

Alert on 2010 Financials and 2011 Outlook

Sector: Real Estate
Country: Lebanon
Date: June 27, 2011

Share Price (USD): 17.60
Fair Value (USD): 19.40
Upside: 10.2%
Recommendation: HOLD

Updating with a HOLD recommendation and a fair value of USD 19.40 to account for additional risk premium and revised forecasts

Revenues exceed our estimates with rentals increasing by 50%

Solidere's revenue has reached a new high of USD 382 million, rising 14% due to growth in land sales and higher rentals. This exceeds our estimates of USD 368 million with land sales continuing to dominate revenues by capturing 88% of total revenues. Rental proceeds experienced a 50% boost due to higher utilization of the South Souks reaching USD 41 million and constituting 11% of total revenues, noticeably higher than 8% in 2010. As part of Solidere's diversification strategy, we expect rentals to capture an even higher share going forward as the company inaugurates the Cineplex in 2012 and the North Souks Department Store in 2013.

Net income grows but below estimates due to heavy advertising

Earnings showed a slow growth of 3.7% reaching USD 196 million, considerably lower than our estimated USD 224 million due to a spike in advertising expenses. With higher land prices recognized in 2010, there was a 4% improvement in gross margin associated with land sales. However, this was eclipsed by rental gross margins which were almost cut in half during 2010 due to the heavy advertising of Solidere's flagship project, the Beirut Souks. This contributed to reducing the profit margin to 44% from 56% in the previous year.

Backlog drops but management optimistic for new deals

Solidere's backlog is estimated at USD 77.5 million and is only composed of two deals in the reclaimed area, significantly lower than USD 429 million in year-end 2009. All of 2010's revenue was recognized from backlog with no new contracts taking place since the beginning of 2010. Management is optimistic on new sales concluding in 2011 but we do not anticipate growth to occur as more than USD 260 million of new sales are needed for revenues to be on par with 2010.

Fair value drops reflecting additional risk premium and backlog slump

We downgrade the fair value of Solidere's share to USD 19.40 as we revised the discount rate upwards to 15% in order to account for the additional risk premium. This new premium resulted from the political turmoil associated with the UN's Special Tribunal for Lebanon, the regional political shocks that have affected investor sentiment in the region along with high likelihood that the Lebanese real estate market may have already peaked. Additionally, due to Solidere's diminishing backlog, we have significantly revised our financial forecasts down anticipating no overall revenue or earnings growth in 2011.

Share Data

Bloomberg Symbol	SOLDA.LB
Reuters Symbol	SOLA.BY
Market Cap	2,690,400,000
Number of Shares	152,280,727
Free Float	92.0%
Price-to-Earnings 2010	13.73
Price-to-Book 2010	1.46

Share Performance



1 Month Return	-3.56%
3 Month Return	-4.56%
6 Month Return	-8.34%
12 Month Return	-22.65%
52 Week Range	22.96 – 17.59

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Performance and Forecasts

Year	2009	2010	2011e	2012f	2013f	2014f
Revenues (USD millions)	336	382	273	309	359	399
Net Income (USD millions)	189	196	119	131	167	202
EPS (USD)	1.24	1.29	0.78	0.86	1.10	1.32
BVPS (USD)	11.90	12.09	10.97	10.70	10.93	10.71
ROA	7%	7%	4%	5%	6%	7%
ROE	10%	11%	7%	8%	10%	12%

