Salhia Real Estate

Undervalued Steady Business

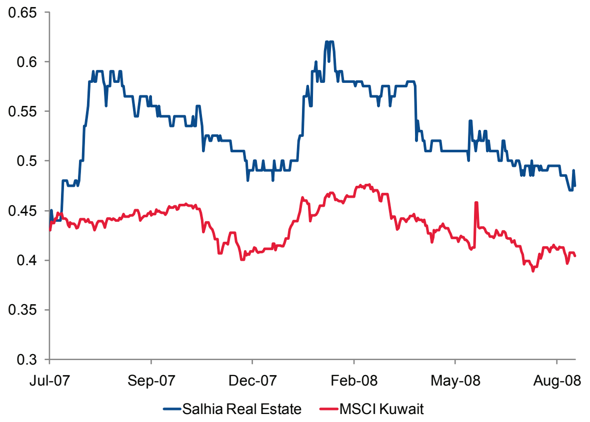
August 20, 2008

Key Data

Current Price*	Avg. Value Traded per Day
KD 0.485	KD 266,383
52-Week High	**Market Cap**
KD 0.620	KD 193.2 million
52-Week Low	**Shares Outstanding**
KD 0.470	398.37 million
Reuters	**Bloomberg**
SREK.KW	SRE KK
Ownership Structure	
Privately Held: 36.1%	Public: 63.9%

** As of August 19, 2008. Sources: Reuters, Zawya, and NBK Capital*

Rebased Performance



Sources: Reuters and NBK Capital

Key Ratios

	2007 a	2008 f	2009 f	2010 f	2011 f
EBITDA Margin	39%	43%	43%	43%	43%
Net Profit Margin	76%	21%	25%	24%	23%
ROAE	22%	5%	7%	6%	6%
EPS Growth	-45%	-74%	36%	-7%	-4%
P/E	6.2	22.8	16.8	18.1	18.9
EV/ EBITDA	18.1	16.5	14.8	15.0	15.0
Dividend Yield	9.2%	3.1%	4.5%	4.4%	4.2%

1Q2008 EBITDA a	3Q2008 EBITDA f
KD 4.3 million	KD 4 million
2Q2008 EBITDA e	**4Q2008 EBITDA f**
KD 4.5 million	KD 4.8 million

a = actual, f = forecast, e= estimate. Sources: Company financials and NBK Capital

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Highlights

12-Month Fair Value: KD 0.589

Recommendation: Buy – Risk Level: 3**

Reason for Report: Initiation of Coverage

- Salhia Real Estate is one of Kuwait's leading real estate companies, with a proven track record of years of operation. The company has three main lines of business: 1) real estate operations in Kuwait and in the UK, 2) hotel operations in Kuwait and 3) care home operations in Germany. The company's real estate operation in the UK is in the form of a joint venture with St. Modwen Properties. The company has projects planned in Bahrain and Oman as well. Diversification across business segments and geographic locations lends strength to the business model.

- The company boasts Class A properties catering to both office and retail demand in prime locations. High standards in quality of service have resulted in 100% occupancy over the years for all its properties in Kuwait. Salhia also enjoys high repeat business from existing clients, as most tenants extend their contracts. The bulk of the tenancy agreements are long-term, further corroborating Salhia's superior quality of service.

- Going forward, supported by a higher proportion of the aged population in Germany and increasing numbers of baby boomers falling into the old age bracket, we expect impressive growth in revenues for the care home operations. We expect segment revenues to grow at a 5-year CAGR of 7.8% until 2012, providing the much needed impetus to boost the otherwise subdued growth in the company's total revenue.

- The company owns real estate properties at a book cost of KD 43.7 million, worth KD 222.8 million as of 2007 end (valuation was done by independent property valuers). Even applying a 50% discount to the market value of the properties yields a 20.5% upside for the stock price, as per the net asset value (NAV) method.

- We arrived at a 12-month fair value for Salhia of KD 0.589 per share by using three valuation methods: discounted cash flow (DCF), NAV and sum-of-the-parts (using forward EV/EBITDA multiples). With an upside potential of 21.4%, we are initiating coverage on the company with a "Buy" recommendation.

*** Please refer to the last page for recommendations and risk ratings.*

EXECUTIVE SUMMARY

Salhia Real Estate Co.'s long-standing reputation is testimony of its high quality service to its tenants through Class A properties in prime locations. Salhia has three main lines of business: 1) real estate operations, 2) hotel operations and 3) care home operations.

Salhia's real estate operations include rental income-generating properties in the office and retail space segment in Kuwait. In addition, it comprises a joint venture in the UK, Key Properties Inc., a 50:50 joint venture with St. Modwen.

The hotel segment includes two Marriot group-run premier hotel properties in Kuwait, the JW Marriott Hotel (5 star) and the Courtyard Marriott Hotel (4 star). In addition to these, it also includes the 1,500 sq. m. Arraya Ballroom.

The company's care home operations in Germany is run by Salhia's 89.7% subsidiary Haddia Holding, which is involved in the development, ownership and management of nursing homes for senior citizens and seniors' residences. The company owns and operates 13 nursing homes and four seniors' residences.

Regarding Salhia's upcoming projects, we would like to highlight the Arraya II office tower, which is expected to be fully operational in 2Q2009, a commercial project in Bahrain, the Elephant and Castle commercial complex, and the Farnborough shopping centre in UK.

We expect revenues from real estate operations to grow at a 5-year CAGR of 4.3% (2007-2012). The incremental segmental revenue is entirely due to the start of the Arraya II office tower in 2Q2009. However, with the expected excess supply of office space in Kuwait over the next few years, we expect pressure on office rental rates going forward.

The expected doubling of hotel rooms in Kuwait is likely to severely impact the hotel segment revenues. We expect revenues from hotel operations to decrease at a 5-year CAGR of 9% (2007-2012).

Going forward, supported by a higher proportion of the aged population in Germany and increasing numbers of baby boomers falling into the old age bracket, we expect impressive growth in revenues for the care home operations. We expect segment revenues to grow at a 5-year CAGR of 7.8% until 2012, providing the much needed impetus to boost the otherwise subdued growth (5-year CAGR of 2.2%) in the company's total revenue.

We arrived at a 12-month fair value for Salhia of KD 0.589 per share by using three valuation methods: discounted cash flow (DCF), net asset value (NAV) and sum-of-the-parts (using forward EV/EBITDA multiples). With an upside potential of 21.4%, we are initiating coverage on the company with a "Buy" recommendation.

We have assigned Salhia a risk rating of 3 (on a scale of 1 to 5). This follows our subjective criteria for risk, such as risks associated with overall operating environment, market risk relating to the investment portfolio, and currency risk. The major risks we believe can have a material impact on the value of the company's stock are:

- The expected large supply of office and retail space could lead to a decline in rental rates for both the segments, even in premium locations.
- The expected doubling of hotel rooms in Kuwait is likely to have a severe impact on the average room rates and the occupancy rates for the hotel business in Kuwait.

VALUATION

The purpose of this valuation exercise is to arrive at a fair value estimate of the share price using fundamental analysis that should prevail for Salhia over the next 12 months. This does not represent a guarantee that this value is achievable within this timeframe, as a wide range of variables and market dynamics affect the market price of an asset.

Each investor must use his or her favorite mix of fundamental research, technical analysis, and market intelligence to arrive at an investment decision that matches his or her objectives and risk tolerance.

We arrived at a 12-month fair value for Salhia of KD 0.589 per share by using three valuation methods: discounted cash flow (DCF), the net asset value method (NAV) and sum-of-the-parts (using forward EV/EBITDA multiples). We specified a weight for each method, as shown in Figure 1. A greater weight is assigned to DCF, as this method examines the fundamentals of the company to determine its future cash-generating ability. The 12-month fair value target is KD 0.589 is 21.4% higher than yesterday's closing, hence our "Buy" recommendation.

Our 12-month fair value for Salhia is KD 0.589, 21.4% higher than its current price

Figure 1 Weighted Average Fair Value per Share

Valuation Method	Value (KD)	Weight
Discounted cash flow	0.561	70%
NAV	0.656	20%
SOTP	0.652	10%
Weighted average fair value	**0.589**	**100%**

Source: NBK Capital

DISCOUNTED CASH FLOW VALUATION

Our DCF valuation (Figure 2) is based on forecasted financial results through 2013. The DCF valuation is a function of the following major variables, which have been estimated using our models:

- Future net operating profit less adjusted taxes (NOPLAT), which is driven primarily by expectations of revenues and operating expenses
- Future changes in working capital
- Future net expenditures on fixed assets
- The weighted average cost of capital (WACC), which is a weighted average of our estimated cost of equity and the after-tax cost of debt
- The long-term expected growth rate in NOPLAT and the expected rate of return on net new invested capital (RONIC).

From the forecasted financial results, we extracted the free cash flows that were used in our valuation. We discounted those cash flows to a point in time that is 12 months into the future, to obtain an estimate of the value of the company's operations. After subtracting net debt and minority interest, and adding the value of non-operating assets, we arrived at a total equity value of KD 223.4 million.

In order to estimate the value of Salhia Real Estate Co.'s operations, we incorporated a varying WACC into our model. Our selection of a cost of equity of 10.4% is based mainly on interest rate levels and the operating environment.

Using the DCF valuation method, we arrived at a fair value per share of KD 0.561

Figure 2 DCF Valuation

Figures in KD Thousands*	Forecast					
Fiscal Year Ends December	2008	2009	2010	2011	2012	2013
Net Operating Profit after Tax	**12,026**	**13,762**	**13,561**	**13,559**	**13,711**	**13,888**
Add: Depreciation and Amortization	4,731	4,771	4,813	4,856	4,900	4,945
Gross Cash Flow	**16,757**	**18,533**	**18,374**	**18,415**	**18,610**	**18,833**
(Incr.)Decr. in Working Capital	29,246	512	(69)	27	39	47
(Incr.)Decr. in Operating Fixed Assets	(779)	(821)	(864)	(906)	(948)	(991)
Free Cash Flow from Operations	**45,224**	**18,224**	**17,441**	**17,537**	**17,701**	**17,889**
Terminal Value						**194,206**

Value of Operations in 12 Months	**210,265**
Add: Excess Cash	71,301
Add: Value of Long-Term Investments	36,834
Less:Total Debt	(93,635)
Less: Minority Interest	(1,350)
Value of Equity in 12 Months	**223,414**
Per Share Value in KD	**0.561**

** Except per share value. Source: NBK Capital*

Sensitivity Analysis

We performed a sensitivity analysis (Figure 3) on two important inputs for our DCF valuation model: the cost of equity and the perpetual growth rate used in computing the terminal value.

Figure 3 DCF Sensitivity

		Growth				
		4.50%	4.75%	5.00%	5.25%	5.50%
Cost of Equity*	9.4%	KD 0.622	KD 0.630	KD 0.639	KD 0.649	KD 0.661
	9.9%	KD 0.587	KD 0.591	KD 0.596	KD 0.602	KD 0.609
	10.4%	KD 0.556	KD 0.558	KD 0.561	KD 0.564	KD 0.567
	10.9%	KD 0.528	KD 0.529	KD 0.530	KD 0.531	KD 0.532
	11.4%	KD 0.504	KD 0.505	KD 0.505	KD 0.506	KD 0.507

** Variations in the cost of equity result in variations in WACC. Source: NBK Capital*

Net Asset Value

Net asset value (NAV), like any other valuation method, computes the intrinsic value of an asset. However, unlike cash flow-based models, the net asset value approach is an asset- based valuation method. The approach is balance sheet driven; this is restated from historical costs to reflect the market/fair value of the assets. A detailed valuation analysis is performed for a company's fixed, financial, and other non-operating assets and liabilities. This approach is best suited for real estate companies and holding companies.

