FFA Private Bank s.a.l

SOLIDERE - Lebanese Real Estate	Current Price: SOLA USD 12.15; SOLB USD 12.16
Equity Research	Target Price: USD 17.00
April 2, 2013	Recommendation: OVERWEIGHT

While we increase our cautiousness for the short to medium term given that the uncertain economic and political backdrop is materializing into slower operations, we still see inherent value in the land bank and recognize upside for patient investors.

Ongoing slowdown in real estate transactions in 2012 in light of a decline in confidence levels

Sluggishness in real estate activity is being felt in light of a decline in confidence from softer economic conditions and rising political uncertainties in Lebanon and the region. In 2012, real estate activity continued to be soft as the number of transactions dropped by 10% YoY following a drop of 12% YoY in 2011. The slowdown is particularly being felt in the high end market encompassing large sized apartments.

Property prices held up well in 2012 despite slowdown in sales activity

In 2012 prices continued to be resilient despite the deceleration in transaction volumes. Official figures released by the Real Estate Registry show that the average value per real estate transaction increased by 16% YoY in 2012 following a 6% increase YoY in 2011. Prices in 2013 however, have been stable to down into February. In the Beirut Central District (BCD), the most expensive new units are located on the front line of the Waterfront area where the starting price hovers around the 8,000-10,000 USD/sqm range, according to FFA Real Estate compared to 4,300-7,000 USD/sqm in the traditional area including Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square.

In 2012, we expect Solidere's revenues and earnings to be well below prior year's levels on account of lower land sales

Although we have assumed that the Company made one land transaction in 2012, we expect revenues and earnings to be well below prior year's levels. We note that Solidere generated USD 304 million in gross revenues in 2011 (with 80% generated from four land sales) and still saw earnings decline YoY (EPS 1.03 vs. 1.28). We have accordingly revised our model assumptions for Solidere accounting for a significant drop in revenues from land sales and a roughly stable income stream from rented properties, rendered services and hospitality. We expect the Company to report an EPS at USD 0.26 significantly down from 1.03 in 2011.

Expect delays in capital spending to compensate for slower operating revenues, which should ease the cash position

To alleviate pressures on cash flows in light of slower land sales, we expect Solidere to defer some of its capital spending in infrastructure and property development, which we view as a favorable measure for the cash position. The completion of both the reclaimed area infrastructure and the development pipeline requires an estimated USD 500 million over a longer period than previously planned.

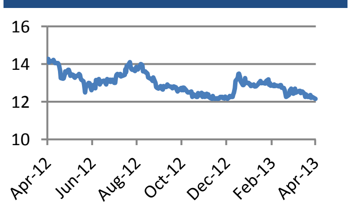
We still recognize favorable upside for patient investors, despite increasing our cautiousness for the short to medium term

We recognize Solidere's position as the prime land owner and master developer in the BCD, its strong track record, attractive margins, and its ongoing revenue diversification strategy to offset the depletion of its land bank. However we are currently more cautious about the stock as we started seeing the uncertain economic and political backdrop materializing into Solidere's operations through slower land sales. We are concerned that the short to medium term will remain challenging given the impact of the difficult operating environment on the property market and Solidere's land sales, which remains the key driver for cash generation. Yet we favorably view Management's decision to defer some upcoming investments to alleviate pressures on cash flows in the medium term before a cyclical rebound in activity drives land sales, and the completion of the real estate pipeline and waterfront infrastructure.

We rate Solidere shares at Overweight with a fair value estimate of USD 17.00 per share down from USD 20.00 previously

Based on our revised forecasts and updated valuation, our fair value estimate is USD 17.00 per share, which implies a P/B of 1.4x based on our estimated 2012 BVPS. We accordingly maintain our Overweight recommendation given that the current price is at a discount of more than 10% to our fair value estimate despite increasing our cautiousness on the stock in the short term.

Solidere A Share Price (In USD)



Share Price Information

Market cap.	USD 2,004.8 million
Shares	165.0 million
Dividend yield	2.1%
Δ 1M	-2.4%
Δ3M	-5.9%
Δ YTD	-6.5%
Δ 12M	-14.9%
52-Week range	USD 12.15-14.47

Key Performance Indicators

In USD millions	2011a	2012e	2013e	2014e
Revenues	304	138	144	248
EBITDA	186	48	52	138
Net income	159	41	41	113
EPS (USD)	1.03	0.26	0.26	0.72
P/E	11.8	46.6	46.8	16.9
P/B	0.99	0.99	0.99	0.95
EV/EBITDA	13.0	52.5	50.0	19.1

Note: Solidere A shares are priced as of market close on April 2nd, 2013; Source: BSE, Company reports, FFA Private Bank estimates

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COMPANY HIGHLIGHTS

Consolidated Financial Highlights and Forecasts

- **In 2011 revenues reflected four land sales in the waterfront area and a drawdown on sales backlog**

Gross revenues declined 21% YoY to USD 304 million in 2011 with the bulk generated from land sales and the remainder from rental income and property management. Revenues from land sales amounted to USD 242 million from four sale contracts signed in the waterfront area totaling USD 222 million (equivalent to about 50,000 sqm BUA at an average price of USD 4,440) and the drawdown of USD 38 million from the sales backlog. Solidere now carries a sales backlog of nearly USD 40 million and an unsold land bank of 1.88 million sqm split nearly 80%/20% between waterfront and traditional areas, respectively.

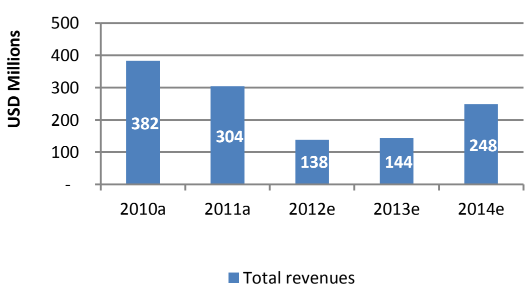
- **In 2012e, we expect revenues to be well below prior year's levels**

Although we have assumed that the Company made one land transaction in 2012e, we expect revenues and earnings will be well below prior year's levels. Noting that Solidere generated over USD 200 million in 2011 in land sales and still saw earnings decline YoY. We expect revenues from land sales to reach USD 57 million in 2012e (77% down from 2011), accounting for nearly 40% of the USD 138 million forecasted revenues, with no expected drawdown from its remaining sales backlog of USD 40 million.

