

Salhia Real Estate Company

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	KWd335	Current Target Price	KWd387
Implied Upside	15.5%		

In-Line FY2018 Results, Maintaining our Accumulate Call and PT

Salhia reported an in-line FY2018; with no major changes to our model we maintain our rating/PT of Accumulate/KWd387. Given 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 yoy. An expected partial recovery in the gross margins to 57.2% from 56.7% as of 2018 in the absence of 2018's one-time maintenance expenses may bring a slight improvement in 2019 on the operational front. At the bottom-line level, a normalized JV Income after 2018's outlier surge of 89% over 2017 is likely to result in a 12% decline in 2019 EPS yoy. We think Assima Mall opening in 2020 still remains the major catalyst for the stock as the project will more than double Salhia's Kuwaiti GLA to 236k sqm from 104k sqm.

Highlights

- **Salhia posted KWD17.3mn in 2018 net profits, in line with our KWD17.6mn estimate, recording a 9.5% rise over 2017.** A slight expansion in revenue and a surge in JV income drove the bottom line growth, whereas declining gross margins and rising SG&A capped the net income growth. As far as 4Q2018 is concerned, net income KWD3.2mn came in a tad below our KWD3.5mn expectation, due to slightly higher-than-expected SG&A.
- **FY2018 net revenue grew 0.9% reaching KWD45.5mn** (0.9% below our estimate). As of FY2018, revenues from care homes rose by 3.4% yoy to KWD16mn, which is attributable to foreign exchange gains as care homes generate revenues in Euros. In the lack of any notable GLA growth and as Salhia operates close to full utilization, revenue from real estate operations (accounting for 41.9% of total) rose by 0.8% over 2017 to KWD19mn. Revenue from hotel operations (22.9% of total) declined by 2.4%, which we think might be due to declining average rates in 2018.
- **FY2018 EBITDA fell by 10.3% yoy to KWD19.4mn YoY** (2% below our forecast). FY2018 gross profits were down 6.4% yoy to KWD25.8mn (a 0.2% deviation from our estimate). Lower margins in the real estate operations (61.2% as of 2017 vs. 56.7% as of 2018) originating from one-time maintenance & renovation costs, coupled with declining margins in the hotel operations (85.9% vs. 77.8%) in parallel to the overall Kuwaiti hospitality sector resulted in Salhia's gross margins to fall from 61.2% as of 2017 to 56.2%. Accordingly, Salhia's gross profits retreated by 6.5% to KWD25.8mn as of 2018 vs. 2017. This combined with an 8.1% rise in SG&A (due to fx rate impact from overseas subsidiaries and royalty fees for hotels) led 2018 EBITDA margins to fall from 48.0% in 2017 to 42.6%.
- **Share in joint venture's results rose by 89% to KWD4.9mn in 2018 and become the main driver of bottom line growth in 2018.** 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. Thanks to 2018's sizable asset disposals, Salhia's JV income surged, reaching 28.5% of the PBT nearly doubling its 2015-2017 average of 15%.
- **No surprise at DPS.** Salhia's board recommends KWd20 as dividends for 2018, in line with our expectations and similar to 2017. Proposed dividend implies a dividend yield of 6.0%.

Catalysts

1) Increase/decrease in JV income, in parallel to asset disposals in the UK 2) Salhia's initiation of Birmingham Phase II. 3) Opening of the Assima Mall.

Recommendation, Valuation and Risks

- **We maintain our rating for Salhia as ACCUMULATE. Our 12 month target price of KWd387 implies a 15.5% 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 10.9x and 9.6x, respectively, implying a 4.3% premium and a 12% discount 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 2019 dividend yield is 6.0%, notably above the international peer group average of 4.5%.
- **Risks:** 1) Geopolitical risks. 2) Slower-than-expected Kuwait growth. 3) Higher interest rates.

