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Investment Update

Kuwait

Salhia Real Estate Company

Building for the elite

August, 2006

Hold

Reuters Code:
SREK.KW

Listing:
Kuwait Stock Exchange

CMP:
590fils (August 15th,2006)

Investment Summary

- We had recommended a "Hold" on **Salhia Real Estate Company (SREC)** stock in our previous report in July 2005. We valued it at a fair value of 713fils. Since then the stock has moved up and down considerably from highest value 870fils and lowest being 580 fils.

- SREC revenue from real estate business amounted to 27.4% of the total revenue, while hotel operation and care home amounted to 35.7% and 37%, respectively in FY2005. In the same period, Salhia Real Estate Revenue from domestic operation has contributed to 63% (FY2004: 64.4%) to the top-line, with the balance 37% (FY2004:35.6%) was generated from Salhia real estate revenue in Europe.

- During FY2005, SREC total revenue declined slightly by 1.1% from its FY2004 level. The hotel operation has been the major driver for this decline as it dropped by 7.9% in FY2005. The revenue from care home and nursing operations increased by 7.5% in 2005, while the revenue from the real estate operation decrease by 2.5% in the same period. The recurring return on core revenue assets declined from 3.6% in FY2004 to 1.7% in FY2005.

- Key Property Investment (KPI), a 50% owned joint venture, has had a good year in FY2005. Total rental revenue reached GBP23.5mn (KD12.3mn) in FY2005, while the net profit amounted to GBP7.4mn (KD3.88mn) achieving a growth of 7.2% YOY. Total shareholders equity grew to GBP121.3mn (KD63.7mn) in 2005 compared to GBP81.7mn (KD42.9mn) in 2004, achieving a 48.5% growth YOY.

- SREC experienced a handsome increase in ROE since it increased from 10.2% in FY 2004 to 17.2% in FY2005. The analysis of ROE using the DuPont System revealed that the main cause for this increase was the large increase in the net profit margin. The efficiency (as indicated by assets turnover) and the degree of leverage the company use (as indicated by the financial leverage multiplier) have remained relatively stable during FY2005 as compared to 2004.

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- SREC has experienced a surge growth in net income which grown by 71.1% during FY2005 compared to only 7.4% during FY2004. This amazing growth has been fueled; however, by the more non-recurring items such as the large gain from sale of investments, which amounted to KD10.43mn, and gain on sale of investment property of KD4.9mn, both of which are component of net income but not recurring income.

- We have assigned an 80% probability to the DCF technique and 20% to the P/BV technique, since the relative valuation approach is very volatile and subject to the market sentiment and other qualitative factors. Based on the weighted average valuation approach we have reached a fair value for SREC of 584fils. Given a current market price of 590 as of August 15, 2006, the stock is currently trading at 1% above the fair value. Therefore, we reiterate our earlier rating on SREC and recommend **HOLD** on the stock with a medium-term prospective.

- **According to our discussion with the management, SREC is about to have a gain on sale of investment properties related to Al-Asima project which the management estimated it to be KD50mn. We have not incorporated this gain in our valuation and projection, since its objective value cannot be reasonably estimated and its probability is at question, at least at this point of time. Had this gain been included in our valuation and projections, the fair value of SREC stock would have been different from what we have currently estimated.**

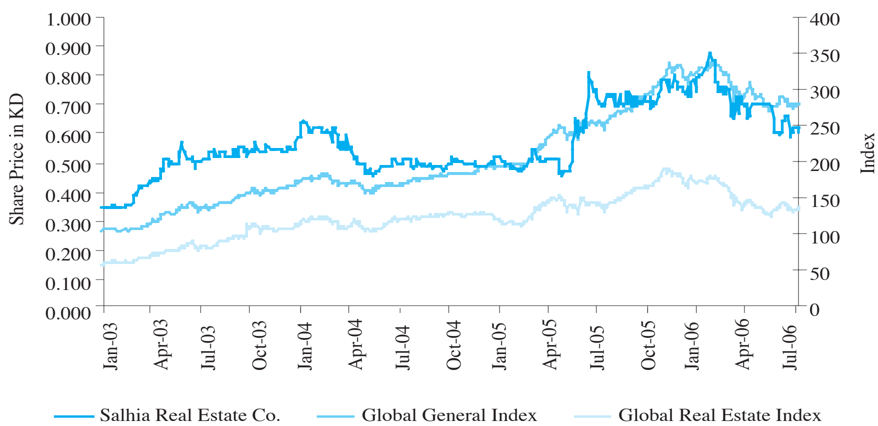
Table 1 SREC at a glance

Price (August 15, 2006)		Shares in issue			Market Cap		52 - week price range	
590 fils		315mn			185.80 KDmn		870-580 fils	
Year	Revenues from Operations (KD Mn)	Operating Profit (KD Mn)	Net Profit (KD Mn)	EPS (fils)	BVPS (fils)	ROAE (%)	P/E (x)	P/BVPS (x)
2007F	40.5	12.2	15.3	50.4	352.8	5.2	11.7	1.7
2006F	37.2	11.2	14.2	46.7	335.9	5.0	12.6	1.8
2005A	33.8	9.1	17.5	57.9	338.8	3.0	13.5	2.3
2004A	34.2	10.7	10.2	34.4	325.9	7.0	15.1	1.6

*(Source: **Global** Research and SREC)*

Note: Historical P / E & P / BV multiples pertain to respective year -end prices, while those for future years are based on closing prices on the KSE as of 15th of August 2006

Figure 1 Share Price Performance Chart



*(Source: Reuters data, **Global** Research)*

Real Estate Sector in Kuwait

Analysis of demand

Macroeconomic Conditions

- Abundant liquidity: Many factors have led to massive boost in the liquidity for Kuwait. The hike in oil prices resulted from the political insecurity in the region combined with the increasing oil production has flushed new cash to Kuwait.

- If we have taken into consideration the characteristics of the real estate-as a defensive investment- we can easily predict that these factors will increase the demand on the real estate sectors. The stock exchange recently has failed to be the investors' first call.

- The increase use of new loans and direct and indirect financing sources- predominantly, Islamic Ijara- should facilitate more fund flow to the real estate sector.

Demographic factors

- Population in Kuwait is expanding at a significant rate, with current population expected to pass the 3mn mark within decades.

- With half of Kuwaitis are under 18 years old, the pumping up of new houses is only a matter of time, As young couples would move away from the family house to their own homes.

- As the economy is growing, the need for expatriate workers has also increased, fueling the demand for housing and rental accommodations.

Governmental Factors:

- The liberalization of Kuwaiti economy and the overall boom should be reflected in growing number of new foreign companies and local companies as well. This, in its turn should increase the demand on the office spaces in the business district. The scarcity of land and spiraling land price in the downtown, will shot the demand for skyward rocketing towers.

- The Municipal Council has recently approved the new set of conditions pertaining heights of commercial building up to 100 floors, paving the way for the commercial investors to meet the predicted demand on office spaces.

- The unofficial lorry parks which acted as temporary storage facilities for many companies that spread over the desert roads, has been overtaken by buildings which has bushed the deserts back out of the town. This will definitely create high demand on the warehousing segment of the real estate sectors. (according to emerging market Kuwait By Oxford Business Group)

- The outlook for commercial segment seems very promising in the next 3-4 year since the need for decent and luxury offices will be huge in the up coming period, which will suit the need for the foreign banks expected to operate in the country.

- In the hotel operation, the competition is currently stiff due to the increasing number of 4-stare and 5-stare hotels in the last few years. Theses competition, however, is not expected to lead to price war as the rental charge per room is subject to price control mechanism stipulated by Kuwait Hotel Owners Association (KHOA). In the future, however, the demand might increase provided that the political instability in Iraq has been alleviated, which in turn will be reflected in higher business activities in the Kuwait as it is considered the most suitable adjacent country to Iraq, and hence more business gusts.

