Lebanese Real Estate

2013 Earnings Preview

April 24, 2014

SOLIDERE (SOLA: USD 13.05, SOLB: 13.01)

Recommendation: OVERWEIGHT

Target Price: USD 17.00

We expect Solidere to report improved financial results in 2013 from a likely bottom in 2012, while shares should remain tied to political developments in Lebanon. Although we see inherent value for long term patient investors, we expect continued cautiousness given weaker operating conditions and investor sentiment.

- **Further slowdown in number of real estate transactions in 2013, yet 2M-14 points to an improvement.** In 2013, sluggishness in real estate activity continued to prevail in light of weak sentiment from soft economic conditions and rising regional and local political uncertainties, with the slowdown particularly felt in the high-end market. Real estate activity was weaker for the third consecutive year as the number of transactions dropped by 7% YoY to 69,198 following decreases of 10% and 12% in 2012 and 2011 respectively. Statistics released until Feb-14 reveal that the number of transactions were up 20% YoY despite weak economic conditions (with real GDP growth estimated at 1.5% in 2013e and 2014e as per the IMF's latest revision). It is still early to set a trend for the year as market activity should remain also tied to political and security developments.

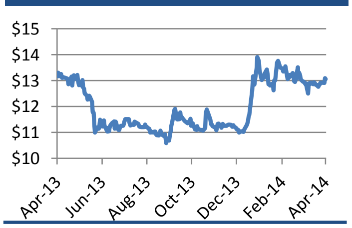
- **National property prices holding up despite timid market activity while sluggishness persists in BCD area.** In 2013 prices continued to be resilient despite a lackluster real estate market. Official figures issued by the Real Estate Registry point to a continuous rise in the average value per real estate transaction which grew by 7% YoY in 2013 to USD 128,201 in line with the trend over previous years (+12% in 2012 and +6% in 2011). Figures until Feb-14 reveal that the average value per real estate transaction jumped by 26% YoY to USD 134,661. In the BCD, most expensive units are located in the waterfront where starting prices are estimated in the USD 7,000-8,000/sqm range compared to USD 4,500-6,000/sqm in the traditional area including Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square. The previous ranges were 8,000-10,000/sqm and 4,500-7,000/sqm respectively suggesting that developers are more inclined to offer lower prices given stagnation in demand.

- **We expect Solidere's revenues and earnings for 2013e to be above prior year's levels on account of higher land sales and roughly flat proceeds from recurring revenues.** Solidere should see improved financial results in 2013e vs. 2012 as the Company may have seen the bottom in profits in 2012 when net profits dropped to USD 18 million or about 10% of the previous year's results. For 2013e, we estimate Solidere to approximately triple 2012's net profits to an estimated USD 55 million and EPS of USD 0.34 on total revenues of USD 175 million. We remind that Solidere revenues from land sales bottomed in 2012 to one land sale in the waterfront and should see improvement to three transactions in 2013e. Revenues from recurring income (rental income and rendered services/hospitality) should remain roughly flat.

- **Expect continued containment in opex and slowdown in capex, facing weaker operating conditions to help cash flows.** For 2013e, gross margins are likely to remain roughly flat as management defends land selling prices at the expense of volumes. We expect low single digit rise in SG&A to ~25% of revenues. Total capex disbursed in 2013e is likely lower than previous year and was principally disbursed in developments as the movie cineplex in the North Souks was completed with the remainder in infrastructure. The next focus is on the department store and the annex which will primarily house restaurants as well as continued infrastructure on the waterfront namely roads and underground utilities. The eastern marina, the park and other properties are pushed to a later delivery as part of the strategy to defer some investments.

