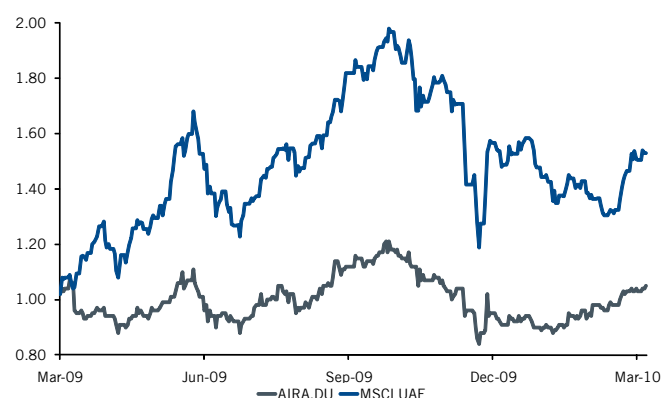


### KEY DATA

<b>Current Price*</b>	<b>Avg. Value Traded per Day</b>
AED 1.05	AED 29.4 million
<b>52-Week High</b>	<b>Market Cap</b>
AED 1.21	AED 4.9 billion
<b>52-Week Low</b>	<b>Current Number of Shares</b>
AED 0.84	4,666.7 million
<b>Reuters</b>	<b>Bloomberg</b>
AIRA.DU	AIRARABI UH
<b>Ownership Structure</b>	
Privately Held: 32.5%	Public: 67.5%

Sources: Reuters, Zawya, and NBK Capital \*Price as of close on March 23, 2010

### REBASED PERFORMANCE



Sources: MSCI, Reuters, and NBK Capital

### KEY RATIOS

	2009 a	2010 f	2011 f	2012 f	2013 f
P/E	10.8	10.8	11.2	12.7	10.1
EPS Growth	-11%	1%	-4%	-11%	25%
EV/ EBITDAR	6.3	5.5	5.1	4.6	4.5
EBITDAR Margin	27%	26%	25%	25%	24%
EBITDAR Growth	3%	13%	9%	10%	3%
Dividend Yield	9.5%	1.9%	1.8%	1.6%	2.0%
ROAE	8%	8%	8%	6%	8%

<b>FY2009 EBITDAR a</b>	<b>1Q2010 EBITDAR f</b>
AED 539 million	AED 120 million
<b>FY2009 EBITDAR f</b>	<b>2Q2010 EBITDAR f</b>
AED 603 million	AED 134 million

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

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### HIGHLIGHTS

**12-Month Fair Value: AED 1.15**

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

**Reason for Report: FY2009 Update**

- In 2009, Air Arabia started expanding in the Middle East and North Africa (MENA) region by establishing a new operation in Morocco (Air Arabia Maroc) and laying the groundwork for another operation in Alexandria, Egypt. Due to legal restrictions and the lack of open skies in the MENA region, Air Arabia does not have controlling stakes in the hubs. The company is responsible for managing these newly established airlines; however, they are accounted for using the equity method and are not consolidated.
- Very little information is available on Air Arabia's operations in Morocco and Egypt. The Egyptian unit is expected to start commercial activity in April 2010, while the Moroccan unit has been operating since 2Q2009. In this update, we have attempted to reflect the effect of the new operations on the value of Air Arabia. Our new valuation for Air Arabia examines the company from the perspective of the three hubs.
- The Moroccan joint venture, which serves 12 destinations in Europe, had a negative impact on the company's FY2009 financial statements due to startup costs. Air Arabia has not disclosed any detailed figures with regard to the Moroccan hub, which prevents us from analyzing the performance of this base. Air Arabia Maroc has attained load factors in the mid-70s, but the unit's performance has exhibited some strong seasonality.
- Air Arabia's total revenue declined by 5% year-on-year to AED 2 billion in FY2009, due to a 20% drop in yield and a 500-basis-points decline in load factor. However, the airline's EBITDAR margin increased from 25.3% in FY2008 to 27.3% in FY2009 due to lower fuel costs. Net income declined by 11% to AED 452.2 million in FY2009 compared to FY2008, and 5.5% below our forecast of AED 478.1 million.
- Though the Middle East region is expected to witness an economic recovery in 2010/2011, we expect that Air Arabia could continue to see pressure on yield as a result of competition. We are concerned about the excess capacity stemming from the legacy carriers.
- Our new 12-month fair value estimate for Air Arabia's share price is AED 1.15, which is 10% higher than the latest close. Our new recommendation for the stock is "Accumulate."

