Salhia Real Estate Company

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	KWd330	Current Target Price	KWd387
Implied Upside	17.3%		

Assima Mall to More than Double GLA; Initiate With Accumulate

We initiate coverage of Salhia Real Estate (SRE) with an ACCUMULATE rating. *Its mixed-usage Assima project, opening in 2020, should be a major catalyst for the stock as the project will more than double Salhia's Kuwaiti GLA to 236k sqm from 104k sqm. Located at the prestigious Central Business District/Sharq area of Kuwait City, Assima Mall is considered as the biggest ongoing commercial project inside Kuwait City. On top of Assima's prime location, we think the timing is also right as the ongoing shortage in prime office space in Kuwait pushes rents higher. In fact, Kuwait's real estate market, specifically office space and retail, so far has been quite resilient vs. its GCC peers as the country's strong macro prospects for 2019 benefit business and consumer sentiment.* ***In our view, the completion of the Assima project should result in a net income CAGR of 18.6% during 2018-2022.*** *While we think Assima should give a substantial boost to Salhia, planned projects in the developing city of Birmingham (UK) are likely to sustain future growth.*

Highlights

- **Developing malls, office space and hotels for its own rental income portfolio, Salhia is the 2nd –largest-listed real estate investment company in Kuwait in terms of market capitalization.** 81% of Salhia's properties are located in Kuwait. Furthermore, SRE has JV investments in the UK and has initiated a direct development & investment business there in recent years.
- **Assima Mall is expected to be operational in 2020 and should increase Salhia's Kuwaiti GLA by 127%…** This 132k sqm GLA project includes a business tower with a GLA of 59.7k sqm, a hotel with 164 suites and a shopping mall with a GLA of 72.2k sqm.
- **…Enabling Salhia's revenue, EBITDA and net income to display CAGRs of 19.0%, 26.0% and 18.6% between 2018 and 2022.** Assima Mall not only boosts GLA, but also increases the weight of higher-margin Kuwait Mall GLA in Salhia's portfolio from 25% to 42%. Consequently, we anticipate Salhia's EBITDA margin to rise from an estimated 43.1% as of 2018 to 51.1% by 2022.
- **A growing economy sets the stage for a resilient real estate market.** While the World Bank forecasts global economic growth to slightly slow to 2.9% in 2019 from an estimated 3.0% for 2018, the agency also anticipates Kuwait`s GDP growth to speed up to 3.6% from 1.7% (2018).
- **Superior ROE to be further bolstered by Assima.** Salhia's 9M18 ROE of 12.7% is higher than the international real estate peer group averages and is notably above the listed Kuwaiti real estate companies' 4%. By 2021, we expect Salhia's ROE to rise further to 14.9%.
- **Long term growth opportunities:** Salhia plans to initiate Phase II and III of Birmingham development, which could cost KWD62mn. This will be Salhia's first sizable development project in the UK without a JV partner. If Phase II and III are completed profitably, it could open the doors to further investments in the UK real estate market for Salhia.
- **Notable "hidden value".** Salhia claims fair value of its assets indicate KWD280mn in "hidden value," which brings its NAV to KWD429mn vs. the reported KWD149mn and its P/NAV to 0.39x, implying a 61% discount to nominal value. Salhia records investment properties at BV. **We note we do not use any part of this "hidden value" in our valuation.**

Catalysts

1) Opening of the Assima Mall. 2) Kuwait's likely upgrade to MSCI EM Index in June'19 (Salhia will NOT be part of the EM index but could benefit tangentially). 3) Salhia's initiation of Birmingham Phase II. 4) Enhancement of dividends.

Recommendation, Valuation and Risks

- ***We rate Salhia as ACCUMULATE. Our 12 month target price of KWd387 implies a 17.3% upside potential, based on a weighted average combination of DCF, international peer comparison and local market P/E.*** Salhia trades at 2019 and 2020e P/E multiples of 11x and 9.7x, respectively, implying 0.3% and 13% discounts to the real estate investment companies' sub-peer group averages. It is noteworthy that Assima's impact on 2020e multiples are only partial and its full impact will be only seen in 2021. Salhia's 2018-2019e dividend yields are 6.1% each, notably above the international peer group averages of 4.1% and 4.4%, respectively.
- **Risks:** 1) Geopolitical risks. 2) Slower-than-expected Kuwait growth. 3) Higher interest rates.

Key Financial Data and Estimates

	2017	2018e	2019e	2020e
EPS (KWd)	30.8	34.4	29.7	33.8
P/E (x)	10.6	9.5	11.0	9.7
EV/EBITDA (x)	13.6	15.2	14.6	11.5
DPS (KWd)	20.1	20.0	20.1	20.8
DY (%)	6.1%	6.1%	6.1%	6.3%

Source: Company data, QNB FS Research; Note: All data based on current number of shares

Key Data

Bloomberg Ticker	SRE KK
ADR/GDR Ticker	N/A
Reuters Ticker	SREK.KW
ISIN	KW0EQ0400642
Sector	Real Estate
52wk High/52wk Low (KWd)	355 /320
3-m Avg. Volume (000)	109.5
Mkt. Cap. ($ bn/KWD bn)	0.56/0.17
EV ($ bn/KWD bn)	0.98/0.30
Current FO* (%)	1%
Shares Outstanding (mn)	512.7
1-Year Total Return (%)	1.3%
Fiscal Year End	December 31

Source: Bloomberg (as of February 4, 2019), *Boursa Kuwait (as of as of February 4, 2019); Note: FO is foreign ownership

Mehmet Aksoy, PhD
+974 4476 6589
mehmet.aksoy@qnbfs.com.qa

Saugata Sarkar, CFA, CAIA
+974 4476 6534
saugata.sarkar@qnbfs.com.qa

Valuation

We value Salhia shares at KWd387 with a 17.3% upside potential using a combination of DCF, international and domestic multiples. We have given the highest weight to DCF (cash flows to firm) methodology, as we think it captures the upcoming Assima Mall's full impact (which is anticipated to be seen in Salhia's financials by 2021-2022) better than market multiples.

Salhia: Valuation Summary

Method	Weight in Overall Salhia Valuation	Salhia`s Upside/Downside Potential
DCF	60%	30.1%
International Comparison	30%	
P/E, 2019e	5%	-12.9%
EV/EBITDA, 2019e	5%	-32.7%
Dividend Yield, 2019e	5%	38.3%
P/E, 2020e	5%	-1.5%
EV/EBITDA, 2020e	5%	-19.6%
Dividend Yield, 2020e	5%	25.8%
Local Comparison	10%	
Boursa Kuwait All Share Index P/E, 2019e @10.16x	10%	-7.9%
Weighted Average Upside Potential for Salhia Shares		17.3%

Source: Bloomberg consensus figures for international peers, QNB FS Research

Property investment companies are safer bets vs. developers during volatile market conditions. In line with our expectations for a volatile 2019 for equity markets, we prefer to maintain a low-beta real estate exposure, which is provided by the property investment companies. Salhia's beta of 0.78 is even below the property investors' sub-peer group average. In terms of key metrics and valuation multiples, real estate investor companies and real estate developers tend to display different characteristics. Property investment companies tend to have higher P/E and EBITDA multiples vs. developers, which are justified with their higher EBITDA margins (doubling the developers), thanks to the higher weight of rent income in their revenue. Furthermore, investment companies' revenue are less prone to macro & market volatility thanks to multi-year duration of rent contracts, which can be seen from property investors' defensive average beta of 0.82 vs. the developers' 1.19x.

