Saudi Real Estate

Sector Note 28 July 2010

Reversing Gears

- **We revise upwards our mortgage estimates in light of potential changes to the ijara structure and REDF's new loan guarantees**
- **Mortgages are unlikely to have immediate impact on overall ownership, but should initially boost organized product demand**
- **DAAR is the only viable play on sector transformation; we maintain a Buy on DAAR and downgrade Al Akaria to a Hold**

Last year's bank retrenchment appears to be reversing with excess liquidity declining 5% and claims on the private sector rising 2% as of April 2010. Retail loans recorded faster growth of 3% in 1Q10 mainly driven by mortgages, which were up 8%—ahead of our estimates.

We revise upwards our mortgage growth assumptions from a 2010–2014e CAGR of 25% to a CAGR of 35%. Our forecast revisions are driven by two main developments: (i) The sticking point surrounding the mortgage law is a Shariah-compliant method other than ijara (lease-to-own), which allows buyers to unlock economic benefit prior to the final settlement, is being addressed. Similar to a conventional loan, such a structure facilitates price appreciation, reducing LTVs and banks' exposure to default/loan loss risk, boosting lending. (ii) New loan guarantees by the REDF means that loans by commercial banks on top of the SAR300,000 allowance will have seniority status in the case of default, encouraging lending.

Still, we continue to hold the view that mortgages are unlikely to have an immediate impact on home ownership, satisfying only 25% of mortgage demand by 2014e. That said, we now break down the market into an organized and unorganized segment and argue that banks are likely to be more selective, giving preference to developers over individual home builders. **Mortgages are likely to have a material impact on the organized segment, which represents c15% of forthcoming supply.** We estimate that by 2014e available mortgages would stand at more than 3x organized sector demand.

We reverse our previous recommendation, now preferring DAAR to Al Akaria. Our thesis regarding the rental market remains unchanged, but we believe this is already fully priced in. Recent yield compression indicates that the price recovery seems to be outpacing rental movement. Liquidity and changes in the REDF policies are likely to propel asset valuations sooner. **DAAR, being the largest/most liquid name with exposure to the ownership market, becomes the only viable play on the sector transformation.** We view recent underperformance as a buying opportunity as we believe that liquidity concerns are overstated. We estimate that by extending its development cycle, the company should be able to manage debt repayments while maintaining historic cash payout.

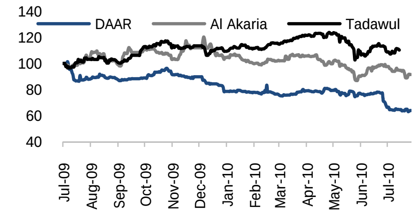
We cut our TP for DAAR to SAR16.9/share from SAR18.9/share, but maintain our Buy rating. We cut our TP for Al Akaria to SAR26.2/share from SAR34.8/share and downgrade our rating to Hold. For DAAR, we now push back our delivery forecasts to reflect tightened funding after the SAR1.1 billion dividend payout. We also raise its beta to 1.5 from 1.2 to reflect governance risk. For both DAAR and Al Akaria, we exclude investments due to a lack of details. For Al Akaria, we also exclude the idle raw land bank given that there is still no clear strategy to unlock its value. We value DAAR at a 22% discount to its 2010e NAV of SAR21.5/share and Al Akaria at a 39% discount to its 2010e NAV of SAR42.7/share.

	Dar Al Arkan			Al Akaria		
	2010e	2011e	2012e	2010e	2011e	2012e
P/NAV	0.5x	0.5x	0.5x	0.5x	0.5x	0.4x
P/E	7.1x	5.5x	4.8x	28.7x	18.7x	14.9x
P/B	0.9x	0.8x	0.8x	0.9x	0.8x	0.7x

Dar Al Arkan	Buy
Target Price (SAR)	16.9
Market Price (SAR)*	11.4
Upside	48%
Bloomberg Code	AL ARKAN AB
RIC Code	4300.SE
Market Cap. (USD mn)	3,283
Daily Turnover (USD mn)	12.7

Al Akaria	Hold
Target Price (SAR)	26.2
Market Price (SAR)*	22.4
Upside	17%
Bloomberg Code	SRECO AB
RIC Code	4020.SE
Market Cap. (USD mn)	717
Daily Turnover (USD mn)	0.1

Price Performance Chart



Price as of 27 July 2010

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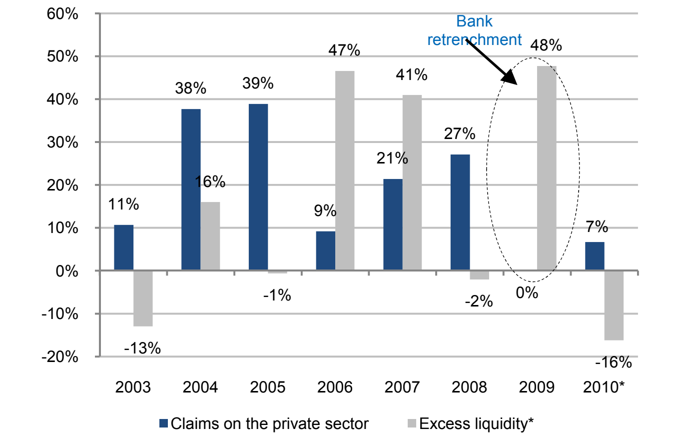
*Disclaimer: See page 26

Top-down: organized product to benefit from easing liquidity

- **In light of potential changes to the ijara structure and REDF's new loan guarantees, we revise upwards our mortgage growth forecasts to a 2010–2014 CAGR of 35% from 25% previously**
- **Still, we continue to believe that mortgages are unlikely to have immediate impact on overall ownership, but should initially boost organized product demand**
- **Our thesis regarding the rental market remains unchanged, but we believe this is already fully priced in; we now prefer the ownership market as current trends are likely to propel asset valuations sooner**

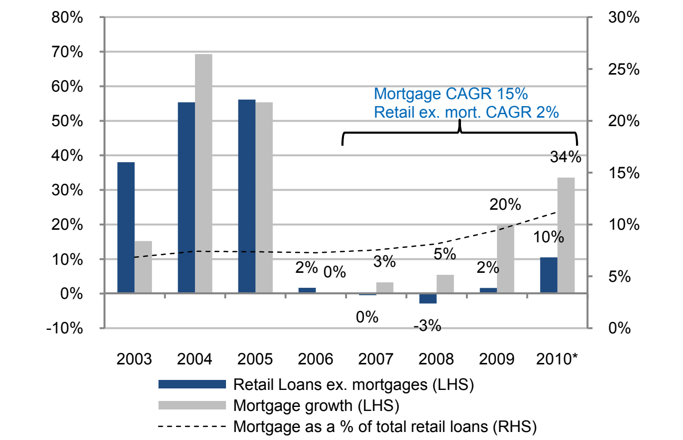
Chart 1

Bank retrenchment seen in 2009 seems to be reversing



Source: SAMA, Excess liquidity = reserves and foreign assets
*2010 numbers annualized based on April 2010 actual

Mortgages growth beats forecasts in 1Q10 at 8%



Source: SAMA, MEP, HC Estimates
*2010 numbers annualized based on 1Q10 actual

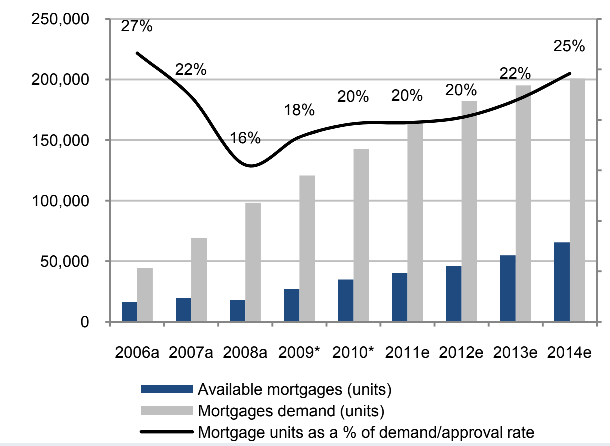
As highlighted in the chart above, the bank retrenchment trend seen last year appears to be reversing. Now banks seem to be loosening their purse strings with excess liquidity (reserves and foreign assets) declining by 5% and claims on the private sector rising by 2% as of April 2010 (-15% and 7% annualized, respectively). Retail loans recorded faster growth of 3% in 1Q10 mainly driven by mortgages, which were up 8% over the same period (11% and 34% annualized, respectively). Accordingly, **we revise upward our mortgage growth assumptions to a CAGR of 35% from a 2010–2014e CAGR of 25%** based on annualized 1Q10 numbers (please refer to chart 3 on page 3).

We believe the stronger-than-expected mortgage growth (34% annualized versus our forecast of 20% in 2010e) can be explained by improved property sector fundamentals with asset valuations starting to pick up again following a 5% decline in 2009, on our estimates. The collateralized nature of these loans, the anticipated mortgage law, and new loan guarantees to be provided by the REDF (loans provided by commercial banks on top of the SAR300,000 allowance from the REDF now have seniority status) are also contributing factors. The proposed mortgage law is expected to provide banks with legal recourse to foreclosure. More importantly, we understand that one of the sticking points is working around a Shariah compliant method of home ownership other than ijara, as it limits the buyer's ability to unlock economic benefit within the lease term. The ijara structure as it currently stands, theoretically discourages mortgage extension as it does not facilitate price appreciation, which under the conventional structure reduces LTVs and as such the banks' exposure to default/loan loss risk. While officials are working to address this hiccup, there is concern that this may lead to excessive speculation. According to SAMA, the mortgage law has been drafted and is awaiting approval from the Shura Council. It was last reported that the council has delayed voting until the end of the summer. As such, we feel the law is unlikely to be passed before the end of the year.

In our thematic initiation note *Nothing but the Rent* published on 24 February, we were the first to argue that despite mortgage loans being a standout growth segment for banks given the low base (2% of total loans as of FY09), it is likely to take time to have a meaningful impact on property ownership. Hence we preferred exposure to the rental market. While we continue to hold this view (despite our more aggressive growth assumptions) we now conduct a more in-depth analysis of the market and differentiate between the impact on the organized sector (i.e. developers) and the unorganized sector (i.e. individual home builders). Here we argue that considering the typically superior build quality, reputation, and accountability of organized developers and given that the real estate market in Saudi Arabia remains highly fragmented (90% of supply is unorganized), banks are likely to focus on the organized product first before extending funds to freelance builders. We conclude that while mortgages are still unlikely to have an immediate impact on overall home ownership, it is likely to have a material impact on the organized segment, representing just c15% of forthcoming supply. As shown in chart 2 below, **we estimate that home financing will account for only 25% of overall mortgage demand by 2014e, but will exceed 300% of the organized sector mortgage demand.**

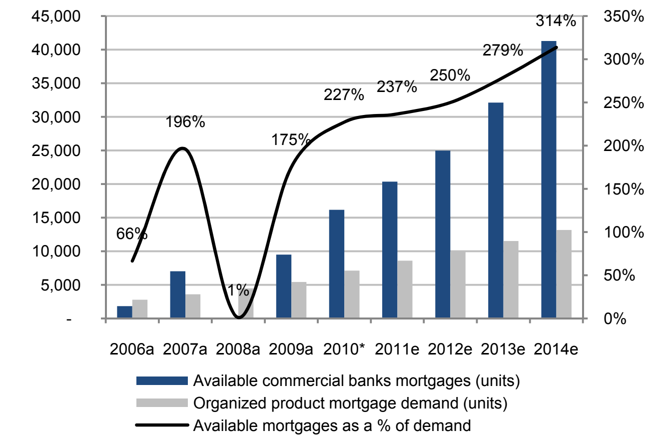
Chart 2

Mortgages to satisfy just 25% of demand by 2014e...