- **We still recognize favorable upside for patient investors, despite remaining cautious for the short to medium term.** We value Solidere's position as the prime land owner and master developer in the BCD, its track record, attractive margins, and its ongoing revenue diversification to offset the depletion of its land bank. However, we remain cautious as the uncertain economic and political backdrop has materialized into Solidere's operations through slower land sales. We are concerned that the short to medium term will remain challenging given the impact of the difficult operating environment on the property market and Solidere's land sales which remain the key driver for cash generation. Yet, we favorably view the decision to defer some investments to help cash flows and see upside potential for patient long term investors upon a rebound in land sales, completion of the real estate pipeline and the waterfront infrastructure giving additional value to the BCD.

Solidere A Share Price



Share Price Information

Market cap.	USD 2,153.3 million
Shares	165.0 million
Dividend yield	n/a
Δ 1M	+0.7%
Δ3M	-2.6%
Δ YTD	+18.1%
Δ 12M	-0.9%
52-Week range	USD 10.53-14.14

Key Performance Indicators

In USD millions	**2012a**	**2013e**	**2014e**	**2015e**
Revenues	120	175	211	218
EBITDA	39	84	113	115
Net income	18	55	79	81
EPS (USD)	0.11	0.34	0.49	0.50
P/E	118.2	37.9	26.5	25.9
P/B	1.09	1.06	1.02	1.00
EV/EBITDA	69.0	32.1	23.9	23.5

Note: Solidere A shares are priced as of market close on April 24, 2014; Source: BSE, Company reports, FFA Private Bank estimates

- **We reiterate our target price on Solidere Shares at USD 17.00 with an Overweight recommendation recognizing value for long term investors.** Our fair value estimate is maintained at USD 17.00 per share using a sum of the parts approach, which implies a P/B of 1.3x based on our 2014 estimated BVPS, in line with its three and five year average. We accordingly maintain an Overweight recommendation given the current price is at a discount of more than 10% to our fair value estimate, recognizing value for long term investors despite remaining cautious in the shorter term against an uncertain political and economic backdrop impacting the property market and investor sentiment. Upside risks include a smooth presidential elections process and favorable outcome to Syrian crisis.

Contacts:
Head of Research: Nadim Kabbara, CFA
n.kabbara@ffaprivatebank.com +961 1 985 195
Analyst: Raya Freyha
r.freyha@ffaprivatebank.com +961 1 985 195
Sales and Trading, FFA Private Bank (Beirut)
+961 1 985 225
Sales and Trading, FFA Dubai ltd (DIFC)
+971 4 3230300

SOLIDERE

Company Description

The Lebanese Company for the Development and Reconstruction of Beirut Central District known as Solidere is the largest real estate player in Lebanon in terms of assets with an asset base at USD 2.9 billion at year-end 2012 and a 1.86 million sqm land bank left in the BCD (of which ~80% in the waterfront and ~20% in traditional). The Company business model is primarily based on revenues from land sales and the strategy is to increase revenues from recurring sources of which rental income, as well as proceeds from rendered services and hospitality. The last three years show an average contribution of land sales to total revenues at ~70%. Solidere International was founded in 2007 in order to expand operations largely outside Lebanon, notably in the region. Solidere owns 39% of Solidere International whereby projects are currently focused in KSA and in UAE via Al Zorah. Solidere shares are listed and traded on the Beirut Stock Exchange (tickers: SOLA, SOLB) and its GDRs on the London Stock Exchange.

Solidere Key Financial Highlights in 2012

Net profits were down to USD 18 million in 2012 (~10% of prior's year level) on weak land sales

- Net profits dropped to USD 18 million in 2012 (-89% YoY). Diluted EPS was USD 0.11 vs.1.03 in prior year.
- These lower earnings in 2012 can be principally attributed to lower land sales which dropped to one in number despite relatively stable selling price and higher revenues from recurring income in addition to a USD 20 million provision which was taken against hospitality and taxes.
- Higher debt levels as Solidere funded the completion of the remaining infrastructure and real estate developments (net debt to total cap up to 22% from 17%).
- No dividends distribution was proposed for 2012 to fit the cautious growth plan in the near term.