More generally, we expect Solidere's land sales to remain moderate in the short term reflecting softer real estate market given more difficult macroeconomic conditions and political uncertainty in Lebanon and the region, including risks of spillover from neighboring Syria.

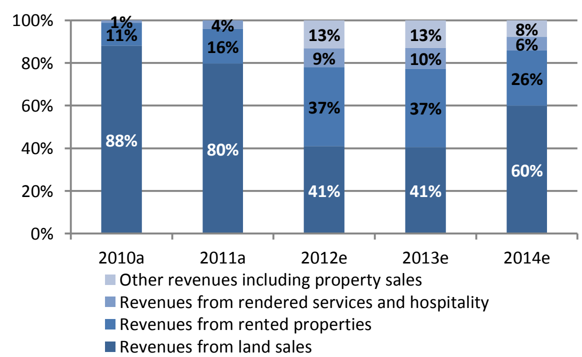
We expect Management will intensify efforts regarding land sales negotiations in the waterfront area extending payment terms to seven years given no likely downward revision in selling prices. Moreover the slowdown in the real estate market since late 2010 which steepened in 2012 and carried into 2013e is compounded by the high ticket transactions that land sales entail given their prime location in the BCD at above average land sizes.

Figure 1: Total revenues



Source: Company reports, FFA Private Bank estimates

Figure 2: Revenues breakdown



Source: Company reports, FFA Private Bank estimates

In 2012e, we expect rental income to remain roughly flat compared to 2011 at USD 51 million, and revenues from rendered services and hospitality should remain roughly stable at around USD 12 million. We have forecasted an additional USD 18 million to be generated in 2012e from property sales in the BCD area, which comprise of units sold in Saifi Village and Zaitunay Bay. Starting 2014e, we expect the completion of real estate developments in the pipeline adding to existing rental income, with full impact starting in 2016e. As highlighted in the table below, we have projected around 100,000 sqm in additional BUA to be completed which would add around USD 50 million in revenues, from the completion of the North Souks and additional properties in the BCD.

Over the medium term, we expect Solidere can ramp up sales regaining some momentum as market conditions improve and the Company starts to get the benefits of the completion of the real estate pipeline portfolio.

Table 1: Real estate property portfolio

	Current		Pipeline		Total
Real estate property portfolio	Pre-Souks portfolio	South Souks	North Souks	Residential, mixed-use, office block	
Completion date	Completed	Completed	Cineplex 2013 Department store 2015	2015	
Leasable space	86,000 sqm	54,000 sqm	46,000 sqm	52,000 sqm	**238,000 sqm**
Recurring rental income	USD 22 m	USD 25 m	USD 20 m	USD 33 m	**USD 100 m**

Source: Company reports

- **Revenue mix shows a rising contribution from rental income but land sales continue to account for the bulk and should continue into longer term**

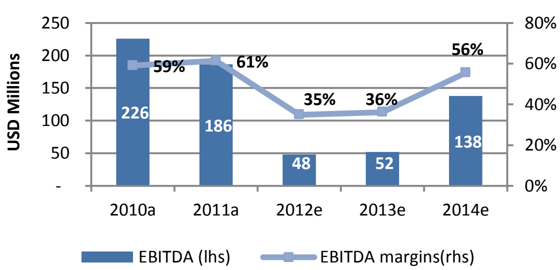
Land bank sales were USD 242 million in 2011, down 28% YoY from USD 337 million in 2010 and continued to represent the bulk of gross revenues with a contribution at nearly 80% down from 88% in 2010. Rental income stood at USD 49.9 million in 2011, up 21% from 2010, with a rising contribution in gross revenues to 16% from 11% in 2010 in line with Solidere's revenue diversification strategy. Revenues from rendered services and hospitality totaled USD 12 million in 2011 up from USD 4 million with a rising share in gross revenues (at ~4% up from 1%).

In the short term we expect the contribution from land sales to bottom to 40% of total revenues, the result of difficult operating environment impacting land sales activity before picking up starting 2014e and stabilizing around 70% in the longer term.

- **Margins on land sales improved as average selling prices increased and land costs were unchanged**

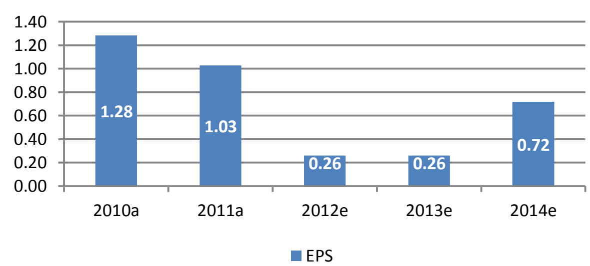
In 2011, gross profits were USD 228 million while our estimated EBITDA was USD 186 million, with margins up about from 71% and 59% respectively to 75% and 61%. Gross margins from land sales also improved to 84% from 77% in 2010 from a higher average selling price at USD 3,607 per sqm (approximately 50,000 sqm at USD 4,400 and 15,000 sqm at USD 2,500), while land costs were unchanged at USD 587/sqm. SG&A was lower on account of efficiencies and lower discretionary expenses, although higher as a percent of sales offsetting some of the gross margin gains. Net profits were USD 159 million and compared to USD 196 million in 2010. EPS was USD 1.03 from USD 1.28 in 2010 and ROE was down to 8.4% from 10.7% in 2010.

