

Esterad Investment Company (EICB.BH)
NEUTRAL

CMP BHD 0.240
Target BHD 0.255
Upside 6.1%

MSCI GCC Index 413.64
 Bahrain All Share Index 1,409.12

Key Stock Data

Sector Financial Services
 Reuters Code EICB.BH
 Bloomberg Code Esterad BI Equity
 Net Out. Shares (bn) 0.155
 Market Cap (BHD mn) 37.200
 Market Cap (USD mn) 99.190
 Avg. 12m Vol. (mn) 0.042
 Volatility (30 day) N/A
 Volatility (180 day) N/A

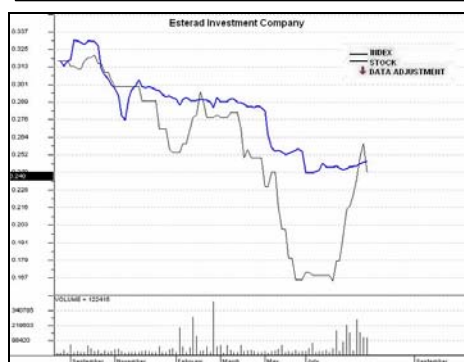
Stock Performance (%)

52 week high / low (BHD) 0.322 / 0.164

	1M	3M	12M
Absolute	42.9	4.3	-24.5
Relative	42.4	11.0	-19.2

Shareholding Pattern (%)

Social Insurance Organization	18.59
National Bank of Bahrain	11.16
Public	70.25

Esterad and Bahrain All Share Index

Highlights of Q2FY10 results

- Esterad Investment Co. (Esterad) reported a total loss of BHD 0.71 million as against a total income of BHD 4.01 million in 1H09.
- The loss was owing to impairments in direct equity investments. The mgmt. expects no major impairment for the current year.
- We revised the general and administrative expenses owing to the decreased number of staff. The mgmt. intends to maintain the current staff levels.
- Net loss stood at BHD 3.67 million, as opposed to a net profit of BHD 0.20 million.
- We have revised our 2010E total income downwards by 5.0%, accounting for continued uncertain macroeconomic conditions across the world. However, on the expectation of lower impairment loss, we have reduced our net loss estimate to BHD 1.54 million compared to our earlier estimate of BHD 2.21 million.
- We are reiterating our earlier NEUTRAL recommendation on Esterad with a revised target price of BHD 0.255, implying an upside of 6.1%.

Overview

BHD Million	2008A	2009A	2010E	2011E	2012E
Total Income	-7.66	2.44	1.88	3.54	5.91
% Change YoY	NA	NA	-23.0%	88.0%	67.0%
Net Profit	-11.03	-3.65	-1.54	0.07	2.25
% Change YoY	NA	-66.9%	-57.8%	-104.9%	NA
Total Assets	79.86	73.80	65.75	72.00	77.77
Net Interest Margin	-17.0%	-7.6%	-10.9%	9.5%	8.0%
Adj. EPS (BHD)	-0.071	-0.024	-0.010	0.000	0.015
RoAE	-18.0%	-6.6%	-2.9%	0.1%	4.1%

Total Income/ (Loss)

Esterad reported a total loss of BHD 0.71 million during 1H10, as against a total income of BHD 4.01 million in 1H09 mainly attributable to an investment loss and absence of profit from associates. The company reported a substantial investment loss of BHD 1.23 million during 2Q10 mainly resulting from fair value changes in investments through profit or loss. Consequently, investment loss for 1H10 stood at BHD 0.77 million as against an investment income of BHD 3.07 million during the prior year period. During 2009, the company partially disposed its investments in United Cement Co. and classified the remaining investments at fair value through profit or loss. Accordingly, the company did not report any profit from associates during the period under review compared to BHD 0.84 million during 1H09. Other income declined 33.2% to BHD 0.07 million.

Operating expenses

Total expenses including impairment loss on investment securities increased 22.9% to BHD 2.99 million from BHD 3.87 million during 1H09. The high quarterly general and administrative expenses of BHD 1.31 million compared to BHD 0.99 million on account of employee severance related costs as well as costs related to bond issuance withdrawal earlier this year. Interest on borrowings declined 11.3% to BHD 0.24 million from BHD 0.28 million. The reduction in impairment losses on investment securities was a significant 45.0% to BHD 1.43 million from BHD 2.61 million during 1H09.

Profitability

Net loss was BHD 3.67 million during 1H10, as opposed to a net profit of BHD 0.20 million led by investment losses, higher expenses and impairment loss on investment securities. Adjusted annualised loss per share was BHD 0.05 as compared to earnings per share of BHD 0.003 during 1H09. The management expects no major impairment during the second half of the year.

