FFA Private Bank s.a.l.

SOLIDERE - Lebanese Real Estate

Equity Research Update

December 15, 2014

SOLA: USD 11.18, SOLB: USD 11.22

Recommendation: OVERWEIGHT

Target Price: ↓ USD 15.50

We expect earnings to see solid improvement in 2014e, while sustainable acceleration should take place upon a significant rebound in land sales. Although we see inherent value in the shares for long term patient investors, we remain cautious in the shorter term and point to a high sensitivity to the political and investment climate

■ **The first ten months of 2014 saw a shy improvement in sales activity following years of contraction.** In 10M/14, number of real estate transactions nudged up 4% YoY following three straight years of contraction. However, real estate activity did not regain significant momentum and remained subdued in the high-end market entailing big transactions as GCC nationals and wealthy Lebanese expatriates with strong purchasing power have shied away from the market due to rising negative investment sentiment. Developers continued shifting towards smaller-sized apartments and less expensive residential areas located outside the capital city as demand is now being driven by less affluent nationals. The area of issued construction permits was on an upward trend in 8M/14 (+11% YoY), while cement deliveries remained unchanged.

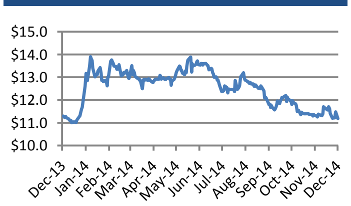
■ **National property prices are holding up yet struggle in high-end markets.** While national property prices have been relatively holding up, we have been seeing some price reductions and discounts specifically in the high-end market. A market study issued by Ramco in April 2014 based on a panel of 65 buildings located in Beirut, showed that 22% of total units that were delivered in 2013 remain unsold. Given stagnation in demand, developers have been reducing prices and offering discounts during negotiations ranging between 10% and 20% according to market experts. In the BCD the most expensive units are located in the waterfront where starting prices are in the USD 7,000-8,000/sqm range vs. USD 4,500-6,000/sqm in the traditional area inc. Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square, down from higher levels previously.

■ **We expect Solidere's earnings to see solid improvement in 2014e on account of higher land sales picking up from a low base in 2013**. Solidere should see improved financial results in 2014e. We estimate Solidere to more than double 2013's net profits to an estimated USD 91 million and EPS of USD 0.57 on total revenues of USD 205 million, mainly driven by stronger revenues from land sales at USD 140 million from four transactions vs. USD 95 million in 2013. We expect rental income to move gradually higher to reach USD 54 million in 2014e vs. USD 52 million last year as it has already absorbed the impact of facilities to tenants. Revenues from rendered services should remain flat at USD 8 million, while hospitality should continue to wind down to USD 3 million in 2014e. For 2014e, gross profit margins should see improvement to 74% vs. 69% in 2013 from favorable revenue mix involving more land sales particularly in the waterfront area. Reminder that net profits were almost nil in H1/14 from no recognition of land sales, leaving responsibility to the back half to drive annual earnings.

■ **Expect continued containment in opex and slowdown in capex, facing weaker operating conditions to help cash flows.** We expect SG&A as % of revenues not to exceed 16% in 2014e compared to 21% in 2013 as Solidere maintains its cost tightening policy. We expect operating margins to also benefit from Solidere International which contributed USD 9.4 million in H1/14. Capex in 2014e should remain contained and principally allocated to the completion of the waterfront's utilities network and the department store. Other infrastructure including the eastern marina, the landscaping of the park as well as other properties in the pipeline were delayed as part of the strategy to help cash flows.

■ **We still recognize favorable upside for patient long term investors, despite remaining cautious for the shorter term.** We value Solidere's position as the prime land owner and master developer in the BCD, its track record, attractive margins, and attempts at revenue diversification to offset the depletion of its land bank. However, we remain cautious as the uncertain economic and political backdrop has materialized 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 environment on the property market and Solidere's land sales which remain the key driver for cash generation. Yet, we favorably view the decision to defer some investments to help cash flows and see upside potential for patient long term investors upon a rebound in land sales, completion of the real estate pipeline and the waterfront infrastructure giving additional value to the BCD.

SOL A 1 year Share Performance



Share Price Information

Market cap.	1,847.3 million
Shares	165 million
Dividend yield	n/a
Δ 1M	-1.3%
Δ 3M	-5.2%
Δ YTD	1.2%
Δ 12M	-1.0%
52-Week range	USD 11.00-14.14

Key Performance Indicators

In USD millions	**2012a**	**2013a**	**2014e**	**2015e**
Revenues	117	159	205	210
EBITDA	40	51	108	117
Net income	18	43	91	97
EPS (USD)	0.11	0.27	0.57	0.61
P/E	103.0	42.0	19.7	18.4
P/B	0.94	0.92	0.88	0.84
EV/EBITDA	59.2	46.2	21.9	20.2

Source: BSE, Company reports, FFA Private Bank estimates, Note: Solidere A shares are priced as of December 15, 2014

■ **We revised our target price on Solidere shares to USD 15.50 from USD 17.00 previously while keeping our Overweight recommendation unchanged.** Our USD 15.50 fair value estimate is derived using a sum of the parts approach and implies a P/B of 1.2x based on our 2014e estimated BVPS, in line with the four year average. We accordingly maintain an Overweight recommendation given the current price is at a discount of more than 10% to our fair value estimate, recognizing value for long term investors despite remaining cautious in the shorter term against an uncertain political and economic backdrop impacting the property market and investor sentiment. Upside risks include the election of a president and the easing of local tensions related to the Syrian crisis.

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SOLIDERE

Company Description

The Lebanese Company for the Development and Reconstruction of Beirut Central District known as Solidere is the largest real estate player in Lebanon in terms of assets with an asset base at USD 2.9 billion at the end of H1/14 and a 1.8 million sqm BUA land bank left in the BCD (of which ~80% in the waterfront and ~20% in traditional). The Company's business model is primarily based on revenues from land sales and the strategy is to strengthen revenues from recurring sources of which rental income, as well as proceeds from rendered services. The last two years showed an average contribution of land sales to total revenues at ~50% compared to 85%+ in the previous five-year period as a result of decelerating land sales activity. Solidere International was founded in 2007 in order to expand operations largely outside Lebanon, notably in the region. Solidere owns 39% of Solidere International whereby projects are currently focused in KSA and in UAE via Al Zorah. Solidere shares are listed and traded on the Beirut Stock Exchange (tickers: SOLA, SOLB) and its GDRs on the London Stock Exchange.

Solidere Key Consolidated Financial Highlights in H1/14

Net profits were USD 0.6 million in H1/14, leaving responsibility to the back half to drive earnings

- The Company saw no recognition of land sales in H1/14 as transactions get typically closed in the back half of the year.
- Lack of land sales recognition dragged down revenues and overall margins given their high margin nature.
- Rented properties and rendered services were roughly in line with expectations while the hospitality business continued to shrink as Solidere winds down the business.
- Significant contribution from Solidere International at USD 9.4 million.
- While USD 1.3 million were booked in net provisions, no income taxes were allocated.
- Operating expenses were heavy on one-time expenses, not likely to be repeated in H2 as Solidere maintains its cost tightening policy.
- Net debt levels were tracking higher on rising working capital needs, reaching USD 535 million up from USD 509 million at the end of 2013.