Our NAV valuation (Figure 4) for Salhia is based on a restatement of the value of investment properties (real estate properties). Other long-term assets and non-operating assets (investment portfolio) have not been taken into consideration for this valuation due to lack of information.

Major assumptions in the NAV valuation are as follows:

- The model only takes into account the restatement of investment properties and ignores changes in other long-term assets, non-operating assets (investment portfolio) and liabilities.
- The market value of the investment properties is derived from the company's annual financial statements for 2007. The company revises the market value of its investment property portfolio at the end of every year. The fair/market value for the properties is determined by referring to independent third party valuations provided by professionally qualified valuers using acceptable methods of calculation, such as sales comparison and income capitalization.
- The properties included are the Salhia Commercial Complex, the Sahab tower, the Arraya Centre, the Staff House Building, and JW Marriot.

We used the 2007 year end equity as the starting point. We then deducted the book cost of the investment properties from the equity and subsequently added back the market value of the same properties provided by the company. We add back only 60% of the market value of the investment properties to reflect the variability in the realizable value of the properties when sold together in the market. Adjusting for all of the above, we arrive at an adjusted NAV of KD 261.15 million.

We apply a discount factor of 40% to the market value of the investment properties for the following reasons:

- We feel that if the company were to sell all the above mentioned properties together in the market, it would definitely realize a value comparatively less than the market value shown in the 2007 financials.
- We are also of the opinion that the increased supply in the office and hotel segment (Salhia is a key player in both the segments) in Kuwait over the next 3-4 years (discussed in detail later) is likely to have a negative impact on the rental rates/revenue for each of these segments. A lower income-generating capacity of these properties is likely to bring down the property valuations.

The NAV valuation yields a fair value per share of KD 0.656

Figure 4 NAV Valuation

Calculation of Net Asset Value - Salhia Real Estate Co.	KD ('000)*
Equity (2007)	151,122
Less: Book cost of Investment Properties (2007)	59,696
Add: Market Value of Investment Properties (2007)	282,868
Net Asset Value (NAV)	**374,294**
Less: Adjustment on Market Value of Investment Properties (40% Discount)	113,147
Adjusted NAV (applying discount factor)	**261,147**
Per Share Value in KD (on adjusted NAV)	**0.656**

** Except per share value. Source: NBK Capital*

Sum-of-the-Parts (SOTP)

Salhia has three distinct business segments, namely: 1) real estate operations, 2) hotel operations and 3) care home operations. Hence, we decided to value the company using the sum-of-the-parts (SOTP) method and a forward enterprise value (EV)-to- earnings before interest, taxes, depreciation and amortization (EBITDA) multiple. We have followed an EV/ EBITDA multiple-based valuation for Salhia, based on our forecast for EBITDA for 2009.

Real Estate Operations

To value Salhia's real estate operations, we have selected eight comparable real estate companies (with similar lines of business) across the globe, concentrating mainly on companies from major European economies. These economies have GDP per capita figures analogous to those of Kuwait. However, we have included one company from each of the US and Singapore. The reason for not including any comparable Kuwaiti or regional real estate companies is a lack of information from accepted data sources on consensus estimates of 2009 EBITDA for such companies. However, in Figure 6 we have shown the relative valuation of Salhia compared to its Kuwaiti counterparts, based on EV/2007 EBITDA. We have not included Salhia's value (arrived at via comparison to local counterparts) in the final value determined using the SOTP method. It is merely an exercise to show our investors how Salhia compares to its local real estate counterparts. For the purpose of selection of peers (global and local), we have tried to focus on companies having rental models comprising of office and retail properties.

There are a few reasons for preferring European-based companies. The first and foremost reason is the comparability of these countries' GDP per capita figures with those of Kuwait. Since real estate companies (rental models) in any country are dependent on the spending power of that particular country, forming a peer basket comprised of similar companies from countries comparable in GDP per capita makes sense. The second reason is because Salhia's real estate operations include a United Kingdom-based joint venture (discussed in detail later) with St. Modwen Properties. The joint venture, known as Key Properties Inc., has a diversified portfolio of rental income-producing investments and redevelopment opportunities. The properties include shopping malls, offices, and residential and industrial sites throughout the UK.

For the purpose of valuation, we obtained the current EV (for the last financial interim) and consensus 2009 EBITDA for each company to arrive at the forward EV/ EBITDA multiple for each of the peer companies. We have calculated the enterprise value for Salhia's real estate operations, only on the basis of simple average (excluding outliers) of the forward EV/ EBITDA multiple for the peer basket.

The simple average (excluding outliers) forward EV/ EBITDA multiple stands at 15.9

Figure 5 **Real Estate Operations - Forward EV/EBITDA Comparison**

Company	Country	Market Data		EBITDA	EV/ 2009 EBITDA
		EV (USD '000)	Mkt. Cap.* (USD '000)	2009 (USD '000)	
Befimmo (SICAFI)	Belgium	2,831,256	1,506,620	145,363	19.5
F&C Commercial Property Trust Ltd	UK	1,247,275	973,159	91,552	13.6
Colonial Properties Trust	US	2,958,810	940,390	182,840	16.2
Nieuwe Steen Investments NV	Netherlands	2,044,604	907,886	136,517	15.0
Alstria Office REIT	Germany	2,401,310	870,752	130,786	18.4
Saul Centers Inc	US	1,536,810	825,500	117,740	13.1
Macquarie Prime REIT	Singapore	1,149,428	720,361	57,668	19.9
Intervest Offices	Belgium	901,230	563,788	61,131	14.7
VastNed Offices/Industrial	Netherlands	1,543,901	499,703	108,963	14.2
Weighted average					**16.4**
Simple average excluding outliers					**15.9**
Simple Average					**16.1**

** Mkt. Cap as of August 18, 2008. Sources: Reuters and NBK Capital*

Using a simple average (excluding outliers) of forward EV/EBITDA of 15.9x and an estimated EBITDA of KD 10.65 million for 2009, we estimate the enterprise value to be KD 169.6 million.

As mentioned earlier, in Figure 6, we have shown the relative valuation of Salhia compared to its Kuwaiti counterparts based on 2007 EV/EBITDA. The rest of the process is the same as in the case of calculating enterprise value on 2009 EBITDA.

The simple average (excluding outliers) 2007 EV/EBITDA multiple stands at 25.6

Figure 6 **Real Estate Operations Valued Using Local Peers**

Company	Market Data		EBITDA	EV / 2007 EBITDA
	EV (KD '000)	Mkt. Cap.* (KD '000)	2007 (KD '000)	
Mabanee Company	734,230	667,920	25,481	28.8
Commerical Real Estate	426,210	352,220	41,659	10.2
Tamdeen Real Estate	423,890	167,820	18,885	22.4
United Real Estate	206,310	121,880	3,515	58.7
Weighted average				**25.8**
Simple average excluding outliers				**25.6**
Simple Average				**30.0**

** Mkt. Cap as of August 18, 2008. Sources: Reuters and NBK Capital*

Using a simple average (excluding outliers) of forward EV/EBITDA of 25.6x and an EBITDA of KD 5.93 million for 2007, we estimate the enterprise value for the real estate operations to be KD 152 million.

Hotel Operations

To value Salhia's hotel operations, we have selected four pure-play hotel companies across the globe. The reason for not including any comparable hotel business from Kuwait is the lack of information from accepted data sources on consensus estimates on 2009 EBITDA. The peers we chose are all regional players. Kingdom Hotel Investments has its main properties in the Middle East, in addition to other international properties.

For the purpose of valuation, we obtained the current EV (for the last financial interim) and consensus 2009 EBITDA for each company to arrive at the forward EV/ EBITDA multiple for each of the peer companies. We have calculated the enterprise value for Salhia's hotel operations, only on the basis of simple average (excluding outliers) of the forward EV/ EBITDA multiple for the peer basket.

The simple average (excluding outliers) forward EV/ EBITDA multiple stands at 8.3

Figure 7 Hotel Operations - Forward EV/EBITDA Comparison

Company	Country	Market Data		EBITDA	EV / 2009 EBITDA
		EV (USD '000)	Mkt. Cap.* (USD '000)	2009 (USD '000)	
Abu Dhabi National Hotels	UAE	1,809,607	2,069,009	187,096	9.7
Kingdom Hotel Investments	UK	1,605,300	1,333,260	133,700	12.0
Orascom Hotels and Development	Egypt	1,396,050	1,056,148	204,180	6.8
Egyptian Resorts Company	Egypt	216,229	278,245	95,210	2.3
Weighted average					**9.3**
Simple average excluding outliers					**8.3**
Simple average					**7.7**

** Mkt. Cap as of August 18, 2008. Sources: Reuters and NBK Capital*

Using a simple average (excluding outliers) of forward EV/EBITDA of 8.3x and an EBITDA of KD 2.24 million for 2009, we estimate the enterprise value for the hotel operations to be KD 18.5 million.

Care Home Operations

To value care home operations, we have selected five similar European companies. Since care home operations for Salhia are based in Germany, we have taken companies from European countries which have GDP per capita figures comparable to those for Germany. We have tried to focus on companies which run nursing homes or care homes for senior citizens.

For the purpose of valuation, we obtained the current EV (for the last financial interim) and consensus 2009 EBITDA for each company, to arrive at the forward EV/ EBITDA multiple for each of the peer companies. We have calculated the enterprise value for Salhia's care home operations, only on the basis of simple average (excluding outliers) of the forward EV/ EBITDA multiple for the peer basket.

The simple average (excluding outliers) forward EV/ EBITDA multiple stands at 8.6

Figure 8 Care Home Operations - Forward EV/EBITDA Comparison

Company	Country	Market Data EV (USD '000)	Market Data Mkt. Cap.* (USD '000)	EBITDA 2009 (USD '000)	EV / 2009 EBITDA
Southern Cross Health Care Group Plc	UK	668,873	440,085	160,375	4.2
Curanum AG	Germany	389,344	188,140	52,241	7.5
Le Noble Age	France	261,292	183,541	22,043	11.9
Marseille-Kliniken AG	Germany	273,959	171,402	41,440	6.6
Maternus Kliniken AG	Germany	140,984	35,444	11,609	12.1
Weighted average					**6.8**
Simple average excluding outliers					**8.6**
Simple Average					**8.4**

** Mkt. Cap as of August 18, 2008. Sources: Reuters and NBK Capital*

Using a simple average (excluding outliers) of forward EV/EBITDA of 8.6x and an EBITDA of KD 6.62 million for 2009, we estimate the enterprise value for the care home operations to be KD 57.2 million.

Adding the respective enterprise value for each business segment for Salhia, we arrive at the total enterprise value for the company. We estimate the total enterprise value of the company is KD 245.3 million. Since we have taken an EBITDA for 2009, we arrive at the enterprise value for 2009. After subtracting the expected total debt and minority interest for 2009 end, and adding the expected excess cash and the value of non-operating assets for 2009 end, we arrive at a total market capitalization of KD 259.6 million for the company, or KD 0.652 per share.

