Ezdan Holding Group

Recommendation	MARKET PERFORM	Risk Rating	R-3
Share Price	15.70	Target Price	16.00
Implied Upside	1.9%		

Good Assets Held Down by Debt; Initiating with Market Perform

We are initiating coverage on Ezdan Holding Group (ERES) with a QR16.00/sh target price (TP) and a Market Perform recommendation (~1.9% total expected return). *We favorably view ERES' real estate assets, its diversified investments, earnings growth trajectory in 2017/2018, and its mostly recurring and stable cash flow profile. However, we view upside to investors as capped by a rich comparable valuation, low float/liquidity, and most importantly a lack of sufficient organic free cash flow (FCF) to satisfy its current dividend payments while simultaneously making its debt repayments.*

Highlights

- **Earnings growth to moderate over the next 3 but remain competitive vs. peers.** We expect growth to moderate over 2016-2019 with top line experiencing a CAGR of ~8% vs. ~28% over 2013-2016. For 2017, we expect the top line to reach ~QR3.1bn (~8% y/y; ~9% peer median) followed by ~10% growth in 2018 (~9% peer median) to ~QR3.5bn. This should drive similar adj. EBITDA growth of ~8% in 2017 (~3% peer median) to ~QR2.4bn as earnings become more skewed in favor of real estate operations (higher opex vs. investments). This should be followed by ~10% in 2018 (~12% peer median) to ~QR2.7bn as ERES recognizes the full contribution of 2 new malls, Ezdan Oasis residential village, and other minor real estate projects.
- **Rich relative valuation should cap upside to shares.** While we see the narrowing valuation gap between ERES and its peers as encouraging, we continue to see the current valuation as rich and limiting any upside for new investors. However, we assume that ERES' low float of ~5.9% (peer average ~45.2%), coupled with its low average 30 day trading volume of ~1.2mn shares (peer average ~4.7mn) should continue to offer support for the shares and we anticipate ERES' valuation premium should continue into the future. We highlight here our model backs up our expectation of a continued premium valuation as we estimate the shares to trade at ~20.0/19.0x our 2017/2018 adj. EPS forecasts vs. peers at 13.4/12.1x.
- **Balance sheet/dividend policy:** We expect ~QR2.0bn each year in debt repayments in 2017-2019 with 2021 being the most significant year of debt repayments where ERES would need to pay back ~QR3.2bn in debt that year. While the company's operations provide for stable recurring cash flows, we do not anticipate that ERES' will generate enough earnings to fund the dividend payments as well as make the necessary debt repayments. Given ERES' ~QR1.3bn in dividend payments, which we model on a go-forward basis, we expect ERES to continue to rely on its balance sheet to fund the dividend and/or potentially re-profile its debt.

Catalysts

- **Ezdan Oasis.** Expected to begin occupancy by 2H 2017.
- **The Curve Hotel.** Soft opening in December 2016; official opening in April 2017.
- **Ezdan Palace.** Soft opening in April 2017; official opening in mid-2017.

Recommendation, Valuation and Risks

- **Market Perform with a QR16.00 12-month TP.** We currently see little upside to investors in the shares. Our estimates suggest a ~1.0x NAV valuation, implying that current operations/upside are fully absorbed into the share price.
- **Risks to thesis.** Dividend sustainability could be challenged during an economic downturn or should debt repayment become a more urgent focus. A continued reliance on the balance sheet to fund operations/dividends could continue to erode long-term shareholder value. Ability to re-profile debt at comparable cost and appropriate maturities. Ability to secure funding for organic/acquisitive growth.

Key Financial Data and Estimates

	2015	2016	2017e	2018e
Adj. EPS (QR/sh)	0.41	0.68	0.79	0.83
P/E (x)	38.2x	23.2x	20.0x	19.0x
CFPS (QR/sh)	0.49	0.50	0.70	0.88
P/CFPS (x)	20.8x	15.3x	23.3x	17.8x
Adj. EBITDA (QR mn)	1,627.1	2,235.7	2,423.6	2,657.0
EV/EBITDA (x)	35.4x	25.8x	23.8x	21.7x

Source: Company data, Bloomberg, QNBFS Research

Key Data

Current Market Price (QR)	15.70
Dividend Yield (%)	3.2%
Bloomberg Ticker	ERES QD
ISIN	QA000A0NE8B4
Sector	Real Estate
52wk High/52wk Low (QR)	20.24 / 14.63
30-d Average Volume ('000)	1,230.0
Mkt. Cap. ($ mn/QR mn)	11,440 / 41,644
Shares Outstanding (mn)	2,652.5
FO Limit* (%)	49.0%
Current FO* (%)	4.0%
1-Year Total Return (%)	(8.9%)
Fiscal Year End	31-Dec

Source: Bloomberg (as of April 11, 2017), * Foreign ownership (as of April 11, 2017) and includes GCC institutions

Mohamed Abo Daff
+974 4476 6589
mohd.abodaff@qnbfs.com.qa

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

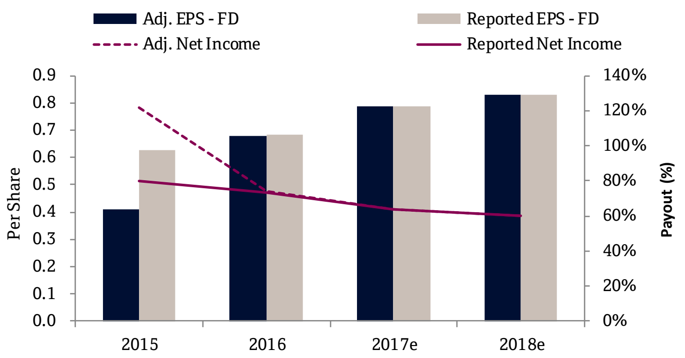
Model Summary

Company Name:	Ezdan Holding Group	Price:	QR 15.70	Target Price:	QR 16.00
Ticker:	ERES QD	Mkt Cap:	QR 41,644 mn	Dividend Yield:	3.2%
Recommendation:	MARKET PERFORM	EV:	QR 57,576 mn	Total Expected Return:	1.9%

	2015	2016	2017e	2018e
Earnings (in QR mn except Per Share Items)				
Revenue	2,169.0	2,909.6	3,139.4	3,450.1
Gross Profit	1,872.6	2,539.0	2,728.4	2,963.3
Adj. EBITDA	**1,627.1**	**2,235.7**	**2,423.6**	**2,657.0**
Adj. EBIT	1,617.8	2,220.0	2,404.3	2,633.5
Reported Net Income	**1,661.9**	**1,812.5**	**2,086.7**	**2,196.8**
Adj. Net Income	**1,090.8**	**1,797.4**	**2,086.7**	**2,196.8**
Reported EPS - FD	0.63	0.68	0.79	0.83
Adj. EPS - FD	0.41	0.68	0.79	0.83
Cash Flow (in QR mn except Per Share Items)				
Operating Cash Flow (ex. WC)	1,311.2	1,319.0	1,866.5	2,329.3
Cash from Operations	**2,001.4**	**2,726.1**	**1,787.4**	**2,345.7**
Cash from Investing	(1,977.0)	(2,282.5)	(122.5)	298.1
Total Capex	(1,603.6)	(2,034.0)	(679.5)	(29.5)
Simple FCF (CFO - Capex)	**397.8**	**692.1**	**1,107.9**	**2,316.1**
Cash from Financing	495.9	(638.8)	(1,594.0)	(3,035.0)
DPS	0.40	0.50	0.50	0.50
CFPS (ex. WC)	0.49	0.50	0.70	0.88
CFPS	0.75	1.03	0.67	0.88
Balance Sheet (in QR mn except Per Share Items)				
Cash/Equiv.	620	426	497	106
PP&E	22	42	52	58
Investment Properties	36,899	38,920	39,570	39,570
Total Assets	**46,939**	**49,829**	**50,511**	**50,136**
Current Debt	1,486	2,001	2,072	2,072
Long-Term Debt	13,474	13,926	14,174	13,052
Total Debt	14,960	15,927	16,246	15,124
Total Liabilities	**16,558**	**19,255**	**19,445**	**18,350**
Owners' Equity	**29,977**	**30,142**	**30,552**	**31,065**
Minority Interest	404	432	513	720

Quarterly Estimates	1Q2017e	2Q2017e	3Q2017e	4Q2017e
Revenue	706.5	764.2	811.0	857.7
Gross Profit	615.3	664.8	704.4	743.8
Adj. EBITDA	**563.7**	**593.2**	**648.2**	**618.5**
Adj. EBIT	559.3	588.5	643.2	613.3
Reported Net Income	**521.6**	**500.8**	**592.0**	**472.4**
Cash from Operations	**287.2**	**476.2**	**526.9**	**497.2**
Cash/Equiv.	116.8	803.5	598.6	497.1
Total Debt	15,926.6	17,246.4	16,746.1	16,245.8
Reported EPS - FD	0.20	0.19	0.22	0.18
Adj. EPS - FD	0.20	0.19	0.22	0.18
CFPS (ex. WC)	0.16	0.17	0.19	0.18

	2015	2016	2017e	2018e
Valuation				
Adj. EV/EBITDA	35.4x	25.8x	23.8x	21.7x
*Peer Average**	*13.6x*	*18.5x*	*14.5x*	*11.5x*
Adj. P/E	38.2x	23.2x	20.0x	19.0x
*Peer Average**	*12.9x*	*12.1x*	*13.4x*	*12.1x*
P/CFPS	20.8x	15.3x	23.3x	17.8x
*Peer Average**	*11.8x*	*13.8x*	*12.6x*	*12.7x*
P/Operating NAV				1.23x
P/NAV				0.99x
Metrics				
Leverage and Debt Service				
Net Debt/adj. EBITDA	8.8x	6.9x	6.5x	5.7x
Debt/Capital	32%	32%	32%	31%
Debt/Equity	0.5x	0.5x	0.5x	0.5x
Interest Coverage	4.1x	3.6x	4.1x	4.5x
Profitability				
Adj. ROA	2.4%	3.7%	4.2%	4.4%
Adj. ROE	3.6%	6.0%	6.9%	7.1%
Adj. ROC	3.7%	4.9%	5.2%	5.7%
Dividend Payouts				
Reported Net Income	80%	73%	64%	60%
Adj. Net Income	122%	74%	64%	60%
Operating Cash Flow (ex. WC)	101%	101%	71%	57%
Cash from Operations	66%	49%	74%	57%
Growth				
Revenue	15.9%	34.1%	7.9%	9.9%
Adj. EBITDA	23.4%	37.4%	8.4%	9.6%
Reported Net Income	27.1%	9.1%	15.1%	5.3%
Adj. Net Income	(16.6%)	64.8%	16.1%	5.3%
Operating Cash Flow (ex. WC)	21.3%	0.6%	41.5%	24.8%



* 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)

Source: Bloomberg, QNBFS Research

Investment Thesis

We are initiating coverage on Ezdan Holding Group (ERES) with a QR16.00/sh target price (TP) and a Market Perform recommendation (~1.9% total expected return). We favorably view ERES' real estate assets, its diversified investments, earnings growth trajectory in 2017/2018, and its recurring and stable cash flow profile. However, we view upside to investors as capped by a rich comparable valuation, low float/liquidity, and most importantly a lack of sufficient organic free cash flow (FCF) to satisfy its current dividend payments while simultaneously making its debt repayments. Therefore, we expect ERES to continue to rely on its balance sheet until the majority of debt is repaid. We could become more constructive on the story provided medium-to-long term earnings growth accelerates through organic development of the company's remaining land bank and/or accelerated debt repayments through potential dividend cuts and/or accretive non-core asset sales.