- In addition to business guests, tourists' arrivals are also expected to increase, refreshing the demands on hotels when Failakah Island Project (discussed below) is completed.

Analysis of supply

- To meet the increasing demand on the residential segment, many housing-construction projects has been initiated a case in point is Jaber Al-Ahmed City in Amghara, where a 1220-unit complex is already underway.

- Another mega project is the Silk City Project at Subiyah, which is considered one of the largest additions to field of real estate development in Kuwait. The city will be built on 250 square kilometers, while the overall investment will exceed KD 25 bn and is expected to house 500,000 residents. The project will be completed on a BOT model, with companies likely to press for leases extend which will extend well beyond the current customary 20-year period. The project plans to build a new seaport in Bubyan Island to be a major marine hub for Kuwait The completion date of the first phase will be within a period of 5-7 years

- A third project is Failakah Island project which will be developed under the BOT mechanism. The companies are looking for 50-year lease period due to the huge investment requirements.

- A fourth project is the Al-Khairan Pearl City, located 40km south of Kuwait City, neighboring Saudi Arabia. The goal is to provide housing for almost100,000 people. The work in phase-I has already been started.
- In the commercial real estate segment, Kuwait Business City, which will consist of hotels, malls and multi-storey car parks, aims to be completed by 2008.

Peer Group Comparison

- SREC has its distinctive style in planning and implementing projects. This in fact has limit SREC competitors to high-class builders who target high-end customers. Tamdeen Real Estate Company, for example, is considered one of the rival competitors of SREC, as it employee the same differentiation strategy. One of Tamdeen`s latest projects is Al-Kout shopping mall in Fehahel. Mabanee Real Estate Company is another competitor, which is currently in the process of finalizing a competing shopping mall named "Avenue" in Shuwaik, that project is expected to be completed in H1 2007.

Table 2 :Comparative Snapshot of Kuwaiti Real Estate Companies (as of FY2005)*

KD' 000	KREC	UREC	NREC	SREC	TAMDEEN	MABANEE
Core revenues**	7,677	12,634	16,157	33,778	7,583	15,902
Operating Profits	3,299	8,694	41,470	9,066	8,364	15,417
Net Profits	62,108	12,550	54,745	17,501	8,185	13,938
Cash & Bank Balances	13,403	6,421	517	2,540	1,812	2,505
Investments Properties	48,496	112,364	67,179	64,159	89,718	13,129
Total Assets - 2005	251,125	191,005	261,525	217,063	264,287	90,157
Shareholders Equity - 2005	192,963	97,031	188,100	101,965	173,749	58,587
Total Debt - 2005	58,162	90,723	73,425	112,482	90,538	31,570
Paid-Up Capital - 2005	65,943	54,191	53,636	31,492	32,000	30,000
EPS (fils)	94.7	23.7	107.0	57.9	21.9	47.2
Book Value per share (fils)	292.6	179.1	350.7	323.8	543.0	195.3
F/D shares outstanding, (`000)	659,428	541,912	536,360	314,924	320,000	300,000
ROAE	64.4%	25.9%	58.2%	34.3%	9.4%	47.6%
ROAA	49.5%	13.1%	41.9%	16.1%	6.2%	30.9%
Price (fils)	240	250	590	590	435	590
P/E	2.5	10.6	5.5	10.7	19.9	12.5
P/BV	0.8	1.4	1.7	1.9	0.8	3.0

Historical prices -including those used in P/E and P/BV calculation –are pertain to the respective year -end, while those for future years are based on closing prices on the KSE as of 2nd of August 2006

** not a complete list*

*** Core revenue excludes gain on sale of investments and other non-recurring items*

SREC Business Strategy:

- The company maintains a clear strategy in dealing with the increasing competition in the local market. The company's strategy is based on two basic foundations, 1) Superior quality in planning and implementing projects and, 2) focus on property ownership in the Central Business District (CBD).

- This implies that the company follows a differentiation strategy that aims to focus its geographical operations in the downtown, where most of Kuwait businesses are located.

- Although the CBD policy might limit the growth potential in other geographical locations, it reduce the general operating risk of the company, as these projects are expected to achieve a good capital appreciation in value regardless of the rental income.

Table 3: Latest development in the local real estate portfolio

Local Investment and properties	Latest development
Salhia commercial complex	The complex was renovated including ceiling replacement of the ground floor and the 1st and 2nd mezzanines, and a change in the complex lighting. Upgrading of the complex security and operating system has also been completed in 2005.
Salhia Plaza	The company currently is in the finishing process for the Salhia Car Park roof, which has been provided with restaurants, cafes', a fountain and other recreational facilities.

Arraya shopping center	In 2005, an electronic video screens were installed to meet the shops marketing activities.
Arraya offices	Was provided with three advanced elevators that links the main ground to the office floors, advanced electronic communication devices, digital phones, internal network and IT system.
Arraya outdoor plaza	In 2005, 3 outdoor cafes where built. The rent contracts for these three cafes are underway.
Arraya tower	This new 57-storey tower will be built on a 1,058 square meter land and will include eleven elevators and a safety system. The phase I development work has been already completed, and the work in the tower is expected to be fully completed by 2008.
Marriot Kuwait Hotels	In 2005, the SREC has started company wide room and bidding initiative for both of its hotels JW Marriott and Courtyard by Marriott.
The Super Block Project:	It is located in Fahad Al Salem Street, covering a total area of 3,605 square meters, which used to occupy eight properties. These properties were demolished to be replaced by the Super Block Project, which consists of two main parts: 1) a commercial complex that encompasses high-raise office tower, shops and multi-storey car park. 2) The redevelopment and landscaping of the surrounding area.
Al Soor Real Estate	In 2005, this property, which built on 1,222 square meter area located in Mohamed Al Ghanem Street, has been sold for KD7.5 Million to realize a net profit of 4.9 million.
Al Asima Project:	The project is located in Sharq and considered one of the largest projects ever undertaken by SREC. The project spread over an area of 21,414 square meters and bounded by 4 main streets. The project comprises of a mall, a 3-floor car park, a café, Cinema Theater, restaurants, 4-star hotel with multi-purpose ballrooms and health club, 70 floor office towers of approximately 1,400 square meters, and an outdoor recreational plaza. Recently, SREC signed a contract with a Kuwaiti firm allowing SREC to own 50% of the project and other investors will own the remaining 50% by owning share in Al-Asima Real Estate Company. Al Asima Real Estate Company will purchase the site from SREC and will complete the entire scheme of the project. The company management estimate the selling value to be KD115 mn, with KD 50mn realized gain expected to contribute to income statement in 2006, provided that the building and planning permissions obtained from the relevant authorities. The construction will commence in the next few months and the entire project is expected to be finalized by 2011.

(Source: SREC)

Table 4: Latest development in the international real estate portfolio

International Investment and properties	Latest development
Key Property Investments (KPI) -UK	In 2005 KPI, a 50% owned joint venture with St.Modwen Properties in UK, has acquired three commercial centers and 30 properties, which are mainly industrial buildings and storage facilities.
Elephant and Castle Commercial Complex-UK	KPI has successfully passed phase I and II to be qualified to enter a joint venture with the county counsel to undergo major regeneration plan for the area surrounding the Elephant and Castel Commercial Complex. The plan aims to construct 5,500 residential units, 75,000-sequare meter of retail space and 55,500 square meters of leisure activities in addition to three centers; social center, educational center and government employment center
Farnborough Shopping Center-UK	KPI will commence a major development plan in the centers northern part in the next few months. The plan entails building residential and commercial units, a hotel, a health club, a multi-storey car park and an extension car park over 7,815 square meter area. The master plan including the development of eight Movies Theater and 4 restaurants in the center southern part. These plans will add an additional 1,232 square meter to the existing 33,356 square meter, leading to a new total rentable area of 34,588 square meters.
Basingstoke Malls-UK	KPI is purchased this Mall in November 2004 at GBP45.9 mn (KD24.2mn) where KPI owns 65% stake in this property. Now KPI and other partners will add 8 floors to the existing floor, which will include 328 residential units, 4 star hotel, retail shops and car park. The center rentable area is 26,490 square meters.
Vulcan Work Newton Le Willow-UK	KPI is contemplating a joint venture with the property adjacent owners to develop residential units with comprehensive related services. The area of this property is currently 138,000 square meter, 63,100 of which are already developed into warehousing and industrial facilities. The development is expected to cover a total area of 250,000 square meters.

