

2Q 2018 Results Update

August 30, 2018

Recommendation	Underweight
Previous Recommendation	Neutral
Current Price (SAR)	9.7
Target Price (SAR)	8.6
Upside/Downside (%)	(11.1%)

As of August 29th 2018

Key Data (Source: Bloomberg)

Market Cap (SAR bn)	8.2
52 Wk High (SAR)	15.58
52 Wk Low (SAR)	9.59
Total Outstanding shares (in mn)	850.0
Free Float (%)	37.3%

EMAAR EC vs. TASI (Rebased)



Price Performance (%)	Absolute	Relative
1m	(12.3%)	(8.8%)
6m	(22.6%)	(30.7%)
12m	(33.3%)	(43.7%)

Major Shareholders (%)

Dayim Modern Real Estate Company	17.3%
MI Royal Capital Company	9.4%
Emaar Middle East Company	5.9%
MI Holding Company	5.9%

Quarterly Sales (SAR mn) and Operating Margin



Source: Bloomberg, Company Financials, FALCOM Research; Data as of 29th August 2018

Emaar records losses in 2Q18 on higher expenses

Emaar The Economic City (EEC) reported net loss of SAR 47.6mn in 2Q18 against a profit of SAR 36.1mn in 2Q17, largely ascribed to lower sales of land plots for industrial purposes and a decrease in profits share from a JV (42.4% YoY), in addition to higher marketing and administrative expenses (+27.9% YoY). On a sequential basis, EEC recorded losses, ascribed to higher selling, marketing, and G&A expenses (+39.7% QoQ) and a decline in other income (47.3% QoQ), coupled with a fall in profit share from a JV (42.8% QoQ). In addition, the higher cost of sales (+61.5% YoY) in 2Q18, compared to 2Q17, weighed on this quarter's results.

In March 2018, King Abdullah Economic City (KAEC) announced plans to build a Disneyland-themed entertainment city in Jeddah, which we believe would help boost KSA's burgeoning entertainment sector. Furthermore, KSA's National Housing Co. (NHC) inked a contract with KAEC to build additional 8,000 residential units in Al-Shurooq under the Sakani program. The strategic partnership between the Ministry of Housing and KAEC represents the government's commitment to the affordable housing program. We expect such programs to stimulate real estate activity; moreover, a recovery in global oil prices should boost the real estate sector in general and EEC in particular. However, we still remain cautious, as we expect EEC's capital expenditure to remain high in the medium term, as it is developing infrastructure for city expansion to draw more visitors to KAEC. We believe this would lead to operating cash flow to remain in the negative territory in the upcoming quarters as well.

- EEC's revenue rose 9.3% YoY to SAR 244.1mn in 2Q18, largely due to higher sales from the residential segment (190.4% YoY), despite a 54.6% YoY and 46.2% YoY decline in the industrial and hospitality segments, respectively. On the contrary, revenue declined 13.1% QoQ, ascribed to a fall in sales from the residential (8.4% QoQ) and industrial (30.9% QoQ) segments.
- Despite a nearly two-fold jump in residential sales (+190.4% Y/Y), the operating margin for the segment declined to 41.8% in 2Q18 from 79.1% in 2Q17. The operating margin for the industrial segment, conversely, remained flat on YoY basis, and expanded 642bps in 2Q18.
- Gross profits fell 23.5% YoY to SAR 104.8mn in 2Q18 owing to higher costs incurred. The cost of sales grew 61.5% in 2Q18 to SAR 139.3mn from SAR 86mn in 2Q17. Consequently, gross margins contracted to 42.9% in 2Q18 from 61.4% in 2Q17. In contrast, gross profit grew 8.4% QoQ, despite a 13.1% fall in revenue, supported by a 24.4% QoQ drop in cost of sales.
- In line with a fall in gross profit, operating profit witnessed a 311.7% YoY drop in 2Q18, ascribed to higher cost of sales (61.5% YoY), selling and G&A expenses (39.7% YoY), and depreciation (55.7% YoY). Consequently, operating margin contracted to a negative 20.5% in the current quarter compared to 10.6% in 2Q17.
- Operating cash flow (OCF) moved further down, as losses widened 515.9% QoQ and 67.8% YoY to SAR 397mn in 2Q18 compared to a negative OCF of SAR 64.5mn in 1Q18 and a negative SAR 237mn in 2Q17. This was mainly due to higher accounts receivables, lower accounts payable, and higher zakat paid.

