Egypt Stock Market: The Blominvest Report

The EGX 30 key drivers displayed a severely weak performance over the past year. This could be traced to the dual influence of a global rout in equity prices, driven mainly by losses incurred by investors as a result of record-low oil prices and weak global growth expectations, especially in China, in addition to market dynamics specific to the Egyptian economy.

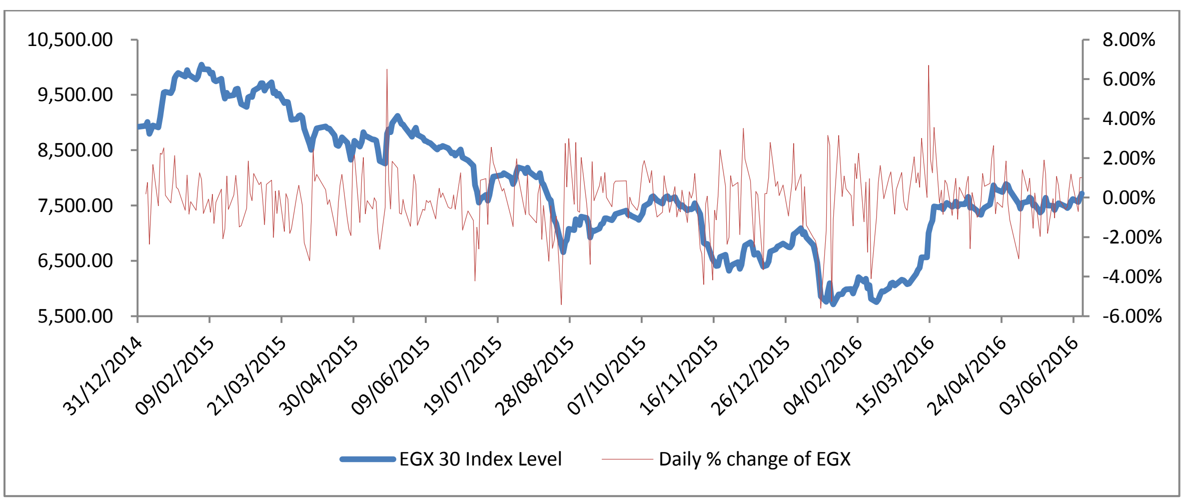
Locally, the Egyptian stock exchange experienced significant headwinds during the past year, mainly from decreasing foreign direct investments in the Egyptian equity market and a Central Bank policy that hampers capital flows in and out of the economy.

The index maintained its overall downward trend up until March 2016, at which time the newly appointed governor of the CBE, Mr. Tarek Amer, began to implement key monetary policies aimed at moving the economy forward:

1. **March 2nd:** removal of the cap on dollar deposits and withdrawals for companies operating in Egypt. This decision allayed concerns held by global brands operating in Egypt that planned on exiting the Egyptian scene, such as General Motors and British Airways.

2. **March 8th:** the CBE extends its decision to individuals' deposits and withdrawals. Monthly caps previously in place for dollar deposits and withdrawals for individuals were also removed. This cap had placed major limitations on individuals' ability to operate businesses and better contribute to the economy.

3. **March 14th:** the CBE devalued the currency by 14.30%, driving the strike price to \$/EGP 8.95 in a bid to close the gap between official and black market rates. This decision was also defended by special dollar auctions and savings certificates with high yields by some private banks. The official exchange rate has since stabilized at \$/EGP 8.88.



Source: Bloomberg, as of June 7th, 2016

EGX 30 Index	7,717.35
52-Weel High	8,905.60
52-Week Low	5,713.35
Y-T-D	10.15%
Market Cap ($M)	24,828.76