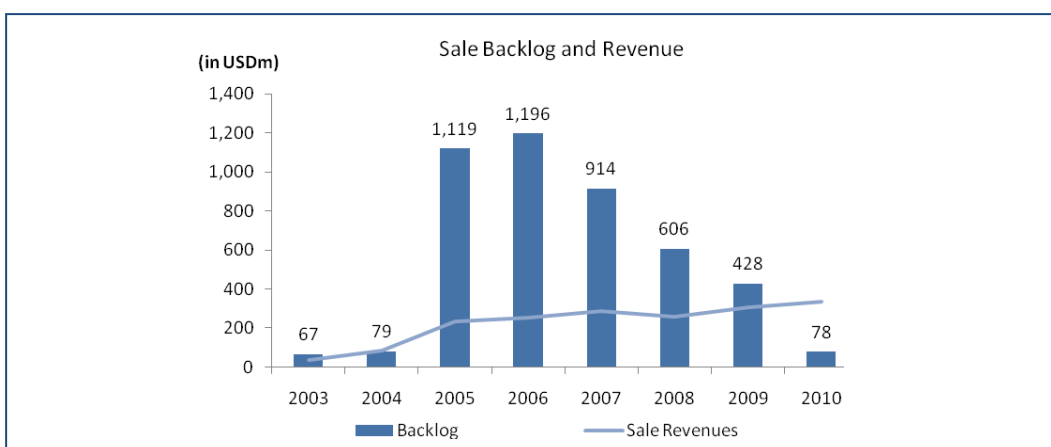
FINANCIALS & VALUATION

Year	2009	2010	2011e	2012f	2013f	2014f		
Profit & Loss Summary								
Revenue (USDm)	286	382	273	309	359	399		
Revenue Growth (%)	-8.3	13.7	-28.4	13.0	16.1	11.1		
Gross Profit (USDm)	234	272	183	202	250	294		
Gross Margin (%)	69.6	71.2	66.8	65.3	69.7	73.8		
Net Profit (USDm)	189	196	119	131	167	202		
Profit Margin (%)	56.3	51.3	43.6	42.2	46.5	50.7		
Net Profit Growth (%)	3.3	3.7	-39.2	9.6	27.8	21.0		
Earnings Per Share (USD)	1.24	1.29	0.78	0.86	1.10	1.32		
Price-to-Earnings (Forward P/E)	11.56	11.15	18.35	16.74	13.10	10.90		
Balance Sheet Summary (USDm)								
Cash & Cash Balances	177	170	100	111	137	162		
Accounts & Notes Receivables	346	487	328	355	413	458		
Inventory of Land & Real Estate	1,125	1,084	1,018	885	755	686		
Investment Properties	366	443	443	506	568	568		
Other Assets	384	417	425	434	434	434		
Total Assets	2,398	2,601	2,315	2,291	2,307	2,307		
Total Liabilities	590	762	648	664	646	669		
Book Value Per Share (USD)	11.90	12.09	10.97	10.70	10.93	10.71		
Profitability								
ROA (%)	6.6	6.7	4.1	4.8	6.2	7.4		
ROE (%)	10.3	10.7	6.8	7.9	10.1	12.2		
Liquidity								
Cash / Current Liabilities	0.30	0.22	0.15	0.17	0.21	0.24		
Current Assets / Current Liabilities	0.95	0.92	0.72	0.77	0.92	0.99		
Net Working Capital / Current Assets	(0.05)	(0.09)	(0.40)	(0.30)	(0.09)	(0.01)		
Comparables (using FY 2010)								
	Valuation			Margin Analysis (%)			Profitability (%)	
	P/E	P/Rev	P/BV	Gross	Operat.	Net	ROE	ROA
Solidere	13.7	6.5	1.5	71.2	57.9	51.3	10.7	7.5
Average of Peers	12.1	4.6	1.2	55.0	34.7	28.7	9.3	4.3
Valuation								
				USDm		USD/shr		FV %
Value from Sales of Traditional Land				608		3.9		20
Value from Sales of Reclaimed Land				2,499		16.1		83
Value from Rentals				245		1.6		8
Book Value of Solidere International				314		2.0		10
Book Value of Non-Operating Assets				760		4.9		25
Total Liabilities				(762)		(4.9)		-25
Value Loss from General & Admin.				(300)		(1.9)		-10
Tax Effect				(421)		(2.7)		-14
Fair Value				2,943		19.4		100%

Backlog Update and Outlook for 2011

Backlog plunges as no new contracts signed since end of 2009 but management optimistic

By the end of 2010 and until recently, Solidere's backlog is estimated at USD 77.5 million and is only composed of two deals in the reclaimed area, significantly lower than USD 429 million in year-end 2009. All of 2010's revenue was recognized from backlog with no new contracts taking place since the beginning of 2010. This presents a major concern as sale transactions, which still constitutes more than 88% of Solidere's revenues, require a considerable amount of time to be recognized as revenue due to prolonged negotiations and the technicalities of transferring ownership. The company's management however has indicated they are confident and optimistic on new deals concluding over the next few months in 2011, which will enable them to report revenues from new sales without being reported as backlog first.