Valuation: We have revised our target price downward with a fair value of SAR 8.6, after incorporating weak 1H 18 performances in our forecasts. We downgrade EEC with 'Underweight' rating from 'Neutral' as we do not foresee any significant upside from current levels.

	2Q'18	2Q'17	% YoY	FY18E	FY17	% YoY
Revenues (SAR mn)	244.1	223.2	9.3%	1,374.9	1,438.0	-4.4%
Gross Profit (SAR mn)	104.8	137.0	-23.5%	618.7	822.4	-24.8%
EBITDA (SAR mn)	(29.8)	60.5	NM	369.1	538.3	-31.4%
Net Profit (SAR mn)	(47.6)	36.1	NM	144.2	240.9	-40.2%
EPS basic (SAR)	(0.1)	0.0	NM	0.2	0.3	-40.2%
Gross Margin (%)	42.9%	61.4%	-18.4%	45.0%	57.2%	-12.2%
EBITDA Margin (%)	-12.2%	27.1%	NM	26.8%	37.4%	-10.6%
Net Profit Margin (%)	-18.1%	16.2%	NM	10.5%	16.8%	-6.3%

Source: Company Financials, FALCOM Research

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.

FALCOM Financial Services

Contact us on the below phone numbers:

Customer Services: **8004298888**

Brokerage Services: **920004711**

Fax or Email us at the below number:

Fax: **+966 11 2032546**

Email: **addingvalue@falcom.com.sa**

Mail us at the following address:

P.O. Box 884

Riyadh 11421

Kingdom of Saudi Arabia

Disclaimer and Risks Warning:

The information in this report was compiled from various public sources believed to be reliable and whilst all reasonable care has been taken to ensure that the facts stated in this report are accurate and that the forecasts, opinions, future prices and expectations contained herein are fair and reasonable, FALCOM makes no representations or warranties whatsoever as to the accuracy of the data and information provided and, in particular, FALCOM does not represent that the information or expected future prices in this report is complete or free from any error. This report is not, and is not to be construed as, an offer to sell or solicitation of an offer to buy any financial securities. Accordingly, no reliance should be placed on the accuracy, fairness or completeness of the information or the expected prices contained in this report. FALCOM accepts no liability whatsoever for any loss arising from any use of this report or its contents, and FALCOM shall not be in any way responsible for the contents hereof. Opinions, forecasts or price projections contained in this report represent FALCOM's current opinions or judgment as at the date of this report only and are therefore subject to change without notice. There can be no assurance that future results, prices or events will match any such opinions, forecasts or prices projections which represent only one possible outcome and these price estimates may not occur in the future whatsoever. Further, such opinions, forecasts or price projections are subject to certain risks, uncertainties and assumptions that have not been verified and future actual results or events could differ materially. Any value or price, or income from, any investments referred to in this report may fluctuate and/or be affected by changes. Past performance is not necessarily an indicative of future performance. Accordingly, investors may receive back less than originally invested amount. This report provides information of a general nature and does not address the circumstances, objectives, and risk tolerance of any particular investor. Therefore, the person who obtain a copy of this report should understand that this report is not intended to provide personal investment advice and does not take into account his/her financial situation or any specific investment objectives or particular needs which he/she may have. Before making an investment decision the investors should seek advice from an independent financial, investment and/or other required advisers due to the investment in such kind of securities may not be suitable for all recipients. This research report might not be reproduced, nor distributed in whole or in part, and all information, opinions, forecasts and price estimates contained; are protected by the intellectual property laws, copyright and publishing rules and regulations applied in the Kingdom of Saudi Arabia.

All rights reserved.

FALCOM acquired the Saudi Capital Market Authority license number (37-06020) on 27/05/2006, and commenced providing its services to the investors in the Saudi Stock Exchange on 19/02/2007 with CR Number 1010226584 Issued on 04/12/1427H.