

# Palestine – Value and Opportunity

11 July 2011



As at 30 June 2011

**Market Cap: US\$2.8bn**  
**Market PE: 8.0**  
**Market Price/Book Value:**  
**Market Dividend Yield: 5.9% historic**

**Nominal GDP: US\$5.4bn**  
**Population, West Bank: 2.5m**  
**Population, Gaza: 1.5m**  
**Population, Diaspora: app. 7m**

**Companies In This Issue:**

- Bank of Palestine
- PADICO
- Palestine Exchange (PEX)
- Palestine Investment Fund
- Paltel
- Rasmala Palestine Equity Fund
- Wataniya Mobile

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**PALTEL GROUP**

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A p/e ratio of 8, a yield of 5.9% and a GDP growth rate of 10%. These are statistics that demand attention of any investment allocation specialist. The London Stock Exchange recognised this last month, when it held a “Palestine Day” to strengthen links with the country’s financial community and to encourage some of London’s \$1.2 trillion international equity investment pool into the country.

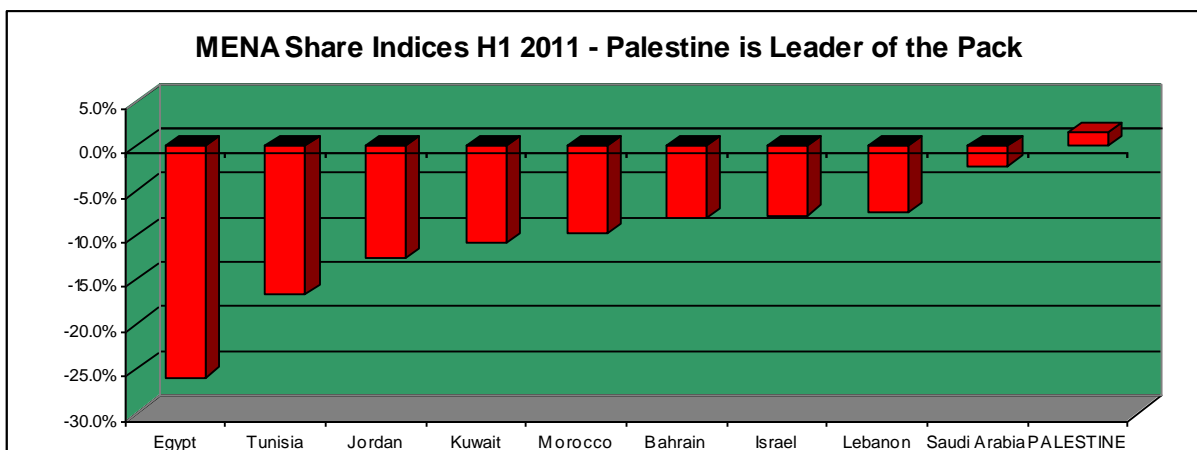
Palestine has not, to date, been an obvious choice for international investment funds. Even though it is recognised as a “country” by over 130 nations around the globe, it is still denied a seat at the United Nations. It lacks an airport. Its imports and exports take place (and all too often do not take place) subject to the will of Israel.

It has sea ports, on the coast at Gaza, but because of Israel’s blockade it cannot use them. It has beautiful beaches there as well, and some tourist facilities, but the fact they are not used cannot in this case be blamed upon Israel. It is a self imposed own goal because of Gaza’s reputation for violence and militancy. You can’t find Gaza in a single Western tourism brochure.

Politically, Palestine is in some respects two countries rather than one. The West Bank and Gaza have separate Governments, run by different political parties (Fatah and Hamas respectively) that loathe each other and only three years ago were at war.

Yet, as investment managers search the globe for niche areas that can give an edge to performance, Palestine cannot be ignored. As a country, almost everything that can go wrong has already gone wrong, including the 2009 invasion and temporary occupation of Gaza by the Israeli military, and the 2007 internal Civil War. Even so, the stock market has survived, the companies quoted upon it have ultimately prospered, and even now in far from ideal conditions are turning a profit.