Valuation Multiples: International Peers vs. Salhia

	Country	Mcap	Beta	P/E			EV/EBITDA			EBITDA Margin			Dividend Yield			ROE%		
Company		USDmn		2018e	2019e	2020e	2018e	2019e	2020e	2018e	2019e	2020e	2018e	2019e	2020e	2018e	2019e	2020e
RE INVESTORS																		
Mabanee	Kuwait	2,004	0.86	11.3	10.3	8.9	14.2	11.5	10.3	76.9%	75.5%	72.0%	1.6%	1.6%	1.6%	13.0%	12.3%	12.1%
Emaar Malls	UAE	5,173	0.77	8.9	7.9	7.4	8.1	7.6	7.3	64.1%	63.7%	63.6%	5.6%	7.9%	8.7%	13.2%	13.2%	13.4%
NEPI Rockcastle	S.Africa	5,378	0.61	n.a.	13.3	17.3	18.3	16.1	15.0	85.0%	84.6%	85.1%	7.3%	7.3%	7.6%	8.8%	8.8%	9.1%
Growthpoint Properties	S.Africa	5,675	0.72	14.6	11.0	11.0	16.1	14.5	13.7	74.1%	88.3%	88.1%	9.0%	8.6%	9.1%	8.8%	8.7%	9.1%
UOA Development Bhd	Malaysia	1,054	0.67	7.3	11.0	9.6	8.8	7.6	6.6	41.3%	42.0%	41.9%	7.1%	6.3%	6.3%	7.5%	7.5%	8.9%
IOI Development Bhd	Malaysia	2,179	1.00	10.8	12.8	12.8	17.2	16.1	15.7	38.2%	43.8%	42.6%	3.2%	3.3%	3.5%	4.4%	3.7%	3.9%
Phoenix Mills Ltd.	India	1,270	0.89	35.6	23.8	23.8	16.5	14.7	13.2	48.3%	49.7%	48.9%	0.5%	0.6%	0.6%	10.3%	10.5%	11.3%
Aldar Properties	UAE	3,297	1.33	6.3	5.7	5.7	7.0	6.7	6.2	36.2%	35.6%	36.9%	0.6%	1.7%	2.8%	9.2%	9.2%	9.6%
Investors Sub-peer Group Normalized Av.		**3,217**	**0.82**	**10.6**	**11.1**	**11.2**	**13.5**	**12.0**	**11.0**	**57.1%**	**59.9%**	**59.0%**	**4.2%**	**4.7%**	**5.1%**	**9.6%**	**9.5%**	**10.0%**
RE DEVELOPERS																		
Al Mazaya Holding, Kuwait	Kuwait	148	0.99	6.0	9.0	18.0	23.2	16.2	23.9	20.9%	21.7%	43.3%	11.4%	11.1%	11.1%	4.7%	4.7%	4.0%
Emaar Properties	UAE	7,992	1.16	5.4	4.5	4.1	4.9	4.6	4.5	39.3%	39.2%	40.0%	3.4%	3.8%	4.0%	11.2%	11.2%	11.7%
Damac	UAE	2,059	1.47	3.3	5.0	5.3	3.8	3.6	3.8	23.1%	25.4%	26.2%	9.9%	7.0%	7.8%	9.9%	9.9%	8.3%
Emaar Misr	Egypt	897	1.10	6.8	5.3	4.7	9.2	6.7	5.2	29.6%	31.2%	32.4%	n.a.	5.4%	8.0%	21.3%	21.3%	19.6%
Talaat Mostafa	Egypt	1,283	1.07	15.4	10.2	7.2	11.7	9.8	7.6	31.2%	32.9%	34.3%	0.9%	1.8%	2.5%	5.5%	5.5%	6.3%
SODIC	Egypt	296	1.20	7.7	5.4	3.9	6.0	3.7	2.7	21.4%	26.8%	30.1%	n.a.	4.2%	6.1%	14.3%	14.3%	18.0%
Palm Hills Development	Egypt	409	1.11	6.3	4.2	4.4	7.4	5.2	5.9	27.3%	30.7%	25.2%	n.a.	8.1%	8.5%	10.8%	10.8%	14.7%
Dar al Arkan	KSA	2,903	1.11	17.7	24.2	19.4	11.8	15.4	16.3	15.3%	14.3%	14.1%	5.5%	4.0%	4.5%	3.1%	3.1%	1.9%
Pakuwon	Indonesia	2,325	1.45	15.9	13.1	11.9	10.3	9.9	9.1	54.5%	54.7%	54.4%	1.0%	1.2%	1.4%	19.2%	19.2%	17.6%
PT Alam Sutera Realty Tbk	Indonesia	492	1.33	4.4	5.1	4.5	6.8	6.5	6.3	51.9%	51.7%	51.1%	0.5%	1.7%	1.8%	11.1%	11.1%	12.5%
Developers Sub-peer Group Normalized Av.			**1.19**	**8.5**	**7.2**	**7.5**	**8.5**	**7.7**	**7.3**	**30.6%**	**32.4%**	**35.3%**	**4.1%**	**4.5%**	**5.4%**	**10.8%**	**10.8%**	**11.6%**
Peer Group Normalized Av.			**1.04**	**9.8**	**9.6**	**9.6**	**10.9**	**9.8**	**9.2**	**42.8%**	**44.7%**	**45.9%**	**4.1%**	**4.4%**	**5.0%**	**10.1%**	**10.1%**	**10.7%**
Salhia	**Kuwait**	**558**	**0.78**	**9.5**	**11.0**	**9.7**	**15.2**	**14.6**	**11.5**	**43.1%**	**44.0%**	**45.4%**	**6.1%**	**6.1%**	**6.3%**	**11.5%**	**9.6%**	**10.4%**

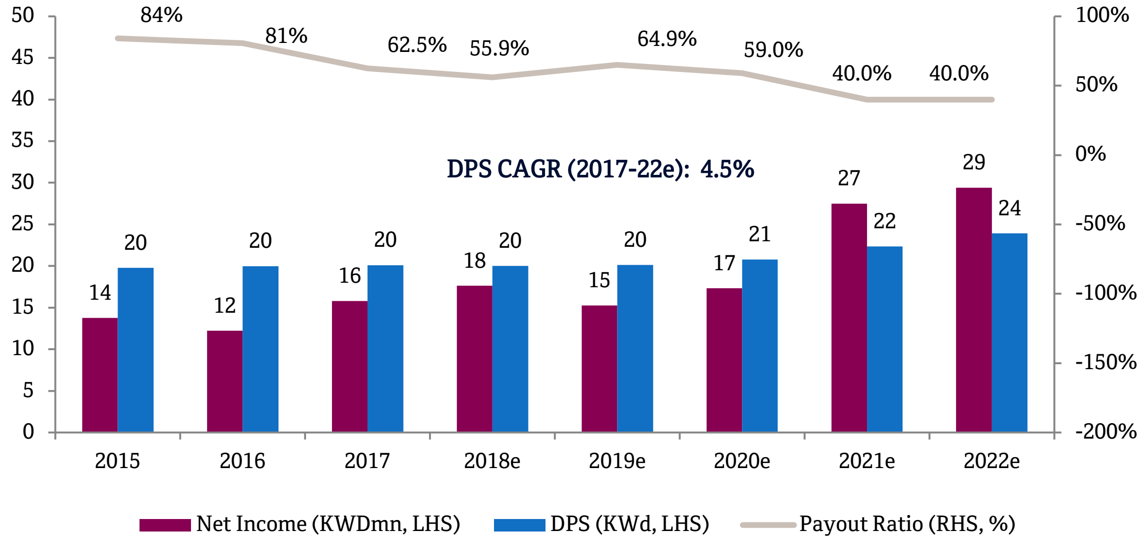
Source: Bloomberg consensus figures for international peers, QNB FS Research

Meanwhile, some developers also have substantial rent income such as Emaar Properties (accounting for 33% of consolidated revenue as of 2017), and some property investors have substantial development businesses such as Aldar (comprising 37% of consolidated revenue as of 2017).

Salhia's 2019 & 2020 P/Es are lower than property investment companies' sub-peer group, despite our conservative 2019 net income forecast. Salhia trades at 2019 and 2020e P/E multiples of 11.0x and 9.7x, implying 0.3% and 13% discounts to the real estate investors' sub-peer group averages. On the other hand, compared to the whole international real estate peer group (both containing property investors and developers), Salhia's 2019e and 2020e multiples imply 15% and 2% premiums, respectively. **Please note that Salhia's growth story,** (the expected net income growth after Assima's opening in 2020) **is only partially reflected into our 2020 forecasts and multiples. Once the mall opens in 2020, we will be able to observe Assima Mall's full positive impact on Salhia's bottom-line as well as its multiples starting from 2021.**

When Assima becomes operational, we anticipate Salhia's revenue, EBITDA and net income to display CAGRs of 19.0%, 26.0% and 18.6%, respectively over 2018-2022. Not only Assima Mall more than doubles Salhia's Kuwait GLA to 236k sqm by 2020 from 104k sqm as of 2018, but it also increases the weight of higher-margin-mall-GLA in the Salhia's portfolio from 25% to 42%. Therefore, we anticipate Salhia's EBITDA margin to rise from an estimated 43.1% as of 2018 to 51.1% by 2022. Nevertheless, primarily due to the low-margin care home operations in Germany (accounting for 35.9% of Salhia's revenue as of 9M18), Salhia's EBITDA margin is below the property investors sub-peer group's 57.1% as of 2018e. Note that Salhia's EV/EBITDA multiples of 14.6x for 2019 and 11.5x for 2020e are above the property investors sub-peer group's 12.0x and 11.0x respectively and we do not expect Salhia's EV/EBITDA to be at a discount to property investment companies' averages until 2021.

Salhia's Net Income, Dividend & Payout Ratios



Source: Salhia, QNB FS Research

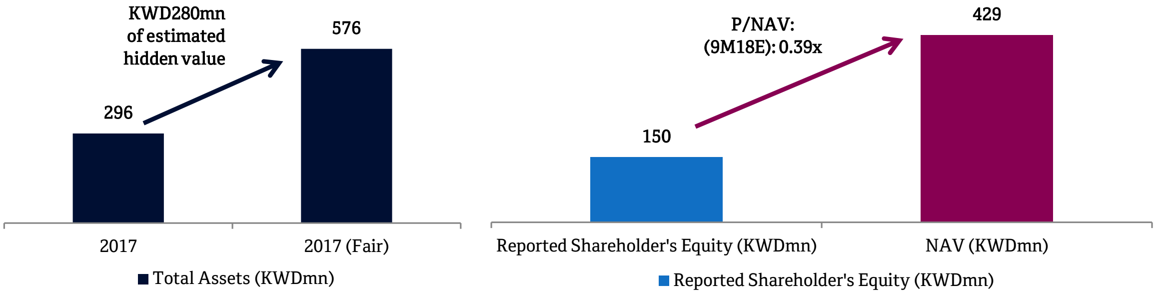
Our conservative view on the company's JV income results in a 13.5% yoy decline in Salhia's 2019 expected net income, however a revision to our forecasts could be required within the year, depending on KPI's asset disposals. Salhia keeps its JV exposure (Key Property Investment-KPI) in its books at cost and whenever KPI sells an asset, Salhia records the transaction's profits to its P&L as JV income. Assuming no more asset sales during 4Q18, we expect Salhia's JV income to account for 28% of its 2018e net income. For 2019, it is hard to foresee the amount of assets to be disposed at this point (as well as their book values). Therefore we forecast the JV income to turn back to its normal pattern of 16% of its net income, which is the average of 2015-2018e, as well as the figure recorded in 2015 & 2017. As a result of our conservative approach, we expect Salhia's bottom-line to contract by 13.5% to KWD15.25mn from KWD17.6mn estimated for 2018. However, it is noteworthy that if KPI has managed to liquidate its assets at reasonable prices even during 2018's relatively hard market conditions, we think it can do the same in 2019.

Salhia's dividend yields are superior to its peers, both historically and on a forward looking basis. While Salhia's 2017 dividend yield of 6.1% is above the international real estate companies' 4.6%, its forecasted dividend yields of 6.1% for 2018 & 2019 are notably above the its peers' 4.1% and 4.3%. In 2020, with Assima's partial contribution, we anticipate Salhia's dividend yield to rise to 6.3%, beating the peers' 5.0%. Meanwhile Salhia's historic dividend yields are also higher than Borsa Kuwait's (3.8% for 2017) which could be attractive for retail investors.