Solidere International (SI) Key Highlights in 2012

Net profits at USD 7.7 million in 2012 and exposure mostly on KSA

- Projects encompassed Golden Tower (Jeddah, KSA), Wadi Qortoba (Riyadh, KSA), Takhassussi residences (Riyadh, KSA), Al Malga Development (Riyadh, KSA), Abdulmajeed Land (Jeddah, KSA) the Rebirth of Duhaira (Riyadh, KSA), Al Zorah Development (Ajman, UAE), Hazmieh Development (Hazmieh, Lebanon).
- Net income for 2012 at USD 7.7 million on account of sizeable liquidity with cash levels at USD 321 million at the end of 2012. We currently include Solidere's ownership of SI's cash and balances net of liabilities and minority interest in our sum of the parts valuation given the still early stage in their various projects.

Recent Developments

- **Solidere sold three lands in 2013 compared to one in 2012 (equivalent to~ 30,000 sqm and no material change in land selling price):** During the last four months of 2013, Solidere sold three lands which were smaller on average with two located in the traditional area and one located on the waterfront. The Company was able to maintain its selling price relatively unchanged (~USD 3,000/sqm in traditional and ~4,500/sqm in the waterfront). Revenues from land sales are likely to double in 2013e from USD 50 million in 2012.
- **USD 185 million securitization deal to improve Solidere's working capital:** Solidere closed a USD 185 million securitization transaction through BLC Bank and BSEC in 2013. The transaction created a securitization fund with the aim of liquidating a part of Solidere's land sales receivable portfolio. The proceeds are intended to provide Solidere with part of the financing needed to continue its real estate development activity and infrastructure on the waterfront.

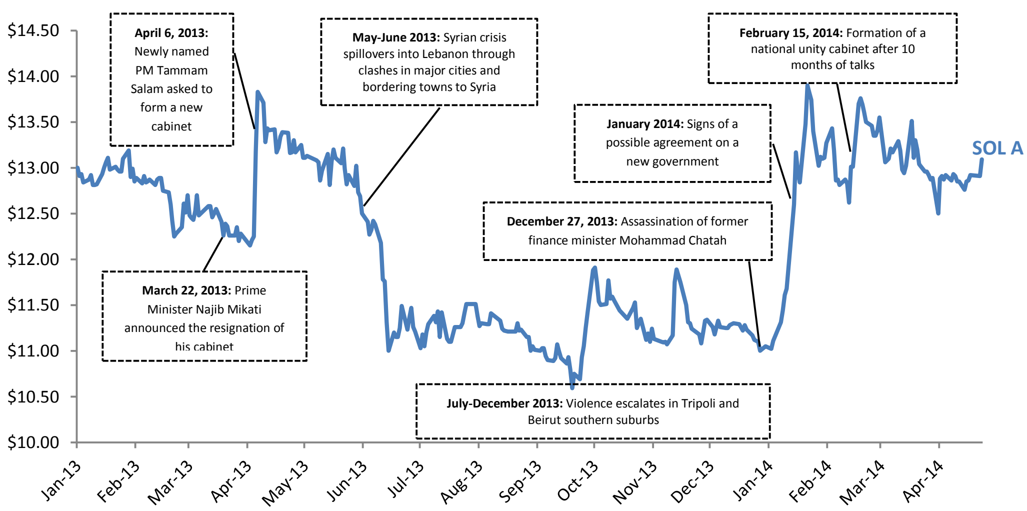
- **New appointee to senior management:** In April 2014, Solidere appointed Jamal Itani to be general manager of operations.
- **SI is maintaining focus on KSA and UAE through Al Zorah project:** Management has indicated that SI is maintaining its focus on KSA and UAE through Al Zorah project. Golden Tower (Jeddah, KSA) is currently in the execution phase and Wadi Qordoba (Riyadh, KSA) is in the final stage of design. SI is also involved in land purchases in KSA via two funds. Few projects are going on in Al Zorah, the flagship of Solidere in UAE.
- **Solidere International reached amicable agreement with SODIC:** In March 2014, SI reached an amicable agreement with Egyptian developer SODIC over a land bank purchase in Westown (Cairo) that SI made and will be repaid by SODIC for the purchase price over two years with interest.

