



EFG - Hermes

Al Arafa for Investment and Consultancies Suited For Strong Export Growth

23 February 2007

Egypt | Textiles

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ST Rec. : Buy Current Price* : USD 1.30
LT Rec. : Buy LT Fair Value : USD 1.93

- Arafa is a leading export-oriented apparel and textile manufacturer, with facilities in Egypt, and a prominent retailer in Egypt (Concrete, 7% market share of menswear) and the UK (BMB, 16% market share of men's suits). About 90% of revenue are generated from outside of Egypt, with the UK being the largest market (formal menswear) followed by the US (casual menswear).
- Arafa carried out an IPO through the issue of 77.5 million new shares, offered for both public subscribers at USD1.14 per share and for institutions and high net worth individuals in a private placement at USD1.2 per share. Offering proceeds amounted to USD92 million and will be used to finance Arafa's acquisition / expansion plans. The free float of the company stands at 32.6%.
- The growth strategy of Arafa depends on controlling distribution channels to ensure stable supply agreements that help expand the majority-owned apparel segment, which is the cash generator of the group, and mitigate the negative impact from intensified competition. Almost 28% of the apparel revenue is generated from partly controlled retailers/JVs with wholesalers.
- Arafa expects to have upgraded its apparel capacity by 33% in December 2007 and textile capacity by 50% through to December 2008, from 2005 levels. We forecast an 8.8% CAGR in consolidated revenue (16% on a proportionate basis) over 2007- 09. We forecast strong growth in the apparel and textile segments but a softening in the revenue of UK-based BMB, due to a slowdown in the UK market.
- We expect the EBITDA margin will expand to 14.8% by 2008, up from 12.0% in 2006, supported by a shift to higher margin apparel and textile sales mix and a restructuring at BMB. We believe that in the medium term manufacturing margins will likely soften because of increased competition. We forecast strong earnings growth of 32% on average in 2007-08.
- Our estimated fair value for Arafa stands at USD1.93 per share, implying an upside potential of 48% over and above the share price. We add a 15% acquisition / expansion premium to our DCF value to account for the fact that our forecasts do not include the use of proceeds from the capital increase in any acquisitions and /or major expansions. We assign a ST Buy / LT Buy recommendation to Arafa.

March year end	Mar 2006a	Mar 2007e	Mar 2008e	Mar 2009e
Operating Income (mn)	25.9	32.7	39.3	44.5
Net Income (mn)	18.9	21.3	32.1	37.2
Normalized Net Attrib. Income (mn)	17.3	22.6	29.9	34.6
ROE	31.0%	14.4%	17.0%	17.7%
EPS (Reported)	0.13	0.14	0.14	0.16
EPS (Attrib.)	0.12	0.14	0.13	0.15
EPS Growth	54.2%	21.9%	-12.4%	15.9%
P/E* (Attrib.)	11.03	9.05	10.33	8.92
DPS (net)	N/R	0.04	0.05	0.06
Dividend Yield	N/R	2.8%	4.2%	4.8%
BVPS*	0.35	0.66	0.74	0.82
P/BV*	3.73	1.96	1.75	1.58
CFPS (Operating CF)	0.15	0.17	0.13	0.13
P/CF	8.59	7.61	10.07	9.65
EBITDA (mn)	33.1	39.8	47.4	53.2
EBITDA Margin	12.0%	13.5%	14.8%	15.0%
EV/EBITDA	11.88	7.55	6.07	5.23
Net Debt (Cash)** (mn)	67.2	-30.6	-50.1	-67.2
Net Debt (Cash) / BV**	91.9%	-17.0%	-24.5%	-28.9%
Net Debt / EBITDA	2.0	(0.8)	(1.1)	(1.3)

**excluding dividends



Estimate Changes

(USD mn)	2006a		2007e		2008e	
	Old	New	Old	New	Old	New
Revenue	275.3	N/R	293.9	N/R	319.6	N/R
EBITDA	33.1	N/R	39.8	N/R	47.4	N/R
EBITDA Margin	12.0%	N/R	13.5%	N/R	14.8%	N/R
Norm. Net Attrib. Inc.	17.3	N/R	22.6	N/R	29.9	N/R

Stock Data:

Last Ex-Div Date	N/R
Mkt. Val. (Local mn)	USD308.8
Shares (mn)	237.5
Av. Monthly Liqd. (mn)	USD37.1
52-Week High / Low	USD1.41 / 1.11
Bloomberg / Reuters	AIVC EY / AIVC.CA
Est. Free Float	32.6%

Wafaa Baddour, CFA
+20 2 332 1163
wbaddour@efg-hermes.com

Samar Refai
+20 2 332 1159
srefai@efg-hermes.com

Hatem Mohsen
+20 2 332 1161
hmohsen@efg-hermes.com

*As at 22 February 2007

KINDLY REFER TO THE IMPORTANT DISCLOSURES AND DISCLAIMER ON PAGE 43.

EXECUTIVE SUMMARY

Profile, Strategy and Growth Drivers

Al Arafa for Investment and Consultancies (referred to in this report as Arafa Holding or Arafa) is one of the leading export-oriented and integrated apparel and textile manufacturers in Egypt and the Middle East and a prominent retailer in Egypt and the UK. Production includes men's formal and casual wear for some of the world's largest retailers such as M&S, GAP and Target and most recognized brands such as Valentino, Jaeger and Haggar. Arafa owns production capacity in Egypt for men's formal and casual wear equivalent to 2.55 million suits, fabric capacity of 3.5 million meters, and yarn capacity of 1,250 tons (as at December 2006). Arafa controls part of its distribution channels by owning retailing operations. Its retail segment includes Concrete, a well-known men and kids wear retail chain in Egypt with a 7% market share of menswear (91.6% owned) and BMB Group, the largest retailer and wholesaler of menswear in the UK with a 16% market share of men's suits (39.1%, with a call option to acquire up to 100%). Arafa is setting up two other retail companies in the UK (Apparel International, 34%) and Italy (Querini, 49%). About 90% of group revenue is generated from outside of Egypt, with the UK being Arafa's largest market (formal wear) followed by the US (casual wear). Arafa expects to have upgraded its apparel capacity by 33% in December 2007 and textile capacity by 50% through to December 2008, from 2005 levels.

The business model of Arafa has been transformed from that of being solely an integrated manufacturer of apparel and textiles to also becoming a retailer/wholesaler in order to control its distribution channels and ensure stable medium-term supply agreements that help expand the majority owned apparel segment, which is the cash generator of the group. This partly mitigates the negative impact from the intensified competition from China, India and Turkey. Currently, almost 28% of the apparel revenue is generated from partly controlled retailers (13% from BMB, 4% others)/ joint venture with wholesaler (11%).

Besides consolidating its presence in the UK and Italy, Arafa is also targeting other European markets such as Germany, France, and Spain. Furthermore, Arafa plans to increase its presence in North America by penetrating the formal wear market. Arafa plans to replicate the BMB arrangement in acquiring new retail companies; i.e. buying a stake with a call option to acquire up to 100%. It is possible that Arafa acquires distressed / loss making companies and restructures their business model to make them profitable, similar to the examples of Concrete and BMB. These efforts should translate into: i) An increase in capacity in the apparel and textiles segments to meet growth in retail, and ii) a gradual reduction in Arafa's relative (but not absolute) exposure to the UK market. Recently, Arafa announced it had leased facilities in Beni Sueif city, including 212,000 square meters of land with a 35,000 square meter of buildings to support expansions in the textile and apparel segments.

Financial Performance and Outlook

On a consolidated basis, the retail segment is the largest contributor to revenue (69%), while the apparel segment is the largest contributor to EBITDA (52%) and net profit (72%). On a proportionate basis; i.e. taking into consideration Arafa's ownership in each segment, the contribution of the apparel segment to revenue is almost equal to the contribution of the retail segment.

Consolidated revenue has grown at an average annual rate of 10.4% over 2005-06 (year end March) to USD275 million. Growth was mostly driven by the apparel (+18% in net revenue, excluding intra-group sales) and the retail (+10%) segments, while the textile segment saw a decline (-20%). On a proportionate basis, growth in revenue was higher at 14%. We forecast an 8.8% CAGR in consolidated revenue (16% on a proportionate basis) over 2007-09. Although we forecast strong growth in the apparel and textile segments, a softening in the revenue of UK-based BMB, due to a slowdown in the UK market, is expected to limit consolidated revenue growth. An increasing portion of apparel and textile production goes to BMB starting January 2007. Since revenue numbers at the consolidated level exclude intra-group sales, this will be reflected in improved consolidated margins rather than in top line growth.

The EBITDA margin stood at 12.0% in 2006 on a consolidated basis (17.4% on a proportionate basis). EBITDA is adjusted to include the export rebate, which accounted for 16% of EBITDA and 31% of attributable net income in 2006. Recently, the textile and apparel sector was granted a renewal to the export rebate for three years from April 2007 to end March 2010. While it is not guaranteed that the export rebate will be renewed at the end of the three-year period, management commented that the government will likely phase it out gradually. This is the same assumption we use in our forecasts

We expect the EBITDA margin will expand in 2007 to 13.5% and 2008 to 14.8% supported by: i) An increase in the apparel margin to 19.6%, on average, from 19.0% in 2006 as Arafa introduces new formal products and subcontracts relatively lower margin casual wear. ii) An expansion in the retail margin to 7.5% by 2008, up from 6.3% in 2006, achieved mostly at the level of BMB due to the completion of its restructuring, the full dependence on subcontracting by BMB, and the cessation of production at BMB's factory (limiting it to production of samples). iii) An uplift in the textile margin to 28.4% from 27.0% in 2006 backed by a shift in the product mix towards 100% wool fabric, the introduction of shirting fabric, and improved marketing efforts by a new management.

We believe that over the medium to long term margins will likely soften particularly at the manufacturing level because of increased competition in the global market, excess capacity in China, and the entry in strength into Egypt by Turkish, Jordanian and Asian textile and apparel manufacturers setting up production facilities. This is likely to have a more pronounced effect on the textile segment than on the apparel segment because: i) Competition is more intense in fabric and casual wear than in harder-to-produce formal wear (62% of apparel sales). ii) While the apparel segment partly controls its distribution channels, it has little discretion in choosing the textile segment as its fabric supplier if customers prefer another supplier.

Arafa generated positive free cash flow in 2005-06, amounting to 5% of sales on average. Capex was relatively high, driven mostly by the upgrades in textile and apparel capacities, with the bulk of related capex paid in 2006. We forecast capex to sales of 2% to 3% over 2007-09 and, accordingly, an increase in FCF to sales to 9%. Our forecast assumes a normal annual increase in apparel capacity of about 12% annually. It does not include the impact of any acquisitions or JVs with European retailers that may result in the direction of major orders to the apparel segment and require a major expansion in capacity.

In 2005, attributable earnings grew 31%, with all the increase coming from operations. In 2006, attributable earnings grew by 54% coming mostly from an increase in proportionate EBITDA of 13% and FX gains. We forecast strong earnings growth of 32% on average in 2007 and 2008 backed by strong revenue growth and an expansion in the EBITDA margin. It is worth noting that the company will report a one-off item of USD2.8 million related to IPO fees in March 2007 income statement. Arafa exercised the BMB call option in December 2006, to increase its stake in BMB to 39% from 31.6% in December 2006. According to management, Arafa will be eligible to 39% of BMB profits for the full year ending March 2007 and we reflect this in our forecasts.

Arafa has been taking on debt to finance operations, expansions and the acquisition of BMB. Net debt amounted to 92% of equity in 2006. The proceeds from the IPO should have transformed the company's net debt position into a net cash position. Management has commented that future debt to equity levels will depend on acquisition opportunities.

The Listing of Arafa Shares End 2006

In December 2006, Arafa carried out an initial public offering in the form of a primary offering of 77.5 million shares. The new shares were offered in two tranches: i) 17.5 million to public subscribers at USD1.14 per share, and ii) 60 million shares to institutions and high net worth individuals in a private placement at USD1.20 per share. Offering proceeds amounted to USD92 million and will be used to finance Arafa's expansion plans. Shares were listed in the Cairo and Alexandria Stock Exchanges (CASE) and started trading on 24 December 2006. The free float of the company stands at 32.6%.



Valuation

Our estimated fair value for Arafa stands at USD1.93 per share, implying an upside potential of 48% over and above the share price. Using a discounted cash flow (DCF) method, we arrive at an equity value of USD1.7 per share, to which we add a 15% acquisition / expansion premium. The rationale for adding this premium is to compensate for the fact that our forecasts, although they assume the company will successfully enter into new subcontracting agreements with European and US companies that will fuel growth in the apparel segment, do not include the use of proceeds from the capital increase in any acquisitions, major expansions, or the development of Beni Sueif Land. Arafa management has not yet announced details on its acquisition / expansion plan. We initiate coverage of Arafa with a ST / LT Buy recommendation.

We also draw a comparable valuation table for textile manufacturers in the emerging and developed universe. The company trades below the two sets of comparables, but in line with Indian peers. Arafa multiples will be inflated by EPS dilution following the recent capital increase, and until the use of proceeds starts paying off.

Upside and Downside Risks

Upside risks to our valuation include: i) Faster than forecast expansions in the retail segment outside of Egypt and ii) the ability to expand margins by shifting to higher margin production. Downside risks to our valuation include: i) Increased competition from emerging country competitors setting up facilities in Egypt to sell to Arafa's main markets, ii) the intensification of competition globally putting downward pressure on margins, iii) a slower than forecast pace of growth, iv) a change in regulations governing incentives to exporters in the short term, and v) unfavorable currency movements vis-à-vis the USD.

Head of Research

Philip Khoury
+971 4 363 4002
+20 2 332 1150
pkhoury@efg-hermes.com

UK/US Sales

Mohamed Ebeid
+20 2 332 1054
mebeid@efg-hermes.com

Local Institutional Sales

Amr El Khamissy
+20 2 332 1045
amrk@efg-hermes.com

Retail Sales

Hisham Eissa
+20 2 332 1067
hissa@efg-hermes.com

Gulf Sales

Mohsen Mansour
+20 2 332 1077
mohsenm@efg-hermes.com

I. TEXTILE & APPAREL IN EGYPT AND MAJOR MARKETS

A. Overview of the Egyptian Textile and Apparel Industry

Egypt's textile and apparel industry is the country's second largest industry after processed food, accounting for 27% of industrial production. It takes advantage of low labor and energy costs and some of the world's best raw cotton. Egypt is the only country in the MENA region whose industry is vertically integrated, with its own supply of raw cotton and spinning, dyeing, weaving and apparel manufacturing.

The private sector currently accounts for 70% of apparel production

Until recently, the textile industry was a government monopoly. The state Holding Company for Cotton and Textiles exercised significant control over the internal trade and supply of cotton, as well as the spinning, weaving and dyeing of fabrics. Since the 1980s, the private sector's participation in the industry has increased tremendously. On the other hand, state-owned textile companies have recently suffered losses due to the antiquated equipment, poor management and over-employment. The private sector currently accounts for approximately 10% of cotton spinning, 40% of fabric production and 70% of apparel production.

B. Regulations, Trade Agreements and Competition

Over the past few years, several global and local developments have resulted in an intensification of the competition facing Egyptian manufacturers both in Egypt and in export markets. These developments include the following: i) The removal of bans and the reduction of tariffs on imports into Egypt have allowed for an increased level of imports, particularly from China. ii) The removal of quotas between WTO members, which previously constrained the growth of exports from textile giants such as China and India, has resulted in an increased level of competition in Egypt's major export markets; the EU and the US. iii) Turkish and Asian manufacturers are establishing factories in Egypt to benefit from its low cost environment and / or proximity to Europe, which is again expected to increase the level of competition facing Egyptian manufactures in export markets, particularly Europe.

Two positive trade arrangements are expected to partly mitigate the impact of the above-mentioned developments: i) In December 2004, Egypt signed the QIZ agreement with the US, which allows Egyptian products to enter the US at reduced tariff rates, and ii) The EU and the US have applied safeguard measures against China until December 2007, and December 2008, respectively. According to these measures, Chinese exports of some textile and apparel products into the EU and the US are restricted by certain quotas.

i) Relaxing tariff and non-tariff barriers on Egyptian Imports

Egypt used to impose tariff and non-tariff barriers on imports of textile and apparel in an attempt to protect local industry. Tariff rates were as high as 70% on apparel, 65% on home textiles, 60% on fabrics and 45% on fibers. In June 1995, the government signed the WTO agreement, which included an obligation to relax tariff and non-tariff barriers through to January 2005.

As a result, the government has gradually relaxed its tariff structure and lifted the ban it previously imposed on textile and apparel imports in several steps:

- 1) The ban on fabric imports was lifted in January 1998 but tariffs remained high at 54%.
- 2) The ban on apparel imports was lifted in January 2002. However, at the same time the government imposed a per-piece duty on apparel that reached up to EGP1,400 per piece for some products, which again restricted imports of apparel.
- 3) In January 2004, the government announced that, as of January 2005, it will replace the per-piece tariff system on apparel with an ad valorem system and apply lower tariffs on textile and apparel products that are in line with its WTO obligations. This included reducing tariffs on apparel to 40%, home textiles to 35%, fabrics to 30%, and fibers to 15%.