Drawbridge Securities LTD-UK	SREC owns 50% of Drawbridge Securities LTD, which has a GBP2mn capital (KD1.05mn) in addition to 2mn preferred shares. SREC also entitled to 65% of the profit against financing of GBP2mn working capital. The main activity of the company is to purchase exclusive land options with 3 years expiration period. Drawbridge aims to obtain municipalities approval to change the use of land and get planning permissions for the new developments, which should in turn cause the market value of the land to appreciate. The company might sell the land options, afterward, or enter into joint venture to redevelop the land with the selling capital gain shared among Drawbridge and the co-partners.
Llanfoist property -UK	Recently, Drawbridge Securities was able to sell land option of Llanfoist property at GBP of 1 mn (KD 525,000) after obtaining the municipality's approval to reorganize the land block.
Ditton Widnes Property-UK	A 445,000 square meter property with storage facilities of 46,500 square meters all leased to major European firms. The tenants utilize the site to benefit from expected railroad extension inside the property. The option cost was GBP 250,000 or KD131,362 and the Drawbridge Securities expect to incur additional licensing and research studies cost to develop new warehousing facilities covering a space of 79,000 square meter. The company intends to enter into joint venture with a financing partner to develop the property.

Southampton Property-UK	The Drawbridge Securities was able to obtain the required approval on the land and has exercised the call option right to purchase the land. The company now entered into a 50/50 partnership with a UK developer to develop the site into a 4-storey office building and committed GBP 200,000 capital. In addition, Drawbridge is negotiating the purchase of call option on land block in Peterborough City, which is agricultural land spread over 1mn square meter. The option cost approximately GBP 400,000 (KD210,000), the company intend to reorganize the land into logistic storage facilities covering 200,000 square meter. Drawbridge is also negotiating the purchase of another option on property in Durham City. The property comprises of five agricultural blocks spread over 1mn square meter and owned by three parties with an existing leased storage facilities that occupies one block of land.
Haddia Holding Gmbh- Germany	The primary activities of Haddia Holding gmbh is the development, ownership and management of nursing homes and senior residence in northern Germany. The company operating activities has declined in the recent period as a result of declining demand on the nursing homes.
Dana Home Service Gmbh- Germany	It is a specialized company established by Haddia Holding Company that provides nursing care services for aging people residing at their private homes. The company services includes medical care, house keeping and meals.
SAREC Gmbh- Germany	It is a 90% owned subsidiary specialized in leasing properties. SAREC mainly lease properties to Dana Gmbh, a home care operators and a 90% owned subsidiary of SREC. Dana Gmbh is considered the operating company of the care homes operation of SREC. Recently, SAREC has completed the establishment of 2000 bed nursing home for elder care that includes 18-hour food service, emergency care, rooms, recreational facilities and residential apartments.

(Source: SREC annual reports, Management meeting)

Financial Statements Analysis…

Q1-2006 Financial performance

Table 5: Income Statement

Amount in KD'000 Income Statement	**Q1 - 2005**	**Q1- 2006**	**% change**
Income from Real Estate, Hotel & care home Ops	8,568	8,266	-3.5%
Direct Operating Expenses	(3,755)	(3,525)	-6.1%
Gross Profit	**4,813**	**4,741**	**-1.5%**
Other Operating items			
Share in JV results	499	285	-42.9%
General & Administrative Expenses	(1,527)	(1,111)	-27.3%
Depreciation & Amortization	(1,275)	(1,259)	-1.2%
Sales & marketing expenses	(284)	(217)	-23.7%
Operating income from continued operation	**2,226**	**2,439**	**9.6%**
Investment & interest income	2,222	492	-77.8%
Financing Charges	(1,611)	(1,912)	18.6%
Recurring income from continued operation	2,837	1,020	-64.1%
Other Unusual or infrequent Items			
Gain on sale of investments property	0	0	
Foreign exchange gain /losses	122	54	-55.4%
Other Income	87	85	-1.9%
Provision for impairment	(43)	-	-100.0%
Income before taxes, BOD and minority interest	**3,003**	**1,159**	**-61.4%**
Foreign Tax	(111)	(84)	-24.6%
Provision for KFAS	(26)	(10)	-62.4%
BoD Remuneration	-	-	
Provision for NLST	(65)	(24)	-62.3%
Net Income from continued operation	**2,800**	**1,041**	**-62.8%**
Extraordinary Items	-	-	
Net Profit	**2,800**	**1,041**	**-62.8%**
EPS, fils	**9.2**	**3.5**	**-62.0%**

(Source: SREC)

- During 1Q2006, the top-line decreased marginally by 3.5% vis-à-vis the corresponding period in 2005. This has been mainly driven by the decrease in total revenue generated from the Hotel Operation and Care Home and Nursing operation, which declined by 12% and 5%, respectively in 1Q 2006 as compared to 1Q2005. The Real Estate operation, in contrast, has recorded a 12% increase in total revenue in the same period.

- The direct operating expenses in 1Q2006 also decreased by almost 6% as compared to the corresponding period in 2005. The segment information revealed that the Hotel Operation and the Care Home Operation – which represent almost 90% of the total direct cost in 1Q 2006 has decreased by 28% and 3%, respectively. Although the real estate operation has experienced a large 177% increase in cost in 1Q2006, this has left only marginal effect on total direct cost in 1Q2006 since it amounted to only 10% of the 1Q2005direct cost.

- Therefore, the gross profit has decreased in 1Q2006 by 1.5% as compared to 1Q2005. The operating profit has recorded an increase of 9.6% thanks to shrinking general and administrative expenses and sales and marketing expenses over 1Q 2006 as compared to 1Q2005. The recurring income, however, has been decreased by 64% in the same period because of the large decrease in the income generated from investment and interest, which also negatively affected the net profit and the EPS (a decrease of 62.8% and 62% respectively, over 1Q2006 as compared to 1Q2005)

- The total assets in 1Q2006 was KD219mn increasing from KD217mn as of the end of FY 2005. Although the fixed assets decreased by almost KD1.8mn, the investments recorded a KD1.14mn increase in 1Q2006 over 2005 year-end, this was a result of increasing the foreign investment portfolio (a KD4.06mn increase over 1Q2006 from end of FY2005) which overwhelmed the decrease in the local investment portfolio (a decrease by KD2.04mn over the same period).

- The liability in 1Q2006 also increased by KD5.45mn as compared to the end-FY2005. Although the company reduced some of its long-term and short-term liability, the Due to Banks increased by KD10.20mn, during the 1Q2006 versus end-FY2005.

- The shareholder's equity decreased by KD 2.88mn over Q1-2006 from end of FY2005 mainly due to increase in the negative Cumulative Change in Fair Value.

2005 Financial performance…

Financial highlight of SREC UK joint venture - Key Property Investment (KPI)…

Table 6: KPI financial Performance

GBP' 000	2001	2002	2003	2004	2005	% CAGR, 2001-05	% change 2004-05
Total Assets	82,276	120,188	229,689	275,100	310,572	39%	12.9%
Shareholders equity	23,755	33,550	45,020	81,740	121,345	50%	48.5%
Net Income	3,026	1,912	7,092	6,928	7,424	25%	7.2%
Paid Up Capital	17,550	25,000	25,000	47,750	47,750	28%	0.0%
Book Value / Share (GBP)	1.35	1.34	1.8	1.71	2.54	17%	48.5%

(Source: SREC)

- KPI total rental revenue reached GBP23.5mn (KD12.3mn) in FY2005, while the net profit amounted to GBP7.4mn (KD3.88mn) achieving a growth of 7.2% YOY. Total shareholders equity grew to GBP121.3mn (KD63.7mn) in FY2005 as compared to GBP81.7mn (KD42.9mn) in FY2004, achieving a 48.5% growth YOY.

