

Initiation Coverage
May 28, 2018

Recommendation	Neutral
Current Price (SAR)	13.6
Target Price (SAR)	12.6
Upside/Downside (%)	(7.3%)

As of May 24, 2018
Key Data (Source: Bloomberg)

Market Cap (SAR bn)	11.52
52 Wk High (SAR)	16.38
52 Wk Low (SAR)	11.74
Total Outstanding shares (in mn)	850.0
Free Float (%)	36.94%

EEC vs TASI (Rebased)


Price Performance (%)	Absolute	Relative
1m	(3.4%)	0.0%
6m	16.9%	(7.5%)
12m	(3.4%)	(19.8%)

Major Shareholders (%)

Dayim Modern Real Estate Management Company	17.6%
MI Royal Capital Company	9.4%
Emaar Middle Easy Company	5.9%
MI Holdings Company	5.9%

Quarterly Sales (SAR mn) and Operating Margin


Source: Bloomberg, Company Financials, FALCOM Research; Data as of 24th May, 2018

In 1Q18, Emaar The Economic City (EEC) reported SAR 3mn profit as compared to SAR 19mn loss in 1Q17. The improved performance was mainly due to the absence of the impairment provision this year. On a sequential basis, the company's net profit fell sharply by 98% QoQ mainly due to change in accounting of change in infrastructure cost estimates of residential and industrial projects. In FY17, EEC reported a 67% Y/Y drop in net profit to SAR 241mn primarily driven by the changes in accounting estimates, increase in depreciation and increase in financial charges due to higher borrowings.

EEC operates King Abdullah Economic City (KAEC) which is located along the coast of the Red Sea, around 100 km north of Jeddah, the commercial hub of Saudi Arabia. It has total development area of 173 km². KAEC's plan to launch KSA's first investment fund by the end of this year, to support small and medium-sized entrepreneurs in the restaurants and hospitality sector, will further boost the commercial real-estate growth. Despite the strong demand outlook, EEC's declining ROE (par below sector average), absence of dividend pay-outs and weak balance sheet makes it less appealing for investors at current levels. Hence, we recommend 'Neutral' rating on the stock.

Entertainment sector to be a prime growth driver

The Saudi government is undertaking ambitious social and economic reforms. A key part of the reforms is the opening up of the entertainment sector which is expected to provide major boost to tourism. The city, situated near the upcoming Red Sea resort, is uniquely positioned to attract well-heeled tourists. To realise this new opportunity, the company is working on 45 leisure and tourism projects, 30 of which are set to be completed this year.

Government incentives to stimulate real estate activity

In 2018 budget, the government launched an SAR 72bn package which subsidized loans for first-time home buyers, waived fees for small businesses and provided financial aid for distressed companies. The government's concerted and firm push will provide fillip to residential and commercial segments of the real estate sector. KAEC, being a prominent real estate project in the Kingdom will be one of the major beneficiaries.

Booming oil sector to boost economy

Since the beginning of 2018, oil prices have increased substantially. Saudi Arabia is still dependant on oil revenue for a significant portion of its budget. The previous contraction in oil prices inserted pressure on the government to undertake belt tightening measures which negatively impacted consumer sentiment and hurt economic growth. With oil prices recovering, the government can go slow on its fiscal consolidation and support its ordinary citizens through the economic transition. Recovery in consumer sentiment will provide boost to the country's real estate sector in general and EEC in particular.

Capital intensive business entails high leverage

EEC, being a real estate company, is expected to be substantially levered. However, even by sector the standards, EEC has high leverage. The company has a long term debt of SAR 7.3bn (D/E of 1.0x), while net debt/ EBITDA, stands at 12.6x suggesting limited headroom for more borrowings, given its already stressed balance sheet. However, SAR 5.0bn of the long term debt is from the Ministry of Finance at fixed rate with an extended grace period, which provides some relief. Also, the company is backed by its parent, Emaar, which has proven and excellent track record in the real estate sector.

Valuation: We valued Emaar The Economic City using DCF Approach to arrive at a fair value of SAR 12.6 per share. We considered WACC at 8.0%, with a terminal growth rate of 2.0%.