Solidere Key Consolidated Financial Highlights in 2013

Net profits were up to USD 42.6 million in 2013, higher than previous year yet still significantly lower than historical average prior to real estate slowdown

- Net profits on a consolidated basis at USD 42.6 million in 2013, up 147% YoY although lower than previous periods prior to the real estate slowdown.
- Revenues reflect three land sales, lower revenues from rented properties and flat revenues from combined rendered services and hospitality.
- Revenue mix shows greater contribution from land sales compared to 2012.
- Higher proportion of land sales in the revenue mix, coupled with improved margins from rented properties, now positive margins on rendered services, and cost containment drives margins improvement.
- Flat debt levels as Solidere maintains cautious strategy involving some investments deferrals and cost tightening initiatives.
- No dividend distribution was proposed for 2013 to fit the cautious growth plan in the near term.

Solidere International (SI) Key Highlights in 2013

Net profits at USD 11.3 million in 2013 and exposure mostly on KSA

- Projects include: Al Zorah Development (Ajman, UAE), Uptown Park (Hazmieh, Lebanon), Golden Tower (Jeddah, KSA), Wadi Qortuba (Riyadh, KSA), Takhassussi Residences (Riyadh, KSA), Rebirth of Duhaira (Riyadh, KSA), Al Malga Development (Riyadh, KSA), Rayat Obhur (Jeddah, KSA).
- Net income for 2013 at USD 11.3 million (up from USD 7.8 million in 2012) on account of sizeable liquidity with liquid assets (cash and bank balances) at USD 127 million at the end of 2013.

Solidere's Strategy Update

- **Focus on land sales given difficult operating conditions:** Solidere's key focus is on land sales in light of current market conditions which are materializing into slower activity. Management is seeking to accelerate land sales by putting efforts in negotiations and offering easier payment terms given no major downward revision in selling prices.

- **Capital spending deferrals and securitization deal to ease pressures on operating cash flow:** To alleviate pressures on cash flows in light of slower land sales, Solidere is reducing and deferring some of its capital spending in infrastructure and property development, which we view as a favorable measure for the cash position. The USD 185 million securitization and transfer of receivables into instruments also helped to alleviate pressures on working capital last year.

- **Cost tightening policy to help the bottom line:** Cost tightening policy is being maintained facing weak operating revenues by reducing overheads and gradually decreasing general and administrative expenses.

Recent Performance of Solidere Shares

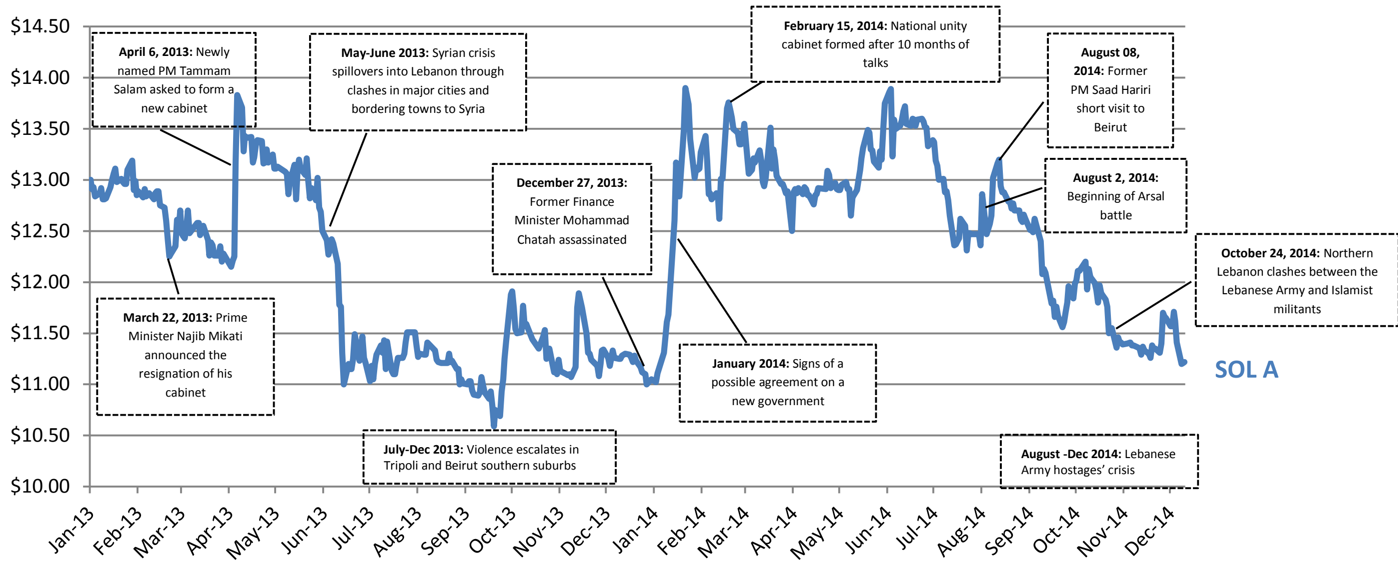
We continue to believe that Solidere shares reflect investors' sentiment which has been impacted by rising political uncertainties and softer market conditions

Solidere shares rose in January 2014 likely driven by signs of possible agreement on a new cabinet formation, virtually reaching the USD 14 level after the share price remained below the USD 12 level for the previous seven months. The cabinet was formed in February 2014. Shares ended up stabilizing in the USD 12 - USD 14 range in the March 2014 - September 2014 period. In September 2014 shares slipped back below the USD 12 level on rising political and security fears.

At today's market price Solidere A and B shares closed at USD 11.18 and USD 11.22 respectively, which represents shy 1.2% and 1.8% Ytd increases respectively and likely reflects a cautious investor sentiment influencing the real estate market and materializing into difficult operating conditions.

At the current share price, Solidere A shares trade at a premium valuation to peers in terms of P/E: 19.7x on our 2014e estimates and 42.0x on 2013a vs. a MENA average of 15.2x (info available in appendix 2). This premium can be attributed to Solidere's soft land sales, undiversified revenue stream dependent on land sales, unfavorable operating leverage and provisions driving down EPS. On a P/B basis however, Solidere's shares currently trade in line with the MENA average at 0.9x.

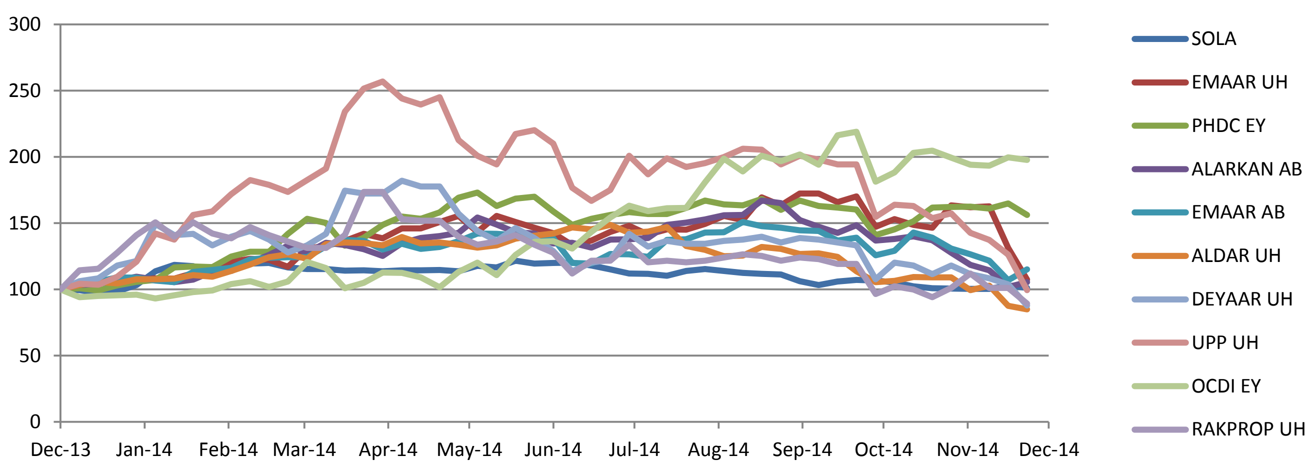
Figure 1: Solidere A share performance and selected political and security events