- **Earnings growth to moderate over the next 3 but remain competitive vs. peers**. We expect growth to moderate over the 2016-2019 with top line experiencing a CAGR of ~8% vs. ~28% over the 2013-2016 period. For 2017, we expect the top line to reach ~QR3.1bn (~8% y/y; ~9% peer median) followed by ~10% growth in 2018 (~9% peer median) to ~QR3.5bn. This should drive similar adj. EBITDA growth of ~8% in 2017 (~3% peer median) to ~QR2.4bn followed by ~10% in 2018 (~12% peer median) to ~QR2.7bn as ERES recognizes the full contribution of 2 new malls, Ezdan Oasis residential village, and other minor real estate projects. Our adjusted EBITDA estimates exclude net earnings from associates/JVs (given non-control), revaluation of investment properties, impairments/write-downs, and other non-operating income/expenses. We note that our selected methodology might differ from other investors' way of estimating adj. EBITDA. We estimate that real estate revenue/adj. EBITDA should normalize in 2017 following 2016, which witnessed an exceptionally large contribution from investments to earnings. For 2017, we expect ~73/67% of revenue/adj. EBITDA to be derived from real estate operations (~58/47% in 2016; ~76/68% in 2015).
    - i. **Real estate operations (~89% of NAV).** For 2017, we expect these existing operations to continue to provide stable revenue to the company (~QR2.3bn in 2017; 36% y/y) driven by the contribution of ERES' near-term development projects (Ezdan Oasis, Ezdan malls in Al Wakra/Al Wukair, and other minor projects).
    - ii. **Investments (~24% of NAV).** For 2017, we expect ERES to generate ~QR260mn in dividend income (~6% y/y). We expect ERES to generate ~QR560mn in revenue from securities trading (~42% decline y/y) reflecting the unusually high investment revenue generated in 2016. Overall, we expect average investment contribution to operating income of ~33% of total estimate through 2021.
    - iii. **Publishing/distribution (~0.2% of NAV).** This business segment is overall immaterial to our valuation. We expect management to slowly turn around this segment, which has been a minor drag on earnings and that by 2018, should become earnings-neutral.
    - iv. **Equity-accounted associates/JVs (~8% of NAV).** We do not directly model these businesses but rather apply a steady-state growth rate (~3%) to equity earnings. For 2017, we estimate that they will contribute ~QR350mn to earnings (~17% of total estimate).
- **Rich relative valuation should cap upside to shares.** While we see the narrowing valuation gap between ERES and its peers as encouraging, we continue to see the current valuation as rich and limiting any upside for new investors. However, we assume that ERES' low float of ~5.9% (peer average ~45.2%), coupled with its low average 30 day trading volume of ~1.2mn shares (peer average ~11.1mn) should continue to offer support for the shares and we anticipate ERES' valuation premium should continue into the future. We highlight here our model backs up our expectation of a continued premium valuation as we estimate the shares to trade at ~20.0/19.0x our 2017/2018 adj. EPS forecasts vs. peers at 13.4/12.1x.
- **Balance sheet/dividend policy**. ERES exited 2016 with ~QR16.0bn in debt and ~QR426mn in cash. We note that our model incorporates the additional US$500/QR1,821mn in Sukuk issued by ERES in April 2017 at marginally higher coupon than the existing Sukuk with maturity of ~5 years. We expect ~QR2.0bn each year in debt repayments in 2017-2019 with 2021 being the most significant year of debt repayments where ERES would need to pay back ~QR3.6bn in debt that year. While the company's operations provide for stable recurring cash flows through its real estate segment, we do not anticipate that ERES' real estate operations will generate enough earnings to fund the dividend payments as well as make the necessary debt repayments. We expect various business segments (including investments) to generate ~QR1.2bn in free cash flow (FCF) before any mandatory debt repayments or dividends in 2017 followed by ~QR2.0/2.2bn in 2018/2019. Given ERES' ~QR1.3bn in dividend payments, which we model to continue, we expect ERES to continue to rely on its balance sheet to fund the dividend and/or potentially re-profile its debt as it tackles its mandatory debt repayment requirements.

Valuation

Overall net asset valuation (NAV). We value the business operating segments separately and utilize a Net Asset Valuation (NAV) methodology dependent on segment-specific operating metrics and assumptions. We estimate corporate operations valuation of ~QR37.5bn with ~QR6.6bn in value attributable to available for sale financial assets, ~QR3.3bn in remaining land bank value, and ~QR3.4bn in value attributable to associates/JVs. Finally, we estimate net balance sheet items erasing ~QR8.7bn of value. This translates into a ~QR42.0bn in NAV or QR15.85/sh NAVPS. As such, we set our target price at QR16.00/sh for a total expected return of ~1.9%.

Discounted cash flow methodology. We forecast free cash flow to equity holders (FCFE) over the next 5 years then assume a terminal nominal growth rate of ~5%, inclusive of ~2% inflation expectation. Finally, we discount our FCFE by our estimated cost of equity for each of our forecast periods (Fig 1).

Fig 1 – Our cost of equity and weighted average cost of capital calculations

Discount Rate Calculations	2017	2018	2019	2020	2021	Terminal
Market data as at: 3/22/2017						
	1-Year	2-Year	3-Year	4-Year	5-Year	Terminal*
US Treasury Yield	0.99%	1.26%	1.54%	1.76%	1.95%	2.42%
Country Def. Swap Rate Premium	0.06%	0.13%	0.25%	0.43%	0.64%	1.14%
Rf Rate	***1.05%***	***1.39%***	***1.79%***	***2.19%***	***2.60%***	***3.56%***
Adj. Beta	1.2100	1.2450	1.4100	1.3000	1.2690	0.9190
** Terminal year values based on 10 year US Treasury yield, 10 year country CDS rate, and 10 year adj. Beta*						
Debt						
Debt	16,246	15,174	14,358	13,603	12,580	12,580
Mkt Cap + Debt	58,288	57,217	56,400	55,645	54,622	54,622
Total Debt/EV %	*27.9%*	*26.5%*	*25.5%*	*24.4%*	*23.0%*	*23.0%*
Wgtd Avg Cost of Debt	3.77%	3.84%	3.87%	3.88%	4.01%	4.01%
Tax Rate	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Cost of Debt	***3.7%***	***3.7%***	***3.8%***	***3.8%***	***3.9%***	***3.9%***
Equity						
Market Value of Equity	42,042	42,042	42,042	42,042	42,042	42,042
Mkt Cap + Debt	58,288	57,217	56,400	55,645	54,622	54,622
Market Cap/EV %	*72.1%*	*73.5%*	*74.5%*	*75.6%*	*77.0%*	*77.0%*
Adj. Beta	1.2100	1.2450	1.4100	1.3000	1.2690	0.9190
Rm	8.0%	8.0%	8.0%	8.0%	8.0%	5.0%
Rf	1.05%	1.39%	1.79%	2.19%	2.60%	3.56%
Size/Liquidity Premium	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cost of Equity*	*10.7%*	*11.3%*	*13.1%*	*12.6%*	*12.7%*	*8.2%*
** Terminal year market risk premium assumes mature operations and macro economic growth*						
WACC	***8.8%***	***9.3%***	***10.7%***	***10.4%***	***10.7%***	***7.2%***

Source: Bloomberg, Company reports, QNBFS Research

Detailed valuation. Overall, we break down the valuation into (Fig 2-5):

- **Real estate operations**. We value operating assets and near-term development assets at ~QR34.0bn with the value of the company's land bank (~800kSqM) at ~QR3.3bn. Breaking down the real estate segment, we value residential/commercial operations at ~QR26.3bn, hotels at ~QR4.8bn, and malls at ~QR2.9bn. Overall, our valuation of the consolidated real estate segment (including the land bank) stands at ~QR37.3bn or ~89% of our total valuation.
- **Investments (publishing/distribution and associates/JVs only)**. We include in this segment the dividend income generated from securities held by ERES along with the value of the publishing/distribution business and the net income/loss generated from associates/JVs. Our dividend income value is estimated at ~QR3.4bn with ~QR3.4bn in value attributed to associates/JVs. We note that associates/JVs are included in our NAV based on prevailing market cap for publicly-listed companies and BV for private businesses. The publishing segment is overall immaterial to our valuation and we assign a ~QR96mn valuation to it.
- **Available for sale financial/investment assets**. These are securities held by the company and we note that management is highly active as a market participant. Given the uncertainties associated with predicting trading activity and gains/losses generated, we excluded that income from our DCF (though include it in our earnings estimates). We have elected to value available for sale financial assets based on the carrying-value on the balance sheet at ~QR6.6bn (~16% of total valuation).
- **Balance sheet items.** Net balance sheet items are estimated to be ~QR8.7bn including ~QR426mn in cash at YE2016, which erases ~21% of our total valuation.

