unlike SHUAA, AABAR is financially sound having divested all its energy assets near the peak of the oil cycle and has yet to ask for any of the AED6.684bn cash underlying the IPIC converts. (3) Possible reputational hit for the ADX market, since substantially all of what IPIC will be converting into will consist of its own cash, the only reason to renegotiate terms would be to hurt the minority shareholders.

Risk II: IPIC may not have enough liquidity to fund AABAR; we disagree. Wholly owned by the government of Abu Dhabi, the UAE's largest and the world's 5th largest oil exporter with 5+ years of budget surpluses driven by booming oil prices, IPIC has the financial resources to go through with the conversion, in our view. An active dealmaker that frequently taps the capital markets (most recently, IPIC is in the process of placing a $1bn loan to fund its investment in Oil Search), any perceived weakness on the part of IPIC (and by extension the Abu Dhabi government) to complete the AABAR deal could have significant reputational/liquidity concerns. In our view, this is something that the Abu Dhabi government would never allow to happen.

Risk III: IPIC tenders to buy the remaining minority shares; this scenario still likely to yield upside to current price of AED1.31. IPIC could, in theory, tender to buy up the 29% stake of the minority shareholders instead of converting the bonds to equity at AED3/share. While this makes financial sense for IPIC, it could still lead to reputational/liquidity concerns we mentioned in risk II. Furthermore, it is our understanding that AABAR is a public investment vehicle for IPIC into non-energy assets. Therefore, to privatize AABAR makes little sense, in our view. However, we think even a tender for minority shares should yield some upside versus current market price.

Net-net, we rate AABAR shares a "special situation" Outperform. With the most likely scenario being IPIC converting its bonds at AED3/share by end-Nov., AABAR presents a compelling investment opportunity. Risks not outlined above, such as IPIC offloading its energy investments into AABAR at terms detrimental to minority shareholders after the convertible bonds are converted into equity, do nothing to derail our investment thesis. *We recommend investors buy AABAR below AED1.69 and sell it above AED2.10. We will revisit our thesis post the IPIC bond conversion on 11/30/2009.*

Initiating with an Outperform

Initiating coverage with a "special situation" Outperform, AABAR could generate 29-60% upside by 11/30/2009. AABAR's compelling investment case has fallen under most investors' radar. Thus, we consider this report timely as we think AABAR is an interesting opportunity for investors looking for a favorable risk/reward profile in regional equities.

Company Description

Having sold its energy assets near the peak of the oil cycle, AABAR is a diversified investment company presently. Aabar Investments, formerly known as Aabar Energy, went public in July-2005, and trades on the Abu Dhabi Stock Exchange (ADX). The company sold off all its energy assets, including Dalma to GulfCap on 12/17/2007 and Pearl to Mubadala on 5/20/2008. AABAR recorded gains of AED298mm on sale of the Dalma assets and AED692mm on sale of the Pearl assets. The Pearl divestiture was especially fortuitous in hindsight, as it took place near the peak of oil prices.

The IPIC Investment Marks a New Chapter in the AABAR Story. On 9/24/2008, IPIC entered into an agreement with AABAR to purchase ***mandatorily*** convertible bonds set to convert into 2.228mm common shares at AED3/share on or before 11/30/2009. The bonds are ***not redeemable for cash*** and after conversion will give IPIC a 71% stake in AABAR. The first tranche of payment for the bonds was due on or before 10/30/2008. However, AABAR so far has not asked for any payments from IPIC given the company had AED2.3bn in cash (as of 3Q2008) which it has used, along with some debt (AED1.8bn cash/AED1.1bn debt), to fund three acquisitions since late November 2008. We believe AABAR used debt instead of asking for cash from IPIC given the relatively expensive cost of carry (3-month EIBOR+1.95bps) for IPIC funds.

Figure 1. Recent Acquisitions Have Significantly Altered AABAR's Profile

Date	Details	Type of Business Acquired	AEDmm Cash Paid	AEDmm Debt Used or Assumed	AEDmm Total Price
12/30/2008	Acquires through its 100%-controlled subsidiary Sopela Beteiligungsverwaltungs GmbH a 3.3% equity stake in publically-traded (Milan stock exchange) Atlantia S.p.A. from UniCredit; price paid is €250mm (€80mm cash/€170mm bank loan)	Atlantia is the sole owner of Autostrade per l'Italia, Italy's largest toll motorway builder and operator	377.32	801.80	1179.12
12/1/2008	Announces acquisition of AIG Private Bank Ltd. for $254mm in cash and $83mm in assumed debt	AIG Private Bank is a wealth management firm catering to high net worth individuals; based in Switzerland, the firm has offices in Hong Kong, Shanghai, Singapore and Dubai; also owns a 42.5% stake in bank zweiplus ag, a leading Swiss investment and retirement savings bank; total dient assets (end-2007) is $18.5bn	933.45	305.03	1238.48
11/23/2008	Agrees to purchase from Tasameem Real Estate 2 residential land plots in the Al Raha development area in Abu Dhabi for AED500,876,100; Aabar eventually plans to develop up to 4 residential towers on the tracts	Real estate development	500.88	0.00	500.88

Source: Company reports, Al Mal Capital

Valuation

Our analysis reveals AABAR could generate 29-60% returns in the near-term. (1) Our "bear-case" scenario yields a fair value/share of AED1.69, which ascribes *no value* for AABAR's investments since Nov. 2008. (2) Indeed if we consider these investments at very heavy discounts to fair/market prices as we do in our "base-case," we could envision AABAR trading up to AED2.10. (3) We have also included a "bull-case" which provides investors with a flavor of how much AABAR shares could be worth (AED2.46) if the overall market returns to any semblance of normalcy. Note we used a WACC (essentially cost of equity as we assume cash net of all debt) of 16.8% made up of a 7% risk free rate, a 7% risk premium and a beta of 1.4.