Source: BSE, Media Reports

We are concerned in the short term as we expect earnings to remain dependent on market conditions and no restart of dividend distribution which could add to income-oriented investor anxiety. Ultimately, Solidere shares represent a vote of confidence on Lebanon and as such are subject to sentiment swings from the reaction to volatile security and political developments. Key determinants are linked to the domestic political impasse and the spillovers of the Syrian and regional unrest.

Figure 2: Solidere A one year share performance vs. regional peers



Source: Weekly figures from Bloomberg priced as of December 12, 2014
Note: All companies' tickers and corresponding names are present in appendix 2

While we believe that Solidere shares hold potential for long-term patient investors, we note a cost of opportunity vis-a-vis other MENA real estate players. As highlighted in the graph above which illustrates the share performance of major MENA real estate players, Solidere shares have underperformed peers over the past year although exhibiting less volatility.

Financial Highlights and FFA Key Model Assumptions

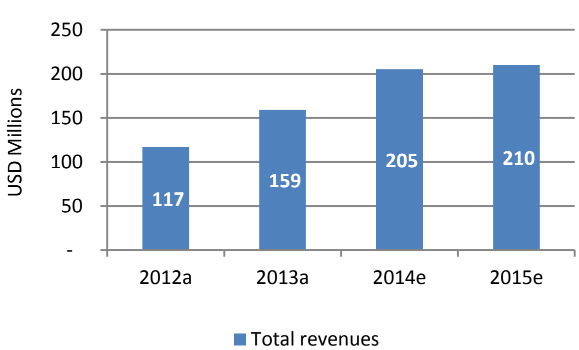
While Solidere saw no recognition of land sales in H1/14, we expect land sales for 2014e to be higher than 2013 and substantial acceleration to remain tied to investment climate

Gross revenues amounted to USD 39 million in H1/14 generated from rental income and property management as Solidere saw no recognition of land sales in the first half, as the firm typically closes transactions in the back half of the year while there was no drawdown on sales backlog. Solidere now carries a sales backlog of nearly USD 40 million and an unsold land bank of 1.83 million sqm BUA split nearly 80%/20% between waterfront and traditional areas, respectively.

We have modeled 35,000 sqm worth of land sales for 2014e from contracts that should be signed in the back half of the year, equivalent to four plots (compared to three in 2013 totaling ~ 30,000 sqm) at a price of USD 3,250/sqm in the traditional area and USD 4,300/sqm on the waterfront averaging USD 4,000/sqm. These assumptions should drive land sales to USD 140 million in 2014e vs. USD 95 million in 2013. Reminder that Solidere has been facilitating payment terms while remaining stiff on pricing. For 2015e, land sales should amount to USD 144 million.

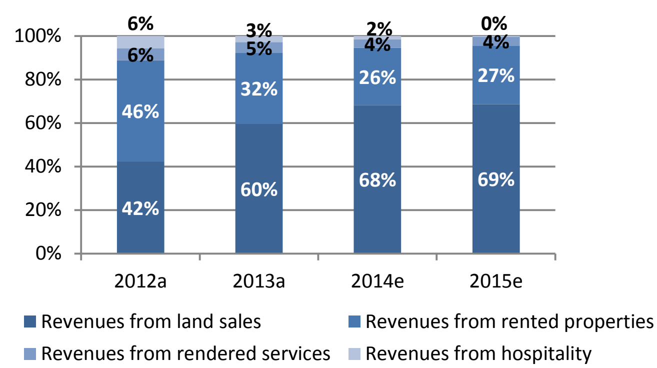
More generally, we expect Solidere's land sales to remain moderate in the short term reflecting softer real estate market given difficult macroeconomic and political conditions, including risk of increased spillovers from neighboring Syria. The slowdown in the real estate market since 2011 which steepened in 2012 and 2013 and carried into 2014 is compounded by the high ticket transactions that land sales entail given prime locations in the BCD at above average land sizes.

Figure 3: Total gross revenues



Source: Company reports, FFA Private Bank estimates

Figures 4: Gross revenues breakdown



Source: Company reports, FFA Private Bank estimates

Note: Gross revenues exclude net proceeds from property sales averaging USD 4.3 million/year in 2012-2013 and expected at same level in 2014e-2015e

Longer term, we expect Solidere to ramp up sales regaining some momentum if market conditions improve and a tangible improvement in investor sentiment is felt.

Saifi and Mina El Hosn residential projects hold potential for additional revenues in 2014e from apartment sales

In addition to its core business of land sales, Solidere has a potential to generate additional revenues from residential units sales to tenants wishing to acquire apartments rented upon expiration of leases. Those properties are owned by Solidere and are located across the BCD more specifically in the Saifi and the Mina El Hosn areas. In 2013, Solidere results comprised a USD 4.2 million gain from the sale of investment properties including units in Saifi and Mina El Hosn.

While no proceeds from the sale of residential units across the BCD area were registered in H1/14, we have forecasted similar proceeds as in 2013 to be generated in the back half of 2014e based on Management's indications.

Rental income was little ahead of estimates in H1/14, while income from rendered services came in slightly softer than expected and hospitality continued to wind down. For the full year 2014e, we expect slightly higher rental income, roughly flat revenues from rendered services and lower revenues from hospitality versus 2013

Rental income was at ~ USD 27 million in H1/14 slightly stronger than estimates accounting for the bulk of gross revenues (~70%) as no land sales were recognized during the first half of the year. Income from rendered services came in softer in H1/14 at ~ USD 4 million. Income from hospitality continued to narrow amounting to USD 1.5 million in H1/14.

For the full year 2014e, we forecasted a slightly higher rental income compared to 2013 at USD 54 million up from USD 52 million as it already absorbed the impact of credit facilities to tenants and includes an additional USD 1 million rent from the Cineplex. Regarding income from rendered services, we have forecasted a roughly similar amount to last year at USD 8 million. Revenues from hospitality should continue to trend downwards in the back half of 2014e resulting from downsizing, down to our expected USD 3 million in 2014e from USD 4 million + last year. Overall, revenues from recurring sources should remain roughly similar to 2013 at ~USD 65 million, as slightly higher rental income should offset lower revenues from hospitality within mostly unchanged revenues from rendered services.

Looking at 2015e, revenues from recurring sources should remain roughly unchanged as hospitality downsizing is likely to be offset by gradually higher rental income and revenues from rendered services.

Table 1: Real estate property portfolio

	Current			Pipeline	
Real estate property portfolio	Pre-Souks portfolio	South Souks	Other including Parking, Marina	North Souks	Additional properties in the BCD: Residential, mixed-use, office block
Completion date	Completed	Completed	Completed	Cineplex: Completed Department store: 2017 Annexes to the Cineplex and department store: Delayed	Delayed
Leasable space	90,000 sqm	54,000 sqm			

Source: Company reports

Longer term, we expect rendered services to gradually increase as the completion of the pipeline development portfolio adds to leasable space, while revenues from hospitality should become negligible in line with the Company's strategy to wind down an unprofitable line of business.