Fig 2 – Our discounted cash flow model

QR mn except per share items	Attrib. %	2017	2018	2019	2020	2021	Term. Year
Segment Operating Income (Revenue - Opex)	*100.0%*	**2,171**	**2,636**	**2,800**	**2,850**	**2,902**	**2,989**
Residential/Commercial	*100.0%*	1,418	1,811	1,962	2,001	2,041	2,102
Hotels	*100.0%*	283	346	353	360	368	379
Malls	*100.0%*	207	211	215	219	224	230
Dividends	*100.0%*	262	262	262	262	262	270
Publishing/Other	*100.0%*	2	6	7	7	8	8
Less Corporate Drag		**(1,377)**	**(2,086)**	**(1,804)**	**(1,761)**	**(1,444)**	**(410)**
G&A		(305)	(306)	(308)	(309)	(311)	(320)
D&A		(19)	(23)	(28)	(32)	(35)	(36)
Net Interest Expense		(587)	(587)	(555)	(524)	(465)	NA
Estimated Normalized Taxes	*2.5%*	(46)	(58)	(62)	(63)	(64)	(66)
Add Back D&A		19	23	28	32	35	36
Capex		(680)	(30)	(30)	(30)	(30)	(30)
Additions to Debt		2,320	950	1,217	1,030	2,620	NA
Repayment of Debt		(2,001)	(2,072)	(2,072)	(1,871)	(3,201)	NA
Change in WC (ex. Cash & ST Debt)		(79)	16	6	6	6	6
Implied EV/Adj. EBITDA		31.6x	25.3x	23.7x	23.2x	22.8x	22.1x
Implied P/E		34.3x	25.1x	22.5x	21.7x	20.5x	16.2x
Implied P/CFPS		36.1x	24.5x	22.1x	21.2x	20.1x	16.0x
Implied FCF* Yield		*1.4%*	*4.1%*	*4.6%*	*4.8%*	*5.0%*	*6.3%*

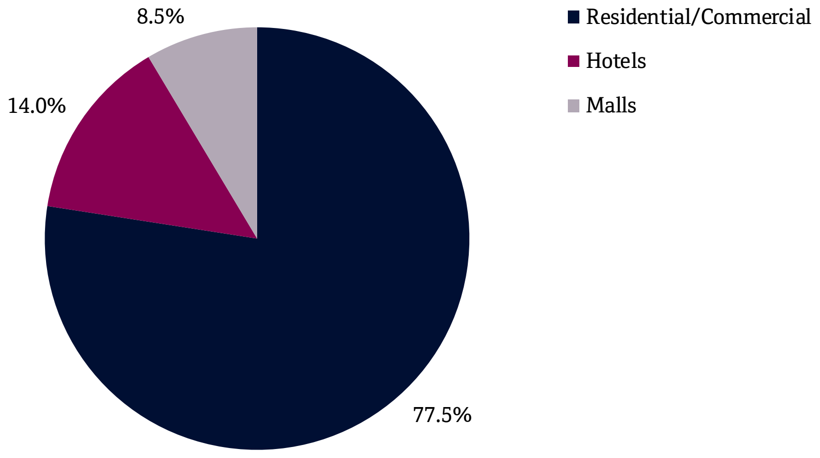
** FCF calculated as operating income less G&A, interest expense, normalized taxes, capex, net changes in debt, change in WC, and minority interest*

QR mn except per share items		2017	2018	2019	2020	2021	
Cost of Equity		*10.7%*	*11.3%*	*13.1%*	*12.6%*	*12.7%*	*8.2%*
PV of Free Cash Flow (FCF)		**794**	**494**	**779**	**763**	**902**	**33,767**
Residential/Commercial		519	339	546	536	634	23,749
Hotels		103	65	98	96	114	4,277
Malls		76	39	60	59	70	2,601
Dividends		96	49	73	70	81	3,050
Publishing/Other		1	1	2	2	2	89
Total Value							**37,499**
Residential/Commercial							26,323
Hotels							4,755
Malls							2,904
Dividends							3,420
Publishing/Other							97
Other Items							**4,539**
Less:						**1.00x**	
PV of Debt Remaining after Net Debt Changes over DCF Forecast Period			(8,679)			1.00x	(8,679)
Non-Controlling Interest			(432)			1.00x	(432)
Add:						**1.00x**	
Cash/Equiv.			426			1.00x	426
Undeveloped Land Package			3,286			1.00x	3,286
Available for Sale Financial Assets			6,553			1.00x	6,553
Available for Sale Investment Assets			-			1.00x	-
Associates/JVs:							
Publicly Traded (Market Cap):	*Ownership***		Attrib. Value*				
QIIK QD	*20.0%*		1,944			1.00x	1,944
MCGS QD	*13.3%*		361			1.00x	361
QISI QD	*10.0%*		94			1.00x	94
WDAM QD	*3.0%*		34			1.00x	34
Privateltly Held (BV):			Carrying Value**				
Dar Al-Sharq for Printing, Publishing & Dist.	*44.8%*		537			1.00x	537
White Square Real Estate	*32.5%*		186			1.00x	186
Dar Al-Arab	*21.6%*		76			1.00x	76
Al Waraq for Printing Press	*51.0%*		153			1.00x	153
Equity Value			**42,038**				
Current FD Shares Outstanding			2,652				
Expected Shares from Equity Raise			-				
Additional Cash from Equity Raise			-				
Fully Funded FD Shares Outstanding			2,652				
Fully Funded & FD Total Equity Value			**42,038**	**15.85**			
Current Market Value			**41,644**	**15.70**			
Premium/(Discount) to Equity Value				***0.9%***			

* Attributable values are as of Apr 11, 2017
** Ownership % and carrying values are as of Dec 31, 2016

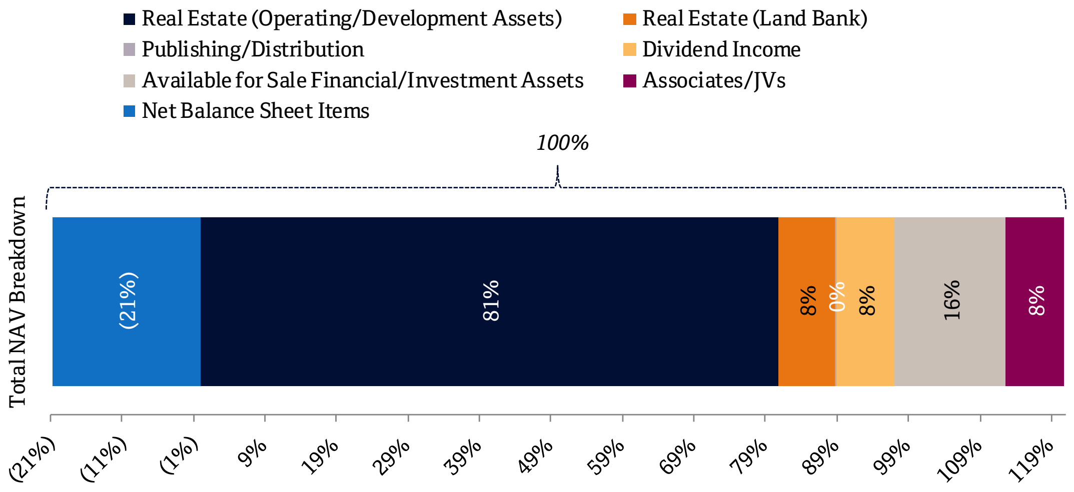
Source: Bloomberg, QNBFS Research

Fig 3 – Breaking down our real estate operating NAV



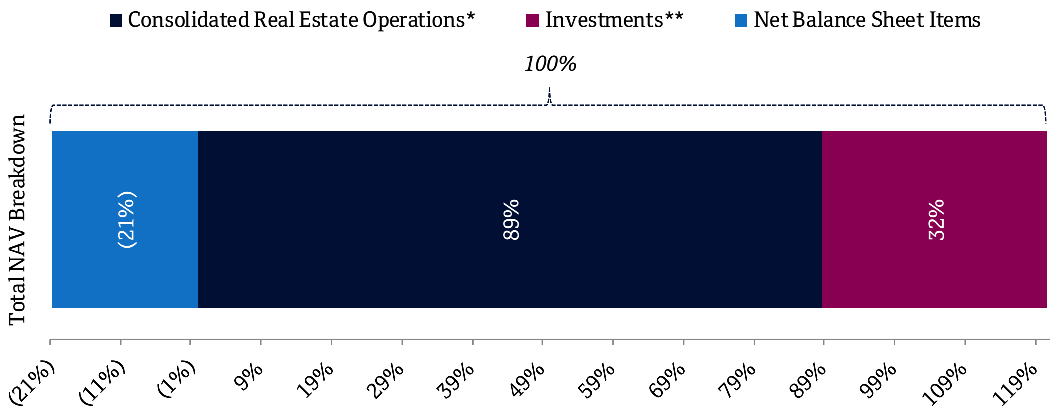
Source: Bloomberg, QNBFS Research

Fig 4 – Breaking down our valuation by segment



Source: Bloomberg, QNBFS Research

Fig 5 – Breaking down our overall valuation



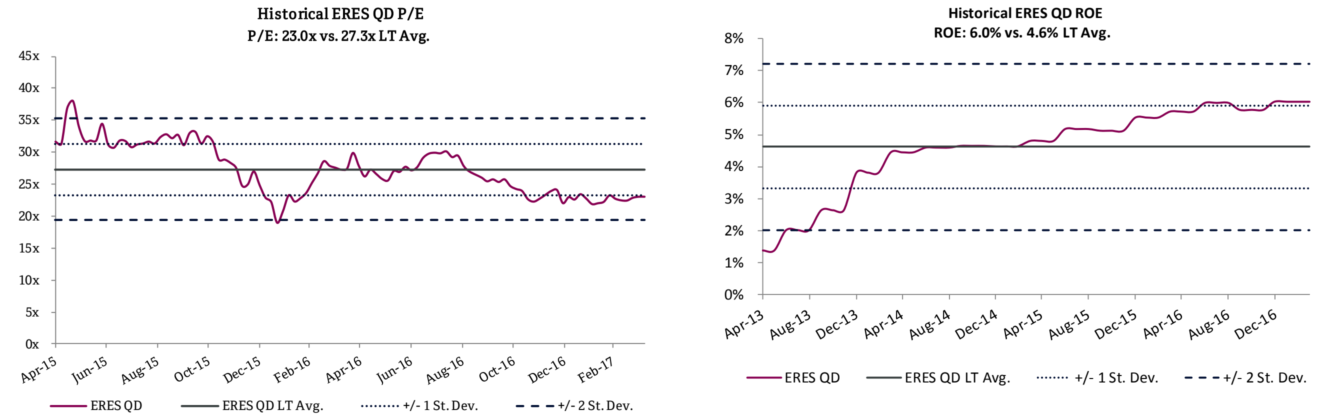
* Includes land bank value
** Investments segment includes securities available for sale, dividend income, net income from associates/JVs, and the publishing segment

Source: Bloomberg, Company reports, QNBFS Research

A Premium Relative Valuation Supported by Low Float/Liquidity

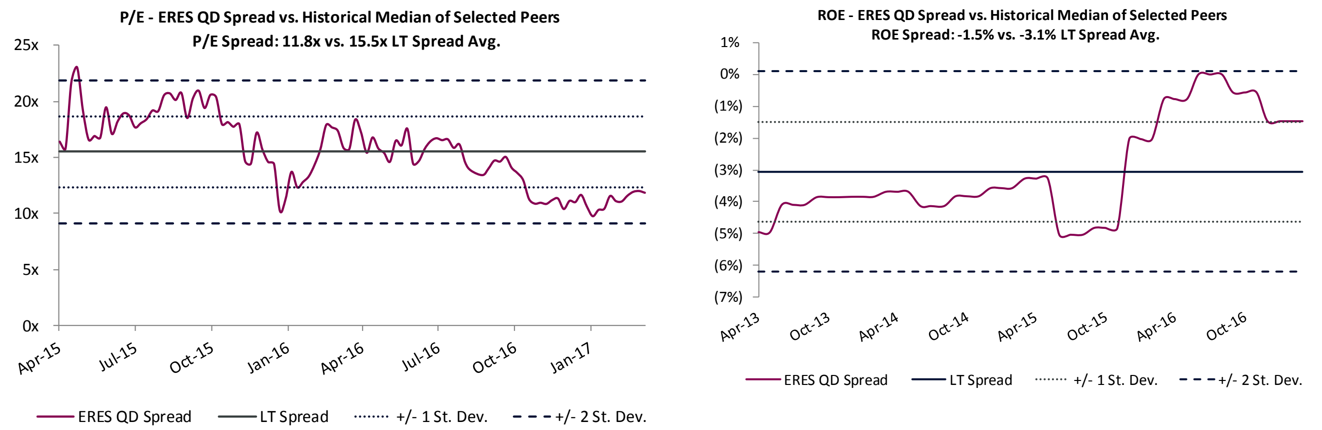
ERES has historically traded at a significant premium to wider peers. We attribute the premium historical valuation in the market to ERES' scale as well as its diversified exposure to multiple sectors through its investment division, low liquidity, and its growth trajectory. On a historical basis, ERES currently trades at ~23.0x its TTM earnings vs. its 3 year average of ~27.3x highlighting the pressure that the Qatari real estate sector has been experiencing from late 3Q 2016 despite posting higher profitability as measured by its current ROE of ~6.0% vs. long-term average of ~4.6% (Fig 6). The story is similar when comparing the historical P/E spread between ERES and its peers where the shares continue to trade at a significant spread of ~11.8x higher than peers. This spread has certainly narrowed from the long-term average of ~15.5x (Fig 7). However, profitability has again improved on a relative basis with ROE spread narrowing to ~1.5% below peer average vs. long-term spread of ~3.1% below peers.