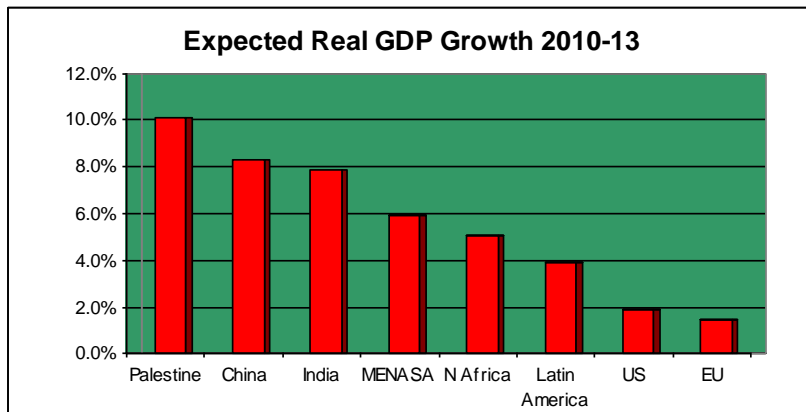
Most of what could go wrong for this country, and this market, has already done so. All that is in the price. Investors should be asking, what will happen if events start moving in Palestine’s favour, and in particular, if the UN votes for recognition in September?



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### PALESTINE THE COUNTRY



Palestine starts from a low base, but is likely to have one of the world's highest growth rates over the next five years, by a common consensus of all major forecasters. GDP has risen 50% since the beginning of 2007. It has a young population, and has a supportive diaspora of approximately 7 million Palestinians living overseas. Politically, the matter of recognition is being brought before the United Nations again in September 2011.

At The London Stock Exchange's Palestine Day held at the end of June, Dr. Mohammed Mustafa, the Economic Adviser to the Palestinian President and Chairman and CEO of the Palestine Investment Fund, spoke on the subject of the economy. He pointed out that the IMF and the World Bank are predicting a growth rate for the country of between 10% and 12% p.a. over the years 2010-2014. The two bodies predict that this will be the fastest growth rate in the MENA (Middle East North Africa) region. It is also faster than the growth rates in China and India. The World Bank forecast growth rate for MENA as a whole, 2010-14 is 4.9%, Mustafa was too polite to highlight the recent problems in some other MENA countries that mean even these forecasts are now unlikely to be met.

Interestingly, the growth rate in the poorer and more isolated part of the country, Gaza, is likely to be higher than the West Bank at 15% p.a., in his view.

GDP per head is low, Mustafa said, but not out of line with some other countries in the region. He pointed out the low inflation rate, 3.7% in 2010. Statistical sources are not consistent, but the CIA estimates GDP per head to be \$2,900, placing the country 140<sup>th</sup> out of 194 in the international wealth league table. Israel's GDP per head is, again according to the CIA, ten times higher.

Mustafa described the Government's policies as "business friendly", committed to reforms at all levels and to further improving the business environment. He described the laws covering business promotion as "attractive", and stressed the relatively sophisticated regulatory system. Regulatory bodies include The Palestine Monetary Authority regulating the financial sector and with a brief to maintain monetary stability and a Capital Markets Authority to oversee the stock market, promote transparency and corporate governance. Foreign investors can benefit from using The Palestinian Investment Promotion Agency, which provides incentives and assistance to foreign investing companies as well as local ones.

Given the way that the 4 million Palestinians have had to create and carve out a country of their own out of such a hostile political environment, it is no surprise to find a Government agency at the heart of the generation of private enterprise activity. The Palestine Investment Fund was established in 2003 with a brief to get the country moving economically by promoting private enterprise. The money involved appears pretty modest when viewed from the standpoint of a larger richer country – even now assets under management amount to only \$831m. Its record, however, is one that many investment managers in London would envy. In the eight years since

**One of the world's highest growth rates**

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establishment it has distributed back to its shareholder, the Government, funds equivalent to 100% of its paid up capital, and has still seen a 30% increase in the value of its funds under management.