Regarding rental income, we expect the completion of real estate developments in the pipeline to continue to add to existing rental income. Solidere has delayed most planned developments except the Cineplex and the department store to preserve its liquidity position within a slowdown in land sales. While the Cineplex was completed and already generates revenues, the next focus is on the department store which is expected to be completed by the end of 2016e and start generating revenues in 2017e. All other pipeline developments are postponed for later completion. Ultimately and upon completion of all planned developments, rental income should pick up from current levels.

Contribution from land sales lower than historical average due to decelerating activity but still the main driver of business

While no land sales were recognized during H1/14, most recent full year results point to lower contribution from land sales averaging 50% in the 2012-2013 period down from an average of 88% in the previous five-year period. This lower contribution can be explained by a gradual increase in rental income and more importantly by a steep drop in land sales starting 2012.

Our forecasts for 2014e, translate into a contribution of land sales, rental income, rendered services and hospitality to gross revenues at 68%, 26%, 4% and 2% respectively as compared to 60%, 32%, 5% and 3% in 2013 respectively on higher land sales YoY. Our assumptions for 2015e, translate into a revenue mix at 69%, 27%, 4% and 0% as all business segments continue growing and hospitality business continues to shrink.

Longer term, Solidere will continue deploying efforts to grow recurring revenues by strengthening rental income and property management as it seeks to decrease its reliance on land sales given the future depletion of its land bank.

Table 2: Main assumptions 2014e-2015e

Main Assumptions	Notes
Land sales (in USD/sqm BUA)	Selling prices of USD 3,250 in the traditional area and USD 4,300 in the waterfront area, with a weighted average price of USD 4,000 growing at the rate of inflation
Land sales (in sqm BUA)	Land sales of 35,000 sqm in 2014e and 2015e
Rental income	Gradual increase in rental income over the short term while substantial increase should be seen longer term upon completion of planned developments
Rendered services & hospitality	Flat income from rendered services in 2014e, moving gradually higher in 2015e Income from hospitality to continue to wind down
Margins	Gross margins on land sales ~85% Gross margins on rental income ~55% Gross margins on rendered services ~22%
Expenses	Cost containment and decrease in the amount of SG&A as % of gross revenues in the short term
Dividend payout	Dividend distribution not expected to be reinstated in the short term
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

In H1/14 overall gross margins trended unfavorably in the absence of recognized land sales, yet should trend higher for the full year 2014e on higher land sales YoY particularly in the waterfront

In H1/14 gross margins were dampened by the absence of recognized land sales which typically entail high margins, while segment margins were at 50% for rental income and 24% for rendered services.

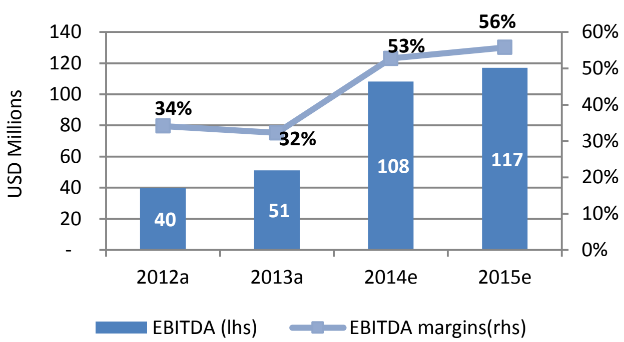
In 2014e and 2015e, we expect land sales margins to be around 85% up from 80% in 2013 from favorable revenue mix involving more land sales particularly in the waterfront. Gross margins on rental income should move closer to 55%. While gross margins on rendered services should be around 22%. Overall, gross profit margins should see improvement to 74% in 2014e and 77% in 2015e vs. 69% in 2013.

Longer term, we forecast gross margins from land sales to move towards 90% and gross margins from rental income should also trend higher towards 60% from 55% currently as newer developments command higher rents. Gross margins from rendered services should remain stable at 22%.

Although SG&A came in heavier than expected in H1/14, we expect cost tightening initiatives to continue to alleviate pressures to the bottom line

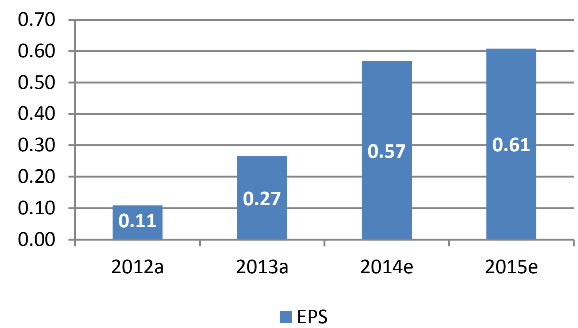
SG&A costs came in higher than expected in H1/14 at ~USD 19 million largely on one-time expenses. We expect the back half of the year to see lower SG&A costs than in the first half as the Company continues to reduce its SG&A. Based on our assumptions, SG&A for the full year 2014e are expected to trend slightly higher than previous year to reach USD 34 million vs. USD 33 million in 2013. We expect SG&A as % of gross revenues not to exceed 16% in 2014e-2015e as Solidere maintains its cost tightening policy. We expect operating margins to also benefit from Solidere International which contributed USD 9.4 million in H1/14. EBITDA should reach USD 109 million in 2014e and USD 117 million in 2015e compared to USD 51 million in 2013 with an EBITDA margin at 53% in 2014e and 56% in 2015e as compared to 32% in 2013.

Figure 5: EBITDA and EBITDA margins



Source: Company reports, FFA Private Bank estimates

Figure 6: EPS (in USD)



Source: Company reports, FFA Private Bank estimates

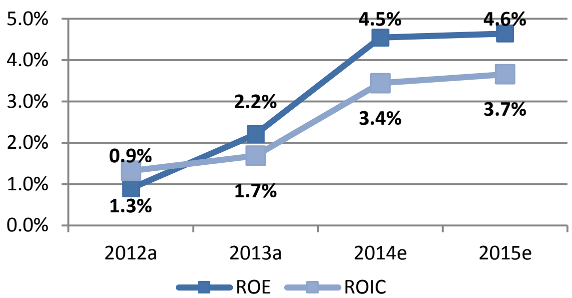
Net profits were USD 0.6 million in H1/14 or 0.00 EPS, leaving responsibility to the back half of the year to drive earnings closer to our USD 91 million estimate in 2014e and versus USD 43 million in 2013. This expected improvement in the bottom line YoY should be mainly driven by a higher amount of land sales from a low base in 2013 and a higher contribution from Solidere International despite some provisioning for the impairment of fixed assets (hospitality) which should continue to exert some pressures on profits in the short term. We forecast EPS at USD 0.57 in 2014e and USD 0.61 in 2015e up from USD 0.27 in 2013e. We do not expect a dividend distribution to resume this year as the focus remains on preserving cash flows.

Longer term, we expect total revenues and total net profits to substantially increase only upon acceleration in land sales activity driven by an improvement in investors' sentiment.

