Kuwait

Global
بيت الاستثمار العالمي
Global Investment House

Global Research - Kuwait

Salhia Real Estate Company (KSC)

Investment Update

Reuters Code
SREK.KW

March, 2003

Listing
Kuwait Stock Exchange

BUY

Current Price
415 fils

Investment Indicators

- During FY2001 and FY2002, Salhia Real Estate Company (SREK.KW) outperformed our expectations outlined in our May 2000 research report in terms of sales and gross profit.
- The company declared and paid a dividend of 20 fils per share on a total EPS of 28.0 fils for FY2002.
- In March 2003, UNCC has approved a compensation of USD8.73 million for the company. The total claims by the company at the end of FY2002 was KD 7.0 million as stated in its annual report for FY2002.
- The new projects are progressing well and will ensure continuous revenue stream for the company.
- In the light of the expected performance of the company, we recommend a BUY on the stock.

Table 01: Salhia at a Glance

Price March 19, 2003	Shares in Issue	Market Cap	52-week Price Range
415 fils	238,412,460	KD98,941,171mn	415-270fils

Year	Operating Income KD '000	Net Profit KD '000	EPS fils	Book Value fils	ROE	P/E*	P/BV*
2004F	17,303	10,166	42.6	321.9	13.7%	9.7	1.3
2003F	13,882	11,116	46.6	301.3	16.1%	8.9	1.4
2002A	11,694	6,635	28.0	278.8	10.3%	12.1	1.2
2001A	10,716	5,895	25.0	261.7	9.8%	10.8	1.0

* *Historical P/E & P/IV multiples pertain to respective year-end prices, while those for future years are based on market price in the Kuwait Stock Exchange as in 19 March, 2003.*
Source: Salhia and "Global's" Estimates

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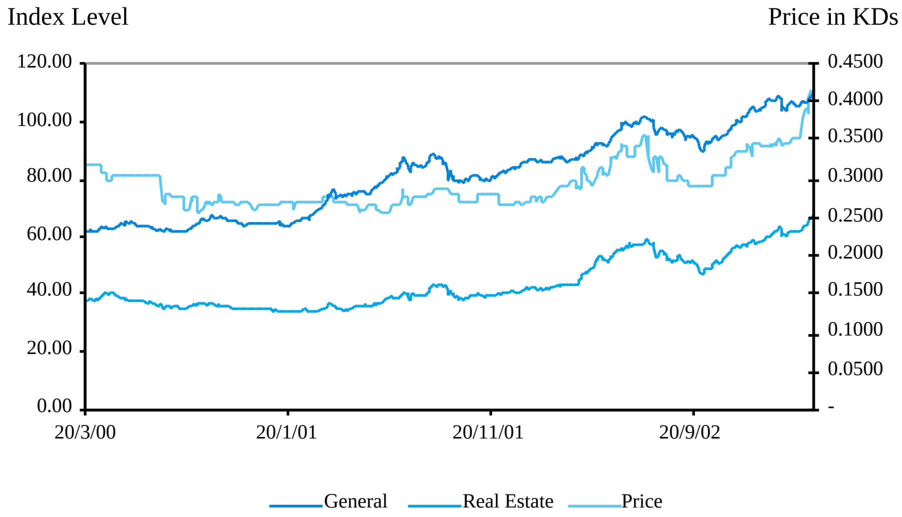
Share price vis-à-vis Global Indices