Revenue mix

- The real estate business contributed to 27.4% to the total revenue, while hotel operation and care home business contributed to 35.7% and 37%, respectively in FY2005.

- During FY2005, the total revenue declined slightly by 1.1% from its FY2004 level. The hotel operation has been the main cause for this decline as it dropped by 7.9% in FY2005. The revenue from care home and nursing operating increased by 7.5%. The income from this operation is expected to boost the overall revenue in the future as a direct result of the new investments made in it.

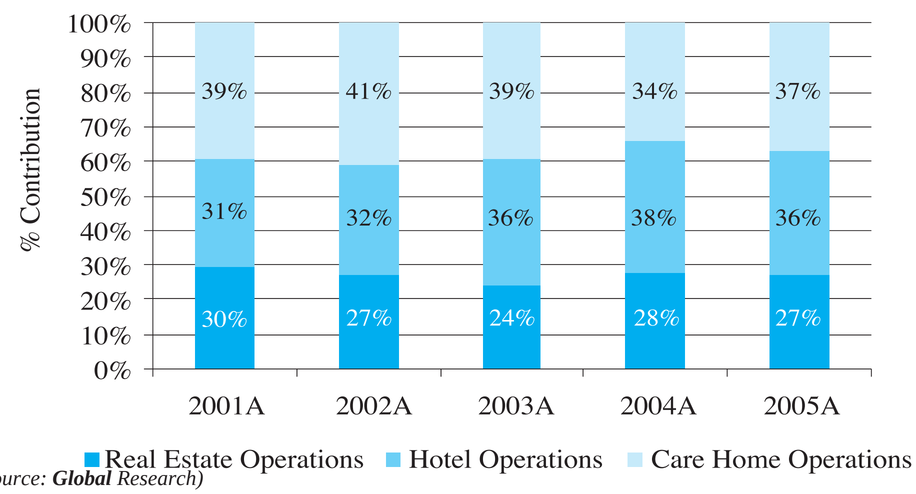
- Nevertheless, revenue from all operations witnessed a good CAGR during FY2002-05 as it grows by 18%, with income from real estate, hotel & care home operations growing by a CAGR of 18.4%, 22.5%, 14.1% respectively. Revenue from joint venture graw by 34%, while investment in this joint venture declined by 10% during the same period.

Table 7: Revenue Break-up

Revenue break up, in KD'000	2002A	2003A	2004A	2005A	% CAGR, 2002-05	% chg 2004-05
Real Estate Operations	5,585	6,323	9,501	9,268	18.4%	-2.5%
Real Estate %	*27.2%*	*24.5%*	*27.8%*	*27.4%*		
Hotel Operations	6,542	9,370	13,046	12,019	22.5%	-7.9%
Hotel Ops %	*31.8%*	*36.3%*	*38.2%*	*35.6%*		
Care Home Operations	8,414	10,147	11,619	12,491	14.1%	7.5%
Care Home Ops %	*41.0%*	*39.3%*	*34.0%*	*37.0%*		
Total revenue	**20,541**	**25,841**	**34,165**	**33,778**	**18.0%**	**-1.1%**
Share of income in JV results	**622**	**2,329**	**2,094**	**1,498**	**34.0%**	**-28.5%**

*(Source: SREC, **Global** Research)*

Figure 2: Revenue Mix



*(Source: **Global** Research)*

- During FY2005, SREC`s domestic operation contributed to 63% (FY2004: 64.4%) to the top-line, while the balance 37% (FY2004:35.6%) of the revenue was generated from SREC`s operation in Europe.

- Core revenue assets have grown at a rate that is comparable to the growth in total assets during the FY2005. The core revenue assets grow at a rate of 14% during the year while total assets grow at 15%. The CAGR for the core revenue assets has been 11% during the period from FY2002-05 compared to 12% for the total assets for the same period.

Table 8: Core revenue assets

Core revenue assets, Net (KD'000)	2002A	2003A	2004A	2005A	2006F	2007F	2008F	2009F	%CAGR 2002-05	% change 2004-05
Net fixed Assets	74,796	104,382	99,229	99,281	102,701	106,326	110,169	114,242	9.9%	0.1%
Investment Properties (Net)	44,086	44,142	68,707	64,159	69,376	79,269	90,646	103,730	13.3%	-7%
Joint Venture Investments	11,514	13,960	17,188	15,447	16,600	16,715	17,996	19,531	10.3%	-10%
Total core revenue assets	**130,397**	**162,484**	**185,125**	**178,887**	**188,677**	**202,310**	**218,810**	**237,502**	**11.1%**	**-3%**
Total Assets	**14,457**	**14,457**	**27,525**	**27,525**	**27,525**	**27,525**	**27,525**	**27,525**	**23.9%**	**0%**

*(Source: **Global** Research)*

- The recurring return on core revenue assets declined from 3.6% in FY2004 to 1.7% in FY2005. In addition to the increase in assets, the numerator also decreased. Both factors combined led to the decrease in this ratio, bearing in mind that recurring income exclude the gain from sale from investments and gain on sale of investment properties and all other more-volatile, discretionary component of net income.

- Recurring return on average investments also witnessed a slight decrease from its FY2004 level to 1% in FY2005.

Table 9: Recurring return

	2003A	2004A	2005A
Recurring Return on core revenue assets*	5.0%	3.6%	1.7%
Recurring Return on Average Investments**	3.2%	2.4%	1.0%

**Recurring income/ core revenue earning assets (net)*

*** Recurring income / Capital Employed (Owners` Equity + Due to Bank + Long-term Debts)*

*(Source: **Global** Research)*

- SREC was able to maintain a healthy gross profit margin of around 60% in FY2005 and FY2004. The operating profit margin and the recurring profit margin, nevertheless, witnessed a decrease from 31.3% to 26.8% and from 18.5% to 8.9%, respectively, during FY2005. This is largely due to the increase in the General and administrative expenses which has grown at 6.1% during FY2005. Depreciation also soared by 17.9% during the same period.

- The net profit margin experienced a large increase in FY2005 as it approached 52% level compared to only 30% in FY2004. The discrepancy between the net profit margin and the recurring profit margin is due to the large gain from sale of investments, which amounted to KD10.44mn, and gain on sale of investment property of KD4.9 mn, both of which are components of net income but not of recurring income.

- The gross profit and the operating profit grow at CAGR of 19.8% and 13.3%, respectively, during FY2002-05.

- The company maintains a debt-driven expansion strategy which, in combination with the spiraling interest rate, resulted in increase in financing charges of 38.7% during FY2005, achieving a CAGR of 29.7% during the period FY2002-05.

ROE improves thanks to the net profit margin…..

- SREC has experienced a handsome increase in ROE, which increased from 10.2% in FY2004 to 17.2% in FY2005. The analysis of ROE using the DuPont System better indicates the main cause for this increase, which was the large increase in the net profit margin. The efficiency (as indicated by Assets turnover) and the degree of leverage the company use (as indicated by the financial leverage multiplier) have remained relatively stable during FY2005.

Table 10: ROE using DuPont System

	Unit	2003A	2004A	2005A
1-Net Profit Margin	%	36.9	30.0	51.9
2-Assets Turnover	X	0.1	0.2	0.2
3-Financial Leverage Multiplier	X	2.4	2.2	2.1
ROE Using DuPont System	%	12.1	10.1	17.2

*(Source: **Global** Research)*

- From the Extended DuPont system, we can conclude that ROE has increased mainly due to the improvement in the EBIT profit margin, which increased dramatically from 47.8% in FY2004 to 76.1% in FY2005. Given a stable assets turnover, the EBIT on assets consequentially improved from 7.4% to 11.8 % in the same period. The interest expenses relative to assets has had a minor negative effect on ROE since it increased from 2.3% to 3.3% , but this has been over-offset by decrease in the effective tax rate, which was only 6.8% in FY2005 compared to 9.1% in FY2004.

