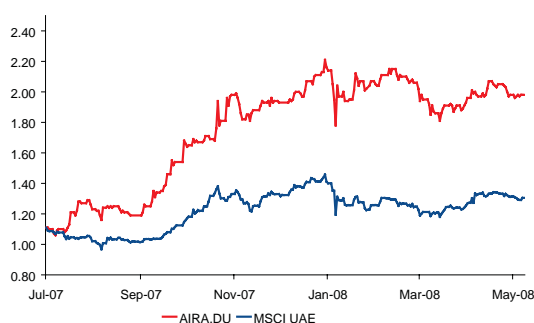


Key Data

Current Price*	Avg. Value Traded per Day
AED 1.98	AED 193.4 mln
52-Week High	Market Cap
AED 2.21	AED 9.24 bln
52-Week Low	Current Number of Shares
AED 1.02	4,666.7 mln
Reuters	Bloomberg
AIRA.DU	AIRARABI.UH
Ownership Structure	
Privately Held: 45%	Public: 55%

* Price as of close on May 28, 2008. Sources: Reuters, Zawya, and NBK Capital

Rebased Performance



Sources: MSCI, Reuters, and NBK Capital

Key Ratios

	2008 f	2009 f	2010 f	2011 f	2012 f
P/E	17.7	14.7	12.4	11.7	11.3
EPS Growth	40%	21%	19%	5%	4%
EV/ EBITDAR	11.5	9.0	7.2	6.5	5.8
EBITDAR Margin	28%	27%	27%	26%	26%
EBITDAR Growth	40%	28%	25%	10%	13%
Dividend Yield	1.4%	1.7%	2.0%	2.1%	2.2%
ROAE	10%	11%	12%	11%	11%

1Q2008 EBITDAR a	2Q2008 EBITDAR f
AED 88.2 mln	AED 110.0 mln
1Q2008 EBITDAR f	3Q2008 EBITDAR f
AED 120.0 mln	AED 232.2 mln

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

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Highlights

12-Month Fair Value: AED 1.89

Recommendation: Hold-Risk Level: 4**

Reason for Report: 1Q2008 Update

- The number of passengers flying with Air Arabia during 1Q2008 grew by 31% year-on-year to 757 thousand. This increase is a result of the airline's ability to increase output by 31% while maintaining its load factor at 85%.
- Air Arabia saw its revenues grow by 56% in 1Q2008 (year-on-year) to reach AED 383 million. However, the rise in fuel prices had an adverse effect on operating margins. Fuel costs as a percentage of revenue increased from 30% in 1Q2007 to 39% in 1Q2008. Since Air Arabia has not been hedging its fuel costs, its only defense against rising fuel prices has been adding fuel surcharges—a mechanism that takes some time for its effects to kick in.
- Air Arabia was able to post an increase of 81% in net income in 1Q2008; however, this did not result from an increase in operating income (which declined by 6% year-on-year), but rather from an interest income of AED 45.3 million.
- Air Arabia started operations in its second hub in Katmandu, Nepal in January 2008 with one aircraft. It added a second aircraft in the second quarter. The operation in Nepal has so far been able to post good results (considering it is still a startup) as it is generating load factors above 70%, with yields almost twice that of Sharjah.
- Air Arabia has moved away from its strategy of leasing aircraft. So far in 2008, it has purchased three Airbus A320s, one of which it was already leasing. Thus, the number of aircraft in Air Arabia's Sharjah fleet stands at 13 as of the date of this update publication.
- We have revised our forecasts for Air Arabia, which led to an increase in our 12-month fair value estimate for the share price from AED 1.76 to AED 1.89. 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.
- Since our fair value estimate is 4.5% lower than the market price, our recommendation for Air Arabia is "Hold."