4) In August 2004, Egypt revamped its old tariff structure and reduced tariffs on textiles and apparel products below the previously planned levels. Tariffs on fiber imports were reduced to 12% down from 15%, while those on fabric imports were reduced from 30% to 22%, with no change in tariffs on apparel imports. Following the reduction of tariffs, Egypt's imports of apparel started to increase, particularly from China.

5) In February 2007, the government reduced tariffs on apparel and textiles once more. Tariffs on fiber imports were reduced to 5%, fabric imports to 10% and apparel imports to 30%. Following this reduction, the government imposed temporary anti-dumping duties on cotton-fiber imports from two specific companies in Syria for four months. This came in response to a complaint filed by the Holding Company for Spinning and Weaving, stating that Egyptian manufacturers are bearing losses as a result of the flow of low-priced Syrian fibers into the market.

Table 1.1: Tariff Schedule for Egypt's Textile and Apparel Exports

	Planned*	Aug 2004	Feb 2007 (Current)
Raw Inputs**	5%	0% to 5%	0% to 5%
Fibers	15%	12%	5%
Fabrics	30%	22%	10%
Apparel	40%	40%	30%
Home Textile	35%	32%	30%

*Previously planned tariff schedule that was supposed to be applied starting January 2005, in line with Egypt's WTO obligations

**Includes cotton, wool and silk

Source: Ministry of Trade & Industry and Egypt commitment schedule under GATT

ii) Quotas between WTO Members

The Multi-Fiber Agreement (MFA) is an accord under which individual countries are restricted from exporting textile products beyond a certain level to European and US markets. Under the MFA, a specific quota is fixed for each country and no country can exceed the quantity assigned. The motive behind this agreement was to protect the interests of domestic textile industries in the European Union and the US from low cost emerging market producers. In 1995, the WTO renewed the MFA with an Agreement on Textiles and Clothing (ATC), which stated that all quotas on textiles and clothing between WTO member countries would disappear on January 1, 2005. The ATC marked the end of quotas that had limited trade in textiles and clothing between WTO members. Large importers from developing countries such as China and India were the most affected by quotas and were therefore the most obvious beneficiaries of the ATC. In anticipation of the phasing out of quotas, China built excess capacity. Trade statistics for 2005 show that US textile and apparel imports from China, Indonesia, India and Bangladesh experienced growth rates of 54%, 18%, 27% and 19%, up from growth rates of 25%, 10%, 13% and 7% in 2004, respectively.

Members of the WTO, who believe that imports of textiles and apparel products from a certain country would cause/is causing market disruption, can request consultations with that country that could lead to the implementation of safeguard measures. During consultation, this country is obliged to hold exports of products concerned to a level no greater than 7.5% (6% for wool) above the most recent 14 months preceding the month in which consultation was requested.

Both the EU and the US exercised this provision against China in the following manner: i) In June 2005, China and the European Commission signed a memorandum of understanding (MOU), limiting the growth rates of several Chinese products to between 10%-12.5% annually until December 2007. ii) In November 2005, China signed an MOU with the US limiting the growth of certain Chinese products to 10%-15% in 2006, 12.5%-16% in 2007 and 15%-17% in 2008. In addition to benefiting local industries in the US and the EU, these safeguard measures are also benefiting other emerging country exporters such as Hong Kong, Bangladesh, Indonesia, and Vietnam.

Phasing out of quotas between WTO members starting January 2005...

...with safeguards available to restrain the Chinese giant

iii) Egypt's QIZ Protocol

The growing tendency of the US to expand its network of trade agreements, either Free Trade Agreements (FTA) or special schemes such as Qualified Industrial Zone (QIZ) Protocols, has placed Egypt in a less favorable competitive position relative to US trade partners that enjoy the benefits of exporting to the US free of tariff or at reduced tariffs.

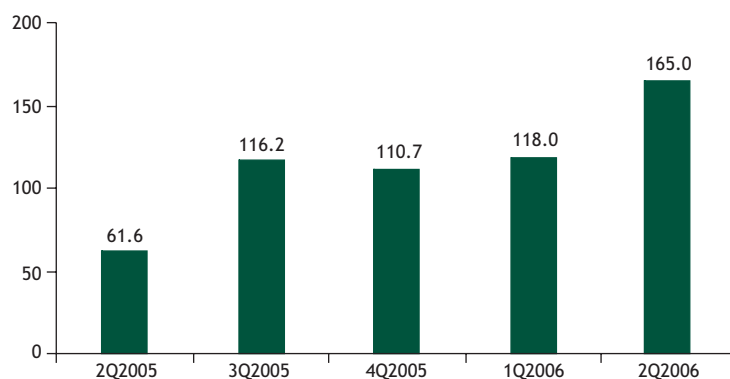
Egypt has been seeking to sign an FTA with the US over the past few years but has not managed to conclude one thus far. As a second best choice, Egypt signed a QIZ Protocol in December 2004 with the US and Israel. According to this protocol, goods produced in QIZs should include 11.7% Israeli inputs to enter the US market at reduced tariff rates. While in the meantime the QIZs could help Egypt to better handle the initial hit from the phasing out of quotas between the WTO members, the Egyptian government hopes that the QIZ pact will be a first step towards obtaining a free trade agreement with the US.

The QIZs are expected to boost textile and apparel exports over the medium term

Initial signs show that the QIZ agreement has had a positive impact on Egypt's exports to the US as shown in figure 1.2. In 2Q2006 exports of QIZ members jumped to USD165 million (mostly of textile and apparel) compared to USD62 million in 2Q2005 and the number of exporters increased to 137, up from 54. The number of QIZ members exporting to the US represents only about 21% of total companies registered.

Challenges facing QIZ members, according to industry sources, include: i) New exporters will need time to understand and penetrate the US market. ii) Prices of Israeli inputs are estimated to be 10% to 20% higher than substitutes from other suppliers and this is partly offsetting the benefit of reduced tariffs. The Egyptian government has been negotiating with the parties of the agreement to reduce the Israeli input requirement to 8%, similar to what happened for Jordan: Jordan's QIZ protocol originally required Israeli inputs of 11.7%, but these were later negotiated down to 8%. Few weeks ago, the parties of the agreement decided to reduce the Israeli input requirement to 10.8%, down from the current 11.7%, effective as of 1 April 2007.

Figure 1.2: Exports of QIZ Members (USD million)



Source: Ministry of Foreign Trade and Industry - QIZ Unit

iv) Competition from Emerging Country Competitors Setting Up Facilities in Egypt

Starting in 2005, Turkish and Asian textile and apparel manufacturers have been setting up/applying to set up factories in Egypt to benefit from its low cost environment and /or proximity to Europe. Most of these investments are concentrated, initially, in the downstream segment of the industry due to its low initial investment cost relative to the upstream segment. This trend will further intensify the competition Egyptian firms are facing from these countries, particularly in Europe and, to a lesser extent, the US.

Turkish manufacturers are losing competitiveness against Asian peers in the US market due to the appreciation of the New Turkish Lira versus the USD and increasing energy and utility prices. The rush on the part of Turkish companies to establish factories in Egypt has increased following the signing of the FTA between Egypt and Turkey in December 2005: According to the General Authority for Investment and Free Zones (GAFI), seven textile and apparel Turkish companies were established from 2005 to date and another eight are underway (a total investment cost of almost USD300 million).

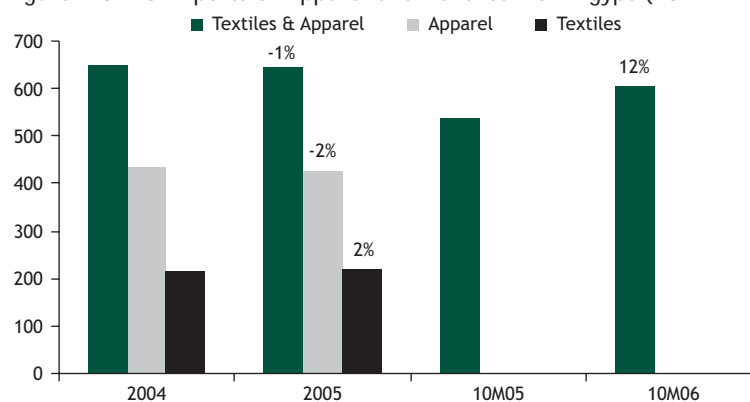
Asian manufactures, on the other hand, are moving to Egypt to benefit from its proximity to Europe, cutting down their shipment time by 17 days. There are already a few Indian companies operating in Egypt and several Chinese operations are underway. According to media sources Chinese companies are injecting investments of EUR160 million (USD200 million) into Egypt, most of which is in textile and apparel projects.

According to GAFI statistics, the number of Egypt-based Turkish and Indian companies that have succeeded in becoming members of the QIZ is on the rise. Accordingly, they are set to benefit from access to the US market at reduced tariffs in addition to enjoying, from an Egyptian tax perspective, the advantages of establishing themselves free and/or special zones. It is worth mentioning that some Turkish and Indian investors have already started production in free zones.

C. Egypt Exports to the US and the EU

The EU and the US are Egypt's largest textile and apparel markets. According to EU statistics, EU imports of textiles and apparel from Egypt amounted to EUR644 million (USD824 million) in 2005, of which 66% are of apparel. Imports from Egypt showed a strong growth of 12% in 10M2006 Y-o-Y, compared to a decline of 1% in 2005.

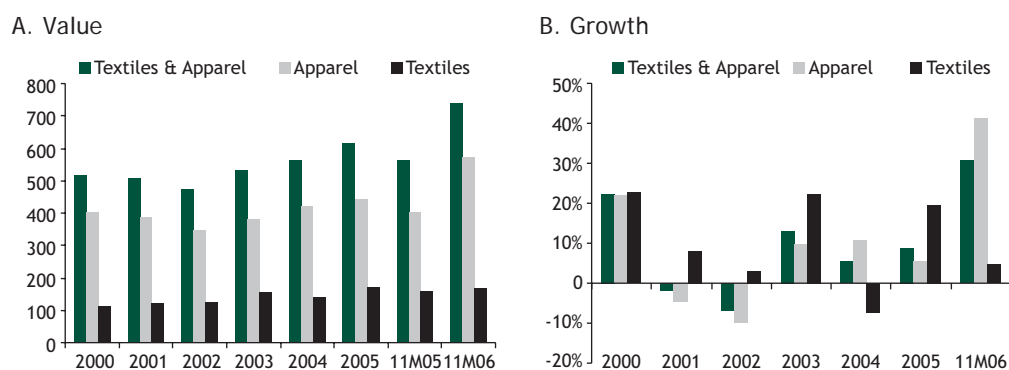
Figure 1.3: EU Imports of Apparel and Textiles from Egypt (EUR million)



Source: European Commission

According to US statistics, the US imported USD614 million of textiles and apparel from Egypt in 2005, of which 72% are apparel. US imports of textiles and apparel from Egypt increased significantly in 11M2006 by 31% Y-o-Y, up from an annual growth rate of 9% over the three years to 2005. Apparel experienced stronger growth of 41% Y-o-Y.

Figures 1.4: US Imports of Apparel and Textiles from Egypt (USD million)



Sources: OTEXA and US Department of Commerce

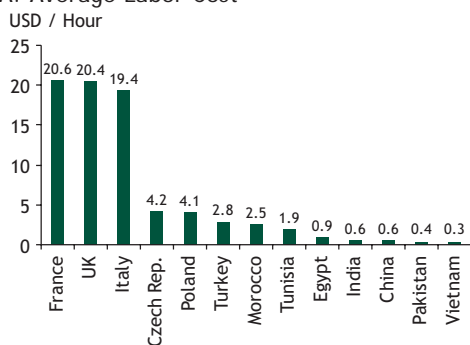
BOX 1: EGYPT'S COMPETITIVE ADVANTAGE AS AN EXPORTER

A Shift in Global Production from Developed to Low Cost Emerging Countries

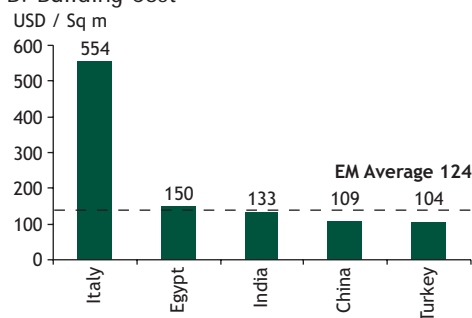
The global production of textile and apparel was initially dominated by what are today developed countries. However, due to the rising production costs across the globe, the industry has been shifting to emerging countries like China, India, Hong Kong and Turkey where there is access to low cost inputs. Egypt's main advantage as a sub-contractor vis-à-vis its competitors lies in: i) its low energy costs (gas and electricity), ii) its proximity to Europe (shipment to Europe takes 3 days from Egypt compared to 20 days from the Far East), and iii) an abundant supply of low-cost labor relative to competitors. Population grows at 1.9% per annum, with 33% of the population under the age of 14. It is worth mentioning that the Egyptian work force grew at a CAGR of 2.5% over 2002-2006.

Figures 1.5: Cost Advantage in Developing Countries

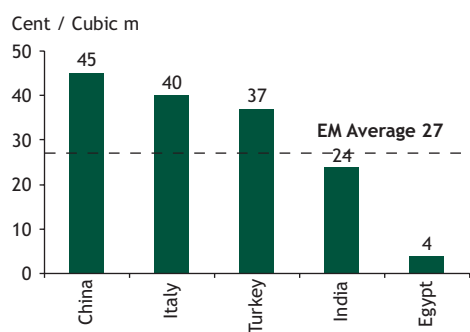
A. Average Labor Cost



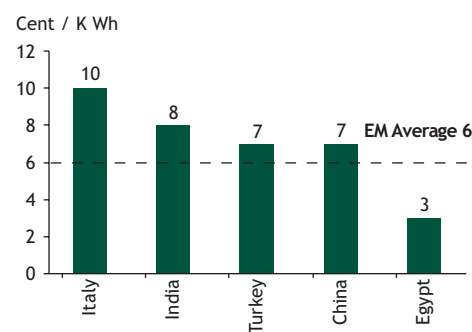
B. Building Cost



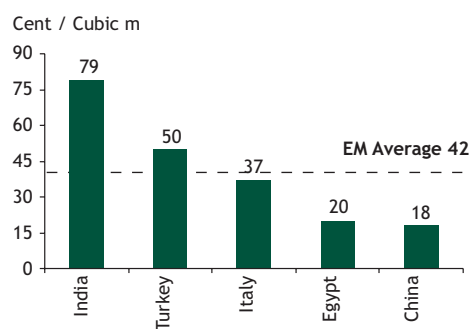
C. Gas Cost*



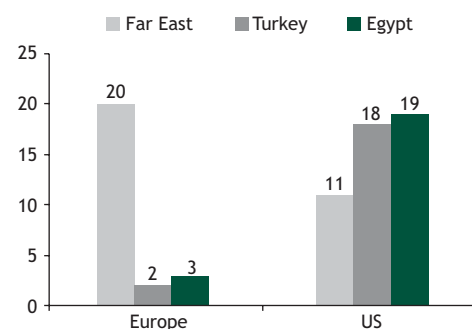
D. Electricity Cost**



E. Water Cost



F. Shipment Time to Europe and the US (Days)



*Over 2004-2006, several countries increased their natural gas prices, including Egypt. Currently natural gas prices in Egypt remain below 5 cent/cubic m

**Electricity costs in Egypt increased in 2004, however, they remain low at 4 cent /k Wh

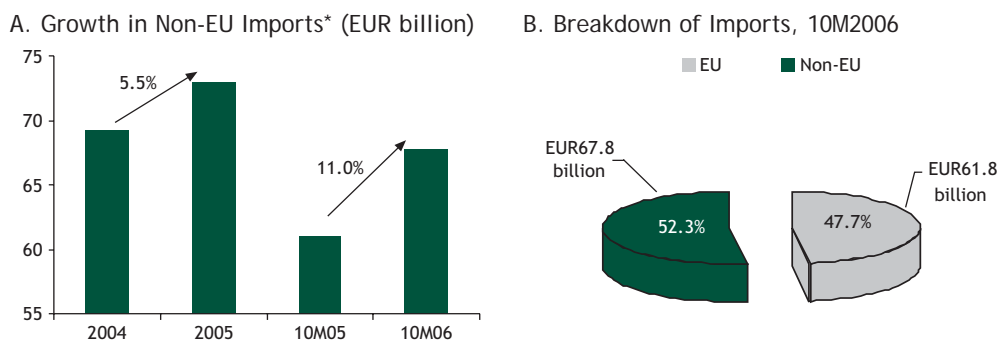
Sources: Arafa Holding, Werner International Textile Industry Report-2003, and ITMF

BOX 2: EU TEXTILE AND APPAREL IMPORTS

Trade Liberalization Increases EU Textile and Apparel Imports

Since the late 1990s, EU textile and apparel imports have been growing slowly or declining in value terms, but increasing in volume terms due to increasing market share of lower-priced Asian products. Moreover, the EU has witnessed production declines as local producers could not cope with low-cost producers. Exports from the EU were further pressured by the appreciation of the EUR against the USD. The lifting of import quotas in January 2005 let more imports into the EU market, both by volume and by value. In value terms, in 2005, textile and apparel imports increased by 5.5% to EUR73.0 billion (approximately USD91 billion). In 10M2006, imports grew at a higher rate, rising by 11.0% Y-o-Y to EUR67.8 billion.