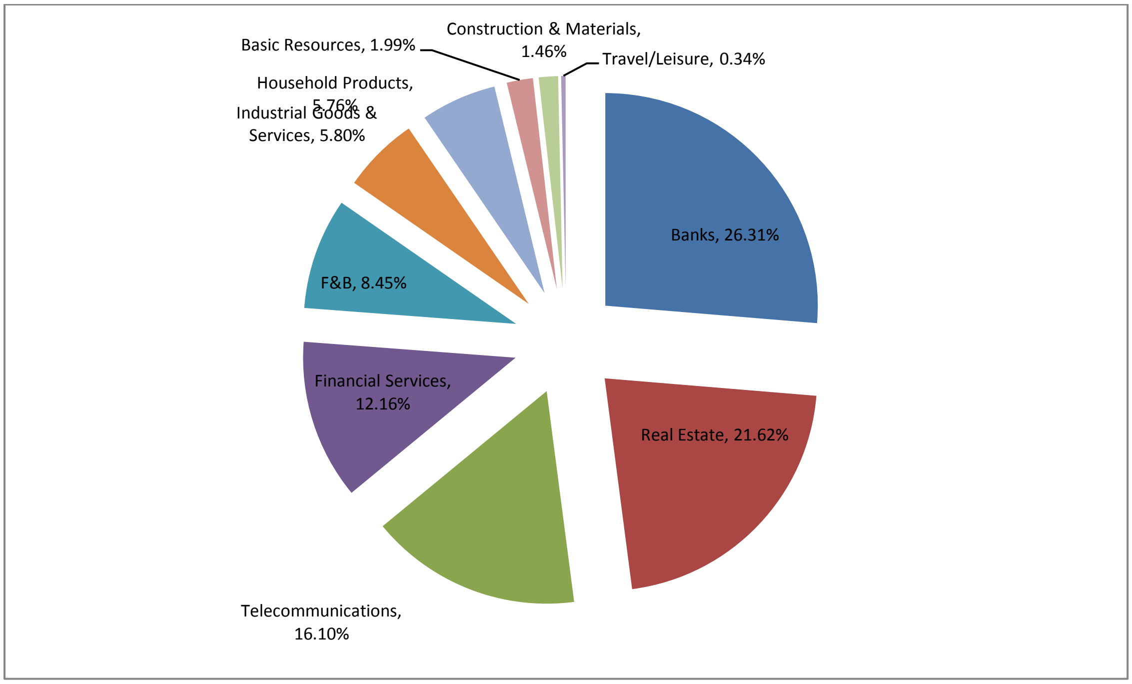
Source: Bloomberg, as of June 7th, 2016

As of June 7th, 2016

These monetary policy decisions positively impacted the performance of the EGX 30, driving the index up 26.19% between March 1st and June 7th, 2016. Overall, the index displayed a gain of 10.15% y-t-d, narrowing the y-o-y plunge to 11.59%, further signaling the importance of these policies in boosting market sentiment and performance. As of June 7th, the EGX 30 stood at 7,717.35 points.

Breakdown of Sector Weights by Market Capitalization

–as at June 07, 2016



EGX30 performance and composition

as at June 07, 2016

Sector	Members	Market Cap ($M)	Industry Beta	YTD Return (%)	P/E	P/B
EGX 30	30	24,8523	1	10.15	12.23	2.75
Banks	2	6,530	1.04	17.91	10.25	3.41
Real Estate	7	5,355	1.07	5.28	17.64	2.78
Telecommunications	3	4,000	1.06	44.68	4.26	2.9
Financial Services (Excluding Banks)	6	3,021	1.17	24.01	18.11	1.93
Food & Beverage	2	2,099	0.66	-9.35	23.95	3.87
Industrial Goods & Services	3	1,434	0.91	7.48	7.29	1.32
Personal/Household Products	3	1,430	0.68	-1.57	7.68	1.19
Basic Resources	1	494	1.18	-6.6	-	1.17
Construction & Materials	2	363	1.65	31.06	18.4	0.8
Travel & Leisure	1	97	1.1	-12.33	3.97	1.02

Source: Bloomberg

One of the weaknesses of the equity index is the significant weight of the banking sector on its performance. Commercial International Bank (CIB) and Credit Agricole constitute the largest industry grouping on the exchange in terms of market cap, accounting for 26.31% of the index's total market capitalization. As a result of this heavy weight on the index, the banking sector has a beta score of 1.04, and ranks as the closest beta to 1.