We expect Salhia's DPS to rise with a CAGR of 4.5% during 2017-22e from KWd20 to KWd23.9 as of 2022e assuming that the company prefers to utilize the cash generated by Assima to reduce its financial debt and to finance new developments. For 2018, to be on the safe side, we forecast Salhia`s 2018 payout ratio as 55.9% (below 2017's 62.5%) and expect the company to maintain its DPS at KWd20, same as 2015-17. Note that Salhia had higher dividend payout ratios in 2015 (84%), 2016 (81%) and 2017 (62.5%) and paid KWd20 each year during 2015-17. Despite an expected 11.5% EPS growth in 2018 supported by an expected 92.6% rise in "share of JV results", we expect Salhia to again pay KWd20/share as DPS for 2018. **If the company expects less asset disposals from KPI in 2019, we think Salhia could prefer to keep DPS volatility low by not increasing its 2018 DPS followed a possible fall in 2019 to be again followed by another rise in 2020 DPS with Assima's opening.** Meanwhile, even after Assima's cash flows start to arrive in full-force after 2020, we think Salhia could not immediately go back to its historical higher dividend payout ratios and could prioritize to reduce its leverage. This, coupled with the lack of sufficient information regarding the company's investment expenditure plans in Birmingham-UK, lead us to stay on the conservative side and forecast a moderate DPS CAGR of 4.5% between 2017-22e. Salhia's Phase II and III capex in Birmingham-UK might cost GBP160mn (KWD62mn), which could drain some cash from potential dividend payments.

Substantial "hidden value": Salhia claims that the market value of its assets indicates KWD280mn of "hidden value". Consequently, we calculate the company's fair asset value and NAV to be 94% and 187% above their reported book values, respectively. As of 2017, Salhia declares the market value of its assets (including an independent professional appraisal for its property portfolio) as KWD576mn vs. the stated KWD296mn, implying KWD280mn of hidden asset value for Salhia. **The company also states that its property portfolio recorded no impairment losses during 9M18, which could mean that 2017's hidden asset value has been sustained as of 9M18.** Given the company's total reported assets of KWD314mn as of 9M18 and KWD165mn of liabilities & minority interest, we calculate NAV of KWD429mn for Salhia, which is 2.9x of Salhia's official shareholder's equity of KWD149.6mn as of 9M18. Accordingly, we calculate 9M18e P/NAV of Salhia shares as 0.39x, implying a 61% discount to nominal value and notably below its P/BV of 1.1x as of 9M18.

Salhia's Estimated Hidden Asset Value and 9M18e P/NAV



Source: Salhia, QNB FS Research

Meanwhile, Salhia's 9M18 P/BV is at 1.1x nearly double the Kuwaiti real estate companies' 0.66x; however, it is more than justified with the company's strong RoE. **Salhia's RoE is one the highest among the international real estate peer group companies at 12.7% as of 9M18, notably above the listed Kuwaiti real estate companies' 4.0%.**

DCF Assumptions:

- **In the lack of any solid details from the company regarding their GBP160mn (KWD62mn) investment, we have not included the possible impact of Beorma Square project located in Birmingham-UK into our DCF model. We forecast a 1.5% terminal growth for Salhia; however, we feel this growth could be conservative** given the company's business prospects in the UK market. Salhia's c20 years of property investment experience in the UK has been scaled up from a JV partnership to direct development with the completion of (estimated) GBP18mn Beorma Square Phase I project. Hence we think Beorma Square Phase II and III (the first sizeable project that Salhia will develop in the UK by its own) could be an important catalyst to increase our target price for Salhia shares in the future.

- **Although not immediately, Salhia could need to revamp (or even replace) some of its flagship properties. To be on the safe side, we foresee KWD10-17mn /year capex for 2019-2028 and KWD17.5mn pa for 2029 and onward.** Built in 1978, Salhia Commercial Complex is Salhia's flagship asset with its 25.5k sqm GLA of office space and 14.4k sqm GLA of retail space. Thanks to its prime location and benefitting from synergies with nearby Salhia assets, Salhia Commercial Complex maintains 100% occupancy on the retail side. However, we think sooner or later, Salhia could be obliged to renovate the asset. Similarly, built in 1997, Sahab Tower with its 14k sqm of office space could require a revamp in the future.

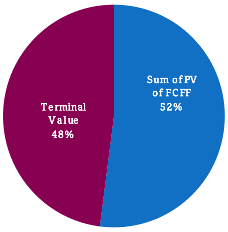
DCF Summary

WACC calculation	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	Value Normalized
Cost of equity		10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
RFr (US 10 yr+Kuwait 10yr CDS)		3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%	3.8%
ERP		6.24%	6.24%	6.24%	6.24%	6.24%	6.24%	6.24%	6.24%	6.24%	6.24%	6.24%
ERP for 1x Beta		8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Beta		0.78	0.78	0.78	0.78	0.78	0.78	0.78	0.78	0.78	0.78	0.78
After-tax cost of debt		4.54%	4.66%	4.42%	3.95%	3.71%	3.71%	3.71%	3.71%	3.71%	3.71%	3.71%
Weight of Equity		54.93%										
Weight of Debt		45.07%										
Mcap (KWDmn)		169										
Debt (KWDmn)		139										
Total (KWDmn)		308										
WACC		**7.6%**	**7.7%**	**7.6%**	**7.6%**	**7.6%**	**7.8%**	**8.0%**	**8.1%**	**8.2%**	**8.2%**	**8.2%**

DCF-Cash Flow to Firm (KWD)	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	Term. Value Normalized
EBIT (1-tax rate)	**18,617,766**	**16,334,388**	**20,872,709**	**32,968,229**	**33,932,265**	**34,936,714**	**34,734,335**	**34,399,477**	**34,231,486**	**34,055,421**	**33,871,290**	**36,617,852**
EBIT	19,589,432	17,186,883	21,962,061	34,688,849	35,703,199	36,760,070	36,547,129	36,194,795	36,018,036	35,832,782	35,639,041	38,528,947
Tax rate	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Depreciation	**5,496,847**	**5,646,428**	**5,698,058**	**5,851,096**	**6,005,569**	**6,161,506**	**6,335,191**	**6,526,654**	**6,727,798**	**6,938,654**	**7,159,254**	**4,296,624**
Capital Expenditure	**20,000,000**	**10,000,000**	**10,000,000**	**10,000,000**	**10,000,000**	**10,000,000**	**12,000,000**	**14,000,000**	**15,000,000**	**16,000,000**	**17,000,000**	**17,500,000**
% of Enterprise Value	5.9%	2.9%	2.9%	2.9%	2.9%	2.9%	3.5%	4.1%	4.4%	4.7%	5.0%	5.1%
Change in WC	**-1,381,096**	**465,963**	**196,302**	**-151,797**	**-73,949**	**-75,166**	**-72,058**	**-72,465**	**-65,905**	**-67,223**	**-68,568**	**-69,939**
Chg. working capital days	-11.0	3.7	1.3	-0.7	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	2.0
Net Sales	45,853,890	46,126,520	55,792,460	75,351,642	77,331,310	79,317,919	79,638,406	79,774,818	80,150,476	80,533,646	80,924,480	81,323,131
Change in sales	0.0%	0.6%	21.0%	35.1%	2.6%	2.6%	0.4%	0.2%	0.5%	0.5%	0.5%	0.5%
Free cash flow to the firm (FCFF)	**5,495,708**	**11,514,852**	**16,374,466**	**28,971,122**	**30,011,783**	**31,173,386**	**29,141,584**	**26,998,597**	**26,025,189**	**25,061,298**	**24,099,112**	**23,484,416**
WACC		7.6%	7.7%	7.6%	7.6%	7.6%	7.8%	8.0%	8.1%	8.2%	8.2%	8.2%
Discount Factor		1.00	1.08	1.16	1.25	1.34	1.45	1.56	1.69	1.83	1.98	2.14
PV of FFCF		**11,514,852**	**15,205,274**	**24,993,313**	**24,069,123**	**23,226,548**	**20,135,129**	**17,269,073**	**15,398,362**	**13,709,365**	**12,184,240**	**10,973,896**
Sum of PV of FCFF		**177,705,279**										

Terminal Value	**163,855,971**
Terminal FCFF	10,973,896
Terminal Growth Rate	1.5%
Terminal WACC	8.2%
Enterprise value	**341,561,250**
+Cash and cash equivalents	7,938,503
-Debt - long term and short term	126,646,581
-Minority Interest	2,648,432
Fair Value of Equity	**220,204,739**
Shares o/s (mn)	512,723,410
12M target price per share (KWd)	**429**
12 Month Upside Potential	**30.1%**

DCF Enterprise value breakdown



DCF Sensitivity

Terminal Discount Rate %	Terminal Growth Rate 0.5%	1.0%	1.5%	2.0%	2.5%
7.2%	429	455	486	522	566
7.7%	407	429	455	486	522
8.2%	388	407	429	455	486
8.7%	371	388	407	429	455
9.2%	356	371	388	407	429

Terminal Discount Rate %	Terminal Growth Rate 0.5%	1.0%	1.5%	2.0%	2.5%
7.2%	30.1%	38.0%	47.1%	58.1%	71.4%
7.7%	23.4%	30.1%	38.0%	47.1%	58.1%
8.2%	17.6%	23.4%	30.1%	38.0%	47.1%
8.7%	12.4%	17.6%	23.4%	30.1%	38.0%
9.2%	7.9%	12.4%	17.6%	23.4%	30.1%