Recent Performance of Solidere Shares

We continue to believe that Solidere shares reflect investors' sentiment which has been impacted by rising political uncertainties and softer market conditions

Solidere A shares closed at USD 13.05 on April 24, 2014, which represents a 18% increase on a YTD basis. Solidere shares started to rise in January 2014 likely driven by signs of possible agreement on a new cabinet formation, virtually reaching the USD 14 level after the share price remained below the USD 12 level for the previous seven months. The cabinet was formed in February 2014. Shares ended up stabilizing in the USD 12.50-USD 13.50 range starting March 2014. Ultimately, Solidere shares represent a vote of confidence on Lebanon and as such are subject to swings from the reaction to security and political developments.

Figure 1: Recent share performance and selected political events



Source: BSE, Media Reports

FFA Model Assumptions

- We modeled three land sales in 2013e compared to just one in 2012a equivalent to ~27,500 sqm averaging prices in line with their targets of USD 3,000 in the traditional area and USD 4,500 in the waterfront area. These assumptions should drive land sales to roughly double in 2013e vs. 2012a reaching ~USD 100 million.
- We maintained revenues from recurring sources in 2013e roughly unchanged from last year. (~ USD 60 million for rental income and ~ USD 10 million for rendered services/hospitality).
- Given these assumptions, land sales to total revenues should stand at 58% in 2013e, while revenues from rental portfolio and revenues from rendered services/hospitality should stand at 34% and 8% respectively.

Revenues from recurring income are strategic for Solidere which seeks to decrease its reliance on land sales given the future depletion of its land bank. The cineplex in the North Souks was completed in 2013, the next focus is on the department store and the annex which will primarily house restaurants.

Table 1: Main assumptions 2013e-2015e

Main Assumptions	Notes
Land sales (in USD/sqm)	Selling prices of USD 3,000 (per sqm of BUA) in the traditional area and USD 4,500 in the waterfront area, with a weighted average price of USD 3,700 growing at the rate of inflation
Land sales (in sqm)	Land sales of 27,500 sqm in 2013e, 25,000 sqm in 2014e and 2015e
Rental income	Additional rental income from completion of the cineplex in the North Souks
Rendered services & hospitality	Steady improvement in market share in property management and services
Margins	Stable gross margins in land sales, and gradually improving gross margins in rental income; gross margins in rendered services/hospitality below breakeven in short term
Expenses	Cost containment and SG&A maintained at ~22% of gross revenues over 2013e-2015e
Dividend payout	No dividend distribution for 2013, and not expected to be reinstated in short term
Financing	Potential to raise more debt from short-term sources to finance operations, investments, and maturing debt payments at favorable terms

Source: FFA Private Bank estimates

- Our model takes into account continued cost containment and slower capex facing weaker operating conditions to help cash flows. We expect SG&A as % of gross revenues to stand at 25% in 2013e. EBITDA should reach USD 84 million in 2013e with an EBITDA margin of 48% (up from 33% in 2012a).
- We expect a non-repeat of USD 20 million provision taken in 2012 against taxes and hospitality.
- We forecast net profits to amount to USD 55 million in 2013e (vs. USD 18 million in 2012a) and EPS at USD 0.34 (vs. USD 0.11 in 2012a). We do not expect dividend distribution to resume this year as the focus remains on maintaining cash flows.
- We expect total revenues and total net profits to gradually increase over 2014e-2015e to reach a respective USD 211 million and USD 79 million in 2014e and a respective USD 218 million and USD 81 million in 2015e.

