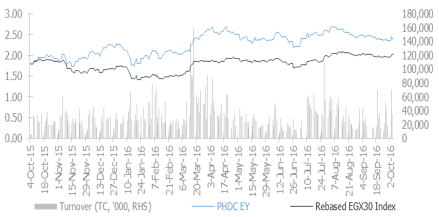
Palm Hills Developments (PHD)

Value Is in Diversity

October 5, 2016

RECOMMENDATION	BUY
Fair Value, EGP/Share	3.47
Reuters/Bloomberg	PHDC.CA/PHDC EY
Last Price, EGP/Share	2.41
Valuation Gap	44.0%
Shares Outstanding, m	2,308.9
Market Cap, EGP m	5,564.6
52W H-L, EGP/Share	2.82 - 1.71
52W ADTV, EGP m	32.8



Shareholder Structure	
MMID	42.50%
Aabar Investments	5.55%
Free Float	51.95%

A ubiquitous developer building on brand equity to seal co-development agreements

In the real estate world, PHD stands out judging by the various projects across Egypt reflecting its solid brand equity. Its real estate development portfolio features many co-development projects, a trend that has become quite widespread in the face of costly land acquisition. Given PHD's track record of real estate development, portrayed by the considerable number of projects under its wing, the firm stands out as the developer of choice for land bank owners.

A well-diversified project portfolio

PHD's development portfolio, which represents EGP1.06 of our total FV, spans West Cairo, East Cairo, and the North Coast. In West Cairo, the firm's 6.2 million sqm of land is spread across multiple development projects including Palm Parks, Golf Views, Golf Extension, Woodville, and Palm Valley. Palm Parks contributes the most (EGP0.23) relative to its neighboring projects to our FV. The firm also develops around 4.5 million sqm in East Cairo, split between many projects including Palm Hills Katameya Extension 2, the 500 Feddan Project, and Capital Gardens. The 500 Feddan Project is the largest East Cairo project contributor (EGP0.33) to our total FV. PHD is also the dominant player in the North Coast, developing Hacienda Bay, Hacienda White, and Hacienda West on a total land area of 3.7 million sqm. Hacienda Bay is the biggest North Coast project contributor (EGP0.27) to our FV.

Market price fails to reflect raw land plots; Buy on FV of EGP3.47/share

Our fundamental sum-of-the-parts FV for PHD is EGP3.47/share. The value is divided among development projects (EGP1.06), receivables (EGP1.73), hotels and club (EGP0.11), commercial land (EGP0.62), and raw land (EGP1.01). We believe the market is not discounting the firm's raw land plots, whose strategic fate has yet to be determined.

Further NUCA collaboration would be a key catalyst

PHD is currently negotiating the potential signing of a co-development agreement with the New Urban Communities Authority (NUCA) on 6,000 feddans in 6th of October City. PHD is also negotiating the potential acquisition of two land plots in the North Coast. If these negotiations prove fruitful and materialize into contracts, they will definitely be a key catalyst for share price performance and will represent a key upside revision of our FV.

Sales momentum to continue in short term, despite signs of systemic risks

We expect EGP5.8 billion in contracted sales in 2016. We believe sales momentum will continue over the next two-four quarters, fueled by North Coast sales in 3Q16, the launch of the 500 Feddan Project in 4Q16, and the launch of Hacienda West in 1H17. We do realize that the market has started to show some signs of slowdown, including high supply of projects targeting the same client segments, upper and upper-middle income groups, across the east and west of Cairo and in the North Coast. Furthermore, secondary market sales have shown significant signs of slowdown, and are threatened by the extended payment plans offered by developers. That said, we believe that macroeconomic factors will render real estate investment one of the top choices, specifically given the scarcity of foreign currency, high inflation, and diluted confidence in banking sector savings.

Lack of client-segment diversification a potential threat

The risk associated with PHD lies in its perpetual focus on catering to the high-income segment, a segment we believe is targeted by the majority of current and upcoming projects.