Source: KSE and Global's Estimates

Income Statement *Amount in KDs thousands unless stated otherwise*	**2001**	**2002**
Income from real estate & hotel operations	17,978	20,541
Direct operating expenses	(7,262)	(8,847)
Gross profit	**10,716**	**11,694**
Income from subsidiaries	677	437
Administrative expenses	(2,472)	(2,862)
Other operating expenses*	(712)	(990)
Depreciation & amortization	(1,966)	(2,224)
Profit from Operations	**6,243**	**6,055**
Financing charges	(3,785)	(3,276)
Net provisions	-	-
Add: Investment & interest income	3,016	3,498
Changes in Value of investments	-	(385)
Add: Other Income	861	1,093
Profit from Ordinary Activities	**6,334**	**6,985**
Minority interest	(25)	(7)
Tax	(89)	(52)
Extraordinary items	-	-
Earnings Before KFAS, NLST, BoD	**6,220**	**6,926**
KFAS contribution	(112)	(62)
BoD remuneration	(77)	(77)
NLST	(135)	(152)
Net Profit	5,895	6,635

Source: Salhia Real Estate Company

The income from real estate and day care home operations almost increased by 18% each during FY2002 as compared to that during FY2001 while the increase in the real estate operations was a mere 4.47%. Overall there was an increase of 14% in the total income for the company.

Increase in operations income..

At the same time the direct operating costs also increased by about 22% for FY2002 as compared to that for FY2001. The main reasons for the rise was the consolidation of subsidiaries for which the direct costs were at much higher proportion of the total revenue (60%) as compared to Hotel Operations (44%), and Real Estate operations (8.5%) for FY2001. Hence, the decline in the gross and operating profit margins.

..accompanied by increase in Operating costs

The operating profit for FY2002 was marginally lower than that for FY2001 because 2-3 floors for the hotel were under renovation and did not bring in any revenue during 2002; also the operating cost as a percentage of income from real estate and hotel operations - was higher by 3% as compared to that for FY2001. Total capital expenditure on renovation works is expected to be around KD6.5 mn.

Despite a 14% increase in the total revenues, the Operating Profit for the company decreased by 3% for FY2002 as compared to that for FY2001.

The positive outcome from the results has been the increase in the interest and the investment income for the company that rose by about 16% for FY2002 as compared to the same period for FY2001. A similar trend was seen for Other Income, which increased by about 27% over FY2002 as compared to that in FY2001. This was mainly on account of profit made on the sale of investment properties and other fixed assets. The company aims at having 80% of its assets in domestic market and 20% out of Kuwait. This is the long-term aim of the company.

Interest and investment income increased substantially

The company is expected to continue this trend in the revenues growth for some time to come. The reasons for the same are varied including growth in the business of subsidiaries, a buoyant local real estate market, and likelihood that Arraya complex would start operations from this year. The German subsidiary also plans to increase the scale of operations and hence its earnings.

The difference in the bottom lines for FY2002 and FY2001 comes mainly from the non-operating income rather than some fundamental change in the operating income. The operating cost of the company increased during FY2002 as a result of the non-capitalization of the renovation expenditure as per German accounting regulations. This along with a slight increase in the operating costs for the existing businesses resulted in the higher operating costs for the company as a whole.

Company needs to cut operating costs

The company's current ratio in fact came down from a value of 2.99 to 2.68 due to a fall in the cash and cash equivalents and the receivables. Here we have included the investments of the company in the current assets.

The EPS for FY2002 was 28.0 fils per share – an increase from value of 25 fils for FY2001. The EPS for FY2002 was calculated on an adjusted basis that accounted for the treasury shares. The EPS is expected to rise in the near future as new projects come on stream.

The Return on average equity for year 2002 was 10.3% - an improvement over the value for FY2001 of 9.8%. This was due to the substantial increase in the net profit for the company for year 2002 over FY2001 despite a rise in the shareholders' equity over the same period.

The Debt-Equity ratio for the company rose from 1.12X at end of FY2001 to 1.21X for the end of FY2002. The company has borrowed through its subsidiaries and its joint ventures in order to expand the operations. These loans would be repaid over a period of time stretching beyond 2006. We expect the debt-equity ratio to come down after 2003 when the operations would stabilize somewhat.