Fig 6 – Historical P/E and ROE metrics for ERES



Source: Bloomberg, QNBFS Research

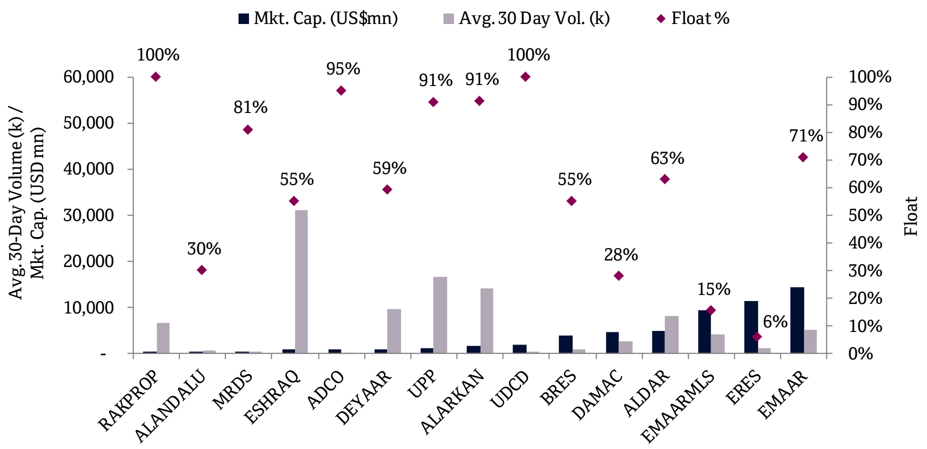
Fig 7 – ERES vs. peers P/E and ROE historical spreads



Source: Bloomberg, QNBFS Research

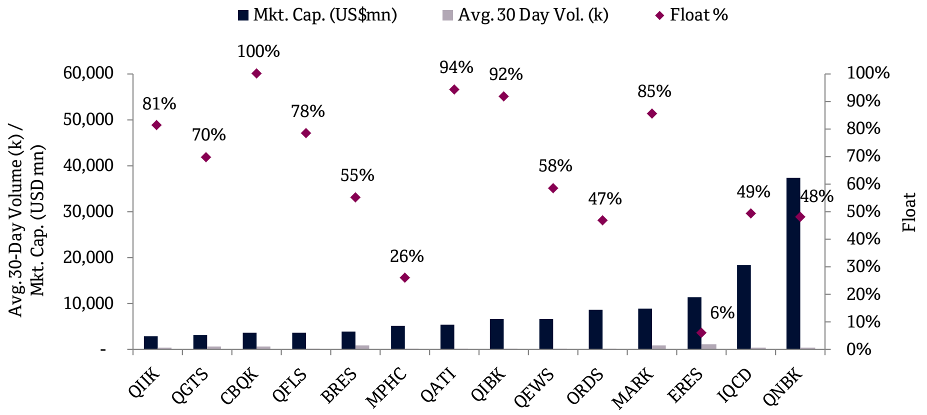
Rich relative valuation should cap upside to shares. While we see the narrowing valuation gap between ERES and its peers as encouraging, we continue to see the current valuation as rich and capping upside for new investors. However, we assume that ERES' low float of ~5.9% (peer average ~45.2%), coupled with its low average 30 day trading volume of ~1.2mn shares (peer average ~4.6mn) should continue to offer support for the shares and ERES' valuation premium – Fig 8-9. We highlight here our model backs up our expectation of a continued premium valuation as we estimate the shares to trade at ~20.0/19.0x our 2017/2018 adj. EPS forecasts (Fig 10-11). Note that ERES' foreign ownership limit of 49% implies that the most foreign investors can own of the outstanding shares is ~6% only; thus limiting, in our view, the shares' attractiveness to foreign investors. As such, we expect ERES to continue to be a local play on the Qatar stock exchange.

Fig 8 – Float vs. Average 30-day trading volume of GCC real estate peers (sorted by normalized market cap)



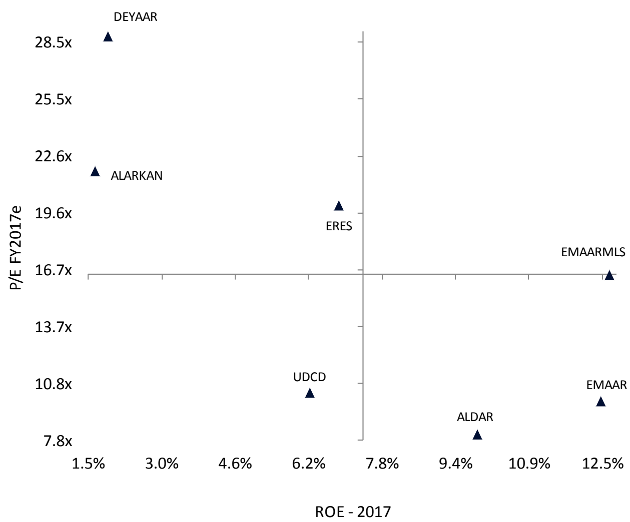
Source: Bloomberg, QNBFS Research

Fig 9 – Float vs. Average 30-day trading volume QSE-listed, +QR1.0bn market cap companies



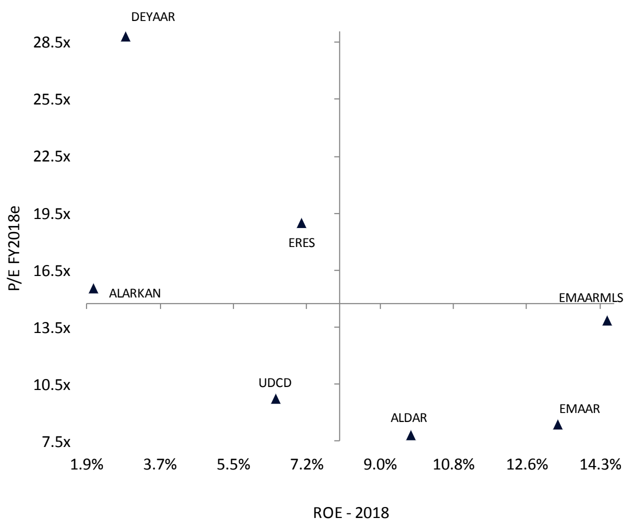
Source: Bloomberg, QNBFS Research

Fig 10 – 2017 P/E vs. ROE



Note: Only Companies with either QNBFS or Available Bloomberg Estimates/Data are Included in the Plot (7 Companies)

Fig 11 – 2018 P/E vs. ROE



Note: Only Companies with either QNBFS or Available Bloomberg Estimates/Data are Included in the Plot (7 Companies)

Source: Company reports, QNBFS Research

Real Estate Operations

Real estate operations. With ~89% of our valuation driven by the real estate business (~81% excluding our estimate for the value of the remaining land bank), these operations are, in our view, the primary driver for earnings and growth (see page 16 for background information on operations). The company's real estate operations can be broken down into residential/commercial, malls, and hotels with Fig 14 summarizing our Base case valuation scenario drivers:

- **Residential/commercial –** ERES currently operates ~19,550 residential units along with ~255 offices located within its various buildings and 23 residential villages it manages. These existing operations contributed ~QR1.2bn to top line revenue in 2016, which was in line with 2015's performance. Given that the residential units are higher margin operations (we estimate ~12.5% opex), gross margin contribution for 2016/2015 was ~QR1.0bn/1.0bn respectively. For 2017, we expect these existing operations to continue to provide stable cash flows to the company (~QR1.6bn in 2017 revenue; ~31% y/y). The significant increase y/y should be driven by contribution of ERES' near-term development projects (Ezdan Oasis). This project includes ~8,765 residential units, ~577 commercial stores, a hypermarket, and 2 schools. We highlight that ~80% of the capex for this new village has been spent (~QR3.0bn total capex) and we estimate that ~QR700mn will be spent in 2017 to finalize the project before handing over units/stores to customers. As such, we expect residential/commercial revenue/gross profit to increase ~31/36% in 2017 followed by ~28/28% in 2018.

- **Malls –** Currently there are 3 malls in operations with Ezdan malls in Al Wakra/Al Wukair beginning operations in late 2016 ~QR152/91mn was contributed to revenue/gross profit in 2016 (~QR112/82mn in 2015) and we expect 2017 to reflect the full contribution of the 2 new malls for a total of ~QR295/206mn respectively. Overall, the company has ~102.2kSqM of leasable space that is 100% contracted with a substantial waiting list for interested retailers. It is important to highlight that the 2 new malls (Al Wakra and Al Wukair) are both located in high residential concentrated neighborhoods with no other malls in close proximity. This, in our view, offers a significant advantage to those operations in terms of driving foot traffic to those malls and pricing power over retailers.

- **Hotels –** Currently there is one hotel complex in operation called Ezdan Hotel and Suites (3 star hotel) with current occupancy of ~86%, which is significantly higher than the overall average occupancy for hotels in Qatar (~61%). The complex includes 4 towers located in West Bay and offering hotel rooms and serviced, fully furnished apartments (studios and 1-3 bedrooms) totaling ~3,000 room keys. We expect 2017 to see the first contribution of both Ezdan Palace (5 star hotel) and The Curve Hotel (4 star hotel; 32.5% ownership) to the P&L. Ezdan Palace is expected to have its soft opening in April 2017 with official opening by mid-2017. The Curve Hotel already had its soft opening in December 2016 with official opening expected in April 2017. In 2016 Ezdan Hotel contributed ~QR281/202mn to revenue/gross profit (in line with 2015) and we expect the addition of the 2 new properties to increase hotel segment contribution to ~QR380/285mn to revenue/gross profit.