\*\*\* Please refer to page 8 for recommendations and risk ratings.

## VALUATION

### A New Approach

In 2009, Air Arabia started expanding in the MENA region as the company established a new operation in Morocco (Air Arabia Maroc) and laid the groundwork for another operation in Alexandria, Egypt. Legal restrictions and the lack of open skies in the MENA region meant that Air Arabia's involvement in these new operations will be different from that of the company's Sharjah operation. Accordingly, the setup of these new operations resembles that of a franchising agreement. Air Arabia does not have a controlling stake in these hubs; however, the company is responsible for managing these newly established airlines. Moreover, Air Arabia uses the equity method of accounting for these two new operations.

Very little information is available on Air Arabia's operations in Morocco and Egypt. The Egyptian unit is expected to start commercial activity in April, while the Moroccan unit has been operating since 2Q2009. In this update, we have attempted to reflect the effect of the new operations on the value of Air Arabia. We previously assumed that all the aircraft that Air Arabia had a confirmed order for will be operated out of Sharjah. Our new valuation for Air Arabia examines the company from the perspective of the three operations, each of which will be an airline operating around 20 to 25 aircraft at maturity.

Our new 12-month fair value estimate for Air Arabia's share price is AED 1.15, which is 12% lower than our previous estimate. This change was driven primarily by a 22% drop in the fair value derived from the valuation based on price-to-earnings (PEG) multiples, as the valuation based on our discounted cash flow (DCF) model saw a 10% decline. Given that our fair value estimate is 10% above the latest market price, our recommendation for Air Arabia is "Accumulate<sup>1</sup>."

Figure 1 Fair Value per Share <sup>1</sup>

Our 12-month fair value for Air Arabia is AED 1.15

Valuation Method	Old		New		Change
	Weight	Value	Weight	Value	
Discounted cash flow	70%	AED 1.35	70%	AED 1.20	-11%
Peer comparison	30%	AED 1.33	30%	AED 0.96	-28%
<b>Weighted average fair value</b>	<b>100%</b>	<b>AED 1.30</b>	<b>100%</b>	<b>AED 1.15</b>	<b>-12%</b>

Source: NBK Capital

### Moroccan Hub Update: Not Enough Disclosure, but Management Seems Pleased with Current Progress

We have very little information on the performance of the Moroccan hub (Air Arabia Maroc), which started operations in 2Q2009. Air Arabia uses the equity method to account for the company's 29% stake in the Moroccan joint venture (JV), which had a negative impact on the company's FY2009 financial statements due to startup costs. The airline has not disclosed any detailed figures with regard to Air Arabia Maroc, which prevents us from analyzing the performance of this subsidiary. Management indicated that the Moroccan JV is still establishing itself, yet the company is pleased with the progress that has so far been achieved. Air Arabia Maroc has attained load factors in the mid-70s, but the performance has exhibited some strong seasonality. The challenge facing the Moroccan JV is developing the out-of-season business, due to a very seasonal market centered on summertime.

<sup>1</sup> Our recommendation does not take into account the AED 0.10 dividend per share, for which the stock goes Ex-div on March 31, 2010.

Currently, Air Arabia Maroc flies to 12 destinations in Europe that have large communities of Moroccan expatriates. The target customer base of the Moroccan JV are passengers traveling from Morocco, which makes the airline more focused on outgoing traffic rather than incoming traffic. This puts the airline in direct competition with Royal Air Maroc, rather than with the European low-cost carriers (LCCs). Given that Turkey has a substantial Moroccan community, the airline was quick to introduce a route to Istanbul. Management has been very pleased with the take-up rates on this destination, though it is a relatively long route for a Moroccan-based LCC. Since the airline currently travels to European destinations only, aircraft utilization has been lower than that of Sharjah due to restrictions on nighttime travel. Management is attempting to gain access to Africa as this would help improve the fleet utilization.