Floating stock is not much, so not a very liquid stock

Trading in the stock is scant as most of the shareholders have been with the company through thick and thin and do not wish to divest their stakes. With large entities owning altogether 51% of the outstanding stock, the floating stock is reduced and so is the trading activity in the stock.

The second JW Marriott-branded hotel in the Middle East has opened in January 2003 in central Kuwait City, as a result of the conversion of the existing 291-room Le MeridienHotel.

Thus the total areas under Salhia's management are the following:

Commercial	=	30,800 Sq meters
Office	=	40,950 Sq Meters
Car Park	=	30,800 Sq Meters
ConventionCenter	=	2,700 Sq Meters

The Gross and the Written Down values for different properties are as follows:

	Cost	Depreciation	Net Book Value
Salhia Complex	20,417,323	8,919,823	11,497,500
Sahab	6,821,433	802,924	6,018,509
JW Marriott	22,532,520	10,574,584	11,957,936
Fahad Al Salem*	10,590,860	6,357	10,584,503
Al-Sour*	2,588,250	Nil	2,588,250
Haddia	26,211,890	3,162,569	23,049,321

*Source: Salhia, 2002 * fully depreciated value*

The company has incurred large amount of long-term loans – which are to be paid fully beyond 2006 even and partial collateralization against the investment properties and the real estate apart from small amount of investment as well. A large proportion of these loans, about KD23.0 mn have been obtained by subsidiaries with no recourse to the parent company. The interest coverage ratio for the company had been low in absolute terms (around 2.0) yet the trend it follows is an increasing one. We hope that the interest coverage will continue to improve in the future.

FY2001 Review

Good result during FY2001 as compared to that for FY2000..

During the FY2001 the top line for the company grew radically by about 88% as compared to that during FY2000 while the direct operating costs increased by about 180%. This resulted in an increase of 52% in the Gross Profit and about 53% increase in the Profit from Operations. The main reason for the same was the consolidation of subsidiaries especially, Haddia, which altogether contributed KD7.1 mn to the total revenues for the company. At the same time, operating costs for the subsidiaries was also substantial and it reduced the gross profit for the company by KD4.3 mn for FY2001.

There was an extraordinary gain of KD2.9 million during FY2000 on account of the Government Debt Settlement Program wherein a previously recognized liability was reversed. This pushed the FY2000 bottom line up by more than 227%. The net income for the year 2001 was 25.2 fils while for FY2000 it was 21.8 fils per share. The company paid the National Labor Support Tax for the first time in 2001.

.. because of Consolidation of Haddia

The company consolidated its subsidiaries in its account and therefore, there was an addition of around KD23.3 million to the Fixed Assets for the company during FY2001. This was mainly on account of the consolidation but there was also a capital expenditure of KD6.5 mn.

Consolidation also gave rise to minority interest and taxes paid for the subsidiaries to be reported on the P&L statement for the company for FY2001. The company paid a dividend of 15% of the par value per share for FY2000 while it paid 18% for FY2001. As a result of the consolidation, the company's total assets stood at KD136.9 million at the end of FY2001 compared to the KD106.6 million at the end of FY2000.

The Key Property Investments (KPI) has been doing well in the past and it is expected to continue the trend. KPI investments include the refuge portfolio, the Queen's Mead and Kings Mead shopping centers and the Marconi real estate portfolio. At the end of 2001, KPI's Total Assets reached KD22.66 mn with a net shareholders' equity of KD10.59 mn. KPI's total turnover reached KD6.21 mn from KD3.71 mn in 2000. Net pre-tax profits reached KD1.79 mn in 2001 as compared to KD1.29 mn in FY2000.

Other Developments at the Company

Arraya project is going on schedule

New projects are proceeding as planned, albeit a bit delayed, such as the Arraya Project, the Salhia Car Park Project due to be completed by February 2003. Other new project is Al Asima complex that is awaiting clearance from authorities.