Source: SAMA, REDF, 8th Development Plan, HC Research
*2009 REDF annualized based on 3Q09, 2010 CBs annualized based on 1Q10

...But to exceed 3x organized sector mortgage demand

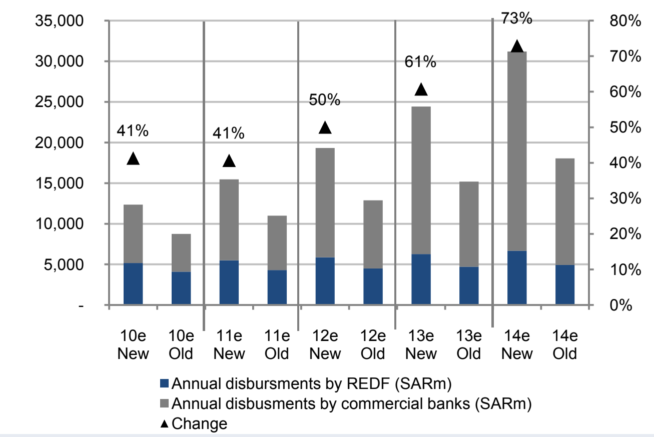


Source: SAMA, HC Research, 8th Development Plan
*2010 CBs no. annualized based on 1Q10

Following 1Q10 figures, which showed growth of 8% (annualized 34%)— ahead of our 20% forecasts—we revisit our assumptions, applying a 2010–2014e CAGR of 35%. The left chart below provides a breakdown of our new mortgage estimates in absolute terms versus our previous numbers. The change in our forecasts is driven by assumed higher participation from the commercial banks as the REDF's balance sheet is saturated with disbursement growth now a function of repayments. This is a result of the government's reluctance to inject additional funds given its policy objective to improve intermediation of the banking sector within this segment. **If 1Q10 growth patterns persist into the year-end, we estimate that the banks' mortgage outlays this year will for first time exceed those of the REDF.**

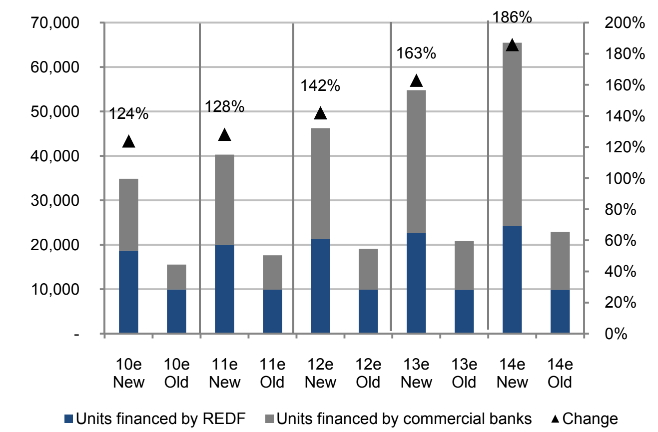
Chart 3

Mortgages revisiting forecasts (disbursements in SARm)



Source: SAMA, MEP, HC Estimates

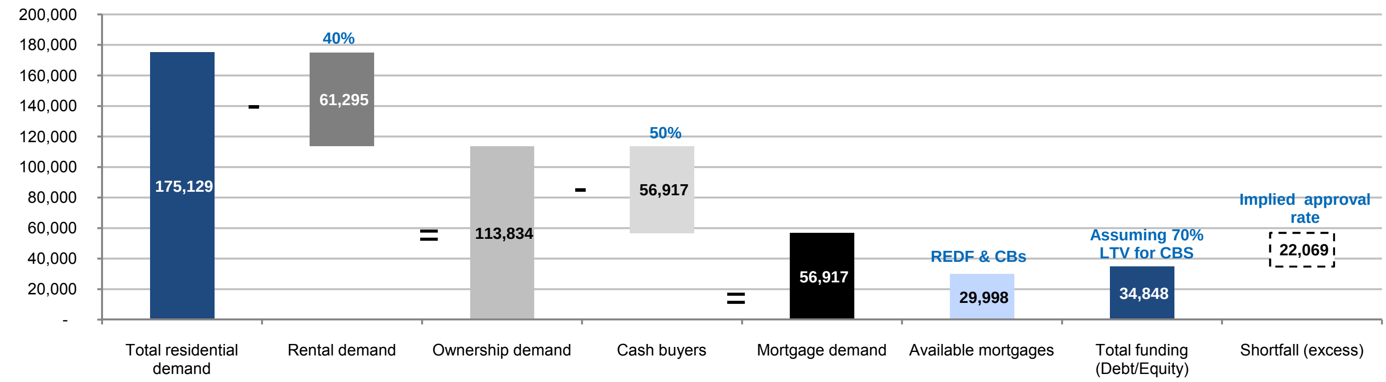
Mortgages revisiting forecasts (no. of units)



Source: SAMA, MEP, HC Estimates

Chart 4

Methodology explanation: total mortgage demand (units) and resultant shortfall/excess estimation *



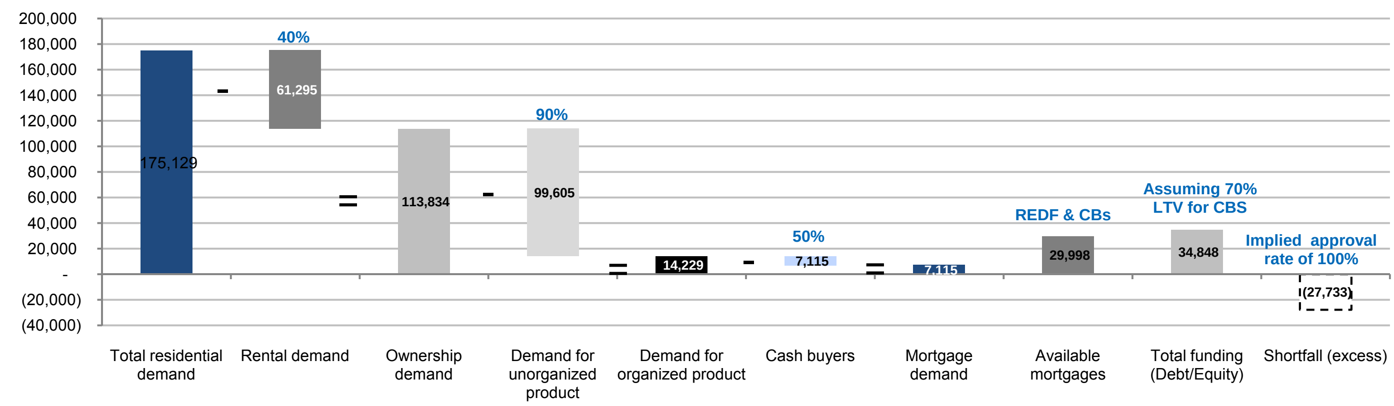
Source: SAMA, 8th Development Plan, HC Estimates
* Figures are annual based on 2010e forecasts

The chart above summarizes the methodology we follow to derive the mortgage funding gap for the overall sector. First we quantify potential ownership demand by deducting the rental component, which based on historic figures published by the Central Department of Statistics and Information stood at around 40%. Going forward, we assume a steady decline in the proportion of rental demand to 30% by 2014e, driven by (i) an expected fall in the expatriate population due to the Saudization and (ii) higher affordability driven by wider availability of funding. To arrive at total mortgage demand we deduct cash buyers, which according to Saudi Home Loans historically stood at roughly 50% of ownership demand. Finally, to measure the funding gap we assume an LTV of 70%, in line with current levels. As we mentioned in the previous section, our mortgage forecasts are based on both disbursements by the REDF and commercial banks. In line with historic trends, we assume a 2010–2014e CAGR of 3% for the REDF and 35% for commercial banks. Accordingly, we estimate that by 2014e available funding would satisfy only 25% of mortgage demand. **In other words, the approval rate would stand at only 25%, which brings us to our thesis that lenders are likely to be selective, thus giving preference to organized developers over freelance builders.**

In the chart below, we break down ownership demand further to derive the demand for the organized product. As we mentioned earlier, the property sector in Saudi Arabia remains highly fragmented with the unorganized sector currently making up roughly 90% of supply, according to Dar Al Arkan and industry experts. To be conservative, in our analysis we assume that this number will gradually drop to 80% by 2014e, driven by (i) a shift in the culture towards integrated communities, (ii) more regional developers entering the market (e.g. TMG, Emaar, Damac, Limitless, etc.), and most importantly (iii) the REDF lifting the requirement of land ownership for loan qualification, instead allowing borrowers to use the funds to acquire completed properties. Also, the REDF is moving to provide loan guarantees whereby loans extended by commercial banks on top of those by the REDF will have seniority status. Following this logic, **we estimate that by 2014e available mortgages would stand at more than 3x the organized sector mortgage demand, implying an approval rate of 100%.**

Chart 5

Methodology explanation: organized sector mortgage demand (units) and resultant shortfall/excess estimation *



Source: SAMA, 8th Development Plan, Saudi Home Loans,HC Estimates
* Figures are annual based on 2010e forecasts

Table 1: Based on 35% mortgage CAGR (2010-2014) we estimate only 25% of total demand would be satisfied

	2006a	2007a	2008a	2009a	2010*	2011e	2012e	2013e	2014e
REDF									
Outstanding Loans	71,241	73,393	75,394	77,509	79,834	82,229	84,696	87,237	89,854
Growth	*3.4%*	*3.0%*	*2.7%*	*2.8%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
Loan Repayments	1,829	2,039	2,954	2,706	2,840	3,116	3,412	3,731	4,074
Loan Repayments %	*2.6%*	*2.8%*	*3.9%*	*3.5%*	*3.6%*	*3.8%*	*4.0%*	*4.3%*	*4.5%*
Loan Disbursements	3,965	3,558	4,988	4,842	5,166	5,511	5,879	6,272	6,691
Avg. Unit Price SAR mn	0.28	0.28	0.28	0.28	0.28	0.28	0.28	0.28	0.28
Price Growth %	*-2%*	*0%*	*0.0%*	*0.0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Units financed	**14,279**	**12,868**	**18,040**	**17,512**	**18,682**	**19,931**	**21,262**	**22,683**	**24,199**
Remarks	*REDF book growth limited (1% CAGR 1997-2007), hence struggling to meet growing needs. Commercial banks likely to drive growth going forward. Our forecasts are based on historic figures*								
Commercial Banks									
Outstanding Loans	13,690	15,631	14,905	17,860	23,860	32,211	43,485	58,705	79,251
Growth	*0%*	*14%*	*-5%*	*20%*	*34%*	*35%*	*35%*	*35%*	*35%*
Loan Repayments	685	782	745	893	1,193	1,611	2,174	2,935	3,963
Loan Repayments %	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Loan Disbursements	718	2,722	20	3,848	7,193	9,962	13,448	18,155	24,509
Avg. Assumed LTV	*70%*	*70%*	*70%*	*70%*	*70%*	*70%*	*70%*	*70%*	*70%*
Total Funding (Debt and Equity)	1,026	3,889	28	5,497	10,276	14,231	19,212	25,936	35,013
Remarks	*We assume an average LTV of 70%, in-line with current levels*								
Avg. Unit Price SAR mn	0.56	0.55	0.61	0.58	0.64	0.70	0.77	0.81	0.85
Price Growth %	*-2%*	*0%*	*10%*	*-5%*	*10%*	*10%*	*10%*	*10%*	*10%*
Units Financed	1,847	7,032	46	9,513	16,165	20,352	24,978	32,114	41,289
Remarks	*Since REDF targets the low income segment with awards capped at SAR300K, for commercial banks we assume double the prices. Based on April 2010 annualized figures, we assume 35% 2010-2014 CAGR*								
Total Units Financed (Annual)	16,126	19,901	18,086	27,025	34,848	40,283	46,240	54,797	65,489
Annual Total Residential Demand (Units)	140,223	144,691	149,372	154,279	175,129	186,169	192,523	199,208	206,247
Rental Demand	*39%*	*38%*	*37%*	*36%*	*35%*	*34%*	*33%*	*32%*	*31%*
Ownership Demand	85,536	89,708	94,104	98,739	113,834	122,871	128,990	135,462	142,310
Cash Buyers	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*
Remarks	*50% cash buyers assumption based on Saudi Home Loans estimates*								
Mortgage Demand (Units)	42,768	44,854	47,052	49,369	56,917	61,436	64,495	67,731	71,155
Cumulative Shortfall/(Excess)	44,463	69,416	98,382	120,727	142,797	163,950	182,205	195,138	200,805
Mortgage % Of Demand/Approval Rate	27%	22%	16%	18%	20%	20%	20%	22%	25%
Remarks	*We estimate that the number of units financed p.a. will grow to 65,000 by 2014e from 27,000 units in 2009, satisfying just 25% of total mortgage demand by 2014e. We conclude that it is unlikely to have an immediate impact on home ownership and that banks are likely to continue to be selective in their lending, preferring the organized sector due to track record, superior build quality, and accountability*								