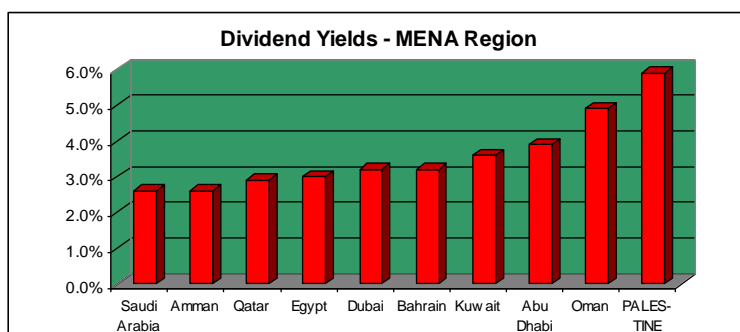
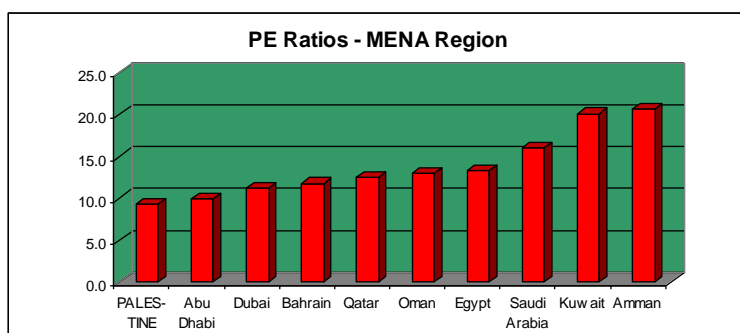
The PIF investment programme over the next five years is considerably more ambitious. It plans \$4bn of investment. The largest investment sector will be real estate, at 35% of the planned total. Energy will be the second largest sector, with a \$1bn spend; Palestine is at present largely dependent upon Israel for its electricity supply. There are three electricity supply companies servicing the West Bank; they purchase 95% of their required electricity wholesale from Israel Electric Corporation. The remaining 5% comes from Jordan. Moreover, the distribution network needs upgrading, and it is widely recognised that there is scope for a solar power generation plant on the West Bank.

**Ambitious investment programme**

Telecoms is having \$700m earmarked for development. There are already two quoted telecoms companies in Palestine; PIF owns 6% of the largest of these, Paltel, and also 36.5% of the biggest new issue in the market last year, Wataniya Mobile.

SMEs are not forgotten in this development programme.

## PALESTINE'S STOCK EXCHANGE



The record of quoted companies listed on the Palestine Exchange (PEX) last year was creditable. Of the 42 companies listed at the year end, 40 reported their results within the legally required timeframe. Of the two that missed the deadline, one was in any case already suspended.

31 out of the 42 companies were profitable, 74% of the total, and total dividend payouts, in cash and stock, of companies listed on the exchange totalled US\$152m. Of this, US\$118m of the dividends were in cash.

**74% of the companies are profitable**

For the London Stock Exchange to host a Palestine Day, therefore, wasn't as or brave as it seemed at first sight, therefore. It was thoroughly sensible, especially as the Palestine Stock Exchange, or PEX, is itself opening up to outside investors. Strategic links with Exchanges in other countries must be under consideration, and London will

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want to be at the front of the queue if that is to be the case.

Tracey Pierce, London's Director of Equity Primary Markets, described as "impressive" the steps taken by legislators, the Palestine Exchange and the Palestine Capital Markets Authority to build a "world class regulatory environment and market infrastructure". With a clear eye on the future possibilities, she highlighted the "seismic changes" sweeping through the broader MENA region.

Compliance issues are properly understood and computerised systems for monitoring potential insider abuse are both in place and being used. The trading platform comes from NASDAQ and is capable of handling 50,000 trades a second, and supporting 200,000 simultaneous orders. PEX has just been awarded "Affiliate" status by the World Federation of Exchanges, which permits PEX to attend the Federation's forthcoming Annual Meeting in Johannesburg in October as an observer. "We are only a few steps away from attaining WFE Full Membership", says PEX CEO Ahmad Aweidah.

The Exchange has 10 registered stockbrokers. Its trading levels are, by the levels of the major stock exchanges of the world, low; trades average 1,000 – 2,000 a week, compared to the 500,000 – 600,000 bargains a week on the London Stock Exchange, and most weeks the value of stocks traded is below US\$10m, compared to the equivalent of US\$50bn – 70bn a week in the UK. The ability of institutions to move large sums of money in and out of this market are, therefore, limited. This is a niche market, not a replacement home for all the funds currently in flight from China.

Because PEX is a relatively new market, with a small number of stocks, liquidity is concentrated in the very largest companies. 49% of all trades by value in Q1 2011 took place in just two companies, PADICO and Paltel. Both companies are reviewed in this Conference Report.

The market has its own index, the Al-Quds Index, which in addition to its main index has six separate, sector sub-indices. Performance in 2011 to date is up 1.5%. It is the only index in the MENA region to register a gain in the first half of 2011.

Both the Al-Quds Index and the leading shares on the market are on Bloomberg, though not on Fidessa or Hemscott. PEX also operates a website, [www.pex.ps](http://www.pex.ps).