Arraya Project, when finished, will boast of a world-class convention center, a three star hotel of 310 rooms, commercial space and office space as well. Already partial bookings have been made for renting out the office space on the ground, mezzanine and mezzanine roofs. As per the management, the Arraya Project would be major milestone in the commercial real estate in the capital governorate.

The company is granted USD8.753 mn as compensation claim by the UNCC which would be received in 2003. We have built this payment into our forecast.

Future Strategy of the Company

The company is expected to continue pursuing its new and the ongoing projects so that the full potential of the company may be realized. It is planning to have a judicious mix of local and international portfolio of properties and is working towards such an arrangement.

Hotel Business

The company is concentrating on hotel business especially the new JW Marriott

The company has converted a five star hotel in the capital area into a Marriott Hotel of 291 beds. There was renovation of the existing facilities along with some new facilities being implemented. Because of these renovations the usual occupancy rates were affected to certain extent. Moreover, the company is not planning to offer special rates for Hala February despite the marginal rise in traffic because the rates were too low. Thus, company controls and operates one of the four five star deluxe hotel in Kuwait. Through JW Marriott , the company has 30% of the capacity for the deluxe hotels in Kuwait in terms of number of rooms.

Also, the new hotel in the Arraya Tower is expected to do well

The company is also planning to introduce a new hotel in the first class category in the Arraya tower that is being completed in the first half of 2003. That hotel would have 310 rooms and would offer quality that is between a three and a five star hotel for reasonable price. We have noted the capacity of the new hotel and accordingly forecast the revenues for the company in our projections. Also, our projections take into account a higher occupancy rates than that for the deluxe hotel. If the war scenario continues for longer period, it would affect the occupancy in the local hotels and therefore, the revenue forecasts may not be met at all.

Real Estate Business

Salhia complex - some of the contracts may be re-negotiated as petroleum companies shift out

The company will continue to manage the main properties viz. the Al Fahad Al Salem street buildings, the Al Sour street buildings and the Sahab towers and Salhia complex. The eight buildings on the Fahad Al Salem street altogether measure about 3,600 sq. meters. Also, the company is managing Salhia complex whose rental levels are at a premium as compared to the other similar properties in the area. The company is planning to undertake further renovations of the complex and would be re-negotiating some of the contracts even. As of now, the complex enjoys close to 100% occupancy. We have continued with the past rentals as we believe the company will be able to negotiate rental contracts at the present rates.

Arraya Tower, when completed, would provide further boost to real estate business of the company when the convention center and office spaces are ready by August 2003. The parking lot is also ready and slated for a soft opening in April 2003. The revenues from these real estates are expected to gradually build up from second half of FY2003 and accordingly have been built up in our projections.

Care Home Business

Haddia has plans for expansion and is doing well

The company has planned to increase the number of care home beds to 1,800 by 2004 from an existing number of 1,074 beds for its German Subsidiary, Haddia Gmbh. It has recently purchased three land areas for the purpose. But given the present situation, we have been conservative in our assumptions to include only 1500 operational beds by 2005. The company plans to take its German subsidiary public in the future when the markets are ready for this stock. The company takes the advantage of avoidance of double taxation to increase return to its shareholders. The company had already commissioned a feasibility study for Haddia's expansion plan and it projects "reasonable" IRR on post tax basis. In order to reach a target of 1,800 beds, the total investment required would be Euro47 mn of which the equity portion is expected to be Euro9.5 mn.

KPI

KPI has also been doing well

The KPI business had achieved its target with the value of the joint venture company's total assets being around BP200 million from a value of BP25 mn capital. The company is taking advantage of the double taxation avoidance treaty to reduce the tax on the dividend that it receives from the company.

The company acquired the following properties in the UK during 2002:

Elephant and Castle Shopping Center	-	for BP29.25 mln with car park
Alshtom property	-	for BP111 mln 19 properties in 10 cities
Marconi portfolio of properties	-	for BP59.53 mln – 12 properties in and around London

These acquisitions have been funded using Shareholder's loan that would be converted into share capital later on and the loans from banks. Thus total value of assets with the company is now more than BP200 mln.