The seven real estate companies combine to form the next biggest sector grouping on the index, representing 21.62% of total market cap. The real estate industry's beta is the fourth largest on the index, and offers investors slightly higher volatility than the market.

Real Estate and Development Industry performance and composition –as at June 07, 2016

Considering the nature of the problems engulfing Egypt over the past 5 years and since the ousting of Husni Moubarak and the consequent shifts in the political and security landscape, the Egyptian real estate sector has historically lacked the necessary drive to fulfill its potential as the main driver behind economic growth in Egypt.

New Market Conditions Aiding Real Estate

However, the real estate and development sector has recently shown signs of life once again, with 2015 and the coming years earmarked for the launching and completion of several noteworthy projects. Such projects include Palm Hills' 2.1M sqm project in East Cairo, which will be co-developed with urban design company SWA Group and the Egyptian New Urban Communities Authority "NUCA" and Talaat Mostafa's Open Air Mall in Madinaty.

These projects did not realize the momentum they were expected to achieve as a result of limited FDIs in these projects and the significant drag on the country's tourism sector, in the form of Russian and British travel bans and repetitive issues with Egypt Air, taking a toll on hotel revenues and occupancy rates.

Therefore, the monetary decisions implemented in March of this year and discussed above are expected to have an overall positive impact on the sector's performance. Both the currency devaluation and the removal of caps on dollar deposits and withdrawals allow for increased FDI activity. Despite this decision, the Egyptian Pound is still under pressure from the currency's black market. Thus, the government has not ruled out the possibility of another devaluation maneuver during 2016.

Influence of Market Conditions on Real Estate Sectors:

In the real estate sector in particular, the overall reaction to the devaluation has been positive, although not all forms of real estate investment stand to benefit equally. In fact, according to Jones Lang Lasalle's (JLL) "Cairo Real Estate Market Overview" for Q1, 2016, hospitality and residential segments are expected to have the most upside potential. Meanwhile, office and retail sectors may not adjust as smoothly as tenants may experience difficulties in meeting dollar-denominated rental payments.

This classification seems to especially ring true for rental revenue streams from each of the four real estate segments mentioned.

a) Tourism Sector Set to Improve

The hospitality segment, after a difficult 2015 due to heightened security concerns and political instability linked to parliamentary elections held in October, seems to be experiencing a recovery on the back of the currency devaluation. According to the EY Middle East hotel benchmark survey, hotel occupancy rates in Cairo between January and April 2016, compared to the same period last year, improved by 13 percentage points (pp) to 60%, while the average room rates (ARR) and average room yields (ARY) witnessed positive movements of 23% and 57.1% year-on-year to respective values of $126 and $76. The increases in the three metrics of hotel performance represent the largest in their respective categories across the MENA region for the mentioned period. We can conclude these findings to be fairly representative of the general condition of the hotel industry in Egypt since, according to the Egyptian hotel association, 4-and-5-star hotel rooms combine to account for 66.22% of all hotel rooms in the Egyptian hotel industry.

b) Middle-Income Citizens Driving Growth in Apartment Sales

The residential segment also stands to benefit from current economic and market conditions with the initiation and continuation of large residential housing projects targeted at low-to-middle income individuals. This trend can be most clearly witnessed in New Cairo, where residential apartment sales gained 7% y-o-y, opposed to sales of villas in the same region decreasing by 12% y-o-y. Supply of residential real estate properties is expected to increase during 2016 as the government continues with its housing plan of supplying affordable housing to citizens belonging to lower income classes.

c) *Office and Retail Segments Still Facing Obstacles*

In contrast, the office and retail segments are projected to experience more difficulties moving forward. Office vacancies have improved slightly y-o-y, moving down from 33% in Q1 2015 to 29% in Q1 2016, but the rate is still considered to be high, and leasing activity during the year has been stagnant. In addition, regulations currently in place restricting multinationals from expatriating their profits may be a deterrent for some firms to operate in the country. Meanwhile, retail spaces experienced delays in delivery, while the currency devaluation applied headwinds on rental income earned from foreign retailers due to higher selling prices.

