TAQA
A New Player on the Global Energy Landscape

INVESTMENT RESEARCH

INITIATION OF COVERAGE | 15 May 2008

UNITED ARAB EMIRATES

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Last Price:	3.48
Price Target:	4.50
Sector:	Energy

Stock Rating
UNDERPRICED

BLOOMBERG: TAQA UH

REUTERS: TAQA.AD

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The National Investor

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Growing towards a global blue chip energy company

TAQA is well-advanced in its ambition to become a major global blue chip energy company. Building upon its domestic power and water utility assets, the company has effectively increased its asset base by almost 70% in the past 15 months through an aggressive acquisition campaign securing upstream, midstream and downstream interests. Oil and gas production is forecast at around 137.0 mboe/d in 2008 (versus only 19.7 mboe/d in 2007) with proven and probable reserves now standing at over 0.5 billion boe.

Financial strength in uncertain times

Unlike the uncertainties facing many of its competitors in current difficult financial markets, TAQA's government support and credit ratings of AA- from S&P and Aa2 from Moody's will underpin ongoing expansion when many of its peers struggle. Asset rationalisations by the oil majors and companies in difficulties should present numerous acquisition opportunities.

Establishing a global footprint for a UAE company

The formation of a global industry footprint provides the company's stakeholders with exposure to domestic and international energy markets. Sector fundamentals are very attractive and TAQA is pursuing a deliberate strategy to capture value from the upstream, midstream and downstream divisions. We see the upstream business becoming the major profit contributor from 2008 onwards.

Initiating coverage with an Underpriced rating

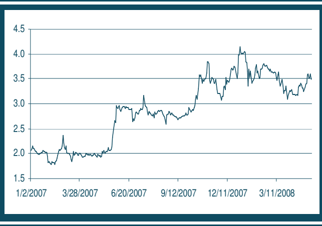
We believe that the current share price is not fully reflective of the huge growth potential that TAQA offers to its shareholders. It already has a demonstrable track record of rapidly building a global energy foothold. As this strategy is maintained the benefits of scale and synergistic efficiencies will become more apparent and should lead to a market re-rating. Our price target of AED 4.50, or an upside of 30% over current levels, still has the stock trading at undemanding PE multiples of 7.5 and 4.4 times forecast 2008 and 2009 earnings respectively.

Share Data

No of shares (m)	4,150
Daily vol (US$m)	9.4m
Daily vol (AEDm)	34.6m
Free float	25%
Mkt cap (US$m)	3,935m
Mkt cap (AED)	14,442m

Source: Reuters

Share price performance



Source: Reuters

Forecasts and Ratios

Yr to Dec	Revenue (AED m)	EBITDA (AED m)	Net Profit (AED m)	EPS (% ch)	EV/EBITDA (x)
2007	8,336.8	4,707.0	1,034.6	113.3%	12.5
2008E	19,238.6	9,924.4	2,214.7	87.3%	8.0
2009E	27,236.5	14,591.0	4,266.8	71.3%	5.8
2010E	30,821.5	16,486.1	5,265.1	23.4%	4.9

Source: TNI Investment Research

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Unique energy sector exposure

Rapid global energy growth in both developed and developing nations sets a very attractive framework in which TAQA is fast becoming a significant player. The ability to capitalise and leverage off business units across the whole value chain from production to ultimate end-use gives the company a large competitive advantage over many of its peers. The energy sector is a dynamic industry and TAQA is already showing instances of how it proposes to capture value for its stakeholders in this evolving world.

Enviable financial credentials

The support of the Abu Dhabi government and its blue chip investment credit ratings place TAQA in a unique position to expand its global energy status. The ongoing turmoil in world debt markets will have a major impact on the ability of many participants to source new debt or indeed refinance existing facilities. TAQA is capable of ongoing expansion against lessening competition for the many emerging opportunities.

Demonstrable growth to continue

The company's stated goal to increase its asset base three-fold by 2012 is an ambitious one. However given its financial strength and favourable investment climate, we see the established growth trend being sustained. The pace of expansion is likely to be more moderate than the stellar record set in 2007, but nonetheless TAQA has the credentials to grow when most of its peers will find the going much harder.

Repatriating value to UAE stakeholders

The establishment of a truly global energy industry footprint gives TAQA's UAE stakeholders exposure in both the domestic and international arenas. The income stream to its bondholders is underwritten by its low risk but growing utility business, whereas its equity holders are exposed to the positive commodities market in the higher risk-higher return upstream oil and gas business.

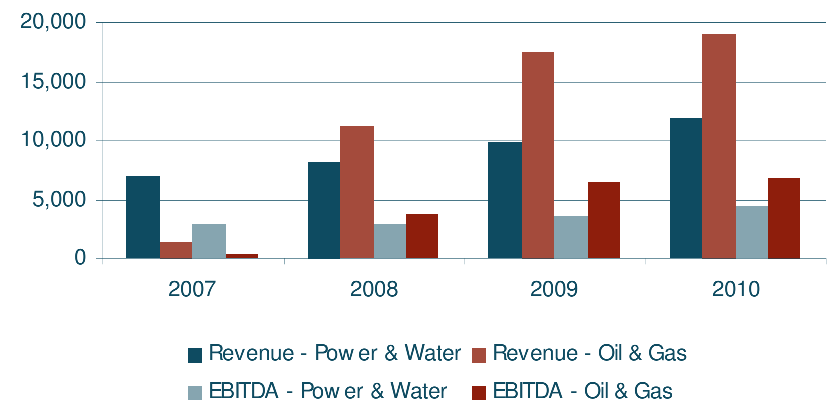
We are initiating coverage with an Underpriced rating

Our Underpriced rating of TAQA is based upon the company's unique advantages to grow and capture value in a space with very positive underlying fundamentals. Against a background of tougher times for most of its competitors, TAQA's enviable established growth record is set to continue. A valuation comparison with some of its peer group indicates that the company's shares are underpriced by at least 30% which underpins our one year price target of AED 4.50.

TAQA: diversifying its energy profile

TAQA is rapidly evolving into a diversified global energy company where all three business units – upstream, midstream and downstream – will contribute to future earnings.