The SOTP valuation yields a fair value per share of KD 0.652

Figure 9 SOTP Valuation

Enterprise Value	(KD '000)
Real Estate Operations	**169,625**
Hotel Operations	**18,510**
Care Home Operations	**57,201**
Total Enterprise Value	**245,336**
Add: Excess Cash	80,868
Add: Value of Long-Term Investments	37,732
Less:Total Debt	(102,938)
Less: Minority Interest	(1,362)
Mkt. Cap.	**259,638**
Per Share Value in KD	**0.652**

Source: NBK Capital

Risk and Challenges

- With a large supply of commercial property (both office and retail space) on the market, we cannot rule out the possibility of oversupply, which could lead to a decline in rental rates for office and retail space, even in premium locations.
- The expected doubling of hotel rooms in Kuwait is likely to have a severe impact on revenues for Salhia's hotel operations. Because many new hotels are opening and existing hotels are adding new rooms, it is likely that average room occupancy and average room rates will drop.
- The company is exposed to market risk with respect to its investment portfolio. The market downturn is likely to negatively impact investment income and hence the net profit estimates for the company.
- The company is exposed to currency risk through its overseas operations and borrowing in foreign currencies. Fluctuations of foreign currencies compared to the Kuwaiti dinar can negatively impact the company's financials.
- Global economic slowdown owing to all-time high oil prices and the credit crisis may have a negative bearing on developed economies like Germany. This may in turn negatively impact Salhia's care home operations.

BULLS VS. BEARS

Bull Story

- Salhia is well diversified across its three main lines of business, namely: real estate operations, hotel operations and care home operations. The company has operations spread across Kuwait, the United Kingdom and Germany. Salhia has a real estate operation in the form of a joint venture with St. Modwen Properties in the United Kingdom. The company has future projects in other GCC countries such as Bahrain and Oman. The diversification across business segments and geographic locations not only lends strength to the business model, but also greatly insulates the company from downturn in any particular region or country.
- The company carries on its book real estate properties worth KD 43.7 million, the fair value of which is KD 222.8 million (as per 2007 company financial statements, the fair value assessment was carried on by independent property valuers). Even after applying a 50% discount to the market value of the properties yields a 20.5% upside to the stock price, as per the net asset value method.
- The company maintains a focused strategy in coping with increasing competition in the local market. The company mainly focuses on superior quality in planning and implementing projects and on property ownership in the Central Business District (CBD) of Kuwait, which provides its tenants with the ideal mixture of quality properties in prime locations.
- The company has an impressive line of projects. Worth highlighting are the Arraya II office tower, which is expected to be fully operational from 2Q2009, a commercial project in Bahrain, the Elephant and Castle commercial complex, and the Farnborough shopping centre in the UK.
- The Kuwaiti real estate sector trades at a PE of 10.94x (TTM), a PB of 1.69x (1Q2008 Equity), a RoAA of 9% (2007), a RoAE of 17.5% (2007) and dividend yield of 2.7% (on 2007 payout). Salhia appears attractive on all parameters compared to its peers as it trades at a PE of 6.8x (ttm), a PB of 1.3x (1Q 2008 Equity), a RoAA of 10.9% (2007), a RoAE of 21.7% (2007), and a dividend yield of 8.8% (on 2007 payout).

Bear Story

- We expect Kuwait to experience an excess supply of office space in the range of 400,000 sq. m to 450,000 sq. m in the next 3-4 years. This is likely to create pressure on office rental rates. Though Salhia boasts many Class A properties in prime locations, it would still bear the brunt of the expected pricing pressure.
- The unattractiveness of Kuwait as a tourist destination compounded by the oversupply of new hotel rooms is likely to negatively impact average room rates and occupancy rates of hotels in Kuwait. Being one of the prominent players in the hotel segment, Salhia is likely to be adversely affected.
- The global correction of equity markets leading to lackluster performances may have a negative bearing on the return from the investment portfolio for Salhia.

COMPANY BACKGROUND AND BUSINESS MODEL OVERVIEW

Established in 1974, Salhia Real Estate Company is one of Kuwait's leading real estate companies. The company was listed on the Kuwait Stock Exchange in 1984 and is well diversified across business segments and geographic locations. The company operates across three business segments, namely:

- Real estate operations in Kuwait and the UK.
- Hotel operations in Kuwait.
- Care home operations in Germany.

Real Estate Operations

The real estate operations include rental income generating-properties in both the office space segment and the retail space segment. It includes properties in Kuwait and in the UK. The operation in the UK is a 50:50 joint venture between Salhia and St. Modwen Properties, called Key Properties Inc. The joint venture has a diversified portfolio of rental income-producing investments and redevelopment opportunities. The properties include shopping malls, offices, and residential and industrial sites throughout the UK. We have discussed the joint venture separately and hence it is not included in the real estate operations.

Salhia Commercial Complex

Established in 1978, the Salhia Commercial Complex is one of Kuwait's premier shopping and office complexes. It includes 25,471 sq. m of rentable office space and 14,372 sq. m of retail space. The mall is an upmarket one and houses premium global brands. The Salhia Commercial Complex has an enviable track record of 100% occupancy in the last 14 successive years. This is due to Salhia's insistence on providing world class service to its tenants. Timely renovation and maintenance activities are two of the superior services provided to tenants, significantly boosting satisfaction.

Sahab Tower

Completed in 1997, the Sahab Tower is a 20-storey office tower that includes three floors of retail space. The tower includes a total of 10,738 sq. m of rentable space. Its prime location and superior tenant services have ensured that renowned international and regional players have offices in the Sahab Tower. The Sahab Tower boasts a 100% occupancy rate in the recent past.

Salhia Plaza

Completed in 2006, the Salhia Plaza has become an integral component of the Salhia Commercial Centre. It was constructed after completion of the Salhia Car Park, as the spacious area above the car park was a perfect strip for cafés and restaurants. The car park accommodates approximately 450 vehicles.

Arraya Commercial Centre

This mixed-use project includes a contemporary mall, a four-star hotel, offices, conference centre and multi-storey car park. An occupancy rate of 100% for the fourth consecutive year is a testimony to the highest level of quality in construction and service.

Arraya Commercial Complex

The three-storey shopping mall, with a space of 10,749 sq. m, is home to many premium retailers offering the finest global brands. The mall is also complemented by fine restaurants and cafés.

Arraya Offices

The Arraya Tower provides office space of 5,950 sq. m, occupied by local and international firms. The offices are complemented by state-of-the-art technology and security systems.

Arraya Car Park

The Arraya Car Park can accommodate 1,400 vehicles over six floors. It serves as a car park for visitors to the Arraya Commercial Centre and the surrounding commercial area.

Upcoming Projects

Salhia has many upcoming real estate projects in the next 4-5 years, discussed in detail below. However, except for the Arraya Tower II Project, we have not included any of the projects in our revenue projections from this segment. This is because most of these projects are in their initial stages; hence the company management is currently not in a position to disclose material information regarding these projects. However, we will furnish required details regarding all upcoming projects in our subsequent updates and will duly incorporate the information in our forecast model when we source it from the company.

Arraya Tower II Project

Estimated to be 300 meters high, the Arraya Tower II will be one of Kuwait's tallest buildings when completed by the end of the second quarter of 2009. The tower will have 60 floors and will be serviced by 16 elevators. Each floor will have rentable office space ranging from 520 sq. m to 740 sq. m. The total project cost is estimated at KD 32 million.

Al-Asima Project

Salhia holds a 50% stake in the Al-Asima Real Estate Company, which owns the Al-Asima project. The Al-Asima project will be located in Kuwait's business district, and will be built on a site having a total area of 40,152 m².This project will include a commercial mall, café, restaurants and cinemas, four-star hotel apartments, a 75-floor commercial and office tower and a car park consisting of 3 basement levels.

Bahrain

This project will include an office tower and multi-storey car park. The project cost is expected to be KD 32 million. The office tower will have 36,000 sq. m of rentable office space and 7,900 sq. m of retail space. It will be complemented by 891 parking spaces. The preparatory work is expected to be completed by the third quarter of 2008.

Financial Overview

The real estate operation is the biggest business segment in terms of total assets, accounting for 82% of Salhia's total assets as of 2007. On average, it accounted for more than three-fourths of the company's total assets in the last 5 years. The real estate operations accounted for an average of 27% of the company's total revenue in the last 5-years (2003-2007). Revenues from the real estate operations have grown at a 5 year (2002-2007) CAGR of 16%. However, the segment reported subdued growth rates for operating profits by growing at a 5-year CAGR of 1.8% during the same period. The operating margin has shown a declining trend over the last five years and has averaged at 48% over a 5-year period (2003-2007). It stood at 25% in 2007. Total assets for the segment increased at a 5-year (2002-2007) CAGR of 17% and reached KD 266.7 million at the end of 2007.

Real estate operations accounted for 82% of the total assets in 2007

Figure 10 Real Estate Operations - Key Financial Parameters

	2003	2004	2005	2006	2007
Revenues (KD million)	6.3	9.5	9.3	10.2	11.7
% of Total Revenue	24%	28%	27%	28%	29%
Operating Profit (KD million)	4.6	6.0	4.0	3.5	2.9
% of Total Operating Profit	46%	57%	44%	37%	34%
Operating Profit Margin (%)	73%	64%	43%	34%	25%
Assets (KD million)	147.8	164.0	167.1	190.4	266.7
% of Total Assets	77%	75%	77%	79%	82%
Operating Profit / Avg. Assets (%)	3.4%	3.9%	2.4%	1.9%	1.3%

Sources: Company Financials and NBK Capital

Industry Overview and its Impact on the Business Segment

The commercial segment (office and retail space) of Kuwait's real estate sector is experiencing an unprecedented growth phase, supported by a surge in oil prices and booming economic growth culminating in robust corporate activity. Since the company's real estate operations comprise office towers and retail malls, we would restrict our industry overview to these two segments only.

Changes in the law regarding construction of high-rise office towers have resulted in a slew of ongoing projects which are expected to be completed in the next 3-4 years. Height restrictions were relaxed in 2005 (following a number of such changes over the years), when the Kuwait Municipality decided to allow the construction of 100-storey buildings in Kuwait City, provided the height did not exceed 400 meters and buildings did not occupy more than 10,000 sq. m in area. This new trend attracted more developers, as the additions of floors meant more income on the same plot of land.

We expect the corollary effect of this new trend to negatively impact the office segment business in Kuwait. We expect a fresh supply of office space in the next 3-4 years to result in a huge excess, thus putting pressure on office rental rates. We expect a new supply of 216,000 sq. m in 2008, 106,000 sq. m in 2009 and 223,000 sq. m in 2010. Notable office towers expected to be completed within this period are as follows:

Quite a few office towers are expected to be completed in the next 2-3 years in Kuwait

Figure 11 A Few Important Upcoming Office Towers in Kuwait

Office Towers	Floors	Leasable Area sq. m	Expected Completion
Al-Jawhara Tower	34	24,082	May-08
Panasonic Tower	34	29,067	Oct-08
Kuwait Trade Center	37	25,000	2008
Arraya Tower II	60	36,326	Mar-09
Al-Hamra Tower	77	133,350	Beginning of 2010
United Tower	60	40,000	End of 2011

Source: NBK Capital

We expect Kuwait to see an excess supply of office space in the range of 400,000 sq. m to 450,000 sq. m. According to various industry sources, this excess is expected to range anywhere between 300,000 sq. m and 500,000 sq. m. A huge 617,000 sq. m of cumulative office space is expected to be added to currently available office space by 2012, which accounts for an astonishing 70% of the current supply.