Name	Weight on EGX30 (%)	Market Cap ($M)	Beta	YTD Return (%)	P/E	P/B
Real Estate Development	21.62	5,355.39	1.07	5.28	17.64	2.78
Talaat Mostafa Group	5.56	1,381.09	1.19	-3.98	15.71	0.46
Emaar Misr for Development SAE	5.18	1,283.41	1.07	-8.76	-	1.57
Medinet Nasr Housing	3.41	844.77	1.09	11.49	31.53	7.78
Palm Hills Development	2.55	632.87	1.22	11.59	4.76	0.96
Heliopolis Housing	2.51	621.6	0.74	-0.4	32.3	9.62
Six of October Development & Investment	1.82	446.79	1.06	26.08	12.83	1.2
Porto Holding SAE	0.59	144.86	1.19	-27.48	-	-

Source: Bloomberg

Information Summary for EGX Real Estate Companies

Name	Description	Date of Listing	Main Shareholders + %	Main Segments	Project Distribution	Hotel Revenue (%)	Target Income Classes
Talaat Mostafa	Investment	2007	TMG Investment (44.61%)	Residential complexes, hotels/resorts	Concentration in Cairo, majority of projects developed lie either to the East or West of the city	11.25%	Upper + Middle
Palm Hills	Developer	2008	Mansour & Maghraby Investment (42.78%)	Residential and commercial real estate	West/East Cairo, North Coast	1.37%	Upper + Middle
Emaar Misr	Developer	2015	Emaar Properties (85.27%)	residential community projects, resorts	Cairo, North Coast	-	Upper
SODIC	Developer	1998	Abanumay Walid (12.76%)	Retail and commercial spaces	Sheikh Zayed, Cairo, Alexandria	-	Middle-Upper
Porto Group*	Developer	2015	SOL Holding (35%)	Residential units	East/West Cairo	-	NA
Medinet Nasr	Developer	1995	Beltone Investment (31.19%)	Residential and commercial buildings, land sale and purchase, construction	Cairo, Cairo-Suez Road	-	Middle
Heliopolis	Developer	1995	National Build & Construction (72.25%)	Residential projects	Cairo	-	Middle

source: Bloomberg and company websites

Performance Metrics for listed Real Estate Companies

based on trailing 12 months, including Q1 2016 results

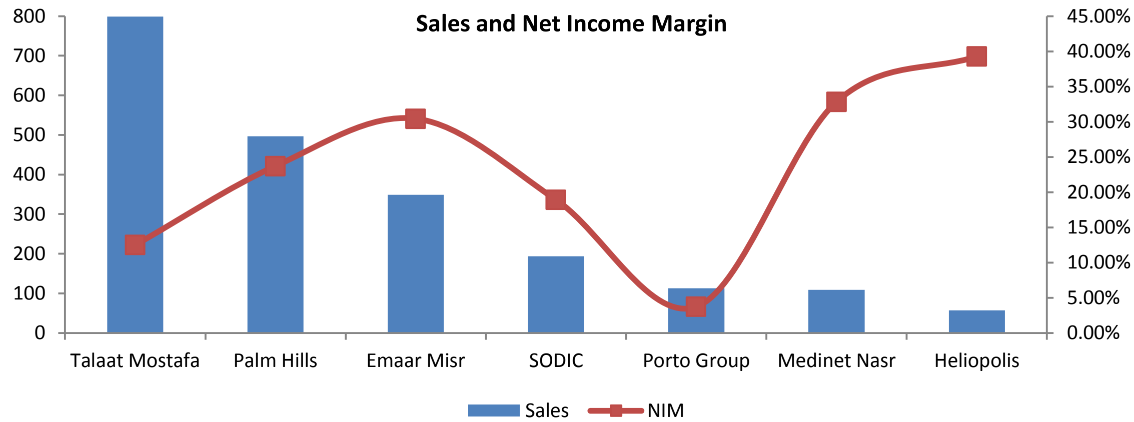
Name	Sales ($M)	Net Income Margin	EBITDA ($M)	EBITDA Margin	D/E
Talaat Mostafa	798.67	12.49%	229.07	28.68%	0.11
Palm Hills	496.83	23.71%	87.23	17.56%	0.72
Emaar Misr	349.18	30.44%	102.27	29.29%	0.04
SODIC	193.31	18.91%	31.05	16.06%	0.73
Porto Group*	112.80	3.71%	31.31	27.75%	-
Medinet Nasr	108.93	32.84%	41.37	37.98%	0.16
Heliopolis	57.3	39.27%	24.4	42.58%	0.48