Table 2: FFA model forecasts 2013e-2015e

Key Performance Indicators				
In USD millions	**2012a**	**2013e**	**2014e**	**2015e**
Revenues from land sales	**50**	**101**	**116**	**119**
As % of total revenues	*41%*	*58%*	*55%*	*55%*
Revenues from rental portfolio	**58**	**59**	**72**	**74**
As % of total revenues	*48%*	*34%*	*34%*	*34%*
Revenues from rendered services/hospitality	**13**	**14**	**16**	**18**
As % of total revenues	*11%*	*8%*	*8%*	*8%*
Other revenues	**-**	**-**	**6**	**7**
As % of total revenues	-	-	*3%*	*3%*
Revenues	**120**	**175**	**211**	**218**
EBITDA	**39**	**84**	**113**	**115**
EBITDA margin	33%	48%	54%	53%
Net income	**18**	**55**	**79**	**81**
Net income margin	*15%*	*32%*	*37%*	*37%*
EPS (USD)	0.11	0.34	0.49	0.50
P/E	118.2	37.9	26.5	25.9
P/B	1.09	1.06	1.02	1.00
EV/EBITDA	69.0	32.1	23.9	23.5

Source: Company reports, FFA Private Bank estimates; Note: Other revenues represent property sales

Investment Opinion

We still see inherent value in the land bank and recognize favorable upside for patient investors, despite remaining cautious for the short to medium term given that the uncertain economic and political backdrop has materialized into slower operations

We recognize Solidere's position in its domestic market as the prime land owner and master developer in the Beirut Central District (BCD), its track record in developing superior quality properties and infrastructure, and its ongoing revenue diversification strategy to counterbalance the depletion of its land bank. We like the firm's relatively higher operating margins and lower levels of indebtedness. However we remain cautious as we have been seeing the uncertain economic and political backdrop materializing into Solidere's operations through slower land sales. We are concerned that the short to medium term will remain challenging for Solidere given the impact of the difficult operating environment on the property market and the Company's land sales, which remain the key driver for cash generation. Yet we favorably view Management's decision to defer some upcoming investments to alleviate pressure on cash flows and see upside potential for patient long term investors upon a rebound in land sales, the completion of the real estate pipeline and the waterfront infrastructure providing additional value to the BCD.

Target Price Revision and Recommendation

We reiterate our target price on Solidere shares at USD 17.00 with an Overweight recommendation recognizing long term value

Our fair value estimate is USD 17.00 per share using a sum of the parts approach, which implies a P/B of 1.3x based on our 2014e estimated BVPS, in line with its three and five year average. We accordingly maintain the Overweight recommendation given that the current price is at a discount of more than 10% to our fair value estimate, recognizing value for long term investors despite remaining cautious in the shorter term against an uncertain political and economic backdrop impacting the property market and investor sentiment. Upside risks include a smooth presidential elections process and favorable outcome to Syrian crisis.

Key Investment Risks

- Cyclical nature of the real estate sector and high sensitivity to macroeconomic conditions.
- Business model based on a finite land bank.
- High dependence on land sales in a limited geographic area with a large client concentration.
- Political instability and heightened security events in Lebanon.

REAL ESTATE SECTOR AND MACRO HIGHLIGHTS

Lebanese Real Estate Sector Highlights

Further slowdown in number of real estate transactions in 2013, yet figures for 2014 highlight an improvement

Sluggishness in real estate activity continued to prevail in 2013 in light of weak sentiment from soft economic conditions and rising regional and local political uncertainties, with the slowdown particularly felt in the high-end market where limited transactions are taking place. Real estate activity was weaker for the third consecutive year as the number of transactions dropped by 7% YoY to 69,198 following decreases of 10% and 12% in 2012 and 2011 respectively according to the figures released by the Real Estate Registry. In first two months of 2014, number of transactions were up 20% YoY representing a positive surprise in a still weak and uncertain economic environment (real GDP growth at 1% in 2013e and 2014e as per the IMF's latest revision). It is still early to set a trend for the year as market activity should also remain tied to political and security developments.