Fig 12 – Estimated real estate revenue contribution at Base case target occupancy rates

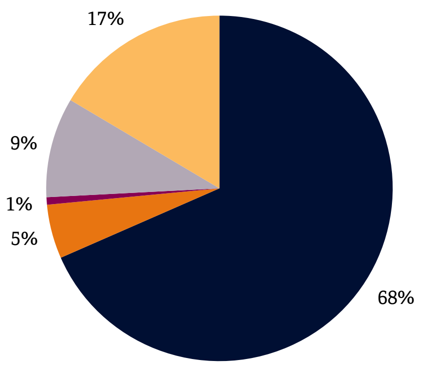
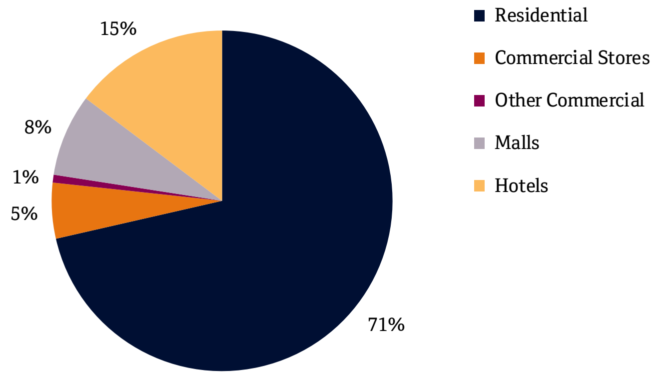


Fig 13 – Estimated real estate gross profit contribution at Base target occupancy rates



Source: Company reports, QNBFS Research

Fig 14 – Base case drivers for real estate operations

Base Scenario	Count	Unit	Occupancy Rates % Current	Occupancy Rates % Target	Estimated Revenue Run Rate /Unit per mo	Estimated Revenue Run Rate /qrt (QR mn)	Estimated Revenue Run Rate /yr (QR mn)
Residential	**28,339**				**6,237.1**		
Buildings	4,350	Apt./Houses	*92.0%*	*92.0%*	6,200.0	80.9	323.6
Residential Villages	15,200	Apt./Houses	*92.0%*	*92.0%*	6,200.0	282.7	1,130.9
Ezdan Villas*	24	Villas	*0.0%*	*92.0%*	50,000.0	3.6	14.4
Ezdan Oasis Village Development*	8,765	Apt./Houses	*0.0%*	*92.0%*	6,200.0	163.0	652.1
Residential Revenue						**530.3**	**2,121.0**
Residential Operating Expenses	*12.5%*					(66.3)	(265.1)
Residential Gross Profit						**464.0**	**1,855.9**
Commercial Stores	**802**				**16,316.7**		
Residential Villages Offices	225	Stores	*92.0%*	*92.0%*	12,000.0	8.1	32.4
Ezdan Oasis Village Development - Commercial Stores*	577	Stores	*0.0%*	*92.0%*	18,000.0	31.2	124.6
Commercial Stores Revenue						**39.3**	**157.0**
Commercial Stores Operating Expenses	*12.5%*					(4.9)	(19.6)
Commercial Stores Gross Profit						**34.4**	**137.4**
Other Commercial					**NA**		
Hypermarket*	5,824	SqM	*0.0%*	*100.0%*	122.0	2.1	8.5
Schools 1*	1	School	*0.0%*	*100.0%*	541,666.7	1.6	6.5
Schools 2*	1	School	*0.0%*	*100.0%*	541,666.7	1.6	6.5
Other Commercial Revenue						**5.4**	**21.5**
Other Commercial Operating Expenses	*10.0%*					(0.5)	(2.2)
Other Commercial Gross Profit						**4.8**	**19.4**
Malls	**102.2**				**236.5**		
Ezdan Mall	36.7	k SqM	*100.0%*	*100.0%*	288.5	31.8	127.0
Al Wakra Mall	40.0	k SqM	*100.0%*	*100.0%*	218.8	26.3	105.0
Al Wukair Mall	25.5	k SqM	*100.0%*	*100.0%*	189.5	14.5	58.0
Malls Revenue						**72.5**	**290.0**
Malls Operating Expenses	*30.0%*					(21.8)	(87.0)
Malls Gross Profit						**50.8**	**203.0**
Hotels	**3,810**				**372.1****		
Ezdan Hotel	3,000	Rooms	*86.0%*	*86.0%*	280.0	75.6	302.4
Ezdan Palace	210	Rooms	*0.0%*	*86.0%*	1,322.8	25.0	100.0
The Curve Hotel	600	Rooms	*0.0%*	*86.0%*	500.0	27.0	108.0
Hotels Revenue						**127.6**	**510.4**
Hotels Operating Expenses	*25.0%*					(31.9)	(127.6)
Hotels Gross Profit						**95.7**	**382.8**
Overall Real Estated Revenue at Target Occupancy						**775.0**	**3,100.0**
Overall Real Estated Opex at Target Occupancy	***16.2%***					(125.4)	(501.5)
Overall Real Estated Gross Profit at Target Occupancy						**649.6**	**2,598.5**

*Part of development pipeline that is expected to begin contributing to P&L by mid 2017

** Average revenue per day

Source: Company reports, QNBFS Research

Valuation scenarios. Fig 15 highlights our high-level assumptions for each of our Base case, Upside, and Downside scenarios. Our Base case valuation reflects current occupancy rates for residential/commercial, malls, and hotels, while our Upside scenario assumes a ~5% increase in unit prices along with another ~5% incremental increase in occupancy rates. The exception to the incremental increase in occupancy rates is for the hypermarket and schools, which logically cannot be partially occupied as ERES leases out the entire land. Our Downside scenario is the opposite of our Upside scenario.

Fig 15 – Assumptions for Base case, Upside, and Downside valuation scenarios

	Target Occupancy Rates Downside	Target Occupancy Rates Base	Target Occupancy Rates Upside	Prices Downside	Prices Base	Prices Upside	Unit
Residential							
Buildings	*87.0%*	*92.0%*	*97.0%*	5,890.0	6,200.0	6,510.0	QR/month per unit
Residential Villages	*87.0%*	*92.0%*	*97.0%*	5,890.0	6,200.0	6,510.0	QR/month per unit
Ezdan Villas*	*87.0%*	*92.0%*	*97.0%*	47,500.0	50,000.0	52,500.0	QR/month per unit
Ezdan Oasis Village Development*	*87.0%*	*92.0%*	*97.0%*	5,890.0	6,200.0	6,510.0	QR/month per unit
Commercial Stores							
Residential Villages Offices	*87.0%*	*92.0%*	*97.0%*	11,400.0	12,000.0	12,600.0	QR/month per store
Ezdan Oasis Village Development - Commercial Stores*	*87.0%*	*92.0%*	*97.0%*	17,100.0	18,000.0	18,900.0	QR/month per store
Other Commercial							
Hypermarket*	*100.0%*	*100.0%*	*100.0%*	115.9	122.0	128.1	QR/SqM per Month
Schools 1*	*100.0%*	*100.0%*	*100.0%*	514,583.3	541,666.7	568,750.0	QR/month per School
Schools 2*	*100.0%*	*100.0%*	*100.0%*	514,583.3	541,666.7	568,750.0	QR/month per School
Malls							
Ezdan Mall	*95.0%*	*100.0%*	*100.0%*	274.0	288.5	302.9	QR/SqM per Month
Al Wakra Mall	*95.0%*	*100.0%*	*100.0%*	207.8	218.8	229.7	QR/SqM per Month
Al Wukair Mall	*95.0%*	*100.0%*	*100.0%*	180.1	189.5	199.0	QR/SqM per Month
Hotels							
Ezdan Hotel	*81.0%*	*86.0%*	*91.0%*	266.0	280.0	294.0	QR/Room per Day
Ezdan Palace	*81.0%*	*86.0%*	*91.0%*	1,256.6	1,322.8	1,388.9	QR/Room per Day
The Curve Hotel	*81.0%*	*86.0%*	*91.0%*	475.0	500.0	525.0	QR/Room per Day

Source: Company reports, QNBFS Research

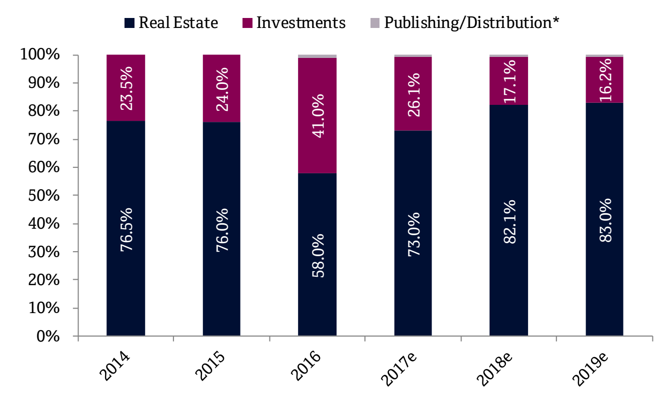
Investment Operations

Investment book supports overall earnings through stable dividend income. ERES' investment team is very active within the Qatari stock market and in many ways is a major player/market maker in the country. Given their scale and active operations, we assume that the team is able to secure an informational/cost advantage over many institutional (certainly retail) investors in Qatar given their likely ability to view deals and block trades before most other investors. We estimate that ERES generated ~4% in dividend yield income in 2016, which is what we model on a go-forward basis. To make that estimate, we look at the relationship between recognized dividend income on the income statement to the average financial assets on the balance sheet (average of current/prior period). While we are first to admit that this method is not 100% accurate, we maintain that it is a proxy of ERES' actual dividend income. For 2017, we expect ERES to generate ~QR260mn in dividend income (~6% y/y).

Active trading of securities more difficult to predict but continues to contribute to earnings. Trading in securities is significantly more complicated and largely impossible to predict. As such, we assume a nominal ~5% return each year on the average balance of financial assets available for sale. For 2017, we expect ERES to generate ~QR560mn in income from securities trading (~42% decline y/y). We highlight that 2016 had an unusually high contribution from investment operations given ~QR966mn recorded as a gain on the sale of an investment (~QR340mn in 2015) related to divestiture of several investments as part of ERES' need to reduce its ownership share in several asset classes to ~10% or less as required by the Qatari regulator. We estimate that ~74% of adj. net income in 2016 was generated from investment operations vs. 2014/2015 at ~44/64%. Over the next 5 years, we expect overall investment income (including dividend income) to constitute an average of ~33% of ERES' overall adj. net income.

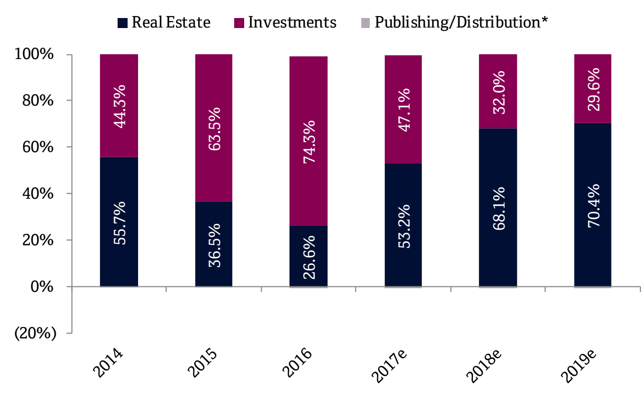
Equity-accounted associates/JVs and publishing/distribution. We do not directly model these businesses but rather apply a steady-state growth rate (~3%) to equity earnings. For 2017, we estimate that they will contribute ~QR350mn to earnings (~17% of total estimate).