Source: QNB FS Research

Investment Themes

- **Kuwait's potential entry to MSCI EM Index** in June'19 could also be an important catalyst for the Kuwaiti stocks. Salhia will NOT be part of the EM index but could benefit tangentially.
- **Kuwait: A growing economy sets the stage for a healthy office space and commercial real estate market.** In its Jan'19 report, World Bank cut its 2019 global growth forecast from 3.0% to 2.9%, which is also below the agency's 2018 global growth estimate of 3.0%. On the contrary, the agency increased its 2019 growth forecast for Kuwait by 0.1pp to 3.6% which is expected to speed up from an estimated 1.7% for 2018.
- **81% of Salhia's assets are located in Kuwait and the Kuwaiti real estate market (excluding the private residential segment) is one of the most resilient real estate markets in the GCC.** After posting promising 2Q18 data (sales were up 0.9% qoq and 31% yoy as of 2Q18), 3Q18 real estate sales statistics for Kuwait were encouraging, implying increases of 7.5% qoq and 81% yoy. 3Q18 investment real estate sales rose by 14% qoq and 147% yoy, which is attributable to rising apartment sales. We think declining real estate prices in the GCC region could be causing leading Kuwaiti investors to focus on their local market, which results in a growing number of local real estate transactions. 3Q18's commercial property sales growth was also robust, displaying a 61% rise vs. 3Q17. Due to the high occupancy rates in the office space market (96% as of 2017) we observe that prime office rents rose by c3-5% in 2018. On the other hand, we think prime retail space rents have managed to remain flat, despite the new supply originating from Mabanee's Phase IV addition. Among major segments, only the private residential segment saw lower prices and declining rents due to over-supply combined with decelerating growth of expat population.
- **Thanks to Assima Mall, we anticipate Salhia's revenue, EBITDA and net income to display CAGRs of 19.0%, 26.0% and 18.6% between 2018 and 2022.** Assima project commenced in 2015 and is set to be completed in 2020. **Salhia claims that more than 56% of Assima Mall has been pre-leased as of Sep'18, even prior to the completion of the project.**
- **Strong profitability to be further boosted by Assima Mall.** Salhia's RoE of 12.7% as of 9M18 is one the highest among the international real estate peer group companies and notably above the listed Kuwaiti real estate companies' 4%. By 2021, we expect Salhia's ROE to rise to 14.9% once Assima Mall's full positive impact is reflected in Salhia's results.
- **Long term growth opportunities are strong.** After the completion of Phase I at an estimated cost of GBP18mn, Phase II & III of the Birmingham-UK project will be a major scale-up for Salhia's UK operations with their total GBP160mn cost. Salhia has been in the UK property market since 1998 with its JV partners and its direct investment in Birmingham Phase I has been completed successfully, with Adaggio Hotel reaching 90% occupancy and 2 story of Digbeth Cold Storage been let out to a prestigious client (the Price's Trust). If Phase II and III are completed profitably, they could open the doors of UK real estate market to Salhia, which could be a major growth catalyst for the company.
- **Attractive dividend yield:** While Salhia's 2017 dividend yield of 6.1% for 2017 is above the international real estate companies' 4.6%, its forecasted dividend yields of 6.1% for 2018 & 2019 are notably above the its peers' 4.1% and 4.3%. In 2020 with Assima's partial contribution, we anticipate Salhia's dividend yield to rise to 6.3%, beating the peers' 5.0%. Meanwhile Salhia's historic dividend yields are also higher than Boursa Kuwait's (3.8% for 2017) which might be an attraction for local retail investors. **To be on the safe side, we forecast a moderate CAGR of 4.5% for Salhia's DPS during 2017-2022e from KWd20 to KWd23.9, as we think the company could prefer to use Assima's cash flows to reduce its leverage and to finance its development projects in the UK.**
- **Salhia claims that the market value of its assets indicate KWD280mn of "hidden value". Accordingly, we calculate the company's NAV to be 187% above its reported book value and P/NAV at 61% discount to par.** As of 2017, Salhia states the market value of its assets (including an independent professional appraisal for its property portfolio) as KWD576mn vs. the stated KWD296mn, inferring KWD280mn of hidden asset value. The company also states its property portfolio recorded no impairment losses during 9M18, therefore we deduce that 2017's hidden asset value is likely to be sustained as of 9M18. Accordingly, we calculate 9M18e P/NAV of Salhia shares as 0.39, implying a 61% discount to nominal value and notably below its P/BV of 1.1x as of 9M18. We note we do not use any part of this ""hidden value"" in our valuation.

Investment Challenges

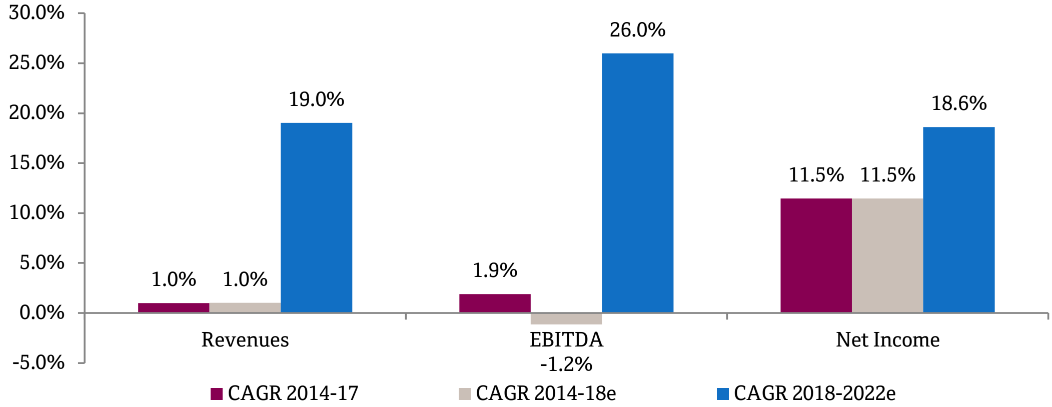
- **Although Assima Mall's completion should increase Salhia's cash generation substantially, we think the company could still be obliged to maintain its capex as some of its key properties might be aging.** Built in 1978, Salhia Commercial Complex is Salhia's flagship asset with its 25.5k sqm GLA of office space and 14.4k sqm GLA of retail space. Thanks to its prime location and benefitting from synergies with nearby Salhia assets, Salhia Commercial Complex maintains 100% occupancy on the retail side. However, we think sooner or later, Salhia could be obliged to renovate the asset. Similarly, built in 1997, Sahab Tower, with its 14k sqm of office space, might require a revamp in the long term.
- **Treasury shares complicate the valuation to an extent and could create selling pressure in the market if the company decides to dispose them.** As of Sep'18, Salhia holds 18.3mn shares of its own (down from 21.3mn as of Dec'17), which correspond to 3.58% of Salhia's total shares. If the company prefers to sell these shares in the market, it could create a short-term supply boost in Salhia shares. **On the other hand, a possible cancellation of these shares should be a positive catalyst for Salhia shares.**
- **A possible fruitless outcome from the Brexit negotiations between the UK and the EU could trigger potential volatility in the UK property market which could affect Salhia's JV income adversely.** Key Investment Properties-UK (Salhia's joint venture with St Modwen-UK), is managing a real estate portfolio of GBP180mn (KWD70mn), mainly composed of revenue generating assets bought during 1998-2002. While Key Investment Properties' real estate portfolio tends to generate an average c5% rental return annually, Salhia's return from the JV could be impacted from possible revaluation losses/gains that could arise in the coming periods. Besides, Salhia's income from its UK operations is exposed to the fluctuations of the GBP/KWD parity. **As of 9M18, Salhia recorded KWD5.3mn of income in its P&L as the "share in joint ventures' tax results, net of tax", accounting for 37% of its net income.** Hence any volatility in the income generated from UK operations could have a significant impact on Salhia's bottom-line.

Al Assima Project

PROJECT DETAILS

Given the lack of new major openings over the last five years, Salhia's revenue grew slightly since 2014 and its EBITDA shrank; however, its net income rose thanks to lower financial expenses, depreciation charges, and impairment provisions, coupled with higher JV income. In fact since the opening of Arraya Tower II in 2009 (which added 36k sqm GLA of office space to Salhia and brought the company's GLA to 104k sqm with a 54% increase), Salhia has had no major additions to its portfolio that would boost its revenue and profits. **However, the company has not been dormant at all; it has been investing in the Assima Project, while expanding its (so far relatively small yet promising) business in Birmingham, UK.**

Salhia's Pre & Post- Assima Mall Revenue, EBITDA and Net Income CAGRs

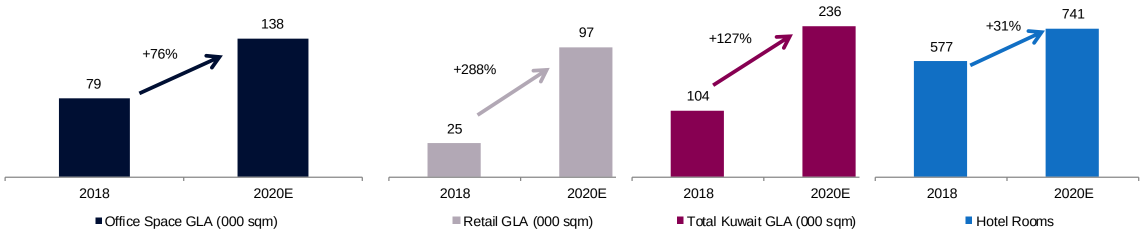


Source: Salhia, QNB FS Research

Al-Assima, the mixed-use mall development in Kuwait City is expected to be completed in 1H2020, which we think will be a major catalyst for Salhia shares in the medium term as the project will more than double Salhia's Kuwait GLA to 236k sqm from 104k sqm. The project is executed by Al-Assima Real Estate Company, a fully owned subsidiary.

Superb location: Assima Mall is located at the prestigious Central Business District/Sharq area of the Kuwait City on part of a 21.4k sqm land which is rarely found in the Capital area of the city. Assima has the great advantage of being located near to many high rise office towers, which are the headquarters of many local and international companies. The project is also located close to multiple landmark buildings such as the Kuwait Stock Exchange, the Central Bank of Kuwait and many residential areas.

Salhia's Pre & Post Assima GLAs in Kuwait



Source: Salhia, QNB FS Research

Assima Mall is considered as the biggest commercial project inside Kuwait City with an estimated total built up area of 380k sqm. The 132k GLA project includes a business tower with a GLA of 59.7k sqm, a hotel with 164 suites and a shopping mall with a GLA of 72.3k sqm containing restaurants, coffee shops, entertainment activities, cinema theatres and a health club at the heart of Kuwait City. The project is expected to cost KWD150mn to Salhia and has been financed internally.