Figures 1.6: The EU Textile and Apparel Imports

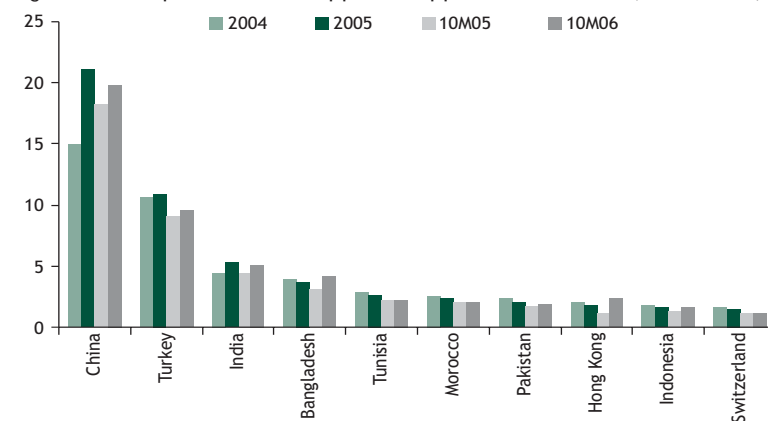


Source: European Commission

Imports from China Boom in 2005, Decelerate in 10M2006

The removal of quotas led to a boom in Chinese textile and apparel exports to the EU in 2005, rising by 35.6% in volume terms and 41.6% in value terms. As a result, the Chinese market share increased from 22% to 29% in volume terms. Trade liberalization also benefited India and Turkey, but with only an 18.2% and 3.7% increase in the value of their exports to the EU in 2005. However, growth in Chinese imports came at the expense of other suppliers such as Hong Kong, which received the biggest hit (-13.3%), Pakistan (-13%), Indonesia (-10.1%), Switzerland (-7.8%), Morocco (-7.3%) and Tunisia (-5.8%). The reintroduction of quantitative limits on China in June 2005 led to a deceleration in the growth of total textile and apparel imports from China to 8.5% in 10M2006 Y-o-Y, with declining volumes and increasing unit prices. China's competitors regained some of their losses, especially Hong Kong.

Figure 1.7: Top Textile and Apparel Suppliers to the EU* (EUR billion)



*Romania was excluded from the list as it joined the EU in January 2007

Source: European Commission

BOX 3: THE UK TEXTILE AND APPAREL MARKET

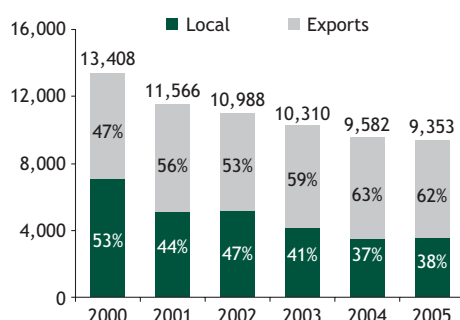
Production and Consumption Trends: Imports Substitute Local Production

In 2005, UK textile and apparel output declined, for the eighth consecutive year, with an average annual decline of 6.9% over 2000-2005, to reach GBP9.4 billion (GBP5.3 billion of textiles, and GBP4.0 billion of apparel). Although exports declined at an annual rate of 1.4% over 2000-2005, their share of output has been increasing, reaching 62% in 2005, due to the decline in total output. Textiles represented about 54% of exports in 2005, while apparel accounted for 46%, both primarily directed to EU countries and the US.

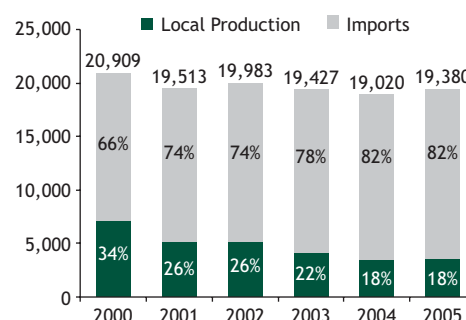
On the other hand, UK textile and apparel consumption declined by an average annual rate of 1.5% over the same period. However, imports increased at a CAGR of 2.9% to reach 82% of consumption in 2005, up from 66% in 2000. This is explained by a trend of sourcing textile and apparel needs from low-cost producers as a result of high labor and energy costs in the UK.

Figures 1.8: Total Textile* and Apparel Production and Consumption

A. Production (GBP million)



B. Consumption** (GBP million)



*Textiles include carpets and home textiles

**Consumption is calculated as local production plus net imports, ignoring changes in inventory

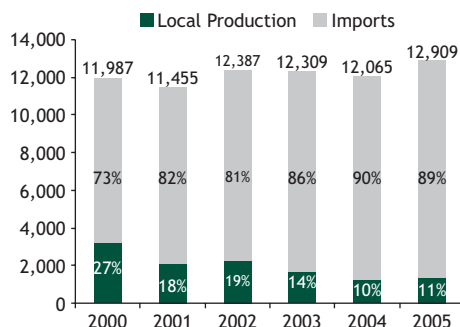
Sources: www.ukfashionexports.com (original sources: Office for National Statistics and HM Custom & Excise) and EFG-Hermes

Analysis of Consumption by Segment

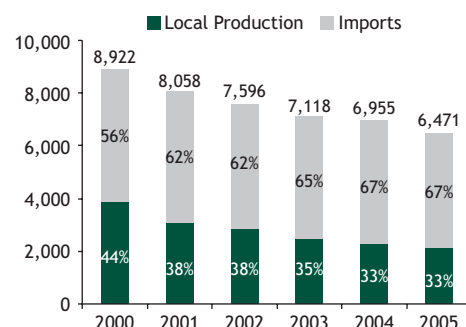
Apparel accounted for 67% of total UK textile and apparel consumption in 2005, while textiles accounted for 33%. UK apparel consumption increased at a CAGR of 1.5% over 2000-2005, whereas textile consumption declined at an average annual rate of 6.2% over the same period.

Figures 1.9: Textile and Apparel Consumption* Breakdown

A. Apparel Consumption (GBP million)



B. Textile Consumption** (GBP million)



*Textiles include carpets and home textiles

**Consumption is calculated as local production plus net imports, ignoring changes in inventory

Source: www.ukfashionexports.com (original sources: Office for National Statistics and HM Custom and Excise) and EFG-Hermes

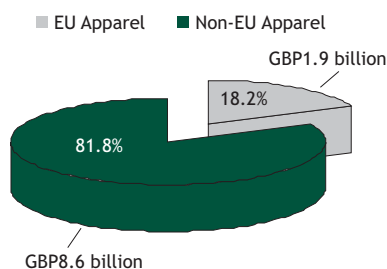
Analysis of Imports by Segment

Apparel accounted for 73% of total textile and apparel imports in 2005. Apparel imports increased significantly at a CAGR of 5.7% over 2000-2005 to reach a dominant share of 89% of total apparel consumption in 2005, reinforcing the trend of substitution of local production by imports as UK retailers and wholesalers are shifting heavily to subcontracting production to lower-cost producers in emerging markets. More than 80% of UK's apparel imports in 2005 were supplied from non-EU sources, with Hong Kong, China and Turkey alone supplying over 40%, while the rest were mainly from EU countries, India and Bangladesh.

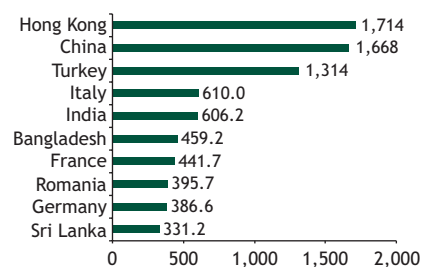
Textiles represented only 27% of the UK's total textile and apparel imports in 2005. Textile imports declined at an average annual rate of 2.9% over 2000-2005. However their contribution to total textile consumption increased to 67% in 2005, up from 56% in 2000 due to the decline in local textile production. The EU supplied the majority of the UK's textile imports in 2005 with a 54.7% share, while non-EU sources, mainly China, India and Turkey, supplied the remainder.

Figures 1.10: UK Textile and Apparel Imports in 2005

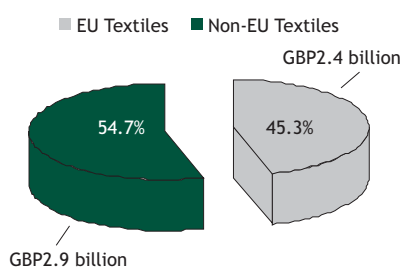
A. Apparel Imports Breakdown



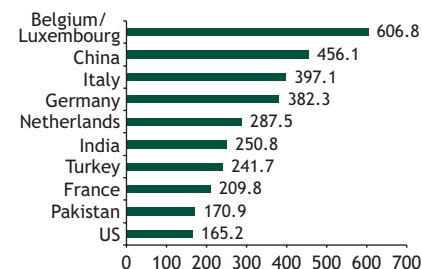
B. Top Apparel Suppliers to the UK (GBP million)



C. Textile Imports Breakdown



D. Top Textile Suppliers to the UK (GBP million)



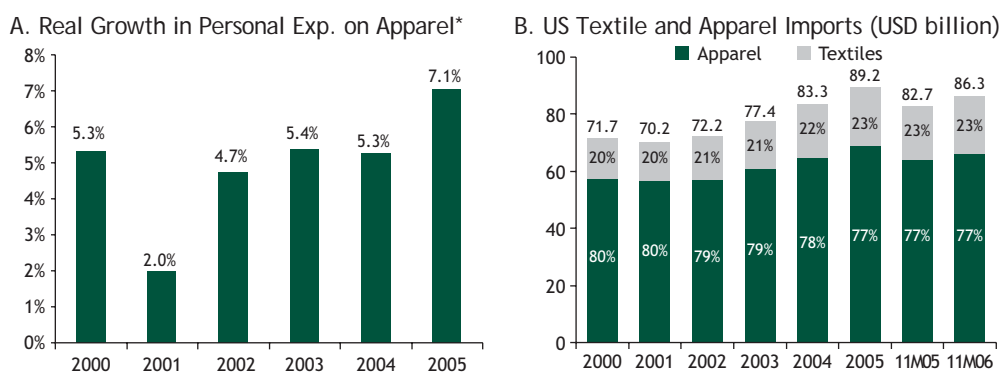
Source: www.ukfashionexports.com (original sources: Office for National Statistics and HM Custom and Excise)

BOX 4: THE US TEXTILE AND APPAREL MARKET

US is a Large Net Importer of Textiles and Apparel

Real growth in personal consumption expenditure on apparel grew by 5.6% annually over 2002-05. The US is a net importer of textiles and apparel, with USD89.2 billion of imports in 2005, compared to exports of USD16.6 billion. The US's textile and apparel imports increased at a CAGR of 4.5% over 2000-05. At the same time, US textile and apparel output has been declining annually through 2000-05, though at decreasing rates. Following strong growth of 7.1% in 2005, US textile and apparel imports increased 4.3% Y-o-Y in 11M06 due to the reintroduction of quotas on China in January 2006. The slowdown in imports from China was partly compensated by sources such as Hong Kong, Bangladesh, Indonesia and Vietnam.

Figures 1.11: US Textile and Apparel Consumption Indicators



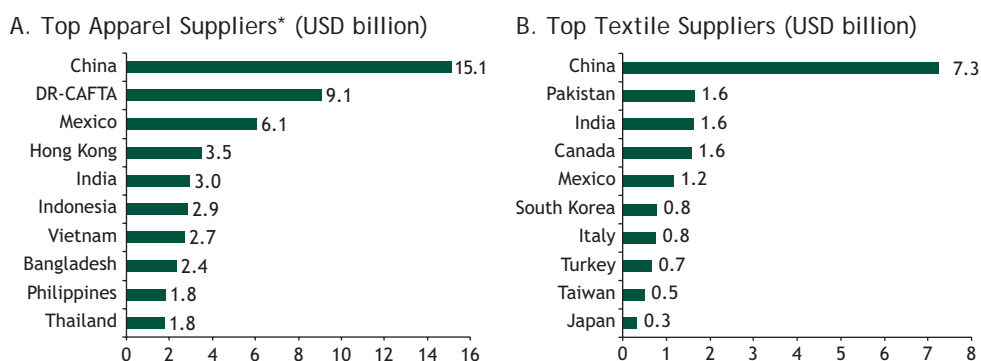
*Based on chained 2000 dollars

Sources: A) Bureau of Economic Analysis and US Department of Commerce, B) OTEXA and US Department of Commerce

Analysis of Imports by Segment: New Restrictions Curb Chinese Growth

US apparel imports increased at a CAGR of 3.7% over 2000-05 to reach USD68.7 billion, 77% of total textile and apparel imports in 2005. China's apparel exports to the US increased at a CAGR of 27.5% over 2000-05, leaping by 69.7% in 2005 alone, as the quotas under the Multi-Fiber Agreements (MFAs) were abolished in January 2005. After the imposition of new quotas in January 2006, however, Y-o-Y growth in 11M2006 decelerated to 18.1%. China supplied the US with over USD15 billion worth of apparel in 2005, 22% of US's total apparel imports. Other major suppliers include DR-CAFTA, Mexico, Hong Kong, and India. Total textile imports increased at a CAGR of 7.2% over 2000-05 to USD20.5 billion. US imports from China increased at a CAGR of 29.1% to USD7.3 billion in 2005, but only by 17.7% in 11M06. China represented 35.4% of total US textile imports in 2005.

Figures 1.12: Top Apparel and Textile Exporters to the US in 2005



*DR-CAFTA = Dominican Republic-Central America FTA, which is between the US and the Central American countries.
Sources: OTEXA and US Department of Commerce

II. PROFILE AND STRATEGY

Overview

A world-class apparel and textile complex

Al Arafa for Investment and Consultancies (referred to in this report as Arafa Holding or Arafa) is one of the leading export-oriented and integrated apparel and textile manufacturers in Egypt and the Middle East and a prominent retailer in Egypt and the UK, with about 90% of revenue generated from outside of Egypt. Arafa manufactures men's formal and casual wear for some of the world's largest retailers such as M&S, GAP and Target and most recognized brands such as Valentino, Jaeger and Haggard. The company owns production capacity for men's formal and casual wear equivalent to 2.55 million suits, fabric capacity of 3.5 million meters, and yarn capacity of 1,250 tons (as at December 2006). Furthermore, Arafa controls part of its distribution channels by owning retailing operations. Its retail segment includes Concrete, a well-known men and kids wear retail chain in Egypt (91.6% owned) with a 7% market share of menswear and BMB Group, the largest retailer and wholesaler of menswear in the UK (39.1%, with call options to acquire up to 100% of the company) with a 16% market share of men's suits.

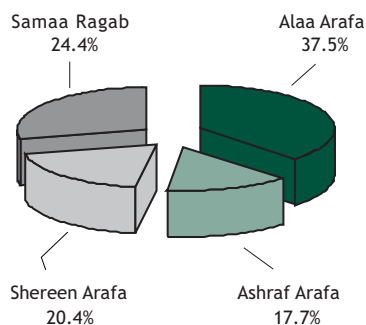
The founding Arafa family has been working in the textiles field since the 1900s, initially as a fabric retailer. In 1984, the family established its first textile factory, followed by an apparel factory in 1989, and a series of acquisitions/ greenfields in the manufacturing and retailing segments. In 2006, the family grouped its textile-related businesses under one umbrella, Arafa Holding.

The listing of Arafa Shares end 2006

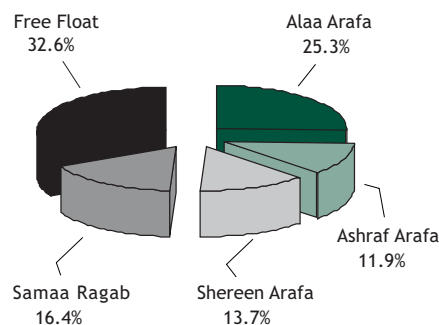
In December 2006, Arafa carried out an initial public offering in the form of a primary offering of 77.5 million shares. The new shares were offered in two tranches: i) 17.5 million to public subscribers at USD1.14 per share, and ii) 60 million shares to institutions and high net worth individuals in a private placement at USD1.20 per share. Offering proceeds amounted to USD92 million and will be used to finance Arafa's expansion plans. Shares were listed in the Cairo and Alexandria Stock Exchanges (CASE) and started trading on 24 December 2006. The free float of the company stands at 32.6%.