Source: Solidere, Blominvest

If we suppose that the USD 77.5 million in backlog will be recognized in 2011, Solidere would still have to sell USD 260 million in the second half of 2011 in order to meet last year's revenues. When doing some quick calculations using a price of USD 3,000 per sqm in the traditional area and USD 4,500 in the reclaimed area, we find that Solidere would have to sell around 87,000 sqm of traditional land or 57,000 sqm of reclaimed land, or a combination of both. This does not seem farfetched as the size of the plots in sale transactions average around 11,000 sqm for traditional land and 25,000 sqm for the reclaimed area. Note however that since 2006, Solidere has relied heavily on its backlog as seen in the graph above, where more than half of annual revenue and sometimes the entire revenue was recognized from existing backlog.

Transfer of ownership plays a key role for why real estate deals may need a few months to a few years to be recognized in the financial statements. Conditions of ownership transfer need to be met. In Solidere's case, 25% of the purchase price needs to be paid in order to indicate commitment by the buyer. A contract needs to be signed along with the title assigned to the new owner representing the transfer of risks and rewards of ownership. Previously, Solidere has been able to recognize sales from traditional land within a few months as infrastructure works are already complete and the title can be instantly transferred to the new buyer once 25% of the purchase price is paid. In the reclaimed area however, infrastructure work is still incomplete in certain parts and we've seen that it may take much longer to recognize sales in that area. We can therefore expect any new sales to take place in the traditional area if it's to be recognized in 2011.

With backlog returning to 2004 levels and more than 4X 2004 revenues needed to maintain growth, new business is crucial

We can expect new sales to occur in the traditional area if they are to be recognized in 2011 due to titles in parts of the reclaimed area not being ready yet

Valuation Downgrade

Fair value drops reflecting the backlog slump and additional risk premium

We estimate the fair value of Solidere's share at USD 19.40 valuing the company's operating assets at market value using a discounted cash flow model (DCF) and the non-operating assets at Book Value. Our fair value has considerably declined since our last issue due to:

Revising the discount rate upwards to 15% in order to account for the additional risk premium associated with the following:

- Political turmoil that penetrated the Lebanese business environment due to arguments around the content and validity of the UN's Special Tribunal for Lebanon
- Regional political shocks that have been occurring since the beginning of the year and have affected investor sentiment in the region as a whole
- High likelihood that the Lebanese real estate market may have already peaked

Adjusting our financial forecasts over the next 4 years:

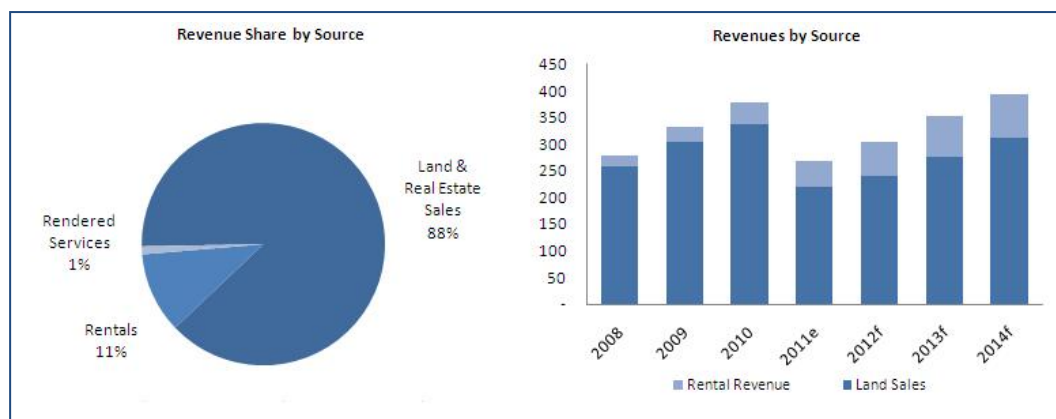
- As backlog has plunged beyond expectations in 2010, there is considerable pressure on Solidere to close new deals that can be recognized during 2011. We expect revenue to decline noticeably even with new deals due to the large gap between 2010 revenues of USD 337 million and the current backlog of USD 77.5 million.
- We kept sale prices steady until 2014 accounting for no price growth due to the Lebanese real estate market overheating over the past few years but recently showing signs of slowdown.