*Porto group financial metrics based on 2015 yearly results

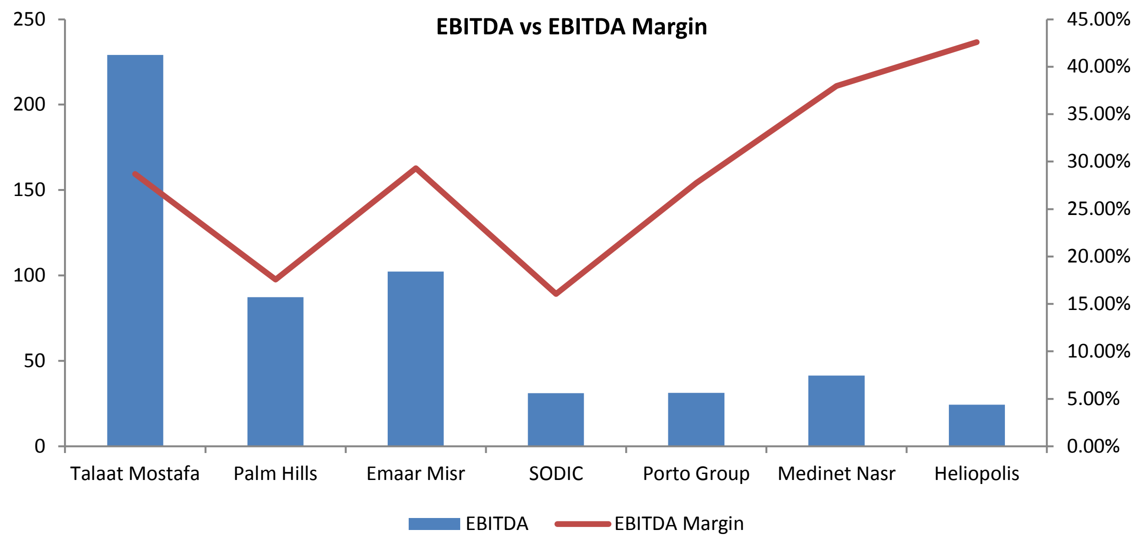
Source: Bloomberg and company financials

The two tables above suggest that Talaat Mostafa is too large of a market player to have any direct competitors in terms of size or sales. It appears that Palm Hills and Emaar Misr are more direct competitors in terms of sales, market segments and target income classes, with the remaining four listed companies (SODIC, Porto, Medinet Nasr and Heliopolis) constituting the remainder of the Egyptian real estate market.

Graphical Representations



Source: Bloomberg



Source: Bloomberg

Going forward, we will analyze the financial performances and investment opportunities of three of the sector's largest companies: Talaat Mostafa Group Holding (TMGH.EY), Sixth of October Development and Investment Company (OCDI.EY) and Palm Hills Development Company (PHDC.EY).

Revenue Breakdowns- TMGH

Revenue Stream	2014	% of Total	2015	% of total	Y-o-Y Change (%)
Total ($M)	596.92		699.93		17.26
Sales of Units ($M)	497.45	83.34%	576.52	82.37%	15.90
Hotel Revenues ($M)	61.57	10.31%	78.77	11.25%	27.94
Services ($M)	37.9	6.35%	44.64	6.38%	17.78

Source: Company financials

Unit sales displayed a decrease in numbers, but higher worth and area. This reflects the hesitance of low-to-middle class home-seekers to purchase new properties, with buyers interested in larger projects forming a larger proportion of TMGH's clients this year.

