

## Saudi Real Estate Co (Akaria)

**BUY**

Target Price  
SAR26.2

### Market Data

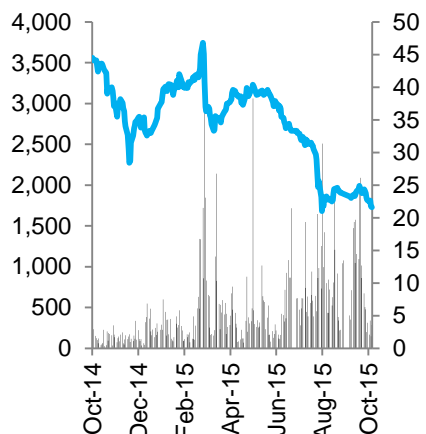
Bloomberg Code:	SRECO AB
Reuters Code:	4020.SE
CMP (28 October 2015):	SAR21.6
O/S (mn)	120.0
Market Cap (SAR mn):	2,592.0
Market Cap (USD mn):	691.3
P/E 2016e (x):	13.0
P/Bv 2016e (x):	0.7

### Price Performance 1-Yr

High (SAR):	47.5
Low (SAR):	21.0
Average Volume ('000):	479

	1m	3m	12m
Absolute (%)	-8.7	-32.3	-51.8
Relative (%)	-4.4	-21.7	-30.0

### Price Volume Performance



Vol ('000) Akaria (SAR)

Source: Reuters, Bloomberg

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- **Net profit falls 37.4%YoY due to low income from investee companies**
- **Slowdown in commercial segment due to strong supply – a concern**
- **Developments on acquired land plots – key catalysts**
- **Target price slashed to SAR26.2 per share; BUY recommended**

Akaria's top line decelerated with only 4%YoY growth in 3Q15 compared to about 5.5%YoY in last two quarters. We believe this was mainly due to oversupply in the commercial real estate market in Riyadh, where most of Akaria's properties are located. However, residential rental market continues to do well, aided by robust housing demand in the Kingdom. Going forward, we believe top-line growth in the commercial segment would continue to remain under pressure, as two new large projects i.e. KAFD and ITCC projects in Riyadh are expected to come on stream in 2016-17 thereby amplifying the supply glut in the industry. This would also exert pressure on the margins. However, on the other hand, Akaria's strong rental portfolio, particularly in the residential space, would continue to underpin earnings growth in the long term. Separately, Akaria's initiation of development on its two land plots acquired this year (a 4.5mn square meter plot acquired jointly with Alinma Investment and a 7.1mn square meter plot in Riyadh) could act as a key catalysts for stock. Akaria has secured funding agreements for about SAR3.7bn from NCB and PIF to support its expansion plans. However, in light of the expected slowdown in Riyadh's commercial real estate sector we revise our target price down to SAR26.2. Nevertheless, we recommend **BUY** on the stock due to a 51.8% fall in Akaria's stock price over the last 12 months which factors in most of the negatives.

### Net profits decline due to lower income from investee companies

Akaria's net profit declined 37.4%YoY to SAR38.4mn in 3Q15. The fall was ascribed to a decline in income from investee companies and the recognition of interest expense in the current quarter (absent in 3Q14). Nevertheless, the company managed to report a 4.1%YoY revenue growth. Furthermore, expansion in both gross margins (70.6% in 3Q15 vis-à-vis 68.9% in 3Q14) and operating margins (62.6% in 3Q15 vis-à-vis 61.4% in 3Q14) aided a 6.7%YoY and 6.3%YoY increase in gross profit and operating profit, respectively. On a QoQ basis, net profit came in 4.5% higher. This was mainly driven by a 3.5%QoQ growth in revenue due to higher rental income. However, higher income taxes restricted the growth in net profit.

SAR'000	3Q15	3Q14	YoY	2Q15	QoQ
Revenue	70,903.0	68,082.7	4.1%	68,487.9	3.5%
Cost of Sales	(20,812.0)	(21,146.3)	-1.6%	(22,423.5)	-7.2%
<b>Gross Profits</b>	<b>50,091.0</b>	<b>46,936.4</b>	<b>6.7%</b>	<b>46,064.3</b>	<b>8.7%</b>
S.G. & A. Expenses	(5,687.2)	(5,147.6)	10.5%	(6,275.2)	-9.4%
<b>Operating Profit</b>	<b>44,403.8</b>	<b>41,788.8</b>	<b>6.3%</b>	<b>39,789.1</b>	<b>11.6%</b>
Other Income	(2,129.4)	21,169.6	NA	(2,947.9)	-27.8%
<b>Net Profit before Zakat</b>	<b>42,274.3</b>	<b>62,958.4</b>	<b>-32.9%</b>	<b>36,841.2</b>	<b>14.7%</b>
Zakat	(3,905.0)	(1,692.8)	NA	(119.9)	NA
<b>Net Profit</b>	<b>38,369.3</b>	<b>61,265.6</b>	<b>-37.4%</b>	<b>36,721.3</b>	<b>4.5%</b>