Kuwait is likely to experience a huge excess supply of office space going forward

Figure 12 Demand-Supply Scenario of Office Space in Kuwait

Office Space	2005	2006	2007	2008E	2009E	2010E
	(sq. m)	(sq. m)	(sq. m)	(sq. m)	(sq. m)	(sq. m)
Supply	748,000	819,775	885,515	1,101,515	1,207,515	1,430,515
Demand	741,076	783,317	803,684	951,039	971,962	996,261
Excess Supply	**6,924**	**36,458**	**81,831**	**150,477**	**235,553**	**434,254**

Source: NBK Capital

On the rental front, a prime office location can be rented for an effective average rate of KD 11 per sq. m per month, while a Class B office can be rented for an effective average rate of only KD 7 per sq. m per month. With the excess supply of office space building up in the next few years, we expect pressure on office rental rates going forward.

Excess supply in office space in the next few years is likely to put pressure on rental rates going forward

Figure 13 Current Rental Rates for Office Space in Kuwait

Rents (KD / sq. m / month)	Low	High	Effective Avg.	Vacancy
Downtown Office				
New Construction (AAA)	8	14	11	4%
Class A (Prime)	8	14	11	2%
Class B (Secondary)	4	10	7	3%

Sources: NAI Global and NBK Capital

With the expected pricing pressures, the moot question to be answered is how will Salhia be impacted? Since Salhia has a portfolio of Class A properties in prime locations, we feel its main competition is the fresh supply of similar kinds of properties. We expect Salhia to bear the brunt of the expected excess supply of office space. However, we are confident that its long-standing reputation as a quality service provider will be of help in times of need.

We expect the decrease in occupancy rates and office rental rates to be lower for Salhia compared to other players in the market. We see potential competition for Salhia emerging from properties such as the United Tower, the office towers in Kuwait Business Town, the Kuwait Trade Centre and the Al-Hamra Tower. These four will add approximately 238,000 sq. m of office space in Kuwait in the next 2-3 years. However, it is quite true that there are presently very few office towers comparable to the ones owned by Salhia in terms of location, quality of service and amenities.

On the retail space front, we expect fresh supplies in the next 2-3 years as well. But we expect the impact to be less severe, compared to the office space segment. We see in Figure 14 that currently (as of 2007 end) there is a tight demand supply situation, with supply marginally outstripping demand. We would like to emphasize that comparatively prominent malls (we have highlighted a few in Figure 15) currently operate at full occupancy rates. As per industry data, prominent malls in Kuwait account for 76% of the total supply (475,000 sq. m), while secondary malls (malls in less attractive locations) make up the remainder. We don't expect occupancy rates to change for the prominent malls going forward. This is mainly due to the reason that the notable supply which is expected in 2010 and beyond from 360^0 Kuwait Mall (leasable area of 82,000 sq. m) and Mall of Kuwait (leasable area of 150,000 sq. m) are being built in new locations far from existing comparable malls. Hence, they would have their own target client base. We have recently seen that the Avenues mall in the Al Rai area (distant from other prime commercial facilities) benefited significantly from its location, though it was initially thought to be a major drawback.

The recent surge in oil prices, leading to booming economic activity in Kuwait and the increased purchasing power of the general masses, has culminated in good business for the retail malls in the recent past. The increase in the purchasing power of individuals, combined with a high degree of brand awareness, has increased the common man's tendency to shop in Kuwait. The lack of other entertainment avenues in Kuwait has further encouraged the average person to shop in these malls. Hence, we perceive that the expected nominal excess of retail space going forward is unlikely to severely impact occupancy rates and rental rates.

A new supply of 319,000 sq. m in the retail space segment is expected in the next 2-3 years in Kuwait

Figure 14 Demand-Supply Scenario of Retail Space in Kuwait

Retail Space	2005	2006	2007	2008E	2009E	2010E
	(sq. m)	(sq. m)	(sq. m)	(sq. m)	(sq. m)	(sq. m)
Supply	300,000	345,000	625,000	694,000	705,820	944,000
Demand	340,360	355,212	602,361	662,597	728,857	911,071
Excess Demand	**-40,360**	**-10,212**	**22,639**	**31,403**	**-23,037**	**32,929**

Source: NBK Capital

On the rental front, we observe (Figure 15) an effective range between KD 18 per sq. m per month to KD 45 per sq. m per month, depending on the location and type of mall. Taking into account strong demand in the retail space segment going forward, we do not expect any major decrease in rental rates for retail malls.

Figure 15 Notable Malls in Kuwait and Rental Rates

Name of the Mall	Leasable Area (sq. m.)	Rent (KD/sq. m/month)
The Avenues	162,500	20-25
Alkout	17,000	25-35
Arraya	10,749	18-20
Marina	31,000	30-45
Thuraya	5,400	25-35
Souq Sharq	28,300	25-35
Alboustan	12,000	20-30
Alfanar	17,000	25-35
Laila Gallery	6,400	20-30
Salhia	14,372	20-30

Source: NBK Capital

We expect rental rates for retail space to remain steady on the back of strong demand

Addressing the impact on Salhia from the new supply of retail space, we would like to state that both retail malls (Salhia Mall and the mall in the Arraya Commercial Centre) managed by the company are upmarket, catering to the highest strata of society. The company has a clear strategy of distinguishing its malls from the other mass market ones and is the only notable player in that particular niche. The 360^0 Kuwait Mall and the Mall of Kuwait are both expected to target the same segment as the Avenues Phase I. The only competition for Salhia is the recently opened boutique mall in the Avenues Phase II. We therefore expect Salhia to continue enjoying high occupancy rates and rental rates since the new supply caters mainly to the mass market segment.

Hotel Operations

Salhia's hotel operation segment includes two premier hotel properties, both under the management of the Marriott group, the JW Marriott Hotel (5 star) and the Courtyard Marriott Hotel (4 star). In addition to these, the segment also includes the 1,500 sq. m Arraya Ballroom, one of Kuwait's most luxurious halls for celebrations and formal activities.

JW Marriott Hotel

The JW Marriott Hotel is a premier 5-star property comprised of 16-storeys, 74 suites, 241 rooms, conference and meeting facilities, and five restaurants. Salhia signed the management agreement with Marriott International in 2002. Previously, Le Méridien held the management contract since the hotel's inception in 1981. The hotel is located in the heart of the city and is connected to the prestigious Salhia Shopping Complex.

Courtyard Marriott Hotel

The Courtyard Marriot Hotel, a 4-star property, is a comparatively newer property than its 5-star counterpart. Opened in 2003, it was Salhia's second hotel offering in Kuwait City's business district, comprised of 306 rooms and 12 VIP suites. Thus, the need for a high quality but moderately priced hotel close to the business district was successfully addressed.

Arraya Ballroom

The Courtyard Marriott also manages the 1,500 sq. m Arraya Ballroom, adjacent to the hotel. Arraya Hall is still one of Kuwait's most luxurious halls for celebrations and formal activities.

Financial Overview

The hotel operations comprise the most profitable business segment for Salhia. On average, the hotel segment accounted for 36% of the company's total revenue over the last 5 years (2003-2007), but only had a meager 1% (5-year average) share of the company's total assets. Revenues from hotel operations have grown at a healthy 5-year (2002-2007) CAGR of 17%. The segment reported similar growth rates for operating profits as well during the same period. The operating margin has averaged at 33% over a 5-year period (2003-2007) and stood at 31% in 2007.

The hotel operations have reported healthy operating results in the past

Figure 16 Financial Performance Overview - Hotel Operations

	2003	2004	2005	2006	2007
Revenues (KD million)	9.4	13.0	12.0	13.3	14.3
% of Total Revenue	36%	38%	36%	36%	35%
Operating Profit (KD million)	4.0	3.4	3.4	4.7	4.5
% of Total Operating Profit	39%	32%	38%	50%	52%
Operating Profit Margin (%)	42%	26%	29%	36%	31%
Assets (KD million)	2.5	2.7	2.3	3.8	4.1
% of Total Assets	1%	1%	1%	2%	1%
Operating Profit / Avg. Assets (%)	167.9%	130.1%	137.7%	154.4%	112.5%

Sources: Company Financials and NBK Capital

Industry Overview and its Impact on the Business Segment

The hotel industry in Kuwait has reported decent growth post 2002, fueled mainly by an overall uptake in corporate activity and marked improvement in cross-border geopolitical tensions, which have gripped the region for so long. Occupancy rates (as per the Kuwait Hotel Owners' Association) for the entire sector have improved significantly over the years, from a dismal 44% in 1998 to 61% in 2007. However, we feel the occupancy rates have peaked, judging by the falling trend in the last three years (67% in 2005, 63% in 2006 and 61% in 2007) and the expected huge supply of new hotel rooms in the next 3-4 years. Since Salhia's hotel operations include a 5-star property and a 4-star property, we would restrict our industry overview to only these two categories of the sector.

According to the Kuwait Hotel Owners' Association, an additional 1,400 new hotel rooms (almost 50% of existing hotel rooms in the 5-star category) are expected to be available in the next 3-4 years. The scenario looks even more gruesome in the 4-star category, where it is expected that hotel rooms will double in the next 3-4 years. This is likely to negatively impact average room and occupancy rates in these categories. We feel the prime location and the fact that both Salhia's hotels are managed by the Marriott group are big positives for the company. But with the huge supply of new rooms managed by equally renowned global names, the hotel segment for the company will definitely be put to the test.

Figure 17 **Expected Supply of Rooms in the 5-Star and 4-Star Categories**

We expect a huge supply of new hotel rooms in Kuwait going forward

Type of Property	Number of Hotels	Existing Rooms	Expected Supply
5-Star	11	2,889	1,400
4-Star	6	1,071	1,070
Total	17	3960	2470

Sources: Kuwait Hotel Owners' Association and NBK Capital

Care Home Operations

Salhia operates its care homes business in Germany through its 89.7% subsidiary Haddia Holding, which is headquartered in Hanover, Employing approximately 900 staff, it is involved in the development, ownership and management of nursing homes and seniors' residences in northern Germany. The company owns and operates 13 nursing homes and four seniors' residences in the Hanover, Hamburg, Bad Pyrmont and Neustadt areas.

Haddia Holding in turn holds stakes in Dana (the operating company for the care homes), SAREC (specializes in leasing properties, mainly leasing nursing homes to Dana), Dana Ambulante (specializes in care home service), and Gredo (specializes in care home catering). The primary activities of these companies are development, ownership, leasing and management of nursing homes and seniors' residences. Salhia holds an 89.7% ownership stake in all these subsidiaries. At the end of 2007, Salhia owned 1,600 beds with a bed occupancy rate of 82.5%.

Financial Overview

The care home operation is the largest segment for Salhia in terms of its share of total revenue (36%), as of 2007. On average, the segment accounted for 36% of the company's total revenue in the last 5-years (2003-2007). Revenues from the care home operations have grown at a 5-year (2002-2007) CAGR of 11.9%. However, operating profits for the segment decreased at a 5 year CAGR of 4.8% during the same period. The operating margin has declined over the last five years and has averaged at 11% over a 5-year period (2003-2007). It stood at 8% in 2007. Total assets for the segment increased at a 5 year (2002-2007) CAGR of 13.1% and reached KD 53.9 million at the end of 2007.