Tightening and delays in capex are compensating for slower operating cash flows

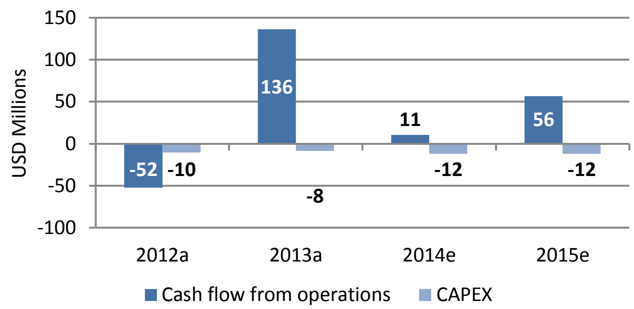
In H1/14 net debt levels were tracking higher on rising working capital needs to reach USD 535 million up from USD 509 million at the end of 2013. Net debt to total capitalization was 20.2%, up from 19.3% in 2013 (net debt/EBITDA at 9.9x in 2013).

Figure 7: ROE and ROIC



Source: Company reports, FFA Private Bank estimates

Figure 8: Cash flow from operations and Capex



Source: Company reports, FFA Private Bank estimates

We expect Solidere to continue reducing and deferring some of its capital spending in infrastructure and property development, a favorable measure for its cash position in light of difficult operating conditions.

Solidere has extended the completion of the reclaimed area infrastructure over a longer period of time and has reviewed the related capital spending downwards to ~ USD 125 million from USD 200 million + previously. By order of expected completion, the reclaimed area infrastructure includes: the utility network (currently under execution, expected completion in 2016e), the eastern marina (execution to start by mid 2015e), and the park. Solidere also postponed development projects in the pipeline except for the department store (expected completion in 2016e).

Table 3: FFA model forecasts 2014e-2015e

Key Performance Indicators				
In USD millions	**2012a**	**2013a**	**2014e**	**2015e**
Revenues from land sales	**50**	**95**	**140**	**144**
As % of total revenues	*42%*	*60%*	*68%*	*69%*
Revenues from rental portfolio	**54**	**52**	**54**	**57**
As % of total revenues	*46%*	*32%*	*26%*	*27%*
Revenues from rendered services	**7**	**8**	**8**	**8**
As % of total revenues	*6%*	*5%*	*4%*	*4%*
Revenues from hospitality	**7**	**4**	**3**	**1**
As % of total revenues	*6%*	*3%*	*2%*	*0%*
Total gross revenues	**117**	**159**	**205**	**210**
EBITDA	**40**	**51**	**108**	**117**
EBITDA margin	*34.1%*	*32.2%*	*52.7%*	*55.8%*
Net income	**18**	**43**	**91**	**97**
Net income margin	*15.7%*	*26.8%*	*44.2%*	*46.2%*
EPS (USD)	**0.11**	**0.27**	**0.57**	**0.61**
P/E	103.0	42.0	19.7	18.4
P/B	0.94	0.92	0.88	0.84
EV/EBITDA	59.2	46.2	21.9	20.2

Source: Company reports, FFA Private Bank estimates
Note: Gross revenues exclude net proceeds from property sales averaging USD 4.3 million/year in 2012-2013

Investment Opinion

We still see inherent value in the land bank and recognize favorable upside for patient long term investors, despite remaining cautious for the shorter term given that the uncertain economic and political backdrop has materialized into slower operations

We recognize Solidere's position in its domestic market as the prime land owner and master developer in the Beirut Central District (BCD), its track record in developing superior quality properties and infrastructure, and attempts at revenue diversification to counterbalance the depletion of its land bank. We like the firm's relatively higher operating margins and lower levels of indebtedness relative to peers. However we remain cautious as we have been 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 and the Company's land sales, which remain the key driver for cash generation. Yet we favorably view Management's decision to defer some upcoming investments to alleviate pressure on cash flows and see upside potential for patient long term investors upon a rebound in land sales, the completion of the real estate pipeline and the waterfront infrastructure providing additional value to the BCD.

Valuation

We value Solidere shares at USD 15.50 per share down from USD 17.00 per share previously using a sum of the parts approach under the following:

- We value the land bank of 1.8 million sqm of BUA down from 1.9 million sqm previously with an average selling price of ~USD 3,700.
- 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% 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 and proportional ownership in two KSA-focused real estate funds.

We derived ~USD 3,700 per sqm as the weighted average selling price for the land bank of Solidere from an estimated end user property price of USD 7,000 per sqm BUA in the waterfront area and USD 4,500 per sqm BUA in the traditional area using the low range of starting prices based on FFA Real Estate's estimates. We also assumed a developer margin of 10% and average construction costs of USD 2,250 per sqm BUA. We applied a discount of 55% 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 company specific 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 15.50 down from USD 17.00 previously.

We estimate every 5% change in the discount to our land bank NAV impacts our value per share estimate by USD 1.50. Our USD 15.50 fair value estimate implies a P/B of 1.2x based on our 2014e estimated BVPS.

Table 4: Sum of the parts valuation

Sum of the Parts Valuation	in USD millions	Per share	Notes
Land Bank:			
Average selling price in BUA	USD 3,659		Estimated end-user prices less 10% margin and USD 2,250/sqm construction costs
Land bank in sqm BUA	1.83		Remaining land bank split 80% waterfront and 20% in traditional
Revenues	6,696.1		
Infrastructure	125.0		Remaining infrastructure to complete land bank, mainly utilities, marina, landscaping
Opex	640.0		
EBIT	5,931.1		
Taxes 15%	889.7		
Net Asset Value (NAV)	5,041.5		
Premium (discount)	(55.0%)		Reflect liquidity, credit, cyclicality, market and political risks
Land Bank	**2,268.7**	**14.17**	Book value adjusted to estimated end user prices
Investment Properties	**228.4**	**1.43**	DCF on current properties and those in pipeline, property management at 15% WACC
Investment in Associate	**169.8**	**1.06**	Share of liquid assets* and proportional ownership in two KSA focused real estate funds
Add:			
Cash	160.0	1.00	100% book value
Prepayments & other debit	42.9	0.27	100% book value
Accounts and notes receivables	437.8	2.73	100% book value
Fixed assets	57.8	0.36	100% book value
Total Other Assets	**698.5**	**4.36**	100% book value
Less:			
Total Liabilities	**(909.3)**	**(5.68)**	100% book value
Value	**2,456.1**	**15.34**	
# of shares (net of treasury)	160.2 m		
Value per share	USD 15.34		
Value Per Share (rounded)	**USD 15.50**	**15.50**	

Source: Company reports, FFA Private Bank estimates Note: *Cash and investments in 2013 financials

Target Price Revision and Recommendation

We revised our target price on Solidere shares to USD 15.50 down from USD 17.00 previously while keeping our Overweight recommendation unchanged recognizing long term value

Our fair value estimate was revised downwards to USD 15.50 per share from USD 17.00 per share previously using a sum of the parts approach, which implies a P/B of 1.2x based on our 2014e estimated BVPS, in line with the four year average. We accordingly maintain the Overweight recommendation given that the current price is at a discount of more than 10% to our fair value estimate, recognizing value for long term investors despite remaining cautious in the shorter term against an uncertain political and economic backdrop impacting the property market and investor sentiment. Upside risks include a smooth presidential elections process and favorable outcome to Syrian crisis.

Key Investment Risks

- Cyclical nature of the real estate sector and high sensitivity to macroeconomic conditions.
- Business model based on a finite land bank.
- High dependence on land sales in a limited geographic area with a large client concentration.
- Political instability and heightened security events in Lebanon.