Figure 3: EBITDA and EBITDA margins



Source: Company reports, FFA Private Bank estimates

Figure 4: EPS (in USD)



Source: Company reports, FFA Private Bank estimates

In 2012e we forecast gross profits of USD 91 million, representing gross margins of 66% and SG&A costs of USD 39 million (at 28% of revenues). EBITDA is expected to reach 48 million in 2012e, net profits to amount to USD 41 million, and EPS of USD 0.26 down from USD 1.03.

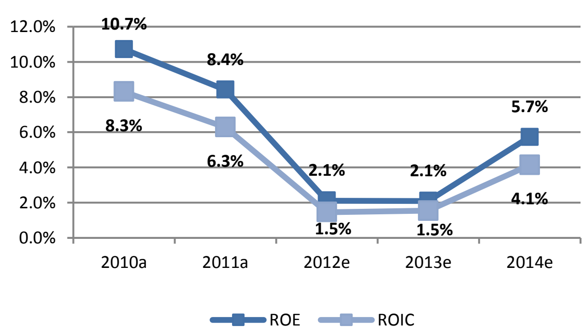
In the medium term, net profits and EPS should pick up from increased land sales on cyclical rebound in market conditions, the completion of the development portfolio which comprises of the North Souk and select properties across the BCD and the completion of the Waterfront infrastructure which should facilitate land sales in the area.

We forecast gross margins from land sales to stabilize in the 85%-90% range in the long term, while gross margins from rental income should gradually pick up above 60%. Simultaneously gross margins from rendered services and hospitality should breakeven over the medium term.

- **Expect delays in capital spending for the completion of the remaining infrastructure and real estate developments to compensate for slower operating revenues**

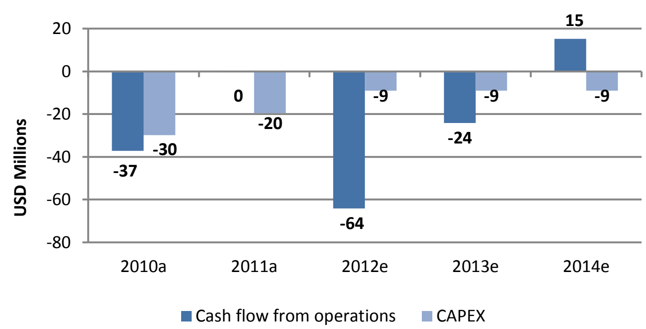
In 2011, net debt levels increased to USD 416 million from USD 311 million in 2010 mostly explained by a new USD 50 million bank facility to bridge cash flow requirements. Debt levels are being driven higher as the Company funded the completion of the remaining infrastructure (USD 50 million in 2011), real estate developments (USD 64 million in 2011) and working capital requirements. In parallel to higher net debt levels, net debt to EBITDA reached 2.3x up from 1.4x in 2010, while net debt to total capitalization was 16.5%, up from 13.4% in 2010.

Figure 5: ROE and ROIC



Source: Company reports, FFA Private Bank estimates

Figure 6: Cash from operations and Capex



Source: Company reports, FFA Private Bank estimates

To alleviate pressures on cash flows in light of slower land sales stemming from the difficult operating conditions that prevailed in 2012, we expect Solidere to defer some of its capital spending in infrastructure and property development, which we view as a favorable measure for the cash position. We expect the company to extend the phase of the completion of the reclaimed area infrastructure until 2017 which revolves around a capital spending of USD 250 million approximately and includes the Eastern marina, the park in the corniche and the utility network. Moreover, the demand sluggishness and the deceleration in Solidere's operations prompted the Company to postpone new projects including the Office Block (Mina El Hosn). The total estimated capex for the completion of the real estate pipeline portfolio is estimated between USD 200 million and USD 250 million now extended over a longer period than previously. We expect Solidere will gradually increase its borrowings over the medium term as it continues to execute its growth strategy, invest in its infrastructure and support its dividend program.

- **Solidere may have to cut its dividend payout**

Solidere provided no indication on change in dividend policy. However we believe that the Company may have to review its dividend payout downwards in the context of declining earnings per share against a challenging real estate and macroeconomic environment and upcoming capital intensive property and infrastructure development costs. It should be noted that for the 2011 financial year, Solidere paid a dividend of USD 0.25 per share (down from USD 0.40 in 2010) in addition to a bonus share (one share for every 50 held).

- **We continue to believe that Solidere shares reflect investor sentiment which has been impacted by rising political uncertainties and softer market conditions**

Currently Solidere shares (Sol A: 12.15 , Sol B: 12.16) are trading at near eight-year lows down around 15% YoY, reflecting a cautious investor sentiment influencing the real estate market and materializing into difficult operating conditions. We are concerned in the short term as we expect significantly weaker earnings this year and a potential cut to the dividend that could add to income oriented investor anxiety, driving some towards the relative attractiveness of upcoming domestic banks' dividend payouts. Ultimately, Solidere shares represent a vote of confidence for investment in Lebanon and as such are subject to swings from the reaction to political developments.

Table 2: Main assumptions

Main assumptions	Notes
Land sales (in USD/sqm)	Selling prices of USD 2,600 (per sqm of BUA) in the traditional area and 4,400 in the waterfront area, with a weighted average price of USD 4,000; increasing at the rate of inflation.
Land sales (in sqm)	Land sales of 12,500 sqm in 2012e and 2013e, 35,000 sqm in 2014e and 70,000 sqm onwards.
Rental income	Full year impact of additional rental income in 2016e.
Rendered services & hospitality	Steady improvement in market share in property management and services.
Margins	Stable gross margins in land sales, and improving gross margins in rental and management segments.
Expenses	Higher operating and financial expenses.
Dividend payout	Dividend policy in line with a constant payout on earnings.
Financing	Potential to raise more debt from short-term sources to finance operations, investments, and maturing debt payments at favorable terms.