Source: SAMA, MEP, HC Estimates
*Figures annualized based on y-t-April 2010 numbers

Table 2

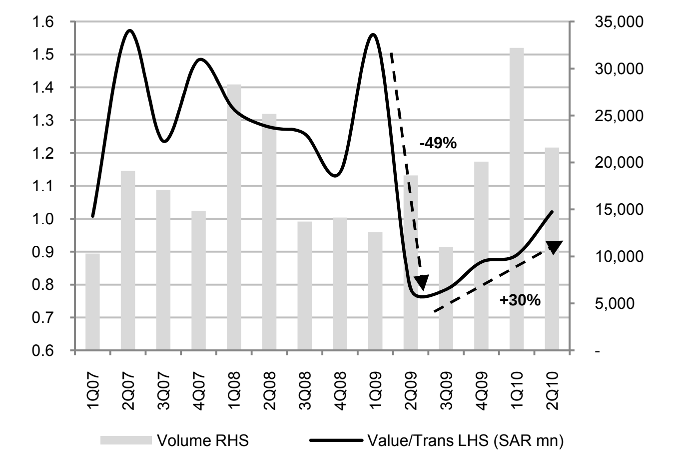
	2006a	2007a	2008a	2009a	2010*	2011e	2012e	2013e	2014e
Annual Residential Demand (Units)	140,223	144,691	149,372	154,279	175,129	186,169	192,523	199,208	206,247
Rental Demand	*39%*	*38%*	*37%*	*36%*	*35%*	*34%*	*33%*	*32%*	*31%*
Ownership Demand (Units)	85,536	89,708	94,104	98,739	113,834	122,871	128,990	135,462	142,310
Unorganized Product as % of Total Supply	*94%*	*92%*	*91%*	*89%*	*88%*	*86%*	*85%*	*83%*	*82%*
Demand for Unorganized Product (Units)	79,976	82,532	85,164	87,877	99,605	105,669	108,997	112,433	115,983
Remarks	*According to industry expert and confirmed by Dar Al Arkan, the property market in Saudi Arabia is highly fragmented, with the unorganized sector accounting for c90% of supply in 2009. Going forward, we assume a gradual decline in the unorganized product to 80% by 2014e. Our assumption is mainly based on new a REDF policy lifting the requirement of land ownership for loan illegibility.*								
Demand for Organized Product	**5,560**	**7,177**	**8,940**	**10,861**	**14,229**	**17,202**	**19,994**	**23,028**	**26,327**
Cash Buyers	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*
Mortgage Demand (Units)	2,780	3,588	4,470	5,431	7,115	8,601	9,997	11,514	13,164
Available Commercial Banks Mortgages (Units)	1,847	7,032	46	9,513	16,165	20,352	24,978	32,114	41,289
Mortgages % Of Demand/Approval Rate	*66%*	*196%*	*1%*	*175%*	*227%*	*237%*	*250%*	*279%*	*314%*
Remarks	*We estimate that organized product mortgage demand will rise to 13,000 units p.a. by 2014e. Meanwhile, available mortgage financing would stand at 40,000, more than 3x the organized sector demand. We conclude that while mortgages are unlikely to have an immediate impact on home ownership, it is likely to have a material impact on the organize sector, representing just c15% of forthcoming supply.*								

Source: SAMA, MEP, HC Estimates
*Figures annualized based on y-t-April 2010 numbers

Liquidity and changes in REDF policies are likely to result in asset valuation vis-à-vis rentals, leading to further yield compression

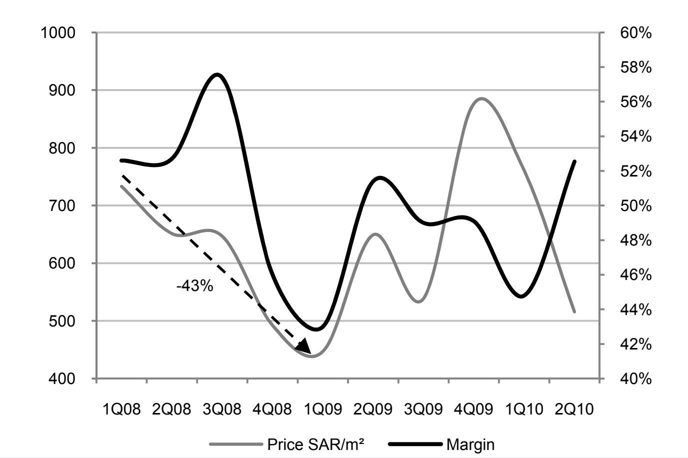
Chart 6

Riyadh land transaction index: Points to a bottom in 2Q09



Source: Riyadh Chamber of Commerce

DAAR plot prices: Margin recovery signals turnaround



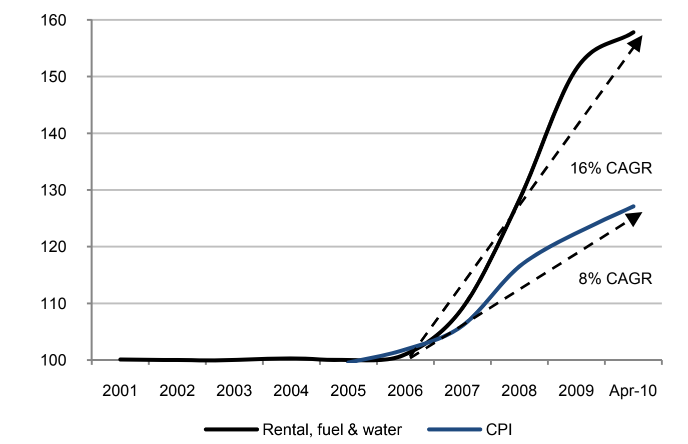
Source: Dar Al Arkan, HC estimates

Based on the Riyadh land transaction index the market looks to have bottomed out in the first half of last year, following a sever correction. This is further supported by data provided by DAAR, which shows a similar pattern (right chart above). However, it is important to note here considering that land is typically transacted on a BUA basis (while here the left chart is valued per transaction and the right chart is on surface area) and given the importance of location the data is not fully indicative. Regardless, what we are after is the general trend, and both data sets confirm signs of recovery. As property prices are a leveraged play on the underlying land, we believe it is safe to assume a similar trend would have been observed. Unfortunately, specific data on property prices is scarce.

Rentals continue to grow at a faster rate than inflation (as highlighted in the left chart overleaf), a clear reflection of the acute shortage in the market, on the back of an upwardly mobile young population and urbanization. This along with subdued asset valuations has led to rapid yield expansion over the past couple of years to up to a c11% yield in Riyadh. Since then, residential yields in Saudi Arabia have compressed to c9%, which is an indication that the price recovery highlighted above seems to have outpaced rental movement. **This marks an inflection point whereby liquidity and the changes in the policies of the REDF are likely to support this trend, leading to further yield compression going forward, in our opinion.**

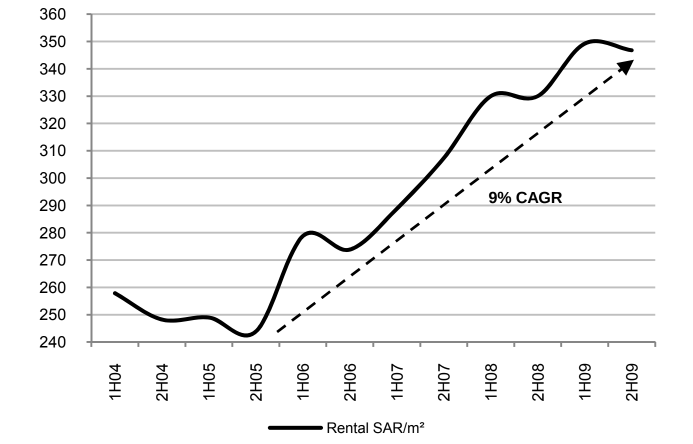
Chart 7

Faster than inflation rental growth highlights market tightness



Source: SAMA

Rental growth at 9% 2006-09 CAGR based on Al Akaria portfolio



Source: Al Akaria, HC Estimates

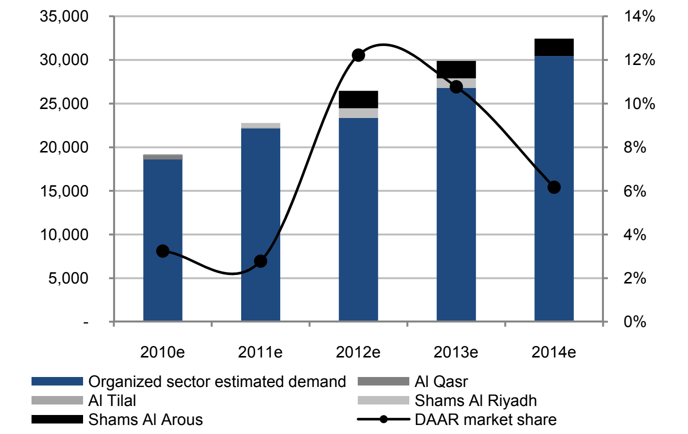
Our thesis regarding the rental market remains unchanged due to its defensive characteristics and steady returns. However, we now believe the ownership segment should outperform especially considering that the market is already fully pricing in the investment assets of listed names (e.g. Al Akaria and Al Riyadh Development Company), with the other more geared plays underperforming (e.g. DAAR). **We reverse our previous recommendation, now preferring DAAR to Al Akaria.**

Bottom-up: DAAR only viable play on sector transformation

- **In light of current trends and given that the market is already discounting rental assets (in our opinion) we reverse our previous recommendation now preferring DAAR to Al Akaria**
- **DAAR being the largest/most liquid name with exposure to the ownership market, becomes the only viable play on the sector transformation despite liquidity and governance concerns**
- **We cut our TP for DAAR by 11% and Al Akaria by 25% and downgrade Al Akaria to a Hold**

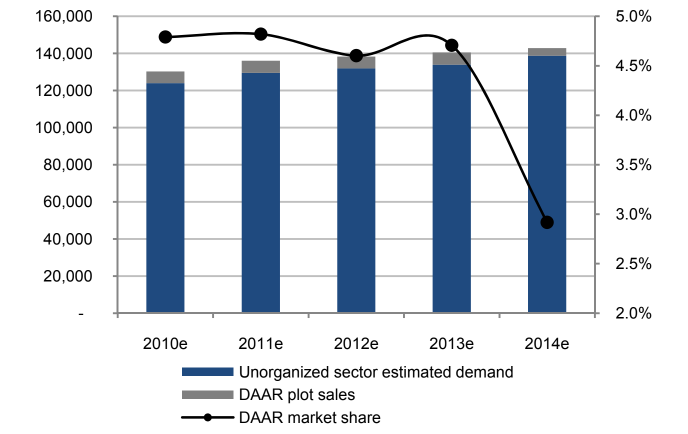
Chart 8

DAAR market share of organized product (units)



Source: Dar Al Arkan, HC Estimates

DAAR market share of unorganized product (units)



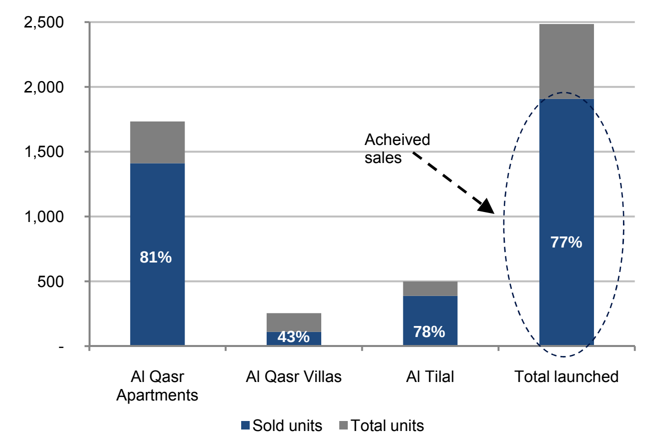
Source: Dar Al Arkan, HC Estimates

In the previous section we concluded that banks are likely to be selective in their mortgage extension in favor of the organized segment. Following on that logic, based on our estimates DAAR will only control no more than a 12% market share of the organized segment in peak delivery years despite being the largest developer (as shown in the left chart above). This, along with the company's strong track record and geographic diversification, is likely to set it apart as a prime candidate, pushing its projects to the top of the lenders' preferred list, in our opinion.