The management believes that there is potential for further growth in the foreign operations and therefore, has made no plans for any divestiture in the near future.

Real Estate Sector in Kuwait

2002 was a good year for the Real Estate Sector in Kuwait

In Kuwait recently the real estate markets have seen hectic activity on account of the UNCC payments. Real Estate accounts for about 7% of the GDP (based on FY2001 GDP) and about 12% of the non-Oil GDP. As per market reports, the total real estate sale increased by nearly 57% in the first half of FY2002 to reach KD588 mn. - a record level. It was the transactions in the Apartments and Commercial sector, which reported the highest increase. The first half of the FY2002 saw the apartments and commercial sectors registering a growth of 204% in value terms compared to the same period in FY2001.

The real estate sector in Kuwait is consisting of 14 companies, whose shares are listed on the stock exchange. They accounted for about 6.7% of the total market capitalization. For the FY2002, "Global" Real Estate Index outperformed the "Global" General Index by more than 18%.

The total profit for the companies was about KD26 mn for the first nine months for 11 companies that submitted their financials to KSE while many of the companies were in red during FY2001 and the total profits were KD18.69 mn only.

Valuation of the company

We have resorted to the DCF Method of Valuation for the company using the Free Cash Flow to Firm (FCFF). The different parameters for the valuation are as follows:

Risk Free Rate	:	3.25%
Equity Risk Premium	:	6.50%
Beta for the stock	:	1.121
Cost of Equity	:	10.54%
Cost of Debt	:	4.5%
Perpetual Rate of Growth	:	3.00%

Based on the above parameters and the FCFF cash flow for the company, we determine the fair value of the company's shares as **475 fils** per share.

We value Salhiya at 475 fils per share

Thus, the fair value for the stock of the company is around 475 fils per share as compared to the market price of 415 fils thereby offering an upside potential of around 14%. We therefore, suggest a BUY for the stock.

Historical and Projected Profit & Loss Statement

Balance Sheet	Salhia Real Estate Company (KSC)					
	2000A	2001A	2002A	2003F	2004F	2005F
Cash & cash equivalents	273	5,270	2,646	4,378	5,503	5,597
Receivables	2,095	4,147	3,758	5,916	7,319	7,806
Advances & prepaid expenses	-	-	-	237	293	312
Inventories	191	226	144	710	878	937
Current Assets	**2,560**	**9,644**	**6,548**	**11,240**	**13,993**	**14,652**
Investment in land	-	-	-	-	-	-
Investments	21,786	16,530	15,780	15,780	15,780	14,991
Joint venture investment	4,500	4,714	11,514	12,658	13,917	15,301
Unconsolidated subsidiary investment	3,409	-	-	-	-	-
Gross fixed assets (incl. cwip)	93,594	71,228	90,949	100,043	105,046	107,147
Accumulated depreciation	(19,172)	(14,059)	(16,152)	(18,503)	(20,971)	(23,512)
Net fixed assets	**74,422**	**57,170**	**74,796**	**81,540**	**84,075**	**83,635**
Investment Properties	-	58,394	44,630	46,861	49,204	51,664
Acc. depreciation (incl_translation_adj)	-	(9,537)	(543)	(1,131)	(1,748)	(2,383)
Net Investment Properties	-	48,857	44,086	45,730	47,456	49,281
TOTAL ASSETS	**106,677**	**136,915**	**152,724**	**166,949**	**175,221**	**177,860**
Due to banks	3,556	5,424	7,037	9,148	9,605	5,763
Payables	1,735	3,645	5,909	5,868	7,184	7,647
Provisions	73	73	125	125	125	125
Short-term loans	2,775	618	-	2,600	2,600	-
Current Liabilities	8,139	9,760	13,071	17,741	19,515	13,535
Long-term loans	39,009	63,323	72,686	76,321	77,847	81,739
Government loans	535	535	-	-	-	-
Employee indemnity	698	777	853	895	940	987
Minority interest	-	126	153	159	166	173
Share capital	23,841	23,841	23,841	23,841	23,841	23,841
Gain on Sale of Treasury Shares	93	-	-	-	-	-
Translation of Forex dealings	-	1	439	439	439	439
Cumulative Changes in Fair Value of Investments		1,284	927	927	927	927
Share Premium	14,457	14,457	14,457	14,457	14,457	14,457
Treasury stock	(1,942)	(1,268)	-	-	-	-
Reserves	13,755	14,999	16,385	18,701	20,821	23,037
Retained earnings	8,091	9,078	9,913	13,467	16,268	18,724
Shareholders' Equity	*58,296*	*62,394*	*65,962*	*71,833*	*76,753*	*81,425*
TOTAL LIABILITIES & EQUITY	**106,677**	**136,915**	**152,724**	**166,949**	**175,221**	**177,860**