Figure 2. Our Bear-Case Valuation Reveals a Fair Price of AED1.69 for AABAR Shares

Bear Case Scenario

	AEDmm		
	Cost	Assumed Value	Comments
Al Raha Real Estate Purchase	500.88	0	We assume no value for acquired land in Abu Dhabi
Acquisition of AIG Private Bank	1238.48	0	We assume no value for AIG's wealth management business
Purchase of 3.3% stake in Atlantia	1179.12	0	We assume no value for acquired stake in a publically traded company
Total Value of Acquisitions		0	
Estimated Net Cash		6018.46	Cash net of all debt plus estimated proceeds of AED6.684bn from IPIC converts
Estimated Firm Value		6018.46	
Estimated Shares O/S (mm)		3128.00	900mm existing shares plus 2.228bn shares from IPIC converts
Estimated Price per Share (AED)		**1.92**	
Present Value per Share @ WACC of 16.8% (AED)		**1.69**	

Source: Company reports, Al Mal Capital

Figure 3. Our Base-Case Valuation Reveals a Fair Price of AED2.10 for AABAR Shares

Base Case Scenario

	AEDmm		
	Cost	Assumed Value	Comments
Al Raha Real Estate Purchase	500.88	250.44	We assume 50% haircut on cost of acquired land given uncertainty in the UAE real estate market
Acquisition of AIG Private Bank	1238.48	619.24	We assume 50% haircut on cost of acquired asset assuming significant hit to AIG's wealth management business given AIG's reputational concerns and high net-worth clients closing/retracting accounts considering volatile equity/debt markets
Purchase of 3.3% stake in Atlantia	1179.12	589.56	We assume 50% haircut on value of a publically traded stock given volatile equity markets
Total Value of Acquisitions		1459.24	
Estimated Net Cash		6018.46	Cash net of all debt plus estimated proceeds of AED6.684bn from IPIC converts
Estimated Firm Value		7477.70	
Estimated Shares O/S (mm)		3128.00	900mm existing shares plus 2.228bn shares from IPIC converts
Estimated Price per Share (AED)		**2.39**	
Present Value per Share @ WACC of 16.8% (AED)		**2.10**	

Source: Company reports, Al Mal Capital

Figure 4. Our Bull-Case Valuation Reveals a Fair Price of AED2.46 for AABAR Shares

	AEDmm		
	Cost	Assumed Value	Comments
Al Raha Real Estate Purchase	500.88	500.88	We value the land acquisition at cost
Acquisition of AIG Private Bank	1238.48	1238.48	We value AIG's wealth management business acquisition at cost
Purchase of 3.3% stake in Atlantia	1179.12	996.23	We value the stake at market price of Atlantia stock
Total Value of Acquisitions		2735.58	
Estimated Net Cash		6018.46	Cash net of all debt plus estimated proceeds of AED6.684bn from IPIC converts
Estimated Firm Value		8754.04	
Estimated Shares O/S (mm)		3128.00	900mm existing shares plus 2.228bn shares from IPIC converts
Estimated Price per Share (AED)		**2.80**	
Present Value per Share @ WACC of 16.8% (AED)		**2.46**	

Source: Company reports, Al Mal Capital

Appendix: Supporting Calculations

Figure 5. Sources and Uses of Cash

Date	Sources	AEDmm	AEDmm	Uses	Date
9/30/2008	Cash	2285.56	500.88	Al Raha Real Estate Purchase	11/23/2008
11/30/2009	Proceeds from Conversion of Convertible Bonds	6684.00	933.45	Acquisition of AIG Private Bank	12/1/2008
11/30/2009	Interest Income	26.30	377.32	Purchase of 3.3% stake in Atlantia	12/30/2008
			58.92	Interest Expense	11/30/2009
11/30/2009		**8995.86**	**1870.57**		**11/30/2009**

Notes: 1) Does not assume any disbursements from IPIC until 11/30/2009
2) For details on interest income/interest expense calculations see detailed tables

Source: Company reports, Al Mal Capital

Figure 6. Net Cash per Share Computation Under Bear-Case Scenario

Date	Details	AEDmm
9/30/2008	Beg. Cash	2285.56
11/30/2009	Change	-1844.27
11/30/2009	Convertible Bonds	6684.00
11/30/2009	End. Cash Balance	7125.29
11/30/2009	Debt	1106.83
11/30/2009	Net End. Cash	6018.46
11/30/2009	Shares O/S (mm)	3128.00
11/30/2009	Net Cash/Share (AED)	1.92

Source: Company reports, Al Mal Capital

Figure 7. Interest Income/Expense Calculations

Interest Income Details	Amount (AEDmm)
Cash (9/30/2008)	2285.56
Cash Used for Acquisitions	1811.65
Net Cash	473.91
Interest Earned (1/1/2009-11/30/2009) @ 6% pa	**26.30**

Note: Does not assume any disbursements from IPIC until 11/30/2009

Interest Expense Details	Amount (AEDmm)
Interest Expense on AIG Debt (12/1/2008-11/30/2009)	17.23
Interest Expense on Atlantia Debt (12/30/2008-11/30/2009)	41.69
Total Interest Expense	**58.92**

Note: Simplifying assumption is that Interest Paid is 3 Month-EIBOR Plus 1.95% , the Maximum Rate Beyond Which Borroning From IPIC Becomes Cost Effective

Source: Company reports, Al Mal Capital

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