The REDF lifting the requirement of land ownership for loan qualification now allows borrowers to use funds to acquire completed properties. Considering that, the SAR300,000 loan limit in most cases falls short of building or purchasing a home, to address this issue the REDF is providing loan guarantees (granting seniority status to the loan portion extended by the commercial banks) to encourage more active bank participation in funding the property sector.

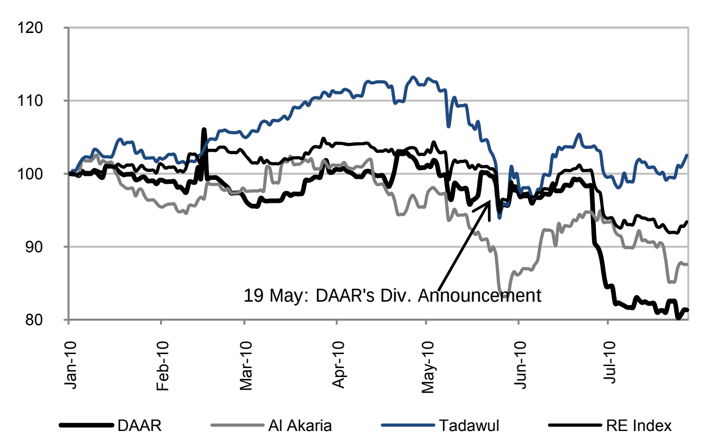
Chart 9

Achieved sales at 80% of launched units (no. of units)



Source: Dar Al Arkan

DAAR underperformed sector -11% following div. announcement



Source: Bloomberg

We believe these developments will undoubtedly lead to a shift in end-demand from self-build to finished products. This is in line with our assumption that the contribution of the organized segment to overall supply will markedly rise over the next five years. DAAR, with an early mover advantage, should benefit from the change in the consumption pattern, which will enhance demand for its product. Contrary to the general perception of DAAR's slow property sales, the data indicates that the company has already sold c80% of launched inventory (highlighted in chart 9 on the previous page).

This is not to say that we are factoring in the company's ambitious future plans into our assumptions (refer to valuation section below). The reason behind this stance is that property development for DAAR is secondary, derived from their primary land trading business. The logic here is launching projects to add value to the land will result in a c100% mark up over acquisition cost—another indication of DAAR's market reputation—with adjoining land appreciating just on the back of an announcement of a planned DAAR project.

We cut our TP for DAAR by 11% and Al Akaria by 25% and downgrade Al Akaria to a Hold

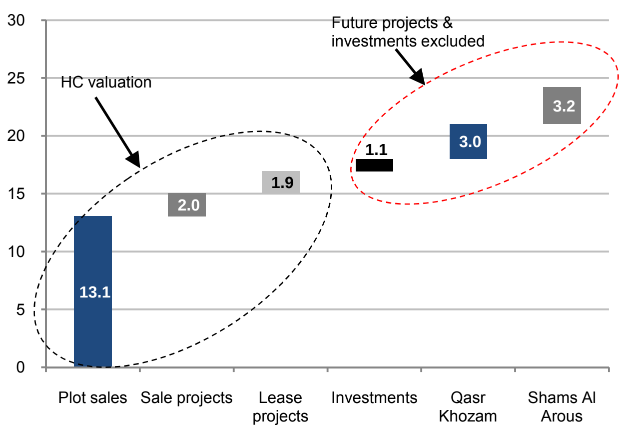
Following the dividend payout, DAAR seems to have fallen out of favor, underperforming the sector by 11% (highlighted in chart 9 on the previous page). The move was seen by the market as value destructive as the company was effectively paying back money borrowed expensively at 10.75%. It also further elevated concerns about DAAR's already stretched balance sheet, which as a result may lead to project delays or cutbacks. While we understand that DAAR operates in a frontier market where paybacks are typically viewed as a reflection of a company's operating health and where investors have grown accustomed to receiving healthy returns during boom years, we believe the move still raises governance concerns. However, the company appears oversold at these levels, especially considering that it stands to benefit most from the current sector transformation.

DAAR recently swapped half the 2015 sukuk (cUSD225 million), reducing the interest cost to 7.95% over SIBOR. While this is likely to reduce the company's short-term borrowing expenses given the outlook on global inflation and expected monetary tightening over the medium-term, the transaction may raise DAAR's overall financing costs on this bond.

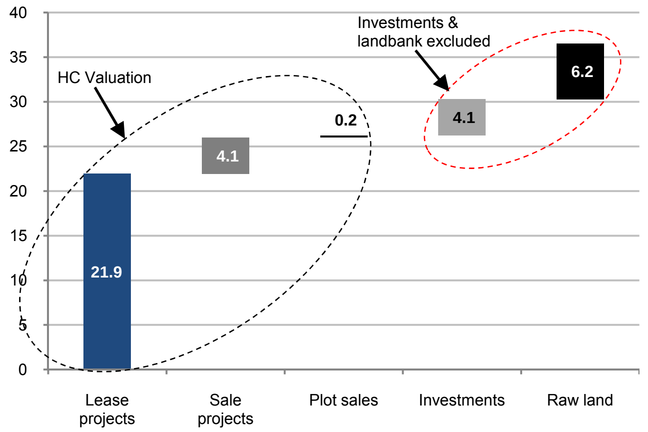
Although investors' concern about DAAR's liquidity position is valid given its stretched balance sheet (net debt/equity standing at 46% as of 1H10), we estimate that by extending its development cycle the company should be able to manage debt repayments while maintaining a 50% payout ratio (please refer to the cash flow analysis section). That said, our analysis is based on the assumption that plot sales will be sustained at close to historic levels. The observed improvement in the sector fundamentals and DAAR's strong track record in land sales, even during the worst of the financial crisis (FY09 land sales at SAR4.9 billion), gives us more comfort in this regard.

Chart 10: Valuation: to be conservative we exclude, investments, raw land, and future projects

DAAR valuation breakdown (SAR/share)



Al Akaria valuation breakdown (SAR/share)



Source: HC Research

Following on our macro theme, we reverse our previous recommendation, now preferring DAAR to Al Akaria. While we continue to like Al Akaria's REIT-like business model and exposure to the rental market through largely operational assets with stable occupancy levels and hence recurring income stream, we believe this is already being discounted by the market.

We value real estate companies using a combination of DCF analysis and land valuation and cross check against their NAVs. Where a final master plan is available, we use a sum of the parts DCF. Otherwise, we rely on land valuation only. For DAAR, we value all current projects under development using a DCF and assume that all the land on its balance sheet (SAR13.4 billion) will be sold over the next six years. To be conservative, for the time being we exclude the company's investments and future projects (Al Qasr

Khozam and Shams Al Arous) from our valuation until further details are available. Given the huge CAPEX requirements for these projects (SAR12.5 billion on our estimates), we remain cautious about the company's ability to fund them without external support. Finally, to address governance and liquidity risks, we raise DAAR's beta to 1.5 from 1.2 and accordingly its cost of equity to 14.3% from 12.3%. As such, **we cut our TP for DAAR by 11% to SAR16.9/share from SAR18.9/share but maintain our Buy recommendation.**

For Al Akaria, the market implied valuation is largely derived from its rental business (SAR21.9/share). Our valuation includes its planned sales development in Riyadh (SAR4.1/share) and some plot sales (SAR0.2/share). We now feel that investors are likely to remain reluctant to price in the company's investments and, more importantly, land bank, which are both held at cost (land acquisition cost on average of SAR70/m²). Given that there is still no clear strategy on how the company intends to monetize these largely idle assets over the medium term, we now exclude them from our valuation. Accordingly, **we cut our TP for Al Akaria by 25% from SAR34.8/share to SAR26.2/share and downgrade our recommendation to a Hold from Buy**. However, we understand that the company is looking to dispose of part of its industrial land in Dammam (5.7 million m²).

Table 3: We now exclude long-term investments from our valuation given the lack of details

	Al Akaria		Dar Al Arkan	
	Amount (SAR mn)	**Ownership**	**Amount (SAR mn)**	**Ownership**
Investments in Associate Companies				
Al Mouayqaliyah Commercial Center	166.10	25.0%		
Investments in Other Companies				
United Glass Company	30.00	15.0%		
Kanan National Development Company	46.58	2.1%		
Dar Al Tamleek Company	53.00	10.0%		
Knowledge Economic City Development Company	112.46	10.0%		
Hael Cement Company	61.00	25.0%		
Real Estate Mortgage Company	0.80	3.0%		
Teeba Real Estate Investment and Development Company	0.01			
Other investments	5.77			
Total	**475.72***		**1,162**	**15%–34%**

Source: Company data
*Investments in funds excluded

Al Akaria's long-term investments at the end of 2Q10 stood at SAR476 million. As highlighted in the table above, the amount mainly represents investments in associate companies and strategic investments in other companies. DAAR's long-term investments stood at SAR1.2 billion at the end of 2Q10, similar to the previous quarter. While the company does not provide a breakdown of these investments, it classifies them as shares of companies that are not publically traded. DAAR's ownership in these companies ranges from 15% to 34%. Since we have very little details on these investments for both Al Akaria and DAAR, to be conservative we exclude them from our valuation.

For DAAR future projects pose upside risk to our valuation, potentially adding SAR6.2/share

For DAAR, announced future projects present an upside risk to our valuation. For the time being, we do not include the two projects highlighted in table 4 due to lack of details as they are still in the planning stage and, more importantly, we do not see any clear funding strategy. We estimate DAAR's cost share in the two projects at SAR12.5 billion, which we feel without government support is difficult to fund given (i) the absence of the off-plan sales model, (ii) the already high leverage position of the company (net debt/equity of 46%), and (iii) outstanding CAPEX requirements for projects currently under development.

We view the two projects as potential catalysts for the stock if they were to go through. We understand that Al Qasr Khozam is based on a JV between DAAR and the government. Therefore, our assumptions are based on a similar model to that of Sorouh on Lulu Island, where the company was given the land for free in return for a share of the profit. According to DAAR, Qasr Khozam is a pure land development project that entails the demolition of existing buildings followed by the redeployment of basic infrastructure. The developed land will then be sold off. We assume a margin of 40% based on historic plot sale prices in Jeddah. We estimate this project could add SAR3/share to our valuation.