The hub in Morocco currently has three aircraft in the fleet, all of which have been leased from Air Arabia. This appears to be the strategy that will be adopted for aircraft financing for the hubs, where Air Arabia would acquire or lease aircraft and then in turn lease to the hubs. Management has emphasized that the subleasing will be done at market rates, and hence, Air Arabia will not realize any material gains from this transaction.

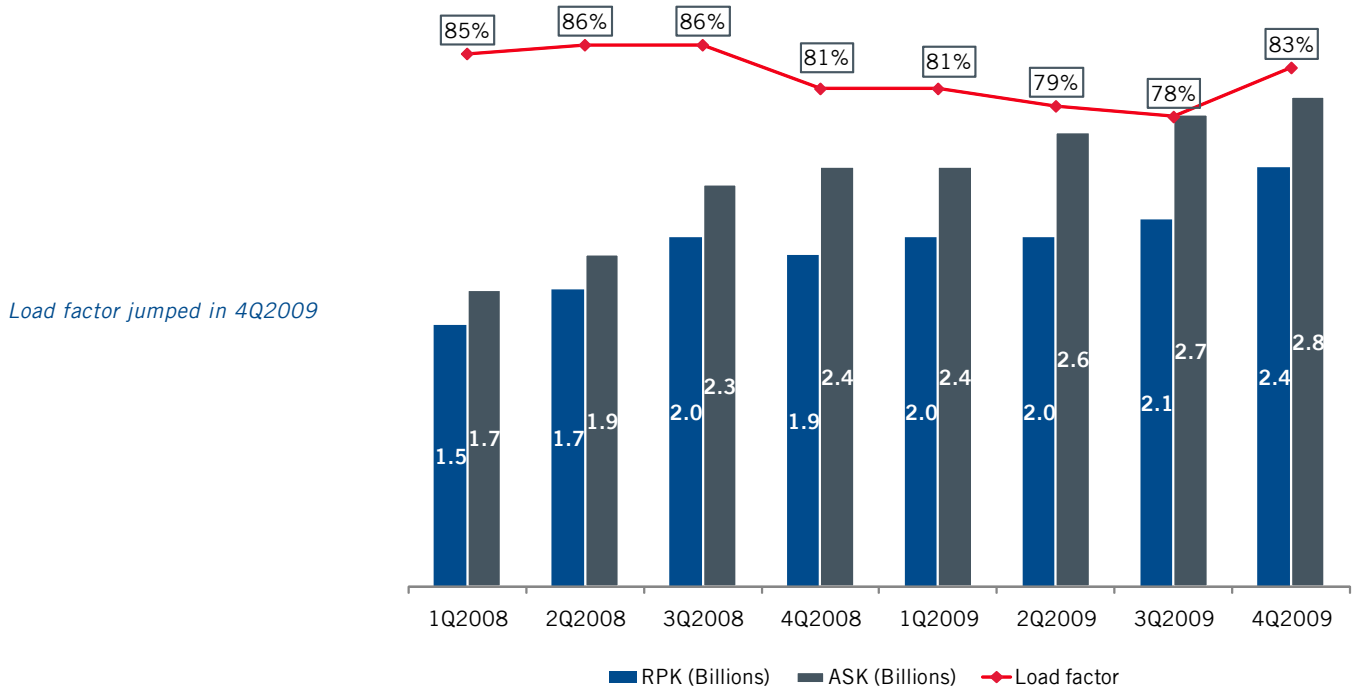
### **A New Hub in Egypt: Expected to Start Operations in April from Alexandria**

Last September, Air Arabia announced that it will be setting up a new airline in Egypt with Travco Group—one of the largest travel and hospitality groups in the Middle East. The airline is expected to start commercial activity with two aircraft in April 2010 from Borg El Arab Airport in Alexandria. According to management, the newly established airline will be flying to destinations in Europe, Africa, and the Middle East. We view such a move by Air Arabia very positively, as Egypt boasts very favorable demographics that can be exploited by a strong low-cost carrier. Moreover, the partnership between Air Arabia and Travco Group will work favorably for this new venture, as the two partners complement each other in terms of knowledge and expertise.