Source: Salhia and Global's Estimates

Historical and Projected Profit & Loss Statement

Income Statement *Amount in KDs thousands unless stated otherwise*	Salhia Real Estate Company (KSC) 2000A	2001A	2002A	2003F	2004F	2005F
Income from real estate & hotel operations	9,573	17,978	20,541	23,662	29,277	31,225
Direct operating expenses	(2,539)	(7,262)	(8,847)	(9,781)	(11,974)	(12,745)
Gross profit	**7,034**	**10,716**	**11,694**	**13,882**	**17,303**	**18,479**
Income from subsidiaries	473	677	437	1,151	1,266	1,392
Administrative expenses	(1,508)	(2,472)	(2,862)	(4,098)	(5,421)	(6,052)
Other operating expenses	(505)	(712)	(990)	-	-	-
Depreciation & amortization	(1,400)	(1,966)	(2,224)	(2,938)	(3,085)	(3,176)
Operating Profit	**4,094**	**6,243**	**6,055**	**7,997**	**10,063**	**10,643**
Financing charges	(3,126)	(3,785)	(3,276)	(3,509)	(4,087)	(4,359)
Net provisions	(859)	-	-	-	-	-
Add: Investment & interest income	1,467	3,016	3,498	3,468	3,686	3,877
Changes in Value of investments	-	-	(385)	-	-	-
Add: Other Income	705	861	1,093	1,093	1,093	1,093
Profit from Ordinary Activities	**2,282**	**6,334**	**6,985**	**9,048**	**10,755**	**11,253**
Minority interest	-	(25)	(7)	(7)	(7)	(7)
Tax	-	(89)	(52)	(136)	(150)	(164)
Extraordinary items	2,927	-	-	2,677	-	-
Earnings Before KFAS, NLST, BoD	**5,209**	**6,220**	**6,926**	**11,582**	**10,599**	**11,082**
KFAS contribution	(94)	(112)	(62)	(104)	(95)	(100)
BoD remuneration	(45)	(77)	(77)	(77)	(77)	(77)
NLST	-	(135)	(152)	(285)	(261)	(273)
Net Profit	**5,070**	**5,895**	**6,635**	**11,116**	**10,166**	**10,632**