Fig 16 – Revenue contribution



* Publishing/Distribution business was equity-accounted for prior to 2016

Fig 17 – Adj. operating income contribution



* Publishing/Distribution business was equity-accounted for prior to 2016

Source: Company reports, QNBFS Research

Balance Sheet and Dividend Funding

Debt repayments will require significant cash outflows. ERES exited 2016 with ~QR16.0bn in debt and ~QR426mn in cash. We note that our model incorporates an additional US$500/QR1,821mn in Sukuk issued by ERES in 2017 at a higher coupon than the existing Sukuk with maturity of ~5 years. As can be seen from Fig 18, we expect ~QR2.0bn each year in debt repayments in 2017-2019 with 2021 being the most significant year of debt repayments where ERES would need to pay back ~QR3.2bn in debt that year. We expect that much of the debt repayment due in 2017 should be funded from the new Sukuk.

Current debt profile to put pressure on cash flows. The Board of Directors (BOD) at ERES recently approved the payment of QR0.50/sh or ~QR1.3bn in dividends to shareholders, which we model as a policy that continues into the future (we do not model dividend increases/cuts). While the company's operations provide for stable recurring cash flows through its real estate segment, we do not anticipate that ERES' real estate operations will generate enough earnings to fund the dividend payments as well as make the necessary debt repayments. As can be seen in Fig 19, we expect various business segments (including investments) to generate ~QR1.2bn in free cash flow (FCF) in 2017 before any mandatory debt repayments or dividends (~QR2.0/2.2bn in 2018/2019). This trend is expected to continue into the foreseeable future (though 2022) as the majority of debt is repaid. As a result, we expect ERES to continue to rely on its balance sheet to fund the dividend and/or potentially re-profile its debt as it tackles its mandatory debt repayment requirements. Based on our current assumptions, ~2023 would be the first year where real estate operations would be able to fully fund the dividend policy (assuming current dividend rates).

Investment book could significantly reduce debt burden… at a cost. While we do not model this possibility, we note that ERES could potentially liquidate a portion of its substantial investment book (~QR6.6bn as of YE2016) to help make its debt repayment requirements. However, we note that this is a double-edged sword given our expectation for continued reliance on dividend income and securities' trading to fund the dividend and generate operation cash flows for ERES. Alternatively, the company could rely on real estate asset sales to help de-lever the balance sheet and we would view this positively should the price obtained be greater than our valuation.

Refinancing debt could relieve cash flow pressure assuming significantly longer maturities. We would look favorably on any steps towards refinancing debt into longer-term maturities. However, while we see value in this to help better manage cash flows, we do not see any material impact on valuation as the company would essentially be extending debt maturities (+ve) while likely increasing its debt service over its operating lifetime (-ve). It is also reasonable to assume that any refinancing would likely occur at higher rates than what is currently being incurred by ERES.

Fig 18 – Debt profile vs. estimated maturities

Loan	Balance (QR mn)	Currency	Repayment Schedule (QR mn) 1 Year	2-5 Years	+5 Years	Rate
Secured Murabaha	5,121	QR	579	2,854	1,689	REPO
Secured Ijara	3,997	QR	345	2,105	1,547	REPO
Secured Murabaha	649	US$	199	434	17	1Y/3 M LIBOR
Secured Ijara	4,339	US$	879	2,461	999	1-3 M LIBOR
Sukuk Financing*	1,821	US$	0	1,821	-	4.375%
Sukuk Financing**	1,820	US$	-	-	1,821	4.875%
Total	**17,747**		**2,001**	**9,675**	**6,072**	

Modeled Repayments	2017	2018	2019	2020	2021	2022
Secured Murabaha	579	713	713	713	500	500
Secured Ijara	345	526	526	526	420	420
Secured Murabaha	199	217	217	17	-	-
Secured Ijara	879	615	615	615	460	460
Sukuk Financing*	0	-	-	-	1,821	-
Sukuk Financing**	-	-	-	-	-	1,820
Total Repayments	2,001	2,072	2,072	1,871	3,201	3,200

* Rated BBB- (Stable) and Ba1 (Stable) by S&P and Moody's rating agencies (as of April 26, 2016)

** Our model incorporates the new US$500mn in Sukuk issued in April 2017 as part of ERES' US$2bn shelf with maturity of 5 years and semi-annual coupon of 4.875%

Source: Company reports, QNBFS Research

Fig 19 – Simplified FCF highlighting dividend/debt repayment deficits

in QR mn	2017	2018	2019	2020	2021	2022	2023
Revenue							
Real Estate	2,292	2,832	3,020	3,080	3,142	3,204	3,269
Investment	819	590	590	590	590	590	590
Publishing/Dist.	28	29	29	30	30	31	32
Total Revenue	**3,139**	**3,450**	**3,639**	**3,700**	**3,762**	**3,825**	**3,890**
Opex							
Real Estate	(385)	(464)	(489)	(499)	(509)	(519)	(530)
Investment	-	-	-	-	-	-	-
Publishing/Dist.	(26)	(23)	(22)	(22)	(23)	(23)	(24)
Total Opex	**(411)**	**(487)**	**(511)**	**(522)**	**(532)**	**(543)**	**(554)**
G&A	**13%**	**14%**	**14%**	**14%**			
Real Estate	(297)	(299)	(300)	(302)	(303)	(305)	(306)
Investment	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Publishing/Dist.	(5)	(5)	(6)	(6)	(6)	(6)	(6)
Total G&A	**(305)**	**(306)**	**(308)**	**(309)**	**(311)**	**(313)**	**(314)**
Interest Expense							
Real Estate	(587)	(587)	(555)	(524)	(465)	(377)	(338)
Investment	-	-	-	-	-	-	-
Publishing/Dist.	-	-	-	-	-	-	-
Total Interest Expense	**(587)**	**(587)**	**(555)**	**(524)**	**(465)**	**(377)**	**(338)**
Capex							
Real Estate	(680)	(30)	(30)	(30)	(30)	(30)	(30)
Investment	-	-	-	-	-	-	-
Publishing/Dist.	-	-	-	-	-	-	-
Total Capex	**(680)**	**(30)**	**(30)**	**(30)**	**(30)**	**(30)**	**(30)**
FCF Before Dividends & Mandatory Debt Repayments	**1,157**	**2,041**	**2,234**	**2,315**	**2,424**	**2,563**	**2,655**
Total Dividends	(1,326)	(1,326)	(1,326)	(1,326)	(1,326)	(1,326)	(1,326)
Mandatory Debt Repayments	(2,001)	(2,072)	(2,072)	(1,871)	(3,201)	(3,200)	(1,300)
Cash Surplus/(Deficit)	(2,170)	(1,358)	(1,164)	(883)	(2,103)	(1,963)	29

Source: Company reports, QNBFS Research

Key Estimates

- **Earnings.** We expect growth to moderate over the 2016-2019 with top line experiencing a CAGR of ~8% vs. ~28% over the 2013-2016 period. For 2017, we expect the top line to reach ~QR3.1bn (~8% y/y; ~9% peer median) followed by ~10% growth in 2018 (~9% peer median) to ~QR3.5bn. This should drive similar adj. EBITDA growth of ~8% in 2017 (~3% peer median) to ~QR2.4bn given earnings being skewed more in favor of real estate operations (higher opex). This should be followed by ~10% in 2018 (~12% peer median) to ~QR2.7bn as ERES recognizes the full contribution of 2 new malls, Ezdan Oasis residential village, and other minor real estate projects. Our adjusted EBITDA estimates exclude net earnings from associates/JVs (given non-control), revaluation of investment properties, impairments/write-downs, and other non-operating income/expenses. We estimate that real estate revenue/adj. EBITDA should normalize in 2017 following 2016, which witnessed an exceptionally large contribution from investments to earnings. For 2017, we expect ~73/67% of revenue/adj. EBITDA to be derived from real estate operations (~58/47% in 2016; ~76/68% in 2015) with the remainder coming from investments including dividend income, securities' trading, and other non-core operations. We see growth driven by:
    - The accretive contribution of Ezdan Al Wakra/Al Wukair malls, which should be fully reflected in the P&L by YE2017 (~QR166mn to the top line). We expect gross margins to slightly improve at ~65-70% but remain largely within historical segment trends (~73% in 2015; ~60% in 2016).
    - The ~50% occupancy of the Ezdan Oasis (residential village), where we expect ERES to generate an additional ~QR230mn in 2017 followed by the full contribution in 2018 to ~QR650mn. We note that much of the capex spend for these projects has already been done with ~QR700mn of the capex for the remaining. We expect gross margins to slightly improve at ~88% but remain generally in line with historical segment trends (~84% in 2015/2016).
    - The contribution of Ezdan Palace and The Curve hotels to the P&L as ERES ramps up occupancy. We model terminal occupancy rates of ~86%. We expect gross margins to improve slightly to ~75% but remain in line with historical segment trends at ~75% (~72% in 2016; ~75% in 2015).
    - This earnings growth should be offset by lower expected investment income, primarily from trading in securities (~QR560mn in 2017 from ~QR966mn in 2016; ~42% lower y/y)

Fig 20 – Earnings growth profile

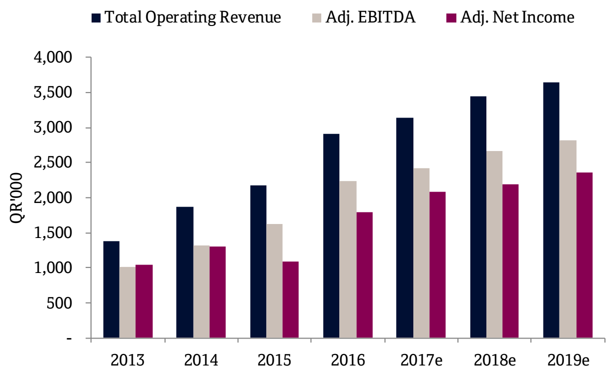
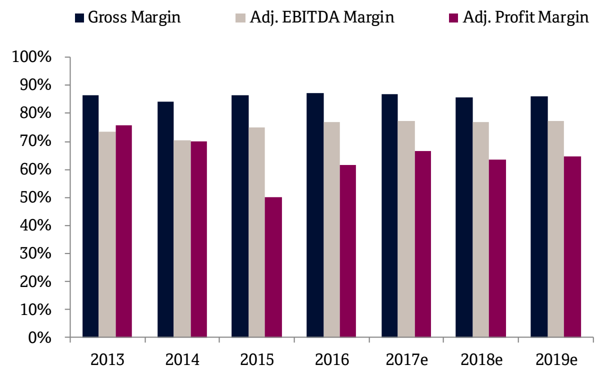