### **2009 Operational Performance: Load Factor Declines but Remains at a Healthy Level**

- The number of passengers flying with Air Arabia increased by 14% in 2009 to reach 4.1 million passengers. Around 1.1 million passengers travelled with Air Arabia in 4Q2009.
- Load factor, on the other hand, dropped from 85% in 2008 to 80% in 2009, a reflection of the tough operating environment during the year. In 2009, Air Arabia had to cope with the effects of the global recession, the impact of the H1N1 virus on air travel, the shift of Ramadan into the summer season, and overcapacity in the market stemming from the legacy carriers. Unlike Air Arabia's past performance, the load factor of 78% in 3Q2009 was the lowest of the year (the third quarter usually achieves the highest load factor level of the year). In 4Q2009, Air Arabia increased its load factor to 83% by successfully stimulating the market by offering attractive fares.
- Air Arabia increased its output by around 27%, from 8.3 billion available seat kilometers (ASK) in 2008 to 10.5 billion ASK in 2009. The 20% increase in revenue passenger kilometers (RPK) was lower than the growth in ASK, which led to the drop in load factor that we witnessed.

Figure 2 Load Factor by Quarters



Sources: Air Arabia and NBK Capital

**2009 Financial Performance: Margins Expand in the Face of a Marginal Decline in Revenue**

- Air Arabia's total revenue declined by 5% year-on-year to AED 2 billion in FY2009, due to a 20% drop in yield (total revenue divided by RPK) and the 500-basis-points decline in load factor. Most of the decline in the yield is a result of lower fuel costs in FY2009 compared to FY2008, which resulted in a drop in the fuel surcharge. Air Arabia's top-line performance in FY2009 was in line with our forecast for the year.
- Despite the drop in both yield and total revenue, Air Arabia witnessed an improvement in the EBITDAR margin, which increased from 25.3% in FY2008 to 27.3% in FY2009. This improvement is due to lower fuel costs, which we discuss further in the next section of this report.
- Air Arabia's EBITDAR saw a minor increase of 3% to AED 539 million for FY2009—a result that is 10% below our forecast.
- Net income declined by 11% to AED 452.2 million in FY2009 compared to FY2008, and 5.5% below our forecast of AED 478.1 million. Included in FY2008 net income is dividend income of AED 56.4 million, while only AED 1.2 million was recorded as dividend income in FY2009.
- Moreover, Air Arabia's FY2009 net income was affected by several new items, such as the AED 36.7 million in unrealized gains on fuel derivatives and the AED 31.7 share of losses from associates. Air Arabia uses the equity method of accounting for the hubs in Morocco and Egypt. In FY2009, the majority of the losses from associates were related to startup costs in Morocco.
- Aircraft lease income represents the lease payments that are paid by the hubs to Air Arabia. The Moroccan hub currently has three aircraft, which have been subleased through Air Arabia.
- We remain concerned regarding the AED 1.2 billion in available-for-sale instruments that represent 20% of total assets and 21.3% of equity.

- Cash from operating activities increased by 5.7% to AED 410.3 million due to a better working capital position.
- The board of directors has proposed the distribution of a cash dividend of AED 0.10 per share. This represents a payout ratio of 103%, and based on the latest closing price, this translates into a dividend yield of 9.5%. We view this as a high dividend payout by Air Arabia, considering the company is in an expansionary phase. Air Arabia's CEO stated that this payment takes into consideration the company's cash flows, current high liquidity position, and future requirements.