Chart 1: Revenue and EBTIDA growth by business segment (AED m)



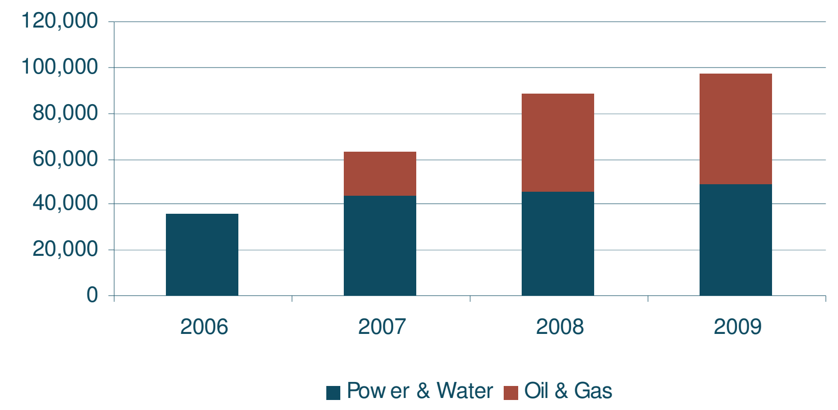
Source: TNI Investment Research

Changing mix of profit drivers

Oil and gas become main profit contributors

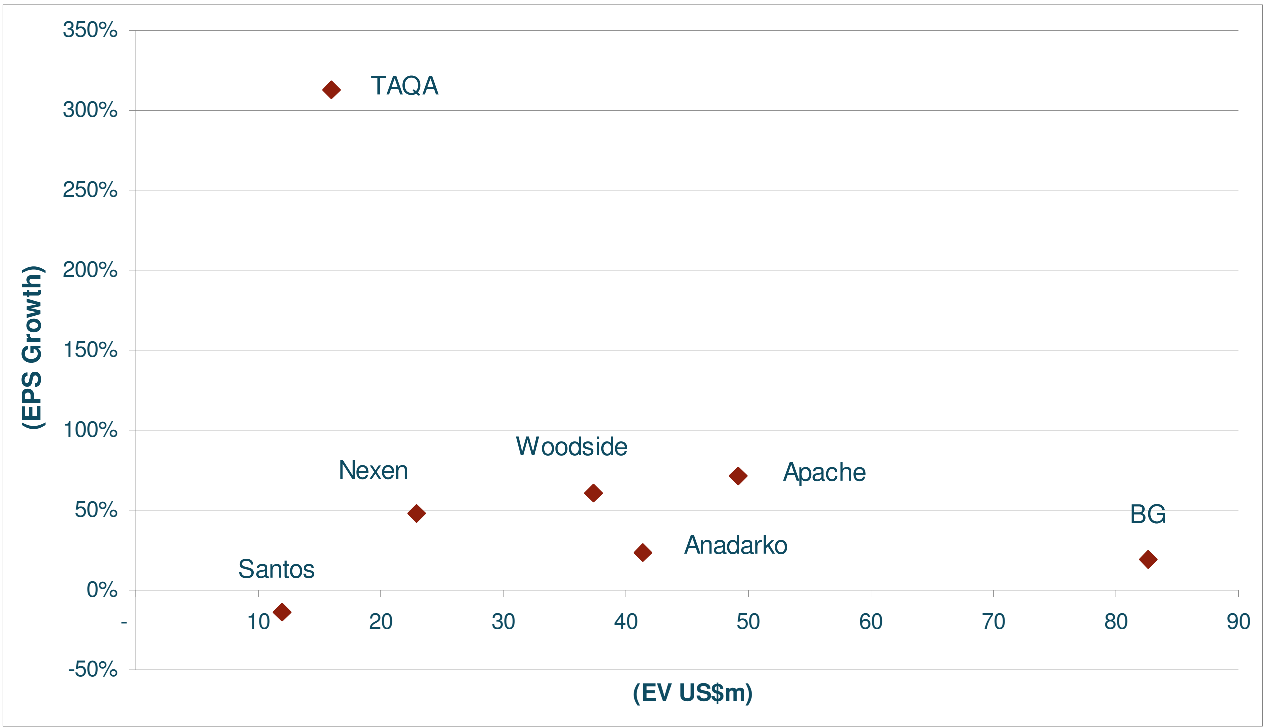
The shift in the makeup of the company's revenue and profit drivers over the next three years is illustrated in these two graphs. From a small contribution only in 2007, the Oil & Gas segment is forecast to overtake Power & Water in terms of revenue and EDITDA this year. Furthermore the former business has a substantial high growth outlook over the next few years coincident with the very positive energy commodities cycle.

Chart 2: Asset growth by segment (AED m)



Source: TNI Investment Research

Chart 3: EPS Growth 2007-09 versus Enterprise Value



Source: TNI Investment Research, Bloomberg

Superior growth momentum

Earnings outlook far exceeds peer group

Its special competitive position should allow TAQA to outstrip most of its peers as they collectively pursue earnings growth and shareholder value accretion. This is highlighted in the above chart showing the company's strong EPS growth over the next two years versus a selection of midsize and large oil and gas independents.

Benefits of scale and competitive advantage

Full impact of scale and cost savings still to come

The greatly-enlarged upstream assets base will provide a big boost in forecast 2008 profitability. However the permanent benefits of scale and synergistic savings will flow through to the bottom line progressively over several years. The Canadian oil and gas division is already positioned to generate significant cost savings and efficiencies and we expect this model to be replicated elsewhere in the company's focus growth areas. The regional businesses also give TAQA a key competitive advantage allowing the accretion of new assets around an established asset base in each area of operations.

Company overview

Background

The Abu Dhabi National Energy Company PJSC ("TAQA") is an energy investment company that was established in June 2005 with the aim to become a major global energy sector participant. It embodies a deliberate strategy of the Abu Dhabi government to accumulate a significant investment position in the world's burgeoning energy sector.

Focused across total value chain

TAQA's investments cover the whole energy value chain "from well head to wall socket". These include interests in power generation, water desalination, upstream oil and gas, pipelines, gas storage, LNG regassification and renewables.

Exceptional growth in past two years

In its short history TAQA has undergone stellar growth. Its asset base at September 2006 amounted to $9 billion comprising majority interests in six of Abu Dhabi's nine independent water and power producers (IWPP's). In a breathtaking series of acquisitions since then, primarily in upstream oil and gas, the asset base had expanded to $23.5 billion by the end of March 2008.

In calendar year 2007 alone, the company announced or completed seven major transactions (5 oil and gas, 2 power) totalling $10.0 billion in value.

Growth trend to continue

There is little reason to suspect that this exceptional growth will stop given the track record to date and the company's access to low cost capital. TAQA's ambitious objective is to expand to $50-60 billion in assets by 2012. This target implies a compound growth rate of around 25% per annum for the next five years including 2008.

The company's goal is to build an international asset portfolio broadly allocated 40% in upstream activities, 20% in the midstream and the remaining 40% in downstream assets. Clearly this is a longer term objective after being established as purely a downstream entity. Depending on business cycles and the resulting new opportunities presented, there will be some variation from time to time from this general structure. Given the positive commodity cycle for oil and gas currently, we would expect a greater focus on upstream project additions in the nearer term.