Table 3: Real estate transactions in Lebanon

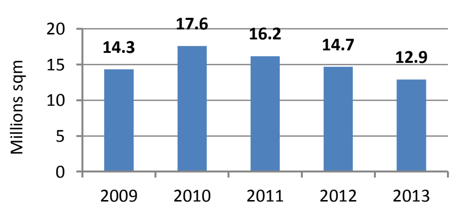
	2009	2010	2011	2012	2013
Value of RE transactions(USD billion)	6.96	9.48	8.84	8.93	8.87
YoY Change	*7%*	*36%*	*-7%*	*1%*	*-1%*
Number of RE transactions	83,622	94,320	82,984	74,569	69,198
YoY Change	*4%*	*13%*	*-12%*	*-10%*	*-7%*
Average value per transaction (USD)	83,172	100,498	106,533	119,700	128,201
YoY Change	*4%*	*21%*	*6%*	*12%*	*7%*

Source: Real Estate Registry

Reflecting weakened demand, construction activity remained soft in 2013, yet recently pointing to an increase

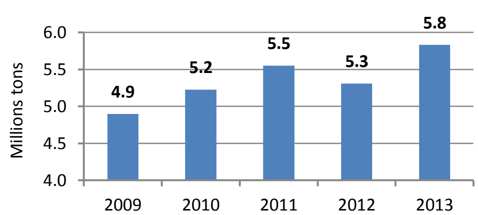
Construction activity slowed down in 2013 and accordingly, the total area of newly issued construction permits (a leading indicator of construction levels) saw a significant year-on-year decrease of 12% in 2013, possibly indicating cautiousness in launching new developments due to the increase in land prices and the changing aspects of market demand. On a contrasting note, cement deliveries, a coincident indicator of construction levels, increased by ~10% YoY in 2013. Figures released so far for 2014 reveal that the total area of newly issued construction permits and cement deliveries, upped 19% YoY (2M-14) and 29% YoY (1M-14) respectively.

Figure 2: Issued construction permits in area



Source: BDL

Figure 3: Cement deliveries in weight



Source: BDL

Property prices hold at the national level although struggle in higher-end markets

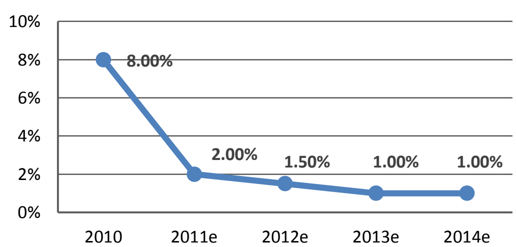
In 2013 prices continued to be resilient despite a lackluster real estate market. Official figures issued by the Real Estate Registry point to a continuous rise in the average value per real estate transaction which increased by 7% YoY in 2013 to USD 128,201 in line with the trend over previous years (+12% in 2012 and +6% in 2011). Statistics for 2014 are still limited to the month of Feb-14 and reveal that the average value per real estate transaction jumped by 26% YoY to USD 134,661.Beirut remains the benchmark in terms of real estate demand. In the BCD, the most expensive units are located in the waterfront where estimated starting prices are in the USD 7,000-8,000/sqm range compared to USD 4,500-6,000/sqm range in the traditional area including Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square down from respective ranges of USD 8,000-10,000 and USD 4,500-7000 previously, suggesting that developers are more inclined to offer lower prices given stagnation in demand.