We expect this trend to continue in 2016, especially with the removal of caps on foreign currencies and the depreciation of the local currency. Real estate investments serve as hedges to inflation and, with rates expected to rise in 2016 in the U.S specifically, more FDIs in the sector can be witnessed in the future. In details, the depreciation of the currency is expected to play varying roles on different forms of real estate. Land purchases and residential units tend to serve as the best hedges for inflation, while rental revenues are expected to suffer because most rental arrangements are dollar-denominated. Revenues from tourism and hotels will be probably boosted by the attractiveness of Egypt as a result of its cheaper currency.

The company's gross profit is expected to augment 15.40% throughout 2016, and a healthy gross margin of 33%. However, financing costs are expected to increase considerably as a result of heavier reliance on short-term financing, thereby dragging down the year's financials slightly.

Revenues will also be boosted by TMGH's hotels business, as security pressure suffocating the sector can be expected to loosen slightly and allow for more prosperity, especially in safer areas of Egypt, such as Sharm El Sheikh.

Revenue Breakdowns- PHDC

Revenue Stream	2014	% of Total	2015	% of total	Y-o-Y
Total	240.78		407.98		69.44%
Sales of Land ($M)	148.57	61.7	239.99	58.82%	61.53%
Revenues from Construction ($M)	87.79	36.46%	159.83	39.18%	82.06%
Club Activities ($M)	2.27	0.94%	4.75	1.16%	109.25%
Hospitality ($M)	2.16	0.90%	3.42	0.84%	58.33%

Source: company financials

In January 2016, PHDC announced the signature of an agreement to begin execution of a 2.1M sqm project in East Cairo co-developed with the architecture and urban design company SWA Group and the Egyptian New Urban Communities Authority “NUCA”.

In February, the company also announced the agreement of a co-development project for a beach resort with a group of private land owners. The resort will spread over an area of 565,560 sqm in Ras El Hekma on the North Coast, and to the west of Hacienda White 1. Palm Hills agreed to be responsible for all construction, development, infrastructure, marketing and sales activities and expenses, in return for an entitlement to 80% of the project’s generated revenue. The development period is expected to be around 7 years, by which time 525 units measured over a Built Up Area (BUA) of 235,000 sqm will result in an estimated total revenue of EGP 2.5-3 billion. Pre-sales are expected to begin in Q3 2016.

These upcoming headline events lead us to forecast another year of fast-paced growth in sales for Palm Hills, reaching $524.21M (EGP 4.63B), with a slightly improved gross profit margin of 35%. We also expect financing costs to spike up from 2015’s level to $6.37M (EGP 56.24M) because of higher long-term debt on 2015’s balance sheet. We also expect a slightly lower EBT from 2015’s level. However, this is due to the sale of two pieces of land in Alexandria and on the North Coast, which took place during the FY 2015. Net Income is also expected to be lower than 2015’s because the company’s exemption from income taxes expired on December 31st, 2015.Consequently, our estimates for Net Income for the coming year stands at 6.03% drop from 2015’s level at $109.78 (EGP 969.33M).