Source: FFA Private Bank estimates

Strategy Update

Despite recent delays in capital spending, strategy remains geared towards the completion of the infrastructure and the development of the real estate portfolio in view of increasing the recurring income stream and adding value to the BCD

The Company's main focus in the long term, in light of its depleting land bank is to diversify its revenue mix and lower its dependence on land sales by developing additional streams:

- Solidere will continue to focus its strategy on the development of a real estate portfolio including the North Souks and several properties in the BCD in view of increasing its rental income. In fact Solidere seeks to double its contribution from rental income to USD 100 million in the next several years and we expect land sales to stabilize around 70% percent of total revenues in the longer term.

- Solidere will continue to seek opportunities for expansion via Solidere International in an effort to expand urban planning and real estate developments outside the BCD district.

In addition, Solidere plans to invest in the completion of its infrastructure mainly related to the waterfront area which includes the completion of the utility network, the Eastern Marina and the park in the corniche in view of adding value to the BCD area.

Recent News

January 2013 – Central Bank initiative to activate lending to the productive sectors: The Central Bank asked Lebanese banks to allocate USD 1.45 billion to activate lending with special emphasis on productive sectors. The Central Bank will give credit facilities to commercial banks with 1% interest and this will allow the banks to lend with an interest rate not exceeding 5%-6%. The ceiling for housing loans was also raised to USD 530,000.

Update on Solidere International

Current international projects encompass: Al Zorah project in UAE, Golden Tower and Qortoba Oasis in KSA as well as a residential community in Lebanon (Hazmieh). Below is an update on those projects:

- **Al Zorah (Ajman, UAE):** a touristic project, whereby infrastructure works are close to be completed.

- **Golden Tower (Jeddah, KSA):** a high end residential tower located on the Jeddah corniche.

- **Qortoba Oasis (Riyadh, KSA):** a residential compound for expats to the north east of Riyadh.

- **Hazmieh (Lebanon):** an urban development project to the south east of Beirut which is currently under design. The completion is expected in 2017.

Investment Opinion

While we increase our cautiousness for the short to medium term given that the uncertain economic and political backdrop is materializing into slower operations, we still see inherent value in the land bank and recognize upside for patient investors.

We recognize Solidere's position in its domestic market as the prime land owner and master developer in the Beirut Central District (BCD), its strong track record in developing superior quality properties and infrastructure, and its ongoing revenue diversification strategy to counterbalance the depletion of its land bank. We like the firm's high operating margins and relatively lower levels of indebtedness.

However we are currently more cautious about the stock as we started seeing the uncertain economic and political backdrop materializing into Solidere's operations through slower land sales. We are concerned that the short to medium term will remain challenging for Solidere given the impact of the difficult operating environment on the property market activity and the Company's land sales, which remains the key driver for cash generation.

Yet we favorably view Management's decision to defer some upcoming investments to alleviate pressure on cash flows in the medium term before a cyclical rebound in activity driven by accelerating land sales, completion of the real estate pipeline and waterfront infrastructure.

Valuation

We value Solidere shares at USD 17.00 per share (down from USD 20.00 previously) using a sum of the parts approach under the following:

- We value the land bank of 1.9 million square meters of BUA with a selling price of USD 4,000.
- We value the investment properties and property management services income using a discounted cash flow approach with a weighted average cost of capital of 15% (up from 14% previously) and a terminal growth rate of 5%.
- We value Solidere International based on the value of its liquid assets, in light of the early stages of the underlying projects.

We derived USD 4,000 per sqm as the weighted average selling price for the land bank of Solidere from an estimated end user property price of USD 9,000 per sqm BUA in the waterfront area and USD 6,000 per sqm BUA in the traditional area using FFA Real Estate's estimates. We also assumed a developer margin of 30% and construction costs of USD 2,200 per sqm BUA in the traditional area and USD 2,500 per sqm BUA in the waterfront area. We applied a discount of 60% (up from 55% previously) to our estimated land bank NAV to reflect the uncertainty regarding the macro-political environment in Lebanon, the cyclical and sensitive nature of the real estate sector, and its inherent risks including operational, credit, and liquidity risks. Our fair value derivation when including the investment properties and the investment in Solidere International in addition to the land bank and adjusted for certain assets and liabilities results in a fair value estimate of USD 17.00 down from USD 20.00 previously. We explain the downward target price revision from lower financial forecasts than previously, a higher discount applied on the land bank NAV and a higher cost of capital, on account of weak land sales performance against a more difficult property market and uncertain political and economic backdrop.

We estimate every 5% change in the discount to our land bank NAV impacts our value per share estimate by USD 2.00. This USD 17.00 fair value estimate implies a P/B of 1.4x based on our 2012 estimated BVPS.

Table 3: Sum of the parts valuation

Sum of the Parts Valuation	in USD millions	Per share	Notes
Land Bank:			
Average selling price in BUA	USD 4,000		Estimated end-user prices less 30% margin & USD 2,200-2,500/sqm construction costs
Land bank in sqm BUA	1.9 m		Remaining land bank split 1.5 million in waterfront, 0.4 million in traditional
Revenues	7,600.0		
Infrastructure	250.0		Remaining infrastructure to complete land bank, mainly utilities, marina, landscaping
Contingencies	760.0		10% of revenues
EBIT	6,590.0		
Taxes 15%	988.5		
Net Asset Value (NAV)	5,601.5		
Premium (discount)	(60.0%)		Reflect liquidity, credit, cyclicality, market and political risks
Land Bank	**2,240.6**	**14.24**	Book value adjusted to estimated end user prices
Investment Properties	**328.6**	**2.09**	DCF on current properties and those in pipeline, property management at 15% WACC
Investment in Associate	**126.7**	**0.81**	Solidere share of liquid assets (cash and investments)*
Add:			
Cash	174.1	1.11	100% book value
Prepayments & other debit	46.5	0.30	100% book value
Accounts and notes receivables	551.3	3.50	100% book value
Fixed assets	70.3	0.45	100% book value
Total Other Assets	**842.3**	**5.35**	100% book value
Less:			
Total Liabilities	**(847.1)**	**(5.38)**	100% book value
Value	**2,691.2**	**17.10**	
# of shares (net of treasury)	157.4 m		
Value per share	USD 17.10		
Value Per Share (rounded)	**USD 17.00**	**17.00**	

Source: Company reports, FFA Private Bank estimates *Note: *Reflects 2010 financials*

Recommendation

We revised our target price on Solidere shares downwards to USD 17.00 per share down from USD 20.00 previously, reflecting our increased cautiousness for the short term. Our Overweight recommendation for the longer term is maintained.