	2017	2018E	2019E	2020E	2021E
Revenues (SAR bn)	1.4	1.5	1.8	2.0	2.4
Operating Profit (SAR bn)	0.3	0.4	0.4	0.5	0.6
EPS (SAR)	0.3	0.5	0.6	0.7	0.8
Operating Margin (%)	20.4%	23.4%	24.1%	24.8%	26.0%
D/E (x)	1.00	0.98	0.95	0.84	0.73
RoE (%)	3.0%	4.8%	5.4%	6.1%	7.0%
P/E (x)	47.6x	28.2x	24.2x	19.9x	16.1x
Price/BV (x)	1.4x	1.4x	1.3x	1.2x	1.1x
EV/EBITDA (x)	33.9x	29.8x	25.6x	21.5x	17.0x

Source: Company Financials, FALCOM Research

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Valuation Summary

Explanation of valuation methodology and assumptions

We valued Emaar The Economic City using the DCF Approach to arrive at a fair value of SAR 12.6 per share. We considered WACC at 8.0% with a terminal growth rate of 2.0%. In relative terms, EEC is trading at 1yr forward P/E of 28.2x, at a premium of 36.9% to its sector peers and at a premium of 85.7% to the Tadawul All Share Index.

SAR Mn	FY 2017	FY 2018E	FY 2019E	FY 2020E	FY 2021E
EBIT	293	359	425	507	628
Taxes	(138)	(46)	(54)	(66)	(81)
Depreciation, amortization and impairment	246	261	281	301	315
Changes in working capital	(308)	169	439	593	807
Net capital expenditure	(661)	(640)	(647)	(644)	(433)
Free Cash Flow to firm	(569)	103	443	691	1,235
<i>Discount Factor</i>		1.0	0.9	0.8	0.8
PV of free cash flow to firm		98	392	566	936
Net Present Value (A)					1,992
PV Terminal Value (B)					15,916
Assumed Terminal Growth Rate					2.0%
Discount Rate					8.0%
Enterprise Value (A+B)	17,908	WACC Assumptions			
Total Cash	771	Risk free rate	3.0%		
Total Debt	8,000	Market returns	7.9%		
Minority Interest	(2)	Beta	1.3x		
Equity Value in SAR mn	10,682	Cost of equity	13.5%		
Number of shares in mn	850	Post tax cost of debt	2.6%		
Target Price in SAR per share	12.6	Weight of equity in capital structure	50.0%		
CMP in SAR as on May 24th, 2018	13.6	Weight of debt in capital structure	50.0%		
Upside/(Downside) to current market price	(7.3%)	WACC	8.0%		

