

United Development Company

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	17.49	Target Price	20.00
Implied Upside	14.4%	Old Target Price	25.50

Maintaining Accumulate but Reducing TP to Reflect Persistent Challenges

We maintain our directionally positive view on UDCD but revise our valuation /TP following a disappointing 2Q2017. We continue to see more upside than downside in the shares with management execution on driving higher occupancy rates and potential earnings' accretive milestones being key to bridging the valuation gap vs. peers. However, we view persistent operational and macro challenges as posing a risk to earnings (and growth) causing us to moderate our prior optimistic assumptions. As a result, we reduced our valuation/TP to QR20.00 from QR25.50, implying a ~14% upside from current share price.

Highlights

- **UDCD's 2Q2017 headline/adjusted earnings missed our estimates** – Net/adj. profit for 2Q2017 came in at ~QR53.2/60.0mn (~27/33% y/y) vs. our estimate of ~QR147mn (-64/59%), which translated into headline/adjusted EPS of QR0.15/0.17 vs. our QR0.42. While revenue was ~18% weaker than expected at QR305.7mn (~13% down y/y), we note that gross profit missed our estimates by a bigger magnitude (~27% below estimate), which is indicative of upward pressure on cost of revenue. The miss on revenue and higher costs of revenue were the main drivers of the adj. EPS miss accounting for ~QR0.27/sh.
- **We anticipate that most of the revenue generated in 2Q2017 was recurring with little coming from land plot sales** – Given UDCD's revenue profile in 2Q2017, we anticipate that few land plot sales were made during the quarter as the company relied heavily on its recurring earnings stream. We note that UDCD kicked off the construction of Al Mutahidah Towers in 1H2017 (480 apartments; delivery in 2019) where phase I has already been sold out, while phase II has had strong interest and success so far. In addition, the company is looking to develop several plots of land (Giardino Village) into residential villas with 10 prototypes to be offered for sale in 3Q2017.
- **Persistent operational/macro challenges giving us pause** – From our conversation with management, we highlight that we are disappointed with the occupancy ramp up on both the residential/commercial sides of the business. On the residential side, occupancy rates have been under mild pressure while commercial occupancy rates have remained stable. The weaker than expected execution was significantly impacted by weaker economic conditions.
- **Revising our estimates lower and reducing our TP** – We admit being surprised by the persistence of the macro challenges impacting the real estate space. However, we think that UDCD can do more to improve occupancy rates, which we view as the most important driver for near-term earnings. Overall, we reduced our real estate pricing parameters to reflect the continued weakness in real estate prices while also reducing the expected yield on rental properties (~7% from ~8%). Additionally, we now expect occupancy levels to remain stable for the remainder of 2017 with pickup expected in 2018 and beyond to ~90% terminal occupancy in 2021 (from ~95% previously). As a result, our 2017/18e EPS estimates dropped to QR1.75/1.78 from QR1.93/2.09. We highlight that 2017 is in our view a "show me" year where we expect UDCD to demonstrate operational improvements while advancing development projects.

Catalysts

1) Sale of Giardino Villa plots and sample villas – 3Q2017 and beyond; 2) Clarity on development of a school and medical facility on the Pearl – timeline unknown; 3) Commercial/full operations at the third Qatar Cool plant in West Bay – 1Q2018; and 4) Clarity on a second Qatar Cool plant in the Pearl – timeline unknown.

Recommendation, Valuation and Risks

- **Reducing TP to QR20.00 from QR25.50; maintaining Accumulate recommendation** – We continue to rate the shares as Accumulate on an attractive dividend yield (~7%) and valuation upside. UDCD is currently trading at ~10x our FY2017 EPS (~23% discount to peers) with P/NAV at ~0.9x suggesting that there remains upside not reflected in the current share price.
- **Risks to our thesis.** General economic weakness, changes in interest rates and project finance risk. Finally, we would welcome clarity on future growth initiatives supporting recurring income, which is necessary to sustain the dividend long-term.