Source: Company Accounts

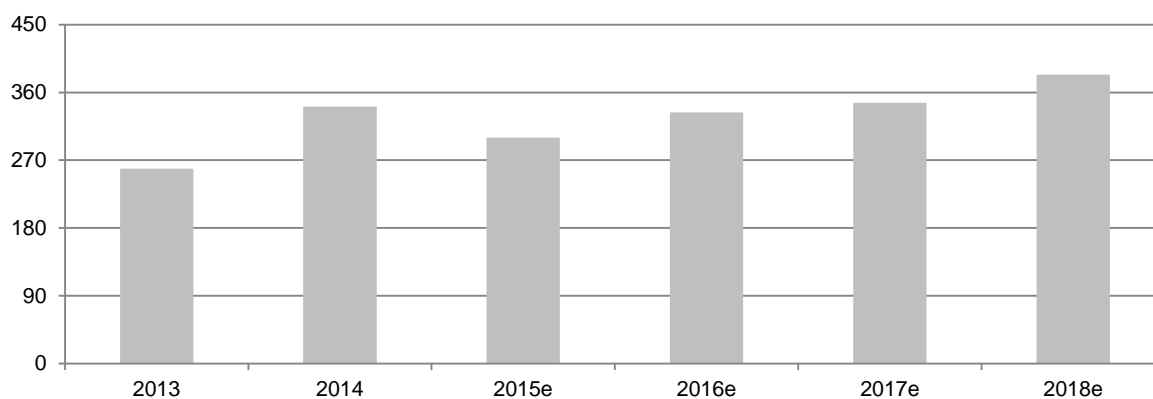
### Riyadh to witness strong supply of commercial properties – a major concern for Akaria

Akaria has a strong concentration of rental assets in and around Riyadh. In Riyadh, average rentals for offices have already started to soften amid looming oversupply concerns. In 2016 and 2017, the commercial real estate market of Riyadh is expected to witness considerable new supply, comprising the major landmark projects of King Abdullah Financial District (KAJD) and The Information Technology and Communications Complex (ITCC). Currently, delays in completions of these projects have been underpinning rentals. However, as the new supply comes on board, the market is expected to be well over-supplied. Moreover, amid a low oil price environment and rationalization of expenditure by the government, the pace of demand growth for these properties is also expected to be slightly subdued. This is likely to weigh on rentals and increase vacancy rates in Riyadh.

### Revenue up 5.0%YoY in 9M15; however, commercial segment to be a drag, going forward

Akaria's revenues grew 5.0%YoY to SAR206.6mn in 9M15. This was driven by higher rental income. The company's residential segment continues to remain strong due to the increasing demand for housing in Saudi Arabia, underpinning its top line. However, as discussed above, the commercial sector in region is concerned about a looming oversupply scenario. Going forward, we expect the commercial segment to be weak. However, Akaria's revenues are expected to increase moderately, driven by the rental portfolio of its residential segment. Consequently, Akaria's top line is expected to expand at a CAGR of 3.7% during 2014-2019e.

Revenue (SARmn)