Based on our revised forecasts and updated valuation, our fair value estimate is USD 17.00 per share (down from USD 20.00 previously), which implies a P/B of 1.4x based on our 2012 estimated BVPS. We accordingly maintain the Overweight recommendation given that the current price is at a discount of more than 10% to our fair value estimate.

REAL ESTATE SECTOR HIGHLIGHTS

Sector Performance- Demand Levels

- **Slowdown in the number of real estate transactions in 2012**

The performance of the real estate sector in 2012 highlighted an ongoing slowing activity on both the demand and the supply side of the market.

In figures, the numbers released by the Real Estate Registry reveal that the property market is witnessing a slow performance the likely result of a disagreement between buyers and sellers as highlighted by a drop in the number of sold properties, which fell by 10% in 2012 compared to the same period last year. This deceleration in real estate activity is happening in light of a decline in investor and consumer confidence stemming from softer economic conditions and rising political uncertainties in Lebanon and the region.

Nevertheless the total value of real estate transactions rose by 4% to USD 9.18 billion higher than USD 8.84 in 2011 highlighting a higher average selling price (refer to table 4). In fact the average value of real estate transaction increased to USD 123,051 in 2012, compared to USD 106,533 in the year 2011.

The slowdown in demand is particularly felt in the high end market encompassing large sized apartments in affluent neighborhoods where fewer transactions are taking place as buyers and sellers are likely not finding agreement on price.

Table 4: Real estate transactions

	2006	2007	2008	2009	2010	2011	2012
Value of real estate transactions (USD billion)	3.14	4.20	6.48	6.96	9.48	8.84	9.18
YoY growth rates	*-5%*	*+34%*	*+54%*	*+7%*	*+36%*	*-7%*	*+4%*
Number of real estate transactions	50,140	67,107	80,709	83,622	94,320	82,984	74,569
YoY growth rates	*-3%*	*+34%*	*+20%*	*+4%*	*13%*	*-12%*	*-10%*
Average value per transaction (USD)	62,605	62,557	80,301	83,172	100,498	106,533	123,051
YoY growth rates	-	*0%*	*+28%*	*+4%*	*+21%*	*+6%*	*+16%*

Source: Real Estate Registry

The current slowdown in the real estate market contrasts with a real estate boom between 2006 and 2010 which was driven by a favorable macroeconomic situation including robust GDP growth and strong capital inflows into Lebanon. Some areas of the capital including the residential segment of the Beirut Central District were primarily affected by the boom which led to a drastic increase in prices triggered by Arab nationals' and Lebanese expatriates' appetite for large and luxurious apartments in high-end areas. Over the same period, property transactions witnessed a strong growth both in volume and in value, with a CAGR at a respective 17% and 32% based on data from the Real Estate Registry.

Sector Performance –Supply Levels

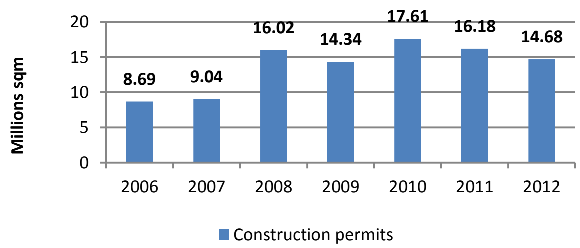
- **Adjustment of supply levels to demand sluggishness**

On the supply side, the retreat in demand has led to a downward adjustment on the supply side of the market. Construction activity is slowing down and accordingly, the total area of newly issued construction permits (the main indicator of oncoming supply) saw a significant year-on-year decrease of 9% in 2012, indicating that investors are becoming more cautious in launching new developments due to the increase in land prices and the changing aspects of market demand. The breakdown per region highlights that the area of newly issued construction permits was significantly down in almost all regions in 2012 compared to 2011, with Mount Lebanon accounting for the lion share at 61% (refer to table 5).

Simultaneously, reflecting a softened developers' sentiment and an adjustment of supply levels to lower demand, the latest statistics from the Central Bank evidenced that cement deliveries, the coincident indicator of construction levels, declined 4% YoY in 2012.

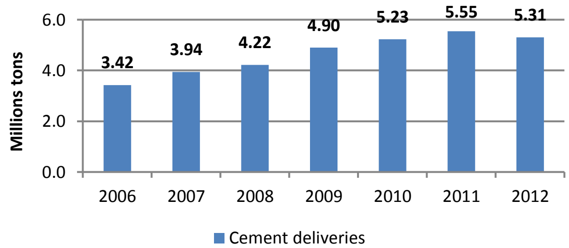
This adjustment of supply levels to demand pressures started to be felt in 2011 as witnessed by softer growth rates of supply indicators: in fact the area of issued construction permits was down 8% in 2011 while cement deliveries edged up 6% after both indicators grew at a CAGR of 19% and 11% respectively between 2006 and 2010.

Figure 7: Area of issued construction permits



Source: Banque Du Liban

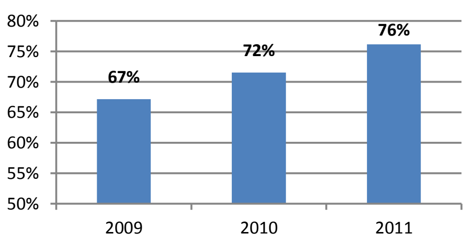
Figure 8: Cement deliveries



Source: Banque Du Liban

In parallel, some new supply trends are emerging as developers are catering their residential projects to a shift in demand's needs and preferences. Consequently supply is shifting towards i) smaller sized apartments, ii) areas located in Beirut's periphery. On the one hand, the existing real estate activity is characterized by a rising demand for smaller sized apartments ranging between 150 sqm and 200 sqm (refer to figure 9), which developers are catering to. On the other hand, buyers' appetite for residential areas located on Beirut's key suburbs is becoming a predominant trend which led developers to cater to this demand.