** Please refer to page 5 for recommendations and risk ratings.

VALUATION

Air Arabia experienced a solid increase in revenues and traffic figures in the first quarter of 2008; however, soaring fuel costs negatively impacted operating margins. This is why Air Arabia's 1Q2008 EBITDAR of AED 88 million came in 26.5 % below our forecast. We do not expect this trend to continue as fuel surcharges will kick in to offset most of the increase in fuel prices and we believe that Air Arabia is fully equipped to reap the benefits that strong economic conditions have on travel demand. Accordingly, we changed our forecasts to reflect: a) the increase in fuel costs, b) increasing yield to reflect the addition of fuel surcharges, c) incorporating the hub in Nepal and d) reducing the purchase price for the aircraft on order with Airbus, as we think our original estimate was on the high side.

Our 12-month fair value estimate for the share price of Air Arabia has increased by 7.1% from our last estimate to reach AED 1.89. This change was driven primarily by a 21.3% increase in the fair value derived from our discounted cash flow (DCF) model. This in turn was influenced by a decline in capital expenditure requirement (as we lowered our estimates for the purchase price of aircraft on order) and a decline in the risk-free rate (in line with the general declining interest rate environment). However, the increase in the DCF value was to a certain extent offset by a 12.4% decline in the fair value, using the peer comparison method based on forward PEG multiples. The decline in fair value using this method is a result of a decline in the peer PEG. Since our fair value estimate is 4.5% lower than Air Arabia's latest share price, our recommendation for Air Arabia stock is "Hold."

Figure 1 Fair Value per Share

Our new 12-month fair value for Air Arabia is AED 1.89

Valuation Method	Old		New		Change
	Weight	Value	Weight	Value	
Discounted cash flow	70%	AED 1.46	70%	AED 1.77	21.3%
Peer comparison	30%	AED 2.48	30%	AED 2.17	-12.4%
Weighted average fair value	100%	AED 1.76	100%	AED 1.89	7.1%

Source: NBK Capital

FIRST QUARTER 2008 OPERATIONAL PERFORMANCE

- The number of passengers flying with Air Arabia grew by 31% year-on-year to 757 thousand in 1Q2008. This increase was coupled with an increase in the load factor, from 84% in 1Q2007 to 85% in 1Q2008. In our opinion, such performance reflects the popularity of Air Arabia's service.
- Air Arabia had an average of 11 aircraft in 1Q2008 compared with an average of 8.4 in 1Q2007. Accordingly, the airline was able to increase its output by 31%, from 1.3 billion ASK in 1Q2007 to 1.7 billion ASK in 1Q2008. The increase in ASK was matched by a 36% increase in RPK, thus leading to an increase in the load factor.
- In 1Q2008, 246 thousand passengers flew with Air Arabia on routes to India, a 43% increase over the same period last year. Air Arabia currently serves 11 destinations in India and has plans to add another four in the near future.
- Air Arabia has purchased three Airbus A320's in 2008 so far. One of these was already being leased. Thus, the number of aircraft in Air Arabia's Sharjah fleet stands at 13 as

of the date of this update publication. This represents a shift in Air Arabia's strategy from leasing aircraft to buying aircraft. The aircraft purchased in 2008 are not part of the order the airline has with Airbus. These aircraft were acquired from the market in new condition, as the downturn in the global economy has resulted in some airlines not taking delivery of ordered aircraft.

- Air Arabia started operations in its second hub in Katmandu, Nepal in January 2008 with one aircraft (a second aircraft was added in the second quarter). The operation in Nepal (which has been branded "Fly Yeti") is a joint venture between Air Arabia and Yeti Airlines, of which Air Arabia owns 51%. Fly Yeti serves destinations in South East Asia, the Indian subcontinent and the Middle East. According to management, Fly Yeti has so far been able to post good results (considering it is still a startup) as it is generating load factors above 70%, with yields almost twice as much as Air Arabia's operation in Sharjah.

