

22 October 2011

Buy

Target price

SR26.55

Price

SR22.60

Short term (0-60 days)

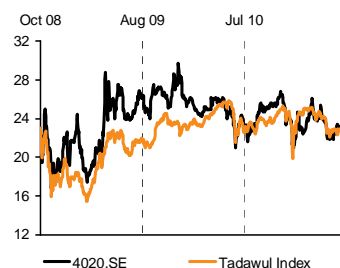
n/a

Market view

No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (SR)	22.65	24.00	25.00
Absolute (%)	-0.2	-5.8	-9.6
Rel market (%)	-0.0	-0.7	-7.3
Rel sector (%)	n/a	n/a	n/a



Market capitalisation

SR2.71bn (€525.97m)

Average (12M) daily turnover

SR5.11m (€0.92m)

Sector: European-DS Tot Mrkt
 RIC: 4020.SE, SRECO AB
 Priced SR22.60 at close 19 Oct 2011.
 Source: Bloomberg

Analysts

Saud Masud

United Arab Emirates
 +971 55 725 8596
 saud.masud@rasmala.com

Divya Arora

United Arab Emirates
 +971 4 424 2784
 divya.arora@rasmala.com

Dubai International Financial Centre,
 The Gate Village, Building 10, Level 1,
 P.O. Box 31145, Dubai, United Arab
 Emirates

www.rasmala.com

Saudi Real Estate Co

3Q11 results update

3Q11 results were above our expectations due to higher-than-expected rental and investment income. We continue to prefer SREC due to its higher value generation from recurring income assets and reasonably healthy dividend yield.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Total property income (SRm)	171.2	432.1	247.2	290.3	340.3
Net rental income (SRm)	171.2	209.2	235.7	240.3	250.3
Normalised PTP (SRm)	108.3	213.2	124.1	144.0	161.9
Normalised EPS (SR)	0.77	1.53	0.90	1.03	1.16
Normalised PE (x)	29.30	14.80	25.00	21.90	19.50
Dividend per share (SR)	0.75	1.25	1.00	1.00	1.00
Dividend yield (%)	3.32	5.53	4.42	4.42	4.42
Adj NAV per share (SR)	25.60	26.70	26.30	27.40	28.50
NNNAV per share (SR)	25.60	26.70	26.30	27.40	28.50
Disc/(prm) to adj NAV (%)	11.60	15.30	14.10	17.40	20.70
Net debt to tot ass (%)	-19.9	-4.56	-0.78	-4.41	-1.01

Accounting standard: IFRS
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

Results beat our expectations on better rental and investment income

SREC's 3Q11 revenue was SR59m (remained flat qoq), beating both our and Reuters consensus forecast of SR56m by 6%. SREC did not engage in land sales during the quarter; the entire revenue recognised was rental and rental related. But gross profit was in line with our estimate of SR38m, as gross margin at 64.4% (down 260bp qoq) was 360bp below our estimate. SG&A expenses improved, dropping from SR5.4m in 2Q11 to SR4m versus our estimate of SR5m. Net profit at SR33.8m (up 34% qoq) was far ahead of our expectation of SR24m (consensus was SR26m) as SREC realised a SR3.1m gain from its financial investment portfolio versus our estimate of a loss of SR5.3m. In 2Q11, SREC realised a loss of SR4.1m from its financial investment portfolio. Our forecasts for the next seven quarters of rental income are in line with 3Q11 rental income – we estimate SR59m-60m till 2Q13, after which we expect completion of Diplomatic Quarters 2 to start providing momentum to the rental income.

Making gradual progress towards utilising cash tied in financial investments portfolio

SREC's financial investment portfolio declined by SR131m from SR1,242 in 2Q11 to SR1,111m during 3Q11, and investment properties and projects under construction together increased by SR108m. It implies that the company is channelling liquidity generated from the sale of its financial investments towards construction of recurring income properties. We believe this would be incremental from ROE standpoint which is currently in low single digits.

Maintain Buy with a target price of SR26.55 per share

Despite its higher valuation versus its peers (trades at current PB multiple of 0.86x versus Dar Al Arkan at 0.44x and Emaar Economic City at 0.73x), SREC's risk/reward looks promising to us because of its low gearing, higher value generation from recurring revenue assets, adequate self-funding capacity and reasonably healthy forecast dividend yield of 4.3%. We estimate 55% of our fair value is driven by investment properties, 33% by financial investments, 11% by the land bank and 1% by properties for sale.

Important disclosures can be found in the Disclosures Appendix.

Distributed outside MENA by The Royal Bank of Scotland N.V. and its affiliates under a strategic alliance with Rasmala Investment Bank Ltd.

Income statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Net rental income	171.2	209.2	235.7	240.3	250.3
Prop development income	0.00	0.00	0.00	0.00	0.00
Other revenue	0.00	222.9	11.5	50.0	90.0
Total property income	171.2	432.1	247.2	290.3	340.3
Other costs	-61.8	-171.5	-101.3	-129.2	-163.1
EBITDA	109.4	260.6	145.9	161.1	177.2
DDA & Impairment (ex gw)	-17.9	-24.4	-5.79	-24.1	-23.3
EBITA	91.5	236.2	140.1	137.0	153.9
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	91.5	236.2	140.1	137.0	153.9
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Net interest	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	16.9	-22.9	-16.0	7.00	8.00
Reported PTP	108.3	213.2	124.1	144.0	161.9
Taxation	-15.7	-30.1	-15.8	-20.2	-22.7
Minority interests	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	92.6	183.1	108.3	123.8	139.2
Dividends declared	-90.0	-150.0	-120.0	-120.0	-120.0
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	109.4	260.6	145.9	161.1	177.2
Normalised PTP	108.3	213.2	124.1	144.0	161.9
Normalised net profit	92.6	183.1	108.3	123.8	139.2