Risks and Concerns to Valuation:

- ❖ Despite strong signs of an economic recovery, it will take some time for benefits to accrue, delaying the company's growth and expansion plans.

Valuation Methodology:

We have used two valuation methods for arriving at Esterad's fair value, as explained below:

- I. Gordon Growth Model (GGM) based P/BV multiple, and
- II. Target P/BV multiple based on industry average.

P/BV Multiple Approach using the Gordon Growth Model (GGM)

The model uses sustainable return on average equity (RoAE), cost of equity (Ke) and expected growth in earnings (g) to arrive at the target P/BV for the company using the formula:

$$\text{Target P/BV} = (\text{RoAE} - g) / (\text{Ke} - g)$$

Subsequently, we multiplied the target P/BV multiple for 2010E with the 2010E BVPS to arrive at the company's fair value over a medium-term investment horizon.

We have used the following assumptions to arrive at the target P/BV multiple for 2010:

- i. Sustainable RoAE has been taken as the 4-year average of the RoAE over 2011E-2014E.
- ii. The cost of equity (Ke) has been calculated as 6.69% using the Capital Asset Pricing Model (CAPM).
- iii. The terminal growth rate (g) has been taken as 2.00%.

GGM Valuation Summary	
Sustainable RoAE	6.01%
Cost of Equity (Ke)	6.69%
Perpetual Growth Rate	2.00%
Target P/BV Multiple for 2010E (x)	0.855
2010E BVPS (BHD)	0.343
Fair Value per Share using Target P/BV (BHD)	0.293
CMP (BHD)	0.240
Upside/(-)Downside	22.2%

Sensitivity Analysis

The following tables present a sensitivity analysis for the estimated fair value per share based on various terminal growth rate, cost of equity and RoAE scenarios. The shaded area represents the most probable outcomes.

Sensitivity Analysis - GGM (Ke vs. g)					
Terminal Growth Rate (g)					
Cost of Equity	1.00%	1.50%	2.00%	2.50%	3.00%
5.69%	0.366	0.369	0.373	0.378	0.384
6.19%	0.331	0.330	0.328	0.326	0.324
6.69%	0.302	0.298	0.293	0.287	0.280
7.19%	0.278	0.272	0.265	0.257	0.246
7.69%	0.257	0.250	0.242	0.232	0.220

Sensitivity Analysis - GGM (Ke vs. RoAE)					
Return on Average Equity (RoAE)					
Cost of Equity	5.01%	5.51%	6.01%	6.51%	7.01%
5.69%	0.280	0.326	0.373	0.419	0.466
6.19%	0.246	0.287	0.328	0.369	0.410
6.69%	0.220	0.257	0.293	0.330	0.366
7.19%	0.199	0.232	0.265	0.298	0.331
7.69%	0.181	0.212	0.242	0.272	0.302

Sensitivity Analysis - GGM (RoAE vs. g)					
Terminal Growth Rate (g)					
Return on Average Equity	1.00%	1.50%	2.00%	2.50%	3.00%
5.01%	0.242	0.232	0.220	0.205	0.187
5.51%	0.272	0.265	0.257	0.246	0.233
6.01%	0.302	0.298	0.293	0.287	0.280
6.51%	0.332	0.331	0.330	0.328	0.326
7.01%	0.362	0.364	0.366	0.369	0.373

Comparative P/BV Multiple Based Valuation

P/BV Multiple Based Valuation Summary	
Esterad's 2010E BVPS (BHD)	0.343
Target P/BV (x)	0.630
Fair Value per Share using Target P/BV (BHD)	0.216
CMP (BHD)	0.240
Upside/(Downside)	-10.0%

Companies	Outstanding Shares (Million)	CMP (USD)	Market Capitalisation (USD Million)	BVPS (USD)	P/BV(x)
Esterad	155	0.640	99	0.91	0.70
Gulf Investment House	442	0.164	73	0.32	0.52
Kuwait Financial Centre	506	0.405	205	0.58	0.70
Global Investment House	1,312	0.210	275	0.33	0.64
First Investment Co.	651	0.332	216	0.51	0.65
Al Mal Investment Co.	528	0.245	129	0.43	0.57
Average P/BV					0.63

Sources: Zawya and Esterad's Financial Statements

CMP as on August 19, 2010

The comparable companies taken do not have an exact business mix as Esterad. These have only been included due to similar sector presence and non-availability of exact comparable companies.

Weighted Average Fair Value

Applying equal weights (GGM – 50% and comparative P/BV – 50%), we arrived at a final fair value or target price of BHD 0.255, which implies an upside of 6.1% over the current market price of BHD 0.240 (as on August 19, 2010).