**The only market in the MENA region to register a gain in H1 2011**

**NOTE: 1 US Dollar = 0.709 Jordanian Dinar**

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**PALTEL**



<b>Share Price</b>	<b>JD5.30</b>
	<b>(US\$7.48)</b>
<b>No. of Shares in Issue</b>	<b>132m</b>
<b>Market Cap.</b>	<b>US\$984m</b>
<b>PE Ratio</b>	<b>8.0X</b>
<b>Price to Book</b>	<b>1.8X</b>
<b>Dividend Yield</b>	<b>7.6%</b>



Paltel is the largest telecoms operator in Palestine, and indeed it is the largest company quoted on the Palestine Stock Exchange. It has annual revenues of \$479m, an EBIT of \$157.6m (EBIT margins of 33%) and a Net Profit of \$121.8m (Net Profit margin of 25%). Its Return on Equity is 25.8% and its track record is formidable, with EBITDA rising 73% and Net Revenues by 85% over the past five years.

Paltel operates in 3 core areas, fixed line, mobile and data/internet.

**Fixed Line.** Paltel has 390,000 fixed line subscribers, a 10% penetration rate, and of these 124,000 are ADSL. In terms of fixed line penetration, Palestine is very much under-telephoned.

**Mobile Operation.** Paltel has 2.25m subscribers, which gives it an 81% market share. Mobile market penetration in Palestine is only 67% - in most advanced countries it is well over 100% (i.e. the average user has more than one handset or other connected device, such as an ipad or a Kindle).

**Internet Provider.** It is the market leader here, with 74,150 subscribers, which gives it a 60% market share. It is astonishing, and speaks volumes for the problems created by the political situation, that there should at present be only 125,000 internet subscribers in a country of 4m people.

Paltel is also active in 3 other areas, IT support, content support for media including the internet, and call centres (it has set up Palestine's first call centre).

It is possible to see significant growth opportunities for Paltel in addition to the obvious one of increased market penetration in a country where telephone ownership and usage has so much potential to increase. The impact of capex is difficult to predict, because a new piece of equipment can be ordered, paid for and delivered to the border, then sit in Israeli Customs awaiting clearance for up to a year.

Paltel shares yield 7.6%, trade on a PE ratio of 8.0 and an EV/EBITDA of 4.7. On all three measures, the shares are cheaper than the MENA telecoms median.

**The largest company quoted on the Palestine Stock Exchange**

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**BANK OF PALESTINE**



<b>Share Price</b>	<b>\$3.05</b>
<b>No. of Shares in Issue</b>	<b>120m</b>
<b>Market Cap.</b>	<b>\$366m</b>
<b>PE Ratio</b>	<b>11.3X</b>
<b>Price to Book</b>	<b>2.0X</b>
<b>Dividend Yield</b>	<b>6.7%*</b>
	<i>in shares</i>



Bank of Palestine is the country's largest bank, with 33 branches in the West Bank and 12 in Gaza, 500,000 customers and over 1,000 employees. It has an 18.44% market share in deposits and a 19.19% share of credit facilities. BoP is also the exclusive owner of Palestine's Point of Sale network of over 4,000 point of sale machines. It is possibly unique worldwide in being the sole principal member in the country for both Visa and Mastercard. It is also active in corporate as well as retail banking, which it demonstrated by being lead banker in syndicated loans for Wataniya Mobile Palestine and Movenpick Ramallah Hotel.

**The country's largest bank**

Bank of Palestine is 50 years old this year, and has an interesting history. It began as (and in some respects still is) a family business, a form of local credit union run by the grandfather of the current Chairman and General Manager, Hashim Shawa. It was shut down by the Israeli authorities between 1967 and 1981, says Shawa, simply because of its name. Eventually Shawa senior took the case to the Israel High Court, which ruled in the bank's favour. Since then its assets have grown almost a thousand fold and there has been only 2 years of those 24 when assets have not grown.

Its Cost Income ratio has been steady in recent years, and is currently 45.8%. Growth in customer deposits has been consistently over 20% a year since 2003 (2002 was a bad year politically for the entire country). This growth rate has been consistently ahead of the average for the banking sector. Growth in credit facilities has been more erratic, but has been 17%, 20% and 59% in the last three financial years. Customer deposits are a little over twice the level of credit facilities, a factor that will give some comfort to banking analysts watching trigger points for potential problems.