Figure 3 Income Statements

Income Statement (AED Thousands)	Full Year Results			Common Size	
	2008	2009	Change	2008	2009
<b>Total Revenue</b>	<b>2,065,786</b>	<b>1,971,965</b>	<b>-5%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of Revenue	1,671,572	1,613,617	-3%	80.9%	81.8%
<b>Gross Profit</b>	<b>394,214</b>	<b>358,348</b>	<b>-9%</b>	<b>19.1%</b>	<b>18.2%</b>
Selling and Marketing	37,067	34,728	-6%	1.8%	1.8%
General and Administrative	66,920	74,496	11%	3.2%	3.8%
<b>Operating Income</b>	<b>290,227</b>	<b>249,124</b>	<b>-14%</b>	<b>14.0%</b>	<b>12.6%</b>
Interest Income	163,900	156,266	-5%	7.9%	7.9%
Aircraft Lease Income	-	27,536		0.0%	1.4%
Dividend Income	56,436	1,197	-98%	2.7%	0.1%
Share of Losses in Associates	-	(31,655)		0.0%	-1.6%
Management Fees	-	2,481		0.0%	0.1%
Unrealized Gain on Fuel Derivatives	-	36,683		0.0%	1.9%
Other, Net	(838)	10,598	-1365%	0.0%	0.5%
<b>Net Income</b>	<b>509,725</b>	<b>452,231</b>	<b>-11%</b>	<b>24.7%</b>	<b>22.9%</b>
<b>EBITDA</b>	<b>326,724</b>	<b>299,338</b>	<b>-8%</b>	<b>15.8%</b>	<b>15.2%</b>
Depreciation/Amortization	36,497	50,214	38%	1.8%	2.5%
<b>EBITDAR</b>	<b>521,661</b>	<b>538,816</b>	<b>3%</b>	<b>25.3%</b>	<b>27.3%</b>
Lease Rentals	194,936	239,477	23%	9.4%	12.1%