Key Financial Data and Estimates

	FY2015	FY2016	FY2017e	FY2018e
Adj. EPS (QR/sh)	1.61	1.91	1.75	1.78
P/E (x)	10.9x	9.2x	10.0x	9.8x
CFPS (QR/sh)	1.78	2.22	1.48	2.19
P/CFPS (x)	8.5x	21.0x	6.0x	nmf
Adj. EBITDA (QR mn)	761.3	896.2	683.8	920.7
EV/EBITDA (x)	11.9x	10.1x	13.2x	9.8x

Source: Company data, Bloomberg, QNBFS Research

Key Data

Current Market Price (QR)	17.49
Dividend Yield (%)	7.1%
Bloomberg Ticker	UDCD QD
ISIN	QA000A0KD6M9
Sector	Real Estate
52wk High/52wk Low (QR)	22.94 / 16.50
30-d Average Volume ('000)	414.5
Mkt. Cap. (\$ mn/QR mn)	1,681 / 6,193
Shares Outstanding (mn)	354.1
FO Limit* (%)	49.0%
Current FO* (%)	10.8%
1-Year Total Return (%)	(6.0%)

Fiscal Year End December 31

Source: Bloomberg (as of July 18, 2017), * Foreign ownership (as of July 18, 2017) and includes GCC institutions

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Model Summary

Company Name:	United Development Co.	Price:	QR 17.49	Target Price:	QR 20.00
Ticker:	UDCD QD	Mkt Cap:	QR 6,193 mn	Dividend Yield:	7.1%
Recommendation:	ACCUMULATE	EV:	QR 9,054 mn	Total Expected Return:	14.4%

	FY2015	FY2016	FY2017e	FY2018e
Earnings (in QR mn except Per Share Items)				
Revenue	1,440.6	2,390.8	1,670.7	1,636.2
Gross Profit	874.9	1,116.0	916.9	1,207.9
Adj. EBITDA	761.3	896.2	683.8	920.7
Adj. EBIT	709.5	818.9	801.5	818.2
Adj. Net Income	570.1	675.1	618.0	632.0

FD EPS	1.95	1.76	1.74	1.78
FD Adj. EPS	1.61	1.91	1.75	1.78

Cash Flow (in QR mn except Per Share Items)				
Operating Cash Flow	632.0	785.6	522.3	775.4
Cash from Operations	728.9	294.5	1,026.0	(70.4)
Cash from Investing	(1,394.6)	584.1	126.6	(540.9)
Total Capex	(607.4)	(449.7)	(107.2)	(560.0)
Simple FCF (CFO - Capex)	121.5	(155.2)	918.8	(630.4)
Cash from Financing	(715.8)	(837.3)	(844.4)	(416.8)
Total Dividends	457.6	544.5	450.5	442.6

CFPS (ex. WC)	1.78	2.22	1.48	2.19
CFPS	2.06	0.83	2.90	(0.20)

Balance Sheet (in QR mn except Per Share Items)				
Cash/Equiv.	2,277	1,566	1,746	718
PP&E	4,499	3,231	3,253	3,693
Investment Properties	8,705	8,861	9,024	9,024
Total Assets	19,138	18,723	17,875	18,766

Current Debt	1,377	1,245	534	460
Long-Term Debt	3,430	3,273	3,594	3,694
Total Debt	4,807	4,518	4,129	4,154
Total Liabilities	7,852	7,413	6,366	7,026
Owners' Equity	10,914	10,898	11,059	11,230
Non-Controlling Interest	373	412	451	511

	1Q2017a	2Q2017a	3Q2017e	4Q2017e
Quarterly Estimates				
Revenue	768.5	305.7	313.2	283.3
Gross Profit	304.2	192.3	223.6	196.7
Adj. EBITDA	287.5	122.1	175.1	99.0
Adj. EBIT	268.9	112.2	343.9	76.5
Adj. Net Income	224.7	60.0	300.0	33.3