Component	USD million	USD per share
Market Value of Operating Assets in Beirut		
Value from Sales of Traditional Land	608	3.9
Value from Sales of Reclaimed Land	2,499	16.1
Value from Rental	245	1.6
Book Value of Solidere International		
Investment in Associates	314	2.0
Book Value of Non Operating Assets		
Cash & Cash Balances	170	1.1
Prepayments & Other Debit Balances	44	0.3
Accounts & Notes Receivables	487	3.1
Fixed Assets	59	0.4
Total Liabilities	(762)	(4.9)
General & Administrative Value Loss	(300)	(1.9)
Tax Effect	(421)	(2.7)
Fair Value	2,943	19.40

INCOME STATEMENT HIGHLIGHTS

Revenues

Solidere's financial results for 2010 show a 15% rise in total revenues reaching USD 386 million with land sales increasing by 10% and rental revenue recording a 52% jump due to higher utilization rate in its South Souks project. We expect rental revenue to further increase in 2011 but the increase will be overshadowed by a decline in land sales.



Source: Blominvest

Recognized land sales reached USD 337 million with the recognition of 132,000 sqm of land sold at an average price of USD 2,550 per sqm. Almost two thirds of land recognized (90,000 sqm) are from the reclaimed area and were sold in 2006. The remaining 42,000 sqm were from Solidere's traditional land portfolio with sales occurring in 2009. No new deals have been taking place since the beginning of 2010 and therefore the entire revenue recognized during 2010 was captured from backlog thus reducing it from USD 428 million at the beginning of the year to USD 77.5 million 12 months later.

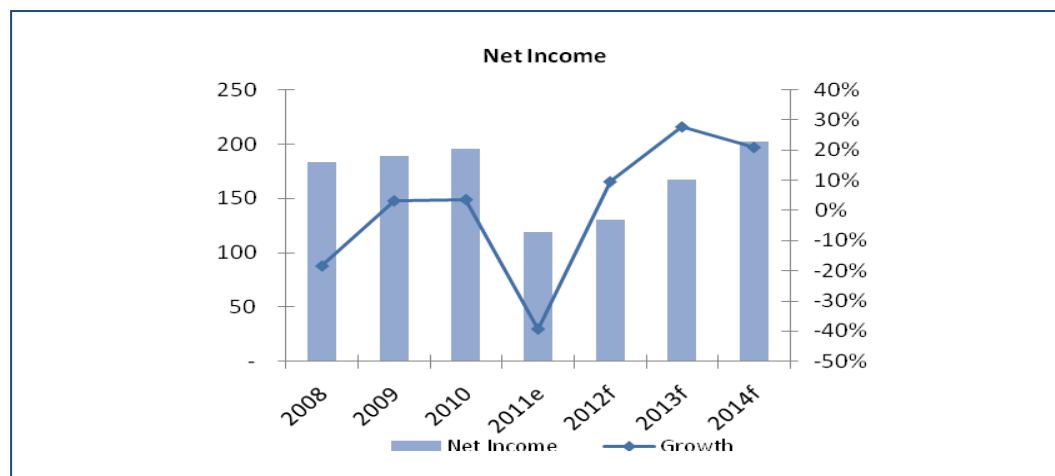
Costs related to land sales declined as 132,000 sqm were recognized during the year compared to 158,000 sqm during 2009. Solidere booked its land bank at an estimated cost of USD 505 per sqm so its cost per sqm does not increase while market prices increase allowing the company to grow revenues and expand its profit margins even though it sold less land.

Rental revenues grew by USD 14 million to USD 41 million caused by higher utilization of the South Souks during 2010. We expect 2011 rental revenues to further increase on even higher utilization of the South Souks while 2012 will see a considerable rise due to the opening of the Cineplex in the second half of that year.

Costs related to rentals increased almost 170% reaching 27 million due to the opening of the Beirut Souks which required a considerable investment in advertising. This forced its rental gross margin to drop to 33% during the year. However, Solidere indicates this to be a special case for 2010 and expects margins to return to their normal levels of around 65% for the South Souks project.