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	643.8	158.6	26.2	154.0	36.9
Props under dev	0.00	0.00	0.00	23.0	155.5
Other current assets	105.8	107.2	76.5	80.5	84.5
Investment prop	1984	2056	2147	2119	2254
Other non-current assets	503.4	1158	1117	1118	1119
Total assets	3237	3480	3367	3495	3650
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Long term debt (3)	0.00	0.00	0.00	0.00	0.00
Other liabilities	170.5	276.8	208.0	212.0	228.0
Total liabilities	170.5	276.8	208.0	212.0	228.0
Total equity (incl min)	3067	3203	3159	3283	3422
Total liab & sh equity	3237	3480	3367	3495	3650
Net debt	-643.8	-158.6	-26.2	-154.0	-36.9

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

SRm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	109.4	260.6	145.9	161.1	177.2
Change in working capital	-26.1	-23.6	-25.3	-23.0	-120.5
Net interest (pd) / rec	n/a	n/a	n/a	n/a	n/a
Taxes paid	-15.7	-30.1	-15.8	-20.2	-22.7
Other oper cash items	40.7	-1.05	16.3	7.00	8.00
Cash flow from ops (1)	108.2	205.9	121.1	124.9	42.0
Capex (2)	0.00	0.00	0.00	0.00	0.00
Disposals/(acquisitions)	-43.1	-78.2	-179.0	2.91	-159.1
Other investing cash flow	639.7	-527.2	76.5	0.00	0.00
Cash flow from invest (3)	596.6	-605.3	-102.5	2.91	-159.1
Incr / (decr) in equity	n/a	n/a	n/a	n/a	n/a
Incr / (decr) in debt	n/a	n/a	n/a	n/a	n/a
Ordinary dividend paid	-122.0	-84.2	-149.4	0.00	0.00
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-0.00	-1.60	-1.60	0.00	0.00
Cash flow from fin (5)	-122.0	-85.8	-151.0	0.00	0.00
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	582.8	-485.2	-132.4	127.8	-117.1
Equity FCF (1+2+4)	108.2	205.9	121.1	124.9	42.0

Source: Company data, Rasmala forecasts

year to Dec

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Saudi Real Estate Co (RIC: 4020.SE, Rec: Buy, CP: SR22.60, TP: SR26.55): We value SREC using a sum-of-the-parts methodology, from which we derive our target price. Key risks to our target price relate to the landbank remaining underutilised, with no clear long-term strategy emerging, and increased residential rentals' visibility softening should macro conditions worsen. If recently announced government plans to build 500,000 houses and a mortgage market coming into existence result in higher property prices, SREC may be a key beneficiary, providing upside risk.

Disclaimer

This report is prepared by Rasmala Investment Bank Limited ("RIB"). RIB is regulated by the Dubai Financial Services Authority ("DFSA"). RIB products or services are only made available to customers who RIB is satisfied meet the regulatory criteria to be a "Professional Client", as defined under the Rules and Regulations of the Dubai International Financial Centre ("DIFC").

Our investment recommendations take into account both risk and expected return. We base our long-term fair value estimates on a fundamental analysis of a company's future prospects, after having taken perceived risks into consideration. We have conducted reasonable research to arrive at our investment recommendations and fair value estimates for the company or companies mentioned in this report. Although the information in this report has been obtained from sources that RIB believes to be reliable, we have not independently verified such information thus it may not be accurate or complete. RIB does not represent or warrant, either expressly or impliedly, the accuracy or completeness of the information or opinions contained within this report and no liability whatsoever is accepted by RIB or any other person for any loss howsoever arising, directly or indirectly, from any use of such information or opinions or otherwise arising in connection therewith.

Readers should understand that financial projections, fair value estimates and statements regarding future prospects may not be realized. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. This research report is prepared for general circulation and is intended for general information purposes only. It is not intended as an offer or solicitation or advice with respect to the purchase or sale of any securities referred to in the report. It is not tailored to the specific investment objectives, financial situation or needs of any specific person that may receive this report. We strongly advise potential investors to seek financial guidance when determining whether an investment is appropriate to their needs.

RIB is not registered with the U.S. Securities and Exchange Commission, or any U.S. state authority, as a broker-dealer or investment advisor. This report has not been approved, disapproved or recommended by the U.S. Securities and Exchange Commission, any state securities commission in the United States, the securities commission of any non-U.S. jurisdiction or any other U.S. or non-U.S. regulatory authority. None of these authorities has passed on or endorsed the merits or the accuracy or adequacy of this report.

RIB and its group entities (together and separately, "Rasmala") does and may seek to do business with companies covered in its reports. As a result, users should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Rasmala and its respective employees, directors and officers shall not be responsible or liable for any liabilities, damages, losses, claims, causes of action, or proceedings (including without limitation indirect, consequential, special, incidental, or punitive damages) arising out of or in connection with the use of this report or any errors or omissions in its content.

The research analyst or analysts responsible for the content of this research report certify that: (1) the views expressed and attributed to the research analyst or analysts in the research report accurately reflect their personal opinion(s) about the subject securities and issuers and/or other subject matter as appropriate; and, (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views contained in this research report. On a general basis, the efficacy of recommendations is a factor in the performance appraisals of analysts.