Key Financial Data and Estimates

	2017	2018	2019e	2020e
EPS (KWd)	32.2	35.1	30.8	35.0
P/E (x)	10.4	9.6	10.9	9.6
EV/EBITDA (x)	13.7	15.8	14.7	11.6
DPS (KWd)	20	20	20	21
DY (%)	6.0%	6.0%	6.0%	6.2%

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)	352 /320
3-m Avg. Volume (000)	119.5
Mkt. Cap. (\$ bn/KWD bn)	0.55/0.17
EV (\$ bn/KWD bn)	1.0/0.33
Current FO* (%)	1%
Shares Outstanding (mn)	512.7
1-Year Total Return (%)	3.7%
Fiscal Year End	December 31

Source: Bloomberg (as of February 21, 2019), *Bursa Kuwait (as of as of February 21, 2019); Note: FO is foreign ownership

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Detailed Financial Statements

Estimates vs. Realizations

KWD000	2017	2018	2018E	A vs. E	YoY	4Q2017	4Q2018E	3Q2018	4Q2018	YoY	QoQ
Revenue	45,041	45,461	45,854	-0.9%	0.9%	11,909	11,752	10,564	11,359	-1.3%	7.5%
Gross Profit	27,549	25,795	25,751	0.2%	-6.4%	8,407	6,911	5,701	6,954	-17.8%	22.0%
EBITDA	21,617	19,383	19,777	-2.0%	-10.3%	7,009	5,649	4,631	5,254	-19.4%	13.4%
Net Income to Equity	15,815	17,312	17,624	-1.8%	9.5%	4,809	3,476	4,740	3,164	-27.7%	-33.3%
EPS	32.15	35.07	35.70	-1.8%	9.1%	9.78	7.04	9.60	6.41	-28.0%	-33.3%
DPS (KWd)	20	20	20	0%	0%						
Gross Margin	61.2%	56.7%	56.2%			70.6%	58.8%	54.0%	61.2%		
EBITDA Margin	48.0%	42.6%	43.1%			58.9%	48.1%	43.8%	46.3%		
Net Margin	35.1%	38.1%	38.4%			40.4%	29.6%	44.9%	27.9%		

Note: EPS based on current number of shares

Source: Company data, QNB FS Research

Income Statement

In KWD 000	2017	2018	2019e	2020e	2021e
Revenue	45,041	45,461	46,127	55,792	75,352
COGS	17,493	19,666	19,727	22,702	28,726
Gross Profit	27,549	25,795	26,399	33,091	46,626
SG&A	5,932	6,412	6,117	7,765	8,065
Depreciation	5,234	5,369	5,646	5,698	5,851
Operating Income	16,382	14,014	14,636	19,628	32,710
EBITDA	21,617	19,383	20,282	25,326	38,561
Impairment Loss on Investment Properties	-1,021	0	0	0	0
Other Income	263	129	121	163	168
Gain from the sale of Property	0	254	0	0	0
Investment Gains/(Losses)	605	84	99	104	109
Net FX Gain	64	-81	0	0	0
Impairment Loss of AFS Investments	-982	0	0	0	0
Share in joint venture's results, net of tax	2,591	4,899	2,589	2,330	1,971
Taxation of Overseas Subsidiaries	-136	-181	-258	-263	-268
Total Other Income	1,385	5,105	2,551	2,334	1,979
Net Finance Income(Expense)	-913	-668	-953	-3,520	-5,422
Finance Income	22	18	-5	-12	-17
Finance Expense	-935	-687	-948	-3,508	-5,405
Income Before Taxes & Non-Recurring Items	16,854	18,450	16,234	18,442	29,267
KFAS, NLST and Zakat	-836	-903	-812	-922	-1,463
Non-controlling interests	-203	-235	-207	-235	-373
Net Income	15,815	17,312	15,215	17,285	27,431
Net Profit Margin	35.1%	38.1%	33.0%	31.0%	36.4%
EPS (KWd)	32.2	35.1	30.8	35.0	55.6
DPS (KWd)	20.1	20.0	20.1	20.7	22.3