TAQA is an Abu Dhabi-listed public joint stock company (PJSC). The Abu Dhabi government holds an effective 75% interest with the remaining 25% owned by UAE nationals.

Downstream Assets

Founded upon domestic assets

At its inception TAQA was essentially a downstream utility company. It owned interests in six large IWPP's providing 85% of Abu Dhabi's electricity and water. These interests were transferred into TAQA from the Abu Dhabi Water and Electricity Authority (ADWEA) which retains a residual direct interest in the assets.

The water and power assets are held in six 60%-owned subsidiaries which are operated by major internationals including International Power, Total, Marubeni and Tokyo Electric. Electricity and water are sold to ADWEA through long term Power and Water Purchase Agreements (PWPA's).

Expanded internationally in 2007

The downstream assets are located in the UAE, India, Saudi Arabia, Morocco and Ghana. This footprint honours TAQA's stated focus area of the GCC countries, the wider Middle East, Africa, Europe, South Asia and North America.

The following table summarises the six domestic and three international downstream operations listing their respective electricity generation and water desalination capacities.

Growth in utility businesses

TAQA expects to increase its generating capacity from about 9,300MW currently to 16,000MW over the next 3-5 years. Given the developing world's almost insatiable demand for electricity, this aim would not appear overly ambitious. Our modelling of TAQA's future earnings stream reflects an annual compound growth rate of 15% in total plant capacity.

Table 1: Downstream assets

Facility	TAQA interest	Partners/ operators	Plant capacity: Power (MW)	Water (m galls/day)
Domestic				
Taweelah A1	54%	Suez, Total	1,350	84
Taweelah A2	54%	Marubeni	777	50
Taweelah B	54%	Marubeni, Others	1,370	100
Fujairah 1	54%	SembCorp	650	100
Umm Al Nar	54%	Mitsui, Tokyo Electric	1,700	160
Shuweihat S1	74%	International Power	1,500	100
Total UAE			**7,347**	**594**
International				
Jorf Lasfar, Morocco	100%		1,356	
Neyveli, India	100%		250	
Jubail, Saudi Arabia	25%	Marafiq	250	
Takoradi, Ghana	90%	Volta River Authority	220	
Total International			**2,076**	
Grand Total			**9,423**	**594**

Source: TAQA annual report, TNI Investment Research

The six IWPP's located in the UAE are primarily gas-fired power generation facilities. Gas is supplied free of charge by ADWEA, the counterparty to the PWPPA's under which the electricity generated is sold. Should additional fuel be required during times of gas supply disruption or shortages, the fuel purchase costs are passed through to the customer.

A supplemental fuel income (revenue) line and fuel expenses line are included on TAQA's income statement, but apart from some timing issues, the arrangement is effectively a pass-through, nil profit one.

Looking for new sources of gas fuel

Recent gas shortages in the UAE have resulted in increasing amounts of supplemental fuel being consumed and this trend is expected to continue into the future until new regional gas supply sources eventuate. Potential supply options include local sour gas, pipeline gas from elsewhere in the Gulf and imported LNG. The changing fuel mix is not expected to impact on TAQA's profitability given that electricity and water prices effectively include a fuel cost component.

Upstream and Midstream Assets

Five upstream transactions to date

Over the past 18 months TAQA has built a very substantial position in the upstream and midstream oil and gas industry through a rapid series of international acquisitions to complement its foundation downstream assets.

In the chronological order in which the transactions were announced, these deals were as follows:

- BP Netherlands comprising upstream gas production and midstream gas storage and regassification for $694 million (November 2006);
- Talisman's North Sea Brae area interests including oil and gas production and pipeline interests for $550 million (January 2007);
- Acquisition of Northrock Resources consisting of Canadian onshore gas and oil production and midstream assets for $2 billion (May 2007);
- Acquisition of Pioneer Canada providing further Canadian producing properties for $540 million (August 2007);
- Acquisition of PrimeWest Energy Trust owning Canadian gas and oil production and reserves for $4.9 billion (September 2007).

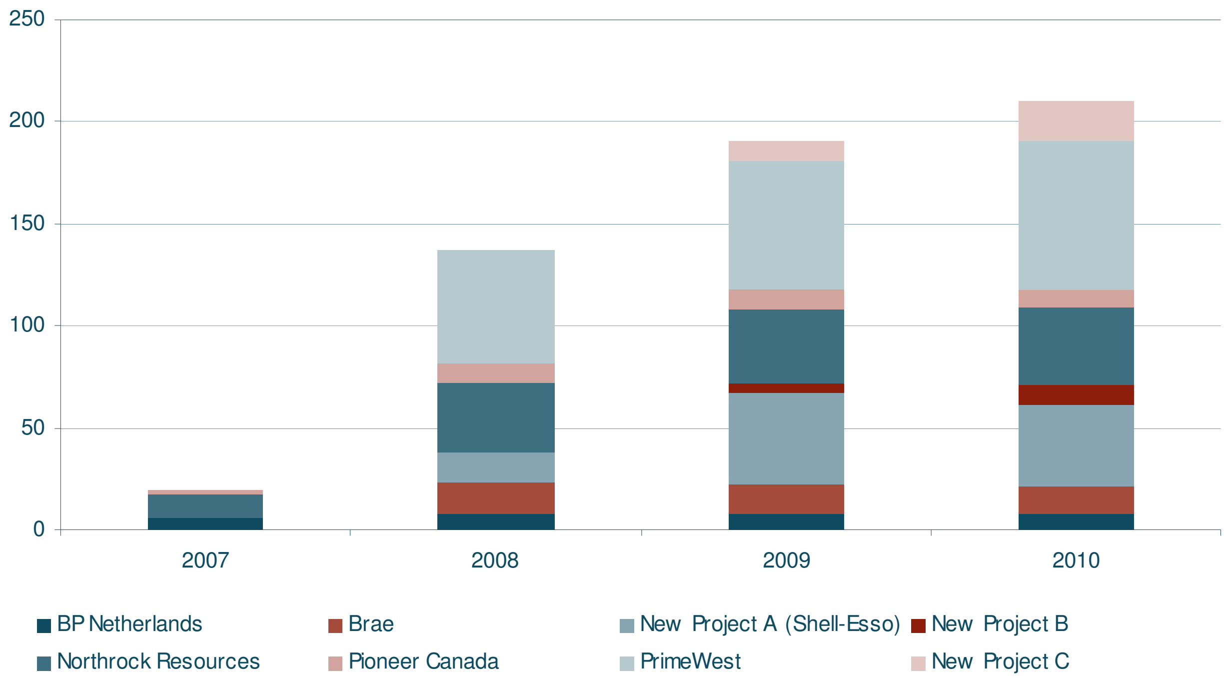
In total this amounted to approximately $8.7 billion expended to establish a large, diverse oil and gas presence across two continents. By mid-January 2008 all these deals had closed.