Cash from Operations	838.8	95.3	(142.3)	234.2
Cash/Equiv.	1,923.8	1,972.5	1,704.5	1,746.1
Total Debt	4,439.8	4,384.5	4,281.2	4,128.6

FD EPS	0.65	0.15	0.85	0.09
FD Adj. EPS	0.63	0.17	0.85	0.09
CFPS (ex. WC)	0.69	0.23	0.36	0.19

* Bloomberg consensus estimates; calculated if more than 3 observations are present

NA: Not Applicable

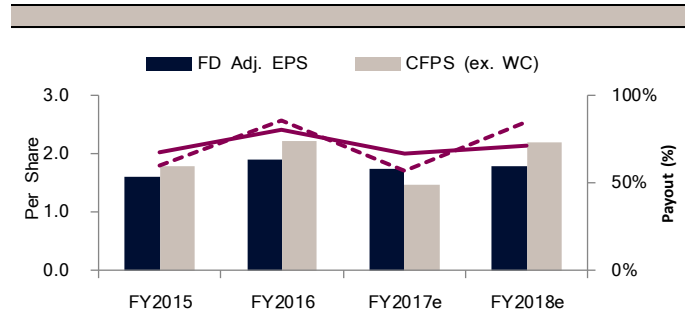
nmf: Not Meaningful (typically refers to negative or exceedingly large values)

	FY2015	FY2016	FY2017e	FY2018e
Valuation				
Adj. EV/EBITDA	11.9x	10.1x	13.2x	9.8x
Peer Median*	15.0x	14.7x	13.7x	11.9x
Adj. P/E	10.9x	9.2x	10.0x	9.8x
Peer Median*	11.1x	11.1x	13.2x	11.2x
P/CFPS	8.5x	21.0x	6.0x	nmf
Peer Median*	12.8x	12.3x	13.0x	12.6x
P/Operating NAV				0.80x
P/NAV				0.87x

Metrics				
Leverage and Debt Service				
Net Debt/adj. EBITDA	3.3x	3.3x	3.5x	3.7x
Debt/Capital	26%	25%	24%	23%
Debt/Equity	0.4x	0.4x	0.4x	0.4x
Interest Coverage	5.4x	6.7x	5.0x	6.0x
Profitability				
Adj. ROA	3.0%	3.6%	3.4%	3.4%
Adj. ROE	5.3%	6.2%	5.6%	5.7%
ROC	5.4%	6.0%	5.9%	5.8%

Dividend Payouts				
Adj. Net Income	67%	81%	67%	72%
Operating Cash Flow	60%	86%	57%	85%

Growth				
Revenue	(24.4%)	66.0%	(30.1%)	(2.1%)
Adj. EBITDA	(16.6%)	17.7%	(23.7%)	34.7%
Reported Net Income	10.2%	(9.6%)	(1.0%)	2.4%
Adj. Net Income	(16.1%)	18.4%	(8.5%)	2.3%
Operating Cash Flow	(17.0%)	24.3%	(33.5%)	48.5%