Fig 21 – Margin profile



Source: Company reports, QNBFS Research

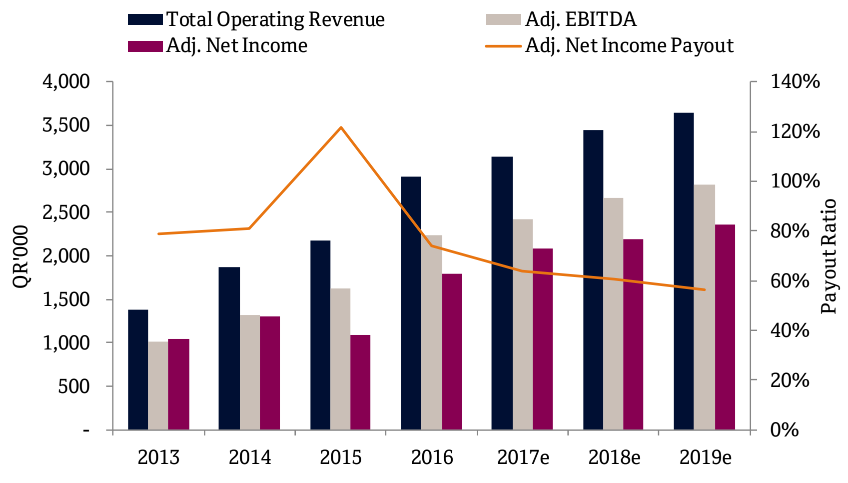
Fig 22 – Margins by business segment

Gross Margin	2014	2015	2016	2017	2018	2019
Residential/Commercial	*81%*	*84%*	*84%*	*88%*	*88%*	*88%*
Hotels	*76%*	*75%*	*72%*	*75%*	*75%*	*75%*
Malls	*70%*	*73%*	*60%*	*70%*	*70%*	*70%*
Investments - Dividends	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Investments - Sale of Securities	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Publishing/Other	*NA*	*NA*	*(24%)*	*8%*	*20%*	*25%*
Total	***84%***	***86%***	***87%***	***87%***	***86%***	***86%***

Source: Company reports, QNBFS Research

- **Corporate drag.** We model corporate drag growth (G&A, D&A, and net interest expense) at slower than inflation as we assume inflationary pressure impacting costs by a smaller magnitude than revenue. Effectively, our model assumes that inflation should be mostly passed on to customers with a small absorption by ERES (e.g. salaries are unlikely to rise in line with inflation). For 2017, we expect G&A to remain relatively stable at ~QR305mn vs. 2016 (~QR303mn). We expect D&A charges to increase as the company begins to expense the capitalized costs of projects coming online and hitting the P&L in 2017. This, however, should be largely offset by lower interest expenses in 2017 (~QR592mn vs. ~QR623mn in 2016) as ERES focuses on debt repayment over the next couple of years in an effort to de-lever its balance sheet.
- **Per share items.** The above should drive adj. EPS/CFPS (ex. WC) in 2017 of QR0.79/0.70 vs. 2016 at QR0.68/0.50 followed by QR0.83/0.88 in 2018.
- **Capex and free cash flow.** We estimate capex spend to decline significantly in 2017 to ~QR700mn as much of the Al Wakra/Al Wukair malls and Ezdan Oasis residential village spend has been done in 2016/2015 (~QR2.0/1.6mn). Coupled with the contribution of those properties to earnings, we expect operating cash flow (CFO ex. WC) and cash from operations to improve to ~QR1.9bn and ~QR1.8bn respectively driving a much improved simple free cash flow (FCF) profile for the company in 2017 of ~QR1.1bn (before dividends and debt repayment) vs. ~QR700mn and ~QR400mn in 2016 and 2015.
- **Dividends.** At ~QR0.50/sh dividend, the total dividend spend is ~QR1.3bn and we do not model any increases/cuts at this point. ERES closed 2016 with dividend payout on net income of ~73%, an improvement over 2015's ~80%. We highlight that when excluding gains on revaluation of investment properties (~QR600mn in 2015) as well as other non-recurring/non-cash charges, dividend payout on adj. net income in 2015 topped ~122%, implying that dividends were funded at least in part by debt. For 2017, we expect earnings growth to drive a more favorable payout of ~64%, which should continue to trend lower as the company grows operations (~60% in 2018). However, we highlight our expectation of ERES needing to borrow more to maintain its current nominal dividend payments as operating cash flow is currently not enough to sustain capex spend along with dividend payments and scheduled debt repayments.

Fig 23 – Consolidated earnings profile and payout ratio

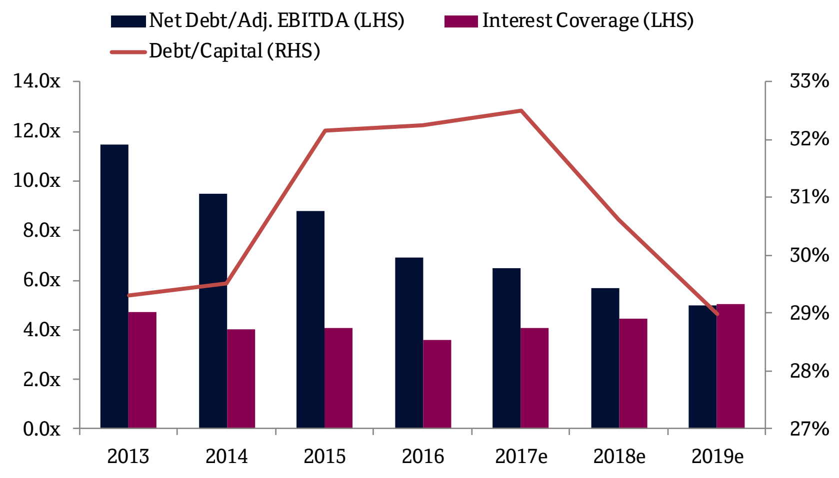


Source: Company reports, QNBFS Research

- **Debt.** Sitting at ~QR16bn in debt as of last reporting period (YE2016), we expect ERES to begin deleveraging the balance sheet given the expected improvement in earnings profile especially as management reach mandatory debt repayments as highlighted in their year-end financials. We expect at least ~QR2.0bn to be repaid in 2017 with another ~QR2.0bn paid down in 2018. We also incorporate an additional US$500/1,821mn in new Sukuk as part of ERES' US$2.0b/QR7.3bn shelf (currently issued ~QR1.8bn) and use the proceeds to re-profile part of the debt in an effort to better manage cash flows. The original issued Sukuk currently trade on the Irish stock exchange with a coupon of 4.375% paid semi-annually and mature in 2021. They are currently rated BBB- (Stable) and Ba1 (Stable) by S&P and Moody's respectively. However, as mentioned, we expect continued reliance on debt to partially fund the dividend at current levels and see operating cash flow able to fully sustain the dividend along with debt repayments by ~2023. Overall, we expect net debt/adj. EBITDA to improve to ~5.7x by 2018 from ~6.9x in 2016, which remains substantially higher than peers average at ~2.3x. By 2018, debt/capital should also improve to ~31%

along with interest coverage to 4.5x; both of which remain elevated relative to peers at ~21% and ~7.2x.

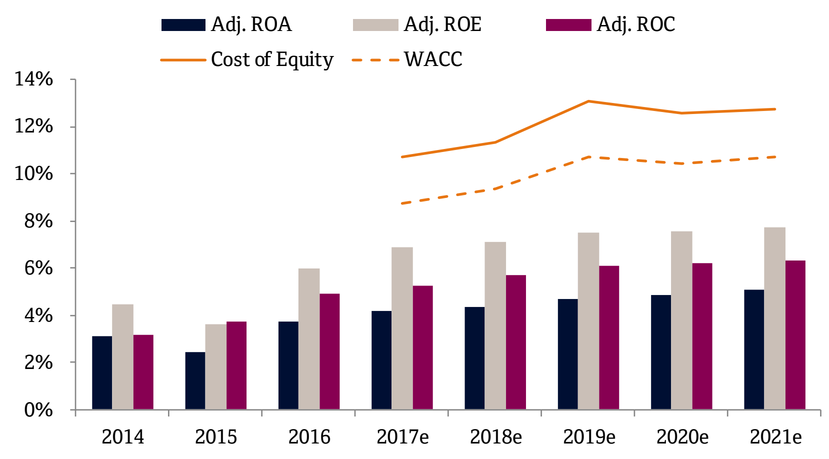
Fig 24 – Leverage profile



Source: Company reports, QNBFS Research

➢ **Profitability metrics.** We expect ERES to generate ~4.1% ROA and ~6.7% ROE in 2017, which both remain below peer medians at ~5.4% and ~9.4% respectively. We highlight that our ROC estimates are also below peer median at ~5.1% vs. ~6.4% while our long-term ROC estimates continue to be below our cost of equity and weighted average cost of capital estimates (Fig 25), which suggests an inability to generate profit rates higher than the company's cost of equity/capital. All this supports our muted view on ERES shares and backs up our TP/rating. We highlight that the low profitability metrics are a reflection of the underutilized assets of ERES. Given the substantial land bank at management's disposal, there is an opportunity to significantly improve these metrics in later years should clarity on future development timelines, estimates, and costs are obtained. Currently, we include the land bank only on a price/SqM basis in our valuation, which does not impact these metrics.

Fig 25 – Profitability metrics vs. cost of equity/capital



Source: Company reports, Bloomberg, QNBFS Research

Upcoming Catalysts

1. **Ezdan Oasis residential village contribution to earnings.** Expected to begin occupancy by 2H 2017.
2. **The Curve Hotel.** Begin contributing to P&L in 2017. Soft opening in December 2016; official opening in April 2017.
3. **Ezdan Palace.** Begin contributing to P&L in 2017. Soft opening in April 2017; official opening in mid-2017.

Risks to Thesis

General economic weakness. The real estate market in Qatar is highly correlated to the overall economic conditions in the country. As such, any economic weakness should negatively impact our valuation as it should reduce demand for residential and commercial real estate. Therefore, the company is susceptible to lower yields on its real estate properties should a downturn in the economy occur. While ERES does rely heavily on investment income to sustain general operating earnings, we view ERES as primarily a real estate company and as such it would be exposed to economic trends. In addition, macro weakness would be expected to impact ERES' investment book as well and as such would put pressure on the overall profitability of the company.

Dividend sustainability. We currently model sustained levels of divided payments each year at ~QR1.3bn; however, as we noted before, we expect ERES to rely on its balance sheet to fund a significant portion of the dividend into the foreseeable future. Given the high nominal value of dividend payments, we expect any slowdown in operations as a result of weaker than anticipated operating results or macro factors to negatively impact dividends and put additional pressure on ERES' BOD to reduce the dividend payment. We would look favorably on any effort to reduce dividend payments as that would reduce the need to leverage the balance sheet further.