Source: Company Financials, FALCOM Research Estimates

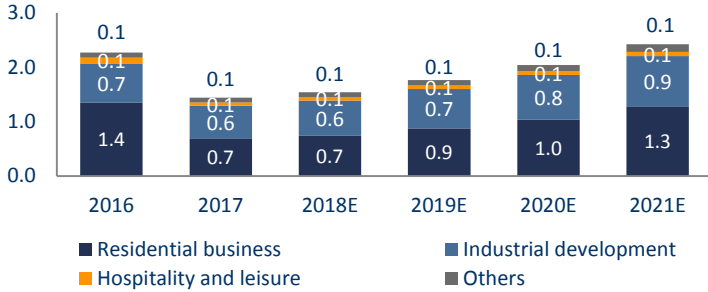
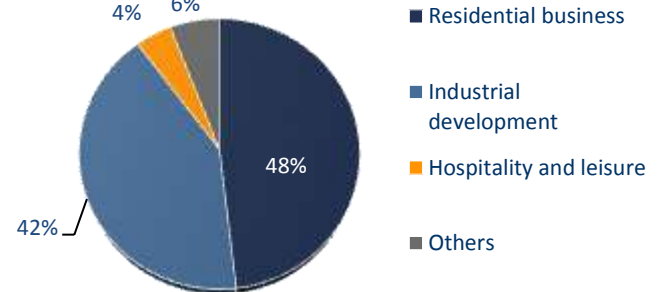
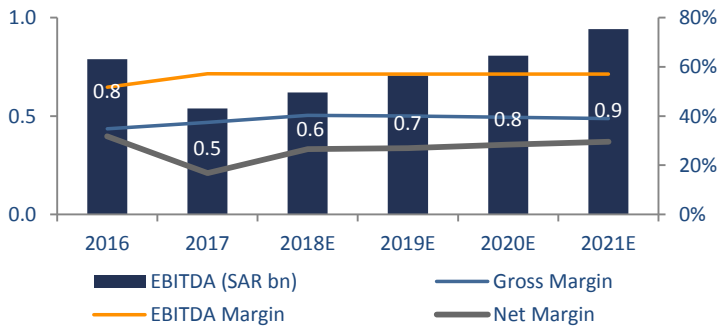
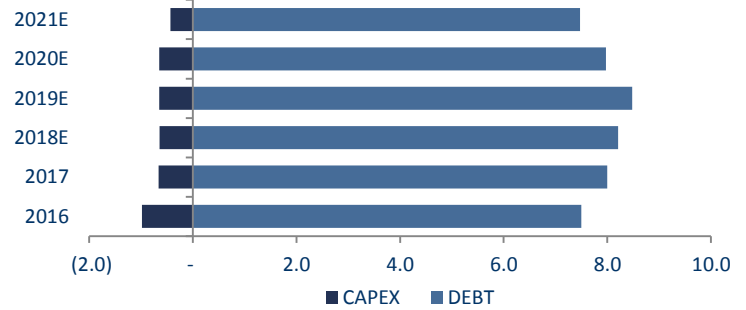
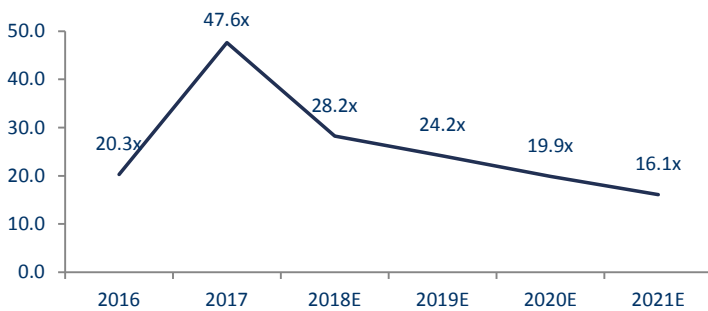
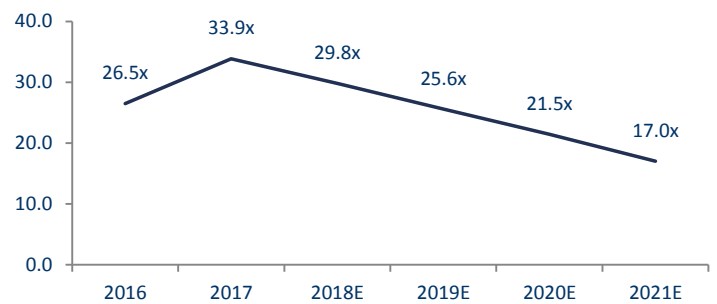
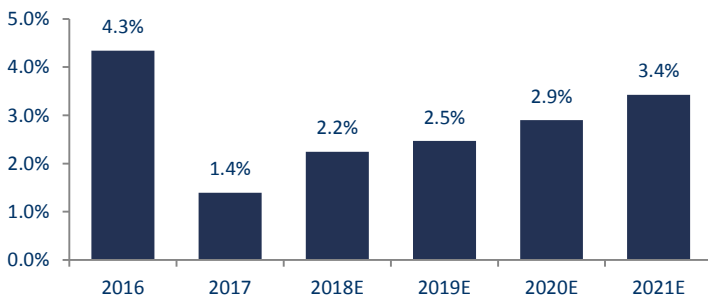
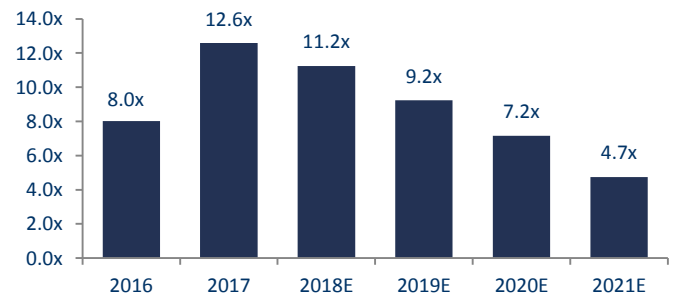
Risks

Upside Risks:

- The National Transformation Plan (NTP) seeks to increase the share of PPPs in the real estate sector to 10% by 2020 from the current 5%, which will help mitigate real-estate shortage in KSA.
- Better than anticipated growth in the residential sector, considering the imposition of the white land tax and announcement of large housing schemes.

Downside Risks

- In March 2018, KSA raised its repo and reverse repo rates by 25 basis points to 2.25% and 1.75%, respectively. Yet another spell of Fed rate hikes would further raise KSA interest rates, which would negatively affect the demand for real estate loans.
- KSA implemented a 5% VAT on goods and services from January 2018. Any further such reforms will lead to an increase in the cost of fuel and construction materials, thereby adversely affecting the cash flow of real estate developers.