Source: Bloomberg, QNBFS Research

Fig 1 – Historical quarterly results vs. QNBFS estimates

	Unit	2Q2016	3Q2016	4Q2016	1Q2017	2Q2017	QNBFS Est.	Δ	q/q	y/y
Financial Results										
Total Operating Revenue	QR mn	353.4	500.2	1,079.1	768.5	305.7	370.6	(18%)	(60%)	(13%)
Gross Profit	QR mn	187.7	212.2	405.9	304.2	192.3	264.2	(27%)	(37%)	2%
Gross Margin	%	53%	42%	38%	40%	63%	71%			
Adj. EBITDA	QR mn	132.4	159.2	296.7	287.5	122.1	207.6	(41%)	(58%)	(8%)
Adj. EBITDA Margin	%	37%	32%	27%	37%	40%	56%			
D&A	QR mn	(17.9)	(18.7)	(47.9)	(25.6)	(14.4)	(23.2)	(38%)	(44%)	(20%)
Adj. EBIT	QR mn	120.6	150.0	255.0	268.9	112.2	191.4	(41%)	(58%)	(7%)
Adj. EBIT Margin	%	34%	30%	24%	35%	37%	52%			
Net Interest Expense	QR mn	(22.2)	(21.3)	(20.7)	(30.9)	(31.7)	(31.5)	1%	2%	43%
Adj. EBT	QR mn	98.4	128.7	234.3	237.9	80.6	160.0	(50%)	(66%)	(18%)
Adj. EBT Margin	%	28%	26%	22%	31%	26%	43%			
Reported Net Income (Attrib. to Common Equity)	QR mn	72.9	119.8	171.6	230.8	53.2	147.2	(64%)	(77%)	(27%)
Reported Net Income (Attrib. to Common Equity) Margin	%	21%	24%	16%	30%	17%	40%			
Adj. Net Income	QR mn	89.7	117.8	208.8	224.7	60.0	147.2	(59%)	(73%)	(33%)
Adj. Net Income Margin	%	25%	24%	19%	29%	20%	40%			
Cash/Equiv.	QR mn	1,610.1	1,544.0	1,565.9	1,923.8	1,972.5	2,179.9	(10%)	3%	23%
Total Debt	QR mn	4,733.1	4,633.5	4,517.9	4,439.8	4,384.5	4,310.7	2%	(1%)	(7%)
Operating Cash Flow (Before WC)	QR mn	103.3	129.1	300.2	244.6	82.1	159.7	(49%)	(66%)	(21%)
Operating Cash Flow (Before WC) Margin	%	29%	26%	28%	32%	27%	43%			
Per Share Items										
Reported EPS - FD	QR/sh	0.21	0.34	0.48	0.65	0.15	0.42	(64%)		
Adj. EPS - FD	QR/sh	0.25	0.33	0.59	0.63	0.17	0.42	(59%)		
CFPS (ex. WC)	QR/sh	0.29	0.36	0.85	0.69	0.23	0.45	(49%)		

NA: Not Applicable
nmf: Not Meaningful

Source: Company reports, QNBFS Research

Fig 2 – Our 2017/18 revised vs. prior earnings estimates

	Unit	2017e			2018e		
		Revised	Prior	Δ	Revised	Prior	Δ
Financial Results							
Total Operating Revenue	QR mn	1,670.7	1,994.4	(16%)	1,636.2	1,824.3	(10%)
Gross Profit	QR mn	916.9	1,189.4	(23%)	1,207.9	1,330.5	(9%)
Gross Margin	%	55%	60%		74%	73%	
Adj. EBITDA	QR mn	683.8	932.8	(27%)	920.7	1,008.7	(9%)
Adj. EBITDA Margin	%	41%	47%		56%	55%	
Adj. Net Income	QR mn	618.0	684.6	(10%)	632.0	738.5	(14%)
Adj. Net Income Margin	%	37%	34%		39%	40%	
Total Debt	QR mn	4,128.6	4,101.5	1%	4,154.4	4,127.2	1%
Total Dividends Paid	QR mn	450.5	450.5	0%	442.6	442.6	0%
Current Adj. Net Income Dividend Payout Ratio	%	73%	66%		70%	60%	
Per Share Items							
Adj. EPS - FD	QR/sh	1.75	1.93	(10%)	1.78	2.09	(14%)
CFPS (ex. WC)	QR/sh	1.48	2.21	(33%)	2.19	2.47	(11%)