Weighted Average Fair Value			
Valuation Method	Fair Value per Share (BHD)	Weightage	Weighted Value per Share (BHD)
GGM based P/BV Multiple Method	0.293	50%	0.147
Comparative P/BV Method	0.216	50%	0.108
Target Price			0.255
CMP (BHD)			0.240
Upside/(-)Downside			6.1%

Investment Opinion

The Bahrain All Share Index reflected the weak economic conditions prevalent during the past two years. It fell 19.2% in 2009, almost depleting investments held by companies. Investment companies witnessed huge losses with impairments and provisions eroding earnings. The market switched to a recovery mode during the first three months of 2010 generating YTD returns of 10.1%. The market even touched a high of 1,605.98 on April 07, 2010 before plunging on global uncertainties to post a YTD loss of 3.4% as of August 19, 2010. Accordingly, the trading portfolios of investment companies registered declines. Going forward, we expect the volatility in macroeconomic factors to reduce and Bahrain's sound financial system to provide the much required growth momentum to investment companies.

We expect that the returns generated by Esterad gradually improving in correlation with the Bahrain All Share Index. Esterad's financial performance directly correlates with the health of the economy and financial markets. Key positives for the company include prudent approach in selecting investment categories and avoiding high-risk companies in the portfolio. In addition, the company's fundamentals are strengthened by its low leverage and liquid balance sheet. On the strategic front, the company plans to focus mainly in the GCC and MENA region broadly across four major asset classes – direct equity, real estate, quoted equity and fixed income. Within the GCC, it intends to focus on Bahrain, Saudi Arabia, Qatar & Oman. The company has diversified investments with 51.1% in Bahrain, 12.6% in the GCC, 22.3% in the US, EU and Japan, and the remaining in other emerging markets. Although the company expects to maintain a similar geographical distribution for its asset classes, it remains open to good investment opportunities. Growth plans for the company also include eliminating hedging exposure and evaluating alternative fee based income sources. The company is already in discussion with some of the potential partners for providing advisory services in the investment space. Furthermore, in order to keep up the growth momentum, the company has been exploring various sources of funds to identify the one with most competitive rate. However, due to uncertain macroeconomic conditions and their subsequent effect on the investment space, impairment losses and inherent risks associated with investments may continue to keep the bottom-line performance under pressure. Accordingly, we reiterate our cautious outlook on the stock at the current levels.

We had updated Esterad on July 04, 2010 with a NEUTRAL recommendation (target price of BHD 0.167 with a 1.3% upside). It may be noted that the stock has moved up by 45%, since 30th June 2010 thereby limiting any upsides from the current level. Based on the expected profit for 2011 and 2012, the stock is trading at a P/E multiple of 496.16x and 16.52 respectively. The stock is also trading at P/B multiple of 0.70x for 2011E and 0.67x for 2012E based on their respective BVPS. Considering the above factors, we arrive at a target price to BHD 0.255, which exhibits an upside of 6.1% from its closing price of BHD 0.240 (as on August 24, 2010). **Accordingly, we are reiterating our earlier NEUTRAL recommendation on Esterad.**

Financial Statements

Consolidated Income Statement							
(BHD '000)	2008A	2009A	1H09A	1H10A	2010E	2011E	2012E
Investment Income/ Loss	-10,122	1,403	3,065	-773	1,666	3,302	5,652
Share of Profits from Associates	2,106	844	844	0	0	0	0
Profit/Loss on sale of assets held for sale	170	0	0	0	0	0	0
Other Income	182	198	103	69	217	239	263
Total Income/ Loss	-7,664	2,444	4,011	-705	1,883	3,541	5,915
General & Administrative Expenses	-1,736	-1,875	-994	-1,309	-1,612	-1,709	-1,829
Interest on Borrowings	-1,137	-446	-275	-244	-431	-418	-599
Impairment loss on investment securities	-518	-3,898	-2,605	-1,434	-1,434	-1,336	-1,158
Total Expenses	-3,390	-6,220	-3,874	-2,987	-3,477	-3,463	-3,586
Loss/Profit for the period	-11,054	-3,775	137	-3,692	-1,594	78	2,329
Attributable to :							
Shareholders of the parent company	-11,032	-3,650	197	-3,671	-1,541	75	2,251
Non-controlling Interest	-22	-125	-60	-21	-53	3	77