Table 11: ROE using Extended DuPont System

	Unit	2003A	2004A	2005A
ROE Using Extended DuPont System				
1-EBIT/Sales	%	54.7	47.8	76.1
2-Assests Turnover	X	0.1	0.2	0.2
3-EBIT/Assets	%	7.4	7.4	11.8
4-Interest expenses/Assets	%	1.9	2.3	3.3
5-Financial Leverage Multiplier	X	2.4	2.2	2.1
6-Tax effect	%	90.1	90.9	94.2
ROE Using Extended DuPont System		12.1	10.1	17.2

*(Source: **Global** Research)*

- The Recurring Return on Average Equity (ROAE) has dropped from 7% to 3% during the FY2005 on the back of the marginally growing stockholder's equity during the period (a growth of 1.2%)

- Recurring Return on Average Assets (ROAA) has also decreased from 3.1% to 1.4% during the same period.

- It worth noting that these two ratios have been computed using the recurring income in the numerator, which, as we discussed before, excludes the more volatile component of net income.

Stable efficiency ….

- SREC has a stable efficiency during FY 2005 despite the slight decline in revenue. For example, the net fixed assets turnover has remained stable at .3x during the period FY04-05. The total assets turnover has also been constant at .2x during the same period .

Mitigated financial risk…

- The company financial risk has mitigated slightly in FY2005. By financial risk, we mean the risk arising from extreme use of long-term debt not short-term debt. Analysis of short-term liquidity is discussed in later part of this report

- The company long-term debt to equity has decreased from 82% in FY2004 to 73% in FY2005. Total debt ratio also been declined from 61% in FY2004 to 58% in FY2005, while long term debt to assets has decreased slightly from 38% in FY2004 to 35% in FY2005.

- Interest coverage ratio was not an exception; it has been improved from 3x in FY2004 to 3.5x in FY2005 despite the increase in the finance expenses.

Tremendous growth in net income but with caution…

- SREC has experienced a striking growth rate in net income, which grew by 71.1% during FY2005 as compared to only 7.4% during FY2004. This amazing growth has been fueled; however, by the non-recurring items such as the large gain from sale of investments, which amounted to KD 10.435mn, and gain on sale of investment property of KD4.9mn, both of which are component of net income but not of recurring income.

- We have to carefully monitor the timing and the frequency of these two non-recurring component in order to decide on the underlying earning power of the company that is expected to be sustainable in the future. The dividends component of the investment income, for example, can be considered recurring since it is less subject to management discretion and less volatile in nature. In contrary, the gain on sale on investments might not be considered recurring since it is volatile and its sustainability is at best questionable.

- The growth rate in EPS approximately mirrors the growth rate in net income since no new share has been issued during the FY 2005. The EPS has been 57 fils in FY2005 as compared to 34.4 fils in FY2004, a growth of 68%, again, special attention should be given to the non-recurring component of the net income since they are highly volatile and subject to management discretion.

- The company intrinsic growth (the ROE times the retention ratio) was 2.35% in FY2005 compared to 2.78% in FY2004. The major reason behind such decline is not the ROE; rather it is the growth in the dividends.

Higher Book Value per Share but higher P/BV …

- SREC has experience a slight growth rate in net worth of 1.2% during FY 2005. This was only one factor contributing to increase in the Book Value Per Share (BVPS), which reached 338 fils in FY2005. The other factor was the reduced number of shares outstanding (301mn in FY 2005) as a result of active share repurchase plan executed in FY2005 which resulted in 13.9mn treasury shares, given a constant number of shares issued of 314.9mn shares.

- The P/BV has also been higher than the FY2004 despite the higher BVPS as it reached 2.3x in FY2005 compared to 1.6x in FY 2004. This higher P/BV ratio can be used to deduce the market expectation about the growth opportunity of the company as reflected in the high stock price.

Analysis of P/E multiple….

- The P/E of SREC at the end of FY 2005 declined to 13.5x in FY 2005 from 15.1x in FY 2004 due to the increasing EPS as previously discussed not because of decrease in price. As we can see, the year-end price has increased from 520 fils to 780 fils in FY2004 and FY2005, respectively.

- The more insightful ratio P/E-G shows that the P/E has in fact increased relative to the intrinsic growth rate the company faced during FY2004. The P/E-G has increased to 5.7x because of lower intrinsic growth rate in the FY 2005. As we discussed earlier, the growth rate was a result of increasing dividends payout ratio, which supposed to be a sign of a healthy performance.

Table 12: P/E-G

	Unit	2003A	2004A	2005A
P/E-G (using intrinsic growth)	X	1.3	5.4	5.7

*(Source: **Global** Research)*

- Using our long-term estimate for cost of equity of 12.25% and the market price of the stock, we can deduce the expectations of the market participants about SREC Present Value of Growth Opportunities (PVGA). The PVGA has reached 307 fils (representing 39% of the stock price) leaving 473 fils for the tangible no-growth value of the stock. This is compared to PVGA of 221 fils in FY2004 (representing 42.5% of the stock price) leaving 299 fils for the no-growth part of the stock price.

Table 13: Present Value of Growth Opportunity (PVGA)

	Unit	2003A	2004A	2005A
Required Rate of Return on Equity (cost of equity) or (r)	%	10.4	11.5	12.25
Estimated Growth Rate (g)	%	3.8	3.8	3.8
Market implied PVGA (Present Value of Growth Opportunity) =Market Price-(EPS ÷ r)	fils	230.0	220.9	307.3

*(Source: **Global** Research)*

Growing dividends …

- The dividends have grown from 25 fils per share in FY2004 to 50 fils in FY2005. The company, however, seems to follow the residual dividends model, in which the company pay as dividends what remained from net income after satisfying expansion expenditures. Although it leaves an undesirable volatility in dividends, it might help the company finance its growth with the lowest cost financing option.

Liquidity decrease due to debt repayments…

- SREC has experienced lower liquidity ratios. Working capital was negative KD26.595mn in FY2005 increasing from negative KD 20.891mn. Cash ratio and quick ratio have also declined from .13x and .37x in FY 2004 to .07x and .26x in FY2005, respectively.

- A careful analysis of the cash flow statement revealed that this is not all negative news; the company in fact seized a cash-cow year to reduce its debt burden and pay strong dividends. The cash flow from operation was KD13.783mn in FY2005, an increase of 70.3% from the preceding year level. The company has also sold some of its investment properties and investment, the thing that turned a negative cash flow from investment activities of KD24.953mn in FY 2004 to a positive KD4.891mn in FY 2005, a decrease by 119%.

- On the other hand, the company had negative cash from financing activity of KD29.4mn in FY2005 compared to a positive KD16.4mn in FY2004, a decrease by almost 280%. Financial charges, repayment of long-term debt and dividends payment were the main caused for the decrease in cash.

Valuation and recommendation

To maintain the consistency in our recommendation we have use the same valuation techniques applied in the previous reports on SREC, the Discounted Cash Flow (DCF) – discounting the company Free Cash Flow to Firm (FCFF)- beside the relative valuation methods, specifically the Price to Book Value (P/BV). We believe both methods combined provide valuation that is more accurate for the company. Even though the use of P/BV might not be an unbiased predictor of the fair value if the market as a whole is over valued or under valued, we believe that the benefits from using this method outweighs its disadvantage especially when used with an assets-heavy company such as SREC and the real estate companies in general.