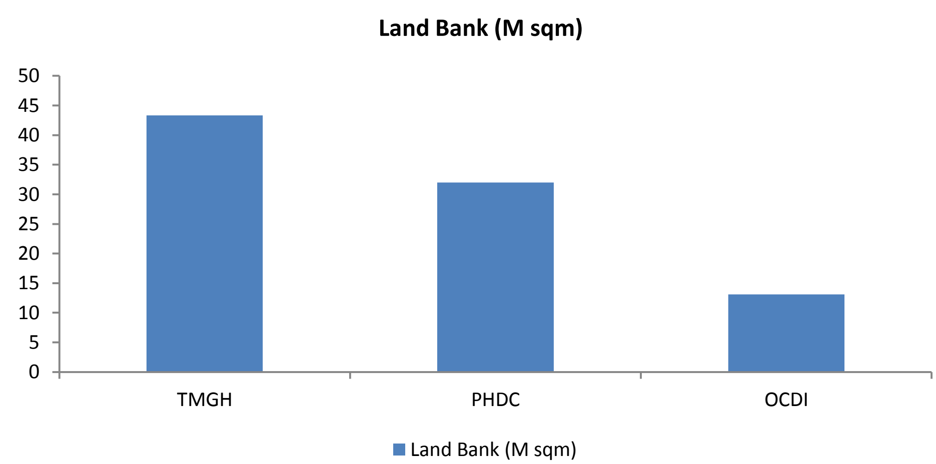
Revenue Breakdowns- OCDI

Revenue Stream	2014	% of Total	2015	% of total	Y-o-Y
Total	154.67		166.58		7.70%
Sales of Real Estate and Land ($M)	148.39	95.94%	158.71	95.27%	6.95%
Beverly Hills City Revenue($M)	2.93	1.89%	2.98	1.79%	1.71%
SODIC West Revenues ($M)	2.47	1.60%	3.96	2.37%	60.32%
Golf Course Revenues ($M)	0.88	0.90%	0.94	0.56%	6.82%

Source: Company financials

Despite the reflection of a poor performance during the first 3 months of 2016, Sodic is still in line for a positive financial performance during 2016, considering the launch of deliveries in the Eastown project during Q2. The company expects to deliver approximately 935 units during the calendar year, compared to a lower 721 units during 2015. Sodic's financials will also likely benefit from a newfound market preference for residential units. The return of such units will probably be boosted by the launch of a co-development agreement of a 2.75M sqm land plot with Heliopolis Housing in East Cairo. Deliveries will begin in Q1 2017 and will help maintain Sodic's positive performances down the line.

Land Bank Comparison (sqm M)



Source: company websites and Blominvest models

Relative Valuation for Real Estate Sector- *as at June 7th, 2016*

Region	Market Cap ($M)	Sales ($M)	Profits ($M)	NI Margin (%)	ROE	ROA (%)	P/B	P/E
Egypt	917.7	445.16	74.05	16.63%	15.10%	4.21%	2.78	12.47
Global	1,370	545.08	70.26	12.89%	6.27%	1.82%	1.79	16.9

Source: Bloomberg

Based on the above table, which compares the mean metrics of the Egyptian real estate sector to the global means, investment in Egypt's real estate sector appears to be a favorable decision. The local real estate market has mean returns on equity and total assets above the global comparables, while the Price to Equity ratio signals that Egyptian real estate stocks are undervalued.

Relative Valuation for Companies- *as at June 7th, 2016*

Name	Market Cap ($M)	YTD Return	NI Margin (%)	ROE	ROA (%)	P/B	P/E	EPS ($)
Real Estate Sector	917.7	5.28%	16.63%	15.10%	4.21%	2.78	12.47	0.077
Talaat Mostafa	1,381.09	-3.98%	12.49%	2.95%	1.25%	0.46	15.71	0.05
Palm Hills	632.87	11.59%	23.71%	18.52%	5.18%	0.96	4.76	0.07
Emaar Misr	1,283.41	11.49%	32.84%	-	-	1.57	--	-
SODIC	446.79	26.08%	30.44%	9.88%	2.04%	1.20	12.83	0.12
Porto Group*	144.86	-0.40%	39.27%	-	-	-	-	-
Medinet Nasr	844.77	-8.76%	18.91%	28.82%	10.97%	7.78	31.53	0.07
Heliopolis	621.60	-26.48%	3.71%	30.47%	7.49%	9.62	32.30	0.20

Source: Bloomberg

A relative valuation of the Egyptian real estate companies discussed in the table would indicate that Palm Hills and SODIC represent the best investment choice in the sector. Both the P/B and P/E ratios indicate that the firms possess upside potential. Palm Hills' ROE and ROA metrics exceed the respective market means, while SODIC's stock is significantly outperforming the sector since the start of the year. In addition, Palm Hills more or less matches the market in terms of EPS, while SODIC outperforms it. This suggests that cash flows to investors will be high, although the two firms' elevated debt to equity ratios must be taken into consideration as well.