Shams Al Arous is a property development project, which entails building 10,000 units (both villas and apartments) at a total estimated investment cost of SAR7.5 billion (or SAR750,000 per unit). Here we assume a gross margin of 30%, in line with previous developments, to arrive at a project NPV of SAR3.5 billion or SAR3.2/share.

Table 4: We exclude DAAR's future projects due to the lack of a clear funding strategy

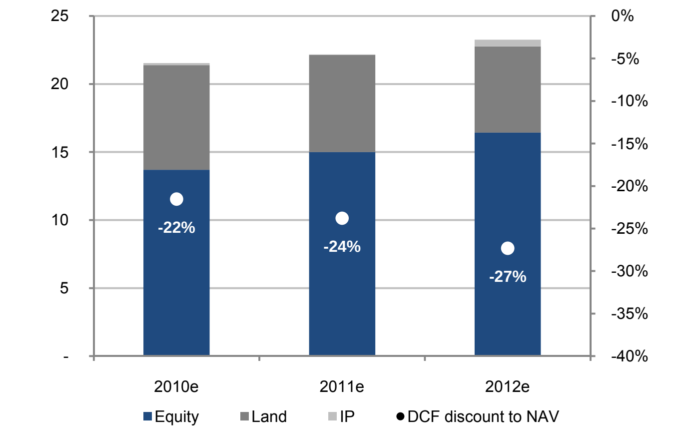
Qasr Khozam		Shams Al Arous	
Location	Jeddah	Location	Jeddah
Timeline	4Q10–3Q15	Timeline	2010–2015
Surface Area (m²)	4,100,000	Surface Area (m²)	3,000,000
Density	610%	Number of Units	10,000
Built-up Area (m²)	25,000,000	Total Estimated Cost (SAR mn)	7,500
Estimated Demolition Cost (SAR/m²)	270	Cost per Unit (SAR mn)	0.75
Estimated Land Infrastructure Cost (SAR/m²)	130		
Total Estimated Cost (SAR mn)	10,000	Average Margin	30%
Plot Sale Price SAR/m²	650	Average Unit Price (SAR mn)	1.1
Project NPV (SAR mn)	6,250	Project NPV (SAR mn)	3,500
DAAR Shareholding	51%	DAAR shareholding	100%
DAAR Project NPV (SAR mn)	3,188	DAAR Project NPV (SAR mn)	3,500
Shares Outstanding (million)	1,080	Shares Outstanding (million)	1,080
Value per Share	**3.0**	**Value per Share**	**3.2**

Source: Company data, HC Research. *Blue: data provided by the company Red: assumptions based on historic data

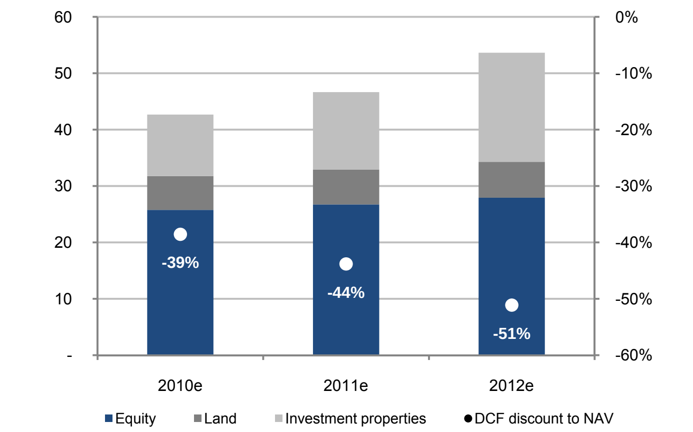
We value DAAR at a 22% discount to its 2010e NAV of SAR21.5 and Al Akaria at a 39% discount to its 2010e NAV of SAR42.7

Chart 11

DAAR NAV breakdown by segment (SAR/share)



Al Akaria NAV breakdown by segment (SAR/share)



Source: HC Research

We value DAAR at a 22% discount to its 2010e NAV of SAR21.5/share and Al Akaria at a 39% discount to its 2010e NAV of SAR42.7/share. The higher discount applied to Al Akaria's assets reflects its largely idle land and investments (representing c43% of book as of 1Q10), which we now exclude from our valuation on the logic that there is still no clear strategy on how the company intends to monetize them over the medium term. As mentioned earlier, we also exclude DAAR's investments (cSAR1.1/share) due to the lack of details. This along with cash flow discounting account for the 16% discount implied by our DCF.

Since Al Akaria and DAAR's land is recognized at cost on their books, we value them at fair value using the residual method. For both, we assume a developer margin of 20% of revenue and work backwards to the value of land based on prevailing property market prices and costs. We also revalue the companies' rental businesses, which are recognized at cost. To value investment properties, we use a capitalization rate of c7% (WACC of c10%—terminal growth rate of 3%). To calculate NOI (net operating income), we apply a blended margin for residential, retail, and office of 70%.

Cash flows sufficient for projects under development and debt repayments, while maintaining cash payout

DAAR is among the most highly leveraged developers under our coverage with net debt of SAR7.7 billion and a net debt/equity ratio of 46%—a large concern for investors. We believe the higher gearing reflects the pre-finished sales model. Although the company has indicated that it has enough cash to fund its current projects under development, we feel that is largely dependent on plot sales. The observed improvement in the sector fundamentals and DAAR's strong track record in land sales, even during the worst of the financial crisis (FY09 land sales at SAR4.9 billion), gives us more comfort in this regard.

Table 5: DAAR's debt maturities (SAR mn)

SAR mn	2009	Maturity	Cost
ST Islamic Murabaha	400	2010	Sibor +1.50% to +2.00%
LT Islamic Murabaha	400	Eight semi-annual payments starting in 2010	Sibor +2.50%
LT Islamic Murabaha	500	2011	Sibor +3.50%
LT Islamic Murabaha	305	2012	Sibor +2.25%
~~Sukuk 2010~~	~~2,250~~	~~2010~~	~~Libor +2%~~
sukuk 2012	3,750	2012	Libor +2.25%
sukuk 2014	750	2014	Sibor +4%
sukuk 2015	1,688	2015	10.75%
Total	**7,793**		

Source: Company data

The table below summarizes our analysis of DAAR's cash flows over the next couple of years. Although concerns about its liquidity position are valid we estimate that by extending its development cycle, the company should be able to manage debt repayments while maintaining a payout ratio in line with historic trends. We estimate total cash of cSAR16.8 billion over the next three years, against a cash outflow of cSAR16.1 billion, assuming no debt refinancing and a 50% dividend payout. However, it is important to note that our analysis does not include additional land acquisition or future projects. As we discussed earlier, although the company has indicated that it is looking to launch two new projects (Al Qasr Khozam and Shams Al Arous), for the time being we exclude them from our analysis due to the lack of details and, more importantly, the tight credit markets. We estimate the company's share in the costs of the projects at roughly SAR12.5 billion.

Table7: Cash flows sufficient for projects under development and debt repayments, while maintaining cash payout

	1H10	2H10	1H11	2H11	1H12	2H12	Total
Cash Balance	1,300						**1,300**
Cash Inflow		**2,537**	**3,178**	**3,046**	**3,344**	**3,409**	**15,514**
Plot Sales		2,218	2,218	2,218	2,390	2,413	11,457
Property Sales		293	903	755	828	853	3,632
Net Rental Income		27	56	73	125	144	425
Cash Outflow							
Lease Properties							
Al Qasr Mall		(193)					(193)
Shams Al Riyadh Retail		(162)	(162)	(223)			(547)
Sale Properties							
Shams Al Riyadh Phase 1		(165)	(165)				(330)
Shams Al Riyadh Phase 2		(217)	(434)	(447)			(1,099)
Shams Al Riyadh Phase 3		(109)	(434)	(447)	(559)	(576)	(2,125)
Land Infrastructure		(964)	(671)	(690)	(388)	(801)	(3,514)
Dividend Payout			(825)		(1,074)		(1,899)
Debt Maturities		(500)		(600)		(4,155)	(5,255)
SG&A		(60)	(76)	(72)	(82)	(83)	(374)
Net Interest Expense		(182)	(182)	(167)	(167)	(63)	(763)
Total Cash Outflow		**(2,552)**	**(2,949)**	**(2,646)**	**(2,270)**	**(5,678)**	**(16,099)**
Net Cash Flow	1,300	(15)	225	400	1,074	(2,269)	715
Net Cumulative Cash Flow	**1,300**	**1,285**	**1,510**	**1,910**	**2,984**	**715**	

Source: Company data, HC Research

Table 8: MENA Real Estate Comparative Multiples

Company	Bloomberg Code	Cur.	CMP*	Market Cap (USD mn)	Rec.	TP	Upside	P/BV			P/NAV			P/E			EPS CAGR	ROE		
								2009a	2010e	2011e	2009a	2010e	2011e	2009a	2010e	2011e	(08a–11e)	2009a	2010e	2011e
Saudi Arabia																				
DAAR	AL ARKAN AB	SAR	11.4	3,283	Buy	16.9	48%	0.9x	0.9x	0.8x	0.4x	0.5x	0.5x	5.8x	7.1x	5.5x	-2%	15%	12%	14%
Al Akaria	SRECO AB	SAR	22.4	717	Buy	26.2	17%	0.9x	0.9x	0.8x	0.6x	0.5x	0.5x	28.6x	28.0x	18.7x	7%	3%	3%	4%
Mean								**0.9x**	**0.9x**	**0.8x**	**0.5x**	**0.5x**	**0.5x**	**17.2x**	**17.6x**	**12.1x**		**9%**	**8%**	**9%**
Median								**0.9x**	**0.9x**	**0.8x**	**0.5x**	**0.5x**	**0.5x**	**17.2x**	**17.6x**	**12.1x**		**9%**	**8%**	**9%**
UAE																				
Aldar	ALDAR UH	AED	2.5	1,748	Buy	9.7	290 %	0.4x	0.4x	0.3x	0.2x	0.2x	0.2x	9.1x	2.9x	1.7x	15%	5%	13%	17%
Aldar **	ALDAR UH	AED	2.5	1,748	Buy	9.7	290 %	0.6x	0.6x	0.5x	0.2x	0.2x	0.2x	9.1x	2.9x	1.7x	15%	7%	21%	27%
Emaar	EMAAR UH	AED	3.2	5,323	Buy	6.6	106 %	0.7x	0.6x	0.6x	0.3x	0.2x	0.2x	59.7x	7.0x	9.5x	132%	1%	9%	6%
Sorouh	SOROUH UH	AED	1.8	1,258	Hold	2.9	65%	0.8x	0.7x	0.6x	0.3x	0.3x	0.2x	9.6x	5.6x	4.7x	-19%	8%	12%	13%
Mean								**0.7x**	**0.6x**	**0.6x**	**0.3x**	**0.2x**	**0.2x**	**26.1x**	**5.2x**	**5.2x**		**5%**	**14%**	**15%**
Median								**0.7x**	**0.6x**	**0.6x**	**0.3x**	**0.2x**	**0.2x**	**9.6x**	**5.6x**	**4.7x**		**7%**	**12%**	**13%**
Egypt																				
TMGH	TMGH EY	EGP	7.3	2,575	Buy	11.5	58%	0.6x	0.6x	0.5x	0.5x	0.5x	0.4x	13.2x	5.9x	4.4x	78%	5%	10%	11%
Nasr City	MNHD EY	EGP	30.3	531	Buy	50	65%	12.4x	10.1x	6.4x	0.3x	0.3x	0.3x	28.1x	38.1x	17.8x	14%	44%	26%	36%
SODIC	OCDI EY	EGP	82.9	518	Buy	125	51%	1.4x	1.2x	0.9x	0.5x	0.6x	0.5x	-20.6x	11.1x	3.8x	186%	-7%	11%	24%
ODH	ODHN EY	CHF	57.8	1,273	Buy	90	56%	1.5x	1.3x	1.1x	0.4x	0.4x	0.4x	12.7x	10.0x	7.9x	21%	12%	13%	15%
Egy. Resorts	EGTS EY	EGP	2.0	367	Buy	4.1	106 %	1.9x	2.0x	2.0x	0.3x	0.3x	0.3x	-529.3x	-207.6x	-298.8x	-130%	0%	-1%	-1%
PHD	PHDC EY	EGP	4.7	858	Hold	7.5	61%	1.0x	1.1x	0.9x	0.4x	0.5x	0.4x	6.6x	7.2x	3.8x	-10%	16%	15%	23%
Mean								**3.2x**	**2.7x**	**2.0x**	**0.4x**	**0.4x**	**0.4x**	**-81.5x**	**-22.5x**	**-43.5x**		**12%**	**12%**	**18%**
Median								**1.5x**	**1.3x**	**1.0x**	**0.4x**	**0.4x**	**0.4x**	**9.6x**	**8.6x**	**4.1x**		**8%**	**12%**	**19%**
Kuwait																				
Mabanee	MABANEE KK	Kwd	690	1,203	Buy	905	31%	3.1x	2.9x	2.7x	1.0x	1.0x	1.0x	20.7x	23.4x	28.1x	18%	15%	12%	10%
Mean								**3.1x**	**2.9x**	**2.7x**	**1.0x**	**1.0x**	**1.0x**	**20.7x**	**23.4x**	**28.1x**		**15%**	**12%**	**10%**
Median								**3.1x**	**2.9x**	**2.7x**	**1.0x**	**1.0x**	**1.0x**	**20.7x**	**23.4x**	**28.1x**		**15%**	**12%**	**10%**
Sector Mean								**2.0x**	**1.8x**	**1.5x**	**0.5x**	**0.6x**	**0.5x**	**-4.4x**	**5.9x**	**0.5x**		**10%**	**11%**	**13%**
Sector Median								**1.2x**	**1.1x**	**0.9x**	**0.4x**	**0.5x**	**0.4x**	**13.4x**	**13.1x**	**8.4x**		**9%**	**12%**	**11%**