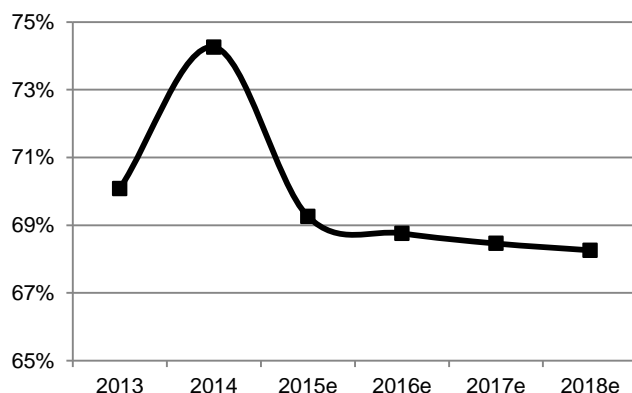


Source: Company Accounts

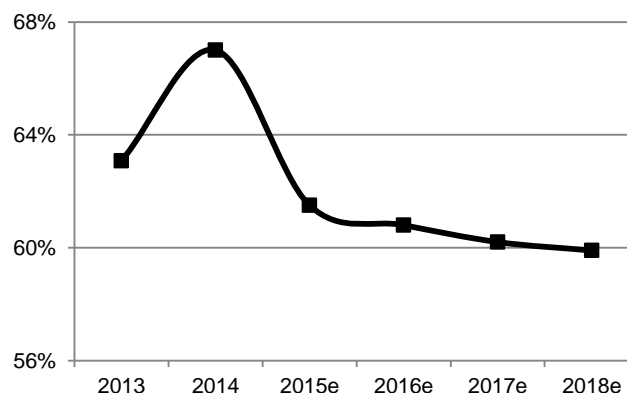
### Margins to continue to reel under pressure

Akaria's margins expanded significantly in 2014, mainly due to an asset sale in 4Q14. Consequently, we expect the gross and operating margins to decline to 69.3% and 61.5%, respectively in 2015e, following the high base of 2014. Thereafter, we expect the gross and operating margins to contract to 68.8% and 60.8%, respectively in 2016e, mainly due to a strong supply of stock in the commercial segment.

Gross Margin (%)



Operating Margin (%)



Source: Company Accounts

### Fees on white land present a risk to earnings

The Government of Saudi Arabia has decided to implement fees on white land (undeveloped land held by real-estate companies as investment). The move aimed at increasing the supply of affordable housing in the Kingdom. However, this could negatively impact Akaria, considering its significant land bank in Saudi Arabia. Akaria will thus have to look at developing projects on its land bank to reduce the impact of such fees on its earnings.

**Developments of land acquired – key catalysts**

In July 2015, Akaria entered into an agreement with Alinma Investment (a unit of Alinma Bank) to jointly buy a land plot of 4.5mn square meters. The quantum of this investment was SAR1.8bn (USD450mn) and the land would be used for construction or property projects. Moreover, earlier this year, Akaria acquired raw land in Riyadh spanning 7.1mn square meters, at an estimated value of SAR2.1bn. However, the exact plan for this property is currently not known; thus we have not included it in our forecasts. However, any positive development on this front can be key catalysts for growth.

**Recent debt issuances aid funding of expansion plans; further headroom for funding available**

Even as some of the major real-estate companies in Saudi Arabia became burdened by huge debt, Akaria was a debt-free company, enjoying a strong balance sheet. However, in 2014, the company entered into two major financing agreements. These included one with the Public Investment Fund that agreed to provide a long-term loan of SAR1.5bn to Akaria for 10 years and a long-term financing contract with the National Commercial Bank of SAR2.2bn for four years. Going forward, Akaria is well-capitalized to raise funds to acquire and develop more real-estate projects in Saudi Arabia.

**Valuation**

We valued Akaria's retail properties using a capitalization rate of 7.0%. For other properties, we utilized a two-stage DCF method. Our target price of SAR26.2 per share is 21.5% above the stock's current market price. Hence, we recommend a **BUY** on the stock.