Figure 9: Share of under 200 sqm residential apartments in new licensed residential units



Source: Order of Engineers in Beirut

Table 5: Breakdown by area in sqm of issued construction permits by region in 2011 and 2012

	2011	2012	YoY growth	Share in total
Beirut	778,395	613,200	-21%	10%
Mount Lebanon	4,512,048	3,893,140	-14%	61%
North Lebanon*	74,191	56,918	-23%	1%
Bekaa	645,458	632,784	-2%	10%
South Lebanon	848,840	743,343	-12%	12%
Nabatiyyeh	604,055	410,473	-32%	6%

*Note: * figures for the North do not include permits issued by the Order of Engineers of Tripoli*
Source: Order of Engineers in Beirut

Property Prices

- **Property prices held up well in 2012 despite slowdown in sales activity**

After years of a rapid surge in prices the property market entered a phase of relative consolidation in late 2010, which became even more evident in 2011 and into 2012 considering the contraction in property sales transactions.

Prices haven't witnessed any significant correction despite the deceleration in transaction volumes. Official data released by the Real Estate Registry show that the average value per real estate transaction has increased by 6% YoY in 2011 and 16% YoY in 2012 (refer to table 4). This rise can be explained by the effects of inflation on prices and constructions costs, the sustained high land prices and end-user demand despite the ongoing effects of the regional turmoil.

The overall resilience of prices to the downside could be attributed to the fact that developers are not ceding to demand pressures by selling new units below market rates in view of protecting margins following acquisition of lands at record highs. Furthermore, the level of leverage of developers is low as projects are somewhat financed through equity rather than debt, which we believe limits distressed sales during difficult times to satisfy loan obligations. Moreover, developers are still optimistic for the longer term and view the downturn on the market as temporary and expect a pick up in the market as visibility on the political situation improves.

Beirut remains the benchmark in terms of real estate demand with the most expensive new units on the Waterfront (front line) where the starting price is in the USD 8,000/sqm- USD 10,000/sqm range according to FFA Real Estate, while the range of starting prices for new apartments in the traditional area of the BCD varies between USD 4,300/sqm and USD 7,000/sqm encompassing areas as Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square.

Table 6: Range of starting prices in the BCD key areas

BCD key areas	USD per sqm	BCD key areas	USD per sqm
Waterfront (Front line)	8,000-10,000	**Martyr Square**	6,000-7,000
Mina El Hosn	6,000-7,000	**Saifi**	4,300-5,000
Wadi Abu Jamil	6,000-6,300		

Source: FFA Real Estate

Outlook

Real estate activity expected to remain lackluster over the short term

In the first two months of 2013, the real estate sector performance pointed to an ongoing slowdown in activity on both the demand and the supply sides of the market as highlighted by respective YoY declines of 19% and 27% in the number of real estate sale transactions (as per the statistics of the Real Estate Registry) and the area of issued construction permits (as per the statistics of the Order of Engineers in Beirut). In parallel, the value of real estate transactions dropped by 21% YoY with the average value per transaction inching slightly lower.

Overall, the Lebanese real estate market is maintaining a wait-and-see outlook. The current situation on the market can best be described as stagnating with limited transactions of new units taking place in the high end residential segment whereas developers keep on executing existing big projects in the pipeline with supply to enter the market in a few years from now.

In the short term we expect real estate activity to remain lackluster and the number of transactions to remain on a downward trend as sellers will be unwilling to lower prices in an effort to protect margins while buyers remain on the sidelines particularly in the residential luxury segment until visibility on economic and political conditions improves. Over the medium to long term, however, we believe favorable fundamentals will continue to support the real estate in Lebanon including its capacity to attract FDIs, the relative inelasticity of residential prices to downward pressures and the attractiveness of the market to Lebanese expatriates and affluent Arab nationals.

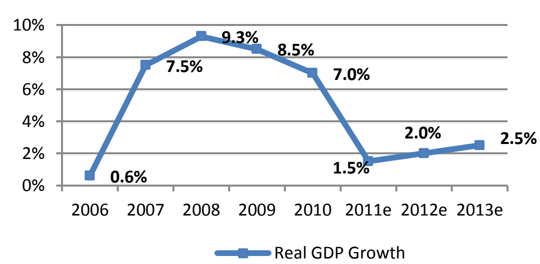
MACROECONOMIC HIGHLIGHTS

- **Slowdown in economic growth continued in 2012 in light of rising uncertainties…**

In 2012, economic developments continued to be soft (following a trend initiated in 2011) in light of a decline in confidence due the rise of regional political and security turmoil which have slowed capital flows into Lebanon, a usual driving force for the Lebanese economy. In fact, economic growth continued to be soft with a real GDP growth rate estimated at 2% in 2012 down from 7% in 2010 according to the IMF.

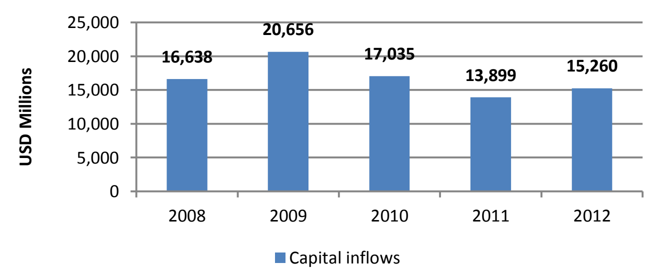
Capital inflows into Lebanon decreased from USD 17 billion for 2010 to USD 15.3 billion for 2012 (yet higher than USD 13.9 billion in 2011) which did not offset the large trade deficit at nearly USD 16.8 billion (compared to USD 15.9 billion in 2011), thus exerting further pressures on the balance of payments that recorded a deficit at USD 1.5 billion after a USD 2 billion deficit in 2011. While Lebanon's imports grew by 6% in 2012 (vs. 12% in 2011), exports increased by 5%, stronger than the 1% in 2011 yet below the 22% growth rate witnessed in 2010. FDI inflows are estimated to have been among the most affected in the context of cautiousness related to regional uncertainties and a sluggish real estate market, the latest official statistics released by the UNCTAD highlight that FDI inflows reached USD 3.2 billion in 2011 representing a near 30% decrease compared to 2010. For 2012e, figures released by the Institute of International Finance show that FDI inflows in Lebanon totaled USD 1.1 billion which represents a steep drop compared to previous years.