Macroeconomic Highlights

Continued slowdown in economic growth in 2013 in light of rising uncertainties

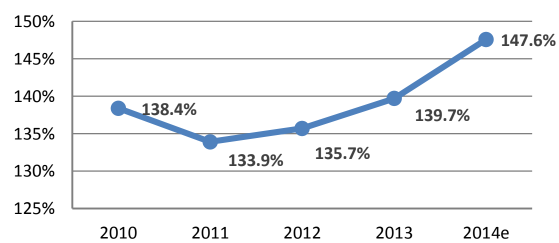
Economic developments continued to be soft in 2013 (following a trend initiated in 2011) with a real GDP growth recently revised downwards to 1% for 2013e and 2014e from 1.5% previously as per the IMF. Capital inflows into Lebanon edged up by 6% YoY to USD 16.2 billion in 2013, which did not offset the large trade deficit at USD 17.3 billion in 2013 which edged up 3% from 2012, thus translating into a balance of payments deficit at USD 1.1 billion in 2013 vs. a deficit of USD 1.54 billion in 2012.

Figure 4: Real GDP growth



Source: IMF World Economic Outlook Database April 2014

Figure 5: Gross debt to GDP ratio



Source: IMF World Economic Outlook Database April 2014

Drop in FDI inflows and resilience in remittances in 2013

FDI inflows are estimated to have been among the most affected in the context of cautiousness related to regional uncertainties and a sluggish real estate market. The Investment Development Authority of Lebanon (IDAL) expects a fall in FDI inflows to Lebanon by 21 percent in 2013 down from USD 3.8 billion in 2012. In parallel, remittances from the Lebanese Diaspora, considered to be one of the largest in terms of proportion to the resident population, have proved to be resilient and are estimated by the World Bank to have reached USD 7.2 billion in 2013 (around 16% of nominal GDP), edging up from USD 6.9 billion 2012 and maintaining Lebanon's ranking among top recipients in developing countries.

Growing structural imbalances as fiscal deficit drives debt levels

Lebanon's public finance continue to weaken in the context of slowing economic activity and prevailing political stalemate. Figures released by the Ministry of Finance show that the fiscal deficit totaled USD 4.2 billion in 2013 and widened by 8% from USD 3.9 billion in 2012 with a fiscal deficit as % of GDP reaching 9.3% in 2013 from 9.1% in 2012. As a result of the rising deficit, Lebanon's gross public debt reached USD 63.5 billion, 10% up from 2012 while the gross debt-to-GDP ratio estimate for 2013 stands at 140% higher than 136% in 2012, suggesting required efforts to improve the country's fiscal imbalances.

Mixed performance in key economic sectors so far in 2014

The real estate market is showing early signs of acceleration in 2014 with number of transactions increasing 20% YoY in the first two months of 2014 and stronger growth in supply indicators including total area of newly issued construction permits and cement deliveries which upped 19% YoY (2M-14) and 29% YoY (1M-14) respectively.

Looking at tourism, we note that incoming tourists are still on a downward trend as highlighted by a 14% YoY decrease in the number of tourists' arrivals in the first two months of 2014 to 145,891 with a noticeable 20% decline in tourist arrivals from Arab countries.

As for the banking sector's balance sheet growth, we note a deceleration into February 2014 with key balance sheet indicators edging up around +0.5% Ytd following an increase in the 7%-10% range in 2013. Non-resident deposits dropped by 4% YoY in the first two months of 2014 to USD 27 billion. While it is still early to draw a conclusion for 2014e in terms of balance sheet growth, we note an loans to deposits ratio at 35% in February 2014, reflecting ample liquidity although highlight that Lebanese banks are still operating in an environment limiting potential for earnings growth.

Sovereign ratings of Lebanon were downgraded by various rating agencies last year, while the outlook was recently revised to stable by S&P

Last year Lebanon was assigned lower outlooks by the three main credit agencies which cited the increased political risk, weak economic conditions and deteriorating public finance and debt. Fitch revised the outlook on Lebanon from stable to negative while maintaining its B long term ratings unchanged. Moody's also revised the outlook on Lebanon from stable to negative while maintaining its B1 long term rating. Standard and Poor's which downgraded the long term rating on Lebanon from B to B- and the outlook from stable to negative last year, recently reversed the outlook to stable citing the country's stable financial system, steady deposits inflows and recent cabinet formation.