Figure 18 **Financial Performance Overview - Care Home Operations**

Though revenue growth has been impressive over the years, the operating margin has shown a declining trend due to rising costs

	2003	2004	2005	2006	2007
Revenues (KD million)	10.1	11.6	12.5	13.0	14.7
% of Total Revenue	39%	34%	37%	36%	36%
Profit from Operations (KD million)	1.5	1.3	1.6	1.3	1.2
% of Total Profit from Operations	15%	12%	18%	14%	14%
Operating Margin (%)	15%	11%	13%	10%	8%
Assets (KD million)	41.7	52.8	47.7	48.2	53.9
% of Total Assets	22%	24%	22%	20%	17%
Profit from Operations/Avg. Assets (%)	4.3%	2.6%	3.3%	2.7%	2.4%

Sources: Company Financials and NBK Capital

Industry Overview and its Impact on the Business Segment

Demographics in Germany are dominated by higher life expectancy and falling birth rates. According to a report released by Germany's Federal Statistics Office in November 2006, the country's population will decrease from the current 82.4 million to 69 million by 2050 and will have a significant percentage of senior citizens. It is expected that more than 10 million people over the age of 80 will live in Germany in 2050, almost triple what it was in 2005 (3.7 million). It is also expected that the life expectancy of persons aged 65 in 2050 will be 4.5 years longer than the 65-year olds of today. The average age of the population will rise from 42 to 50, and every second German will be over 50 by the year 2035.

With an ageing population and comparatively higher disposable income, the developed countries of Western Europe are seeing a heightened demand for quality facilities and nursing skills to address the need. Industry forecasts indicate that an additional 10,000 beds will be required in the near future, underscoring the opportunity for growth in this sector. We expect Germany, with its comparatively high per capita GDP and an aging population, will experience increasing demand for care homes for senior citizens. Coupled with the fact that increasing numbers of baby boomers will be falling into the old age bracket, prospects for the care home business in Germany are bright.

We expect these good industry prospects will have a positive impact on Salhia's care home operations. We expect revenues from care home operations to grow at a 5-year CAGR of 7.8% between 2007 and 2012. A steady rise in both average realization (per bed) and occupancy levels will result in revenue growth from this segment over the forecast period.

Joint venture in the United Kingdom: Key Property Investments

Key Property Investments (KPI) is a 50:50 joint venture between Salhia and St. Modwen Properties. It was established in 1997 with an initial capital of GBP 25 million. The joint venture has a diversified portfolio of rental income-producing investments and redevelopment opportunities. The properties include shopping malls, offices, and residential and industrial sites throughout the UK. Among them are the Elephant & Castle regeneration project in South London, the redevelopment of Farnborough Town Centre and a mixed-use development in Rugby.

Main Upcoming Projects

Elephant and Castle Commercial Complex-UK

The Elephant and Castle Commercial Complex is a major regeneration project located in central London. The property currently includes 21,800 sq. m of a covered shopping mall and an 11-storey office building covering an area of 8,400 sq. m. The future plans for the project include major redevelopment at a total cost of GBP 1.5 billion. The plan includes 60,400 sq. m of retail and other commercial facilities, and up to 5,300 new homes in the area. Construction will be phased across 10 years, starting in 2010.

Farnborough Town Centre

This is yet another redevelopment project. The property currently has 31,000 sq. m of retail, office and residential accommodation, and includes parking spaces for 750 cars. In 2006, KPI obtained the conditional planning consent for partial redevelopment to create a major new mixed-use project on the same site. This new project will include 11,600 sq. m of new retail space, a Sainsbury's supermarket measuring 4,600 sq. m, a 77-room Travelodge, and 159 residential apartments. The construction is already underway and the first units will be ready by the end of this year. In addition, a 2,700 sq. m, eight-screen cinema is due to open in 2009 and an array of restaurants, leisure facilities and offices will be spread over 2,300 sq. m.

FINANCIAL OVERVIEW AND FORECASTS

Total Revenue

As discussed earlier, Salhia operates in three business segments: 1) real estate operations, 2) hotel operations and 3) care home operations. To analyze the future trend of total revenues, we will deal with each segment individually and try to understand the trend going forward.

Real Estate Operations

We expect revenues from real estate operations to grow at a 5-year CAGR of 4.3% between 2007 and 2012. The incremental revenue which we see in Figure 19 below from 2009 onwards (compared to 2007 and 2008) is entirely due to the start of the Arraya II office tower operations. We expect that rental income from the tower will account for 33.8% (average of 2010 to 2012) of the total revenue for the entire segment. We expect the Arraya II office tower would act as the catalyst to boost rental income for the company. Management expects the tower to be fully functional from the start of 2Q2009. Accordingly, we have accounted for only nine months of rental income from the tower in 2009 and we expect an average occupancy level of 94% for the tower in the forecast period (2009-2012).

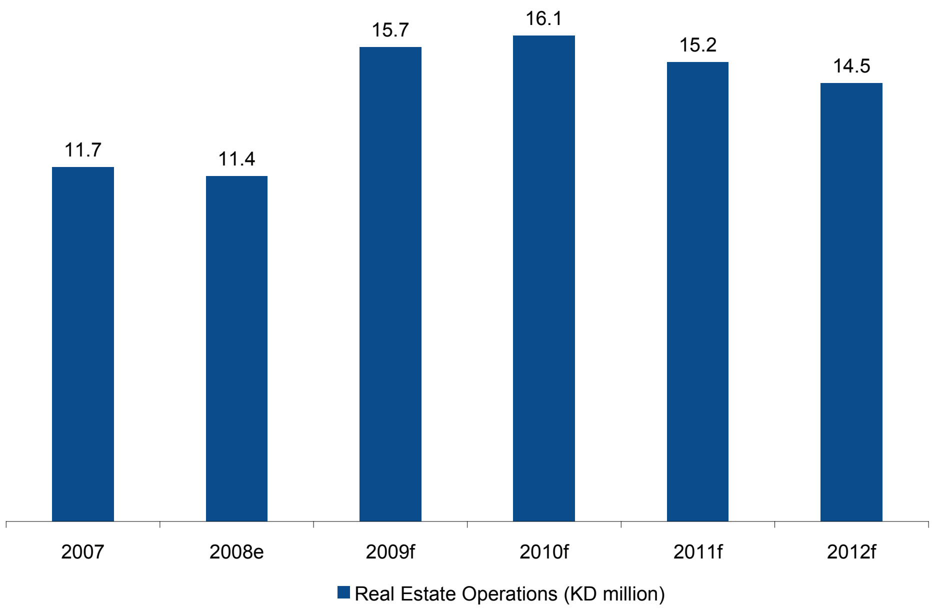
The main drivers for this segment are the average rent (per sq.m) for each of the properties and the occupancy rate. The rental income earned from each of the properties is simply a product of the earlier mentioned drivers (average rent and occupancy rate). As of 2007, Salhia manages a total of 103,606 sq. m of rentable area divided into 78,485 sq. m of office space and 25,121 sq. m of retail space. In the recent past, the company has reported 100% occupancy rates for all properties (both office and retail space). But with the expected huge supply of office space (2008 onwards) and retail space (from 2010 onwards), we are a bit conservative going forward (discussed earlier in detail in the Industry Overview segment).

We expect occupancy rates for Salhia-owned office space (excluding Arraya II) to drop from the current level of 100% to 88% by 2012. Occupancy rates for retail spaces are expected to drop to 90% by 2012. However, the drop in occupancy rates for the office space would be at a faster pace than for the retail space due to the timing difference of the new supplies for each of the categories. On the rental rates front, we expect rental rates for the retail space to marginally decrease over the forecast period (2008-2012) at a 5-year CAGR of 0.6% for the Salhia Commercial Complex and 0.2% for the Arraya Commercial Centre. We expect rental rates for Salhia Commercial Complex and Arraya Commercial Centre office space to decrease at a 5-year CAGR of 2% over the forecast period. We expect rental rates for the Sahab Tower to decrease at a 5-year CAGR of 1.1% over the forecast period.

The decrease in rental rates for each of the properties discussed above might appear incommensurate with our base assumption of a negative impact on the office and retail space segment due to the expected fresh supply in the next 3-4 years. We would like to note that the underlying negative sentiment has been duly reflected in the total rental income for each of these properties, since we have an average decreased occupancy rate of 10%-12%, depending on whether it is retail or office space. We also feel prime properties and long-term rental contracts with clients would insulate Salhia from the expected decrease in rental rates and occupancy rates in the office and retail segment to a certain extent.

The incremental revenue for the real estate operations (compared to 2007 and 2008) is entirely due to the Arraya II office tower, but is partially offset by the expected fall in rental rates and occupancy rates for the other properties

Figure 19 Forecasted Trend of Revenue from Real Estate Operations



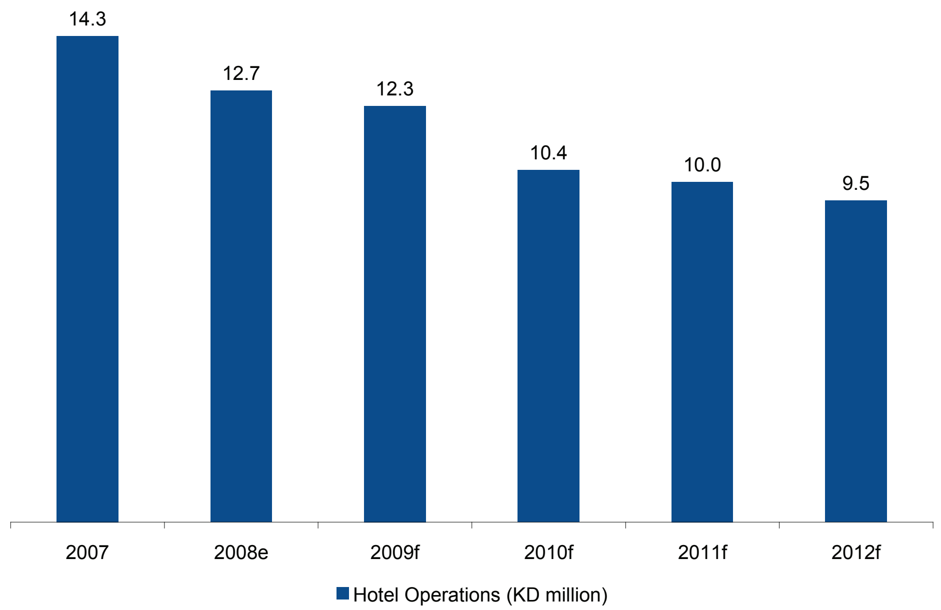
Sources: Company Financials and NBK Capital

Hotel Operations

The expected doubling of hotel rooms in Kuwait will have a severe impact on the revenues from this segment. With many hotels opening and existing ones adding new rooms, it is likely that average room occupancy and average room rates will drop. We expect revenues from hotel operations to decrease at a 5-year CAGR of 9% between 2007 and 2012. We expect occupancy rates for the JW Marriot to drop from 60% in 2008 to 47.5% in 2012. We also expect occupancy rates for the Courtyard Marriot to decline going forward, dropping from 65% in 2008 to 55% in 2012. We expect average room rates for the JW Marriot to decrease from KD 75 per night in 2008 to KD 60 per night in 2012. We forecast room rates per night for the Courtyard Marriot to decline from KD 60 in 2008 to KD 54 in 2012. For the entire forecast period, we expect income from food & beverages, laundry and other sources to account for 16% of total room revenue for each of the hotel properties. However, we expect revenue from the Arraya Ballroom to grow at a meager CAGR of 5% over the forecast period, mainly because it is one of the most preferred locations for weddings and exhibitions in Kuwait.