NA: Not Applicable
nmf: Not Meaningful

Source: QNBFS Research

Detailed Model Summary

Income Statement		2013	2014	2015	2016	2017	2018
Revenue	QR mn	2,081	1,906	1,441	2,391	1,671	1,636
COGS	QR mn	(1,148)	(731)	(566)	(1,275)	(754)	(428)
Gross Profit	QR mn	933	1,175	875	1,116	917	1,208
Gross Margin %	%	44.8%	61.6%	60.7%	46.7%	54.9%	73.8%
G&A	QR mn	(230)	(287)	(312)	(303)	(308)	(314)
Total Operating Expenses	QR mn	(35)	(262)	(114)	(220)	(233)	(287)
Adj. EBITDA	QR mn	898	913	761	896	684	921
Adj. EBITDA Margin %	%	43.2%	47.9%	52.8%	37.5%	40.9%	56.3%
D&A	QR mn	(112)	(84)	(75)	(102)	97	(121)
Adj. EBIT	QR mn	553	855	709	819	802	818
Adj. EBIT Margin %	%	26.5%	44.9%	49.2%	34.3%	48.0%	50.0%
Interest Income	QR mn	22	23	35	37	36	11
Interest Expense	QR mn	(84)	(148)	(131)	(123)	(160)	(137)
Net Interest Expense	QR mn	(62)	(125)	(96)	(86)	(124)	(126)
Earnings Before Taxes	QR mn	490	730	613	733	678	692
Adj. Net Income	QR mn	404	679	570	675	618	632
Adj. Profit Margin %	%	19.4%	35.6%	39.6%	28.2%	37.0%	38.6%
WA Basic Shares Outstanding	mn	354.1	354.1	354.1	354.1	354.1	354.1
WA FD Shares Outstanding	mn	354.1	354.1	354.1	354.1	354.1	354.1
FD EoP Shares Outstanding	mn	337.2	354.1	354.1	354.1	354.1	354.1
Adj. EPS - FD	QR/sh	1.14	1.92	1.61	1.91	1.75	1.78
CFPS (ex. WC)	QR/sh	2.27	2.15	1.78	2.22	1.48	2.19
CFPS	QR/sh	3.16	4.45	2.06	0.83	2.90	(0.20)
Balance Sheet		2013	2014	2015	2016	2017	2018
Cash/Equiv	QR mn	2,002	2,823	2,277	1,566	1,746	718
A/R	QR mn	1,729	1,464	1,386	2,265	1,777	2,839
Inventories	QR mn	3,096	1,665	1,370	2,018	1,269	1,687
Total Current Assets	QR mn	6,848	5,970	5,033	5,849	4,792	5,244
PP&E	QR mn	3,824	4,001	4,499	3,231	3,253	3,693
Total Long-Term Assets	QR mn	11,917	13,244	14,106	12,875	13,083	13,523
TOTAL ASSETS	QR mn	18,765	19,214	19,138	18,723	17,875	18,766
A/P	QR mn	2,313	2,671	2,664	2,589	1,925	2,559
Total Current Liabilities	QR mn	3,775	3,472	4,215	4,000	2,617	3,177
Total LT Liabilities	QR mn	4,243	4,622	3,637	3,413	3,749	3,849
TOTAL LIABILITIES	QR mn	8,018	8,094	7,852	7,413	6,366	7,026
Non-Controlling Interest	QR mn	315	347	373	412	451	511
Issued Capital	QR mn	3,372	3,541	3,541	3,541	3,541	3,541
Retained Earnings	QR mn	4,057	4,099	4,258	4,498	4,747	4,849
TOTAL OWNERS EQUITY	QR mn	10,432	10,772	10,914	10,898	11,059	11,230
Cash Flow Statement		2013	2014	2015	2016	2017	2018
Operating Cash Flow	QR mn	803	761	632	786	522	775
Non-Cash Change in WC	QR mn	317	816	97	(491)	504	(846)
CFO	QR mn	1,120	1,577	729	294	1,026	(70)
Capex	QR mn	(494)	(316)	(607)	(450)	(107)	(560)
CFI	QR mn	(455)	(510)	(1,395)	584	127	(541)
Net Change in Debt	QR mn	(2,519)	(1,075)	(1,938)	(649)	(394)	26
Dividends	QR mn	(345)	(346)	(458)	(544)	(450)	(443)
CFE	QR mn	(1,040)	(524)	(716)	(837)	(844)	(417)
FX Translation	QR mn	-	-	-	-	-	-
Net Change in Cash	QR mn	(375)	544	(1,381)	41	308	(1,028)

Source: Company reports, QNBFS 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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