

Air Arabia

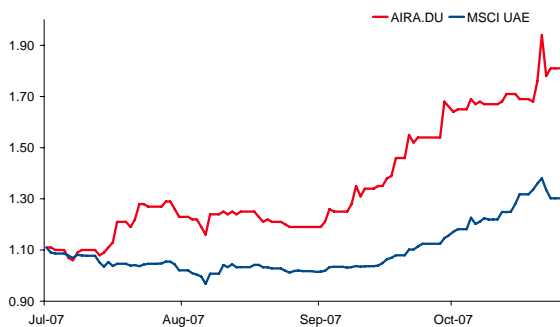
A Quarter to Remember

Key Data

Current Price*	Avg. Value Traded per Day
AED 1.81	AED 169.5 mln
52-Week High	Market Cap
AED 1.94	AED 8.45 bln
52-Week Low	Current Number of Shares
AED 1.00	4,666.7 mln
Reuters	Bloomberg
AIRA.DU	AIRARABI.UH
Ownership Structure	
Privately Held: 45%	Public: 55%

Sources: Reuters, Zawya, and NBK Capital
*Price as of close on November 11, 2007

Rebased Performance



Sources: MSCI, Reuters, and NBK Capital

Key Ratios

	2007 f	2008 f	2009 f	2010 f	2011 f
P/E	20.6	14.5	12.2	11.3	10.7
EPS Growth	n.a.	42%	19%	8%	5%
EV/ EBITDAR	19.3	13.2	10.5	8.4	7.5
EBITDAR Margin	33%	33%	32%	32%	31%
EBITDAR Growth	122%	46%	26%	25%	11%
Dividend Yield	0.6%	1.7%	2.0%	2.2%	2.3%
PBV	1.6	1.5	1.3	1.2	1.1
ROAE	13%	10%	10%	10%	10%
3Q2007 EBITDAR a	4Q2007 EBITDAR f				
AED 153.0 mln	AED 81.0 mln				
3Q2007 EBITDAR f	1Q2008 EBITDAR f				
AED 92.0 mln	AED 120.0 mln				

Sources: Reuters and NBK Capital
a = actual, f = forecast

Analyst

Samir Murad, CFA
Direct: +965 - 2595145
samir.murad@nbkcapital.com

Highlights

12-Month Fair Value: AED 1.76

Recommendation: Hold – Risk Level: 4**

Reason for Report: Third-Quarter 2007 Update

- Air Arabia's performance in 3Q2007 was outstanding. Yield increased by 12% compared with 2Q2006, and load factor reached 92%. Also, Air Arabia's EBITDAR margin reached 42% in 3Q2007, a margin most airlines in the world do not even dream of achieving. Net income for 3Q2007 was AED 165 million, which is 146% higher than 2Q2007.
- The financial results posted by Air Arabia in 3Q2007 exceeded our expectations, which led us to revise our forecasts. In our previous forecast we were expecting operating costs to be close to 88% of revenue, much higher than the 75% achieved in 9M2007 so far. We revised the cost structure for 2007 and put operating costs closer to 80% of revenue, based on management's guidance.
- The revised forecasts for Air Arabia led to an increase in our 12-month fair value estimate for the share price of Air Arabia from AED 1.53 to AED 1.76. To arrive at this fair value estimate, we used a combination of discounted cash flow (DCF) and peer comparison based on forward price/earnings-to-growth (PEG) multiples.
- We are anticipating an announcement by Air Arabia regarding a purchase order for new aircraft. The company is expected to sign a deal with either Airbus or Boeing to purchase 34 A320's or 737's with an option for 15 more.
- Air Arabia announced that its second hub will be based in Morocco, where it signed a management contract with Regional Air Lines to apply a low-cost carrier operating model. Management intends to operate a third hub; however, there are currently no indications as to where that may be. The vast distance between Sharjah and Rabat makes the selection of a hub in the Levant region a probable choice, as this would link all the hubs.
- This report is an update. Readers are advised to read this report in conjunction with our initiation of coverage report published on October 16, 2007.

**Please refer to page 4 for recommendations and risk ratings

VALUATION

The financial results posted by Air Arabia in the third quarter of 2007 exceeded our expectations and those of the market in general—as evident from the spike in the share price following the earnings release. The 3Q2007 results are exceptional and the only reason they are not better is the fact that Air Arabia only had nine aircraft during that period.