Source: HC Research
** Based on prices as of 27 June 2010*
***Excl Reval*

Al Akaria and DAAR Downside Risks

- **Execution Risk:** For Al Akaria, the shift from single building lease properties to large-scale projects is likely to introduce execution risk. For DAAR, the sheer scale of developments in diverse geographic locations (Riyadh and Jeddah) is likely to stretch management and operational capacity, introducing the risk of delays and/or project cancellation.

- **Governance Risk:** Al Akaria and DAAR still operate in an underdeveloped regulatory environment where minority interest can be overlooked.

- **Concentration Risk:** Since most of Al Akaria's and DAAR's current projects are in Al Riyadh, exposure to any downturn in the property market there is high. However, DAAR indicated that it intends to launch two mega projects in Jeddah, which should somewhat mitigate this risk if they were to go through.

Revisiting forecasts

- **2Q10 results miss estimates on lower plot volumes for DAAR and fair value losses on investments for Al Akaria**
- **For DAAR, we slow down plot sales and push back deliveries to reflect tightened liquidity**
- **For Al Akaria, we raise rental income to reflect expected higher occupancy at Al Akaria Plaza following the government deal and plot sales being delayed until next year given the lack of urgency**

DAAR 1H10 results highlights

DAAR's 2Q10 results highlight a recovery in land margins (c53% compared to c45% a quarter earlier) and volumes of c2 million m² compared to c1.4 million m². On the other hand, property sales at Al Tilal project saw property margin compression in 1H10 to c14% compared to c22% a year earlier due to lower affordability in Medina compared to Riyadh. Regardless, property sales are secondary to DAAR as they are a means of adding value to adjacent land resulting in margin expansion as seen in these results. Therefore, as long as projects are profitable, they are deemed sound (e.g. Aldar's Yas Island asset).

During 1H10, land WIP worth SAR600 million was completed and transferred to developed land. Taking that into consideration, WIP remained unchanged despite cost recognition of Al Tilal of SAR200 million, implying that the company spent roughly SAR200 million on development properties. DAAR continues to expand its land bank with roughly SAR600 million invested in land acquisitions. Despite paying out dividends of SAR1.1 billion and net repayment of debt of SAR567 million, the company's cash balance remained healthy, standing at SAR1.3 billion at the end of the first half.

Table 9: We push back deliveries to reflect tightened funding position

DAAR's Revised Estimates	2010e			2011e			2012e		
	New	Old	% △	New	Old	% △	New	Old	% △
Plot Sales	4,225	5,000	-16%	4,436	5,428	-18%	4,803	5,432	-12%
Property Sales	545	797	-32%	1,658	4,008	-59%	1,681	4,128	-59%
Rental Income	26	94	-72%	131	5,428	-18%	269	319	-16%
Total Revenue	**4,796**	**5,891**	**-19%**	**6,225**	**9,595**	**-35%**	**6,753**	**9,878**	**-32%**
Net Profit	**1,729**	**1,860**	**-7%**	**2,247**	**3,486**	**-36%**	**2,599**	**4,096**	**-37%**

Source: HC Estimates

Al Akaria 1H10 results highlights

The main highlight of Al Akaria's 1H10 results was the SAR23 million non-cash loss recorded on the company's held for sale portfolio. Operationally, the company's rental portfolio continues to perform in line with expectations and margins remained intact at 75%. Al Akaria Plaza came on stream in 1Q10, leading to an 11% YoY increase in rental income to SAR95 million in 1H10. While we understand that occupancy at Al Akaria Plaza remains low (c20% on our estimates) the company signed a three-year leasing agreement in June 2010 to a government entity (Atomic Energy City) for SAR49 million annually. This deal is expected to start contributing to the company's revenue in September 2010, increasing occupancy to c75%. Given that it typically takes time for a bulk tenant to settle in, we assume occupancy would rise to 40% in the second half. There were also no plot sales in 1H10, highlighting the company's reluctance to sell land. Although we understand that the company intends to dispose of part of the Dammam land, we remain cautious and exclude the company's land bank from our valuation until we see a clear strategy.

At the end of 1H10, properties under development stood at SAR30 million representing enabling works on the Diplomatic Quarters phase 2 expected to be completed by 2012. The total contract value, which was awarded recently, stood at SAR322 million, in line with the company's previous guidance. Al Akaria's cash balance dropped to SAR246 million at the end of 1H10, mainly due to its investments in Saudi listed securities. Since those investments are very liquid and could be considered cash equivalent, we still believe the company's balance sheet is solid. Accordingly, we feel that the company should be able to fund the Diplomatic Quarters through internal funding. However, we estimate that company would have to raise cSAR800 million to fund the development of its first sales project in Riyadh. We understand that the company is likely to seek the help of the Public Investment Fund.

Table 10

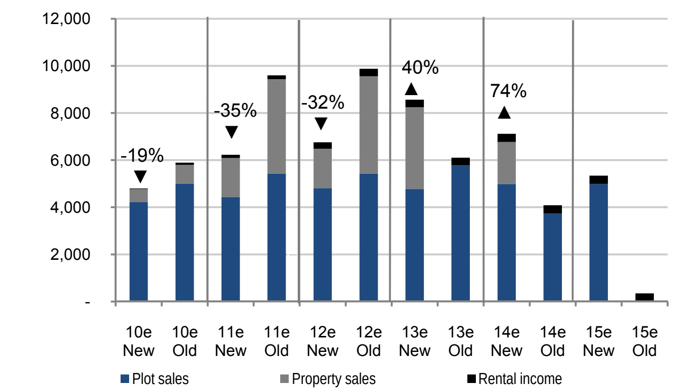
Akaria's Revised Estimates	2010e			2011e			2012e		
	New	Old	% △	New	Old	% △	New	Old	% △
Sale of Land	-	62		64	167	-62%	172	86.9	97%
Sale of Properties	-	-		-	-		-	-	
Rental Income	205	198	3%	240	229	5%	311	283.8	10%
Other Income	-	7		-	8		-	10.3	
Total Revenue	**205**	**268**	**-24%**	**304**	**404**	**-25%**	**482**	**381**	**27%**
Net Profit	**101**	**123**	**-18%**	**141**	**166**	**-15%**	**178**	**147**	**22%**

Source: HC Research

DAAR revised forecasts in charts

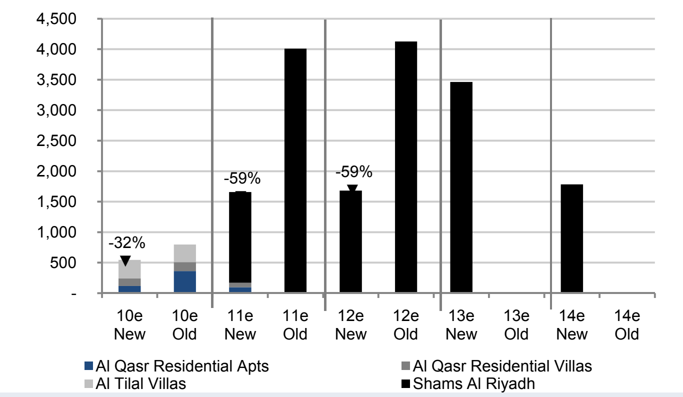
Chart 12

Revenue breakdown by segment (SARm)



Source: HC Estimates

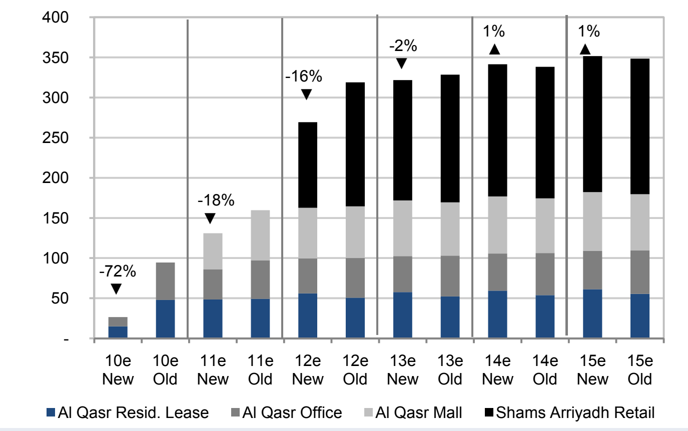
Property sales breakdown by project (SARm)



Source: HC Estimates

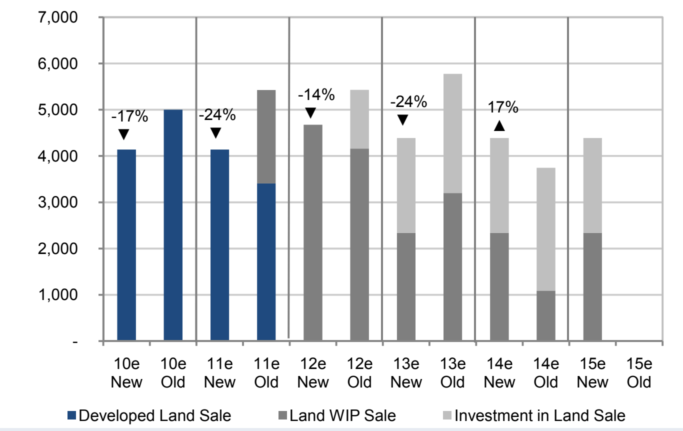
Chart 13

Rental income by project (SARm)



Source: HC Estimates

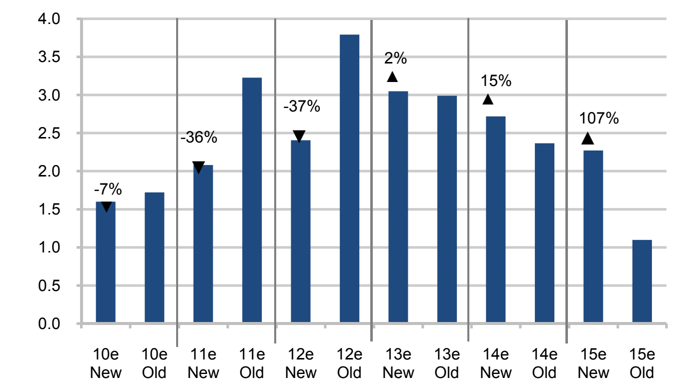
Plot sales breakdown by progress (SARm)