Fuel earnings impact in 2008

However TAQA's 2007 financial results do not give a true reflection of the impact these five major transactions will provide to the group. Only BP Netherlands and the Northrock projects were included for eleven and less than six months respectively.

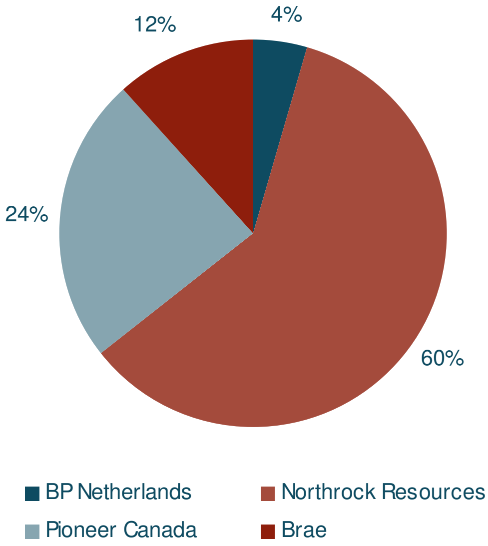
With a full year contribution from all these project areas, the oil and gas business segment's share of profit is forecast to grow from 12% in 2007 to a projected 57% by year-end 2008.

Chart 4: Oil and Gas Production Growth Profile (mboe/d)



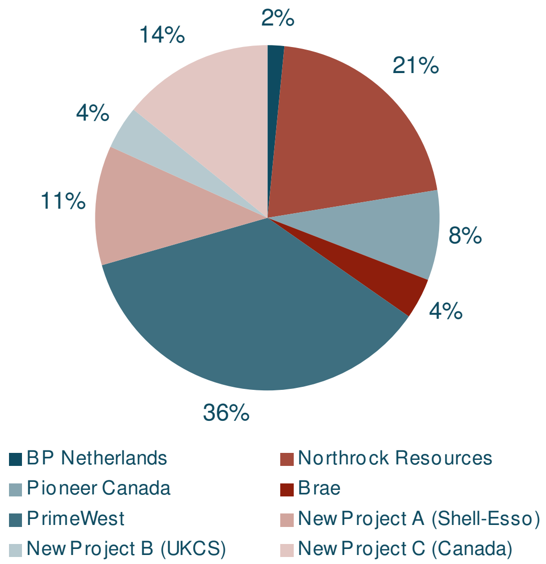
Source: TNI Investment Research

Chart 5: Reserves profile 2007: 247 mmboe



Source: *TNI Investment Research, TAQA*

Chart 6: Forecast reserves profile 2009: 711mmboe



Source: *TNI Investment Research*

BP's Dutch Assets

Initial upstream entry into the Netherlands

In November 2006, TAQA announced its initial entry into the upstream-midstream energy sector with the purchase of BP's exploration and production (E&P) assets and gas infrastructure businesses in the Netherlands.

The purchase price was c. $690 million and the deal was closed around the end of January 2007.

The asset package comprised mature offshore and onshore producing field interests, primarily gas, plus two gas storage projects (the Alkmaar Piek Gas Installatie and the Bergermeer Gas Storage project).

Production of around 62 mmcf/d (10.3 mboe/d) was acquired with remaining 2P (proved and probable) reserves of approximately 11 mmboe.

The Alkmaar gas storage facility was the first peak gas shaver in the Netherlands. It has a capacity to store 17.7 bcf of gas for delivery during extreme cold weather conditions at a maximum daily rate of 1.3 bcf/d. The planned much larger Bergermeer gas project will have a storage capacity of approximately 113 bcf. It will be the largest gas storage facility in Northwest Europe and become fully operational by 2012. Bergermeer will utilise a depleted offshore gas reservoir 35 km off the Dutch coast and close to an interconnecting pipeline between the Netherlands and the UK.

TAQA is planning to consolidate its position in the gas midstream sector by the construction of a major offshore LNG regassification facility. This would allow LNG tankers to bypass the busy Rotterdam port with the gas fed into the Dutch gas infrastructure network via the company's offshore production facilities. The project could become operational by late 2008 or early 2009.

Although the BP assets are mature, they provide a platform for expansion in North West Europe. The LNG regassification project is a good example of TAQA's objective to expand across the energy value chain. Moreover industry experience has shown that much more value can be wrung from non-core assets bought from the oil majors through increased efficiencies and a lower cost base.

Talisman's Brae Area Assets

Consolidating in North Sea region

TAQA announced the purchase of Talisman Energy's non-operated Brae area assets in the UK sector of the North Sea in January 2007. The deal had an effective date of 1 January 2007 although it was not completed until year-end 2007.

The Brae assets acquired included interests between 13% and 18% in the South, Central, East and West Brae fields, plus the Beinn and Braemar fields. In addition 9% interests in the Brae-Forties oil pipeline, the SAGE gas pipeline and onshore terminal and the Brae-Miller linkline were acquired.

The asset package brought net production of c. 19 mboe/d from 2P reserves of 34 mmboe as at year-end 2006. By December 2007, net Brae reserves stood at around 29 mmboe through reservoir depletion.

Although these Brae assets are also relatively mature with a reserves production life of around five years, we see the potential for more UKCS acquisitions to consolidate TAQA's foothold in the region. It is arguable that TAQA has not established critical mass in Northwest Europe to date with only two project areas in two countries. However we expect this to be rectified over the next 12-18 months with further acquisitions including a likely UKCS purchase from Shell-Esso.

Northrock Resources

First Canadian acquisition

TAQA commenced its rapid build-up of a substantial investment in Canadian oil and gas by the purchase of Northrock Resources from its US parent, Pogo Producing, in May 2007.

The consideration was $2 billion which provided production of around 37 mboe/d and gross 142 mmboe of 2P reserves. The production split is 54% oil and 46% gas.

The company established a new subsidiary entity, TAQA North, to manage its Canadian interests which have since expanded following two more major acquisitions. The Northrock transaction closed in August 2007 hence only part of its 2007 results was included in the group's earnings for the year.

Pioneer Canada

Supplemented by second Canadian deal

In August 2007 the company unveiled its second acquisition in Canada with the purchase of Pioneer Canada, the Canadian operations of the large US independent, Pioneer Natural Resources.

For a consideration of $540 million the Pioneer Canada deal brought 2P reserves of 59 mmboe currently producing at more than 10 mboe/d.