REAL ESTATE SECTOR HIGHLIGHTS

The first ten months of 2014 saw a shy improvement in sales activity following years of contraction

We remind that since the Syrian crisis erupted in 2011, the Lebanese real estate market has been in a slump as highlighted by a decrease in the number of real estate transactions for three consecutive years: -12% in 2011, -10% in 2012 and -7% in 2013 according to the figures released by the Real Estate Registry.

In the first ten months of 2014, number of transactions were up 4% YoY from a low base in 2013 following three straight years of sales contraction. This slight improvement should be interpreted with caution as it is difficult to look at the numbers and know whether they reflect sales which already happened in 2014 or if they happened earlier and are only being recorded because units are ready to be turned over to their owners. In addition, we note that there was a more notable YoY acceleration in the early months of 2014 on improved sentiment from government formation after months of vacuum which seems to have been partially offset in following months due to deterioration in security conditions, highlighting the high sensitivity of the real estate sector to political and security developments.

Despite this slight YoY increase in the cumulative number of real estate transactions in 10M/14, real estate activity continued to be soft in light of depleted sentiment amid soft economic conditions and rising political and security concerns. The activity slowdown is particularly being felt in the high-end market entailing big transactions tickets (large apartments in prime locations) where limited transactions are taking place and some developers are putting plans on hold in hopes of better days ahead.

Table 5: Real estate transactions in Lebanon

	2009	2010	2011	2012	2013	10M/13	10M/14
Value of RE transactions(USD billion)	**6.96**	**9.48**	**8.84**	**8.93**	**8.71**	**6.89**	**7.41**
YoY Change	*7%*	*36%*	*-7%*	*1%*	*-2%*	*-*	*7%*
Number of RE transactions	**83,622**	**94,320**	**82,984**	**74,569**	**69,198**	**55,794**	**58,154**
YoY Change	*5%*	*13%*	*-12%*	*-10%*	*-7%*	*-*	*4%*
Average value per transaction (USD)	**83,172**	**100,498**	**106,539**	**119,701**	**125,842**	**123,539**	**127,478**
YoY Change	*3%*	*21%*	*6%*	*12%*	*5%*	*-*	*3%*

Source: Real Estate Registry

Central Bank continues to support real estate demand by subsidizing housing loans at a time of market activity slowdown

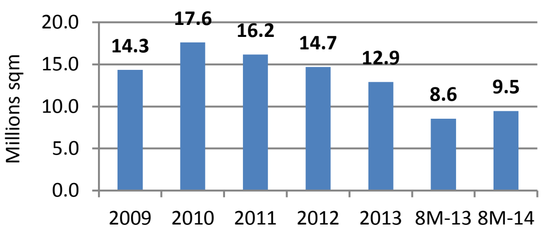
It is worth mentioning that Central Bank's policies are being accommodative and supportive towards some sectors of the Lebanese economy in particular real estate, with the aim of stimulating lending. The BDL has been offering interest rates subsidies on loans granted by banks to some consumer and productive sectors by extending loans to commercial banks at a 1% interest rate, which in turn allow banks to provide loans at reduced interest rates. The first stimulus package amounted to USD 1.5 billion was put at the disposal of commercial banks in 2013. The plan was extended to 2014 with a total of USD 800 million. The Central Bank recently announced an economic stimulus package of USD 1 billion for 2015. These incentive packages helped demand for housing at a time of market activity slowdown as housing loans accounted for more than half of the financial facilities offered by the Central Bank so far.

Looking at figures released by the BDL, we note that lending activity increased at a 13% CAGR in Lebanon during the last five years, while a more vigorous growth was registered in housing loans growing by a 36% CAGR over the same period. At year-end 2013, the total housing loans portfolio reached USD 8.5 billion representing 18% of Lebanese banks' total loan portfolio vs. ~7% five years earlier.

Despite construction permits trending positively so far in 2014, this year has been a hard year for developers who continue to adapt to a buyer's market

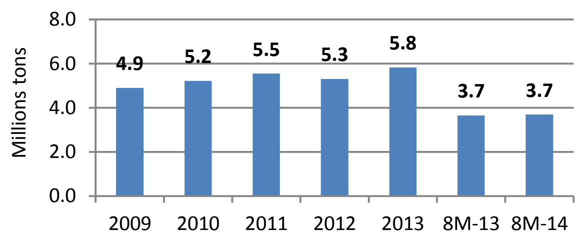
So far this year, total area of construction permits a leading indicator of forthcoming activity in the sector displayed positive 11% YoY growth in 8M/14, following three years of consecutive declines (-8% in 2011, -9% in 2012 and -12% in 2013). In parallel, cement deliveries, the coincident indicator of construction levels, remained unchanged in 8M/14 versus 8M/13.

Figure 9: Issued construction permits in area



Source: BDL

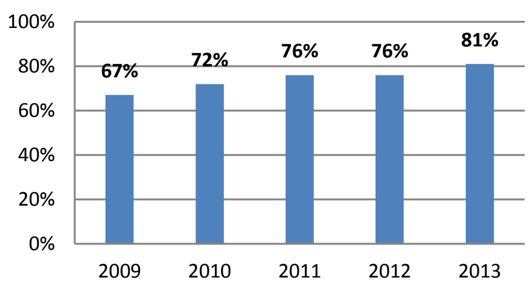
Figure 10: Cement deliveries in weight



Source: BDL

Despite construction permits trending favorably, 2014 has been another tough year for developers who had to adapt to a buyer's market. As such we have been witnessing the emergence of new supply trends echoing changing characteristics on the demand side of the market. While wealthy Arab nationals and Lebanese expatriates who typically used to fuel the demand for big-ticket transactions have shied away from the market due to depleted sentiment, the existing demand is being driven by less affluent nationals looking for an apartment based on real living needs rather than for investment purposes. Reflecting this change in demand characteristics, developers are shifting towards smaller-sized apartments as buyers are now less inclined to make high-ticket property purchases. Figures released by the Order of Engineers in Beirut point to the fact that the share of units below 200 sqm has been trending higher over the past couple of years to reach 81% in 2013 up from 67% in 2009.

Figure 11: Share of units below 200 sqm in new residential units



Source: Order of Engineers of Beirut

Table 6: Breakdown of area of issued construction permits by region in 2012 and 2013

	2012	2013	YoY%	2013 Share
Beirut	1,095,716	615,050	-43.9%	6%
Mount Lebanon	7,296,462	6,064,286	-16.9%	58%
Bekaa	1,330,048	1,330,994	+0.1%	13%
South Lebanon	1,558,677	1,380,624	-11.4%	13%
Nabatiyyeh	926,045	1,008,665	+8.9%	10%
North Lebanon*	154,788	127,360	-17.7%	1%
Total	**12,361,736**	**10,526,979**	**-14.8%**	

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

Looking at the regional breakdown of real estate transactions and issued constructions permits, we note that Beirut has been losing ground as buyers' appetite for less expensive residential areas located in Beirut's key suburbs and outside the capital city is becoming a predominant trend which developers are catering to. The share of Beirut in the total area of issued construction permits shrank significantly to 6% in 2013 down from 18% in 2007. The share of Beirut in real estate transactions has also been trending downwards to 28% in 10M/14 down from 37% in 10M/07, despite gaining some ground YoY.