The DCF model is based on a 4-year (FY2006-FY2009) explicit forecast period for the Free Cash Flow to Firm (FCFF). The terminal value is estimated using the constant growth Gordon Growth Model (GGM). The forecasted cash flow and the terminal value is then discounted at the company Weighted Average Cost of Capital (WACC). In our DCF valuation, we have used the following assumptions:

1. Risk Free Rate (RFR) of 6.25%, as per the latest discount rate announced by the Central Bank of Kuwait (CBK) in 3rd of July 2006.
2. Equity risk premium of 6%.
3. Beta assumed to be 1. The actual Beta of the company is in fact .807, but we preferred to use the more conservative approach of assuming a beta that reflect the overall market risk.
4. The terminal growth rate of free cash flow is 3.75%.

Using the above assumptions, we have derived a cost of equity for the company under the Capital Assets Pricing Model of 12.25%, which is equivalent to the cost of equity of the top-player in the real estate market.

The company has an actual cost of debt of 7.6% on average, which is higher by 270 basis points (bps) than the previous year's cost of debt, which was 4.9%. Given the rising interest rate trend, we have used a cost of debt of 8% - a 30 bps higher than the actual cost of debt. Based on the above, we have arrived at a WACC of 10.22%.

Given the methodology and assumption discussed above, we estimated the fair value of 590.6fils. This suggests that the stock is slightly undervalued as compared to current market price of 590fils (as of August 15th 2006).

Table 14: Free Cash Flow to Firm

FREE CASH FLOW CALCULATION (figures in KD)		2006F	2007F	2008F	2009F
Free Cash Flow		17,073,267	12,701,642	14,880,365	16,500,268
Terminal Value		-	-	-	276,761,908
Total Free Cash Flow		17,073,267	12,701,642	14,880,365	293,262,176
Discounted FCFF		16,155,469	10,932,638	11,650,400	208,855,275
Net Present Value of the FCFF	247,593,782				
Total Cash & Investments, Q1 2006	49,740,979				
Less: Value of Debt, Q1 2006	(119,607,407)				
Total Value (NPV) of Equity	177,727,354				
Total number of shares outstanding*	300,951,590				
Per Share Value, in fils	590.6				
Price as on August 15th, 2006, in fils	590				

** Excluding treasury shares*

*(Source: **Global** Research)*

Sensitivity Analysis

We provide below a sensitivity analysis table, which shows the probable value given different growth rate assumption and WACC. The shaded area represents the most probable outcomes.

Table 15: Sensitivity analysis

		Terminal Growth rate				
	590.6	**1.75%**	**2.75%**	**3.75%**	**4.75%**	**5.75%**
Cost of Capital	7.94%	627.8	768.1	975.5	1,313.1	1,959.7
	8.94%	510.0	608.9	745.9	948.4	1,278.1
	9.94%	421.0	494.0	**590.6**	724.4	922.2
	10.94%	351.4	407.2	478.5	572.8	703.5
	11.94%	295.5	339.3	393.8	463.4	555.6

*(Source: **Global** Research)*

Peer Group Valuation

The peer group valuation is done by comparing the P/BV of the companies in the real estate sector listed in Kuwait Stock Exchange. The book value multiple reflect various factors such as the strength of the balance sheet and the quality of assets.

The weighted average P/BV based on market capitalization as of July 8th, 2006 of listed companies in KSE based on 1Q2006 results averaged at 1.66. Therefore, based on the industry average P/BV, SREC stock price valuation is valued at 557.6 fils.

Weighted Average Valuation

We have assigned an 80% probability to the DCF technique and 20% to the P/BV technique, since the relative valuation approach is very volatile and subject to the market sentiment and other qualitative factors. Based on the weighted average valuation approach provided below we have reached a fair value for SREC of 584fils. Given a current market price of 590 as of August 15, 2006, the stock is currently trading at 1% above the fair value. Therefore, we reiterate our earlier rating on SREC and recommend **HOLD** on the stock with a medium-term prospective.

Table 16 Weighted average valuation

	Fair Value per share (fils)	Weight	Weighted Value
As per FCFF Method	590.6	80%	472.4
As per P / BV multiple	557.6	20%	111.5
Weighted Price			584.0
CMP (August 15th, 2006)			590.0

*(Source: **Global** Research)*

NOTE: According to our discussion with the management, SREC is about to have a gain on sale of investment properties related to Al-Asima project which the management estimated it to be KD50mn. We have not incorporated this gain in our valuation and projection, since its objective value cannot be reasonably estimated and its probability is at question, at least at this point of time. Had this gain been included in our valuation and projections, the fair value of SREC stock would have been different from what we have currently estimated.

INCOME STATEMENT

Amount in KD'000	Salhia Real Estate Co.						
	2003A	**2004A**	**2005A**	**2006F**	**2007F**	**2008F**	**2009F**
Income from Real Estate, Hotel & Care home Ops	25,841	34,165	33,778	37,179	40,469	44,669	51,050
Direct Operating Expenses	(10,539)	(13,822)	(13,667)	(14,128)	(15,378)	(16,527)	(18,888)
Gross Profit	**15,302**	**20,343**	**20,110**	**23,051**	**25,091**	**28,141**	**32,161**
Share in JV results	2,329	2,094	1,498	1,648	1,812	1,994	2,193
General & Administrative Expenses	(3,536)	(4,904)	(5,204)	(4,833)	(5,261)	(5,807)	(6,636)
Depreciation	(2,310)	(4,410)	(5,198)	(6,426)	(7,043)	(7,731)	(8,501)
Sales and marketing expenses	(1,678)	(2,439)	(2,140)	(2,231)	(2,428)	(2,680)	(3,063)
Operating income from continued operation	**10,108**	**10,684**	**9,066**	**11,208**	**12,171**	**13,916**	**16,154**
Dividends & interest income	790	784	1,101	1,115	1,214	1,340	1,531
Finance cost	(3,647)	(5,150)	(7,145)	(7,261)	(7,979)	(8,882)	(10,062)
Recurring income from continued operation	**7,251**	**6,318**	**3,022**	**5,063**	**5,406**	**6,375**	**7,623**
Gain on sale of invetsment property	-	-	4,912	5,157	5,415	5,686	5,970
Gain on sale of invetsment	1,820	5,167	10,435	5,033	5,614	6,562	6,911
Foreign exchange gain /losses	-	-	286	-	-	-	-
Other Income	(461)	(30)	102	102	102	102	102
Provision for impairment	(622)	(254)	(123)	(123)	(123)	(123)	(123)
Income before taxes, BOD and minority interest	**7,988**	**11,202**	**18,634**	**15,232**	**16,414**	**18,601**	**20,483**
Foreign Tax	(691)	(604)	(456)	(494)	(544)	(598)	(658)
KFAS Contribution	(89)	(96)	(164)	(146)	(158)	(179)	(197)
BoD Remuneration	(77)	(77)	(110)	(110)	(110)	(110)	(110)
NLST	(161)	(236)	(403)	(362)	(390)	(443)	(488)
Net Income from continued operation	**6,969**	**10,189**	**17,501**	**14,120**	**15,212**	**17,272**	**19,030**
Extraordinary Items	2,549	-	-	-	-	-	-
Net income	**9,518**	**10,189**	**17,501**	**14,120**	**15,212**	**17,272**	**19,030**
Attributable to:							
Equity holder of the parent company	9,518	10,189	17,501	14,120	15,212	17,272	19,030
Minority Interest	-	-	(43)	(43)	(43)	(43)	(43)
	9,518	**10,189**	**17,458**	**14,077**	**15,169**	**17,229**	**18,987**