*Air Arabia's EBITDAR saw a minor increase of 3%*

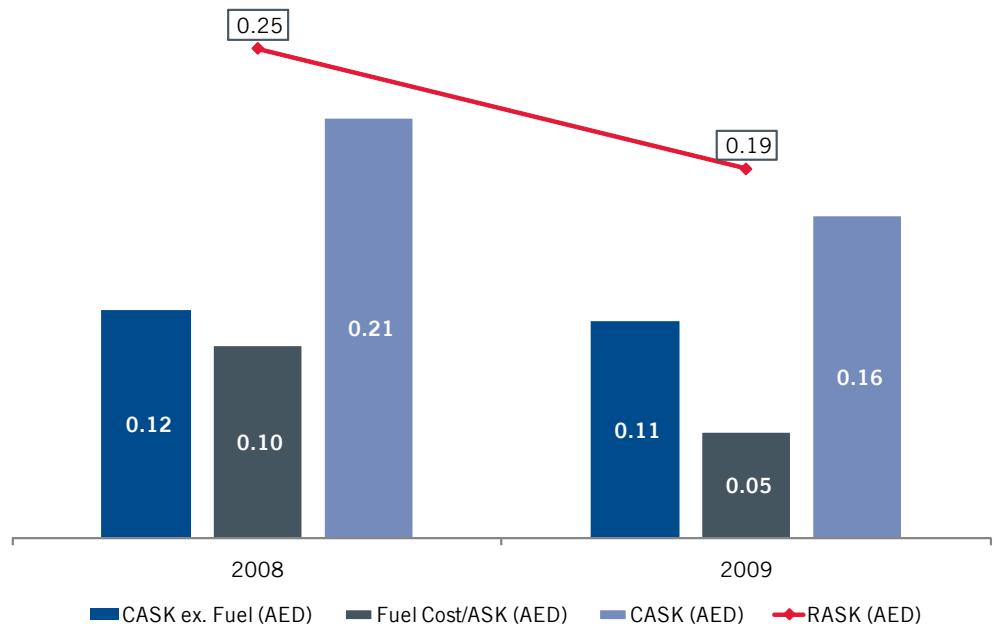
Sources: Air Arabia and NBK Capital

### Per-unit Analysis: CASK Declines but So Does the RASK

- We conducted a per-unit analysis for Air Arabia in order to shed some light on the airline's cost structure.
- Figure 4 shows the operating costs per ASK (CASK) for Air Arabia in FY2008 and FY2009. At first glance, we see a decrease in CASK in FY2009 by 23% to AED 0.19 from AED 0.25 in FY2008. A further examination reveals that the majority of the reduction in CASK is due to the drop in fuel costs, as fuel cost per ASK was cut by more than half from AED 0.10 to AED 0.05.
- The fact that CASK ex-fuel costs declined by 5% is an indication of the airline's ability to keep operating costs under control.
- Revenue per ASK (RASK) saw a drop of 24.5% in FY2009 compared to FY2008, a rate that is slightly higher than the drop in CASK.

Figure 4 FY2009 CASK Comparisons

Fuel cost per ASK was almost cut by half in 2009 compared to 2008



Sources: Air Arabia and NBK Capital

### Outlook: Competition Might Make 2010 a Challenge

Air Arabia had to deal with several challenges in 2009 ranging from the global economic recession to the H1N1 virus. Though the Middle East region is expected to witness an economic recovery in 2010/2011, Air Arabia will likely continue to see pressure on yield as a result of competition. Though flydubai currently operates six Boeing 737s, we do not expect it to have a major impact on Air Arabia in the short term. We are more concerned about the excess capacity stemming from the legacy carriers. As for fuel costs, the airline has hedged around 35% of its fuel need for FY2010 at around USD 65 per barrel, which should bring some stability to Air Arabia's largest cost item.

### New Forecasts: Attempting to Reflect the Impact of the New Hubs

We have revised our forecasts for Air Arabia to reflect the impact of the two hubs in Morocco and Egypt. We had to make several assumptions based on very high-level guidance from management, as we do not have the operational performance of the Moroccan hub in 2009 and Egypt is still being set up. Some of the major assumptions we made include the following:

- Each hub will have around 20 to 25 aircraft upon maturity.
- Yields in Morocco will be similar to those of Sharjah, while Egypt has yields that are 15% lower than those of Sharjah.
- The long-term load factor level for Sharjah will be 82.5%, while we used a more conservative long-term load factor of 77% for the new hubs.
- The long-term EBITDAR margin will be 23% for Sharjah, while we used a long-term EBITDAR margin of 17% for Morocco and 19% for Egypt.
- Fleet financing will be borne by the Sharjah base, which in turn will lease the aircraft to the hubs in Morocco and Egypt.
- The Sharjah base will receive a management fee, which we estimate to be 1.5% of the revenue of the hubs.

## FINANCIAL STATEMENTS

Balance Sheet (AED Thousands)	Historical		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014	2015
<b>ASSETS</b>								
Cash	1,767,125	1,996,251	1,193,412	716,002	2,332,804	1,801,145	1,107,329	995,865
Total Receivables, Net	241,799	292,211	308,090	342,252	386,318	411,757	438,371	463,031
Total Inventory	1,562	5,051	5,809	6,680	7,682	8,450	9,295	10,225
<b>Total Current Assets</b>	<b>2,010,486</b>	<b>2,293,513</b>	<b>1,507,311</b>	<b>1,064,934</b>	<b>2,726,804</b>	<b>2,221,352</b>	<b>1,554,995</b>	<b>1,469,121</b>
Property/Plant/Equipment, Total - Net	921,471	1,135,691	1,958,474	2,812,856	3,533,411	4,451,366	5,561,475	6,142,916
Goodwill and Intangibles	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821	1,281,821
Long Term Investments	1,573,663	1,284,229	1,273,872	1,265,494	1,265,763	1,280,058	1,308,231	1,355,723
Other Long-Term Assets, Total	74,133	76,243	98,596	114,726	132,637	147,665	161,729	177,969
<b>TOTAL ASSETS</b>	<b>5,861,573</b>	<b>6,071,497</b>	<b>6,120,074</b>	<b>6,539,831</b>	<b>8,940,436</b>	<b>9,382,262</b>	<b>9,868,251</b>	<b>10,427,549</b>
<b>LIABILITIES &amp; EQUITY</b>								
Accounts Payable	330,923	427,601	462,873	515,165	581,892	622,056	656,986	688,404
Other Current Liabilities, Total	132,803	129,352	151,920	168,218	190,339	202,269	214,655	225,795
<b>Total Current Liabilities</b>	<b>463,726</b>	<b>556,953</b>	<b>614,793</b>	<b>683,383</b>	<b>772,231</b>	<b>824,325</b>	<b>871,641</b>	<b>914,199</b>
Long-Term Debt	-	-	-	-	2,000,000	2,000,000	2,000,000	2,000,000
Other Liabilities, Total	14,241	46,235	48,547	50,974	53,523	56,199	59,009	61,959
<b>Total Liabilities</b>	<b>477,968</b>	<b>603,188</b>	<b>663,340</b>	<b>734,357</b>	<b>2,825,753</b>	<b>2,880,524</b>	<b>2,930,650</b>	<b>2,976,158</b>
<b>Total Equity</b>	<b>5,383,605</b>	<b>5,468,309</b>	<b>5,456,734</b>	<b>5,805,474</b>	<b>6,114,683</b>	<b>6,501,738</b>	<b>6,937,601</b>	<b>7,451,391</b>
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>5,861,573</b>	<b>6,071,497</b>	<b>6,120,074</b>	<b>6,539,831</b>	<b>8,940,436</b>	<b>9,382,262</b>	<b>9,868,251</b>	<b>10,427,549</b>