Consolidated Balance Sheet

(BHD '000)	2008A	2009A	1H09A	1H10A	2010E	2011E	2012E
ASSETS							
Cash and Cash Equivalents	10,935	15,612	15,260	13,623	5,147	6,891	7,741
Trading Securities	18,562	10,873	9,472	9,917	10,672	12,048	13,401
Investments at fair value through profit/loss	10,366	11,648	14,351	10,529	12,758	14,109	15,648
Derivative Instruments Held for Risk Management	1,655	1,186	1,154	1,256	1,256	1,256	1,256
Available-for-Sale Securities	28,200	27,199	25,488	26,531	28,420	29,712	31,442
Other investment securities	0	4,407	0	4,407	4,407	4,407	4,407
Investment property	1,083	955	1,037	884	1,102	1,235	1,349
Property, Plant and Equipments (net)	70	76	79	68	78	78	74
Other Assets	2,829	1,845	5,827	1,546	1,907	2,269	2,450
Held to Maturity Securities	0	0	3,734	0	0	0	0
Investment in bonds	2,060	0	0	0	0	0	0
Investment in Associates	4,103	0	0	0	0	0	0
Total Assets	79,863	73,802	76,402	68,762	65,746	72,004	77,769
LIABILITIES							
Accrued Interest on Borrowings	280	104	135	138	138	138	138
Borrowings	15,980	14,090	15,035	13,145	7,606	13,481	16,705
Payable to Associate Companies	3,462	0	0	0	0	0	0
Unclaimed Dividends of Prior Years	937	952	1,051	887	887	887	887
Other Liabilities	1,531	4,315	4,298	2,811	3,237	3,541	3,754
Total Liabilities	22,189	19,461	20,519	16,981	11,868	18,048	21,484
SHAREHOLDERS EQUITY							
Equity Share Capital	15,500	15,500	15,500	15,500	15,500	15,500	15,500
Share Premium	9,008	9,008	9,008	9,008	9,008	9,008	9,008
Treasury Shares	-436	-469	-469	-38	-38	-38	-38
Reserves	20,271	23,317	20,946	24,075	24,075	24,075	24,300
Retained Earnings / Accumulated Losses	12,439	6,219	10,066	2,490	4,620	4,695	6,721
Total Shareholders' Equity	56,782	53,574	55,050	51,035	53,165	53,240	55,491
Minority Interest	892	767	833	746	714	717	794
Total Liabilities & Shareholder's Equity	79,863	73,802	76,402	68,762	65,746	72,004	77,769

Consolidated Cash Flow Statement							
(BHD '000)	2008A	2009A	1H09A	1H10A	2010E	2011E	2012E
Cash flow from operating activities	3,403	9,316	7,900	-1,187	-3,562	-3,281	-1,308
Investing activities							
Rent received and other income net of expenses	188	267	58	139	139	0	0
Proceeds from sale of equipment	3	0	0	1	1	0	0
Acquisition of investment property	-1,118	-12	-12	0	-329	-360	-389
Acquisition of equipment	-35	-54	-27	-19	-66	-72	-78
Cash flow from investing activities	-963	200	18	120	-255	-432	-467
Financing activities							
Payment to minority shareholder on liquidation of subsidiary	-44	0	0	0	0	0	0
Non-controlling interest in subsidiary	671	0	0	0	0	0	0
Borrowed funds repaid	-8,485	-1,891	-948	-945	-6,484	5,876	3,223
Interest paid	-1,200	-622	-421	-210	-396	-418	-599
Proceeds from rights issue of capital	11,283	0	0	0	0	0	0
Purchase of treasury shares	-224	-33	-33	0	0	0	0
Dividends paid	-4,836	-2,292	-2,192	-65	-65	0	0
Sale proceeds of treasury shares	0	0	0	297	297	0	0
Directors remuneration paid	-245	0	0	0	0	0	0
Charitable donations paid	-677	0	0	0	0	0	0
Cash flow from financing activities	-3,757	-4,838	-3,594	-923	-6,648	5,457	2,624

TAIB RESEARCH

Financial Ratios

	2008A	2009A	1H09A	1H10A	2010E	2011E	2012E
Profitability							
Return on Average Assets	-12.5%	-4.8%	0.5%*	-10.3%*	-2.2%	0.1%	3.0%
Return on Average Equity	-18.0%	-6.6%	0.7%*	-14.0%*	-2.9%	0.1%	4.1%
Margins							
Cost to Income Ratio	NA	76.7%	24.8%	NA	85.6%	48.3%	30.9%
Liquidity & Assets Quality							
Shareholders' Equity to Total Assets	71.1%	72.6%	72.1%	74.2%	80.9%	73.9%	71.4%
Total Debt to Shareholder's Equity	28.1%	26.3%	27.3%	25.8%	14.3%	25.3%	30.1%
Total Liabilities to Shareholder's Equity	39.1%	36.3%	37.3%	33.3%	22.3%	33.9%	38.7%
Provisions / Gross Loans & Advances	1.8%	12.5%	18.5%	10.2%	4.8%	4.2%	2.6%

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