## Financial Statements

(SAR mn)		2012	2013	2014	2015e	2016e	2017e	2018e
Income Statement	Revenue	325	259	341	300	334	346	383
	Revenue growth	22.9%	-20.4%	31.8%	-12.1%	11.3%	3.8%	10.7%
	Cost of sales	(147)	(77)	(88)	(92)	(104)	(109)	(122)
	<b>Gross Profit</b>	<b>178</b>	<b>181</b>	<b>253</b>	<b>208</b>	<b>229</b>	<b>237</b>	<b>262</b>
	SG&A	(17)	(18)	(25)	(23)	(27)	(29)	(32)
	D&A	(27)	-	-	-	-	-	-
	Other operating income	-	-	-	-	-	-	-
	<b>Operating profit</b>	<b>161</b>	<b>163</b>	<b>229</b>	<b>184</b>	<b>203</b>	<b>209</b>	<b>230</b>
	Net financial charges	-	-	-	(26)	(28)	(34)	(39)
	Other income	30	4	63	25	35	42	51
	<b>Profit Before Taxation</b>	<b>191</b>	<b>167</b>	<b>292</b>	<b>183</b>	<b>210</b>	<b>217</b>	<b>241</b>
	Income tax	(12)	(11)	(15)	(10)	(11)	(11)	(13)
	<b>Net Profit</b>	<b>180</b>	<b>156</b>	<b>276</b>	<b>173</b>	<b>199</b>	<b>206</b>	<b>229</b>
	Minority interest	-	-	-	-	-	-	-
	<b>Net Profit Attributable to Shareholders¹</b>	<b>180</b>	<b>156</b>	<b>276</b>	<b>173</b>	<b>199</b>	<b>206</b>	<b>229</b>
Balance Sheet	Cash and marketable securities	53	18	4	33	86	138	141
	Receivables and prepayments	75	121	130	130	143	149	164
	Development WIP and land & Others	12	12	115	340	347	364	382
			-					
	Net fixed assets	2,019	1,988	1,968	3,925	4,004	4,085	4,208
	Other long term assets	1,288	1,411	1,470	1,470	1,487	1,504	1,523
	<b>Total Assets</b>	<b>3,445</b>	<b>3,551</b>	<b>3,687</b>	<b>5,898</b>	<b>6,067</b>	<b>6,240</b>	<b>6,418</b>
	Accounts payables	14	16	27	21	23	24	27
	Short-term debt	-	-	-	50	55	61	54
	Long-term debt	-	-	-	2,068	2,110	2,152	2,195
	Other liabilities	186	231	200	201	210	220	230
	Retained earnings	135	154	281	361	453	547	652
	Other Adjustments	3,110	3,150	3,179	3,196	3,216	3,236	3,259
	<b>Total Equity &amp; Liability</b>	<b>3,445</b>	<b>3,551</b>	<b>3,687</b>	<b>5,898</b>	<b>6,067</b>	<b>6,240</b>	<b>6,418</b>
Cash Flow	Cash flow from operating activities	229	182	155	(58)	189	192	207
	Cash flow from investing activities	(159)	(45)	(48)	(1,957)	(96)	(98)	(141)
	Cash flow from financing activities	(121)	(121)	(121)	2,044	(40)	(42)	(63)
	Change in cash	(51)	16	(14)	29	53	52	3
	<b>Net Cash at End</b>	<b>3</b>	<b>18</b>	<b>4</b>	<b>33</b>	<b>86</b>	<b>138</b>	<b>141</b>
Ratio Analysis	Gross margin	54.8%	70.1%	74.3%	69.3%	68.8%	68.5%	68.3%
	Operating margin	49.6%	63.1%	67.0%	61.5%	60.8%	60.2%	59.9%
	Net margin	55.2%	60.3%	81.0%	57.8%	59.6%	59.4%	59.6%
	Return on assets	5.2%	4.4%	7.5%	2.9%	3.3%	3.3%	3.6%
	Return on equity	5.5%	4.7%	8.0%	4.9%	5.4%	5.4%	5.8%
	Current ratio (x)	0.75	0.65	1.19	1.98	2.14	2.30	2.38
	Quick ratio (x)	0.67	0.60	0.63	0.64	0.85	1.01	1.05
	Debt / Equity (x)	0.00	0.00	0.00	0.60	0.59	0.58	0.58
	Times Interest Earned (x)	0.00	0.00	0.00	6.96	7.18	6.19	5.87
	EV/Revenues (x)	7.96	9.94	7.58	15.60	14.00	13.47	12.26
	EV/EBITDA (x)	13.74	15.76	11.32	25.36	23.02	22.38	20.46
	EPS (SAR)	1.50	1.30	2.30	1.45	1.66	1.71	1.91
	Book Value Per Share (SAR)	27.04	27.53	28.83	29.64	30.57	31.53	32.60
	Market Price (SAR) *	32.60	34.60	33.41	21.60	21.60	21.60	21.60
	Market Capitalization (SAR mn)	3,912	4,152	4,009	2,592	2,592	2,592	2,592
	Dividend Yield	3.0%	2.9%	3.0%	2.9%	3.4%	3.5%	3.9%
	P/E Ratio (x)	14.44	16.61	9.38	14.94	13.04	12.60	11.34
	P/BV Ratio (x)	1.21	1.26	1.16	0.73	0.71	0.69	0.66

Source: Company Reports &amp; Global Research

\* Market price for 2015 and subsequent years as per closing prices on October 28, 2015

## Disclosure

The following is a comprehensive list of disclosures that may or may not apply to all our researches. Only the relevant disclosures that apply to this particular research has been mentioned in the table below under the heading of disclosure.

Disclosure Checklist					
Company	Recommendation	Bloomberg Ticker	Reuters Ticker	Price	Disclosure
Saudi Real Estate Co (Akaria)	BUY	SRECO AB	4020.SE	SAR21.6	1,10

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