Figures 2.1: Arafa Holding Ownership Structure*

A. Pre-IPO



B. Post IPO**



*Alaa Arafa is the Chairman of Arafa Holding and Ashraf Arafa is the Chairman of the textile segment

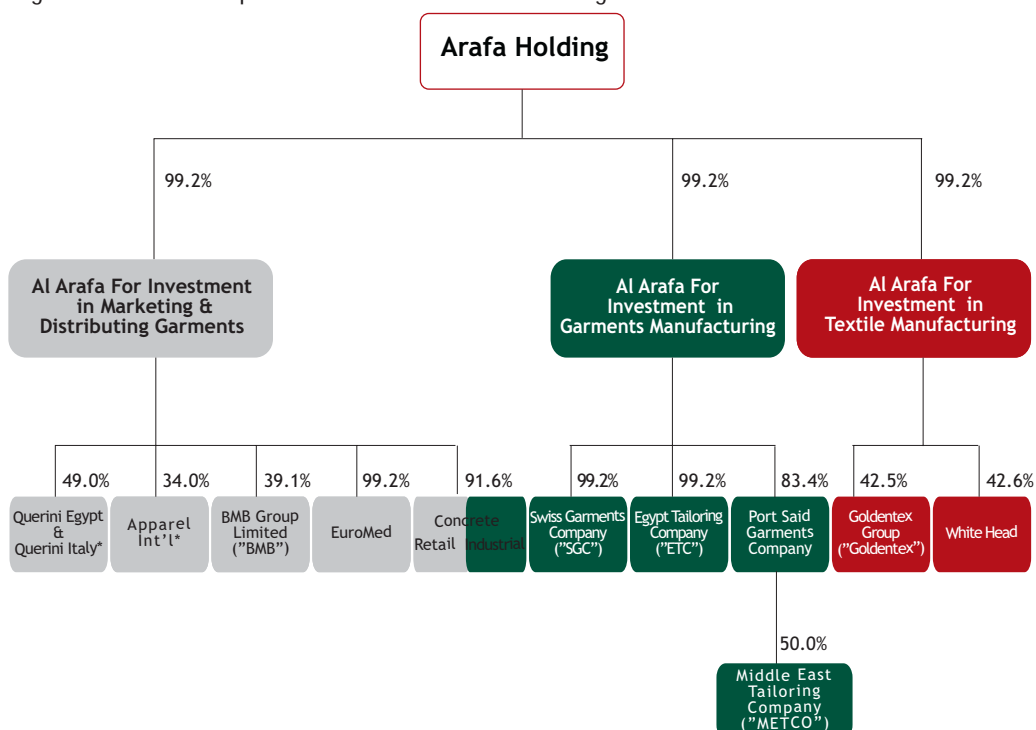
** The free float includes 1.4 million treasury shares that were transferred to the company from the IPO stabilization fund at the end of the blackout period. The company has not yet announced if it will resell the shares on the market or cancel them. It is worth mentioning that the company can hold the shares for up to one year without having to cancel them

Source: Arafa Holding

Corporate Structure

Figure 2.2 summarizes the corporate structure of the company and its ownership in each subsidiary. Furthermore, we provide in Box 5 detailed information on subsidiaries including location, capacity, ownership, financial year end, consolidation method and tax status. It is worth mentioning that consolidated financials include numbers for 12 months to March for subsidiaries with year end March (Holding Company on a stand-alone basis and BMB) and 12 months to December for subsidiaries with year end December (all remaining subsidiaries). This is also the case for all breakdowns mentioned in this report unless otherwise stated.

Figure 2.2: Arafa Corporate Structure and Business Segments



*Under Incorporation
Source: Arafa Holding

Production and Distribution Chain

Arafa's activities are grouped under three business lines: i) retail, which accounts for 69% of consolidated revenue (49% on a proportionate basis), ii) apparel, 29% of consolidated revenue (49% on a proportionate basis), and iii) Textiles, 3% of consolidated revenue (2% on a proportionate basis). Box 6 summarizes the production and distribution chain of the group and the integration within its segments.

Production starts from the spinning and weaving of wool/other inputs in the textile segment to transform wool into wool/blended fabric. The apparel segment uses part of the fabric produced by the textile segment (58% of textile segment gross revenue) as well as imported wool / blended fabric and cotton fabric to produce formal and casual wear. The choice of fabric suppliers is based on customer preference and specifications.

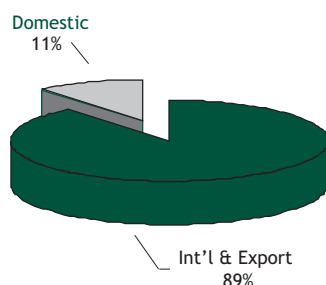
The manufacturing process of formal wear, particularly jackets, is longer and more sophisticated than casual wear. Arafa uses Italian know-how for its formal wear that was bought from an Italian company. Approximately 17% of the apparel segment's output is sold through the retail segment (BMB, Concrete and Euromed). The remaining output of the textile segment is sold to both local and export markets, while the remaining output of the apparel segment is sold to Europe and the US. The retail segment sources its remaining needs through sub-contracting to Egyptian and Chinese manufacturers.

The UK is the largest contributor to revenue

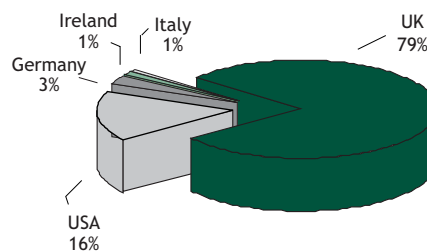
Almost 90% of revenue is generated from outside of Egypt. The UK is the largest contributor to export revenue, with 79% of the total, followed by the US (16%). Revenue generated from the UK includes both apparel export revenue to UK retailers, mostly of formal wear, as well as retail revenue generated by BMB Group. Sales to the US are mostly of casual wear.

Figures 2.3: Contribution to Revenue by Market

A. Domestic versus Export Revenue*



B. Export Revenue by Market**



*Revenue includes intra-group sales
 **UK revenue includes BMB Group for the same period
 Source: Arafa Holding

Business Model and Strategy

Acquiring established brands/retailers to grow the cash generative apparel business,...

The business model of Arafa has been transformed over the past few years from that of being solely an integrated manufacturer of apparel and textiles to also becoming a retailer/wholesaler in order to control its distribution channels and ensure medium-term stable supply agreements that help expand the Egypt-based apparel segment, which is the cash cow of the group. The apparel segment is majority-owned and yields relatively high margins. Currently, approximately 28% of the apparel revenue is generated from partly controlled / joint ventures with retail and wholesale channels.

Major steps taken so far to achieve this were: i) The acquisition of a majority stake in Concrete in 1997 and the establishment of Euromed in 2002, both operating in Egypt. ii) Entering a joint venture with Bagir, the wholesaler of M&S in 2000 (METCO, a manufacturing arm based in Egypt under the apparel segment) to manufacture formal wear for M&S. Currently METCO accounts for 11% of apparel gross revenue. iii) Acquiring 39.1% of BMB Group in the UK and increasing quantities sub-contracted to the apparel segment from BMB. BMB contributes 13% of apparel gross revenue. This is expected to increase due to an increase of 67% in the number of suits subcontracted from BMB to the apparel segment starting in January 2007. iv) Entering a joint venture with Forall Group of Italy in 2006 to target the Italian market with a new brand of mens' suits, "Querini", with products sourced from the apparel segment. v) Establishing a new UK retail company in 2006 to target the growing supermarket business and other UK clients, which are out of BMB's reach, with products partly sourced from the apparel segment.

*...diversify its market mix...*

In addition to expanding its network of external clients, Arafa's approach of controlling its distribution channels is expected to continue. Besides consolidating its presence in the UK and Italy, Arafa is also targeting other European markets such as Germany, France, and Spain. Furthermore, Arafa plans to increase its presence in North America by penetrating the formal wear market. Arafa plans to follow the BMB arrangement in acquiring new retail companies; i.e. buying a stake with a call option to acquire the rest of the company. It is also possible that Arafa might acquire distressed / loss making companies and restructure their business model / shift to lower cost suppliers to make them profitable, similar to the examples of Concrete and BMB. These efforts should translate into: i) An increase in capacity in the apparel and textiles segment to meet growth in retail, and ii) a gradual reduction in Arafa's relative (but not absolute) exposure to the UK market.

...and enhance ability to handle competition

Competition from countries with strong textile industries such as Turkey, India, and China is intensifying with: i) The removal of quotas for exports into the US and Europe in 2005 (although China is constrained in the short term), and ii) Turkish, Jordanian, and Asian manufacturers establishing factories in Egypt to benefit from its low cost base and its proximity to Europe. Controlling distribution channels and entering into medium to long-term supply agreements partly mitigate the negative impact from the abovementioned factors on Arafa.

Shifting production and sales to higher margin products

Arafa plans to shift to higher margin production and sales through: i) Increasing subcontracting of casual wear to other low-cost producers to free part of its casual wear capacity for the manufacturing of higher margin and more-difficult-to-produce formal wear. ii) Shifting its sales mix to formal wear through the above-mentioned acquisition of new brands and the penetration into the US formal market. iii) Increasing dependence on internal production of fabric to enhance the benefits of vertical integration. This, however, will depend on customers' preference for fabric suppliers. iv) Introducing fine shirts to its formalwear product portfolio.

Leasing facilities in Beni Sueif to support expansions in the textile and apparel segments

Early in February 2007, Arafa announced it had leased facilities in Beni Sueif city (in the Nile Valley just 90 minutes south of Cairo), including 212,000 square meters of land with a 35,000 square meter of buildings to support expansions in the textile and apparel segments. Operating in Beni Sueif offers opportunities and several benefits to the company: i) With the strong foreign direct investment from textile companies, Arafa management is considering entering into joint ventures to expand its fabric operations and adding home textiles to its product portfolio. ii) It will provide wide room for expansions in the apparel segment, with the possibility of relocating casual wear production to Beni Sueif and free its capacity in the 10th of Ramadan facilities for suit manufacturing. iii) In addition to cheap, abundant labor and transportation costs in Beni Sueif relative to the company's other locations, the government is supporting the industrial sector in Upper Egypt as part of its Upper Egypt development initiative.

Although exact details on the upcoming use of the Beni Sueif land and the ownership of planned JVs are not yet available, the company expects that: i) the Beni Sueif land will be part of a free zone, ii) the project will cost approximately USD100 million, iii) production will start by 2008 with utilization of the land / factory increasing gradually, and iv) the project will generate a turnover of USD300 million by 2011.

BOX 5: INFORMATION ON SUBSIDIARIES

	Location	Area (sq m)	Products	Capacity*		Ownership		Consolidation method	Tax status	Year-end
				Original	SEU	Arafa Holding	Other			
Arafa Holding (Egypt Based)	10th of Ramadan									
Textiles (Egypt Based)										
Goldentex Group	10th of Ramadan	22,370	Fabrics (000 m) Yarns (t)	3,500 850		42.5%	Others 57.5%	Full Cons.	Taxable	Dec.
White Head Spinning	10th of Ramadan	2,630	Yarns (t)	400		42.6%	Others 57.4%	Full Cons.	Exempt till end 2013	Dec.
Apparel and Tailoring (Egypt Based)										
Swiss Garments Company	10th of Ramadan	33,000	Casual Wear (pcs)	3,231,696	671,302	99.2%	Family 0.8%	Full Cons.	Free Zone	Dec.
			Formal Trousers (pcs)	1,114,225	278,556					
			Formal Jackets (pcs)	630,842	445,300					
Egyptian Tailoring Company	10th of Ramadan	11,100	Trousers (pcs) Jackets (pcs)	516,211 149,925	129,053 112,444	99.2%	Family 0.8%	Full Cons.	Exempt till end 2011	Dec.
			Half/Full Canvas Jackets (pcs)	229,215	259,807					
METCO	Portsaid	8,700	Formal Trousers (pcs) Formal Jackets (pcs)	1,199,647 189,990	299,912 142,492	41.7%**	Bagir - M&S 50%, Others 8.3%	Prop. Cons.	Free Zone	Dec.
Concrete (Manufacturing)	6th of October	7,200	Casual Wear (pcs)	976,855	207,971	91.6%	Others 6.7%, Family 1.7%	Full Cons.	Taxable	Dec.
Retail										
Concrete (Retail)	Egypt			6,032 sq m		91.6%	Others 6.7%, Family 1.7%	Full Cons.	Taxable	Dec.
Euromed	Egypt			2,659 sq m		99.2%	Family 0.8%	Full Cons.	Taxable	Dec.
BMB	UK			23,403 sq m		39.1%	BMB Manag. & Others 60.9%	Full Cons.***	Taxable	Mar.

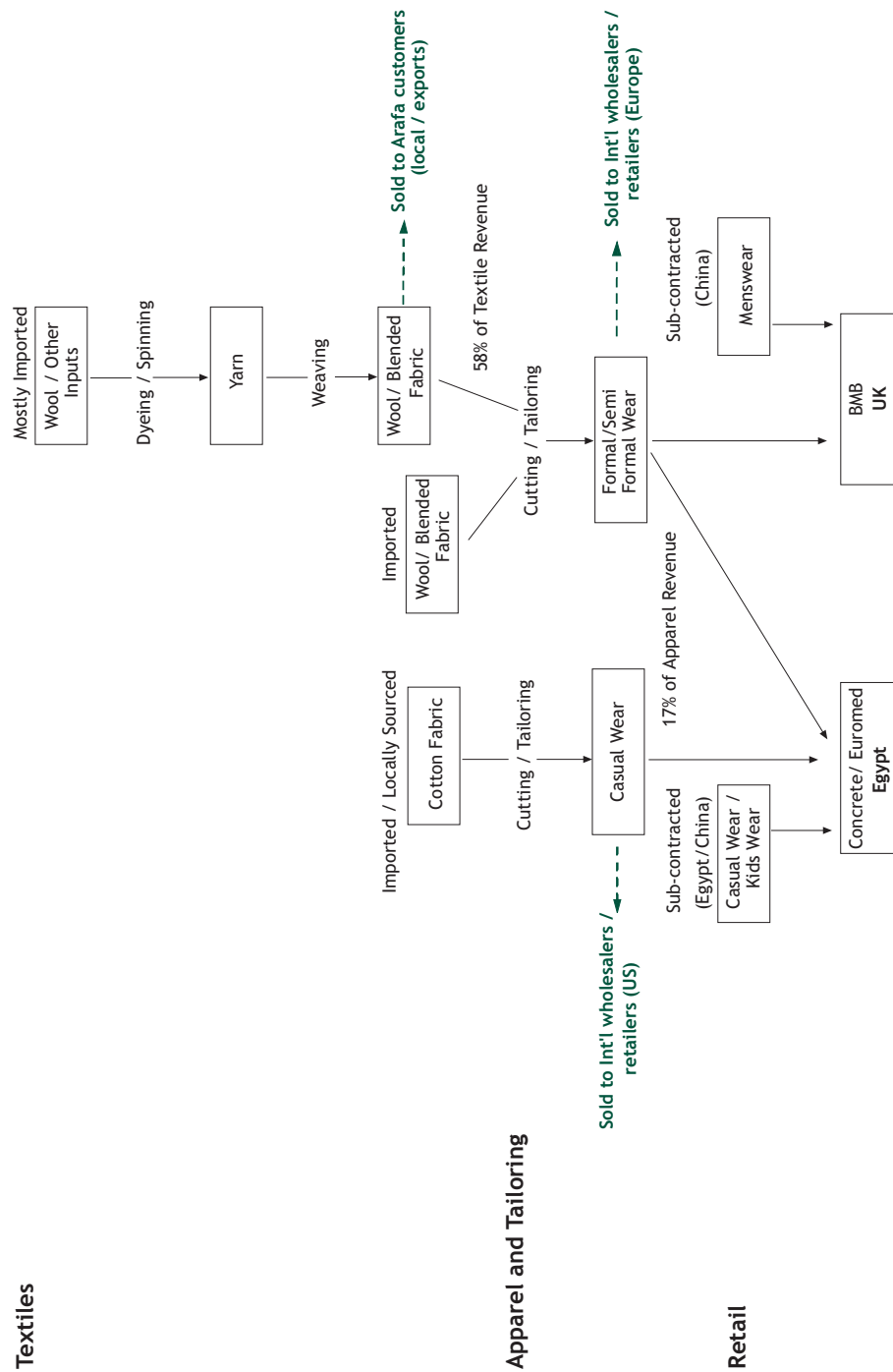
*Capacity as of December 2006, SEU denotes Suit Equivalent Unit, capacity of spinning and weaving could increase depending on the quality of yarn and fabric produced

**Effective ownership of Arafa in METCO. METCO is 50% owned by Portsaid Garments (83.4% owned by Arafa Holding, 16.6% by Arafa family)

*** BMB is fully consolidated because Arafa Holding has a call option to buy up to 100% of the company

Source: Arafa Holding

BOX 6: PRODUCTION AND DISTRIBUTION CHAIN



Sources: Arafa Holding and EFG-Hermes

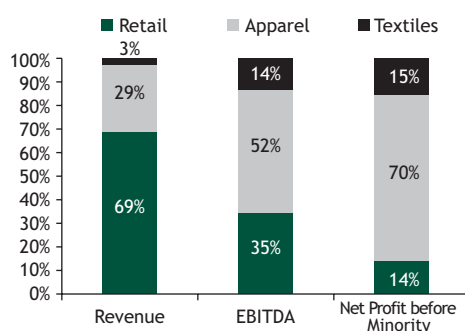
III. BUSINESS LINES

Retail and apparel are the largest contributors to revenue

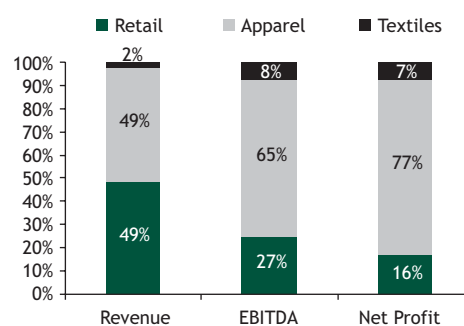
We present the three business lines based on a bottom-up approach; i.e. starting with textiles, followed by apparel and ending with retail. On a consolidated basis, the retail segment is the largest contributor to revenue, while the apparel segment is the largest contributor to EBITDA and net profit. However, on a proportionate basis; i.e. taking into consideration Arafa's ownership in each segment, the contribution of the apparel segment to revenue is almost equal to the contribution of the retail segment.