The transaction did not close until near year-end 2007 hence made minimal impact on the company's 2007 financial results.

The Northrock and Pioneer acquisitions also brought midstream interests into TAQA North. These comprise a 50% interest in the East Cantaur gas storage facility with a storage capacity of 7 bcf and a capacity allocation of 75 mmcf/d in the Alliance pipeline system. This latter capacity allows gas production and sales to be optimised through an important transcontinental pipeline linking producing fields in Alberta with markets in eastern Canada and the northern USA.

PrimeWest Energy Trust

Third bigger Canadian deal achieves critical mass

A third Canadian asset was added to TAQA North's portfolio by the purchase of PrimeWest Energy Trust for CAD 5 billion ($4.9 billion) announced in September 2007.

The PrimeWest transaction is much larger than both Northrock Resources and Pioneer Canada combined adding 254 mboe gross of 2P reserves and about 62 mboe/d of daily production. At the time of announcement PrimeWest's 2P reserves stood at 285 mmboe. However some producing property disposals and reserves revisions subsequently have reduced this volume to 254 mmboe effective at December 2007 by the time the deal closed in mid-January 2008.

One important rationale for the purchase was to provide further scale and associated efficiencies to TAQA North. It also brought a large tax pool of approximately CAD 2.7 billion

Due to major changes to the Canadian tax system during 2007, oil and gas stocks had fallen sharply. The royalty trusts including PrimeWest are set to lose their tax-advantaged status by 2011.

We believe that given TAQA's longer term investment horizon, the PrimeWest acquisition was an astute one after the share price had suffered downward pressure. Most certainly on the acquisition price metric of $16.70 per boe for 2P reserves, the consideration seems reasonable. A comparison table of TAQA's various transactions is presented later in this report.

TAQA North is now the 12th largest oil and gas producer in Canada with a production mix of around 65% gas and 35% oil.

New Projects

Considering the breakneck speed that TAQA made five oil and gas and two power transactions over the past 18 months, we believe that this pace will ease marginally. Accordingly our conservative forecasts assume two oil and gas acquisitions in Europe and a third in Canada over the 2008-09 timeframe at a total cost of $2.8 billion.

Exclusive negotiations for another UKCS asset

Last June Shell UK and Esso Exploration and Production (UK) put a package of their jointly-owned UK Northern North Sea assets up for sale. In March 2008, TAQA confirmed that it is in exclusive negotiations with the two vendors to purchase their interests in four producing fields in the East Shetlands Basin - Tern, Eider, North Cormorant and South Cormorant - plus related subsea satellite fields and infrastructure.

TAQA has also signed a Heads of Agreement with the Wood Group which, if the purchase proceeds, would operate these mature fields at least in the short term.

The asset package would add approximately 50 mboe/d daily production after implementation of waterflood improvement initiatives to complement TAQA's existing Brae production.

In our forecasts we have assumed that TAQA is successful and purchases the Shell-Esso interests for $1.25 billion adding 90 mmboe of 2P reserves. A contribution from the Shell-Esso assets has been assumed in our forecasts commencing from mid-2008.

Assuming two further acquisitions in 2008-09

We have also included two further unnamed upstream acquisitions in 2009. In mid 2009 another Canadian project is incorporated adding 20 mboe/d production and 100 mmboe reserves costing $1 billion. Another Northwest Europe purchase in 2009 is assumed to add 15 mboe/d production and 30 mmboe reserves at a cost of $500 million. Whilst these latter two purchases are generic only at this stage, we believe that this growth at a more modest rate than previously is readily achievable.

Finally the potential for expanded LNG activities is another growth arena for TAQA which has not been included in our forecasting. The strong fundamentals of the global LNG industry have underwritten massive capacity expansion and LNG has become a viable alternative to pipeline gas in many more markets. Thus we would expect that given TAQA's total value chain strategy LNG will form part of the longer term asset portfolio.

Table 2: Actual and projected oil and gas transactions 2007-9

Project	Date completed	Daily production (mboe/d)	2P reserves (mmboe)	Price ($m)	Notes
Actual completed deals					
BP Netherlands	Jan-07	10	11	694	Included 2 gas storage projects
Talisman Brae	Dec-07	15	29	550	Includes pipeline interests
Northrock Resources	Aug-07	37	142	2,000	Northrock & Pioneer included gas storage and pipeline interests
Pioneer Canada	Aug-07	10	59	540	
PrimeWest Energy	Jan-08	60	254	4,900	
Future acquisitions (TNI forecasts)					
Shell-Esso NNS	Mid 2008	50	80	1,250	Exclusive negotiations status
Project B (UKCS)	Mid 2009	15	30	500	
Project C (Canada)	Mid 2009	20	100	1,000	

Source: TNI Investment Research, TAQA

TAQA owns interests in six IWPP's in the UAE

TAQA's primary objective is to become a global blue chip energy company. This goal is being pursued by building an asset portfolio across the whole energy value chain from source through to the ultimate energy user.

In its short three year history, company management has clearly demonstrated an enviable growth record by an ongoing sequence of friendly acquisitions.

The underlying strategy encompasses several key elements.

Financial Strength
The support of the Abu Dhabi government and the group's investment grade credit ratings of Aa2 (Moody's) and AA- (S&P) allow access to low cost and large tranches of capital from world markets and have been pivotal in underwriting TAQA's strong growth to date. Going forward we believe that these important advantages will be maintained, even following the recent turmoil in world capital markets in the wake of the US sub-prime mortgage crisis. Competition for assets is likely to decrease as underfunded players drop out. In addition the Middle East capital markets have been affected to a much lesser degree than elsewhere thus providing TAQA with new low cost capital to power its ongoing expansion.

Value Chain Diversification
The deliberate strategy to occupy all spaces in the value chain from upstream to downstream is allowing TAQA to leverage off its assets. A good example is the LNG regassification project in the Netherlands where existing offshore gas production infrastructure will be used to distribute the degasified liquefied gas. Moreover by making the project an offshore one, port congestion in Rotterdam can be circumvented and various environmental issues may be resolved.

Economies of Scale
The rapid series of acquisitions after an initial entry into each of the core focus areas and the subsequent integration of operations is proving highly beneficial. Not only do the resulting synergies enhance value but also the strategy allows TAQA to quickly build a management team, something that is a huge challenge in today's stretched labour market.

Core Focus Regions
Leveraging off its domestic power and water asset base, the company is targeting markets with limited political, price and volume risk. Already TAQA's operations cover nine countries across the focus regions of the Middle East, South Asia, North Africa, Europe and North America.

Strategy and prospects

We consider the prospects of success as TAQA pursues its goals are excellent, being assisted by several factors including:

Excellent Sector Fundamentals
Growth in the world's population and particularly increasing energy consumption in developing nations provide an optimistic background for continuing strong growth in the energy sector.

