ERES Alert - First Look: 2Q2017 Showed Pressure on Real Estate; Missed our Estimates on Volatile Investment Income

- **ERES' 2Q2017 results showed pressure on hotel/mall operations; missed our estimates on volatile investment income (first take) -** Reported/adj. net income came in at QR208.8/184.3mn or ~39/35% lower from the same period one year ago. This translated into QR0.08/0.07 reported/adj. EPS vs. our estimate of QR0.14. The residential/commercial real estate business was overall in line with our numbers coming in ~6% below our estimates; however, we did notice pressure on the malls/hotels segment, both of which missed our estimates by double digits. On the investment business, we highlight that in 2Q2017 we expected ~QR200mn in topline contribution from the highly unpredictable investment business, in line with trends set in 1-4Q2016. In reality, ERES reported ~QR133.3mn in revenue. Our first thought is that the lower income was influenced by the significantly large (and unusual) contribution in 1Q2017 (~QR845mn).
- **Meeting of shareholders to discuss consolidation of Ezdan Oasis' ownership -** We highlight that ERES' website shows an invitation to a shareholders' meeting on August 13. The purpose of the meeting is to discuss a request initiated by SAK Holding (ERES' partner in Ezdan Oasis) to sell its stake in the project to ERES based on an independent valuation. Management did not provide much color on the rationale behind SAK's request given it is a separate legal entity but highlighted that the meeting is to approve/reject the request. We imagine that SAK would likely retain its right to sell its share of the project to any external third party. SAK Holding has a 32.5% stake in the project.
- **Ezdan Oasis project launch as expected but ramp up likely slower than we expected -** ERES recently announced the launch of the leasing of the first phase of Ezdan Oasis project, the largest in the Group's history (already in our model). The project covers +1mn SqM area with phase I consisting of 2,058 residential and commercial units. We now expect the full ramp up of phase I to be completed by YE2017 (~3,000 units previously expected by YE2017). This ramp up should help offset weakness seen on the other primary operating real estate assets (mainly hotels/malls).
- **Uncertainty weighs down on the shares, exasperated by delisting potential -** From our conversation with management, we note that ERES is waiting for instructions from the regulators on how to proceed with de-listing from the exchange. ERES highlighted that they provided the regulators with their view but are waiting official instructions. We believe that the lack of clarity will continue to weigh down the shares and focus the spotlight on concerns we had given the stretched balance sheet, rich comparable valuation, and low liquidity. The shares are currently trading at ~16x our FY2017 EPS (~17% premium to peers), while offering a lower-than-average 2017 ROA of ~3.7% (~7.1% peer average).

QNB FINANCIAL SERVICES

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Recommendations *Based on the range for the upside / downside offered by the 12-month target price of a stock versus the current market price*	
OUTPERFORM	Greater than +20%
ACCUMULATE	Between +10% to +20%
MARKET PERFORM	Between -10% to +10%
REDUCE	Between -10% to -20%
UNDERPERFORM	Lower than -20%

Risk Ratings *Reflecting historic and expected price volatility versus the local market average and qualitative risk analysis of fundamentals*	
R-1	Significantly lower than average
R-2	Lower than average
R-3	Medium / In-line with the average
R-4	Above average
R-5	Significantly above average

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