We have revised our forecasts for Air Arabia over the short-term. Due to this change, our 12-month fair value estimate for the share price of Air Arabia increased 15.6% from our previous estimate to AED 1.76. This change was driven primarily by a 31% increase in the fair value using the peer comparison method based on forward PEG multiples; which was primarily a result of a 27% increase in our forecast of Air Arabia earnings per share (EPS) for 2008. On the other hand, the value derived from our discounted cash flow (DCF) model increased by 6.5%, mainly due to lowering the cost of equity from 13% to 12.7% to reflect recent changes in the risk-free rate. Since our fair value estimate is 2.8% lower than Air Arabia's latest share price, our new recommendation for Air Arabia's stock is "Hold."

*Our 12-month fair
value for Air Arabia is
AED 1.76*

Figure 1 Fair Value per Share

Valuation Method	Old		New		Change
	Weight	Value	Weight	Value	
Discounted cash flow	70%	AED 1.37	70%	AED 1.46	6.5%
Peer comparison	30%	AED 1.89	30%	AED 2.48	31.0%
Weighted average fair value	100%	AED 1.53	100%	AED 1.76	15.6%

Source: NBK Capital

THIRD-QUARTER PERFORMANCE

- Air Arabia's performance in 3Q2007 was outstanding as the airline was able to register a load factor of 92%, a figure that reflects the high demand for Air Arabia's services. This extremely high load factor was not achieved through lowering prices; on the contrary, the yield (revenue per RPK) for 3Q2007 was 12% higher than in 2Q2007. Management attributed this high demand for Air Arabia's services to people liking the airline's reliability and punctuality.
- Better yields and high load factor made the operating performance in 3Q2007 better than the performance in 2Q2007. This is reflected by the EBITDAR (earnings before interest, taxes, depreciation, amortization, and rent) of AED 153 million recorded in 3Q2007, which is 63% higher than the EBITDAR for 2Q2007. This exceptional performance can be seen on the margin level as well, thus proving that this growth is due to the combined effect of improved efficiency and increased output. EBITDAR margin for 3Q2007 was 42%, a figure that is much higher than industry norms of 15% to 25% for low-cost carriers.

- The number of passengers flying Air Arabia has increased significantly in 2007. Two million passengers flew Air Arabia during the first nine months of 2007; some 300 thousand passengers more than during 2006. These improved figures are a result of the increase in the average number of aircraft for the year and an increase in the load factor.

Figure 2 Third-Quarter Performance

3Q2007 earnings were better than the full year earnings of 2006

	2006	1Q2007	2Q2007	3Q2007	9M2007
Average Aircraft	6.0	8.4	9.0	9.0	8.9
Passengers (Millions)	1.7	0.6	0.6	0.7	2.0
RPK (Billions)	3.7	1.1	1.1	1.3	3.6
ASK (Billions)	4.7	1.3	1.4	1.5	4.1
Load factor	80%	84%	82%	92%	86%
Revenue (AED Millions)	749	246	275	369	889
Yield (AED)	0.20	0.22	0.25	0.28	0.25
EBITDAR margin	25%	28%	34%	42%	36%
Net income (AED Millions)	101	48	67	165	280
Net income margin	13%	20%	24%	45%	31%

Source: Air Arabia and NBK Capital

OUTLOOK

Air Arabia 3Q2007 performance exceeded our expectations, and as such we revised our forecasts over the short-term. Figure 3 presents a summary of our new forecasts for FY2007 compared with our previous estimates. While there is just a minor change in revenues, we significantly improved operating margins. Below is a summary of some of the most important changes we made to our estimates:

- Revenues remain almost the same, since in our previous estimates we had overestimated output in terms of ASK, and underestimated the load factor. When we revised these figures, their effect was almost cancelled out. Our new forecast for output in 2007 is 5.7 billion ASK's and we are expecting a load factor of 88%.
- The most important change made to our forecast comes at the operating cost level. Our previous estimates placed operating costs close to 88% of revenue; however, Air Arabia's performance in 9M2007 puts this figure at 75%. According to Air Arabia's management, performance in 4Q2007 will be weaker than in 3Q2007, as the fourth quarter is generally slower. Management expects operating costs to be around 80% of revenue for the whole year, and we followed their guidance for the revised figures.
- Another significant change made to our forecast for FY2007 was the increase in interest income. Air Arabia earned AED 44 million in interest income in 3Q2007 and we expect that the company will earn a similar amount in 4Q2007.