Earnings and margins

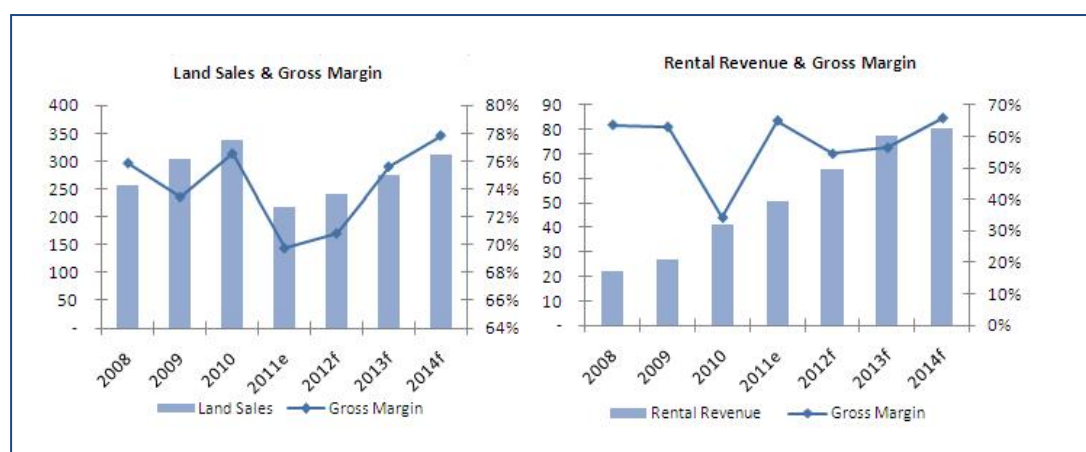
Solidere's 2010 Net Income reached USD 196 million resulting in a 3.7% annual growth from its USD 189 million in 2009 mostly due to higher revenues from land sales and rentals. Its profit margin for 2010 is 51%, lower than 2009's 56% attributed to a spike in Solidere's general and administrative expenses which grew from USD 26 million in 2009 to USD 43 million in 2010.



Source: Blominvest

The company continues to enjoy much higher gross margins in its sales when compared to competitors, hovering around 77% due to booking its land in 1994. In 2010, Solidere reported its highest gross margins yet of 77% and we expect this trend to continue as market prices rise.

As for the rental gross margin, it has historically fluctuated between 64% and 71%, but in 2010 it slid to 34% as noted earlier due to an increase in advertising the newly opened Beirut Souks.