Assima Project's Estimated GLA Breakdown

	Land Allocated (000sqm)	Purpose	Detail	Estimated GLA (000sqm)
Office Tower	**1.75**	**Office Space**	**56 floors**	**59.7**
Commercial Complex	**19.7**			**72.3**
Basement 2-3			Car Park	
Basement 1		Commercial	Hyper central market	6.6
Basement 1		Commercial	Shops	2.1
GF+Mezzannine+1st Floor		Commercial	Shops, restaurants and cafes	28.7
Floor 2-3		Commercial	Entertainment, cinema, restaurant and café	21.5
Floor 4-5		Commercial	Health club & outdoor roof restaurants	13.3
Upper 11 Floors		Commercial	Hotel with 164 suites	
Car Park Capacity			**2,295 cars**	

Source: Salhia, QNB FS Research

REAL ESTATE MARKET IN KUWAIT

A growing economy in Kuwait sets the stage for a resilient office space and commercial real estate market. While the World Bank forecasts global economic growth to fall to 2.9% in 2019 from an estimated 3.0% in 2018, the agency also anticipates Kuwait`s growth to speed up from 1.7% in 2018 to 3.6% in 2019. With its relatively smaller population, rich oil reserves, one of the lowest fiscal break-even oil price in the GCC at USD45 and +USD500bn SWF, Kuwait is one of our preferred investment spaces in the GCC. Thanks to its strong government finances, Kuwait has delayed its VAT implementation to 2021, which should be positive for Kuwait's growth & FDI in the coming years.

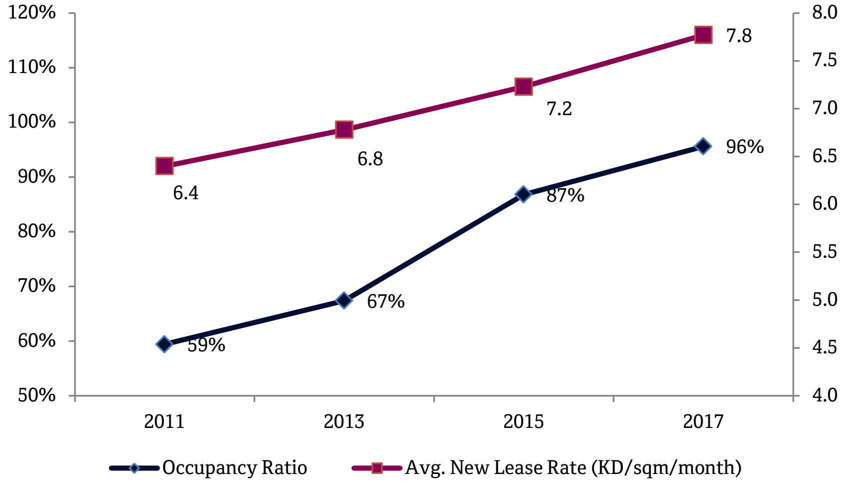
In 2018, Kuwaiti real estate market remained quite resilient, while other GCC real estate markets faced declining sales, prices and rents. After posting promising 2Q18 data (with sales up 0.9% qoq and 31% yoy), 3Q18 real estate sales data for Kuwait has been encouraging, implying 7.5% qoq and a 81% yoy increases. 3Q18 investment real estate sales rose by 14% qoq and 147% yoy, which was attributable to rising apartment sales. We think declining real estate prices in the GCC region could be leading Kuwaiti investors to focus on their local market. 3Q18's commercial property sales growth was also robust, displaying a 61% rise vs. 3Q17. Due to the high occupancy rates at the office space market (96% as of 2017), we observe that prime office rents rose by c3-5% in 2018, while prime retail space rents tend to remain flat, despite the new supply originating from Mabanee's Phase IV addition. Among the major segments, only the private residential segment saw lower prices and declining rents due to over-supply combined with decelerating growth of expat population.

OFFICE SPACE SEGMENT

Assima's new office space will be in the market at the right time as the office space market begins to peak in Kuwait. Kuwait's office space market has more than recovered since its 2011 bottom, reaching nearly full occupancy in 2018, thanks to limited new supply and government support. Low occupancy ratios during 2011-2013 followed by a sharp decline in oil prices during 2014-2016 discouraged new office space development and kept the supply increase limited. On the other hand, as a result of an increase in government employees from 313k as of 2011 to 378k in 2017, Kuwait's Real Estate Association anticipates that the Kuwaiti Government has absorbed 100k sqm of the vacant office space over the last 6 years.

Positive trend in the office space segment has continued in 2018. Due to the all-time high occupancy rates, rents of high-end properties reached their pre-2008 crisis peaks in 2018, rising 3-5%, compared to 2017.

Kuwait Office Space Occupancy Ratios & Average New Lease Rates



Source: Real Estate Association, QNB FS Research

Occupancy rates at international grade office spaces are nearly at 100%, which lead them to enjoy a cKWD2/month rent premium over the A grade. According to Kuwait's Real Estate Association, there are 415 office buildings in Kuwait with a total GLA of 1.43mn sqm and approximately 30% of this stock is considered as A Grade. Office spaces are mainly concentrated in the Central Business District (CBD)/Kuwait City (where Salhia's assets are located) and in Kuwait Free Trade Zone. International grade properties comprise a mere 16% share in Kuwait's office space stock. There are only 6 properties in this category in Kuwait with a total GLA of 38k m2.

Going forward, new supply is not expected to flood the market. New supply (primarily originating from government entities and large corporates for their own use) over the next few years seems to be limited and is only likely to modestly impact the average rent increases. Kuwait Investment

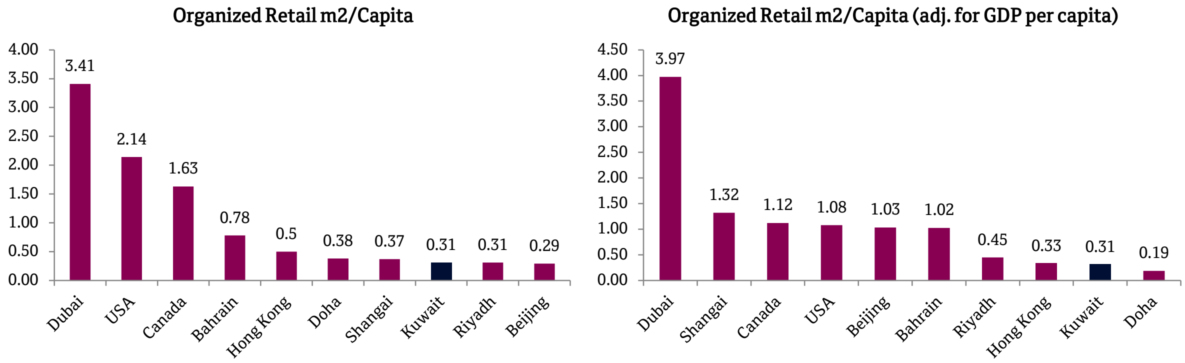
Authority's new 50-story HQ Building in Sharq was completed in 2018 with a total gross floor area of 130,000 sqm. National Bank of Kuwait is also building its new HQ in the Sharq area, with a GFA of 85k sqm and an anticipated completion of 2019-20. Unutilized floors of these buildings are likely to be used by other government entities, which could reduce potential future demand from such organizations. It is noteworthy that as these entities (as well as other government entities that could utilize the free space in the new buildings) have already ongoing lease contracts, it should take a couple of years for them to relocate to their new buildings. Apart from these, Salhia's new Assima project is likely to add 59.7k SQM of GLA to the office space supply in 2020.

RETAIL MARKET

Kuwait is relatively "under-malled" within the GCC context. Given the prime malls' 90-100% occupancy rates, we think new supply (other than Salhia) for the next 3 years, bulk of which has already arrived in 2018, should not depress rents. Consumer spending remains healthy; as a result, we observe flat trends in retail rents in 2018, despite the opening of Avenues Kuwait Phase IV. The latest 85k sqm Phase IV addition to the Avenues Mall (which was opened in 1Q18) constituted bulk of the new supply in Kuwait City. While Avenues Mall as a whole has an occupancy rate of 95%, Avenues Phase IV (which, in fact, is a stand-alone shopping mall with 300 stores) has already reached an occupancy ratio of 90% as of 9M18.

Due to its high urbanization rate of 98.3%, retail activities in Kuwait primarily take place in shopping malls. This, coupled with high per capita GDP (USD72k as of 2017 on a PPP adjusted basis, ranking the 3rd highest in the GCC, as well as 8th in the world) fuels personal spending, thereby increasing the attraction of shopping malls in Kuwait. Successful malls are not only shopping areas, but family entertainment and leisure destinations as well.