While property prices stagnate at a national level, developers are more inclined to revise their prices and offer discounts during negotiations in high-end markets

While national property prices have been holding up relatively well, we have been seeing some price revisions and discounts in the high-end market due to depleted demand. According to a study issued by Ramco based on a panel of 65 buildings located in Beirut, 22% of total units that were delivered in 2013 were still unsold in April 2014, representing an increase of 27% from 2012 and mostly involving large apartments. Developers have been granting discounts during negotiations ranging between 10% and 20% in the capital city according to market experts. In the BCD, the most expensive units are located in the waterfront where estimated starting prices are in the USD 7,000-8,000/sqm range compared to USD 4,500-6,000/sqm range in the traditional area including Saifi Village, Wadi Abou Jamil, Mina El Hosn and Martyr Square down from higher levels previously.

On a national scale, official figures issued by the Real Estate Registry point to a continuous rise in the average value per real estate transaction which increased by 3% YoY in 10M/14 to USD 127,478 in line with the trend over previous years (+5% in 2013, +12% in 2012 and +6% in 2011).

The relative stagnation in prices can be explained by the fact that developers have been paying a high price for land (from increased scarcity) and are unwilling to decrease their units selling prices in an aim to preserve their margins and profitability. Furthermore developers are mostly financing their projects through equity rather than bank loans which limits the risk of distressed sales when the market slows down. Partnerships with land owners and construction suppliers as well as reliance on map sales also help ease developers' cash flow position. The relative stagnation in prices can also be attributed to a solid demand from locals based on real living needs that is being supported by favorable demographics including a ~1% per annum growth for the Lebanese population. We also remind that the cyclical nature of the real estate sector and its high sensitivity to general sentiment is a factor which developers takes into account, bearing in mind that any positive development could favorably impact sentiment and real estate activity.

High-end property market is expected to remain on a standstill until we see an improvement in the investment climate

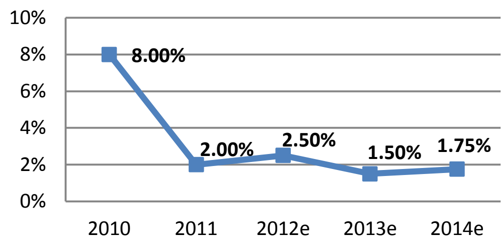
Looking ahead, we believe that the real estate market will remain highly dependent on the political and security situation which drives economic growth and investors' sentiment. In the short term any improvement in the investment climate could positively impact the property market. Longer term, perspectives are more favorable as the Lebanese real estate market attracts a substantial portion of FDIs and benefits from a large diaspora with a high level of interest in acquiring properties in their home land. While Arab investors and wealthy Lebanese expatriates, who typically drive the high-end segment, need to perceive more stability to resume their investment in the country; land scarcity is a factor that should continue to lend support to real estate prices in the long term.

MACROECONOMIC HIGHLIGHTS

Economic activity still soft in light of rising uncertainties with GDP growth at ~2% in 2014e

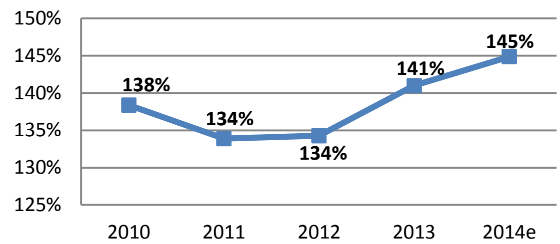
Economic developments continue to be soft with a GDP growth rate averaging 2% between 2011 and 2014 as per the IMF estimates (see figure 5) down from a 9% average in the previous four-year period, suggesting sharp deceleration in economic activity. However, we note that in its recent October 2014 economic outlook database, the IMF revised its estimates for Lebanon's GDP slightly upwards for the 2012-2014e period to ~2% from 1.2% previously. Capital inflows into Lebanon increased by 6% YoY to USD 16.2 billion in 2013, which did not offset the large trade deficit at USD 17.3 billion in 2013 (+3% YoY), thus translating into a balance of payments deficit at USD 1.1 billion in 2013 vs. a deficit of USD 1.5 billion in 2012. Similarly, balance of payments posted a deficit of USD 868 million in 10M/14, as capital inflows were not enough to offset the large structural trade deficit.

Figure 12: Real GDP growth



Source: IMF World Economic Outlook Database October 2014

Figure 13: Gross debt to GDP ratio

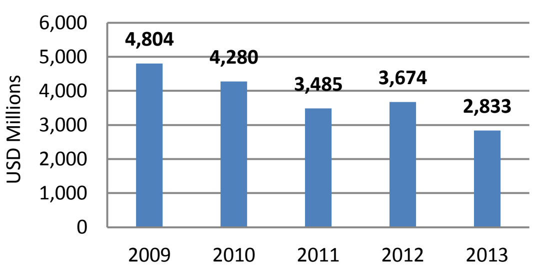


Source: IMF World Economic Outlook Database October 2014

Drop in FDI inflows, yet resilience in remittances to continue to lend support to the economy

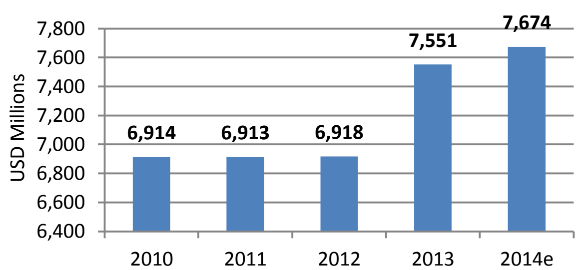
FDI inflows are estimated to have been among the most affected in the context of cautiousness related to regional uncertainties and a sluggish real estate market. Figures released by the UNCTAD show that FDI inflows to Lebanon totaled USD 2.8 billion in 2013 (~6% of 2013 nominal GDP), down 23% from USD 3.7 billion in 2012. 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 larger and more stable than FDIs inflows and are estimated by the World Bank to have reached USD 7.6 billion in 2013, up from USD 6.9 billion in 2012 and maintaining Lebanon's ranking among top recipients in developing countries. In its recently published Migration and Development Brief, the World Bank estimates still strong remittances inflows into Lebanon for 2014 at USD 7.7 billion (~17% of 2013 nominal GDP). We expect these inflows to continue to lend support to the Lebanese economy.

Figure 14: FDI inflows



Source: UNCTAD

Figure 15: Remittances inflows



Source: World Bank, October 2014 update

Growing structural imbalances as fiscal deficits drives debt levels

Lebanon's public finances continue to weaken in the context of slowing economic activity and the prevailing political stalemate. Figures released by the Ministry of Finance show that the fiscal deficit totaled USD 4.2 billion in 2013 widening 8% from USD 3.9 billion in 2012 with a fiscal deficit as % of GDP reaching an approximate 9.4% in 2013 from 9.1% in 2012. As a result of the rising deficit, Lebanon's gross public debt reached USD 63.5 billion, up 10% from 2012 while the gross debt-to-GDP ratio estimate for 2013 stands at 141% higher than 134% in 2012, suggesting required efforts to improve fiscal imbalances. Gross public debt reached USD 66.2 billion at the end of October 2014 (+4% Ytd, +6% YoY), funding fiscal shortfalls. While government fiscal situation worsens, budget deficit as % of GDP is expected to widen to ~11% of GDP for 2014e, driving gross debt to reach 145% of GDP in 2014e as per the IMF.