The opportunities available for Bank of Palestine are interesting. The Palestine GDP per head is just one tenth of that of Israel. BoP operates only 90 ATMs, There is no mortgage industry in the country as yet – the legislation is only now being introduced. There is no pensions industry as it is understood in the UK. Unlike banks in richer countries, BoP is still expanding its branch network, rather than contracting it; it feels the current national coverage by the industry of 1 bank branch per 22,000 people compared to the regional average of 1 per 10,000 gives huge opportunities.

International investors appear to agree with him; foreign investment is up from 10% to 30% of the share capital in 5 years, and .in 2008 the International Finance Corporation (IFC) became a 5% shareholder. Bank of Palestine does not pay a cash dividend, but paid a 20% stock dividend last year.

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**PADICO**



<b>Share Price</b>	<b>\$1.16</b>
<b>No. of Shares in Issue</b>	<b>250m</b>
<b>Market Cap.</b>	<b>\$290m</b>
<b>PE Ratio</b>	<b>7.6X</b>
<b>Price to Book</b>	<b>0.7X</b>
<b>Dividend Yield</b>	<b>6%</b>



باديكو القابضة  
PADICO HOLDING

PADICO HOLDING, the Palestine Development and Investment Company, was established in 1993 after the Oslo peace accords by several Palestinian and other Arab business men in the Diaspora. Since inception, its main mission has been to develop the Palestinian economy through investing in vital economic sectors. This mission is being fulfilled through a group of subsidiaries and affiliates operating in real estate, telecommunications, tourism, industry, and financial services. PADICO has been listed on the Palestinian Exchange since 1997, and has assets of \$671.5 m and over 10,000 shareholders as at 31<sup>st</sup> March 2011.

Its strategy focuses on advancing its current investments in addition to identifying and investing in new business opportunities in power generation, water, recycling and other infrastructure related areas.

At present, 67% of PADICO's investments are in finance and services, notably telecoms through its 31% holding in Paltel. The current investment strategy will rebalance this, reducing the dependence upon the financial and services sector in general and upon telecoms in particular.

Restructuring to date has involved the merging of 7 subsidiaries in the tourism companies under JEDICO holding, consolidating 5 industrial companies under the umbrella of the Palestine Industrial Investment Company (PIIC), and preparing the Palestine Exchange, in which PADICO currently owns 78% of the equity, for its public listing at the end of the year.

Due to the company's track record of mitigating political risk, its new projects include the kind of major property development that is not normally associated with politically unstable countries. For instance the Jericho Gate project which will develop a total land area of 741 acres in the city of Jericho for tourism, residential and commercial purposes. The company is also investing in the largest agricultural development in Palestine, the Medjool Date Farm, which is an export oriented project. In financial markets, PADICO is about to launch the country's first ever issue of corporate bonds, and is also about to launch the first GDR programme out of Palestine.

**A mission to develop the Palestine economy**

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### WATANIYA MOBILE



Share Price	\$1.22
No. of Shares in Issue	258m
Market Cap.	\$315m
PE Ratio	n.a.
Price to Book	1.2X
Dividend Yield	0%



Wataniya Mobile is a 2011 new issue on the Palestine Stock Exchange, and is the second telecoms company to be listed on the market. It launched the service commercially on 1 November 2009, and in less than two years has built up to the position where it has 22% of the mobile market on the West Bank. At end-March 2011 it had 388,000 subscribers and when viewed from a market level, very much reflects the low penetration and still large potential the Palestinian market has. In terms of coverage, however, it is well placed. Its signal covers 95% of the Palestinian population, and roaming agreements are in place with 151 operators in 82 different countries.

Wataniya 's efforts have to date been heavily concentrated upon expanding customer numbers. It operates through preferred dealers, grocery stores, vans and promoters and also has operates six showrooms in key population centres. Its network is GSM, and was designed and built by Ericsson. Customers pay by a mixture of direct debit and by visits to Wataniya's service centres. Growth potential is considerable, most obviously because Wataniya does not yet operate in Gaza, despite having a licence for the territory. Approximately 40% of the population of Palestine lives in Gaza so there is a huge opportunity here.

To date, Wataniya appears to have lower than average revenue per customer than its competitor. Its market share in the West Bank, expressed in terms of revenue revenue is 18.9% compared to its 22.3% market penetration when measured by number of handsets.

Average revenue per user has increased approximately 50% over Q1 2010 levels but has since remained constant at approximately \$12. The company believes there exists the potential to see ARPU marginally increase in the future.