Figure 2 Operating Statistics

*Load factors still high
at 85%*

	2006	2007	1Q2007	1Q2008
Average Aircraft	6.0	9.5	8.4	11.0
Passengers (Millions)	1.7	2.7	0.6	0.8
RPK (Billions)	3.7	5.0	1.1	1.5
ASK (Billions)	4.7	5.8	1.3	1.7
Load factor	80%	86%	84%	85%

Source: Air Arabia

First Quarter 2008 Financial Performance

- Air Arabia's revenue grew by 56% in 1Q2008 (year-on-year) to reach AED 383 million. This strong performance is a result of the airline's ability to maintain its load factor at 85% (without reducing yields), as output increased by more than 30% compared with the same period last year.
- This was spoiled by soaring fuel prices which substantially impacted operating margins. Fuel costs as a percentage of revenue increased from 30% in 1Q2007 to 39% in 1Q2008. Since Air Arabia has not been hedging its fuel costs, its only defense against rising fuel prices has been adding fuel surcharges. However, the impact of fuel surcharges is not immediately felt, as customers book flights six weeks in advance on average.
- Air Arabia saw a 23% increase in EBITDAR (earnings before interest, taxes, amortization, depreciation and rent), but saw its EBITDAR margin drop from 29% in 1Q2007 to 23% in 1Q2008 mainly due to the rise in fuel costs.
- Operating income declined by 6% in 1Q2008, as the operating margin shrank from 13.7% in 1Q2007 to 8.3% in 1Q2008. Besides the increase in fuel costs, the operating results of Air Arabia were affected by setting up the hub in Nepal. 1Q2008 was the first operating quarter for the hub in Nepal and accordingly there were some non-recurring startup costs. According to management, the hub in Nepal negatively affected Air Arabia's 1Q2008 performance to the tune of AED 7 million in total.
- It is important to mention that Air Arabia has changed the method it was using to account for the waiver for landing charges it receives from the Sharjah Airport Authority.

In 2007, the waiver was presented as a non-operating income. However, starting 2008 it is being accounted for as a discount on landing charges, which reduces operating expenses. Accordingly, this explains the 86% decline in other income in 1Q2008.

- Net income increased by 81% in 1Q2008 due to an interest income of AED 45.3 million (58% of bottom line). Air Arabia had an average cash balance of AED 2.6 billion in 1Q2008, as it is yet to invest the majority of its IPO proceeds.

Figure 3 1Q2008 Income Statement

Income Statement (AED Thousands)	First-Quarter Results			Common Size	
	2007	2008	Change	1Q2007	1Q2008
Total Revenue	245,902	383,233	56%	100.0%	100.0%
Cost of Revenue	195,624	330,409	69%	79.6%	86.2%
Gross Profit	50,278	52,823	5%	20.4%	13.8%
Selling and Marketing	8,096	9,040	12%	3.3%	2.4%
General and Administrative	8,385	11,869	42%	3.4%	3.1%
Operating Income	33,797	31,914	-6%	13.7%	8.3%
Interest Income(Exp), Net Non-Operating	1,663	45,320	2625%	0.7%	11.8%
Other, Net	7,777	1,077	-86%	3.2%	0.3%
Net Income	43,237	78,311	81%	17.6%	20.4%
EBITDAR	71,920	88,228	23%	29.2%	23.0%

Sources: Air Arabia and NBK Capital

Rising fuels costs were the main reason behind the decline in operating margins

OUTLOOK

In 1Q2008, Air Arabia demonstrated that there is high demand for its service, as it was able to simultaneously increase both output and load factor levels. Also, Air Arabia has demonstrated its ability to achieve good profitability, even as fuel prices are rising to record levels. We still expect Air Arabia to post a strong performance in 2008, as the airline has the ability to raise its prices by adding fuel surcharges (to offset some of the increase in oil prices) and increase output by expanding its fleet. We have incorporated all this into our new forecasts. We continue to expect strong load factor levels, as Air Arabia can benefit from: a) the impact of strong economic conditions on travel demand in the GCC and b) its generally low prices compared with the competition.

Below is a summary of the most important changes we made to our forecasts:

- Increasing fuel costs to account for 40% of revenue (rather than 30% in the previous forecast).
- In our previous forecast we were expecting yields to increase by 4% in 2008; however, we changed this assumption to 12.5% to reflect the addition of fuel surcharges.
- We included the hub in Nepal on a proportionate basis.
- We reduced our estimate for the purchase price of the aircraft on order with Airbus. In addition to the direct effect this change has on capital expenditures, it also has two indirect effects—reducing depreciation and increasing interest income.
- We started treating the waiver received from the Sharjah Airport Authority as a discount rather than a separate line item. Also, we applied the discount throughout our financial forecast period, which represents a change from our previous assumption that the waiver will be lifted in 2010.