Exit of Majors
An ongoing trend of the oil and gas super-majors and large independents exiting some of their previous core areas provides aggressive companies like TAQA with numerous acquisition opportunities. Portfolio rationalisations by these sellers present projects ripe for better management and cost efficiencies. In some cases the sale of prime assets is dictated by factors other than asset performance or maturity. For example, Talisman's sale of its Brae interests to TAQA was initiated by a corporate asset selldown to reduce debt in the wake of Talisman's earlier takeover of Kerr McGee.

Industry Consolidation
Fragmentation and changing industry dynamics present acquisitive companies like TAQA with opportunities for asset aggregation. The Canadian oil and gas sector with its myriad of small and mid-size players many of which have suffered following recent tax changes is one example. TAQA North has already become a significant force in Canada following three transactions totalling almost $7.5 billion. TAQA's management has indicated that eventually $20 billion will be spent growing the Canadian business.

Table 3: SWOT analysis of TAQA

Strengths	Weaknesses
Financial Position: Government support and solid investment grade allows ready access to capital	**Management Integration:** The speed of TAQA's growth presents significant management challenges to integrate operations, systems and personnel
Energy Sector Fundamentals: The global energy industry presents well-funded aggressive acquirers with many opportunities	**Abu Dhabi Operations:** Limited opportunities for accretive value projects
Domestic and International Mix: Solid downstream domestic assets provide income stream for bondholders whilst international activities provide growth for equity owners	
Value Chains in Focus Regions: Core area focus to create integrated energy chains creates additional value	
Opportunities	**Threats**
Industry Rationalisation: Portfolio downsizing by many energy majors provide a deal flow of attractive assets	**Competition:** Similar aggressive international expansion by China and India may represent serious competition in some arenas
LNG: Changing dynamics and strong growth in the global LNG market offer another link in value chain	

Source: TNI Investment Research

Financials

The historical and projected financial performance of TAQA until year-end 2010 is summarised in the following series of tables and charts.

Rewarding debt and equity holders

TAQA's particular business growth model aims to reward its major stakeholders in two ways. Steady ongoing growth in its downstream utility power and water division provides good low risk returns for the company's bond holders and other debt providers. The upstream oil and gas assets provide higher reward but higher risk returns for the equity holders by direct exposure to the underlying commodity cycle.

The midstream assets are a key link to complete the energy value chain. These operations offer synergies and leverage to both the upstream and downstream assets. As an example, the interests in the East Cantaur gas storage facility and an allocation in the Alliance pipeline system acquired through the Northrock and Pioneer acquisitions allow optimisation of the profitability of the company's producing properties in Western Canada.

Unconstrained growth outlook

TAQA has already proven its ability to grow and diversify its energy asset base exceedingly quickly. Going forward we believe that the company will not be opportunity-constrained. Given ongoing growth in the global energy sector, asset rationalisations by the major energy players and fallout from the current debt crisis, there should be numerous M&A opportunities consistent with TAQA's focused strategy.

Rather we believe that an important factor governing the pace of the company's future growth will be its ability to fund and manage the funding of this projected expansion. Because of its government ownership and support, TAQA is better-placed than most of its peers to capitalise on new growth projects. But the balance sheet is highly geared indicating that future acquisitions will have to be funded by a mix of debt <u>and</u> additional equity.

We do however expect that frenetic speed of new acquisitions posted in 2007 will not be matched in the next few years. Nonetheless we are still forecasting net income to increase by more than 500% over the three year period 2007-2010 from an asset base that expands by over 50%.

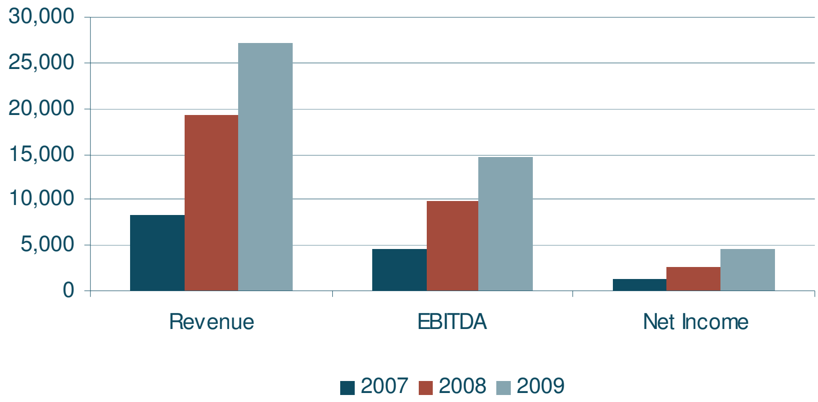
TAQA's long term goal is for a capital structure of approximately 70% debt and 30% equity, although this target may be temporarily exceeded through acquisitions.

Forward funding assumptions

Our modelling assumes that all capital requirements over the next three years are debt-funded following the injection of AED 4.15 million in new equity raised by the planned convertible debenture issue in mid-year 2008. Whilst another equity injection would further reduce pressure on the balance sheet, our forecasts indicate that gearing expressed as debt to total capital employed (debt plus equity) should gradually decrease from the level of 86% at December 2007.

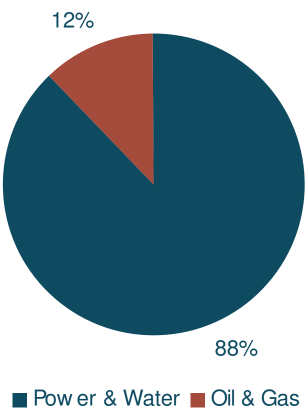
The forecast consolidated income summary (Table 4) shows electricity generating capacity expanding by 52% over the 2007-10 forecast period accompanied by a 1063% rise in oil and gas production. This results in a 509% increase in net income while maintaining relatively flat profitability margins.