Growth rates from a relatively recent launch are obviously impressive. On a shorter term comparison they are good as well, however. Q1 2011 revenues were up 13% on the immediately preceding quarter, suggesting an annualized compound growth rate of in excess of 60%. Of possibly even more interest to the investment community, the Q1 2011 results showed that Wataniya has almost reached EBITDA breakeven. The EBITDA/Sales margin was -3.8%, compared to -28.7% in the immediately preceding quarter. A breakthrough into EBITDA positive territory appears, in our opinion, very

**Growth rates  
are impressive**

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likely in Q2 2011, followed by a move into net profit for 2012.

From the stock market point of view, Wataniya's shares were promoted heavily for its public flotation, and as a consequence lost value in the first three months after launch. Since then, the share price has been stable, and trading has been active – it accounts for 6% by value of all trades on the exchange. It has over 13,000 shareholders. Its current rating values each subscriber at \$800. This may seem a lot compared to the \$370 per customer of Vodafone, but Vodafone customer numbers are growing at less than a quarter of the rate of Wataniya, and Vodafone doesn't have Gaza to expand into.

### RASMALA PALESTINE EQUITY FUND



The Rasmala Palestine Equity Fund is a Luxembourg regulated fund dedicated to investing in stocks listed on the Palestine Stock Exchange and in pre-IPO financings for the exchange. The anchor investor to the fund is the Palestine Investment Fund, and the relationship between the two is a close one. It launched in May 2011 at \$100 a unit, and the current net asset value per share is currently \$99.93, so performance in the two

months of its existence to date has been satisfactory, and apparently slightly ahead of the market during that period. There is no lock-up for new investors.

The policy of the fund is long term capital appreciation by investing in a diversified portfolio of growth and value stocks, with an overall yield for the fund that approximates to the dividend yield of the Al-Quds Index (5.9%). Management fees are well within the normal range for a fund of this type, and arguably at the cheaper end for the investor, at 1.5% p.a. The minimum subscription is \$50,000. The fund boasts a reliable and well known custodian in Kreditrust. Managers are Rasmala Investment Bank, which provides two of the four individuals on the Investment Committee, and two are provided by the Palestine Investment Fund.

The Committee has trimmed the 46 quoted companies on the Palestine Stock Exchange down to a possible universe of 28, by examining issues such as market capitalization, free float, liquidity and availability of analyst coverage. It is aiming at an optimal portfolio of 9 – 13 stocks. Up to 30% of the fund can be invested in IPOs and Pre-IPOs. There is no guidance available yet for the size of the fund.

**A policy of long term capital appreciation**

## THE PALESTINE EXCHANGE



February 1997, in the heady days of Israeli army withdrawal from Gaza. Its shares are currently held 78% by PADICO, 17% by SANABEL and 5% by Euromena Limited Partnership Co.

A combination of the rise in tensions between Israel and Palestine and the world banking crisis mean that the financial record of PEX as a company is not excellent. In 2005, total revenues amounted to \$11.0m. By the year 2010, this had fallen to \$2.27m. In 2005, as a company it earned a net income after tax of \$8.3m, an astonishing and impressive margin of 74% on gross revenues, and a 126% Return On Equity. Since then, there have been five consecutive years of declining profits, culminating, in 2010, with a small loss of \$0.25m, representing negative margins on gross revenues of 9% and Return on Equity of a negative 2.2%. The attraction for potential investors on the coming share float, of course, is the prospect of the market return to the levels of activity seen six years ago. Dealing levels are currently less than a quarter of the 2005 peak.

The fall in trading levels has taught PEX to expand its revenue streams. While trading commission fees have fallen, security transfer commissions, annual membership fees and company registration fees have been rising. Because of this, PEX is now in the enviable position of receiving 39% of its income from non-trading revenue sources. By comparison, The WFE benchmark for 2009 showed 27% of revenues from non-trading streams.. There have been 6 new IPOs on PEX so far in 2011, with another 5 likely. All these will bring additional fee generation.

“If there is a peace agreement then over five years our revenues could grow sixfold. Get in there before the party starts”, says the CEO, Ahmad Aweidah.

The Palestine Exchange does not yet have a share quote, but intends to IPO on its own market before the end of 2011. It has a paid up capital of \$10m, gross revenues of \$2.8m, and positive EBITDA.

PEX was established as a private shareholding company in 1995, and hosted its first trading session on 18

**The attraction is the prospect of the market returning to the levels of activity of six years ago**

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