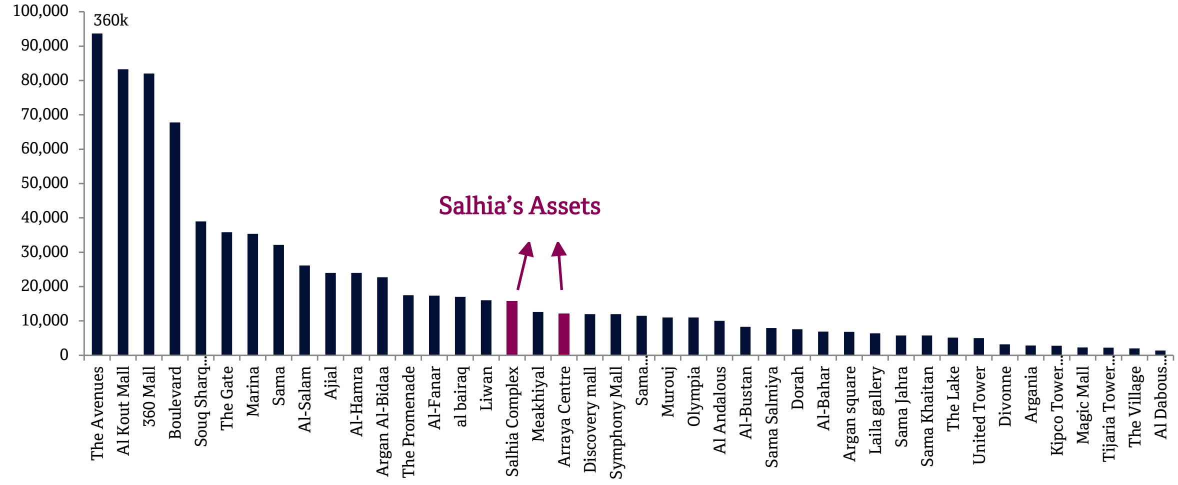
Kuwait Organized Retail GLA/ Capita Comparison



Source: Real Estate Association, QNB FS Research

There are 42 shopping malls in Kuwait; however, the segment is concentrated as the top 10 shopping malls comprise 72% of the GLA. Shopping malls' total GLA of 1.1mn sqm also comprises the bulk estimated 1.3mn sqm of organized retail space. Top ten malls (which are in the premium category) with a total GLA of 785k sqm accounts for 72% of the total shopping mall GLA. The Avenues Kuwait Mall (owned by Mabanee) is the largest mall in Kuwait and continues to be the most visited destination in Kuwait with its 360k sqm GLA and 1,100 stores. 360 Mall, The Gate Mall and Marina Mall are the other high-end malls, with respective estimated GLAs of 82k sqm, 37k sqm and 35k sqm. Opened in 1Q18, Al Kout Mall is the second largest shopping complex in Kuwait (GLA of 83.3k sqm with 260 shops). However, located in the Fahaheel region, it is c30km away from the Kuwait City Centre.

Shopping Malls in Kuwait



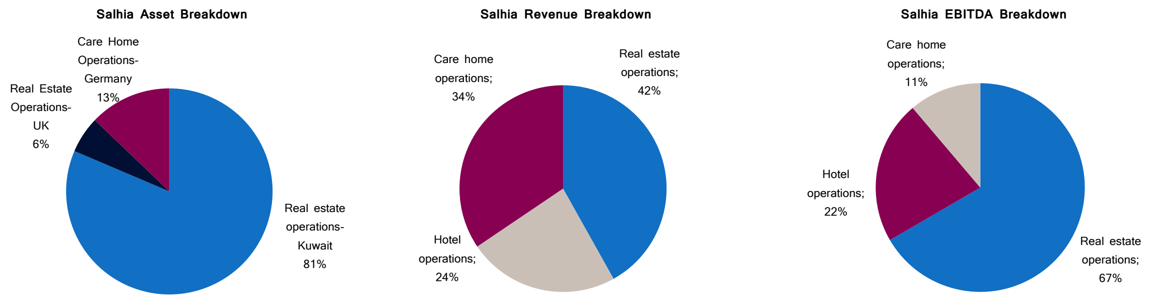
Source: QNB FS Research

In terms of new supply, Tamdeen Group is expanding its 360 Mall to 120k sqm by adding 40k sqm. Planned to be completed by 2020, the project (which is a stand-alone mall itself) also includes a 260-key luxury hotel, a ballroom, and the 7,600-seat Sheikh Jaber Al Abdullah Al Jaber Al Sabah International Tennis Complex. Moreover, Tamdeen has also announced its intention to build the Mall of Kuwait, which could cost $350mn and contain a 150k sqm of retail space. However, this project has been delayed with limited progress thus far.

Company Overview

Established in 1974, Salhia is a real estate investment and development company mainly investing in Kuwait's retail and leisure, hotels and office space markets. The company develops properties for its own investment portfolio with the aim of generating rental income. With its KWD169mn of total mcap as of February 4, 2019, Salhia is the second-largest, publicly-traded, real estate company in Kuwait after Mabanee (KWD610mn) and is followed by Commercial Real Estate, Kuwait (KWD164mn).

Salhia: Geographic Breakdown of Assets, Revenue and Profits, 2017



Source: Salhia, QNB FS Research

Kuwaiti assets dominates Salhia's investment portfolio. 81% of Salhia's assets are located in Kuwait & the GCC (which is almost all Kuwait) and the rest is invested in the UK and Germany. While assets in Kuwait are mainly composed of premium offices, retail space and hotels, Salhia also owns and operates care homes for the elderly in Germany. Further, Salhia invests in the UK property market through its 50% joint venture "Key Properties Investment" and has also initiated a direct development & investment business in the City of Birmingham, UK.

REAL ESTATE PORTFOLIO

We think it is a major success for Salhia to achieve and maintain full occupancy in nearly all Kuwaiti assets although its newest property was built a decade ago. Superior locations, continuous revitalization and maintenance efforts backed by on-board maintenance teams, and synergies created by the geographical proximity of RE assets, lead Salhia to enjoy nearly full occupancy levels at its assets.

Salhia Real Estate Assets

	Location	Opened in	Estimated GLA sqm000 (2018)
Office Space			**78.6**
Salhia Commercial Complex	Kuwait	1978	25.5
Arraya Commercial Centre (Arraya Tower I)	Kuwait	2003	6.0
Arraya Tower II	Kuwait	2009	36.3
Sahab Tower	Kuwait	1997	10.7
Retail			**25.1**
Salhia Commercial Complex	Kuwait	1978	14.4
Salhia Plaza	Kuwait	2006	0.0
Arraya Commercial Centre	Kuwait	2007	10.7
Hospitality			**Rooms**
Courtyard by Marriott Hotel Kuwait City	Kuwait	2004	264
JW Marriott Hotel Kuwait City	Kuwait	2007	313
Arraya Ballroom	Kuwait		1530 m2
Services & Catering			
Revenues (KWDmn)	Kuwait		
Staff Housing	Kuwait		
Care Home			
Beds	Germany		1,614

Source: Salhia, QNB FS Research

Salhia Commercial Complex neighbors three other Salhia properties (the JW Marriott Hotel, the Sahab Office Tower and Salhia Plaza) which together act like a big complex that contain office space, shops, hotel and outdoor areas. These assets are quite close and Sahab Tower is even connected to the Salhia Commercial Complex via a suspended bridge. Salhia Plaza provides outdoor restaurants and an additional two-story parking lot to the neighboring Salhia assets that can be utilized by the visitors and tenants of the Salhia assets.

INTERNATIONAL INVESTMENTS

Apart from Kuwait, Salhia invests and develops real estate in Germany and the UK:

Germany

As of 2017, Salhia's assets in Germany were worth KWD38mn, accounting for 13% of its real estate portfolio. Salhia has its presence in Germany via Haddia Holding GMBH, a German company 91%-owned by Salhia Real Estate. Haddia's subsidiary Dana GMBH is specialized in premium healthcare services and manages 1,614 beds under 13 nursing homes, 4 permanent condo cares and two "Dana Lifestyle" properties, all located in the North Western region of Germany. SAREC, which is another subsidiary of Haddia, wholly owns the nursing homes and the assisted living properties in Germany.

Contrary to Kuwait and the UK, Salhia makes limited investment expenditures in Germany, a mere KWD1.3mn since 2014, which could be attributable to the low profitability of this business. As of 2017, Salhia recorded KWD904k of segment EBT from the care home operations in Germany, which accounts a mere 5.1% of Salhia's ex-headquarters EBT vs. its share of 34% in the consolidated revenue. Consequently, German assets in Salhia's portfolio (in gross terms) yield at 1.6% vs. Salhia's total of 6.0% (excluding the HQ component) as of 2017.

UK

Salhia plans to initiate considerable investments in the City of Birmingham. In the UK, Salhia conducts its investment and development activities via long-standing joint ventures: Key Property Investments and Drawbridge Securities. Salhia also established Salhia International Investments Ltd. to be able to invest directly for the Beorma Quarter Project in the City of Birmingham, UK.

Key Property Investments (KPI) is a UK company owned equally by Salhia and St Modwen Properties PLC, UK. Established in 1997, Key Property Investments (KPI) owns an estimated KWD70mn real estate portfolio of primarily income generating assets acquired between 1998 and 2002. KPI's portfolio is composed of shopping malls, offices, and industrial sites throughout the UK. Apart from the acquired assets, KPI also realized a number of refurbishment and redevelopment projects in time. St Modwen manages KPI's property portfolio.

On the other hand, Salhia plans to expand its direct development business (without JVs) in Birmingham, with a GBP160mn project. Phase I of the Beorma Quarter was completed in 2015 at an estimated cost of GBP18mn, which includes the Adagio ApartHotel and a revamp of the Digbeth Cold Storage Building. The 108-room Adagio ApartHotel reached an occupancy ratio of 90%, while two floors of the Cold Storage have been let to Prince's Trust.

Key Properties Investments (as recorded in St. Modwen`s financials, representing St. Modwen's 50% share)

GBPmn	2015	2016	2017	1H18
Net rental income	5.9	5.5	4.9	2.7
Development profits	0	0	0.9	0
Revenues	**5.9**	**5.5**	**5.8**	**2.7**
Gains/(losses) on disposal of investments/investment properties	2.8	0.8	0.1	-0.3
Investment property revaluation gains/(losses)	6.7	1.2	9.5	-2.6
Change in estimated cost to establish a market in Nine Elms	–	–	–	–
Administrative expenses	-0.1	-0.3	-0.1	-0.1
EBIT	**15.3**	**7.2**	**15.3**	**-0.3**
Finance cost	-2.3	-2.2	-2	-0.8
Finance income	0.5	0.4	0.8	0.4
Profit/(loss) before tax	**13.5**	**5.4**	**14.1**	**-0.7**
Taxation	-2.3	-0.6	-0.9	0.1
Profit/(loss) for the year	**11.2**	**4.8**	**13.2**	**-0.6**
Property portfolio	**104.8**	**99.8**	**90.1**	
Net borrowings	**-34.2**	**-37.3**	**-26.5**	
Net assets	**65.8**	**56.3**	**59.5**	
Growth, YoY				
Revenues		-6.8%	5.5%	-22.9%
EBIT		-52.9%	112.5%	n.m.
Net Income		-57.1%	175.0%	n.m.
Property Portfolio		-4.8%	-9.7%	-5.1%
Key Ratios				
Net Debt/Total Assets	32%	36%	28%	n.a.
EBIT/Financial cost	6.7	3.3	7.7	-0.4
Tax rate	17%	11%	6%	14%
Revaluation Gains/ Real Estate Portfolio	6%	1%	11%	n.a.
Net Return on Assets	10.5%	4.7%	13.8%	n.a.