The real economy as portrayed by the performance of key sectors is showing mixed signals

Lebanon has been witnessing mixed performance in key economic sectors so far in 2014. The coincident of economic an index of economic activity comprising eight weighted economic indicators, reached 265.0 in August 2014 higher than 248.4 in July 2014 and 244.8 in August 2013.

The real estate market, a traditional growth engine, has seen the number of transactions increasing 4% YoY in the first ten months of 2014, however picking up from a very low base in 2013 following several years of decline. On the supply side, we note a YoY growth in total area of issued construction permits which upped 11% YoY in 8M/14.

As for the banking sector, key balance sheet indicators saw a moderate increase in the +4%-6% range Ytd in 10M/14, reaching USD 171.3 billion, USD 142.0 billion and USD 50.1 billion for assets, deposits and loans respectively. Non-resident deposits grew by 3% Ytd in 10M/14 to USD 29.4 billion, funding 21% of total deposits.

Tourism remains lackluster although paring back the sharp decrease in activity seen in previous years. Number of tourists stagnated so far in 2014 as highlighted by a 4% YoY growth in incoming tourists in 9M/14.

Structural issues will continue to threaten sustainable growth unless serious reforms are undertaken

The overall assessment highlights that Lebanon is suffering from adverse effects of the prolonged Syrian crisis as highlighted by i) slowdown in GDP growth to 1-2% in the 2011-2014e period as per the IMF, significantly below pre-Syria crisis levels ii) lower FDIs inflows on account of a deterioration in the investment environment, iii) declining tourism activity iv) slower real estate activity v) large inflows of Syrian refugees now estimated to account for more than a quarter of the population with serious impact on levels of employment and poverty. World Bank estimates fiscal strains from Syrian refugees at USD 2.6 billion between 2012 and 2014e (~6% of 2013e GDP).

In addition to growing pressures from regional tensions and domestic uncertainties, Lebanon has also to deal with fiscal imbalances which are inflating debt levels. Fiscal measures to reduce the structural imbalances and to insure the long-term financial immunity of the country seems unavoidable. Among these measures are: enhancing the efficiency of non-profitable government entities specifically EDL, improving tax collections, promoting private sector participation in infrastructure investment and defining a fiscal framework.

On a positive note, the economy has been showing some pockets of resilience including continuous growth in the banking system although at a slower rate, resilient remittances inflows from Lebanese expatriates as well as monetary stability. A return to healthier economic growth (convergence towards potential GDP) will remain dependent on the improvement in the domestic security situation and on regional political stability, although even with such improvement structural issues facing the Lebanese economy will continue to threaten sustainable growth unless serious reforms are undertaken.

APPENDICES

Appendix 1: Financial highlights and forecasts

INCOME STATEMENT (In USD millions)	2012a	2013a	2014e	2015e
Revenues from land sales	**50**	**95**	**140**	**144**
as % of total revenues	*42%*	*60%*	*68%*	*69%*
Revenues from property rentals	**54**	**52**	**54**	**57**
as % of total revenues	*46%*	*32%*	*26%*	*27%*
Revenues from rendered services	**7**	**8**	**8**	**8**
as % of total revenues	*6%*	*5%*	*4%*	*4%*
Revenues from hospitality	**7**	**4**	**3**	**1**
As % of total revenues	*6%*	*3%*	*2%*	*0%*
Total gross revenues	**117**	**159**	**205**	**210**
Gross profits	**71**	**109**	**153**	**161**
Gross profit margin	*61.0%*	*68.9%*	*74.5%*	*76.6%*
SG&A	(41)	(33)	(34)	(33)
EBITDA	**40**	**51**	**108**	**117**
EBITDA margin	*34.1%*	*32.2%*	*52.7%*	*55.8%*
Net profits	**18**	**43**	**91**	**97**
Net profit margin	*15.7%*	*26.8%*	*44.2%*	*46.2%*
EPS (Basic and Diluted)	**0.11**	**0.27**	**0.57**	**0.61**
EPS growth	*-89%*	*145%*	*114%*	*7%*
Return on Equity (ROE)	*0.9%*	*2.2%*	*4.5%*	*4.6%*
Return on Invested Capital (ROIC)	*1.3%*	*1.7%*	*3.4%*	*3.7%*

Source: Company reports, FFA Private Bank estimates

Note: Gross revenues exclude net proceeds from property sales averaging USD 4.3 million/year in 2012-2013

BALANCE SHEET (In USD millions)	2012a	2013a	2014e	2015e
Cash and balances	162	177	178	224
Accounts and notes receivables	546	435	468	477
Inventory of land and projects	1,208	1,144	1,164	1,189
Investment properties	437	565	566	577
Other assets	484	473	473	474
Total assets	**2,836**	**2,873**	**2,929**	**3,022**
Total liabilities excluding debt	245	237	202	197
Total debt	683	686	686	686
Shareholders' equity	1,908	1,951	2,042	2,139
Total liabilities and shareholders' equity	**2,836**	**2,873**	**2,929**	**3,022**
Current ratio	*0.93*	*0.90*	*1.00*	*1.09*
Net debt/EBITDA	*13.1*	*9.9*	*4.7*	*3.9*
Net debt/total capitalization	*20.1%*	*19.3%*	*18.6%*	*16.3%*

Source: Company reports, FFA Private Bank estimates

CASH FLOW (In USD millions)	2012a	2013a	2014e	2015e
Cash flow from operations	**(52)**	**136**	**11**	**56**
CAPEX	(10)	(8)	(12)	(12)
Free cash flow	**(63)**	**128**	**(1)**	**44**
Dividends paid	45	12	-	-

Source: Company reports, FFA Private Bank estimates

Appendix 2: 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	1,847.3	n/a	36.0	145.1	32.2	26.0	1.5	2.2	46.2	42.0	0.9
Emaar Properties PJSC	EMAAR UH	13,255.2	2.0	25.1	20.0	44.5	22.4	4.5	8.5	10.1	14.8	1.2
Dar Al Arkan Real Estate	ALARKAN AB	2,244.5	n/a	-17.5	-31.5	35.3	25.8	2.5	3.6	11.8	13.7	0.5
Emaar Economic City	EMAAR AB	2,457.2	n/a	45.2	43.9	n/a	40.4	n/a	n/a	n/a	n/a	1.1
Aldar Propeties PJSC	ALDAR UH	4,709.4	3.2	-52.7	13.1	17.0	45.3	4.7	11.8	19.9	8.4	1.0
Deyaar Dev. PJSC	DEYAAR UH	1,134.2	n/a	36.9	298.5	n/a	16.8	4.2	6.3	n/a	16.0	1.0
Union Properties PJSC	UPP UH	962.5	n/a	41.9	840.0	-26.8	27.5	28.3	53.8	n/a	1.7	0.7
Palm Hills Dev. SAE	PHDC EY	729.5	n/a	208.5	n/a	18.5	44.3	2.1	8.5	22.9	16.0	1.3
Six Of October Dev.	OCDI EY	718.7	n/a	-5.3	n/a	-4.9	18.4	-4.3	-21.4	n/a	n/a	0.7
RAK Properties	RAKPROP UH	359.4	7.6	-44.9	14.3	38.1	16.9	3.3	4.3	11.6	8.7	0.4
MENA Average		**2,841.8**	**4.3**	**27.3**	**167.9**	**15.3**	**28.4**	**5.2**	**8.6**	**20.4**	**15.2**	**0.9**

Source: Bloomberg priced as of December 15, 2014, Company reports