BALANCE SHEET

Amount in KD'000	Salhia Real Estate Co.						
	2003A	**2004A**	**2005A**	**2006F**	**2007F**	**2008F**	**2009F**
Cash & Cash Equivalents	3,624	4,259	2,540	2,432	2,584	2,167	3,222
Account Receivables & prepayments	4,883	8,211	7,108	7,646	8,323	9,187	10,499
Inventories	131	409	430	342	372	411	470
Current Assets	*8,638*	*12,879*	*10,078*	*10,421*	*11,280*	*11,765*	*14,191*
Investment in Land	-			-	-	-	-
Investments	20,860	23,066	28,099	30,909	34,000	39,100	44,574
Joint Venture Investment	13,960	17,188	15,447	16,600	16,715	17,996	19,531
Unconsolidated Subsidiary Investment	-	-		-	-	-	-
Gross Fixed Assets (incl. cwip)	122,254	120,109	121,271	128,547	136,260	144,435	153,102
Accumulated Depreciation	(17,872)	(20,880)	(21,990)	(25,846)	(29,934)	(34,267)	(38,860)
Fixed Assets (Net)	104,382	99,229	99,281	102,701	106,326	110,169	114,242
Investment Properties (Gross)	54,771	80,707	77,869	85,656	98,505	113,280	130,272
Acc. depreciation (incl_translation_adj)	(10,629)	(12,000)	(13,711)	(16,280)	(19,235)	(22,634)	(26,542)
Investment Properties (Net)	44,142	68,707	64,159	69,376	79,269	90,646	103,730
TOTAL ASSETS	**191,982**	**BS**	**217,063**	**230,006**	**247,590**	**269,675**	**296,267**
Prepaid Revenues	*1,020*	*1,207*	*1,676*	*1,927*	*2,217*	*2,549*	*2,931*
Due to banks	8,307	9,770	19,477	21,425	22,496	22,721	22,949
Payables	9,428	8,048	7,285	10,373	11,291	12,664	14,473
Provisions	294	172	104	104	706	1,375	2,102
Current portion of long-term debt	7,775	15,780	9,807	10,597	11,657	13,114	14,950
Current Liabilities	*25,804*	*33,770*	*36,673*	*42,499*	*46,150*	*49,874*	*54,473*
Long-term loans	84,939	83,022	74,104	81,515	89,666	100,874	114,997
Employee indemnity (terminal benefits)	1,205	1,342	1,705	2,080	2,538	3,096	3,777
Long-term Liabilities	*86,144*	*84,364*	*75,809*	*83,595*	*92,204*	*103,970*	*118,774*
TOTAL LIABILITIES	**111,948**	**118,134**	**114,158**	**128,021**	**140,570**	**156,393**	**176,178**
Minority interest	247	935	940	897	854	811	769
SHAREHOLDERS EQUITY							
Share capital	23,841	31,492	31,492	31,492	31,492	31,492	31,492
Forex translation reserve	2,874	4,637	1,898	1,898	1,898	1,898	1,898
Cumulative Changes in Fair Value of Inv.	6,520	978	(66)	(66)	(66)	(66)	(66)
Share Premium	14,457	27,525	27,525	27,525	27,525	27,525	27,525
Treasury stock	-	(2,779)	(7,751)	(7,751)	(7,751)	(7,751)	(7,751)
Statutory reserve	7,054	8,121	9,943	11,416	13,003	14,804	16,786
Voluntary reserve	7,054	8,121	9,943	11,416	13,003	14,804	16,786
General reserve	4,250	4,250	4,250	4,250	4,250	4,250	4,250
Retained earnings	12,715	18,451	24,733	20,908	22,811	25,516	28,401
Total shareholders equity	*78,766*	*100,794*	*101,965*	*101,089*	*106,165*	*112,470*	*119,321*
TOTAL LIABILITIES & EQUITY	**191,982**	**221,070**	**217,063**	**230,006**	**247,590**	**269,675**	**296,267**

CASH FLOW STATEMENT

	Salhia Real Estate Co.						
Amount in KD'000	**2003A**	**2004A**	**2005A**	**2006F**	**2007F**	**2008F**	**2009F**
Profit before tax, extraordinary items, KFAS payment, NLST and BoD remuneration	7,988	11,202	18,178	14,738	15,870	18,003	19,825
Adjustments:							
Investment & interest income	(2,609)	(5,951)	(11,536)	(11,306)	(12,243)	(13,588)	(14,413)
Share in JV results	(2,329)	(2,094)	(908)	(1,648)	(1,812)	(1,994)	(2,193)
Forex Translation (Gain) Loss	708	118	(286)	-	-	-	-
Financial Charges	3,647	5,150	7,145	7,261	7,979	8,882	10,062
Depreciation	2,310	4,410	5,198	6,426	7,043	7,731	8,501
(Gain) Loss on Disposal of Fixed Assets	-	-	(4,912)	-	-	-	-
Provision for employee terminal benefits	461	246	738	-	-	-	-
Provisions for impairment of investments	622	254	123	-	-	-	-
Operating profit before changes in operating assets & liabilities	10,797	13,334	13,740	15,471	16,837	19,035	21,783
Decrease / (Increase) in Inventories	13	(278)	(21)	88	(30)	(39)	(59)
Decrease (Increase) in A/R & Prepayments	(1,131)	(3,328)	(396)	(539)	(677)	(864)	(1,312)
(Decrease) Increase in A/P and Accruals	4,607	(1,588)	541	4,504	3,327	4,390	5,435
Cash from operations	**14,286**	**8,140**	**13,863**	**19,525**	**19,457**	**22,522**	**25,846**
Payment of Employee Terminal Benefits	(108)	(109)	(375)	-	-	-	-
Extra-ordinary item	2,549	-		-	-	-	-
KFAS payment	(62)	(89)	(96)	(132)	(142)	(161)	(177)
BoD remuneration	(77)	(77)	(77)	(110)	(110)	(110)	(110)
NLST Paid	(152)	(161)	(236)	(326)	(351)	(398)	(439)
INVESTING ACTIVITIES							
Additions / Purchase of investments properties	(11,962)	(18,440)	(7,651)	(7,787)	(12,848)	(14,776)	(16,992)
Proceeds from sale of investment			28,032				

CASH FLOW STATEMENT - Continued

	Salhia Real Estate Co.						
Amount in KD'000	**2003A**	**2004A**	**2005A**	**2006F**	**2007F**	**2008F**	**2009F**
Joint Venture Investment	-	-		(1,153)	(115)	(1,280)	(1,535)
Investments & interest income	14,177	13,438		11,306	12,243	13,588	14,413
Purchase of investments	-	-	(24,987)	(2,810)	(3,091)	(5,100)	(5,474)
Dividends received	758	756	1,032	-	-	-	-
Purchase of real estate & fixed assets	(27,044)	(20,769)		(7,276)	(7,713)	(8,176)	(8,666)
Dividend income from JVs	618	-	855	1,648	1,812	1,994	2,193
Interest income received	38	28	69	-	-	-	-
Proceed from sale of investment prop. & fixed assets	-	34	7,543				
Net cash from investing activities	***(23,417)***	***(24,953)***	***4,893***	***(6,073)***	***(9,712)***	***(13,750)***	***(16,062)***
FINANCING ACTIVITIES							
Financial charges paid	(3,627)	(5,112)	(7,233)	(7,261)	(7,979)	(8,882)	(10,062)
Inc (dec) in short-term loans	-	-	-	1,948	1,071	225	227
Inc (dec) in long-term loans, net	15,038	6,088	(9,585)	7,410	8,151	11,208	14,122
Inc in share capital & share premium a/c	-	18,335	-	-	-	-	-
Sale (purchase) of treasury shares	-	(2,779)	(4,972)	-	-	-	-
Dividend paid	(4,722)	(110)	(7,609)	(15,048)	(10,191)	(11,029)	(12,248)
Change in Minority interest	-	-	-	(43)	(43)	(43)	(43)
Net cash from financing activities	***6,689***	***16,421***	***(29,400)***	***(12,993)***	***(8,990)***	***(8,520)***	***(8,004)***
Inc (dec) in cash & cash equivalents	(292)	(828)	(11,427)	(108)	152	(417)	1,055
Opening cash & cash equivalents	(4,391)	(4,683)	(5,511)	2,540	2,432	2,584	2,167
Closing cash & cash equivalents	(4,683)	(5,511)	(16,937)	2,432	2,584	2,167	3,222
Due to banks *	8,307	9,770	19,477		-	-	-
Bank balances & cash	**3,624**	**4,259**	**2,540**	**2,432**	**2,584**	**2,167**	**3,222**