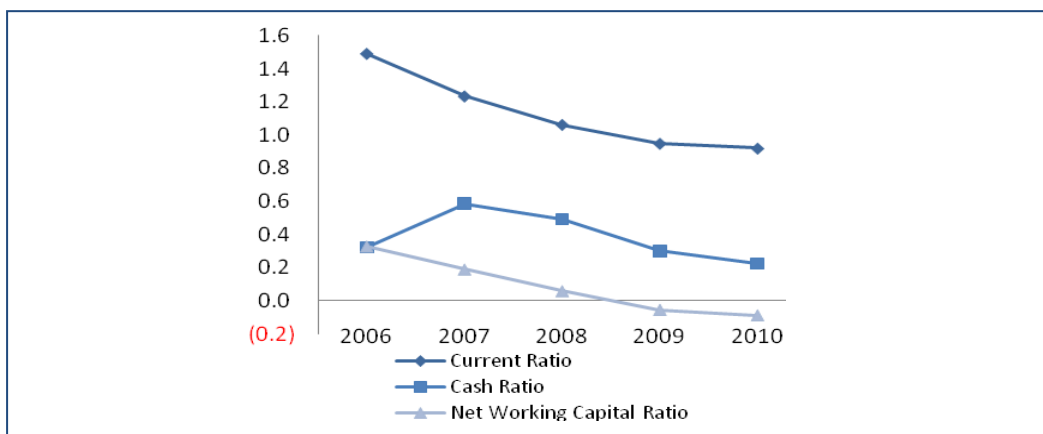


Source: Blominvest

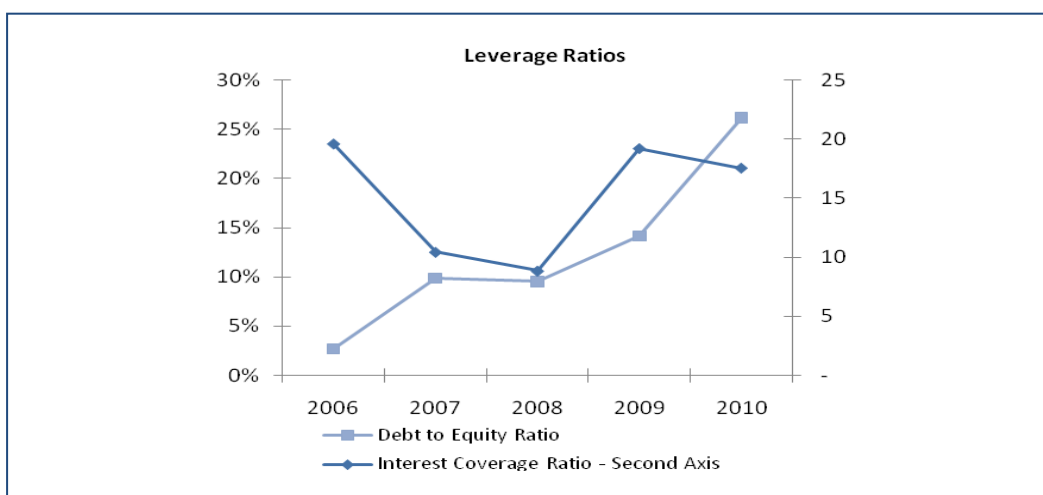
BALANCE SHEET HIGHLIGHTS

Liquidity and Leverage

No noticeable change in Solidere's cash balance occurred in 2010 as the company still carries around USD 170 million in cash, almost 6.5% of total assets. However, its accounts receivable have increased by 40% with 5 customers constituting 82% of receivables. While this appears to be risky from a customer management standpoint, it is normal due to the nature of Solidere's business of selling land plots. We note however that 10% of receivables are already overdue and almost 25% are due in 2011. Overall, liquidity indicators slightly decline in 2010 as seen in the following graph.



As for leverage, we find that debt has almost doubled from USD 256 million in 2009 to USD 481 million in 2010. This raises Solidere's debt-to-equity to 26% from 14% in 2010. It can be clearly seen from the graph below that debt-to-equity has been rising consistently since 2006, as the company uses additional credit facilities to fund the building of its rental properties. Solidere's strategy has revolved around increasing its recurring income from rentals and relying less on sale transactions in order to reduce its exposure to a single revenue stream.



Customer commitments on sale contracts and deferred revenue declined by USD 104 million to reach USD 46 million due to a decrease in new business. The entire 2010 revenue was recognized from backlog, part of which is captured in deferred revenue which explains the decline. Only two sale contracts remain in comparison to six for 2009.

PROJECTED INCOME STATEMENT

<i>In USD million</i>	2009	2010	2011e	2012f	2013f	2014f
Revenues from Land & Real Estate Sales	305	337	219	241	275	312
Revenues from Rented Properties	27	41	51	63	77	80
Revenues from Rendered Services	4	4	4	5	6	6
Provision for previously recognized sales	(7)					
Cost of Land & Real Estate Sales	(81)	(79)	(66)	(70)	(67)	(69)
Charges on Rented Properties	(10)	(27)	(18)	(29)	(34)	(27)
Cost of Rendered Services	(5)	(4)	(7)	(8)	(8)	(8)
Net Revenues from Operations	234	272	183	183	202	294
Share Result from an Associate	8	3	-	-	-	-
General & Admin. Expenses	(26)	(43)	(27)	(30)	(37)	(44)
Depreciation of Fixed Assets	(5)	(4)	(6)	(6)	(6)	(6)
Provision for Doubtful Receivables	(9)	-	-	-	-	-
Other Expenses	(3)	(7)	-	-	-	-
Interest Income	37	21	21	23	28	31
Interest Expense	(11)	(13)	(30)	(35)	(38)	(37)
Profit Before Tax	222	231	140	154	196	238
Income Tax Expense	(33)	(35)	(21)	(23)	(29)	(36)
Profit for the Year	189	196	119	131	167	202

PROJECTED BALANCE SHEET

<i>In USD million</i>	2009	2010	2011e	2012f	2013f	2014f
Assets						
Cash & Cash Balances	177	170	100	111	137	162
Prepayments & Other Debit	37	44	35	44	44	42
Accounts & Notes Receivables	346	487	328	355	413	458
Inventory of Land & Projects	1,125	1,084	1,018	885	755	686
Investment Properties	366	443	443	506	568	568
Investments in Associates	311	314	330	330	330	330
Fixed Assets	36	59	60	60	60	60
Total Assets	2,399	2,600	2,315	2,291	2,307	2,307
Liabilities						
Bank Overdraft & Short Term	256	481	408	393	361	362
Accounts Payable	113	149	100	112	109	105
Dividends Payable	71	86	99	109	122	135
Deferred Revenue & Other Credit Balances	150	46	41	49	54	68
Total Liabilities	590	762	648	664	646	669
Total Equity	1,809	1,838	1,667	1,627	1,661	1,638
Total Liabilities & Equity	2,399	2,600	2,315	2,291	2,307	2,307

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