Figure 3 New vs. Old Forecasts for FY2007

The changed forecast reflects an increase in the gross profit margin

Income Statement (AED Thousands)	2007 Forecast		
	Old	New	Change
Total Revenue	1,261,377	1,231,748	-2.3%
Cost of Revenue	1,013,549	886,518	-12.5%
Gross Profit	247,828	345,231	39.3%
Selling/General/Admin. Expenses	64,071	63,366	-1.1%
Depreciation/Amortization	32,652	32,714	0.2%
Operating Income	151,105	249,151	64.9%
Interest Income (Exp), Net Non-Operating	68,017	95,955	41.1%
Other, Net	31,894	34,911	9.5%
Net Income	251,016	380,017	51.4%

Source: NBK Capital

ANNOUNCEMENT OF A SECOND HUB

On November 8, 2007 Air Arabia announced it will establish a second hub in Rabat, Morocco. Air Arabia signed a management contract with Regional Air Lines, a private carrier in Morocco, whereby Air Arabia will apply the low-cost carrier operating model. Air Arabia also stated (without providing any further details) that it, along with Ithmaar Bank, will make capital investments into Regional Air Lines. The new hub will operate routes to Southern Europe, North Africa, and some areas in the Middle East.

We were surprised by the selection of Morocco as the location of the second hub, due to the vast distance between the UAE and Morocco. From what we have learned so far about the deal, we expect that the new hub will be operated almost in isolation from the Sharjah hub. Air Arabia will create value by making use of its knowledge and experience to apply the operating model of a low-cost carrier in Rabat. Also, management has hinted that it intends to open a third hub, but it did not give any indication as to where. The distance between Sharjah and Rabat makes the Levant region a probable choice, as it will act as a connecting point between the hubs.

In our forecasts we assume that the operations of the second hub will be owned by Air Arabia; however, the announced deal says that it will be a management contract. Given that there is not enough information relating how the management contract will be implemented, we opted not to alter our forecasts until further details are made public.

Risk and Recommendation Guide

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

*1 being least risky

FINANCIAL STATEMENTS

Balance Sheet (AED Thousands)				Forecast					
Fiscal Year Ends December	2004	2005	2006	2007	2008	2009	2010	2011	2012
ASSETS									
Cash and Short-Term Investments	47,642	99,560	182,156	3,604,248	3,827,446	4,253,654	4,739,330	4,444,749	3,227,979
Total Receivables, Net	15,516	35,841	74,760	122,668	177,338	226,486	284,983	325,962	382,990
Total Current Assets	63,158	135,402	256,916	3,726,916	4,004,784	4,480,140	5,024,314	4,770,711	3,610,969
Property/Plant/Equipment, Total - Net	2,724	4,118	40,300	138,300	367,300	455,300	533,300	1,395,300	3,041,300
Goodwill, Net	-	-	-	1,320,860	1,320,860	1,320,860	1,320,860	1,320,860	1,320,860
Long Term Investments	16,601	34,136	27,168	27,803	28,577	29,504	30,598	31,876	33,358
Other Long-Term Assets, Total	12,159	21,058	43,148	69,973	108,034	153,973	204,937	257,268	306,485
TOTAL ASSETS	94,642	194,715	367,531	5,283,853	5,829,555	6,439,777	7,114,009	7,776,015	8,312,971
LIABILITIES & EQUITY									
Accounts Payable	28,527	59,754	118,368	184,903	270,194	350,294	445,243	518,946	617,989
Other Current Liabilities, Total	15,345	41,721	65,449	122,236	176,862	225,964	284,408	325,329	382,294
Total Current Liabilities	43,872	101,475	183,817	307,139	447,057	576,258	729,651	844,275	1,000,282
Long-Term Debt	-	-	-	-	-	-	-	-	-
Other Liabilities, Total	12,323	10,765	9,751	-	-	-	-	-	-
Total Liabilities	56,196	112,240	193,568	307,139	447,057	576,258	729,651	844,275	1,000,282
Total Equity	38,446	82,475	173,964	4,976,714	5,382,498	5,863,520	6,384,357	6,931,741	7,312,689
TOTAL LIABILITIES AND EQUITY	94,642	194,715	367,531	5,283,853	5,829,555	6,439,777	7,114,009	7,776,015	8,312,971
Income Statement (AED Thousands)				Forecast					
Fiscal Year Ends December	2004	2005	2006	2007	2008	2009	2010	2011	2012
Total Revenue	181,308	411,181	749,165	1,231,748	1,786,443	2,287,328	2,884,724	3,306,829	3,889,947
Cost of Revenue	156,674	358,865	615,667	886,518	1,306,667	1,695,442	2,158,988	2,515,955	2,998,796
Gross Profit	24,634	52,316	133,498	345,231	479,776	591,886	725,736	790,873	891,151
Selling/General/Admin. Expenses	24,589	36,154	51,267	63,366	80,562	96,966	116,220	128,610	144,863
Depreciation/Amortization	1,805	3,567	6,353	32,714	46,231	65,013	83,108	101,369	120,258
Operating Income	(1,760)	12,595	75,877	249,151	352,983	429,907	526,409	560,895	626,030
Interest Income (Exp), Net Non-Operating	203	(45)	1,283	95,955	139,579	149,401	164,344	165,107	131,864
Other, Net	1,127	18,759	23,985	34,911	48,484	62,055	3,698	3,843	4,002
Net Income	(430)	31,309	101,145	380,017	541,046	641,362	694,450	729,844	761,896