Source: St Modwen, QNB FS Research

Salhia is expected to start Phase II in 2019 or 2020, which includes a 30-story tower, with an expected 125 apartments and offices in Birmingham. Phase III of the project comprises of a 14-floor office building and a 7-floor residential block. Phase II & III are estimated to cost GBP160mn

(KWD62mn). A new public square called Orwell Place at ground level will be a part of the project, as well. Demolition works have started in preparation for the construction of Phases II & III.

Catalysts

- **Assima Mall's expected opening in 1H2020.** We think increased publicity with the mall's opening should increase investor focus on Salhia.
- **Initiation of Birmingham Phase II** should fuel the company's growth prospects as well as diversify its portfolio. Phase II and III are anticipated to cost a total of KWD62mn, accounting 31% of Salhia's book value of investment properties portfolio (or 11% of Salhia's market value of assets as of 9M18). We forecast a 1.5% terminal growth for Salhia; however, we feel this growth estimate could be conservative, especially given Salhia's c20 years of property investment experience in the UK. Beorma Square Phase II will be the first sizeable project that Salhia will develop in the UK by itself. Success of the project could be an important catalyst to increase our long term growth expectations and consequently our target price for Salhia shares. Phase II (the tower) development is expected to start in 2019 or 2020.
- **A noteworthy increase in DPS.** If the company decides to utilize Assima's cash flows to increase its dividend payments, we expect Salhia shares to be positively affected.
- **A possible upgrade to Kuwait Premier Market in the future.** Salhia is in Boursa Kuwait's Premier Market Watchlist. If the expected growth in assets and profits are reflected to its mcap and average trading volume, Salhia could be included to Kuwait Premier Index in the coming years.
- **Potential selling/cancellation of its treasury shares.** As of Sep'18, Salhia holds 18.3mn shares of its own (down from 21.3mn as of Dec'17). The treasury shares correspond to 3.58% of Salhia's total shares. If the company prefers to sell these shares in the market, it could impact the stock price negatively. **On the other hand, a possible cancellation of these shares should be a positive catalyst for Salhia shares.**

Earnings Outlook

We anticipate Salhia to record KWD3.48mn in net earnings in 4Q18 and KWD17.63mn as of 2018, with a respective decline of 27.7% and an increase of 11.5% yoy. We forecast Salhia's 2018 net sales to rise by 1.8% yoy, thanks to an expected 4.8% rise in care home revenue, which is attributable to a hike in average prices. Due to lower margins in the real estate operations segment originating from one-time maintenance & renovation costs, we foresee Salhia's gross margins to fall from 61.2% in 2017 to 56.2%, leading gross profits to retreat by 6.5% to KWD25.75mn as of 2018 vs. 2017.

We expect 2018 operating income to decline by 12.8% to KWD14.3mn over 2017 as a result of: 1) A 0.7% rise in SG&A to KWD5.97mn, primarily due to an expected 6.6% rise in real estate operations segment's SG&A. 2) A 5.0% rise in deprecation charges yoy to KWD5.5mn. Consequently, we anticipate Salhia to record KWD19.8mn in EBITDA with an 8.5% decline yoy. Due to flattish revenue and rising COGS & SG&A, Salhia's EBITDA margins are foreseen to decline to 43.1% from 48.0% as of 2017.

On the positive front, total other income, which is expected to rise from KWD1.38mn as of 2017 to KWD5.3mn as of 2018 should support bottom-line growth. The forecasted rise in non-operating income is attributable to: 1) JV income, which is expected to expand to KWD4.99mn as of 2018 from KWD2.59mn in 2017 or up 92.6% yoy. 2) Lack of impairment losses which was KWD1.02mn in 2017 3) KWD0.25mn of gains from the sale of properties.

In 2019, we expect Salhia to post KWD46.1mn in revenue (up 0.6% vs. 2018) and due to our conservative expectations for Salhia's JV income (which could be subject to revision within the year), we foresee Salhia to post KWD15.25mn in net earnings with a 13.5% decline yoy. In the lack of any significant change in rents and as the company operates with nearly full occupancy in most of its assets, we anticipate Salhia's top-line to remain flattish in 2019 compared to 2018. In line with our expectations for a recovery in the gross margins to 57.2% from 56.2% as of 2018e in the absence of 2018's one-time maintenance expenses, we forecast a 2.6% rise in Salhia's 2019e EBITDA to KWD20.3mn, despite a 2.4% expected inflation-driven rise in SG&A.

After a strong 2018 when Salhia's JV income is set to rise 92.6% over 2017 reaching KWD4.99mn thanks to asset disposals, we forecast JV income to return back to its normalized pattern at KWD2.59mn, which could mean a 48% contraction vs. 2018. For 2019, it is hard to model the amount of assets to be disposed at this point (as well as their book values); hence, we forecast the company's JV income to revert back to its normal pattern running at 16% of net income, which is the average of 2015-2018e, as well as the figure recorded in 2015 & 2017. As a result of our conservative approach, we expect Salhia's net income to contract by 13.5% to KWD15.25mn from KWD17.6mn estimated for 2018.

Assima Mall's Contribution to Salhia

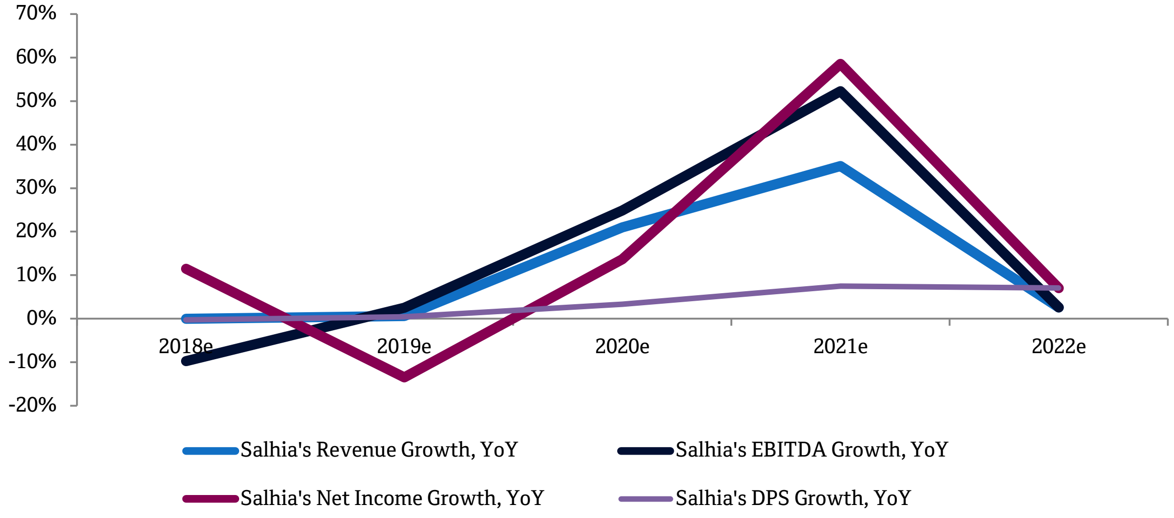
KWDmn	2018e	2019e	2020e	2021e	2022e
Salhia's Kuwait GLA (Sqm 000)	**103.6**	**103.6**	**235.6**	**235.6**	**235.6**
Office Space	78.5	78.5	138.3	138.3	138.3
Growth, YoY		*0%*	*76%*	*0%*	*0%*
Retail	25.1	25.1	97.4	97.4	97.4
Growth, YoY		*0%*	*288%*	*0%*	*0%*
Hospitality (rooms)	577	577	741	741	741
Growth, YoY		*0%*	*28%*	*0%*	*0%*
Salhia's Total Revenue (KWDmn)	**46**	**46**	**56**	**75**	**77**
Growth, YoY	*0*	*0%*	*21%*	*35%*	*3%*
Assima Mall's revenue	0	0	10	29	31
Assima's share in Total Revenue	**0%**	**0%**	**18%**	**39%**	**40%**
Assima's Occupancy Ratios					
Office Space	0%	0%	18%	85%	90%
Retail	0%	0%	28%	85%	90%
Hospitality (Suites)	0%	0%	28%	31%	33%
Salhia's EBITDA (KWDmn)	**20**	**20**	**25**	**39**	**40**
Assima Mall's EBITDA	0	0	6	19	20
Assima's share in Total EBITDA	0%	0%	22%	49%	51%
Salhia's Net Income (KWDmn)	**18**	**15**	**17**	**27**	**29**
Growth, YoY		*-13%*	*14%*	*59%*	*7%*
Salhia's DPS (KWd)	**20**	**20**	**21**	**22**	**24**
Growth, YoY	*0%*	*0%*	*3%*	*8%*	*7%*

Source: QNB FS Research

We expect Salhia to pay a DPS of KWd20 for 2018 and 2019, similar to 2017. For 2018, to be on the safe side, we forecast Salhia`s 2018 payout ratio as 55.9% (below 2017's 62.5%) and expect the company to maintain its DPS at KWd20 (flat with 2015-17). Note that Salhia had higher dividend payout ratios in 2015 (84%), 2016 (81%) and 2017 (62.5%) and paid KWd20 each year during 2015-17. Despite an expected 11.5% EPS growth in 2018 supported by an expected 92.6% rise in "share of JV results", we expect Salhia to pay KWd20/share as DPS for 2018. Doing so should continue to smoothen DPS trends and prevent volatility going forward.