Figures 3.1: Contribution to Revenue*, EBITDA and Net Profit by Segment, March 2006

A. On a Consolidated Basis



B. On a Proportionate Basis**



*Revenue excludes intra-group sales

**Approximated

Sources: Arafa Holding and EFG-Hermes

A. Textiles

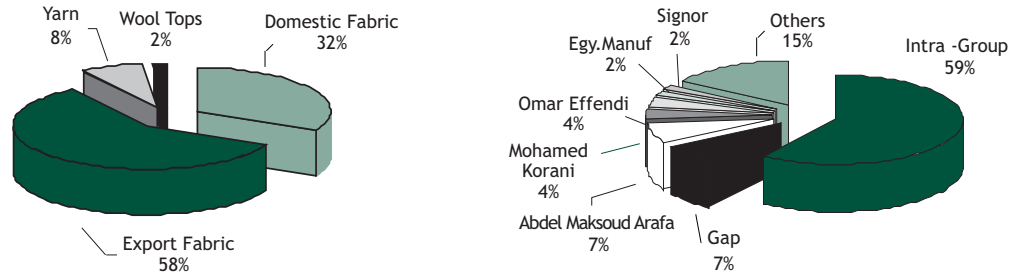
Filling group needs for fabric and selling to local and export markets

The textile segment (43% owned by Arafa Holding) operates fabric capacity of 3.5 million meters and yarn capacity of 1,250 tons (as of December 2006). Both fabric and yarn capacities can go up significantly depending on the quality of products. However, the company has been moving to higher quality products. The production process of the textile segment includes dyeing, spinning and weaving. The segment operates at an 85%+ capacity utilization rate and its products include wool fabric and other blended fabric such as poly viscose, poly wool and poly wool lycra. Approximately 58% of the textile segment's sales, in terms of value, are directed to fill the apparel segment's needs for fabric, while the remaining 42% are generated from sales to export markets and local customers, mostly to other Egypt-based garment exporters.

Fabric accounts for 90% of the textile segment's gross revenue (excluding intra-segment sales but including intra-group sales). Following the removal of the ban and the reduction of tariffs on imported fabrics in Egypt, competition increased in the local market. This urged the company to shift its strategy from focusing primarily on the local market to focus on export markets. Currently, fabric exports account for 60% of fabric sales volume and 64% of fabric revenue. The company sells small amounts of yarn (8% of textile revenue) and wool tops (2%). Yarn and wool tops revenue are decreasing and the textile revenue mix is expected to gradually shift so that fabric revenue grows to become 100% of textile revenue in the near future.

Figures 3.2: Revenue* Breakdown

A. By Product Type B. By Customer mix



*Excluding intra-segment sales but including intra-group sales
Sources: Arafa Holding and EFG-Hermes

Adding capacity and diversifying fabric mix to better serve group needs

The company is increasing its fabric capacity from 3.0 million meters to 4.5 million, adding 500,000 meters annually over December 2006 to December 2008. Machines are already paid for. Furthermore, the company plans to diversify its product mix to include cotton-based fabric, focusing on fine shirting and yarn-dyed fabric.

With the strong foreign direct investment from textile companies, Arafa management is also considering entering into joint ventures to expand its fabric operations and add home textiles to its product portfolio.

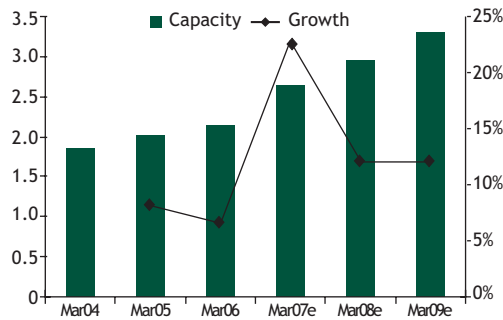
B. Apparel and Tailoring

Exports account for 89% of apparel revenue...

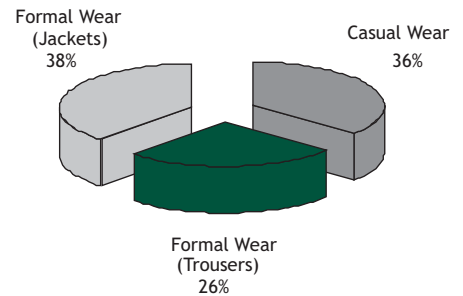
The apparel segment (90%+ owned by Arafa) operates production capacity equivalent to 2.55 million suits (at December 2006). The capacity utilization rate exceeds 90%. The segment's product mix includes: i) Formal products such as trousers, jackets, half canvas jackets, and full canvas jackets, and ii) casual products such as shorts, pants and semi-formal trousers. By December 2007, the company will have increased its capacity by approximately 33% from December 2005 levels, to satisfy new orders from its retail partners (refer to retail segment). Approximately 64% of current capacity is assigned to the production of formal wear and 36% to the production of casual wear.

Figures 3.3: Apparel Capacity (SEU million*) and its Breakdown to Casual and Formal Wear

A. Capacity and Growth in Capacity



B. Contribution to Capacity



*Capacity at apparel year end (December), is calculated on a suit-equivalent basis
Source: Arafa Holding

...sold to Europe and largest US retailers

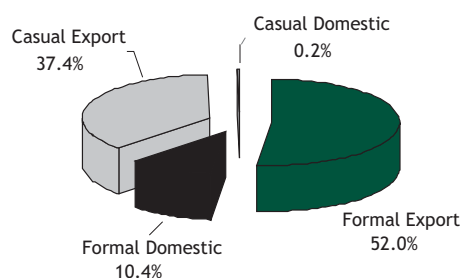
Production is mostly directed to export markets, which accounts for 89% of the segment's revenue (excluding intra-segment sales but including intra-group sales), and include the UK, US, Italy, Germany, and Ireland. The company sells mostly formal wear to the UK, its largest market, while it sells mostly casual wear to the US.

The apparel segment has a total of 24 customers (in March 2006) with approximately 17% of the segment's revenue, in terms of value, generated from selling to the group's retail segment (BMB, Concrete and Euromed) and 83% generated from selling to some of the world's largest retailers such as M&S, GAP, Valentino, Jaeger, Haggar, and JC Penny. Furthermore, the company has started / is negotiating to produce for new clients in Europe and the US such as Hugo Boss, Next, DressMaster, and El Corte Ingles. The company has 5-year supply agreements with BMB, Querini and Valentino and seasonal or annual agreements with other retailers.

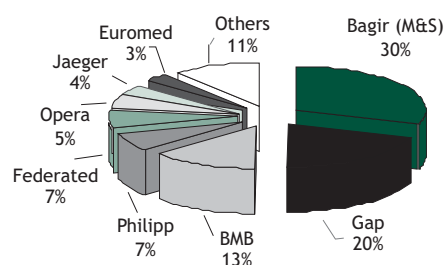
Arafa is the only exporter in Egypt that uses Electronic Data Interchange (EDI) as a marketing tool to approach its US customers such as JC Penny and Macy's. EDI allows the replenishing of stock, on a continuous basis, through a third party warehouse in the US.

Figures 3.4: Revenue Breakdown

A. By Product Type



B. By Customer



*Excluding intra-segment sales but including intra-group sales
Source: Arafa Holding

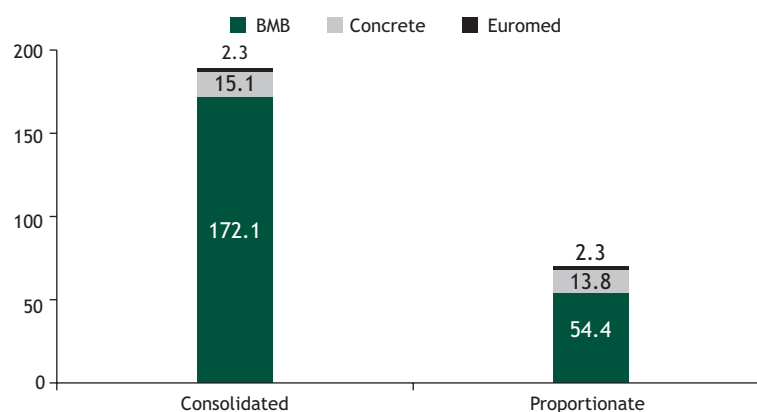
Focus on higher margin formal wear to continue

The apparel segment will continue to focus on higher margin products and brands, primarily through increasing and diversifying production of higher margin formal wear at the expense of the production of casual wear. Within this context, the company plans, over the medium term, to: i) Extend and diversify its formal wear customer base to include the US. ii) Enter into joint ventures / benefit from JVs undertaken by the retail segment with European manufacturers that are planning to relocate their facilities / sub-contract production to lower-cost emerging markets. iii) Manufacture fine shirts, adding for the first time this type of product to its product portfolio. iv) Subcontracting casual wear to other manufacturers, and/or relocating casual wear production to lower cost locations such as Beni Sueif.

C. Retail

The retail segment includes the following operations: i) BMB (39.1% owned), ii) Concrete (91.6%), iii) Euromed (99.2%), iv) Querini (49%, under-establishment), and v) Apparel International (34%, under-establishment). BMB accounts for 91% of retail consolidated revenue (77% on a proportionate basis) and Concrete for 8% (20% on a proportionate basis).

Figure 3.5: Breakdown of Retail Revenue by Company (USD million)



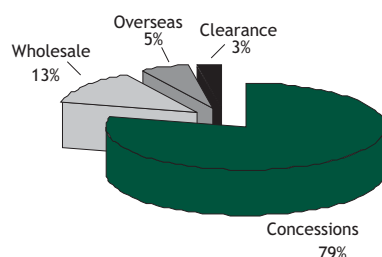
Sources: Arafa Holding and EFG-Hermes

i) BMB

BMB group is the UK's largest men's clothing concessionaire (operator of retailing area within a department store), collaborating with high street giants such as Selfridges, House of Fraser, Debenhams and Burtons as well as quality independent stores. The company also sells through its own stores. BMB Group covers a total retail space of 23,403 sq m, of which 1,834 sq m is owned by BMB and distributed over 11 stores. Furthermore, BMB is one of the largest UK wholesalers with a national network of showrooms selling to over 750 active independent retailer accounts. According to BMB management, its market share of formal suits in the UK stands at approximately 16%. The brands it offers are a mix of wholly-owned and licensed brands including Alexandre Savile Row, Hardy Amies, Jeff Banks, Baracuta and Limehaus. In 2005, BMB acquired the men's formalwear wholesale business of Stuncroft Limited, which includes brands such as Gibson and The Label, and 51% of Addison and Steele Tailoring Limited.

Figures 3.6: Revenue Breakdown and Customer Mix

A. Revenue Breakdown B. Customer Mix



Source: Arafa Holding

	Retail	Wholesale
Concessions High	Clearance	BHS Wholesale
Debenhams	Factory/ Own Shops Independents	Burtons Wholesale
Arcadia		Haggar Wholesale
House of Fraser		Label Division
Chain Stores/ Independents	Overseas	Gibson
Other	US Forces	

Arafa Owns 39.1% of BMB with call options to acquire a majority stake

Arafa acquired a 31.6% stake in BMB Group in 2004 and exercised a call option to increase its stake to 39.1% on 22 December 2006. The 39.1% stake was obtained at a total value of USD14 million. The remaining shares are owned by the chairman and CEO of BMB and other shareholders. Arafa has another call option to acquire a majority stake in BMB with a validity of three years, at a price 65% higher than the price of the recently exercised call option. Arafa Group entered into a shareholders agreement with BMB, which specifies that shareholders are entitled to receive distributions up to 50% of distributable income on an annual basis.

The restructuring of BMB

BMB Group is a result of several management buyouts and acquisitions. The company was loss making in the fiscal year ending March 2006 and is undergoing a major restructuring of its business activities that includes reorganizing the business, discontinuing relatively weak brands, product portfolio optimization, and discontinuing production at owned factories. BMB will limit its factory operations to samples and rely more on sourcing from lower-cost manufacturers from outside the UK. The restructuring cost is USD2.2 million to be spent over 2005-07.

A win-win apparel and fabric supply agreement

The apparel and textile segments have entered into a supply agreement with BMB that includes the following: i) The apparel segment provides BMB with a minimum of 180,000 suits per year until the end of 2006 and a minimum of 300,000 suits per year starting January 2007 and for five years. The price is fixed in GBP over the duration of the agreement. BMB management has indicated that this represents around one-third of its suits requirement and that it will not exceed this threshold in the foreseeable future. ii) The textile segment will provide BMB with 250,000 meters of fabric per year to be used by the apparel segment in manufacturing the aforementioned suits.

A leading retail chain with a 7% market share of menswear in Egypt

Benefits of the supply agreement for BMB include secured capacity within the Arafa group, guaranteeing uninterrupted supply of suits in a low-cost country, a lead-time of five weeks that is relatively short compared to industry norms. Furthermore, BMB uses the apparel segment as a gateway to target the US market through the QIZ agreement. On the other hand, the apparel segment is guaranteed the sale of 12% of its current garment capacity at a fixed price for five years and the textile segment is guaranteed sales equal to 7% of its current capacity.

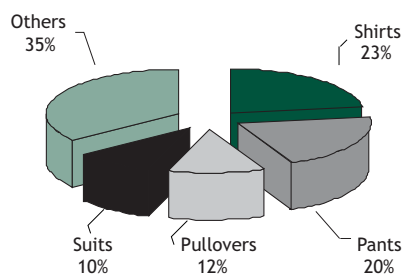
ii) Concrete

Concrete is a leading Egypt-based retail chain with a 10-year history selling formal and casual wear for men under the "Concrete" brand name as well as kids wear (starting at 2 years old) under the "Concrete Generation" brand name. Currently, Concrete has 40 stores spread over the main governorates in Egypt with a total store area of around 6,023 sq m and a 7% share of the highly fragmented menswear market. Concrete targets the large middle income class (i.e. a monthly income in the range of EGP5,000 per month and spends an average of 7% or more of income on clothes).

Concrete sources approximately 30% of its menswear needs from the Group's facilities (partly from a Concrete-owned production facility, which is classified as part of the apparel segment). To offer a full range of products and ensure flexibility, Concrete subcontracts its remaining needs for menswear and all kidswear to local and Chinese manufacturers.

Figures 3.7: Breakdown of Revenue and Evolution in Number of Shops

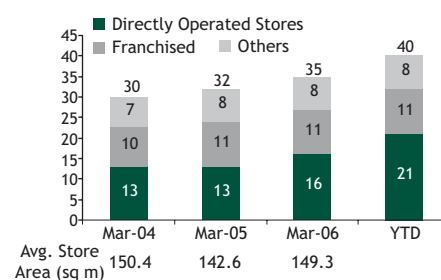
A. Revenue Breakdown by Product Type*



*Others include blazers, jackets, sweatshirts, T-shirts, blouses, shorts, trousers, belts, and dresses, each contribute less than 6% of Concrete revenue

Source: Arafa Holding

B. Number of shops and Average Store Area



Concrete's growth strategy is based on: i) Consolidating its presence in Egypt by opening two to three directly owned stores with a larger store format averaging 350 sq m per store, with the aim of covering all upscale shopping districts and malls. In 2006, Concrete added 5 new stores. ii) Expanding into specialized retail formats. Concrete will launch a new chain of stores under the name of "Concrete Concept" by 2008. These stores will specialize in high-end formal and classic menswear only, offering a full range of products including half canvas suits, shirts, ties, classic pants and jackets. The initial plan is to open three stores in Cairo and one in Alexandria. iii) Expanding the product range to penetrate the 0-2 age group. This segment is underserved in Egypt and is highly dependant on relatively expensive imports. iv) Regional and international expansion. Concrete plans to penetrate Europe by 2008/09 starting with two stores in the UK that will be franchised to BMB. Furthermore, it is negotiating with a Dubai-based company to franchise the "Concrete" brand in the GCC region.