Interest rates. The company is exposed to material changes in interest rates given its debt load. Any significant increase could materially impact the cost of debt and reduce our valuation. We also highlight that dividend-paying real estate plays tend to be negatively correlated to changes in interest rates as higher rates increase the risk premium required on such investments, thus negatively impacting the share price.

Funding of growth projects and project financing. The company's operations are materially impacted by the need and ability to secure funding for growth projects in the real estate segment. While we think that this risk is low, a material decline in operating earnings could significantly hinder ERES's ability to secure project financing and potentially result in equity issuance to partially fund growth initiatives which would result in dilution to current investors.

Company Description

ERES is a holding company with a diversified book of assets covering the real estate market, along with investments in publicly traded and private companies spanning varied sectors within Qatar. Other than real estate, ERES has exposure to the following sectors: banking, insurance, healthcare, food, and publishing/distribution. We highlight that ERES' operations and investments decision are guided by Islamic Sharia-compliant principles. The company's business operations are entirely focused on the Qatar market with no plans in the foreseeable future to expand geographically outside the country. We estimate that ~80-85% of the company's operating revenue in 2017 (~90% in 2018) is recurring in nature and is generated from real estate revenue as well as dividends generated from ERES' substantial investment book in publicly traded securities listed on the Qatar Stock Exchange (QSE). However, we note that 2016 was, in our view, a standout as only ~66% of revenue was recurring given the substantial earnings generated by trading in securities and divestiture of investments.

Real estate operations. Real estate operations focus on the development and operation business with focus on the Qatari market, specifically. It is estimated that ERES properties are currently home to ~100k people, which is ~4% of Qatar's population, making ERES the largest private landlord in the country. Real estate operations are divided into 3 segments: residential/commercial, hotels, and malls with the residential/commercial comprising the majority (~74%) of the real estate segment's revenue as at YE2016 (hotels/malls ~17%/9% respectively). Real estate operations are comprised of the following:

Land Bank – ERES currently has ~1.8mn SqM of land with ~1.0mn SqM designated for the development of the Ezdan Oasis residential village, which is expected to come online in 2H 2017 (part of our DCF and operating income forecasts). We value the remainder (~800k SqM) at ~QR3.3bn based on ~QR3,800/SqM).

Investment operations. Investment operations comprise ERES' direct investment into publicly traded companies listed on the Qatari Exchange or private businesses (more of a private equity play). ERES generates income from these business through:

- **Dividends –** We assume a dividend yield of ~4% on a go-forward basis, which is in line with 2016's dividend income generated.

- **Securities trading –** No visibility on ERES' investment book. We assume a marginal ~5% rate of return (RoR) on book value of assets held for sale in our earnings forecasts (included at ~1.0x BV in our NAV)
- **Income from Associates/JVs –** These comprise ERES' direct and significant/material investment into publicly traded companies listed on the Qatari Exchange or private businesses (more of a private equity play). Fig 26 highlights the current ownership structure and carrying value as of YE2016.

Fig 26 – Associates/JVs as of YE2016

Name	Public/ Private	Ticker	Ownership %		BV (QR mn)	
			2016	2015	2016	2015
Qatar International Islamic Bank	Public	QIIK QD	*20.00%*	*22.65%*	1,911.0	2,083.0
Medicare Group	Public	MCGS QD	*13.25%*	*25.79%*	266.9	388.4
Qatar Islamic Insurance Co.	Public	QISI QD	*10.00%*	*23.82%*	114.5	222.7
Dar Al-Sharq for Printing, Publishing, and Distribution	Private	NA	*44.78%*	*30.00%*	536.7	211.1
White Square Real Estate	Private	NA	*32.50%*	*32.50%*	185.7	192.7
Dar Al-Arab	Private	NA	*21.55%*	*33.33%*	75.7	75.5
Islamic Holding Group	Public	IHGS QD	*0.00%*	*49.00%*	-	29.3
Widam for Food Co.	Public	WDAM QD	*3.01%*	*0.00%*	35.8	-
Al Waraq for Printing Press	Private	NA	*51.00%*	*0.00%*	152.8	-
Weighted Average/Total			*25.16%*	*24.68%*	3,279.0	3,202.7

Source: Company reports, QNBFS Research

Detailed Model Summary

Income Statement	Unit	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	**QR mn**	**1,379**	**1,871**	**2,169**	**2,910**	**3,139**	**3,450**	**3,639**	**3,700**	**3,762**
COGS	QR mn	(184)	(297)	(296)	(371)	(411)	(487)	(511)	(522)	(532)
Gross Profit	**QR mn**	**1,195**	**1,574**	**1,873**	**2,539**	**2,728**	**2,963**	**3,127**	**3,178**	**3,230**
Gross Margin %	*%*	*86.7%*	*84.1%*	*86.3%*	*87.3%*	*86.9%*	*85.9%*	*85.9%*	*85.9%*	*85.9%*
G&A	QR mn	(181)	(255)	(246)	(303)	(305)	(306)	(308)	(309)	(311)
Total Operating Expenses	QR mn	(181)	(255)	(246)	(303)	(305)	(306)	(308)	(309)	(311)
Adj. EBITDA	**QR mn**	**1,014**	**1,318**	**1,627**	**2,236**	**2,424**	**2,657**	**2,819**	**2,869**	**2,919**
Adj. EBITDA Margin %	*%*	*73.5%*	*70.5%*	*75.0%*	*76.8%*	*77.2%*	*77.0%*	*77.5%*	*77.5%*	*77.6%*
D&A	QR mn	(8)	(9)	(9)	(16)	(19)	(23)	(28)	(32)	(35)
Adj. EBIT	**QR mn**	**1,006**	**1,309**	**1,618**	**2,220**	**2,404**	**2,633**	**2,792**	**2,837**	**2,884**
Adj. EBIT Margin %	*%*	*72.9%*	*70.0%*	*74.6%*	*76.3%*	*76.6%*	*76.3%*	*76.7%*	*76.7%*	*76.7%*
Interest Income	QR mn	-	-	-	-	5	2	2	2	5
Interest Expense	QR mn	(212)	(325)	(399)	(623)	(591)	(589)	(557)	(526)	(470)
Net Interest Expense	QR mn	(212)	(325)	(399)	(623)	(587)	(587)	(555)	(524)	(465)
Earnings Before Taxes	**QR mn**	**793**	**984**	**1,219**	**1,597**	**1,818**	**2,047**	**2,236**	**2,313**	**2,419**
Adj. Net Income	**QR mn**	**1,047**	**1,308**	**1,091**	**1,797**	**2,087**	**2,197**	**2,352**	**2,431**	**2,540**
Adj. Profit Margin %	*%*	*75.9%*	*69.9%*	*50.3%*	*61.8%*	*66.5%*	*63.7%*	*64.6%*	*65.7%*	*67.5%*
WA Basic Shares Outstading	mn	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5
WA FD Shares Outstading	mn	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5
FD EoP Shares Outstanding	mn	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5	2,652.5
Adj. EPS - FD	QR/sh	0.39	0.49	0.41	0.68	0.79	0.83	0.89	0.92	0.96
CFPS (ex. WC)	QR/sh	0.29	0.41	0.49	0.50	0.70	0.88	0.94	0.96	0.98
CFPS	QR/sh	0.09	0.37	0.75	1.03	0.67	0.88	0.94	0.96	0.98

Balance Sheet		2013	2014	2015	2016	2017	2018	2019	2020	2021
Cash/Equiv	QR mn	450	298	620	426	497	106	165	318	841
A/R	QR mn	144	82	127	236	190	200	203	207	210
Inventories	QR mn	13	22	20	19	15	16	17	17	17
Total Current Assets	**QR mn**	**676**	**890**	**1,268**	**780**	**802**	**421**	**484**	**640**	**1,167**
PP&E	QR mn	28	28	22	42	52	58	60	58	52
Total Long-Term Assets	**QR mn**	**40,527**	**42,503**	**45,670**	**49,048**	**49,709**	**49,715**	**49,716**	**49,714**	**49,709**
TOTAL ASSETS	**QR mn**	**41,203**	**43,393**	**46,939**	**49,829**	**50,511**	**50,136**	**50,200**	**50,355**	**50,876**
A/P	QR mn	262	324	916	664	536	562	572	581	591
Total Current Liabilities	QR mn	1,867	1,558	2,402	4,176	4,118	4,145	3,954	5,293	3,922
Total LT Liabilities	QR mn	10,692	11,757	14,156	15,079	15,327	14,205	13,551	11,380	12,180
TOTAL LIABILITIES	**QR mn**	**12,559**	**13,316**	**16,558**	**19,255**	**19,445**	**18,350**	**17,505**	**16,673**	**16,102**
Non-Controlling Interest	QR mn	-	-	404	432	513	720	969	1,223	1,481
Issued Capital	QR mn	26,525	26,525	26,525	26,525	26,525	26,525	26,525	26,525	26,525
Retained Earnings	QR mn	861	1,230	1,623	1,882	2,076	2,348	2,750	3,214	3,768
TOTAL OWNERS EQUITY	**QR mn**	**28,644**	**30,077**	**29,977**	**30,142**	**30,552**	**31,065**	**31,727**	**32,460**	**33,294**

Cash Flow Statement		2013	2014	2015	2016	2017	2018	2019	2020	2021
Operating Cash Flow	QR mn	769	1,081	1,311	1,319	1,867	2,329	2,492	2,541	2,591
Non-Cash Change in WC	QR mn	(521)	(111)	690	1,407	(79)	16	6	6	6
CFO	**QR mn**	**248**	**970**	**2,001**	**2,726**	**1,787**	**2,346**	**2,497**	**2,547**	**2,597**
Capex	QR mn	(756)	(400)	(1,604)	(2,034)	(680)	(30)	(30)	(30)	(30)
CFI	**QR mn**	**(1,446)**	**(266)**	**(1,977)**	**(2,283)**	**(122)**	**298**	**298**	**298**	**298**
Net Change in Debt	QR mn	1,305	131	1,557	300	319	(1,122)	(855)	(841)	(581)
Dividends	QR mn	(345)	(822)	(1,061)	(937)	(1,326)	(1,326)	(1,326)	(1,326)	(1,326)
CFF	**QR mn**	**960**	**(691)**	**496**	**(639)**	**(1,594)**	**(3,035)**	**(2,737)**	**(2,692)**	**(2,372)**
FX Translation	QR mn	-	-	-	-	-	-	-	-	-
Net Change in Cash	**QR mn**	**(238)**	**12**	**520**	**(195)**	**71**	**(391)**	**59**	**153**	**523**

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

Contacts

Saugata Sarkar
Head of Research
Tel: (+974) 4476 6534
saugata.sarkar@qnbfs.com.qa

Mohamed Abo Daff
Senior Research Analyst
Tel: (+974) 4476 6589
mohd.abodaff@qnbfs.com.qa

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

Zaid Al Nafoosi, CMT, CFTe
Senior Research Analyst
Tel: (+974) 4476 6535
zaid.alnafoosi@qnbfs.com.qa

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