A greater than 60% increase in hotel rooms in the 5-star and 4-star category by 2010 is likely to negatively impact the segment's revenue going forward

Figure 20 Forecasted Trend Revenue from Hotel Operations



Sources: Company Financials and NBK Capital

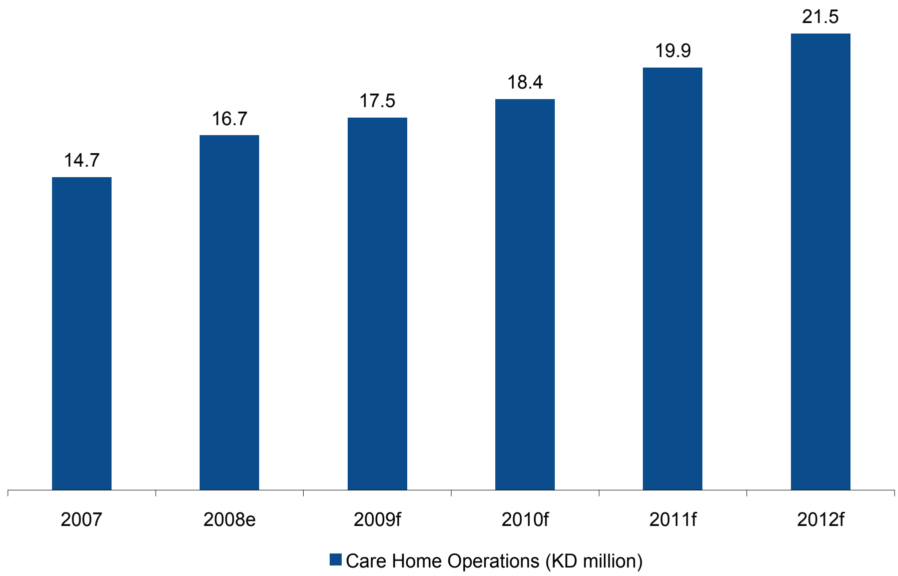
Care Home Operations

We expect revenues from care home operations to be one of the main catalysts driving total revenue for the company. We expect revenues from care home operations to grow at a 5-year CAGR of 7.8% between 2007 and 2012. A steady rise in both average realization (per bed) and occupancy rates will result in revenue growth from this segment in the forecast period.

We expect bed occupancy rates to increase from 82.5% in 2007 to 90% by 2012. This is mainly due to the increasingly high proportion of the aging population in Germany (discussed earlier in detail in the Industry Overview segment). We also expect average realization per bed to increase at a 5-year CAGR of 6% over the forecast period (2008-2012).

An expected increase in the percentage of the senior population in Germany will drive the segment revenue going forward

Figure 21 Forecasted Trend of Revenue from Care Home Operations



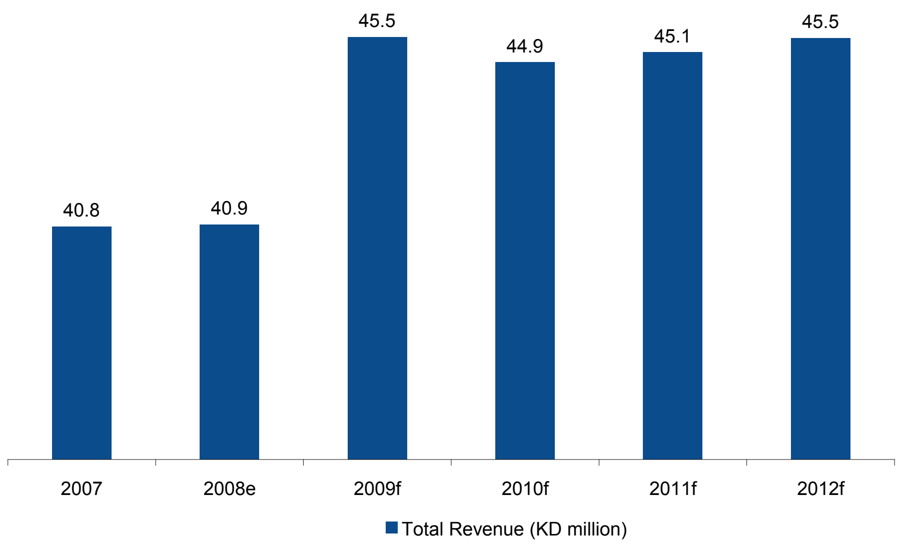
Sources: Company Financials and NBK Capital

Total Revenue

We expect total revenues for the company to grow at a 5-year CAGR of 2.2% between 2007 and 2012. As discussed earlier, care home operations would be the main driver for the growth in total revenue. Incremental revenue from the start of operations of the Arraya II office tower would also have a positive impact on the company's top line. But the negative outlook of the hotel operations to a great extent offsets the positive impact of the other two segments. As a result, we expect subdued top line growth for the company going forward.

Growth in revenues from care home operations would be offset by the fall in revenue from hotel operations, resulting in meager total revenue growth

Figure 22 Forecasted Trend of Total Revenue



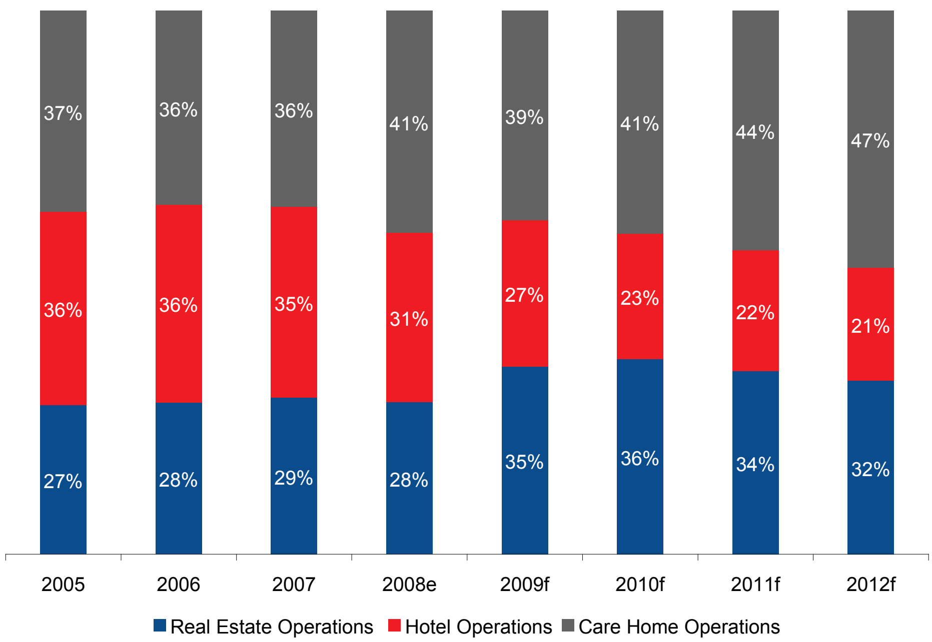
Sources: Company Financials and NBK Capital

Revenue Mix (by segments)

We expect the revenue mix to tilt towards the care home operations, as its share in total revenue is expected to increase to 47% in 2012, compared to 36% in 2007. The share of real estate operations would also marginally increase to 32% in 2012, compared to 29% in 2007. However, a contrasting trend would be visible in the hotel operation, which share of total revenue is expected to decline to 21% in 2012, compared to 35% in 2007.

We expect the share of revenue from care home operations to account for almost half of the company's total revenue by 2012

Figure 23 Forecasted Trend of Revenue Mix

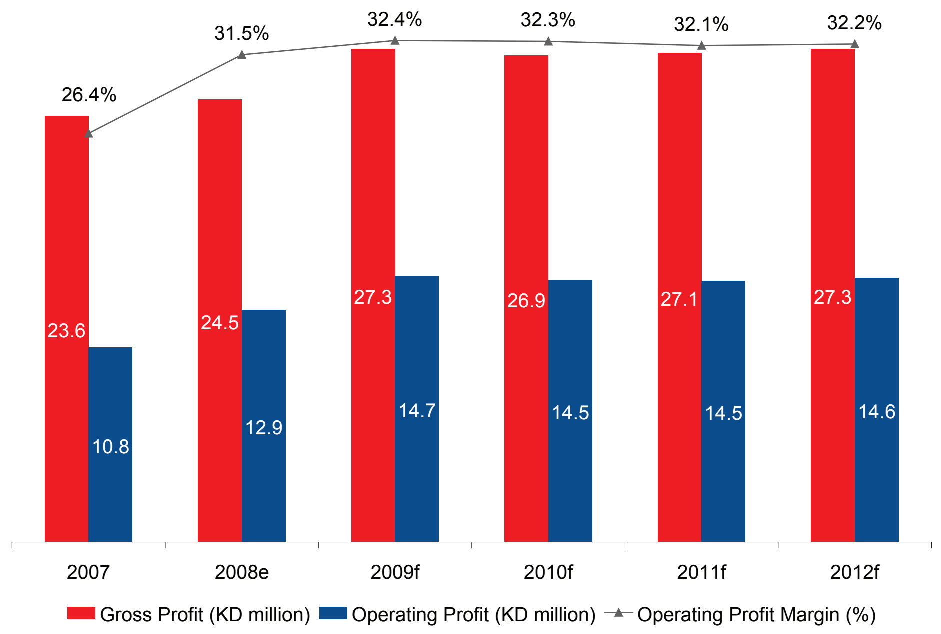


Sources: Company Financials and NBK Capital

Gross Profit and Operating Profit

We expect the gross profit margin to consolidate at 60% in the forecast period, and gross profit to therefore grow at a 5-year CAGR of 2.97%. We expect the operating profit to grow at a 5-year CAGR of 6.32% during the forecast period, pushing the operating profit margin to consolidate in the range of 31.5%-32.5% in the forecast period. We have assumed the cost structure for the company to be very much in line with the historical medium (5 years) and long-term (10 years) averages.

Figure 24 **Forecasted Trend of Gross Profit, Operating Profit and Operating Margin**



Sources: Company Financials and NBK Capital

Gross profit and operating profit to grow at 5-year CAGRs of 2.97% and 6.32% over the forecast period

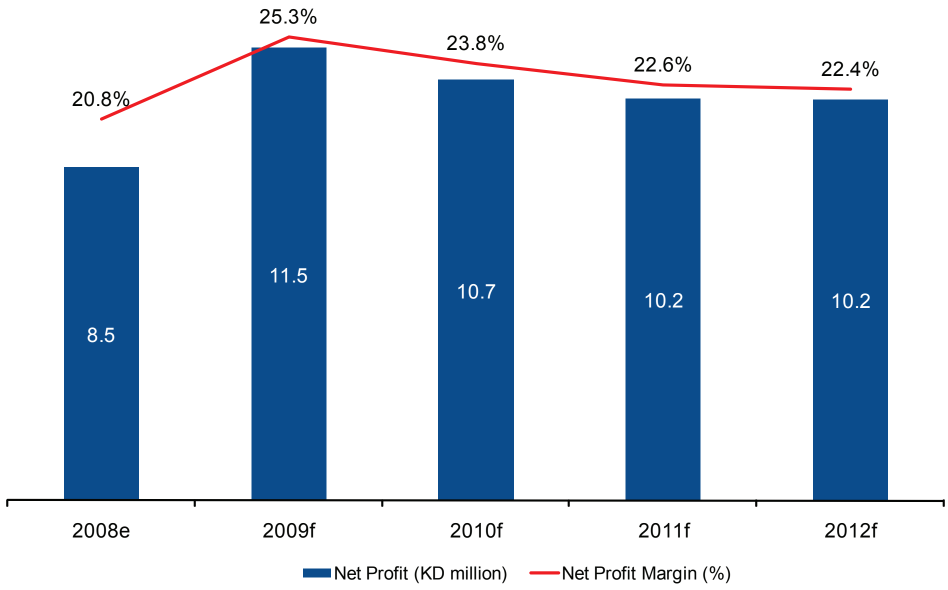
Net Profit and Net Profit Margin

We expect net profit to grow at a 4-year CAGR of 4.7% during the forecast period. This has been calculated considering 2008 as the base year. We would like to note that in both 2006 and 2007, the net profit for the company was boosted by the inclusion of gains from property sales and hence we did not take 2007 as the base. Gains from property sales amounted to KD 49 million and 26.8 million in 2006 and 2007 respectively. In 2006, the company sold a piece of land to Al Asima Real Estate Co. (project managers for the Al Asima project and a 50% subsidiary of Salhia) at a proportionate gain of KD 49.1 million. In 2007, Salhia sold another piece of land (estimated size 3,605 sq. m) at a gain of KD 25.1 million.