Concrete has recently bought: i) Four floors in one building with a total area of 3,840 square meter, and ii) a new store with an area of 1,000 square meters. The two assets are located in prime locations in Cairo. The company plans to use these spaces not only to expand its Concrete brand but also to enter into franchise agreements with foreign retailers to introduce new brands to the Egyptian market.

iii) Euromed

Euromed operates discount retail outlets in Egypt under the name "Brands for Less" to act as an outlet for the excess capacity of the apparel segment. The company has recently entered a franchise agreement with Italian based Vestebene Group to act as a franchisee for two of its women's wear brands in Egypt; "Oltre" and "Motivi". The company recently opened one store for each brand in Alexandria, and a second store is scheduled to be operational by March 2007 in Cairo.

iv) Querini

Querini is a joint venture between Arafa Group and the Italy-based Forall Group to manufacture suits for retail in Italy under a new brand name: "Querini". Arafa will be responsible for the manufacturing through a new fully dedicated production line while Querini Italy will handle the design, brand management, and distribution. Production will start by April 2007, initially with small quantities and is expected to increase gradually as the new brand gains ground.

v) Apparel International

Apparel international is an export company established in 2006 for the purpose of approaching customers in the UK beyond the reach of BMB, with the objective of developing supply agreements with existing and new clients. Production will be sourced from the apparel segment of Arafa Group as well as other manufacturers, particularly Chinese. The company targets mostly the supermarket segment and has already established relationships with key clients in the UK including Tesco. Arafa Holding owns 34% of the company, while the remaining shares are owned by the Arafa Family.

IV. ANALYSIS OF SALES

Annual proportionate revenue growth of 14% over 2005 and 2006 (year ended March)

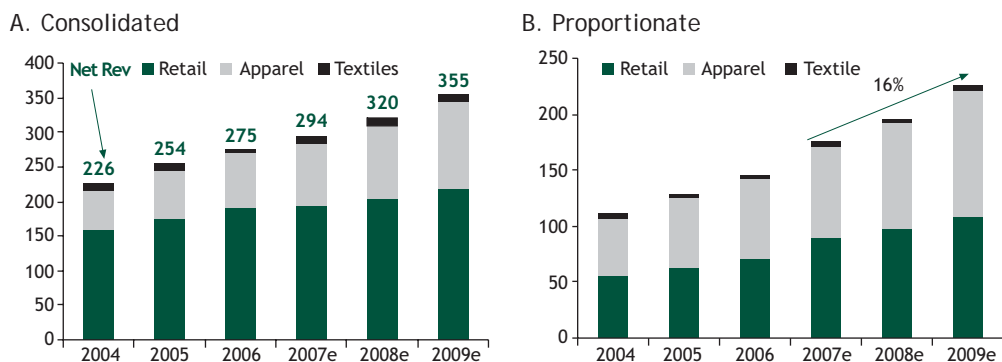
Net consolidated revenue has grown at an average annual rate of 10.4% over the past two years to USD275 million in 2006. Growth was mostly driven by the apparel segment (+18% in net revenue, excluding intra-group sales) and the retail segment (+10%), while the textile segment saw a decline (-20%). On a proportionate basis, revenue grew by 14% over 2005-06.

We forecast 8.8% CAGR in consolidated revenue over the three years to March 2009. Although we forecast strong growth in the apparel and textile segments, a softening in the revenue of UK-based BMB is expected to limit consolidated revenue growth. It is important to note that revenue numbers exclude intra-group sales. Since an increasing portion of apparel and textile production will go to BMB, the positive impact will show up in BMB margins rather than in top line growth for the group. On a proportionate basis, our revenue CAGR goes up to 16%. We expect a jump in proportionate revenue in 2007 as a result of the expected increase in Arafa ownership in BMB from 31.6% to 39.0%.

We provide below an analysis of sales by segment. It is important to note that:

- i) March 2006 breakdowns for the textile and apparel segments denote 12 months to December 2005.
- ii) March 2006 breakdowns for the retail segment denote 12 months to March 2006 for BMB and 12 months to December 2005 for Concrete and Euromed.

Figures 4.1: Evolution of Net Revenue (USD million)*



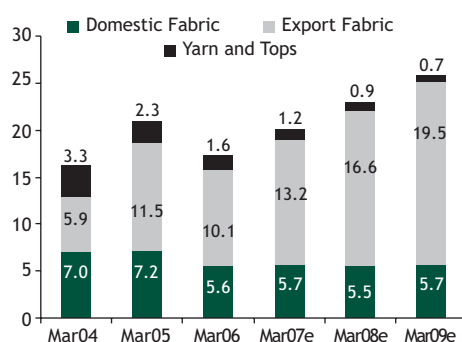
A. Textiles

Reorganization to bring back revenue growth

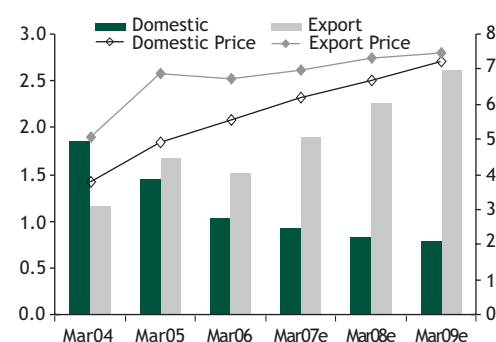
Textile gross revenue declined by 17% in 2006 to USD17.4 million: Intra-group revenue softened by 6%, to USD10.1 million while external revenue dropped 28% to USD7.3 million. The decrease was mostly attributable to a 19% decline in volumes, while prices increased by 5% on average driven by the positive impact of the appreciation of the EGP against the USD on local prices. The sharp decline in external sales is partly attributable to the loss of the segment's founder as well as increased competition after the removal of quotas on exports into the US and Europe. Introducing new management and a reorganization of the segment are expected to bring revenue back to growth. We forecast a 14% CAGR in total textile revenue over 2007-09, backed by additions to capacity. Most of the growth is estimated to be directed to export markets, as per management guidance.

Figures 4.2: Gross Revenue* (USD million), Fabric Volume (million meters) and Average Price (USD)

A. Textile Revenue



B. Fabric Volume (LHS) and Average Price (RHS)



*Excluding intra-segment sales but including intra-group sales (12 months numbers to December)
Sources: Arafa Holding and EFG-Hermes estimates

B. Apparel and Tailoring

20% annual growth in gross revenue over 2005 and 2006

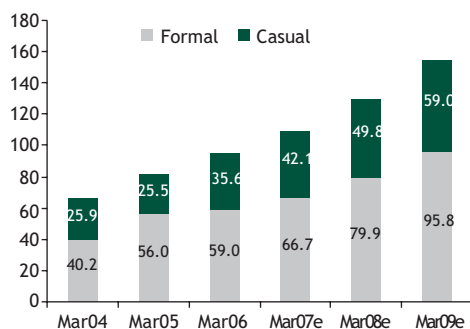
Gross revenue grew at an average annual growth rate of 20% over the past two years to reach USD94.5 million in 2006, driven mostly by strong growth in formal wear in 2005 and in casual wear in 2006. Intra-group revenue (mostly of formal wear) experienced a jump of 54% in 2005 and an increase of 10% in 2006 to reach USD15.8 million. External revenue grew by an annual average rate of 18% to USD78.7 million.

Gross formal wear revenue increased by 5% in 2006, driven by 41% growth in domestic revenue while export revenue remained flat. An increase of 5% in export volumes was offset by a decline in the average price. Casual wear revenue grew by 39%, driven by 21% growth in export volumes and a 15% rise in prices coming from a slight increase in the price of some casual products and a shift in sales to higher priced products such as semi-formal trousers.

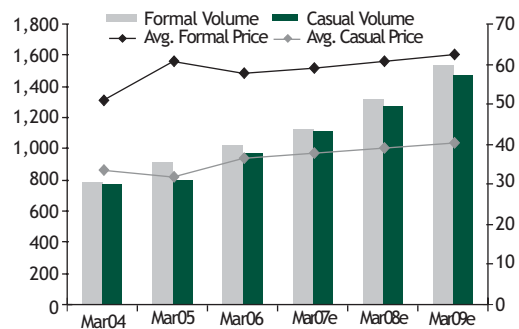
We estimate gross apparel revenue will grow at a CAGR of 18% over 2005-09, backed by the increase in apparel capacity of approximately 23% in December 2006 up from December 2005 levels.

Figures 4.3: Apparel Gross Revenue* (USD million), Sales Volume (000SEU**) and Average Price (USD)

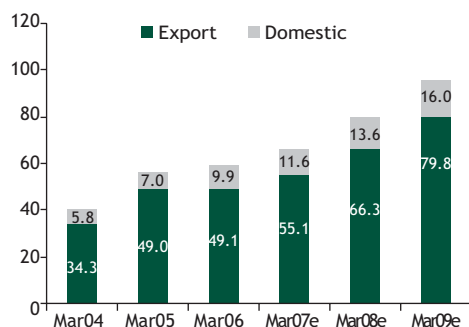
A. Total Apparel Revenue



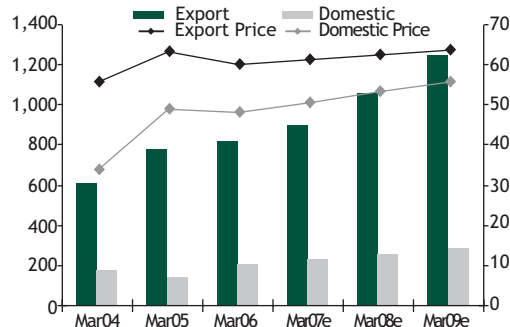
B. Total Apparel Volume (LHS) and Avg. Price (RHS)



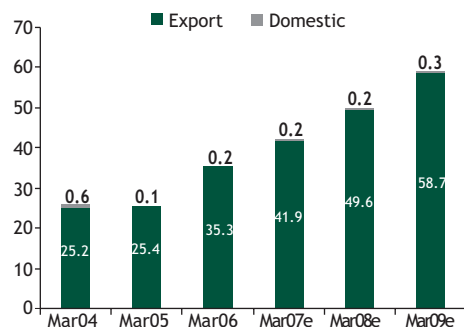
C. Formal Revenue



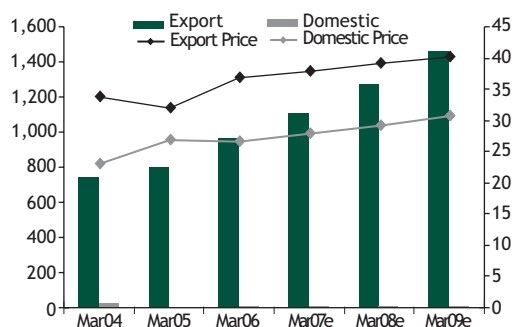
D. Formal Volume (LHS) and Avg. Price (RHS)



E. Casual Revenue



F. Casual Volume (LHS) and Avg. Price (RHS)



*Excluding intra-segment sales but including intra-group sales (12 months number to December)

**SEU denotes Suit Equivalent Unit

Sources: Arafa Holding and EFG-Hermes estimates

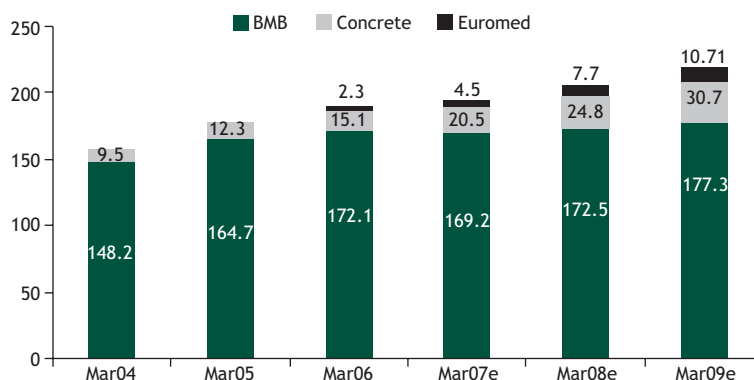
C. Retail

10% annual growth in retail revenue over 2005 and 2006

Retail revenue increased by 12% in 2005 but growth slowed to 7% in 2006, reaching USD189.4 million. BMB, the largest contributor to retail revenue on a fully consolidated basis, experienced moderate growth of 4.4% in 2006 to USD172.1 million, while Concrete continued to deliver growth in excess of 20% to USD15.1 million. Euromed generated revenue of USD2.3 million in 2006.

We have accounted for the impact of the two under-establishment subsidiaries, Querini and Apparel International within the apparel segment rather than the retail segment as the company has not yet provided indicators that enable us to estimate the financial performance of the two retailing/trading companies.

Figure 4.4: Breakdown of Retail Revenue (USD million)



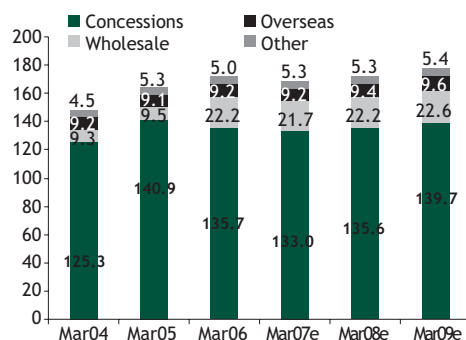
Sources: Arafa Holding and EFG-Hermes estimates

i) BMB Group

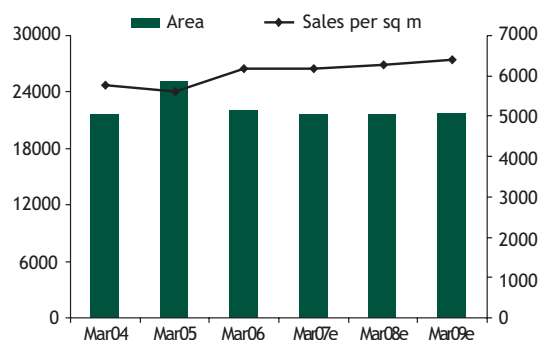
Revenue grew by 11% in 2005 but growth slowed to 4.4% in 2006 as a result of a slowdown in UK retail activity. The wholesale segment was the only segment that grew in 2006 as a result of gaining new clients, particularly following its recent acquisitions. Concession revenue, the most significant contributor to BMB revenue, declined 3.7%. A drop of 12% in concession area was mostly offset by a 10% increase in sales per sq m. BMB management commented that the decline at BMB was much lower than that for the UK market as a whole, which experienced a 10% decline in menswear sales and a 15% decline in men's suits. We expect a softening in revenue in 2007 (-2%), followed by a gradual recovery over 2008 and 2009 during which BMB is expected to grow at 2% to 3%.

Figures 4.5: BMB Revenue (USD million), Concession Area (sq m) and its Sales per sq m (USD)*

A. Revenue Breakdown



B. Concession Area (LHS) & Sales per sq m (RHS)



*12 months numbers to March

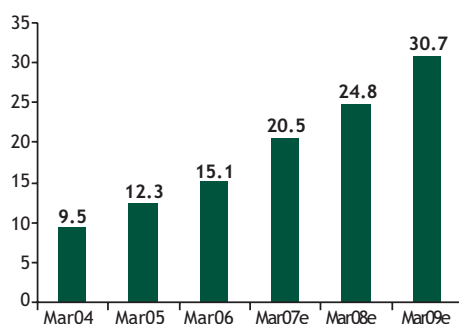
Sources: Arafa Holding and EFG-Hermes estimates

ii) Concrete

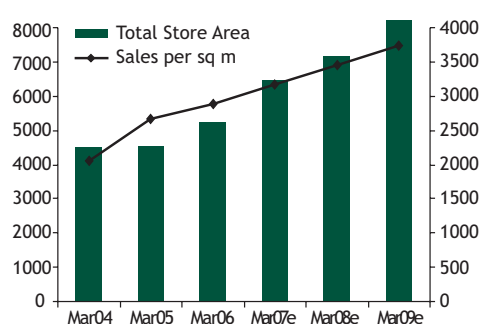
Revenue has grown at an annual average rate of 26% over the past two years, driven by both an increase in total store area (+8%) and in sales per square meter (+19%). We expect revenue growth to remain strong at 26% over 2007-09, backed by a strong increase in both total store area (+16%) and sales per square meter (+9%). This is backed by the recent addition of five new stores in Egypt and the planned expansion outside of Egypt.