Figure 10: Real GDP growth



Source: IMF

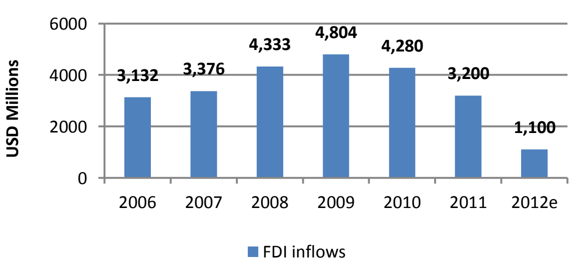
Figure 11: Capital inflows



Source: BDL

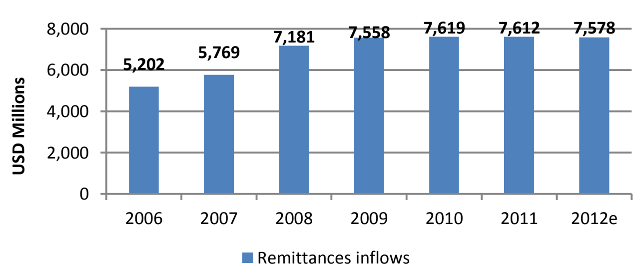
In parallel, remittances from the Lebanese Diaspora, considered to be one of the largest in terms of proportion to the resident population, have proved to be resilient and are estimated by the World Bank to have reached USD 7.6 billion in 2012 (around 18% of nominal GDP), almost unchanged from 2011 and maintaining Lebanon's ranking among top recipients in developing countries.

Figure 12: FDI inflows



Source: UNCTAD, Institute of International Finance

Figure 13: Remittances inflows



Source: World Bank

The year 2012 saw an increase in the gross public debt (from USD 53.7 billion in 2011 to USD 57.7 billion in 2012) while the gross debt-to-GDP ratio reached an estimated 135% by year-end, still ranking among the highest in the world, suggesting required efforts to improve the country's fiscal imbalances.

- **….Amid mitigated performance in key sectors**

It should be noted that the Lebanese economy is primarily based on services which accounts for approximately 67% of GDP (including trade, tourism, as well as banking and financial services) while the construction sector accounts for around 13% of the country's GDP, leaving agriculture and the industrial sector with a small share in the GDP contribution (5% and 8% respectively). Government sector accounts for largely the remainder.

Tourism and real estate which are viewed as the backbone of the Lebanese economy saw weaker conditions following strong growth in recent years. The real estate market pursued its slowdown as witnessed by property sales in number terms declining 10% in 2012 compared to 2011 year, reflecting lower demand levels. Incoming tourists continued to sharply decline in 2012 reaching 1.4 million, the equivalent of a 18% decrease compared to 1.7 million tourists in 2011 with a noticeable 21% decline in tourist arrivals from Arab countries. However, it should be noted that over the same period number of passengers' arrivals at the Beirut Airport picked up 3% YoY to 2.9 million suggesting that Lebanese travelers and expats may have accounted for the increase in airport activity.

On another hand, banking activity seemed to hold up well in 2012 as suggested by its key activity growth indicators and despite witnessing pressures on their earnings from a narrowing spread environment, slower fee income generation and growing provisioning levels. Assets of commercial banks reached USD 151.9 billion at the end of 2012, up 8% from end-2011 (higher than the 3% increase over the corresponding period of previous year). Deposits reached USD 125 billion at the end of 2012, up 8% from USD 116 billion at end-2011 (higher than the 2% increase over the corresponding period of previous year). Also, it should be noted that the non-resident deposits increased by USD 2.8 billion in 2012, still accounting for 19% share in total deposits and represents a vote of confidence for the banking sector. The dollarization rate of deposits stood at 64.8% at the end of 2012 down from 65.9% a year earlier. Lending activity was healthy as loans to the private sector totaled USD 43.5 billion at the end of 2012 growing at a double digit 10% higher than the 4% increase in the corresponding period of previous year.

- **The outlook remains highly tied to political uncertainties**

Overall, the political situation remains uncertain impacting confidence levels and creating a negative environment for tourism and investments. Still, Lebanon has proved to weather challenging operating conditions by maintaining relative stability including a well performing banking system, stable recurring income from Lebanese expatriates while avoiding a recessionary situation. Looking ahead, 2013 is not shaping to look much different than last year, the IMF forecasts for 2013 reflects a certain stability with a real GDP growth rate forecasted at 2.5% similar to the one estimated in 2012 (2%). The health of the Lebanese economy, including its capacity to attract capital and tourists, will remain closely linked to political developments. The most plausible scenario is that the overall economic sentiment will remain in a wait and see mode due to the fact that the country is still facing considerable challenges ahead as the prospects for a near term resolution in Syria are low, the fears regarding the Syrian's unrest spilling over into Lebanon still exist, and as the country heads towards parliamentary elections in 2013e within the context of no agreement on an electoral law and the recent resignation of the Mikati cabinet.