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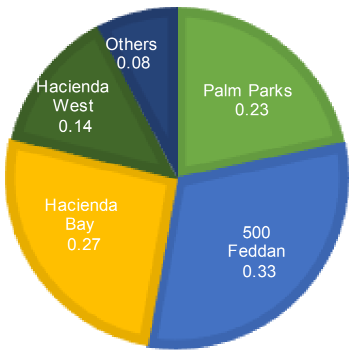
The 500 Feddan Project is a key value driver among development projects

At the end of 2015, PHD signed a co-development agreement with NUCA. According to the agreement, PHD is to develop a 2.1 million sqm integrated community located in East Cairo in close proximity to the New Administrative Capital. NUCA will contribute the land and provide external infrastructure, while PHD will develop the project. PHD will be entitled to 71.6% of revenue, and NUCA will receive 28.4% of revenue in addition to an in-kind payment of 0.2 million sqm. The project is expected to be launched at the end of 2016. Featuring a variety of unit types, the project's sellable BUA stands at 1.3 million sqm. In our model, we set standalone land prices and BUA prices currently at EGP8,900/sqm and EGP5,500/sqm, respectively, which grow at a 10% inflation rate annually. We set apartment land prices and BUA prices at EGP4,000/sqm and EGP9,500/sqm, respectively, which similarly escalate by 10% annually. Costs across all residential projects are expected to increase by 5% annually, except for the initial 10% increase in construction costs and infrastructure costs in the first year due to the exposure of building materials to the imminent devaluation of the EGP against the USD and the implementation of the VAT. SG&A expenses are extrapolated from historical figures and are assumed to be 12.5% of revenue. We assume that the project will be sold over the course of ten years, starting in 2017, given that the expected launch date at the end of 2016 would only generate pre-sales, with subsequent contracted sales commencing in 2017. A seven-year installment schedule is used in our model to project the project's cash flow. Our project FV stands at EGP0.33/share, which constitutes 9.5% of our total FV.

Development projects represent EGP1.06 of FV; 500 Feddan Project, Hacienda Bay, Hacienda West, and Palm Parks contribute the most

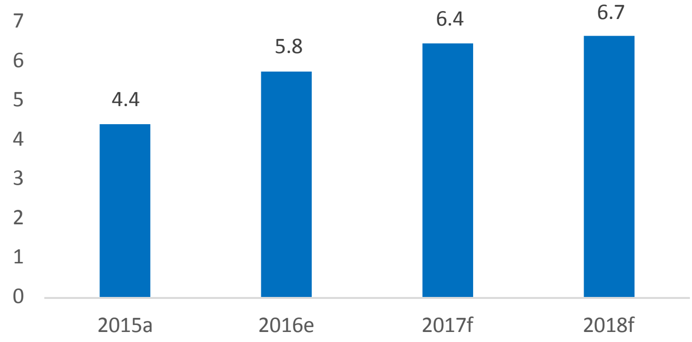
In our model, we value PHD's other development projects in a similar fashion to our valuation of the 500 Feddan Project, on a DCF basis. Land prices (averaging around EGP9,000/sqm) and BUA prices (averaging roughly EGP9,500/sqm) grow by 10% annually, and the majority of projects follow a six-year installment schedule, which spells out the cash flows we discount using a discount rate of 20%.

Figure 2| 500 Feddan Project is the highest value driver among projects



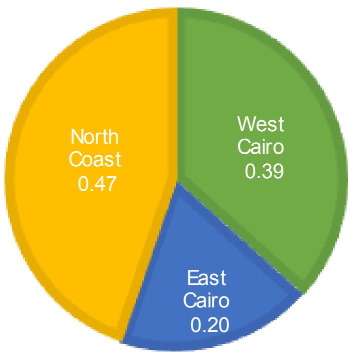
Source: Pharos Research

Figure 1| Projected contracted sales in EGP billions



Source: PHD Earnings Release, Pharos Research

Figure 3| Development projects in North Coast contribute the most of the three locations to our development projects FV