Figure 4 New vs. Old Forecast for CAGR 2007-2012

Income Statement	2007-2012 CAGR	
	Old	New
Total Revenue	26%	29%
EBITDAR	24%	23%
Operating Income	20%	23%
Net Income	15%	17%

Source: NBK Capital

MOROCCO HUB

Air Arabia is still in the process of setting up its hub in Rabat, Morocco. This operation is expected to be large, and might be very close in size to the Sharjah operation. According to management, the Rabat hub is not expected to start operations until late this year at the earliest. However, management has not yet released any information regarding this hub, as it is still in the planning phase. Thus, we have not incorporated Rabat into our forecasts.

Risk and Recommendation Guide

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

FINANCIAL STATEMENTS

Balance Sheet (AED Thousands)		Forecast				
Fiscal Year Ends December	2007	2008	2009	2010	2011	2012
ASSETS						
Cash and Short-Term Investments	2,969,906	3,021,320	3,432,479	3,945,054	3,914,236	3,354,243
Total Receivables, Net	135,720	213,225	279,222	353,608	400,088	464,411
Total Inventory	748	822	905	995	1,095	1,204
Total Current Assets	3,106,374	3,235,368	3,712,606	4,299,658	4,315,419	3,819,858
Property/Plant/Equipment, Total - Net	112,240	773,454	832,655	890,081	1,488,084	2,664,416
Goodwill, Net	1,320,860	1,320,860	1,320,860	1,320,860	1,320,860	1,320,860
Long Term Investments	593,778	622,089	651,852	683,142	716,033	750,607
Other Long-Term Assets, Total	204,308	92,264	149,292	208,114	267,241	322,087
TOTAL ASSETS	5,337,559	6,044,035	6,667,266	7,401,856	8,107,638	8,877,829
LIABILITIES & EQUITY						
Accounts Payable	193,790	322,763	422,910	538,587	617,674	724,815
Other Current Liabilities, Total	104,303	172,918	226,761	287,453	325,296	377,719
Total Current Liabilities	298,094	495,681	649,671	826,041	942,970	1,102,534
Long-Term Debt	-	-	-	-	-	-
Other Liabilities, Total	9,988	-	-	-	-	-
Total Liabilities	308,082	495,681	649,671	826,041	942,970	1,102,534
Total Equity	5,029,477	5,548,354	6,017,595	6,575,815	7,164,668	7,775,295
TOTAL LIABILITIES AND EQUITY	5,337,559	6,044,035	6,667,266	7,401,856	8,107,638	8,877,829
Income Statement (AED Thousands)		Forecast				
Fiscal Year Ends December	2007*	2008	2009	2010	2011	2012
Total Revenue	803,669	2,003,201	2,613,542	3,299,346	3,726,748	4,317,443
Operating expenses	626,001	1,613,841	2,116,015	2,694,084	3,080,251	3,612,037
Depreciation/Amortization	23,552	26,798	35,442	44,884	54,248	64,026
Operating Income	154,117	362,562	462,084	560,378	592,249	641,379
Interest Income (Exp), Net Non-Operating	100,683	151,442	158,435	178,492	187,148	166,701
Other, Net	27,172	4,873	5,135	5,423	5,741	6,090
Net Income	281,972	518,876	625,655	744,293	785,137	814,170
Cash Flow (AED Thousands)		Forecast				
Fiscal Year Ends December	2007*	2008	2009	2010	2011	2012
Cash from Operating Activities	97,965	509,367	585,438	707,155	716,847	800,537
Cash from Investing Activities	594,837	(457,952)	(17,866)	(8,507)	(551,381)	(1,156,988)
Cash from Financing Activities	3,266,700	(129,719)	(156,414)	(186,073)	(196,284)	(203,542)
Net Change in Cash	3,959,501	(78,304)	411,159	512,575	(30,818)	(559,993)

* From June 19, 2007 to December 31, 2007. Sources: Annual Report, and NBK Capital



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