Figures 4.6: Concrete Revenue (USD million), Total Store Area (sq m) and Sales per sq m (USD)*

A. Revenue



B. Store Area (LHS), and Sales per sq m (RHS)



*12 months numbers to December
Sources: Arafa Holding and EFG-Hermes estimates

V. ANALYSIS OF FINANCIALS

EBITDA and EBITDA Margin

The apparel segment is the largest contributor to EBITDA

The EBITDA margin of the group stood at 12.0% in 2006 on a consolidated basis compared to approximately 17.4% on a proportionate basis. The apparel segment is the largest contributor to EBITDA, with 52% of the total on a consolidated basis (65% on a proportionate basis), followed by the retail segment with 35% (27% on a proportionate basis) and the textile segment with 16% (7% on a proportionate basis).

In 2005, the group's consolidated EBITDA margin increased from 9.7% to 12.0% due to an increase in: i) the apparel margin, mainly as a result of a decrease in SG&A, and ii) the retail margin due to the restructuring in progress at BMB group. In 2006, the EBITDA margin remained flat: The apparel segment's margin declined 260 bp partly due to rising labor costs and the textile segment's margin slid to 27.0% from 29.1% on the back of an increase in labor costs and SG&A expenses. This was offset by another expansion in the retail margin due to a decrease in COGS at Concrete (due to a devaluation of the inventory of finished goods).

Export rebate accounts for 16% of EBITDA

It is important to note that the EBITDA is adjusted to include "other operating income", which constitutes mostly of the export rebate. Arafa is eligible for an export rebate that ranges 4% to 7% of export proceeds, depending on the degree of content of local inputs in the exported product. In 2006, "other operating income" accounted for 16% of adjusted EBITDA and 31% of attributable net income. Recently, the textile and apparel sector was granted a renewal of the export rebate for three years from April 2007 to end March 2010. While it is not guaranteed that the export rebate will be renewed at the end of the three-year period, management commented that the government will likely phase it out gradually. This is the same assumption we use in our forecasts

Improvement in margins expected in 2007 and 2008

We expect margins will continue to improve to 13.5% in 2007 and 14.8% in 2008 supported by: i) An improvement in the apparel segment margin to 19.6%, on average, up from 19.0% in 2006 as the company introduces new formal products and subcontracts relatively lower margin casual wear to other manufacturers. ii) An expansion in the retail segment margin to 7.5% in 2008, up from 6.3% in 2006, achieved mostly at the level of BMB due to the completion of its restructuring, the full dependence on subcontracting, and the cessation of production at BMB's factory (limiting production to the production of samples), and shifting to lower cost suppliers. iii) An uplift in the textile margin to 28.4% in 2007 and 2008, on average, backed by a shift in the product mix towards 100% wool fabric, the introduction of shirting fabric, and improved marketing efforts by the new management.

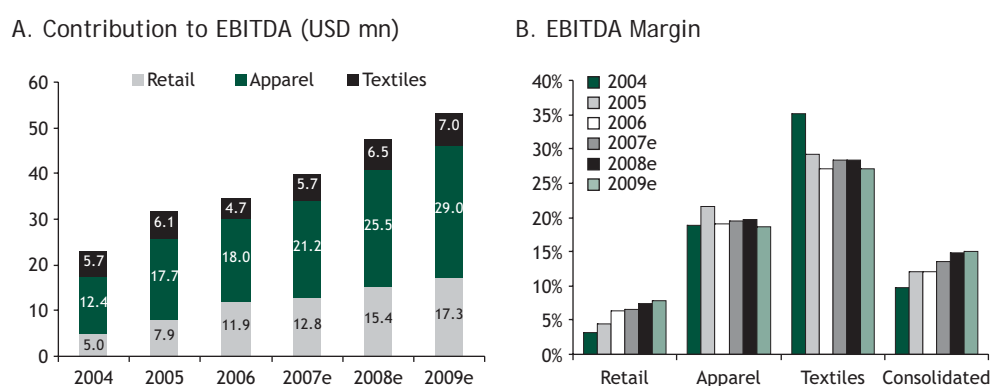
The recent reduction in tariffs is expected to have an almost neutral impact on Arafa: i) The decline in tariff on imported fabrics from 22% to 10% will negatively impact the textile segment's local sales. ii) The decline in tariffs on imported apparel from 40% to 30% will have a positive impact on Concrete margins. iii) The apparel segment will almost not be affected since most of its products are exported and as a result it enjoys tariff exemption on imported raw materials as per the drawback system.

Pressure on manufacturing segment's margins in the medium to long term

Although in the short term management efforts to improve margins will likely bear fruit, we include in our forecasts that over the medium to long term margins will likely soften, particularly at the manufacturing level. We believe this will be driven by the increased competition in the global market, the excess capacity in China, and the invasion of Egypt by Turkish, Jordanian and Asian textile and apparel manufacturers setting up production facilities.

We believe this is likely to have a more pronounced affect on the textile segment than on the apparel segment due to the following: i) Competition is more intense in fabric and casual wear than in harder-to-produce formal wear. As mentioned above, the apparel segment plans to focus on formal wear and subcontract casual wear to other low cost producers, including the Chinese. ii) While the apparel segment partly controls its distribution channels, it has little discretion in choosing the textile segment as its fabric supplier if the end customer prefers another supplier.

Figures 5.1: Contribution to Consolidated EBITDA (USD mn) and EBITDA Margin by Segment, year ended March

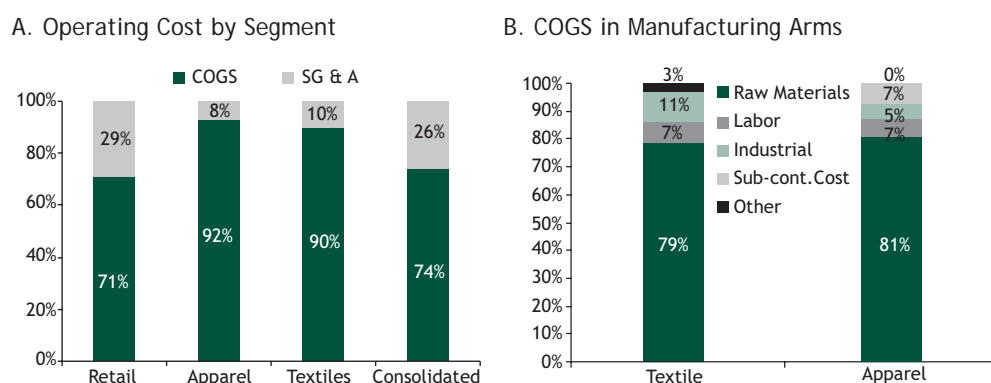


Sources: Arafa Holding and EFG-Hermes estimates

Breakdown of Operating Costs

COGS account for approximately 74% of consolidated operating costs. The bulk of selling, general and administrative costs comes from the retail segment. Raw materials account for 80% on average of the manufacturing segment's COGS, while the contribution of labor costs is low at 7% despite the labor-intensive nature of the industry as a result of low labor costs in Egypt. Subcontracting costs in the apparel segment represent the cost of producing casual wear at other manufacturers' facilities.

Figures 5.2: Operating Costs*, FY2006



*Excluding depreciation

Source: Arafa Holding

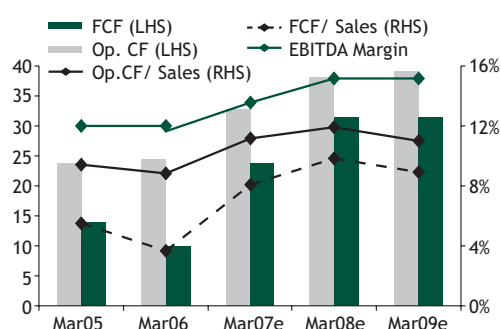
Cash Flow, Working Capital and Capex

Arafa generated positive operating cash flow in 2005 and 2006, amounting to 9% of sales on average. Arafa maintains reasonable levels of trade receivables and payables of around two months. Inventory days on hand (DOH) of approximately five months is split into: i) Raw materials inventory of 42 days on average, ii) semi-finished production of 16 days on average, and iii) finished goods and goods for sale of two and half to three months, mostly held at BMB. We forecast operating cash flow to sales of 11% on average over 2007-09, driven by an increase in the EBITDA margin.

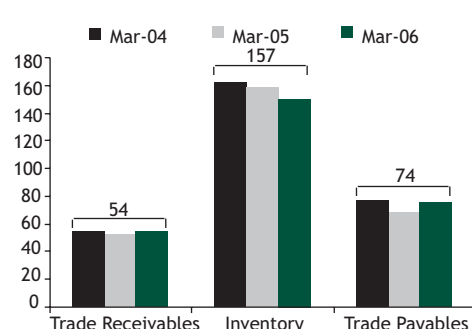
Free cash flow (FCF) to sales was maintained at 5% over 2005-06. Capex was relatively high, driven mostly by: i) All payments related to the new 1.5 million sq m of weaving capacity for the textile segment that were completed in March 2006. ii) The company increased apparel capacity in 2006 and 2007 by around 30%, with the bulk of capex paid in 2006. We forecast capex to sales of 2% to 3% over 2007-09 and, accordingly, an increase in FCF to sales to 9% over the same period. It is important to note that our forecast assumes a normal annual increase in capacity in the apparel segment of about 12% annually. It does not include, however, the impact of any acquisition and / or JV with European retailers that may result in the direction of major subcontracting orders to the apparel segment and requiring a major expansion in capacity.

Figures 5.3: Cash Flow, Capex and Working Capital Indicators

A. Operating* and Free Cash Flow (USDmn)



B. Working Capital Indicators (DOH**)



*After working capital and before capex
 **DOH denotes days on hand
 Sources: Arafa Holding and EFG-Hermes estimates

Earnings

In 2005, attributable earnings grew 31%, with all the increase coming from operations. In 2006, attributable earnings grew by 54%, driven by: i) an increase in proportionate EBITDA by 13%, and ii) the company reporting FX gains of USD2.7 million compared to an FX loss of USD1.4 million in 2005. We forecast strong normalized earnings growth of 32% on average in 2007 and 2008 backed by strong revenue growth and an expansion in the EBITDA margin. It is worth noting that the company will report a one-off item of USD2.8 million related to IPO fees in March 2007 income statement. Arafa exercised the BMB call option in December 2006, to increase its stake in BMB to 39.1% from 31.6% in December 2006. According to management, Arafa will be eligible to 39.1% of BMB profits for the full year ending March 2007 and we reflect this in our assumptions.

Financial Structure

Arafa has been taking on debt to finance operations, expansions and the acquisition of BMB. Net debt to equity dropped from 146% in 2005 to 92% in 2006 due to an increase in paid in capital rather than a decline in debt levels. Paid in capital increased in 2006 from USD14.1 million to USD32.0 million through: i) a cash injection of USD4.0 million in December 2005, and ii) the capitalization of a loan of USD13.9 million injected by shareholders in March 2006. The proceeds from the IPO should have transformed the company's net debt position into a net cash position. Management has commented that future debt to equity levels will depend on acquisition opportunities.

Gross debt amounted to USD78.2 million in 2006, of which 30% is in medium term bank loans. Short-term loans and credit facilities are denominated in local and foreign currencies, medium term loans are mostly undertaken in foreign currencies, while deposits are held in EGP. The company pays an average interest rate of 12% on EGP loans and LIBOR+1% on loans taken out in foreign currencies.

Table 5.4: Capital Mix and Interest Coverage

	Mar-04	Mar-05	Mar-06	Mar-07e
Net debt to Equity	126%	146%	92%	-17.0%
Net Debt to EBITDA (x)	2.7	2.3	2.0	N/R
EBITDA /Net Interest Expense (x)	5.6	6.4	5.9	8.1
FCF /Net Interest Expense (x)	NA	2.9	1.8	4.7

Sources: Arafa Holding and EFG-Hermes estimates

Tax Status

The effective tax rate of Arafa was low at 8% in 2006. We expect effective tax rate will remain below 12% in the medium to long term as Arafa's subsidiaries enjoy several tax exemptions. The tax status of the company's segments is summarized as follows: i) The retail segment is taxable and was subject to an effective tax rate of 29% in 2006. ii) The apparel segment was subject to an effective tax rate of less than 1%.

Approximately 85% of the segment's revenues are generated by SGC and METCO both of which are located in free zones, 13% of revenues are from ETC which enjoys a tax-holiday until end 2011, and only 1% from the fully taxable Concrete factory (the manufacturing arm of Concrete). iii) The textile segment pays an effective tax rate of 19%, with its largest contributor to revenue, Goldentex Group, taxable, while White Head Spinning enjoys a tax exemption until the end of 2013.

Dividend Policy

The company is in the process of formulating its dividend policy. The BoD is discussing paying up to 30% to 40% of earnings to shareholders, to be approved at the next general assembly meeting.

Review of Nine-Month December 2006 Results

Arafa reported consolidated results for the nine-months ending 31 December, the company's first actual results. Revenue was USD228 million and EBITDA came at USD28.7 million, implying an EBITDA margin of 12.6%. Net income was USD17.5 million. These financials consolidate numbers for the nine-months to December for companies with year-end March (the Holding Company on a stand-alone basis and the UK retail subsidiary BMB) and nine-months to September for subsidiaries with year-end December (all remaining subsidiaries).

It is worth mentioning that there might be some classification differences between the nine-month December 2006 results and the pro forma financials of previous years, which might affect both operating and non-operating items. According to the company, full year financials should be consistent with the pro forma financials of previous years.

Table 5.5: Summary of April to December 2006 Income Statement (USD million)

	9M2006/07
Revenue	228.4
Other Operating Income	3.1
COGS	(151.4)
SG&A Expenses	(51.4)
EBITDA	28.7
<i>EBITDA Margin</i>	<i>12.6%</i>
Net Operating Profit	24.9
<i>Operating Margin</i>	<i>10.9%</i>
Investment Income	0.1
Net Interest Income (Expense)	(4.3)
Other Income (Expense)	2.9
FX gains (losses)	1.4
Earnings before Taxes	24.9
Income Tax	(2.9)
Earnings before Minority Interest	22.0
Minority Interest	(4.5)
Net Income	17.5

Source: Arafa Holding

VI. VALUATION

A. DCF

Initiating coverage with a ST/LT Buy recommendation

Our estimated fair value for Arafa stands at USD1.93 per share, implying upside potential of 48% over and above the current share price. Using a discounted cash flow (DCF) method, we arrive at an equity value of USD1.7 per share, to which we add a 15% acquisition / expansion premium. The rationale for adding this premium is to compensate for the fact that our forecasts, although they assume the company will successfully enter into new subcontracting agreements with European and US companies that will fuel growth in the apparel segment, do not include the use of proceeds from the capital increase in any acquisitions, major expansions, or the development of Beni Sueif land. Arafa management has not yet announced details on its acquisition /expansion plan. We assign a ST Buy / LT Buy recommendation for Arafa.

DCF Assumptions

We use a risk free rate of 5.6%, representing the yield on the Egyptian Eurobond that expires in November 2011, which offers a spread of 100 bps over US 10-year treasury bonds. This spread might be underestimating Egypt risk in that it is lower than the spread offered by other similarly rated emerging market sovereign Eurobonds. This is partly because there is a limited stock of tradeable foreign currency Egyptian debt and that the outstanding debt is held closely by Egyptian banks. However, we believe Arafa is only partly affected by Egypt risk in that while its production facilities are located in Egypt, the bulk of its customer base is based in developed markets.

Table 6.1: Valuation

(EGP mn)	2008e	2009e	2010e	2011e	2012e
COPAT	35.2	39.7	43.6	42.5	40.6
Working Capital	(4.5)	(7.7)	(5.9)	(7.5)	(7.2)
Capex	(5.6)	(6.3)	(7.0)	(7.6)	(8.3)
Net Cash Flow	25.0	25.7	30.7	27.4	25.1
PV of NCF	24.2	22.6	24.4	19.8	16.5
PV of Terminal Value	251				
Terminal WACC	10.2%				
Terminal Growth Rate	4.0%				
EV	359				
Net Debt (Cash) 2007e	(39)				
Equity Value	398				
DCF Value per Share	1.7				
Premium	15%				
Fair Value per Share	1.93				

Source: EFG-Hermes estimates

Table 6.2: Estimated Valuation Range

Terminal Growth	Perpetual Cost of Equity				
	9.6%	10.6%	11.6%	12.6%	13.6%
3.0%	2.02	1.87	1.75	1.65	1.56
3.5%	2.15	1.97	1.83	1.72	1.62
4.0%	2.30	2.09	1.93	1.79	1.69
4.5%	2.50	2.24	2.04	1.89	1.76
5.0%	2.75	2.42	2.17	1.99	1.85

Source: EFG-Hermes estimates

B. Risks to Forecasts and Valuation

Upside risks

Upside risks to our valuation include: i) Faster than forecast expansions in the retail segment outside of Egypt and ii) the ability to expand margins by shifting to higher margin production.