Source: HC Estimates

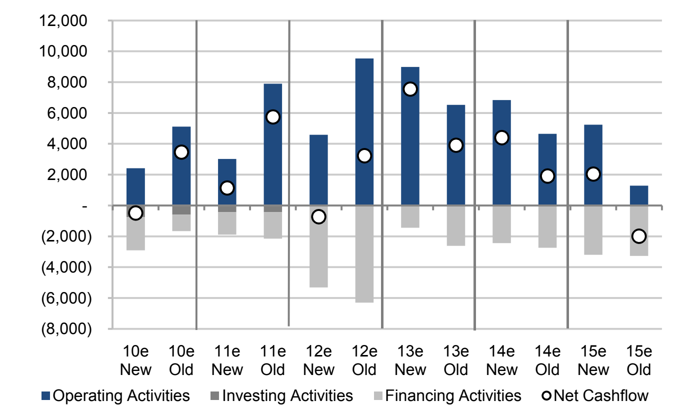
Chart 14

EPS (SAR/share)



Source: HC Estimates

Cash flows breakdown (AEDm)

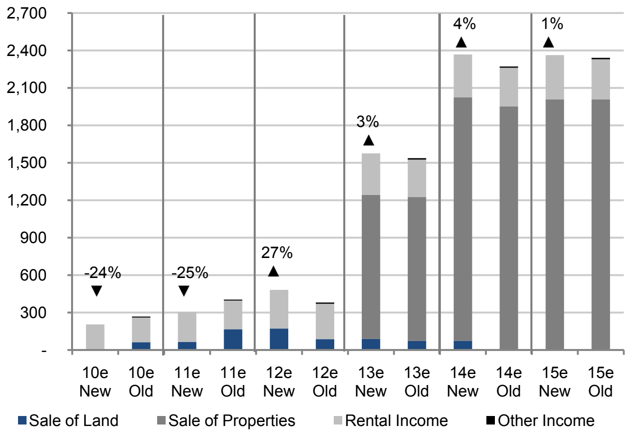


Source: HC Estimates

Al Akaria revised forecasts in charts

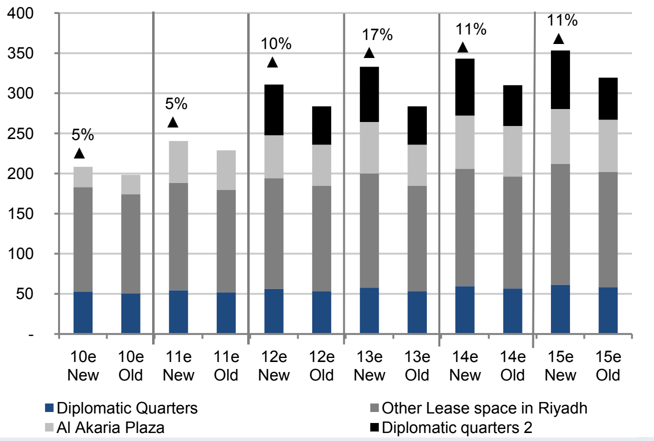
Chart 15

Revenue breakdown by segment (SAR mn)



Source: HC Estimates

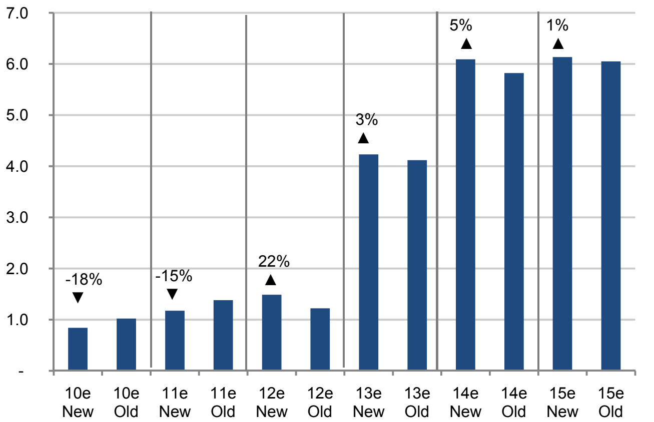
Rental income by project (SAR mn)



Source: HC Estimates

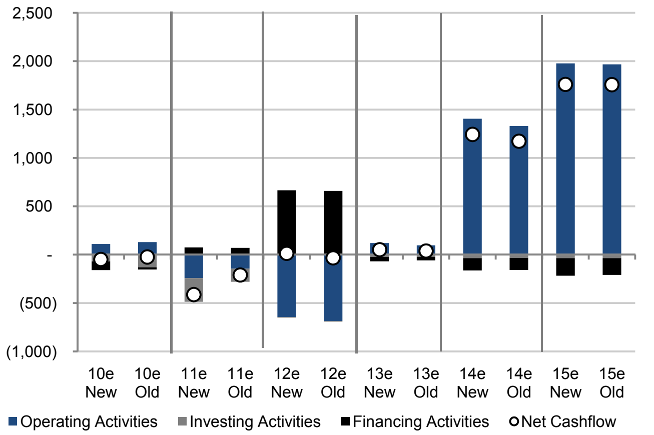
Chart 16

EPS (SAR/share)



Source: HC Estimates

Cash flows breakdown (AEDm)



Source: HC Estimates

DAAR Financials

Income Statement Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Sale of Land	4,620	4,945	4,225	4,436	4,803	4,781	4,990
Sale of Properties	990	519	545	1,658	1,681	3,462	1,783
Rental Income	-	-	26	131	269	322	341
Revenue	**5,611**	**5,464**	**4,796**	**6,225**	**6,753**	**8,565**	**7,114**
Cost of Land	(2,199)	(2,559)	(2,226)	(2,388)	(2,600)	(2,600)	(2,722)
Cost of Properties	(567)	(398)	(460)	(1,106)	(1,089)	(2,205)	(1,115)
Direct Rental Expenses	-	-	(8)	(39)	(81)	(96)	(102)
Total Cost	**(2,766)**	**(2,957)**	**(2,694)**	**(3,534)**	**(3,770)**	**(4,901)**	**(3,940)**
% of sales	*49%*	*54%*	*56%*	*57%*	*56%*	*57%*	*55%*
Gross Profit	**2,845**	**2,507**	**2,102**	**2,690**	**2,983**	**3,664**	**3,174**
Margin	*51%*	*46%*	*44%*	*43%*	*44%*	*43%*	*45%*
Operating Expenses:							
SGA Expenses	(150)	(146)	(124)	(156)	(169)	(214)	(178)
Other	(1)	-	-	-	-	-	-
Depreciation and Amortization	(50)	(41)	(46)	(58)	(63)	(62)	(62)
Operating Expenses	**(201)**	**(186)**	**(170)**	**(214)**	**(232)**	**(276)**	**(239)**
EBIT (incl. Revaluation Gain)	**2,644**	**2,321**	**1,932**	**2,477**	**2,752**	**3,388**	**2,935**
Margin	*47%*	*42%*	*40%*	*40%*	*41%*	*40%*	*41%*
Net Financing Cost (Islamic Murabha/Sukuk Charges)	(245)	(146)	(190)	(185)	(100)	(28)	63
Other Income	17	(2)	31	12	14	17	14
Profit before Taxes	**2,417**	**2,173**	**1,773**	**2,304**	**2,665**	**3,377**	**3,012**
Income Tax	(60)	(54)	(44)	(58)	(67)	(84)	(75)
Minority Shareholder Interest	-	-	-	-	-	-	-
Net Profit (Loss)	**2,356**	**2,118**	**1,729**	**2,247**	**2,598**	**3,292**	**2,937**
Margin	*42%*	*39%*	*36%*	*36%*	*38%*	*38%*	*41%*
Basic EPS	3.3	2.0	1.6	2.1	2.4	3.0	2.7
DPS	2.3	0.0	1.0	1.0	1.2	1.5	1.4
Payout ratio	*0%*	*0%*	*0%*	*50%*	*50%*	*50%*	*50%*
EBITDA	**2,696**	**2,321**	**1,957**	**2,535**	**2,814**	**3,450**	**2,996**
Margin	*48%*	*42%*	*41%*	*41%*	*42%*	*40%*	*42%*

Source: Company data, HC Research

Balance Sheet Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Assets							
Cash and Cash Equivalents	716	2,223	1,644	2,778	2,049	9,596	13,996
Due from Related Parties	57	3	9	9	9	9	9
Prepaid Expenses and Others	1,737	233	420	268	115	-	-
Trade and Other Receivables	949	846	414	263	113	-	-
Developed Land ST and LT	3,099	4,458	2,787	398	-	-	-
Investment in Land	3,727	3,683	4,775	5,541	6,731	6,058	4,712
Land WIP	3,726	5,245	6,285	6,881	4,679	2,753	1,376
Development Properties WIP	4,195	4,023	3,752	4,264	3,974	1,115	0
Current Assets	**18,206**	**20,715**	**20,086**	**20,402**	**17,669**	**19,530**	**20,093**
Investments in Associates	1,120	1,162	1,162	1,162	1,162	1,162	1,162
Deferred Charges Net	127	98	2	2	2	2	2
Property, Plant, and Equipment	120	103	115	152	188	222	256
Investment Properties (incl. WIP)	591	1,518	2,021	2,351	2,293	2,236	2,180
Non-Current Assets	**1,958**	**2,882**	**3,301**	**3,668**	**3,645**	**3,623**	**3,601**
	-	-	-	-	-	-	-
Total Assets	**20,164**	**23,597**	**23,387**	**24,070**	**21,314**	**23,153**	**23,694**
Liabilities							
Trade and Other Payables	171	471	196	125	53	-	-
Borrowings and Short-term Debt	1,635	2,700	550	550	550	550	550
Other	613	635	1,164	1,164	1,164	1,164	1,164
Current Liabilities	**2,420**	**3,806**	**1,943**	**1,844**	**1,768**	**1,714**	**1,714**
	-	-	-	-	-	-	-
Borrowing and Long-Term Debt	6,000	5,655	6,655	6,055	1,900	1,800	1,050
Provision for end of Service Indemnities	8	12	13	13	13	13	13
Non-current Liabilities	**6,008**	**5,667**	**6,668**	**6,068**	**1,913**	**1,813**	**1,063**
	-	-	-	-	-	-	-
Minority Interest in Subsidiaries	-	265	265	265	265	265	265
	-	-	-	-	-	-	-
Paid-up Capital	7,200	10,800	10,800	10,800	10,800	10,800	10,800
Statutory and Other Reserves	3,600	462	462	462	462	462	462
Retained Earnings	936	2,597	3,248	4,630	6,106	8,099	9,389
Shareholder Equity	**11,736**	**14,124**	**14,775**	**16,157**	**17,633**	**19,626**	**20,916**
	-	-	-	-	-	-	-
Total Liabilities and Equity	**20,164**	**23,597**	**23,387**	**24,070**	**21,314**	**23,153**	**23,694**