Chart 7: Forecast financial performance (AED m)



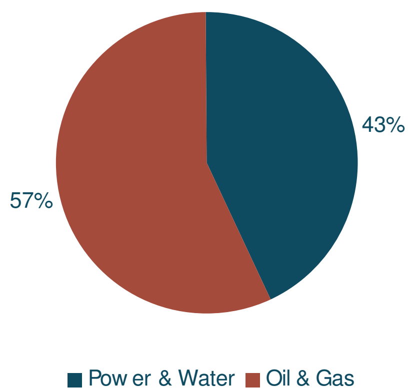
Source: TNI Investment Research

Chart 8: Segment profit contribution 2007



Source: TNI Investment Research, TAQA

Chart 9: Segment profit contribution 2008



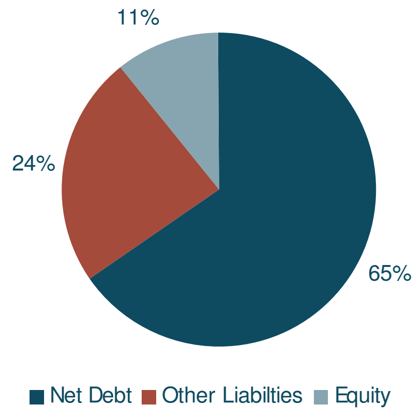
Source: TNI Investment Research

The abridged balance sheet and cashflow summaries (Tables 5 and 6 respectively) detail total assets growing from AED 67,844 to 104,159 million over the forecast period. Total debt peaks in 2009 before net debt repayments in 2010 commence with an attendant reduction in gearing.

Approaching capital structure target by 2010

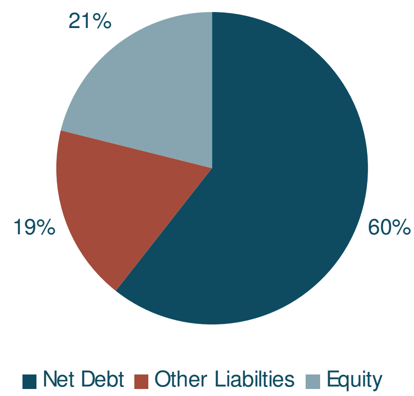
Table 7 provides the company's actual and forecast key financial ratios. Our assumption is that near term expansion will be funded by a combination of the proposed AED 4.1 billion convertible debenture issue and additional debt. Hence the maintenance of a highly geared balance sheet has understandable benefits in pushing returns on equity well above 20%. However our modelling indicates that net debt to equity falls from 6.0 times (2007) to 2.9 times (2010). Gearing expressed as debt to total capital decreases to a projected 74% by December 2010 and is by then approaching the company's 70% long term target.

Chart 10: Capital structure: 2007



Source: TNI Investment Research

Chart 11: Projected capital structure: 2010



Source: TNI Investment Research

Summary financial statements and ratio analysis

Table 4: Consolidated income statement

AEDm		FY2006	FY2007	FY2008E	FY2009E	FY2010E
Global power generation capacity	MW	7,347	9,423	10,836	12,462	14,331
Total daily oil & gas production	mboe/d		19.8	137.0	190.5	210.4
Annual oil & gas production	mmboe		7.2	50.0	69.5	76.8
Revenue from water & electricity	AEDm	3,163.0	4,716.7	5,695.5	6,877.3	8,304.3
Revenue from oil & gas		0.0	1,121.3	10,769.2	17,030.4	18,522.7
Supplemental fuel income		1,465.3	2,027.2	2,432.6	2,919.2	3,503.0
Gas storage revenue		0.0	303.1	333.4	400.0	480.0
Other revenue		212.4	168.5	8.0	9.6	11.5
Total revenue		4,840.6	8,336.8	19,238.6	27,236.5	30,821.5
Cost of sales		2,102.7	3,629.8	9,314.2	12,645.5	14,335.4
EBITDA		2,737.9	4,707.0	9,924.4	14,591.0	16,486.1
EBITDA margin (adj)		81.1%	74.6%	59.1%	60.0%	60.3%
DD&A		872.1	1,427.6	3,340.9	4,566.5	5,108.1
EBIT		1,865.9	3,279.4	6,583.4	10,024.5	11,378.0
EBIT margin (adj)		55.3%	52.0%	39.2%	41.2%	41.6%
Net financing costs		1,059.7	1,961.1	3,175.9	3,835.3	3,807.9
Pre-tax profit		806.2	1,318.3	3,407.5	6,189.1	7,570.2
Income tax		0.0	-57.3	851.9	1,547.3	1,892.5
Net income		806.2	1,375.6	2,555.6	4,641.9	5,677.6
Net margin		16.7%	16.5%	13.3%	17.0%	18.4%
Net income after minorities		485.0	1,034.6	2,214.7	4,266.8	5,265.1

Source: TNI Investment Research

Table 5: Summary - Balance sheet

AEDm	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Cash	16,021.2	7,601.1	7,621.7	8,945.0	8,740.9
Receivables	2,592.4	2,358.0	2,358.0	2,358.0	2,358.0
Other current assets	960.3	1,817.0	1,817.0	1,817.0	1,817.0
Total current assets	19,573.9	11,776.0	11,796.6	13,119.9	12,915.8
PP&E	29,328.4	46,050.8	71,883.9	79,618.0	81,876.9
Goodwill & intangibles	987.6	3,467.0	3,300.0	3,071.7	2,816.3
Other fixed assets	1,877.5	6,550.4	6,550.4	6,550.4	6,550.4
Total assets	**51,767.4**	**67,844.3**	**93,530.9**	**102,360.0**	**104,159.4**
Current IB debt	826.2	3,547.8	47.8	47.8	47.8
Other current liabilities	3,503.2	5,002.9	5,951.5	6,336.8	6,603.6
Total current liabilities	4,329.4	8,550.7	5,999.2	6,384.6	6,651.4
Long-term IB debt	36,505.0	44,999.3	44,999.3	41,999.3	38,999.3
Other LT liabilities	3,364.4	6,165.3	28,185.3	35,525.3	35,525.3
Total liabilities	44,198.8	59,715.3	79,183.8	83,909.2	81,176.0
Share capital	4,150.0	4,150.0	4,150.0	4,150.0	4,150.0
Retained earnings & reserves	1,689.5	2,544.1	8,657.1	12,645.3	17,050.9
Total shareholders' equity	5,839.5	6,694.1	12,807.1	16,795.3	21,200.9
Minority interests	1,729.1	1,435.0	1,540.0	1,655.5	1,782.6
Total equity	**7,568.6**	**8,129.1**	**14,347.1**	**18,450.8**	**22,983.4**
Total equity & liabilities	**51,767.4**	**67,844.3**	**93,530.9**	**102,360.0**	**104,159.4**

Source: TNI Investment Research

Table 6: Summary – Cash flow statement

AEDm	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Net income	806.2	1,318.3	3,407.5	6,189.1	7,570.2
Depreciation & amortisation	872.1	1,427.6	3,340.9	4,566.5	5,108.1
Change in working capital	639.4	-1,478.1	-314.2	-1,224.4	-1,986.0
Operating cashflow	2,317.7	1,267.8	6,434.2	9,531.2	10,692.2
Capex	-6,778.1	-4,194.4	-29,006.9	-12,072.3	-7,111.6
Other investments	-1,190.4	-12,949.0	548.9	567.6	653.3
Investing cashflow	-7,968.4	-17,143.5	-28,458.1	-11,504.7	-6,458.3
Increase in equity capital	0.9	0.0	4,025.5	0.0	0.0
Change in debt	18,657.9	8,906.2	18,520.0	4,340.0	-3,000.0
Other financing	-159.6	-1,004.0	-501.0	-1,043.2	-1,438.0
Financing cashflow	18,499.2	7,902.2	22,044.5	3,296.8	-4,438.0
Net cashflow	12,848.4	-7,973.5	20.6	1,323.3	-204.1
Year-end cash position	15,788.5	7,430.6	7,451.2	8,774.5	8,570.4