APPENDICES

Appendix 1: Financial highlights and forecasts

INCOME STATEMENT *(In USD millions)*	2010a	2011a	2012e	2013e	2014e
Revenues from land sales	**337**	**242**	**57**	**58**	**149**
as % of total revenues	*88%*	*80%*	*41%*	*41%*	*60%*
Revenues from property rentals	**41**	**50**	**51**	**53**	**65**
as % of total revenues	*11%*	*16%*	*37%*	*37%*	*26%*
Revenues from rendered services and hospitality	**3.96**	**12**	**12**	**14**	**16**
as % of total revenues	*1%*	*4%*	*9%*	*10%*	*6%*
Other Revenues including property sales	**-**	**-**	**18**	**19**	**19**
As % of total revenues	*0%*	*0%*	*13%*	*13%*	*8%*
Total revenues	**382**	**304**	**138**	**144**	**248**
Gross profits	**273**	**228**	**91**	**96**	**183**
Gross profit margin	*71.3%*	*75.1%*	*65.9%*	*66.8%*	*73.8%*
SG&A	**(43)**	**(38)**	**(39)**	**(41)**	**(42)**
EBITDA	**226**	**186**	**48**	**52**	**138**
EBITDA margin	*59.0%*	*61.4%*	*34.9%*	*36.2%*	*55.5%*
Net profits	**196**	**159**	**41**	**41**	**113**
Net profit margin	*51.1%*	*52.3%*	*29.7%*	*28.5%*	*45.5%*
EPS (Basic and Diluted)	**1.28**	**1.03**	**0.26**	**0.26**	**0.72**
EPS growth	*4%*	*-20%*	*-75%*	*0%*	*176%*
Return on Equity (ROE)	*10.7%*	*8.4%*	*2.1%*	*2.1%*	*5.7%*
Return on Invested Capital (ROIC)	*8.3%*	*6.3%*	*1.5%*	*1.5%*	*4.1%*

Source: Company reports, FFA Private Bank estimates

BALANCE SHEET *(In USD millions)*	2010a	2011a	2012e	2013e	2014e
Cash and balances	170	174	174	174	174
Accounts and notes receivables	487	551	549	536	581
Inventory of land and projects	1,084	1,178	1,218	1,268	1,318
Investment properties	443	445	439	473	506
Other assets	417	435	435	435	435
Total assets	**2,600**	**2,783**	**2,815**	**2,887**	**3,015**
Total liabilities excluding debt	281	257	177	178	202
Total debt	481	590	700	770	801
Shareholders' equity	1,838	1,936	1,938	1,939	2,013
Total liabilities and shareholders' equity	**2,600**	**2,783**	**2,815**	**2,887**	**3,015**
Current ratio	*0.99*	*1.03*	*0.99*	*0.89*	*0.89*
Net debt/EBITDA	*1.4*	*2.3*	*11.9*	*12.4*	*4.7*
Net debt/total capitalization	*13.4%*	*16.5%*	*19.9%*	*22.0%*	*22.3%*

Source: Company reports, FFA Private Bank estimates

CASH FLOW *(In USD millions)*	2010a	2011a	2012e	2013e	2014e
Cash flow from operations	**(37)**	**(0)**	**(64)**	**(24)**	**15**
CAPEX	(30)	(20)	(9)	(9)	(9)
Free cash flow	**(67)**	**(20)**	**(73)**	**(33)**	**6**
Dividends paid	159	63	39	39	39

Source: Company reports, FFA Private Bank estimates

Appendix 2: SWOT Analysis

Strengths	Weaknesses
• Strong domestic franchise with a prime land bank • Resilient real estate prices for land and properties • High operating margins and relatively cleaner balance sheet • Positive track record despite challenging macroeconomic and political conditions	• Business model based on a finite land bank • High dependence on land sales in a limited geographic area • Significant client concentration
Opportunities	**Threats**
• Attractive long-term fundamentals in the real estate sector • Demand from Gulf nationals and Lebanese expatriates • Potential to reduce dependence on land sales by increasing rental and other income from current levels	• High sensitivity of the real estate sector to macroeconomic conditions • Uncertainty from domestic political instability and regional turmoil hurting investor sentiment

Source: FFA Private Bank

Appendix 3: Comparable valuation

Name	Ticker	Market Cap (USD million)	Div. Yield %	Sales Growth %	EPS Growth %	EBITDA Margin %	Debt/ Cap %	ROA %	ROE %	EV/ EBITDA	P/E	P/B
Solidere A*	SOLA LB	2,004.8	2.1	-20.6	-19.9	61.4	23.4	5.9	8.4	13.0	11.8	1.0
Emaar Properties PJSC	EMAAR UH	8,689.9	1.9	2.6	20.7	38.2	23.1	3.5	6.6	11.5	15.0	1.0
Dar Al Arkan Real Estate	ALARKAN AB	2,375.9	n/a	7.4	-8.9	34.9	21.2	4.3	6.2	10.3	9.0	0.5
Emaar Economic City	EMAAR AB	2,198.5	n/a	32.7	123.0	52.5	40.6	1.4	2.5	31.6	43.9	1.1
Aldar Propeties PJSC	ALDAR UH	1,683.8	4.3	68.6	100.0	27.8	63.1	3.7	17.6	5.5	4.6	0.7
Sorouh Real Estate	SOROUH UH	1,200.7	3.6	-20.4	33.1	15.4	24.9	3.1	6.8	11.9	9.8	0.7
Deyaar Dev. PJSC	DEYAAR UH	487.7	n/a	-43.3	3.1	17.5	18.5	0.6	1.0	24.6	46.3	0.5
Union Properties PJSC	UPP UH	360.2	n/a	-66.3	n/a	7.3	58.7	1.9	7.1	35.4	8.2	0.5
Palm Hills Dev. SAE	PHDC EY	298.6	n/a	-30.0	58.9	-39.4	42.5	-0.9	-3.9	n/a	n/a	0.6
Six Of October Dev.	OCDI EY	252.4	n/a	133.2	n/a	22.3	16.7	3.8	12.4	5.4	6.8	0.8

*Note: *Solidere shares A are priced as of market close on April 2nd 2013*
Source: Bloomberg priced as of market close on April 2nd 2013, Company reports