Key Charts
Revenue (SAR bn)

Revenue Split (2017)

EBITDA & Margins

CAPEX and Debt (SAR bn)

Price to Earnings

EV/EBITDA

ROA

Net Debt/EBITDA


Source: FALCOM Research Estimates

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Summary Financials

P&L (SAR mn)	2017	2018E	2019E	2020E
Revenue	1,438	1,538	1,765	2,042
Gross Profit	822	877	1,006	1,164
EBITDA	538	620	705	808
EBIT	293	359	425	507
Equity Accounted Investees	31	32	30	29
Net Interest	(38)	(36)	(38)	(23)
Other	103	108	124	143
PBT	389	463	541	656
Zakat	(138)	(46)	(54)	(66)
Minorities	10	8	10	12
Net Income	241	408	477	578
EPS	0.3	0.5	0.6	0.7
DPS	-	-	-	-

BS (SAR mn)	2017	2018E	2019E	2020E
Cash	1,228	1,237	1,962	2,193
Current Assets	3,381	3,769	3,722	3,651
Fixed Assets	5,091	5,511	5,914	6,293
Intangibles	15.2	15.4	15.8	16.7
Investment Properties	5,085	5,045	5,008	4,971
Total Assets	17,296	18,175	19,324	19,933
Current Liabilities	1,797	2,010	2,422	2,907
Short Term Debt	-	-	-	-
Long Term Debt	7,350	7,600	7,850	7,385
Shareholders Equities	8,007	8,424	8,910	9,500
Total Liabilities & Shareholders' Equity	17,296	18,175	19,324	19,933

CF (SAR mn)	2017	2018E	2019E	2020E
Operating Cash Flow	112	590	767	891
Working Capital Changes	(308)	169	439	593
Cash Flow from Operating Activities	(196)	758	1,206	1,484
Capex	(661)	(640)	(647)	(644)
Cash Flow from Investing Activities	(260)	(957)	(752)	(750)
Changes in Debt	500	208	270	(502)
Dividends	-	-	-	-
Cash Flow from Financing Activities	507	208	270	(502)

Source: Bloomberg, Company Financials, FALCOM Research

Growth	2017	2018E	2019E	2020E
Revenue Growth	-36.6%	6.9%	14.8%	15.7%
EBITDA Growth	-31.7%	15.2%	13.7%	14.5%
Operating profit Growth	-49.2%	22.8%	18.1%	19.4%
PBT Growth	-47.6%	19.0%	16.8%	21.3%
Net Income Growth	-66.5%	69.4%	16.8%	21.3%

Ratios (%)	2017	2018E	2019E	2020E
Gross Margin	57.2%	57.0%	57.0%	57.0%
EBITDA Margin	37.4%	40.3%	40.0%	39.6%
EBIT Margin	20.4%	23.4%	24.1%	24.8%
Net Margin	16.8%	26.5%	27.0%	28.3%
ROE	3.0%	4.8%	5.4%	6.1%
ROCE	1.6%	2.5%	2.8%	3.4%
ROA	1.4%	2.2%	2.5%	2.9%
Debt/Equity	1.0	0.98	0.95	0.84
Net Debt/EBITDA	12.6	11.2	9.2	7.2
FCF Yield	-5.0%	0.9%	3.9%	6.0%
Dividend Yield	NA	NA	NA	NA

Valuation	2017	2018E	2019E	2020E
PE	47.6x	28.2x	24.2x	19.9x
PB	1.4x	1.4x	1.3x	1.2x
EV/EBITDA	33.9x	29.8x	25.6x	21.5x
EV/EBIT	62.3x	51.5x	42.5x	34.2x
EV/Sales	12.7x	12.0x	10.2x	8.5x

Peer Valuations	12M Fwd PE	12m Fwd EV/EBITDA
Dar Alarkan Real Estate Development Co.	38.3x	21.4x
Taiba Holding Co.	20.6x	19.7x
Aldar Properties PJSC	6.9x	6.6x
Emmar Properties	5.5x	5.5x
Deyaar Development PJSC	22.6x	21.5x
Emaar The Economic City	28.2x	29.8x
Sector Median	18.8x	14.9x
TASI	20.6x	19.7x

FALCOM Rating Methodology

FALCOM Financial Services uses its own evaluation structure, and its recommendations are based on quantitative and qualitative data collected by the analysts. Moreover, the evaluation system places covered shares under one of the next recommendation areas based on the closing price of the market, the fair value that we set and the possibility of ascent/descent.

Overweight: The Target share price exceeds the current share price by $\geq 10\%$.

Neutral: The Target share price is either more or less than the current share price by 10%.

Underweight: The Target share price is less than the current share price by $\geq 10\%$.

To be Revised: No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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