**Changes in "Due to banks" from year 2006F to 2009F included in the "Inc(dec) in short term loans" in the body of the CFS.*

FACT SHEET

		Salhia Real Estate Co.						
	Unit	2003A	2004A	2005A	2006F	2007F	2008F	2009F
Internal Lequidity and Solvency Ratios								
Working Capital	KD 000	(17,167)	(20,891)	(26,595)	(32,078)	(34,871)	(38,109)	(40,281)
Cash Ratio	X	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Quick Ratio	X	0.3	0.4	0.3	0.2	0.2	0.2	0.3
Current Ratio	X	0.3	0.4	0.3	0.2	0.2	0.2	0.3
Profitability Ratios								
Gross Profit Margin	%	59.2	59.5	59.5	62.0	62.0	63.0	63.0
Direct operating costs / Sales	%	40.8	40.5	40.5	38.0	38.0	37.0	37.0
Operating Profit Margin	%	39.1	31.3	26.8	30.1	30.1	31.2	31.6
Recurring Profit Margin	%	28.1	18.5	8.9	13.6	13.4	14.3	14.9
Net Profit Margin	%	36.8	29.8	51.8	38.1	37.7	38.8	37.4
Recurring Return on Average Equity (ROAE)	%	10.0	7.0	3.0	5.0	5.2	5.8	6.6
Recurring Return on Average Assets (ROAA)	%	4.2	3.1	1.4	2.3	2.3	2.5	2.7
Return on Equity (ROE)	%	12.1	10.1	17.2	14.0	14.4	15.4	16.0
Return on Assets (ROA)	%	5.0	4.6	8.1	6.2	6.2	6.4	6.4
Recurring Return on Core Revenue Assets*	%	5.0	3.6	1.7	2.8	2.8	3.0	3.3
Recurring Return on Average Investments**	%	3.2	2.4	1.0	1.7	1.7	1.9	2.1
ROE using DuPont System:								
1-Profit Margin	%	36.8	29.8	51.8	38.1	37.7	38.8	37.4
2-Assets Turnover	X	0.1	0.2	0.2	0.2	0.2	0.2	0.2
3-Financial Leverage Multiplier	X	2.4	2.2	2.1	2.3	2.3	2.4	2.5
ROE Using DuPont System (1x2x3)	%	12.1	10.1	17.2	14.0	14.4	15.4	16.0
ROE Using Extended DuPont System								
1-EBIT/Sales	%	54.6	47.6	76.0	60.2	60.0	61.3	59.6
2-Assests Turnover	X	0.1	0.2	0.2	0.2	0.2	0.2	0.2
3-EBIT/Assets	%	7.3	7.4	11.8	9.7	9.8	10.2	10.3
4-Interest expenses/Assest	%	1.9	2.3	3.3	3.2	3.2	3.3	3.4
5-Financial Leverage Multiplier	X	2.4	2.2	2.1	2.3	2.3	2.4	2.5
6-Tax passthrough effect (KFAS and NLST)	%	90.1	90.8	94.2	93.3	93.2	93.3	93.3
ROE Using Extended DuPont System ((3-4)x5x6)		12.0	10.0	17.1	14.0	14.3	15.3	15.9
Effeciency Ratios								
Net Fixed Asset Turnover (average)	X	0.3	0.3	0.3	0.4	0.4	0.4	0.5
Net Fixed Asset Turnover, incl investment prop's (average)	X	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total Assets Turnover (average)	X	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Equity Turnover (average)	X	0.4	0.4	0.3	0.4	0.4	0.4	0.4
Business Risk								
Standard Deviation of Recurring Income ***	KD 000			2,222	1,664	1,289	680	1,111
Mean Recurring Income ***	KD 000			5,530	4,801	4,497	5,615	6,468
Coeffecient of Variation of Recurring Income	%			40.2	34.6	28.7	12.1	17.2

FACT SHEET - Continued

		Salhia Real Estate Co.						
	Unit	2003A	2004A	2005A	2006F	2007F	2008F	2009F
Standard Deviation of Revenue***	KD 000			4,698	1,862	3,346	3,754	5,328
Mean Revenue***	KD 000			31,261	35,041	37,142	40,772	45,396
Coeffecient of Variation of Revenue	%			15.0	5.3	9.0	9.2	11.7
Degree of Operating Leverage (DOL) (%Δ operating Income÷%ΔRevenue)	X	2.4	0.2	13.4	2.3	1.0	1.4	1.1
Financial Risk								
Long term Debt to Equity	%	107.8	82.4	72.7	80.6	84.5	89.7	96.4
Total Debt Ratio (TD/CE)	%	65.1	61.0	58.4	62.7	64.4	66.2	68.5
Long term Debt to Assets	%	44.9	38.2	34.9	36.3	37.2	38.6	40.1
Interest Coverage Ratio	X	3.6	3.0	3.4	3.0	2.9	3.0	2.9
By how Far earning can be reduced and still be able to pay interest	%	72.3	66.4	71.0	66.1	65.7	66.1	65.5
Operating Cash Flow Coverage Ratio	X	4.5	1.5	1.8	2.6	2.4	2.5	2.5
Operating Cash Flow /Long-term debts	%	19.1	9.1	17.3	22.7	20.4	21.0	21.1
Degree of Financial Leverage (DFL) %Δnet income÷%Δ operating income)	X	0.7	1.2	4.7	0.8	-0.9	-0.9	-0.6
Total Internal Risk								
Degree of Total Leverage (DTL) (DOL X DFL)	X	1.7	0.2	63.2	1.9	-0.9	-1.3	-0.7
Growth Ratios								
Revenue from real estate, hotel operations & care home operation	%	25.8	32.2	-1.1	10.1	8.8	10.4	14.3
Net Profit	%	43.3	7.0	71.8	-19.0	7.7	13.5	10.2
Total Assets	%	25.7	15.2	-1.8	6.0	7.6	8.9	9.9
Net Worth	%	19.4	28.0	1.2	-0.9	5.0	5.9	6.1
Intrinsic Growth (ROE x Retention Ratio)	%	12.1	2.8	2.3	13.9	14.3	15.3	15.9
Valuation Ratios								
EPS total	fils	36.4	34.4	57.9	46.7	50.4	57.2	63.0
EPS from ordinary activity	fils	26.7	34.4	57.9	46.7	50.4	57.2	63.0
Book value per share - BVPS (in fils)	fils	330.4	325.9	338.8	335.9	352.8	373.7	396.5
No. of Shares Outstanding (minus treasury shares)	mn	238,412	309,252	300,952	300,952	300,952	300,952	300,952
Price Per Share	fils	580.0	520.0	780.0	590.0	590.0	590.0	590.0
Market cap	KD 000	138,279	160,811	234,742	177,561	177,561	177,561	177,561
P/E multiple #	X	15.9	15.1	13.5	12.6	11.7	10.3	9.4
P/BV multiple #	X	1.8	1.6	2.3	1.8	1.7	1.6	1.5
Cash Dividend per share	fils	0.0	25.0	50.0	33.9	36.6	40.7	41.9
Dividend Payout Ratio	%	0.0	72.7	86.4	72%	73%	71%	67%

**Recurring income/ core revenue earning assets (net)*

*** Recurring income / Capital Employed (OE+due to bank+LT)*

**** For the respective last 4 years*

 # Historical P / E & P / BV multiples pertain to respecitve year -end prices, while those for future years are based on closing prices on the KSE as of 15th of August 2006

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Salhia Real Estate Co.	HOLD	SREK.KW	590fils	1, 10

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