We expect Assima Mall's full impact on Salhia's financials to be seen in 2020 & 2021 results; we anticipate Salhia's revenue, EBITDA and net income to display CAGRs of 19.0%, 26.0% and 18.6% between 2018 and 2022. Assima Mall not only boosts Salhia's GLA, but also increases the weight of higher margin Kuwait Mall GLA in Salhia's portfolio from 25% to 42%. Consequently, we anticipate Salhia's EBITDA margin to rise from an estimated 43.1% as of 2018 to 51.1% by 2022.

Salhia's Total Revenue, EBITDA, Net Income & DPS Growth Estimates After Assima Mall Becomes Operational



Source: QNB FS Research

We also forecast Salhia's DPS to rise with a CAGR of 4.5% during 2017-22e from KWd20 to KWd23.9 as of 2022e. Even after Assima's cash flows start to arrive in full-force after 2020, we think Salhia should not immediately go back to its historical higher dividend payout ratios and could prioritize to reduce its leverage. This, coupled with the lack of sufficient information regarding the company's investment expenditure plans in Birmingham-UK, lead us to stay on the conservative side and forecast a moderate DPS CAGR. Salhia's Phase II and III capex in Beorma Square, Birmingham, might cost GBP160mn (KWD62mn), which could drain some cash from potential dividend payments.

Detailed Financial Statements

Income Statement

In KWD 000	2017	2018e	2019e	2020e	2021e
Revenue	**45,041**	**45,854**	**46,125**	**55,792**	**75,352**
COGS	17,493	20,102	19,726	22,702	28,726
Gross Profit	**27,549**	**25,751**	**26,399**	**33,091**	**46,626**
SG&A	5,932	5,974	6,117	7,765	8,065
Depreciation	5,234	5,497	5,646	5,698	5,851
Operating Income	**16,382**	**14,281**	**14,636**	**19,628**	**32,710**
EBITDA	21,617	19,777	20,282	25,326	38,561
Impairment Loss on Investment Properties	-1,021	0	0	0	0
Other Income	263	100	121	163	168
Gain from the sale of Property	0	254	0	0	0
Investment Gains/(Losses)	605	94	99	104	109
Net FX Gain	64	124	0	0	0
Impairment Loss of AFS Investments	-982	0	0	0	0
Share in joint venture`s results, net of tax	2,591	4,989	2,589	2,330	1,971
Taxation of Overseas Subsidiaries	-136	-253	-258	-263	-268
Total Other Income	**1,385**	**5,309**	**2,551**	**2,334**	**1,979**
Net Finance Income(Expense)	-913	-832	-918	-3,473	-5,368
Finance Income	22	36	30	35	37
Finance Expense	-935	-869	-948	-3,508	-5,405
Income Before Taxes & Non-Recurring Items	**16,854**	**18,757**	**16,269**	**18,489**	**29,320**
KFAS, NLST and Zakat	-836	-890	-813	-924	-1,466
Non-controlling interests	-203	-239	-207	-235	-373
Net Income	**15,815**	**17,628**	**15,248**	**17,329**	**27,481**
Net Profit Margin	35.1%	38.4%	33.1%	31.1%	36.5%
EPS (KWd)	**30.8**	**34.4**	**29.7**	**33.8**	**53.6**
DPS (KWd)	**20.1**	**20.0**	**20.1**	**20.8**	**22.3**

Note: EPS based on current number of shares

Source: Company data, QNB FS Research

Balance Sheet

In KWD 000	2017	2018e	2019e	2020e	2021e
Cash & Cash Equivalents	4,896	7,082	7,082	7,082	7,082
Investments Held for Trading/ST Investments	2,633	3,254	856	761	924
Accounts Receivable & Prepayments	12,847	13,493	9,487	6,591	8,901
Due From Related Parties	449	0	0	0	0
Inventories	287	312	306	352	445
Total Current Assets	**21,112**	**24,141**	**17,731**	**14,785**	**17,353**
Available for Sale Investments	5,367	0	0	0	0
Held to Maturity Investments	0	6,332	6,815	7,298	7,781
Investment in Joint Ventures	6,381	9,327	6,626	6,367	6,008
Investment Properties	187,063	205,124	213,104	221,002	228,820
Goodwill & Intangibles	0	0	0	0	0
Property, Plant & Equipment	76,414	73,436	72,599	71,773	70,930
Non-Current Assets	**275,224**	**294,220**	**299,145**	**306,440**	**313,538**
Total Assets	**296,336**	**318,360**	**316,876**	**321,226**	**330,891**
Short-Term Debt	10,693	5,188	5,188	5,188	5,188
Insurance Payables, Accounts Payable & Accruals	7,747	9,748	9,276	10,341	13,085
Due to Related Parties	0	0	0	0	0
Current Liabilities	**18,440**	**14,936**	**14,463**	**15,529**	**18,273**
Employees End of Service Benefits	4,535	4,999	5,509	6,072	6,691
Long-Term Debt	118,135	133,647	126,647	121,647	110,647
Other L/T Liabilities	8,819	8,819	8,419	8,226	7,787
Non-Current Liabilities	**131,489**	**147,464**	**140,575**	**135,944**	**125,125**
Total Liabilities	**149,929**	**162,400**	**155,038**	**151,473**	**143,398**
Total Shareholder's Equity	143,895	153,312	159,189	167,105	184,844
Minority Interest	2,812	2,648	2,648	2,648	2,648
Liabilities & Shareholder's Equity	**296,636**	**318,360**	**316,876**	**321,226**	**330,891**

Source: Company data, QNB FS Research

Cash Flow Statement

	2017	2018e	2019e	2020e	2021e
Cash Flow From Operations	**24,507**	**21,715**	**24,028**	**29,520**	**39,217**
Cash Flow From Investment Activities	-29,909	-16,300	-6,634	-8,200	-8,180
Cash Flow From Financing Activities	4,150	886	-17,802	-18,404	-26,630
Cash Flow From Other Activities	-425	-3,261	-1,990	-3,011	-4,244
Change In Cash	**-1,677**	**3,040**	**-2,398**	**-96**	**163**
Cash Beginning of Period	6,573	4,896	7,082	7,082	7,082
Decrease (increase) in Fixed Deposits	-305	-854	2,398	95	-164
Cash End of Period	**4,896**	**7,082**	**7,082**	**7,082**	**7,082**

Source: Company data, QNB FS Research

Ratio Analysis

Key Metrics

Particulars	2016	2017	2018e	2019e	2020e	2021e
Growth Rates						
Revenue	1.4%	3.4%	1.8%	0.6%	21.0%	35.1%
Gross Profit	5.5%	3.3%	(6.5%)	2.5%	25.3%	40.9%
EBITDA	1.7%	5.1%	(8.5%)	2.6%	24.9%	52.3%
EBIT	1.7%	11.5%	(12.8%)	2.5%	34.1%	66.7%
PAT/EPS	5.2%	29.3%	11.5%	(13.5%)	13.6%	58.6%
DPS	1.0%	0.5%	(0.3%)	0.4%	3.3%	7.5%
CFPS	4.3%	23.6%	(11.4%)	10.7%	22.9%	32.9%
Operating Ratios						
Gross Margin	61.2%	61.2%	56.2%	57.2%	59.3%	61.9%
Gross Margin, Excluding Depreciation & Amortization	61.2%	61.2%	56.2%	57.2%	59.3%	61.9%
EBITDA Margin	47.2%	48.0%	43.1%	44.0%	45.4%	51.2%
EBIT Margin	33.7%	36.4%	31.1%	31.7%	35.2%	43.4%
Net Margin	28.1%	35.1%	38.4%	33.1%	31.1%	36.5%
Working Capital Ratios						
Inventory Days	7	6	6	6	6	6
Average Collection Period	130	104	107	75	43	43
Payable Days	162	162	177	172	166	166
Finance Ratios						
Debt-Equity Ratio	0.8	0.9	0.9	0.8	0.8	0.6
Net Debt-Equity Ratio	0.7	0.8	0.8	0.8	0.7	0.6
Net Debt-to-Capital	0.4	0.5	0.5	0.4	0.4	0.4
Net Debt-to-EBITDA	4.9	5.6	6.5	6.1	4.7	2.8
Interest Coverage	9.0	17.5	16.4	15.4	5.6	6.1
Return Ratios						
ROIC	5.9%	6.0%	4.9%	5.0%	6.7%	10.9%
ROE	8.8%	11.0%	11.5%	9.6%	10.4%	14.9%
ROA	4.6%	5.3%	5.5%	4.8%	5.4%	8.3%
FCF Yield	7.6%	-7.8%	2.5%	15.7%	17.6%	23.2%
Liquidity Ratios						
Current Ratio	1.2	1.1	1.6	1.2	1.0	0.9
Quick Ratio	1.2	1.1	1.6	1.2	0.9	0.9
Valuation						
EV/Sales	6.3	6.5	6.6	6.4	5.2	3.7
EV/EBITDA	13.3	13.6	15.2	14.6	11.5	7.3
EV/EBIT	18.6	17.9	21.0	20.2	14.8	8.6
P/E	13.8	10.6	9.5	11.0	9.7	6.1
P/CF	8.5	6.9	7.7	7.0	5.7	4.3
P/BV	1.2	1.2	1.1	1.1	1.0	0.9
Dividend Yield	6.1%	6.1%	6.1%	6.1%	6.3%	6.8%
FCF Yield	7.6%	(7.8%)	2.5%	15.7%	17.6%	23.2%

Source: Company data, QNB FS Research

Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

Contacts

Saugata Sarkar, CFA, CAIA
Head of Research
Tel: (+974) 4476 6534
saugata.sarkar@QNB FS.com.qa
FS.com.qa

Shahan Keushgerian
Senior Research Analyst
Tel: (+974) 4476 6509
shahan.keushgerian@QNB FS.com.qa

Zaid al-Nafoosi, CMT, CFTe
Senior Research Analyst
Tel: (+974) 4476 6535
zaid.alnafoosi@QNB

Mehmet Aksoy, PhD
Senior Research Analyst
Tel: (+974) 4476 6589
mehmet.aksoy@QNB FS.com.qa

QNB Financial Services Co. W.L.L.
Contact Center: (+974) 4476 6666
PO Box 24025
Doha, Qatar

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