Note: EPS based on current number of shares

Source: Company data, QNB FS Research

Balance Sheet

In KWD 000	2017	2018	2019e	2020e	2021e
Cash & Cash Equivalents	4,896	7,814	2,792	2,582	7,082
Fixed Deposits	2,633	2,300	2,300	2,300	924
Accounts Receivable & Prepayments	12,847	13,999	9,487	6,591	8,901
Due From Related Parties	449	0	0	0	0
Inventories	287	258	306	352	445
Total Current Assets	21,112	24,371	14,885	11,825	17,353
Financial Assets Available for Sale	5,367	0	0	0	0
Financial Assets At Fair Value Through Other Comp. Income	0	5,071	4,293	3,515	7,781
Investment in Joint Ventures	6,381	8,352	6,626	6,367	6,008
Investment Properties	187,063	211,561	213,104	221,002	228,820
Goodwill & Intangibles	0	0	0	0	0
Property, Plant & Equipment	76,414	72,065	72,599	71,773	70,930
Non-Current Assets	275,224	297,049	296,623	302,658	313,538
Total Assets	296,336	321,420	311,508	314,482	330,891
Short-Term Debt	10,693	2,297	2,297	2,297	5,188
Insurance Payables, Accounts Payable & Accruals	7,747	7,699	7,326	8,167	13,085
Due to Related Parties	0	0	0	0	0
Current Liabilities	18,440	9,995	9,623	10,463	18,273
Employees End of Service Benefits	4,535	5,150	5,848	6,640	6,691
Long-Term Debt	118,135	140,308	126,647	121,647	110,647
Other L/T Liabilities	8,819	13,583	12,418	12,124	7,787
Non-Current Liabilities	131,489	159,041	144,912	140,410	125,125
Total Liabilities	149,929	169,036	154,535	150,874	143,398
Total Shareholder's Equity	143,895	149,698	154,288	160,922	184,844
Minority Interest	2,812	2,686	2,686	2,686	2,648
Liabilities & Shareholder's Equity	296,636	321,420	311,508	314,482	330,891

Source: Company data, QNB FS Research

Ratio Analysis

Key Metrics

Particulars	2016	2017	2018	2019e	2020e	2021e
Growth Rates						
Revenue	1.4%	3.4%	0.9%	1.5%	21.0%	35.1%
Gross Profit	5.5%	3.3%	(6.4%)	2.3%	25.3%	40.9%
EBITDA	1.7%	5.1%	(10.3%)	4.6%	24.9%	52.3%
EBIT	1.7%	11.5%	(15.2%)	5.4%	34.1%	66.7%
PAT/EPS	5.2%	29.3%	9.5%	(12.1%)	13.6%	58.7%
DPS	1.0%	0.5%	(0.3%)	0.3%	3.3%	7.6%
CFPS	4.3%	23.6%	(19.6%)	25.7%	19.2%	31.8%
Operating Ratios						
Gross Margin	61.2%	61.2%	56.7%	57.2%	59.3%	61.9%
Gross Margin, Excluding Depreciation & Amortization	61.2%	61.2%	56.7%	57.2%	59.3%	61.9%
EBITDA Margin	47.2%	48.0%	42.6%	44.0%	45.4%	51.2%
EBIT Margin	33.7%	36.4%	30.5%	31.7%	35.2%	43.4%
Net Margin	28.1%	35.1%	38.1%	33.0%	31.0%	36.4%
Working Capital Ratios						
Inventory Days	7	6	5	6	6	6
Average Collection Period	130	104	112	75	43	43
Payable Days	162	162	143	136	131	131
Finance Ratios						
Debt-Equity Ratio	0.8	0.9	1.0	0.8	0.8	0.6
Net Debt-Equity Ratio	0.7	0.8	0.9	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	6.8	6.1	4.7	2.8
Interest Coverage	9.0	17.5	20.2	15.4	5.6	6.1
Return Ratios						
ROIC	5.9%	6.0%	4.8%	5.2%	6.9%	11.3%
ROE	8.8%	11.0%	11.6%	9.9%	10.7%	15.5%
ROA	4.6%	5.3%	5.4%	4.9%	5.5%	8.5%
FCF Yield	7.4%	-7.7%	1.3%	17.3%	17.3%	22.9%
Liquidity Ratios						
Current Ratio	1.2	1.1	2.4	1.5	1.1	1.1
Quick Ratio	1.2	1.1	2.4	1.5	1.1	1.1
Valuation						
EV/Sales	6.3	6.6	6.8	6.5	5.3	3.8
EV/EBITDA	13.4	13.7	15.8	14.7	11.6	7.3
EV/EBIT	18.8	18.1	22.1	20.4	15.0	8.6
P/E	14.0	10.4	9.6	10.9	9.6	6.0
P/CF	8.7	7.0	8.7	6.9	5.8	4.4
P/BV	1.2	1.2	1.1	1.1	1.1	1.0
Dividend Yield	6.0%	6.0%	6.0%	6.0%	6.2%	6.7%
FCF Yield	7.4%	(7.7%)	1.3%	17.3%	17.3%	22.9%

Note: EPS based on current number of shares

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

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