Source: Pharos Research

Solid recurring revenue sourced from hotels and Palm October Club; generate EGP0.11 in FV

PHD owns three hotels through its subsidiaries. In our model, we use an occupancy rate of 75% for the 6th of October hotel and an occupancy rate of 68% for the Ismailia hotel. We use a relatively lower occupancy rate of 30% for the Sharm El Sheikh hotel, which has been feeling the brunt of the current state of the tourism industry in Egypt. Our terminal value is based on a long-term growth rate of 2%. The company's Palm October Club contributes EGP0.09/share to our total FV. We conservatively assume that the company will sell 3,120 memberships over the course of eight years to PHD residents who pay the membership price tag of EGP100,000, which increases, in our model, by 5% every three years. These new memberships, in addition to the 2,200 memberships sold prior to our forecast horizon, are assumed to bring in EGP4,500/membership in annual fees, which increase, in our model, by 3% every three years.

FV boosted by unutilized land adding EGP1.63 to FV

Given the absence of strategic plans for the current commercial land bank, we simply value the land on a NAV basis. The firm has 0.1 million sqm of commercial land area in West Cairo (excluding Palm October Club), 0.5 million sqm of commercial land area in East Cairo, and 0.1 million sqm of commercial land area in the North Coast. We conservatively value the commercial area in West Cairo, East Cairo, and the North Coast using respective prices/sqm of roughly EGP2,700, EGP2,275, and EGP1,600. Also conservatively valued are the firm's raw land plots in Botanica, Sahl Hasheesh, Galala, and Saudi Arabia. We assign a price of EGP225/sqm for the 7.1 million sqm Botanica land plot, EGP200/sqm for the 5.0 million sqm Saudi Arabian land plot, EGP450/sqm for the 0.1 million sqm Sahl Hasheesh land plot, and EGP405/sqm for the 0.5 million sqm Galala land plot. Our conservative approach is sought because the manner in which these land plots will be monetized is virtually unknown.

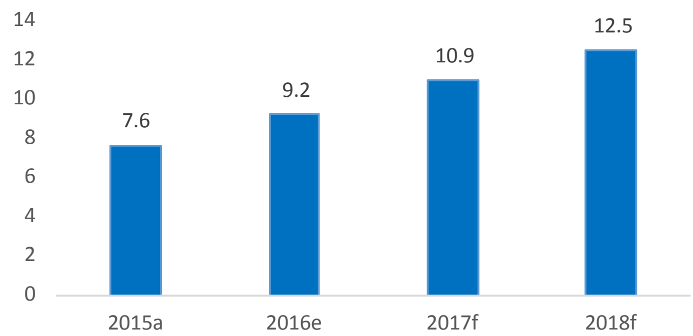
Installments from past sales a major cash inflow and value contributor

As of end June 30, 2016, PHD's receivables stood at EGP9.0 billion. As per management guidance, these receivables are expected to be paid to the company over the coming eight years. However, out of conservatism, we assume an impairment loss of 25% annually. It is notable that management has recently decided to monetize around EGP2.5 billion of its receivables over two to three years in an effort to free up some liquidity that may be used for construction spending and debt payment.

Reiterate: market price fails to reflect raw land plots

The stock's current market price of EGP2.41/share seems to disregard the value of PHD's raw land. The company's raw land contributes EGP1.01/share to our FV.

Figure 4| Projected receivables in EGP billions



Source: PHD Financials, Pharos Research

Valuation Breakdown	Value (EGP)	FV/Share (EGP)	Percentage of FV
Development Projects	2,440,890,407	1.06	30.4%
Hospitality	36,231,578	0.02	0.5%
Palm October Club	217,529,888	0.09	2.7%
Commercial Land	1,435,881,450	0.62	17.9%
Raw Land	2,337,712,958	1.01	29.2%
Receivables	3,994,146,367	1.73	49.8%
Net Cash	(2,443,409,552)	(1.06)	-30.5%
Total	8,018,983,095	3.47	100.0%

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