However, for our forecasts, we have not taken into account any income from property sales. The company management has not expressed any interest in selling any specific property, but is open to the idea if the transaction yields an attractive return for the shareholders' in general. Since for the purpose of initiation we have ignored such items, in our subsequent updates we will be comparing our net profit estimates to the normalized net profit figures actually reported by the company. We expect an average net profit margin of 23% for the forecast period (2008-2012).

Figure 25 **Forecasted Trend of Net Profit and Net Profit Margin**

We expect net profit to grow at a 4-year CAGR of 4.7% during the forecast period



Sources: Company Financials and NBK Capital

Available-for-sale Investment Portfolio

The company's available-for-sale investment portfolio stood at KD 102.7 million as of 2007 year end. In 2007, managed portfolio accounted for almost 79.7% of the total investment portfolio, whereas unquoted securities accounted for 20%. Managed funds accounted for a meager 0.3% of the total investment portfolio in 2007. However, on a 4-year (2004-2007) average, the managed portfolio accounted for 53% of the total investment portfolio, whereas unquoted securities and managed funds accounted for 34% and 13% respectively. The managed portfolio comprises local and foreign equity instruments, whereas the unquoted securities are private equity investments. The company expects to maintain the investment portfolio in the range of KD 30 million – KD 40 million going forward, which translates into 12% -13% of forecasted total assets.

Figure 26 **Historical and Forecasted Trends - Investment Portfolio and Return on the Portfolio**

We expect the investment portfolio to account for 12% -13% of total assets going forward

	2005	2006	2007	2008e	2009f	2010f	2011f	2012f
AFS* Investment (KD million)	28.1	36.8	102.7	35.9	37.7	39.6	39.6	39.6
% of Total Assets	13%	15%	32%	13%	13%	12%	12%	12%
Investment Income (KD million)	11.5	0.9	6.1	3.5	1.8	1.9	2.0	2.0
% of Net Income	65%	2%	20%	41%	16%	18%	19%	19%
Yield on the portfolio (%)	45%	3%	9%	5%	5%	5%	5%	5%

** Available-for-Sale. Sources: Company Financials and NBK Capital*

Considering the variability of expected returns from the investment portfolio, we have tried to be as conservative as possible regarding the returns from the portfolio in the forecast period. We expect a 5% return from the investment portfolio for each of the years in our forecast period (2008-2012). Our conservatism regarding the expected returns from the portfolio is largely based on the historic trend of returns from the portfolio. The portfolio returns from 1997 can be broken down into 3 distinct phases: Phase I (1997-2000), in which the returns averaged 4.9%; Phase II (2001 – 2005), in which the portfolio returns averaged 24.5%, with returns peaking at 44.8% in 2005; and finally Phase III (2006 – 2007), in which portfolio returns averaged 5.8% (2007 return – 8.8%).

We feel the geographical allocation of underlying assets will play an increasingly important role regarding the total returns of the portfolio. We believe that the striking average returns during the period 2001-2005 were mainly to do with the regional concentration of the portfolio and the stellar performance of most of the regional equity markets. Our argument becomes even stronger when we observe that returns from the portfolio increased from 15.3% in 2001 to 44.8% in 2005, following the trends of the regional equity markets. However, we observe in Figure 27 that foreign investment (as a % of total investment portfolio) has gradually increased from 33% in 2004 and currently stands at 71% in 2007. We feel that the increased concentration of foreign investment would result in returns being comparatively subdued, significantly reduced from the lofty heights of 2004 and 2005. Our 5% expected return from the investment portfolio is very much in line with the average return generated in the periods 1997-2000 and 2006-2007. The company's new investment strategy of focusing on partial capital guaranteed liquid assets further reinforces our expectation regarding returns from the portfolio.

Increased weight of foreign investment in the last four years

Figure 27 Historical Trend - Allocation of the Investment Portfolio

Investment Portfolio	2004	2005	2006	2007
Local Investment (% of total Investment)	67%	65%	55%	29%
Foreign Investment (% of total Investment)	33%	35%	45%	71%

Sources: Company Financials and NBK Capital

Property & Equipment, Investment Properties and Cash Balance

As discussed earlier, except for the Arraya Tower II Project, we have not included any of the other upcoming projects in our projections. Hence, for forecasting the property and equipment block, we have considered meager additions and expect it to grow at a 5-year CAGR of 1.5% over the forecast period (2008-2012).

We expect no further addition to the investment properties block going forward and hence this block would be reduced by the amount of depreciation for each of the years in the forecast period.

We consider the substantial cash balance of KD 62.95 million in 2008 (significant throughout the forecast period) does not truly reflect the future. We expect this amount to be gainfully used for upcoming projects and hence the company would revert back to its usual ways of maintaining the required cash balance. We would like to highlight that maintaining a significantly high cash balance (as it appears in the forecasted financials) is in no way an intended policy of the company and does not lead to any conclusion regarding the lack of the company's alternative investment opportunities. We believe the company is already sitting on an impressive pipeline of projects and would use this cash to successfully execute those. Investors have no reason to believe that a significant pile up of cash would drag down the company's overall returns.

Debt - Is it a Serious Issue for Salhia?

Salhia has maintained an average debt-to-equity ratio of 0.96 over the last 11 years from 1997 – 2007, ranging from a maximum of 1.28 in 2003 to a minimum of 0.64 in 2006. The ratio stands at 0.94 in 2007, almost equivalent to the 10-year average. We believe a debt-equity ratio of 1 for Salhia should not be of material concern to the investors; the company's robust business model has a proven history of continued service of its debt burden and is likely to work in this manner in the foreseeable future. We don't expect any significant change in the trend of debt-to-equity ratio going forward, since the company management expects to adhere to a debt-to-equity ratio range of 0.5-1. On the interest serviceability front, we expect the company to have a 5-year average (2008-2012) EBITDA Interest Cover and EBIT Interest Cover ratio of 2.8x and 2.1x respectively over the forecast period.

We expect the company to maintain a debt-to-equity ratio in the range of 0.5-0.75 going forward

Figure 28 Salhia is suitably placed to service its outstanding debt

Key Debt Parameters	2005	2006	2007	2008e	2009f	2010f	2011f	2012f
Total Debt (KD million)	103.4	86.8	143.0	84.3	102.9	121.6	131.8	133.0
Debt-Equity Ratio	1.00	0.64	0.94	0.50	0.60	0.70	0.75	0.75
EBITDA Interest Cover (x)	2.00	1.77	2.13	2.58	3.47	2.87	2.54	2.46
EBIT Interest Cover (x)	1.27	1.18	1.44	1.88	2.62	2.15	1.90	1.84
Net Opr. Cash Flow / Int. (x)	1.83	1.28	2.53	6.53	3.31	2.60	2.33	2.26
Subsidiary's Loans (KD million)	36.9	34.2	36.8					
Parent Co's Loans (KD million)	66.5	52.6	106.2					
Secured debt (KD million)	33.7	25.2	55.5					

Sources: Company Financials and NBK Capital

We expect the company to manage its debt policy in a prudent way going forward, as it has done in the past. Salhia's future debt policy will not only act as a source of capital for ensuring successful execution of its upcoming projects, but would also lower the overall cost of capital for the company, thus maximizing shareholders' value.

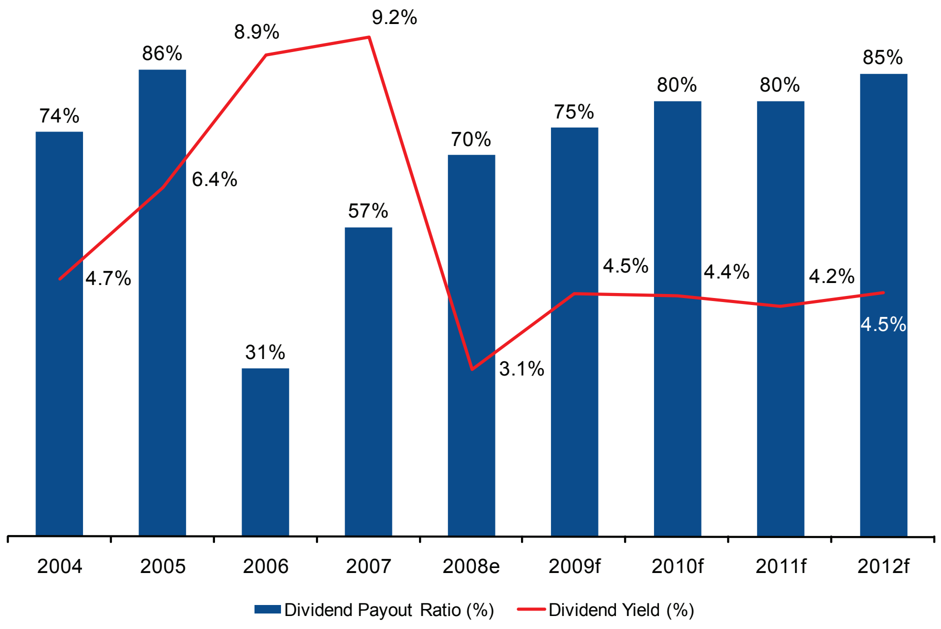
We would like to note (Figure 28) that 25% of the 2007 total outstanding debt is due to loans obtained by subsidiaries, with no recourse on Salhia.

Dividend Play

Salhia has a track record of consistent high cash dividend payouts (average of 62% in the last 4 years) resulting in an attractive current dividend yield of 8.8% [on dividend per share (DPS) for 2007]. On an expected DPS of KD 0.015 for 2008, the stock is currently trading at a dividend yield of 3.1%. We expect consistency in dividend payouts to be maintained going forward, (average of 78% for the period 2008-2012) and to comparatively improve, taking into consideration the matured business model of the company and its ability to generate sustainable cash flows.