Source: Company data, HC Research

Cash Flow Statement Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Net Profit before Minorities	**2,417**	**2,173**	**1,729**	**2,247**	**2,598**	**3,292**	**2,937**
Depreciation and Amortization	50	41	46	58	63	62	62
Change in Working Capital	296	2,236	543	718	1,928	5,632	3,838
Change in Provisions	4	5	2	-	-	-	-
Net Financing Cost	-	-	(91)	(185)	(100)	(28)	63
Interest Income/Expenses	-	-	190	185	100	28	(63)
Net Cash Generated from Operating Activities	**2,766**	**4,455**	**2,419**	**3,023**	**4,589**	**8,986**	**6,836**
Investments Activities:							
CAPEX (Land)	(744)	(1,193)	(214)	-	-	-	-
CAPEX (Investments)	(3,798)	(930)	-	-	-	-	-
CAPEX (Excl IP and Hotels)/PPE	(3)	(1)	(21)	(40)	(40)	(40)	(40)
CAPEX (IP WIP)	(425)	(1,818)	(526)	(385)	-	-	-
Net Cash Generated from Investment Activities	**(4,971)**	**(3,942)**	**(761)**	**(425)**	**(40)**	**(40)**	**(40)**
	-	-	-	-	-	-	-
Financing Activities:	-	-	-	-	-	-	-
Dividends Paid	(1,620)	-	(1,080)	(864)	(1,123)	(1,299)	(1,646)
Bank Borrowings Raised	1,235	720	(1,067)	(600)	(4,155)	(100)	(750)
Others	(41)	270	-	-	-	-	-
Net Cash Generated from Financing Activities	**(426)**	**990**	**(2,147)**	**(1,464)**	**(5,278)**	**(1,399)**	**(2,396)**
Net Addition (Deduction) in Cash	**(2,630)**	**1,507**	**(489)**	**1,134**	**(729)**	**7,547**	**4,400**
Cash at Beginning	3,347	717	2,224	1,735	2,868	2,139	9,686
Cash at End of Fiscal Year	**717**	**2,224**	**1,735**	**2,868**	**2,139**	**9,686**	**14,086**

Source: Company data, HC Research

Table 11: FCF Value

Year	2008a	2009a	2010e	2011e	2012e	2013e	2014e	...	2027e
EBIT	2,644	2,321	1,932	2,477	2,752	3,388	2,935		283
Tax Rate	3%	3%	3%	3%	3%	3%	3%		3%
EBIT * (1-T)	2,578	2,263	1,884	2,415	2,683	3,303	2,861		276
Depreciation and Amortization	50	-	25	58	63	62	62		56
Capital Expenditure	(4,971)	(3,942)	(761)	(425)	(40)	(40)	(40)		(40)
Changes in Working capital	296	2,236	543	718	1,928	5,632	3,838		-
Free Cash Flow: Explicit Period	**(2,046)**	**557**	**1,691**	**2,766**	**4,633**	**8,957**	**6,721**		292
Terminal Growth Rate									3%
FCF: Terminal									3,331
FCF: Total	**(2,046)**	**557**	**1,691**	**2,766**	**4,633**	**8,957**	**6,721**		**3,622**

Source: HC Research

Table 12: Valuation

Terminal Growth Rate	3.00%	WACC	
NPV: FCF (mn)	**23,861**	Beta	1.5
Net Debt/ (Cash) mn	5,561	Risk Free Rate	4.5%
Equity mn	18,300	Country Risk Premium	6.5%
Outstanding Shares	1,080		0.0%
DCF Value	**16.9**	**Cost of Equity**	**14.3%**
		Cost of Debt	
Value of Investments (mn)	-	**After Tax Cost of Debt**	**6.8%**
Value of Investments per Share	-	Weights (SAR mn)	**-**
		Equity Market Capitalization	12,528
		Debt	
Total Value	**16.9**	Total	20,883
		Tax Rate	2.5%
		WACC	**12.0%**

Source: HC Research

Al Akaria Financials

Income Statement Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Sale of Land	57	-	-	64	171	89	74
Sale of Properties	-	-	-	-	-	1,153	1,951
Rental Income	162	171	205	240	311	333	343
Other Income	6	-	-	-	-	-	-
Revenue	**225**	**171**	**205**	**304**	**482**	**1,575**	**2,368**
Cost of Land infrastructure	(34)	-	-	(41)	(106)	(54)	(44)
Cost of Properties	-	-	-	-	-	(698)	(1,182)
Direct Rental Expenses	(46)	(43)	(61)	(72)	(93)	(100)	(103)
Total Cost	**(80)**	**(43)**	**(61)**	**(113)**	**(199)**	**(852)**	**(1,329)**
% of sales	*36%*	*25%*	*30%*	*37%*	*41%*	*54%*	*56%*
Gross Profit	**145**	**128**	**143**	**192**	**283**	**723**	**1,039**
Margin	*64%*	*75%*	*70%*	*63%*	*59%*	*46%*	*44%*
Operating Expenses:							
Depreciation	(18)	(20)	(23)	(24)	(25)	(25)	(25)
SGA Expenses (Excl. Depreciation)	(17)	(17)	(20)	(30)	(48)	(158)	(237)
Operating Expenses	**(34)**	**(36)**	**(44)**	**(54)**	**(74)**	**(183)**	**(262)**
	-	**-**	**-**	**-**	**-**	**-**	**-**
EBIT (Incl. Revaluation Gain)	**110**	**92**	**99**	**138**	**210**	**540**	**777**
Margin	*49%*	*54%*	*49%*	*45%*	*43%*	*34%*	*33%*
Net Financing cost	-	6	6	8	(27)	(25)	(28)
Other Income/ Expenses	27	17	13	10	12	13	14
Profit before Taxes	**137**	**115**	**119**	**155**	**195**	**528**	**763**
Income Tax	(20)	(21)	(18)	(14)	(17)	(21)	(32)
Minority Shareholder Interest	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
Net Profit (Loss)	**117**	**94**	**101**	**141**	**178**	**508**	**731**
Margin	*52%*	*55%*	*49%*	*46%*	*37%*	*32%*	*31%*
Basic EPS	**1.0**	**0.8**	**0.8**	**1.2**	**1.5**	**4.2**	**6.1**
DPS	0.7	0.7	0.8	0.3	0.4	1.1	1.5
Payout Ratio	*71%*	*87%*	*92%*	*25%*	*25%*	*25%*	*25%*
EBITDA	**124**	**101**	**110**	**161**	**235**	**566**	**803**
Margin	*55%*	*59%*	*54%*	*53%*	*49%*	*36%*	*34%*

Source: Company data, HC Research

Balance Sheet Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Assets							
Cash and Cash Equivalents	749	644	568	155	168	219	1,461
Trade and Other Receivables (Current and Non-Current)	13	13	12	12	12	12	12
Other Current Assets	5	6	8	8	8	8	8
Land Held for Sale	174	135	135	167	98	44	-
Development Property WIP	125	125	127	472	1,370	1,828	1,216
Inventory	2	2	2	2	2	2	2
Current Assets	**1,068**	**925**	**853**	**817**	**1,659**	**2,113**	**2,700**
Long-Term Investments	477	491	476	476	476	476	476
Land	667	747	789	789	789	789	789
Property, Plant, and Equipment	6	5	7	11	18	41	76
Investment Properties	663	641	1,048	1,264	1,239	1,214	1,190
Investment Properties WIP	309	354	-	-	-	-	-
Non-Current Assets	**2,123**	**2,238**	**2,320**	**2,541**	**2,522**	**2,521**	**2,531**
Total Assets	**3,191**	**3,163**	**3,173**	**3,358**	**4,181**	**4,634**	**5,231**
Liabilities							
Trade and Other Payables	33	36	27	20	13	7	-
Advances from Customers	43	40	40	17	3	0	-
Provision for Tax	29	17	3	3	3	3	3
Current Liabilities	**105**	**93**	**70**	**40**	**20**	**10**	**3**
	-	-	-	-	-	-	-
Borrowing and Long-Term Debt	-	-	-	100	800	800	800
Provision for Employee Services	11	12	12	12	12	12	12
Non- Current Liabilities	**11**	**12**	**12**	**112**	**812**	**812**	**812**
Minority Interest in Subsidiaries	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
Paid-Up Capital	1,200	1,200	1,200	1,200	1,200	1,200	1,200
Statutory and Other Reserves	1,790	1,799	1,799	1,799	1,799	1,799	1,799
Retained Earnings	137	98	98	213	357	820	1,424
Unrealized Losses on Investments	(53)	(39)	(5)	(5)	(5)	(5)	(5)
Shareholder Equity	**3,074**	**3,058**	**3,091**	**3,207**	**3,350**	**3,813**	**4,417**
Total Liabilities and Equity	**3,191**	**3,163**	**3,173**	**3,358**	**4,181**	**4,634**	**5,232**

Source: Company data, HC Research

Cash Flow Statement Year to 31 December (SAR mn)	2008a	2009a	2010f	2011f	2012f	2013f	2014f
Net Profit before Minorities	**137**	**60**	**101**	**141**	**178**	**508**	**731**
Depreciation and amortization	20	9	23	24	25	25	25
Change in Working Capital	(43)	(4)	(14)	(408)	(848)	(414)	649
Change in Provisions	5	1	-	-	-	-	-
Net Financing Cost	-	6	6	8	(27)	(25)	(28)
Interest Income/Expenses	-	(6)	(6)	(8)	27	25	28
Net Cash Generated from Operating Activities	**119**	**66**	**110**	**(243)**	**(645)**	**119**	**1,405**
Investments Activities:							
CAPEX (PPE)	(3)	(15)	(2)	(5)	(7)	(24)	(36)
CAPEX (Investment Properties)	(184)	659	(68)	(240)	-	-	-
Others	(367)	3	-	-	-	-	-
Net Cash Generated from Investment Activities	**(554)**	**647**	**(69)**	**(244)**	**(7)**	**(24)**	**(36)**
Financing Activities:							
Dividends Paid	(122)	(122)	(90)	(25)	(35)	(45)	(127)
Bank Borrowings Raised	-	-	-	100	700	-	-
Net Cash Generated from Financing Activities	**(122)**	**(122)**	**(90)**	**75**	**665**	**(45)**	**(127)**
Net Addition (Deduction) in Cash	**(558)**	**591**	**(50)**	**(413)**	**13**	**51**	**1,243**
Cash at Beginning	619	61	644	594	181	194	245
Cash at End of Fiscal Year	**61**	**652**	**594**	**181**	**194**	**245**	**1,487**

Source: Company data, HC Research

Table 13: FCF Value

Year	2008a	2009a	2010e	2011e	2012e	2013e	2014e	...	2027e
EBIT	110	92	99	138	210	540	777		281
Tax Rate	-	(21)	(18)	(14)	(17)	(21)	(32)		(64)
EBIT * (1-T)	-	71	81	124	193	520	745		217
Depreciation and Amortization	14	9	10	24	25	25	25		22
Capital Expenditure	(554)	647	(69)	(244)	(7)	(24)	(36)		(10)
Changes in Working capital	(43)	(4)	(14)	(408)	(848)	(414)	649		-
Free Cash Flow: Explicit Period	**(583)**	**723**	**8**	**(505)**	**(638)**	**107**	**1,384**		229
Terminal Growth Rate									**3%**
FCF: Terminal									3,212
FCF: Total	**(583)**	**723**	**8**	**(505)**	**(638)**	**107**	**1,384**		**3,442**

Source: HC Research

Table 14: Valuation

Terminal Growth Rate	3.00%	WACC	
NPV: FCF mn	**2,509**	Beta	0.9
Net Debt/ (Cash) mn	-644	Risk Free Rate	4.5%
Equity mn	3,152	Country Risk Premium	6.5%
Outstanding Shares mn	120		
DCF Value	**26.2**	**Cost of Equity**	**10.4%**
		Cost of Debt	
Value of Land	-	**After tax cost of debt**	**4.3%**
Value of Investments	-	Weights (SAR mn)	
Value of Land and Investments	-	Equity Market Capitalization	2,700
Value of land and investments per Share	**-**	Debt	
Total Value	**26.2**	Total	2,700
		Tax Rate	15.0%
		WACC	**10.4%**

Source: HC Research

Rating Scale

Recommendation	Upside
Buy	Greater than 20%
Hold	-5% to 20%
Sell	Less than -5%

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