Downside Risks

Downside risks to our valuation include: i) Increased competition from emerging country competitors setting up facilities in Egypt to sell to Arafa's main markets. ii) The intensification of competition globally putting downward pressure on margins. iii) A slower than forecast pace of growth. iv) A change in regulations governing incentives to exporters in the short term. v) The financials of Egyptian subsidiaries are in EGP and BMB's financials in GBP. These financials are translated into USD to be included in the Holding company's financials. This may expose the company to unfavorable currency movements vis-à-vis the USD.

C. Comparable Valuation

We introduce two sets of comparables for Arafa Holding. A set of emerging markets manufacturers and retailers of textiles and apparel and another for developed markets peers. Arafa trades below the average of the two sets, but in line with Indian peers. However, it must be borne in mind that Arafa multiples are inflated by the following: i) March 2008 (= 2007e in table 6.3) EPS is diluted by the recent capital increase, and ii) our forecasts do not include the use of proceeds from the capital increase in any acquisitions and /or major expansions. As a result March 2009 earnings may well surprise on the upside.

Table 6.3: Comparable Valuation

	Country	Price* (Local)	Mkt. Cap. (USD mn)	EV/Sales			EV/EBITDA			PER			EBITDA Mgn 06e
				06e	07e	08e	06e	07e	08e	06e	07e	08e	
Developed													
Moss Brothers	UK	0.72	130	0.42	0.39	N/A	5.91	6.23	N/A	28.7	17.5	15.6	7.1%
Ted Baker	UK	6.41	538	2.15	1.98	1.87	11.28	10.33	9.19	20.1	18.1	16.7	19.1%
Perry Ellis Int'l	USA	29.5	430	0.79	0.74	0.73	9.61	8.36	N/A	20.3	16.4	N/A	8.2%
Emerging													
Arafa*	Egypt	1.30	309	1.02	0.94	0.85	7.55	6.34	5.65	9.1	10.3	8.9	13.5%
Ningbo Shanshan	China	9.07	480	2.65	2.04	1.39	21.44	15.63	12.62	34.9	26.7	23.9	12.4%
Ningbo Veken	China	5.35	202	0.76	0.68	N/A	N/A	N/A	N/A	41.2	35.7	N/A	N/A
Zhonghe	China	25.2	350	8.17	6.29	N/A	71.36	53.59	N/A	52.4	41.2	N/A	11.5%
AS Baltika	Estonia	24.2	194	5.40	4.15	3.50	40.20	30.93	24.53	32.3	23.7	18.5	13.4%
Fountain Set	Hong Kong	2.85	290	0.56	0.51	0.46	6.77	6.34	5.35	7.3	11.0	8.1	8.3%
Victory City Int'l	Hong Kong	3.44	283	1.02	0.83	0.68	6.49	5.77	5.17	6.9	5.5	5.2	15.7%
Alok Industries	India	63.2	225	1.43	1.13	0.93	6.33	4.73	3.75	8.4	5.9	3.8	22.6%
Arvind Mills	India	51.6	244	1.47	1.35	1.39	8.88	8.07	6.85	19.0	12.6	10.3	16.6%
Bombay Rayon Fashions	India	203	225	2.19	1.13	0.69	11.16	5.34	3.05	23.3	11.3	7.3	19.6%
Gokaldas Exports	India	264	205	1.08	0.91	0.76	9.57	8.18	6.91	12.3	9.9	8.4	11.3%
Raymond	India	365	507	1.52	1.30	1.18	9.91	7.81	6.74	12.6	10.3	8.4	15.3%
S. Kumars Nationwide	India	76.3	267	1.90	1.51	N/A	10.24	8.63	7.58	20.6	9.9	N/A	18.5%
LPP	Poland	990	568	2.15	1.81	1.60	15.94	12.34	10.49	30.4	23.4	20.5	13.5%
Altinyildiz Mensucat	Turkey	4.02	116	1.03	N/A	N/A	6.13	6.13	N/A	N/R	12.8	N/A	16.8%

*2006 = Mar 2007 for Arafa, etc
Prices as at 22 February 2006

Sources: Reuters and EFG-Hermes estimates

A Glance at Comparable Companies

In the paragraphs below, we briefly describe the comparable companies, ranking them by comparability to Arafa. Our ranking is based on a 1-5 scale, with 1 being the least relevant and 5 being the most relevant.

i) Developed Markets Peers

Moss Brothers Group is engaged in the retail sale and hire of formal menswear and accessories. The company has over 150 stores located throughout the UK. It owns and operates a franchise for Hugo Boss and the only franchise for Canali in the UK. During FY 2005, the company invested in the development of three key brands: Blazer for European styling, Dehavilland for casual and formal wear at mid-range prices, and Ventuno 21 for fashion products at high street prices.

Relevance: 3.5

Rationale: From a comparability perspective, the best thing about Moss Bros is that it is specialized in formal wear, and produces suits and fashion products at different price ranges. The company claims 20% market share in the UK. However, the main drawback is that its stores are only in the UK.

Ted Baker is a UK-based designer, wholesaler and retailer of casual wear and related accessories for men, women and children. With a total retail area of over 13,000 sq m, it has branches in the UK, Ireland and Denmark. Moreover, the company recently expanded into the US market, and is scheduled to open in Hong Kong, Dubai, Singapore, Bangkok and Jakarta. In 1H2006, retail revenue represented 63% of total revenue, with wholesale accounting for 34% and licensing 3%. Menswear accounts for 56%, women's wear 40% and other 4%.

Relevance: 3.5

Rationale: sells formal and casual wear through a wide retail network.

Perry Ellis International is a US apparel company that designs and produces men's and women's brands. It markets its products through its own retail stores across the US, in addition to department stores and other independent retailers in the US, Canada and the UK. Retail revenue accounted for 97% of FY 2006 revenue. Perry Ellis also licenses its own brands to other producers domestically and internationally (3% of revenue). In FY 2006, approximately 80% of Perry Ellis' net revenue was generated from branded products, and the rest represented private label production for other retailers. Revenue included formal and casual shirts (44%), formal and casual pants (44%), swimwear and other (12%).

Relevance: 3.5

Rationale: 20% of revenue is private label sales (like Arafa sales to M&S for example), and has a wide international retail network, but swimwear and other represents 12% of revenue which is not an insignificant portion.

ii) Emerging Markets Peers

Ningbo Shanshan manufactures apparel including suits, shirts and leisurewear under local and international brand names, in addition to chemical materials. In FY 2005, its apparel segment accounted for approximately 63% of revenue. The company sells its products domestically and internationally.

Relevance: 3

Rationale: more comparable to Arafa than Veken, since it produces suits and has a greater dependence on apparel segment, and it also exports.

Ningbo Veken is a Chinese producer of textile products including home textiles, yarns and apparel. The company's exports represented 67% of revenue in FY 2005.

Relevance: 2.5

Rationale: greater focus on textiles, but it does produce apparel, and exports through a specialized trading subsidiary. However, it is involved in other areas such as real estate and energy.

Zhonghe is a Chinese manufacturer of more than 2,000 types of cotton textiles for casual garments. It is headquartered in China, but has subsidiaries and representative offices in Hong Kong, Paris and New York.

Relevance: 2

Rationale: the only focus is on textiles. It exports through its representative offices.

AS Baltika is an Estonian manufacturer, retailer and wholesaler of menswear and women wear. Its products are mainly marketed through a chain of about 80 retail outlets in seven countries: Estonia, Latvia, Lithuania, Poland, the Ukraine, Russia, and Sweden. During 1H2006, the company's retail revenue represented 81% of total revenue, wholesale 17%, and other sales 2%.

Relevance: 3

Rationale: the main segment is retail, and it produces suits and classical wear besides casual. However, it is mainly present in Eastern Europe.

Fountain Set is a vertically integrated producer of textiles and children wear. The company delivers fabric to garment manufacturers in over 40 countries that supply to international retail brands. Fountain Set is based in Hong Kong and has production facilities in China, Sri Lanka and Indonesia, and marketing and representative offices in eight countries.

Relevance: 2

Rationale: it is vertically integrated and has an international presence, but is specialized in children wear and does not have direct retail outlets.

Victory City International is a Hong Kong-based company specialized in the production and sale of knitted fabric and dyed yarn, and the provision of related subcontracting services. The company is also engaged in the sourcing and export of casual garment apparels.

Relevance: 2.5

Rationale: focused on knitted fabrics and textiles, but has a subsidiary for the manufacturing and export of casual apparel.

Alok Industries is India's largest textiles producer with fabric capacity of 60 million meters per annum. It has four divisions: apparel fabric (51% of revenue in FY 2006), home textiles (22%), texturising yarn (26%) and formal and casual garment (1%). Alok is the preferred dealer for global retailers such as Wal-Mart, JC Penney, GAP and garment exporters in India.

Relevance: 2.5

Rationale: exporter and wholesaler, but nearly all revenue comes from textiles.

Arvind Mills is the largest cotton textiles manufacturer and exporter in India. The company exports high quality denim to the US, Europe, Japan and Korea. Furthermore, it has a garment segment producing jeans and shirts for its own local brands as well as international brands. This segment represents 19% of total revenue. Arvind is undertaking an aggressive retail store expansion plan to reduce its dependence on denim revenue.

Relevance: 2.5

Rationale: same business segments, but inverted business mix compared to Arafa (textile is the most important, followed by apparel, then retail). The company's aggressive plans will adjust the business model more towards retail. However it does not produce suits at all.

Bombay Rayon Fashions is an Indian textile company manufacturing woven fabric (shirting and suiting fabric using cotton, man-made fibers and their blends), garments (both casual and formal), and home textiles (bed sheets, pillow and quilt covers). The company exports 100% of its garments and supplies fabrics to domestic garment exporters. Moreover, it recently established a wholly owned subsidiary in the Netherlands which is an export-oriented woven fabric manufacturer with a capacity of approximately 10.2 million meters per annum.

Relevance: 2.5

Rationale: 100% exporter but focussed on textiles.

Gokaldas Exports is the largest exporter of textiles and apparel in India, with exports accounting for 98% of revenue. It has more than 40 factories manufacturing more than 2.4 million pieces of garment per month. The company designs, manufactures and sells a wide range of garments for men, women and children, including sportswear, winter wear, casual pants, chinos, linen trousers and denim jeans. Furthermore, Gokaldas plans to enter the structured suits market for men and women. Currently, its client base includes Nike, MEXX, Polo Sport, Ralph Lauren, Tommy Hilfiger, M&S and GAP.

Relevance: 4

Rationale: very similar business model, but only now starting to produce suits.

Raymond is a major exporter of textiles and apparel in India with its products sold to over 50 countries, including the US, Canada, EU, Japan and Australia. Its textile products (64% of revenue in FY 2006) include denim fabric, cotton yarn, pure wool and wool blends, polyester fabric, in addition to rugs, blankets, shawls and furnishing fabric. The apparel segment (22% of revenue) includes suits (with a capacity of 300,000 suits per annum), jackets, formal trousers (1.8 million pieces), shirts (1 million pieces) and jeans (3 million pieces). Raymond has a retail network of over 320 outlets, including 27 overseas.

Relevance: 3

Rationale: same three segments but inverted focus compared to Arafa, like Arvind Mills but more comparable in terms of products (already produces suits and formal wear) and has an established retail network overseas.

S Kumars Nationwide is an Indian textile and apparel manufacturer with a capacity of over 200,000 meters per day and a large retail chain of 30,000 outlets in India. Its products include consumer textiles (mostly uniforms), home textiles, suits (under the Scottish brand Reid & Tailor), blazers, shirts, trousers and ties.

Relevance: 3

Rationale: similar business model, but mainly local.

LPP is a Poland-based company that designs and distributes garments, accessories and materials. Designs are drafted in Poland, while production is carried out in the Far East under the control of an LPP office in China. The company produces casual wear, jeans and underwear under several trademarks it owns and holds distribution rights for. Its exports are mainly to east and central Europe.

Relevance: 2.5

Rationale: has established retail and apparel activity, but only for casual wear and exports to low-middle income east and central Europe countries.

Altinyildiz Mensucat is a manufacturer of fabric and clothing in Turkey. The company's products include: i) fabrics such as wool, linen and their blends, and ii) business suits and casual clothing for men and women. Altinyildiz operates a chain of stores, which sells its apparel under its own brand names. In 2005, exports represented 19% of revenue.

Relevance: 3

Rationale: Similar business model but relatively low dependence on exports.

Pro Forma Financial Statements (March year end)

(USD mn)	Mar 04a	Mar 05a	Mar 06a	Mar 07e	Mar 08e	Mar 09e
Balance Sheet						
Cash and Time Deposits	6.5	8.3	16.3	71.8	93.7	103.7
Accounts Receivables	33.9	36.5	40.7	43.3	47.1	52.2
Inventory	66.3	73.3	75.6	80.5	86.6	96.9
Other Current Assets	23.4	10.7	10.1	9.6	9.8	10.1
Total Current Assets	130.2	128.8	142.6	205.2	237.2	262.9
Total Fixed & Slow Assets	54.5	60.5	76.4	78.4	76.5	75.9
Total Assets	184.6	189.3	219.0	283.6	313.7	338.9
ST Debt	41.1	47.5	57.0	12.7	19.4	18.5
Suppliers	31.7	31.4	38.1	39.4	42.4	47.4
Dividends Payable	3.1	3.7	5.3	10.1	15.1	17.4
Other Current Liabilities	35.7	27.0	13.1	12.0	11.0	10.5
Total Current Liabilities	111.7	109.6	113.5	74.2	87.9	94.0
Provisions	1.0	1.3	2.2	2.2	2.6	3.1
Other Liabilities	1.8	3.1	9.1	9.1	9.1	9.1
LT Debt	22.5	27.3	21.2	18.5	9.1	0.5
Minority Interest	17.6	16.2	17.4	22.3	29.1	36.6
Net Worth	30.0	31.9	55.7	157.2	175.9	195.7
Income Statement						
Revenues	225.7	253.9	275.3	293.9	319.6	354.8
COGS	(150.2)	(169.0)	(183.7)	(195.8)	(210.6)	(235.5)
SG&A	(58.4)	(58.5)	(63.8)	(63.9)	(68.1)	(73.6)
Other Operating Income*	4.7	4.1	5.3	5.6	6.5	7.6
EBITDA	21.9	30.5	33.1	39.8	47.4	53.2
EBITDA Margin	9.7%	12.0%	12.0%	13.5%	14.8%	15.0%
Depreciation and Amortization	(3.2)	(5.5)	(7.2)	(7.1)	(8.1)	(8.7)
Net Operating Profit	18.7	25.0	25.9	32.67	39.26	44.50
Net Operating Margin	8.3%	9.8%	9.4%	11.1%	12.3%	12.5%
Investment Income	0.0	0.0	0.1	0.1	0.1	0.1
Net Interest Income (Expense)	(3.9)	(4.8)	(5.6)	(4.9)	3.0	3.9
Other Income (Expense)	1.1	(0.3)	0.5	3.0	2.1	2.5
FX Gain (Loss)	(1.4)	(1.4)	2.7	2.0	(0.0)	(0.0)
Provisions	(1.2)	-	(1.0)	(0.1)	(0.8)	(0.9)
Earnings before Taxes	13.4	18.6	22.5	32.8	43.6	50.2
Taxes	(0.7)	(1.8)	(1.7)	(3.8)	(4.8)	(5.4)
Earnings before Minority Interest	12.7	16.8	20.8	29.0	38.8	44.7
Minority Interest	(3.1)	(3.9)	(1.9)	(4.9)	(6.7)	(7.5)
Earnings before Unusual Items	9.6	12.9	18.9	24.1	32.1	37.2
Unusual Items**	-	-	-	(2.8)	-	-
Net Income	9.6	12.9	18.9	21.3	32.1	37.2
Appropriations	(1.1)	(1.7)	(1.6)	(1.6)	(2.2)	(2.6)
Net Attributable Income	8.5	11.2	17.3	19.8	29.9	34.6
Cash Flow Statement						
Cash Operating Profit after Tax		28.7	31.4	36.0	42.6	47.8
Change in Working Capital		(4.9)	(7.0)	(3.7)	(5.5)	(9.3)
Cash Flow after Change in WC		23.8	24.4	32.3	37.1	38.5
Capital Expenditure		(9.9)	(14.3)	(9.1)	(6.8)	(7.6)
Free Cash Flow		13.9	10.1	23.2	30.3	30.9
Non-operating Cash Flow		(3.0)	(5.7)	(0.7)	0.1	0.1
Cash Flow before Financing		10.9	4.4	22.6	30.4	31.0
Net Financing		(9.0)	3.5	33.0	(8.5)	(21.0)
Change in Cash		1.8	8.0	55.6	21.9	10.0

*Mostly export rebate

**IPO fees

Sources: Arafa Holding and EFG-Hermes estimates

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EFG-Hermes (Main Office), 58 Tahrir Street, Dokki, Egypt 12311
Tel.: +20 2 332 1140 | Fax: +20 2 336 1536 | Website: www.efg-hermes.com
Bloomberg: EFGH | Reuters pages: .EFGS .HRMS .EFGI .HFISMCA .HFIDOM