NBK Capital

Kuwait

Head Office

17th Floor, Dar Al-Awadi Building
Ahmed Al-Jaber Street, Sharq
P.O. Box 4950, Safat 13050
Kuwait
Tel: +965 224 6900
Fax: +965 224 6904

International Network

United Arab Emirates

NBK Capital Limited

Precinct Building 3, Office 404
Dubai International Financial Center
P.O. Box 506506, Dubai
United Arab Emirates
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Turkey

NBK Capital

Arastima ve Musavirlik AS
SUN Plaza, 30th Floor
Dereboyu Sk. No.24
Maslak 34398, Istanbul, Turkey
Tel: +90 212 276 5400
Fax: +90 212 276 5401

MENA Equity Research

Tel: +965 224 6663
Fax: +965 224 6984
E-mail: menaresearch@nbkcapital.com

Disclaimer

This document and its contents are prepared for your personal information purposes only and are not an offer, or the solicitation of an offer, to buy or sell a security or enter into any other agreement. Projections of potential risk or return are illustrative and should not be taken as limitations of the maximum possible loss or gain. The information and any views expressed are given as at the date of writing and subject to change. While the information has been obtained from sources believed to be reliable, we do not represent that it is accurate or complete, and it should not be relied on as such. NBK Capital, and its affiliates and subsidiaries, accept no liability for any direct or consequential loss arising from use of this document or its contents. At any time, NBK Capital or its employees may have a position, subject to change, in any securities or instruments referred to, or provide services to the issuer of those securities or instruments.

www.nbkcapital.com

NBK

Kuwait

National Bank of Kuwait SAK

Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 242 2011
Fax: +965 243 1888
Telex: 22043-22451 NATBANK

International Network

Bahrain

National Bank of Kuwait SAK

Bahrain Branch
Seef Tower, Al-Seef District 428
P.O. Box 5290, Manama
Bahrain
Tel: +973 17 583 333
Fax: +973 17 587 111

Jordan

National Bank of Kuwait SAK

Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297
Shmeisani, Amman 11194
Jordan
Tel: +962 6 560 8800
Fax: +962 6 560 8811

Saudi Arabia

National Bank of Kuwait SAK

Jeddah Branch
Al-Andalus Street, Red Sea Plaza
P.O. Box 15385
Jeddah 21444, Saudi Arabia
Tel: +966 2 653 8600
Fax: +966 2 653 8653

Lebanon

National Bank of Kuwait

(Lebanon) SAL
BAC Building
Justinian Street, Sanayeh
P.O. Box 11-5727, Riyad El Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 741111/742222
Fax: +961 1 747846/747866

Iraq

Credit Bank of Iraq

Street 9, Building 178
Sadoon Street, District 102
P.O. Box 3420
Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

United States of America

National Bank of Kuwait SAK

New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom

National Bank of Kuwait

(International) Plc

Head Office

13 George Street
London W1U 3QJ, UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait

(International) Plc

Portman Square Branch

7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

NBK Investment

Management Limited

13 George Street
London W1U 3QJ, UK
Tel: +44 20 7224 2288
Fax: +44 20 7224 2102

France

National Bank of Kuwait

(International) Plc

Paris Branch

90 Avenue des Champs-Elysees
75008 Paris, France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore

National Bank of Kuwait SAK

Singapore Branch

9 Raffles Place #51-01/02
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

Vietnam

National Bank of Kuwait SAK

Vietnam Representative Office

Room 2006, Sun Wah Tower
115 Nguyen Hue Blvd, District 1
Ho Chi Minh City
Vietnam
Tel: +84 8 827 8008
Fax: +84 8 827 8009

China

National Bank of Kuwait SAK

Shanghai Representative Office

Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120
China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

Associates

Qatar

International Bank of Qatar (QSC)

Suhaim bin Hamad Street
P.O. Box 2001
Doha, Qatar
Tel: +974 447 3700
Fax: +974 447 3710