Income Statement (AED Thousands)	Historical		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014	2015
Total Revenue	2,065,786	1,971,965	2,364,578	2,627,001	2,962,997	3,149,729	3,344,638	3,519,165
Operating Expenses	(1,739,062)	(1,672,626)	(2,083,197)	(2,325,096)	(2,626,556)	(2,803,527)	(2,961,168)	(3,102,367)
Management fees and Lease Income	-	30,017	88,341	190,048	303,143	421,383	563,487	752,991
Depreciation/Amortization	(36,497)	(50,214)	(71,942)	(131,231)	(205,993)	(280,673)	(379,451)	(502,324)
<b>Operating Income</b>	<b>290,227</b>	<b>279,141</b>	<b>297,779</b>	<b>360,722</b>	<b>433,591</b>	<b>486,911</b>	<b>567,506</b>	<b>667,465</b>
Interest Income (Expense), Net	163,900	156,266	155,911	71,385	(60,001)	(30,519)	(64,482)	(86,881)
Other, Net	55,598	16,823	1,404	3,818	12,921	27,426	41,806	61,653
<b>Net Income</b>	<b>509,725</b>	<b>452,231</b>	<b>455,095</b>	<b>435,925</b>	<b>386,511</b>	<b>483,819</b>	<b>544,830</b>	<b>642,237</b>

Cash Flow Statement (AED Thousands)	Historical		Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013	2014	2015
Cash from Operating Activities	388,591	410,667	410,925	525,511	683,363	793,472	966,813	1,186,757
Cash from Investing Activities	(1,602,959)	233,919	(747,094)	(915,735)	(849,260)	(1,088,367)	(1,411,663)	(1,029,773)
Cash from Financing Activities	11,587	(415,460)	(466,670)	(87,185)	1,782,698	(236,764)	(248,966)	(268,447)
<b>Net Change in Cash</b>	<b>(1,202,780)</b>	<b>229,126</b>	<b>(802,839)</b>	<b>(477,409)</b>	<b>1,616,802</b>	<b>(531,659)</b>	<b>(693,816)</b>	<b>(111,464)</b>

Sources: Air Arabia and NBK Capital

**RISK AND RECOMMENDATION: GUIDE**

RECOMMENDATION		UPSIDE (DOWNSIDE) POTENTIAL		
BUY		MORE THAN 20%		
ACCUMULATE		BETWEEN 5% AND 20%		
HOLD		BETWEEN -10% AND 5%		
REDUCE		BETWEEN -25% AND -10%		
SELL		LESS THAN -25%		
RISK LEVEL				
LOW RISK			HIGH RISK	
1	2	3	4	5

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