

KSA Real Estate sector: Dar Al-Arkan Real Estate Development

Investment outlook update | March 2013

Outlook

We reiterate our 'Overweight' stance on Dar Al-Arkan with an updated 12-month price target of **SAR10.7/share** (indicating a downward revision of 12% from our last recommendation released on 25th Dec 2012. It should be noted that the downward revision is due to: i) Change in Beta to 1.8 (2 years weekly beta) ii) No expectation of unit sales in 2013 as indicated by the company. Dar Al-Arkan highlighted that it will start selling residential units in 2H - 2014. We continue to believe that the prime revenue source is from land sales. We believe that Dar Al-Arkan is gradually shifting its strategic goals by: i) Seeking more project financing, instead of direct borrowing, ii) Seeking to attract more corporate clients rather than individuals, iii) Increasing its rental portfolio iv) Avoiding mega residential projects for the coming two years.

Investment consideration

Our updated 12-month price target is indicating the stock is offering a potential upside of **29.7%** over the market price of SAR8.25/share (as of 9th Mar 2013).

Key updates

- On valuation front, we update the company's (i) equity risk premium to 13.146%; where a synthetic risk free rate remained 2.7%, (ii) capital structure and cash flows in accordance with 2012. iii) Beta updated to 1.8x (2 year weekly beta).
- The company in 2012, posted net income of SAR 989mn as compared to 1,088mn in 2011, depicting a decrease of 9%Y/Y, despite of a 7% Y/Y jump in revenues. The weakness in result was due to weak performance in 4Q-2012, as the company during the quarter sold low margin land. Despite of a 20% Q/Q jump in revenues during 4Q-2012, net income showed a decline of 34.7%Q/Q.
- Going forward we expect the company's revenue to grow at a CAGR of 15%. Whereas net income is expected to show a CAGR of 15.0%, on the back of better price realization and residential units sales.

Key financial data

Amount in SARmn, unless otherwise specified	2011	2012	2013e	2014e	2015e	2016e
Income statement						
Sales revenue	3,313	3,557	3,872	5,219	6,206	7,301
Growth YoY (%)	-20.0%	7.4%	8.8%	34.8%	18.9%	17.6%
Cost of sales	(1,943)	(2,163)	(2,374)	(3,465)	(4,200)	(4,878)
Gross Profit	1,369	1,394	1,498	1,755	2,006	2,423
Growth YoY (%)	-22.4%	1.8%	7.5%	17.1%	14.3%	20.8%
General & administration expenses	(91)	(154)	(168)	(226)	(268)	(316)
Depreciation	(28)	(55)	(44)	(45)	(44)	(50)
Operating Profit	1,250	1,184	1,276	1,474	1,684	2,050
Growth YoY (%)	-22.7%	-5.3%	7.7%	15.5%	14.2%	21.7%
Financial/Bank charges	(212)	(263)	(245)	(201)	(204)	(207)
Other income/expenses	99	93	101	136	162	190
Profit before zakat & minority interest	1,137	1,014	1,132	1,409	1,641	2,033
Zakat	(49)	(25)	(29)	(36)	(41)	(51)
Net profit	1,088	989	1,114	1,383	1,609	1,989
Growth YoY (%)	-25.3%	-9.1%	12.7%	24.2%	16.3%	23.6%
Key fundamental ratios						
Liquidity ratios						
Current ratio (x)	0.7	1.3	2.6	2.6	3.2	4.3
Quick ratio (x)	0.7	1.2	1.1	1.6	2.3	3.3
Profitability ratios						
Gross profit margin	41.3%	39.2%	38.7%	33.6%	32.3%	33.2%
Operating margin	37.7%	33.3%	33.0%	28.2%	27.1%	28.1%
Net Profit margin	32.8%	27.8%	28.8%	26.5%	25.9%	27.2%
EBITDA margin	41.3%	39.2%	38.7%	33.6%	32.3%	33.2%
Return on average assets	5.3%	5.1%	5.7%	6.6%	7.4%	8.6%
Return on average equity	7.2%	6.2%	6.7%	8.0%	9.0%	10.5%
Leverage ratio						
Debt / equity (x)	0.47	0.27	0.25	0.19	0.18	0.18
Interest coverage (x)	5.89	4.50	5.21	7.32	8.24	9.88
Market/valuation ratios						
EV/sales (x)	4.08	3.80	3.49	2.59	2.18	1.85
EV/EBITDA (x)	10.56	10.89	10.23	8.89	7.81	6.43
EPS (SAR)	1.01	0.92	1.03	1.28	1.49	1.84
BVPS (SAR)	14.43	15.10	15.62	16.26	17.00	17.92
Market price (SAR) *	7.25	8.25	8.25	8.25	8.25	8.25
Market-Cap (SAR mn)	7,830.0	8,910.0	8,910.0	8,910.0	8,910.0	8,910.0
Dividend yield	0.0%	0.0%	0.0%	6.1%	6.1%	6.1%
P/E ratio (x)	7.20	9.01	8.00	6.44	5.54	4.48
P/BV ratio (x)	0.50	0.55	0.53	0.51	0.49	0.46

Source: Aljazira Capital * We have taken respective December closing prices for 2012, while for years 2013 & onwards we used closing price of 9th Mar 2013. We used the company's preliminary (unaudited) quarterly financial statements for 2012.

New recommendation	Overweight
Old recommendation	Overweight
New 12-month price target	SAR10.7/share
Old 12-month price target	SAR12.1/share
Current market price	SAR8.25 (9 th Mar 2013)
Upside / (Downside)	29.7%

Price performance

	3M	9M	12M
Absolute (%)	1.88	-18.09	-18.50
Relative to TASI (%)	-1.40	-20.79	-13.05

Source: TASI & Zawyia

Key growth drivers for 2013

- We expect the company to sell 7.0mn sqm of land at a price of SAR 507/sqm .
- Mortgage law will result in higher liquidity for the Saudi market, resulting in higher units demanded, which we believe will impact the land prices. However we believe, Dar will not be able to realize the full impact of Mortgage law, as the criterion for mortgage approval will still be based on the income level of the individual.

Key risk factors for 2013

- Any further delay in implementation of the mortgage law.
- Weakness in real estate market prices.

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RATING
TERMINOLOGY

1. **Overweight:** This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. **Underweight:** This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. **Neutral:** The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. **Suspension of rating or rating on hold (SR/RH):** This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

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