We expect the company to maintain a high dividend payout ratio going forward

Figure 29 Notable Cash Dividend Yield



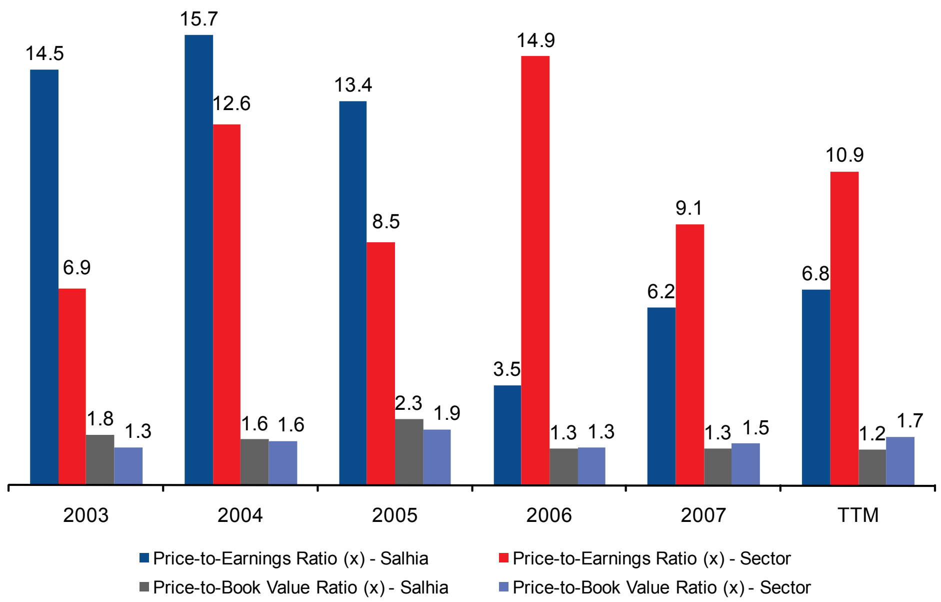
Sources: Company Financials and NBK Capital

Attractive on Price Multiples - Compared to the Kuwait Real Estate Sector

Salhia traded at a premium to the sector on a price-to-earnings ratio (x) (PE) basis from 2003 to 2005 (Figure 30). But from 2006 onwards, it has traded at a substantial discount to the sector. We feel this is mainly due to rising investor concerns regarding quality of earnings, since the net profit for both 2006 and 2007 were significantly boosted by gains from property sales, as discussed earlier. We feel the inherent strength of the business model and future expectations do not warrant the currently low trailing twelve month (ttm) PE (x) of 6.2, which is at a 61% discount to the ttm PE (x) for the Kuwaiti real estate sector. We would like to highlight that strategic sales of real estate properties by a real estate company cannot be entirely termed as non-operating income. Sale of real estate properties for unlocking value for comparatively high yielding projects is very much in line with the strategic objectives of any company. We are of the opinion that the Kuwaiti real estate sector as whole suffers from susceptible quality of earnings (please refer to Kuwait Real Estate Primer dated 28, May 2008). Net profits for Kuwaiti real estate companies are not only significantly influenced by investment income, but the real estate companies also have significant amounts of their assets invested in non-core investment portfolios. Salhia, on the contrary, is one of the comparatively better players in terms of both these parameters. We feel the impact of gain from property sales for Salhia has been overemphasized and hence we expect a rerating in the PE (x) going forward, thus leading to appreciation in the stock price. On a price-to-book value (PB) basis, it has been a mixed story, with the company sometimes underperforming and sometimes outperforming the sector.

The company currently trades at a substantial discount to the sector on both PE (x) and PB (x)

Figure 30 Historical Trend of PE (x) and PB (x)



Sources: Company Financials and NBK Capital

1Q 2008 Results - Review

Salhia's total revenue increased by 8.3% to KD 11 million in 1Q2008, compared to KD 10.16 million in 1Q2007. Revenue growth in all three business segments contributed to the growth in total revenues, though care home operations were comparatively more instrumental. Gross profit grew at rates very similar to total revenues in 1Q 2008. However, operating profit decreased by 8% to KD 2.75 million in 1Q2008, compared to KD 2.99 million in 1Q2007. This was mainly due to a 28% rise in general and administrative expenses during the period. Investment income more than doubled to KD 2.48 million in 1Q2008, compared to KD 1.18 million a year ago. Significantly boosted by a rise in investment income, the net profit grew by 21.7% to KD 3.79 million in 1Q2008, compared to KD 3.12 million in 1Q2007.

A more than doubling of the investment income was instrumental for the net profit growth

Total assets increased by 24.3% to reach KD 292.45 million in 1Q2008, compared to 1Q2007. This was mainly due to an almost one and a half fold increase in the investment portfolio. Available-for-sale investments stood at KD 95.72 million in 1Q2008, compared to KD 40.32 million in Q12007. Total equity stood at KD 155.79 million at the end of 1Q2008.

Figure 31 Highlights of 1Q2008 Results

Key Financial Data	1Q 2007	1Q 2008	Y-O-Y growth
Income Statement	KD million	KD million	
Real Estate Operations	2.81	3.00	7.0%
Hotel Operations	3.84	4.14	7.8%
Care Home Operations	3.52	3.87	9.8%
Total Revenue	10.16	11.01	8.3%
Gross Profit	5.87	6.34	8.0%
Operating Profit	2.99	2.75	-8.0%
Investment Income	1.18	2.48	109.4%
Finance Costs	1.41	1.95	38.4%
Net Profit	3.12	3.79	21.7%
Balance Sheet			
Available-for-Sale Investments	40.32	95.72	137.4%
Investment Properties	49.14	43.42	-11.6%
Property and Equipment	110.20	115.48	4.8%
Total Assets	235.23	292.45	24.3%
Total Borrowings	74.22	107.00	44.2%
Total Equity	141.90	155.79	9.8%

Sources: Company Financials and NBK Capital

FINANCIAL STATEMENTS

Balance Sheet (KD Thousands)	Historical		Forecast				
Fiscal Year Ends December	2006	2007	2008	2009	2010	2011	2012
ASSETS							
Cash and Short-Term Investments	22,458	10,346	62,959	82,234	99,943	111,109	112,641
Investments	36,819	102,673	35,935	37,732	39,619	39,619	39,619
Total Receivables, Net	8,370	43,027	8,170	9,102	8,977	9,027	9,098
Total Inventory	462	351	409	455	449	451	455
Total Current Assets	**68,109**	**156,396**	**107,473**	**129,523**	**148,988**	**160,206**	**161,814**
Property/Plant/Equipment, Total - Net	103,956	110,196	111,849	113,527	115,230	116,958	118,713
Other Long-Term Assets, Total	70,388	58,104	57,479	56,884	56,319	55,750	55,211
TOTAL ASSETS	**242,453**	**324,696**	**276,801**	**299,933**	**320,536**	**332,914**	**335,737**
LIABILITIES & EQUITY							
Accounts Payable	11,560	19,849	14,298	15,928	15,710	15,797	15,922
Short-Term Debt	6,925	62,276	9,277	11,323	13,376	14,502	14,629
Total Current Liabilities	**18,485**	**82,125**	**23,574**	**27,251**	**29,086**	**30,299**	**30,551**
Long-Term Debt	79,875	80,736	75,056	91,615	108,227	117,332	118,361
Deferred Gain	9,057	9,505	9,505	9,505	9,505	9,505	9,505
Minority Interest	926	1,208	1,339	1,362	1,379	1,395	1,407
Total Liabilities	**108,343**	**173,574**	**109,474**	**129,732**	**148,196**	**158,531**	**159,824**
Total Equity	**134,110**	**151,122**	**167,327**	**170,201**	**172,340**	**174,384**	**175,913**
TOTAL LIABILITIES AND EQUITY	**242,453**	**324,696**	**276,801**	**299,933**	**320,536**	**332,914**	**335,737**

Income Statement (KD Thousands)	Historical		Forecast				
Fiscal Year Ends December	2006	2007	2008	2009	2010	2011	2012
Total Revenue	36,503	40,803	40,850	45,508	44,885	45,134	45,492
Cost of Revenue	16,180	17,225	16,340	18,203	17,954	18,054	18,197
Gross Profit	**20,324**	**23,578**	**24,510**	**27,305**	**26,931**	**27,080**	**27,295**
Selling/General/Admin. Expenses	6,310	8,364	8,170	9,102	8,977	9,027	9,098
Depreciation/Amortization	5,200	5,202	4,731	4,771	4,813	4,856	4,900
Operating Income	**10,481**	**10,767**	**12,853**	**14,738**	**14,513**	**14,469**	**14,631**
Interest Income (Exp), Net Non-Operating	(8,715)	(6,719)	(5,904)	(3,803)	(4,459)	(4,965)	(5,148)
Other, Net	50,057	30,124	2,488	1,560	1,609	1,640	1,643
Net Income before Taxes	**51,823**	**34,172**	**9,437**	**12,495**	**11,663**	**11,144**	**11,127**
Provision for Income Taxes	2,866	2,980	827	977	952	909	921
Net Income after Taxes	**48,957**	**31,192**	**8,610**	**11,518**	**10,711**	**10,234**	**10,206**
Minority Interest	(74)	215	130	23	17	16	12
Net Income	**49,031**	**30,977**	**8,479**	**11,495**	**10,694**	**10,218**	**10,194**

Sources: Sahlia's financial statements and NBK Capital

FINANCIAL RATIOS

Key Financial Ratios	Historical		Forecast				
Fiscal Year Ends December	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Liquidity							
Current Ratio	3.7	1.9	4.6	4.8	5.1	5.3	5.3
Quick Ratio	3.7	1.9	4.5	4.7	5.1	5.3	5.3
Capital Structure & Solvency							
Total Debt-to-Equity	0.6	0.9	0.5	0.6	0.7	0.8	0.8
EBITDA Interest Cover (x)	1.8	2.1	2.6	3.5	2.9	2.5	2.5
EBIT Interest Cover (x)	1.2	1.4	1.9	2.6	2.2	1.9	1.8
Return on Investment							
Return on Average Assets	21.3%	10.9%	2.8%	4.0%	3.4%	3.1%	3.0%
Return on Average Equity	41.2%	21.7%	5.3%	6.8%	6.2%	5.9%	5.8%
Return on Average Invested Capital	4.92%	4.2%	4.7%	5.6%	5.1%	4.8%	4.8%
Operating Performance							
Gross Profit Margin	55.7%	57.8%	60.0%	60.0%	60.0%	60.0%	60.0%
EBITDA Margin	43.0%	39.1%	43.0%	42.9%	43.1%	42.8%	42.9%
Operating Profit Margin	28.7%	26.4%	31.5%	32.4%	32.3%	32.1%	32.2%
Net Profit Margin	134.3%	75.9%	20.8%	25.3%	23.8%	22.6%	22.4%
Per Share Analysis							
Earnings Per Share (EPS)	148.7	81.7	21.3	28.9	26.8	25.6	25.6
Book Value Per Share (BVPS)	406.7	398.5	420.0	427.2	432.6	437.7	441.6
Dividend Per Share (DPS)	50	50	15	22	21	21	22
Asset Utilization							
Accounts Receivable Turnover	1.5	1.6	1.6	5.3	5.0	5.0	5.0
Accounts Payable Turnover	1.0	1.1	1.0	1.2	1.1	1.1	1.1
Total Assets Turnover	0.1	0.1	0.1	0.2	0.1	0.1	0.1
Valuation							
Price-to-Earnings Ratio (x)	3.5	6.2	22.8	16.8	18.1	18.9	19.0
Price-to-Book (x)	1.3	1.3	1.2	1.1	1.1	1.1	1.1
Dividend Yield (%)	8.9%	9.2%	3.1%	4.5%	4.4%	4.2%	4.5%
Dividend Payout Ratio	31%	57%	70%	75%	80%	80%	85%
Free Cash Flow Yield (%)	7.5%	8.2%	23.4%	9.4%	9.0%	9.1%	9.2%
Enterprise Value/ Sales	7.9	7.1	7.1	6.4	6.4	6.4	6.4
Enterprise Value/ EBITDA	18.5	18.1	16.5	14.8	15.0	15.0	14.8
Enterprise Value/ EBIT	27.6	26.9	22.5	19.6	19.9	20.0	19.8

Sources: Sahlia's financial statements and NBK Capital

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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