Source: Salhia and Global's Estimates

Historical and Projected Ratios

Ratios	Salhia Real Estate Company (KSC)					
	2000A	2001A	2002A	2003F	2004F	2005F
Valuation Ratios						
Number of shares outstanding in million	238.412	238.412	238.412	238.412	238.412	238.412
Book value per share in fils	244.52	261.71	276.67	301.30	321.93	341.53
EPS in fils	21.80	25.00	28.00	46.62	42.64	44.60
CEPS in fils	27.14	32.97	37.15	58.95	55.58	57.92
Price per share in fils	265.00	270.00	340.00	415.00	415.00	415.00
P/E multiple	12.16	10.71	12.22	8.90	9.73	9.31
P/BV multiple	1.08	1.03	1.23	1.38	1.29	1.22
Profitability Ratios						
Return on average equity	8.8%	9.8%	10.3%	16.1%	13.7%	13.4%
Return on average assets	4.8%	4.8%	4.6%	7.0%	5.9%	6.0%
Gross profit margin	73.5%	59.6%	56.9%	58.7%	59.1%	59.2%
EBIDT margin	57.4%	45.7%	40.3%	46.2%	44.9%	44.3%
EBIT margin	42.8%	34.7%	29.5%	33.8%	34.4%	34.1%
Net profit margin	53.0%	32.8%	32.3%	47.0%	34.7%	34.1%
Operational Profit Margin	10.1%	13.7%	13.5%	19.0%	20.4%	20.1%
Net Profit Analysis						
Operational profit (KD '000)	968	2,457	2,779	4,487	5,976	6,284
% share in net profit	19.1%	41.7%	41.9%	40.4%	58.8%	59.1%
Investment income	1,467	3,016	3,498	3,468	3,686	3,877
% share in net profit	28.9%	51.2%	52.7%	31.2%	36.3%	36.5%
Extraordinary income	2,927	-	-	-	-	-
% share in net profit	57.7%	0.0%	0.0%	0.0%	0.0%	0.0%
Gross real estate assets	93,594	129,623	135,578	146,905	154,250	158,811
Net real estate assets	74,422	106,027	118,883	127,271	131,531	132,916
EBIDT to gross real estate assets	5.9%	6.3%	6.1%	7.4%	8.5%	8.7%
EBIT to net real estate assets	5.5%	5.9%	5.1%	6.3%	7.7%	8.0%
Liquidity Ratios						
Interest coverage	0.7	1.7	2.1	3.3	2.6	2.6
Current ratio	1.23	2.99	2.68	1.71	1.52	1.53
Leverage Ratio						
Total debt to equity	79%	112%	121%	123%	117%	107%
Long-term debt to equity	67.8%	102.3%	110.2%	106.2%	101.4%	100.4%
Total liabilities to equity	81.8%	118.2%	130.2%	131.2%	127.1%	117.2%
Total debt ratio	45.4%	54.4%	56.8%	57.0%	56.2%	54.2%
Paid Dividend %	(14.64)	(17.72)	(20%)	(22.00)	(25.00)	(30.00)
Dividend KD	(3,490)	(4,224)	(4,768)	(5,245)	(5,960)	(7,152)
Dividend payout ratio	68.8%	71.6%	71.9%	47.2%	58.6%	67.3%

Source: Salhia and Global's Estimates

The following is a comprehensive list of disclosures which may or may not apply to all our researches. Only the relevant disclosures which apply to this particular research has been mentioned in the table below under the heading of **disclosure.**

Disclosure Checklist

Company	Recommendation	Ticker	Price	Disclosure
Salhia Real Estate Co.	BUY	SREK.KW	415 fils	1,9,10

1. Global Investment House did not receive and will not receive any compensation from the company or anyone else for the preparation of this report.
2. The company being researched holds more than 5% stake in Global Investment House.
3. Global Investment House makes a market in securities issued by this company.
4. Global Investment House acts as a corporate broker or sponsor to this company.
5. The author of or an individual who assisted in the preparation of this report (or a member of his/her household) has a direct ownership position in securities issued by this company.
6. An employee of Global Investment House serves on the board of directors of this company.
7. Within the past year , Global Investment House has managed or co-managed a public offering for this company, for which it received fees.
8. Global Investment House has received compensation from this company for the provision of investment banking or financial advisory services within the past year.
9. Global Investment House expects to receive or intends to seek compensation for investment banking services from this company in the next three month.
10. Please see special footnote below for other relevant disclosures.