Source: TNI Investment Research

Table 7: Ratio analysis

	FY2006	FY2007	FY2008E	FY2009E	FY2010E
Growth					
Revenues	61%	72%	131%	42%	13%
EBITDA	-9%	72%	111%	47%	13%
EBIT	-16%	76%	101%	52%	14%
Net profit	-36%	71%	86%	82%	22%
Net profit after minorities	-50%	113%	114%	93%	23%
Margins					
EBITDA margin	81.1%	74.6%	59.1%	60.0%	60.3%
EBIT margin	55.3%	52.0%	39.2%	41.2%	41.6%
Net margin	16.7%	16.5%	13.3%	17.0%	18.4%
Liquidity & Leverage					
EBITDA/net interest cost	2.6	2.4	3.1	3.8	4.3
Debt (AED m)	40,674	51,860	70,380	74,720	71,720
Net debt (AED m)	24,653	44,259	62,758	65,775	62,979
Net debt/equity (*)	400%	598%	465%	376%	288%
Debt/debt+equity (*)	80%	86%	82%	79%	74%
Current ratio	4.5x	1.4x	2.0x	2.1x	1.9x
Valuation					
P/E	29.8x	14.0x	7.5x	4.4x	3.5x
EV/revenue	8.1x	7.0x	4.1x	3.1x	2.6x
EV/EBITDA	14.2x	12.4x	8.0x	5.8x	4.9x
Returns (*)					
ROE	7.9%	14.0%	16.4%	24.4%	24.0%
ROA	4.2%	5.7%	7.4%	10.2%	11.3%
ROIC	6.1%	6.3%	8.6%	12.0%	13.4%

Source: TNI Investment Research

** Note: Equity adjusted for distorting effect of unrealised derivative losses*

Table 8: Peer group profitability comparison

	TAQA		Santos	BG	Dana Gas	Aabar
Year	**2007**	**2010**	**2007**	**2007**	**2007**	**2007**
Net Debt-to-Equity	598%	288%	57%	1%	19%	23%
Debt-to-Total Capital	86%	74%	36%	1%	16%	19%
ROA	6%	11%	10%	19%	4%	1%
ROIC	6%	13%	10%	24%	3%	1%
ROE	14%	24%	13%	24%	2%	2%

Source: TNI Investment Research

The business structure of TAQA is uncommon comprising assets right along the energy value chain. The vast majority of its peers in the energy sector are pursuing more focused strategies by concentrating their efforts wholly in oil and gas, either solely upstream or incorporating degrees of vertical integration.

Accordingly peer group comparisons are made difficult. Nonetheless some useful observations can be made with regard to TAQA's current and projected performance.

We have chosen a comparison universe of two larger independent E&P companies, BG and Santos, and two other ADX-listed energy companies, Dana Gas and Aabar.

The following comments can be drawn from the table above:

- TAQA is the most highly geared with a current debt/total capital ratio of 86%.
- BG has the lowest gearing of the sample group and it could be argued that notwithstanding its past exceptional returns, the company has a "lazy" balance sheet.
- TAQA's return on equity is second only to BG and by 2010 is forecast to equal BG's high returns.
- TAQA's profitability ratios are considerably better than either of its ADX counterparts.
- TAQA's capital mix currently at a high 86% (net debt/total capital) is forecast to fall to 74% by 2010 which is close to the company's long term target.

Table 9: Peer group valuations

		TAQA	Santos	BG
EV/EBITDA (x)	2008	8.0	7.9	8.3
	2009	5.8	7.8	8.3
Prospective P/E (x)	2008	7.5	20.7	16.7
	2009	4.4	20.8	17.0
Prospective P/CF (x)	2008	2.8	7.6	12.5
	2009	2.0	8.1	11.8
Yield	2008	5.7%	2.3%	0.8%
	2009	7.2%	2.3%	0.9%

Source: TNI Investment Research, Bloomberg

Underpriced versus its peers

The above comparison data comparing TAQA's key valuation multiples with Santos and BG indicate that TAQA is underpriced, particularly when viewed on prospective 2009 results.

We maintain that the valuation metrics of its peers suggest that TAQA has at least 30% price upside which would bring the stock more in line with its peer group. This sets our price target of around AED 4.50 per share.

Catalysts for stock re-rating

The catalysts for a stock re-rating are expected to be the following events:

- Confirmation of the huge earning power of the expanding group with the release of further quarterly profit results;
- Firm evidence of synergistic benefits and efficiency gains as the upstream projects are integrated and consolidated ; and
- Further acquisitions albeit probably at a more modest pace than posted over the past 12-18 months.

Glossary of terms

ADX – Abu Dhabi Securities Exchange

ADWEA – Abu Dhabi Water and Electricity Authority (51% owner of TAQA)

AED – UAE dirham

bcf – billion cubic feet of natural gas

boe – barrels of oil equivalent

boe/d – barrels of oil equivalent per day

IWPP's – Independent Power and Water Producers

LNG – liquefied natural gas

mboe/d – thousands of barrels oil equivalent per day

mmboe/d – millions of barrels oil equivalent per day

mcf –thousand cubic feet of gas

mmcf – million cubic feet of gas

mmcf/d – millions of cubic feet per day

MW – megawatt

PWPA's – Power and Water Purchase Agreements

Reserves:

1P – Proven (90% probability of recovery)

2P – Proven and Probable (50% probability)

3P – Proven, Probable and Possible (10% probability)

UKCS – United Kingdom Continental Shelf

Ratings Definitions

Underpriced

A stock is rated Underpriced when TNI Investment Research believes its fair value lies at 15% above the current market price and the stock is likely to reach such fair value within the next 12-18 months.

Fairly Priced

A stock is rated Fairly Priced when TNI Investment Research believes its fair value lies between -15% and +15% of the current market price and the stock is likely to stay within this range during the next 12-18 months.

Overpriced

A stock is rated Overpriced when TNI Investment Research believes its fair value lies at least 15% below the current market price and the stock is likely to reach such fair value within the next 12-18 months.

All stock market data refer to the closing prices of 11 May 2008

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