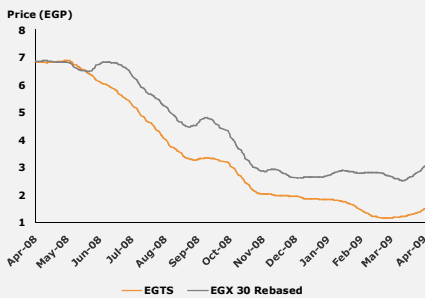


ERC: Cash preservation is key – HOLD

EGTS vs EGX30 Rebased



Source: Reuters, Naeem Research

Many point to the market's significant undervaluation of Egyptian Resorts Company's (ERC) land bank. With an implied land value of USD9/sqm and recent realised sales value of USD143/sqm, it's hard to disagree. Nevertheless, we believe ERC is set to continue to underperform the market on a 12-month view. We believe that investors could become increasingly uncomfortable about ERC's lack of cash flow through a possible two-year lean spell in sales. The attractiveness of the business model is hard to deny, but we believe the market has yet to reflect the long nervous wait to the point where profits begin to flow again.

Market Price (EGP)	1.78
Target Price Range (EGP)	1.60-1.70
52 week high-low	7.39-1.07
Free Float	36.9%
Market Cap. (EGPm)	1,869.00
Reuters Code	EGTS.CA
Bloomberg Code	EGTS EY

Based on ERC closing price as of 13 April 2009
Source: Reuters, ERC and NAEEM estimates

Year to 31 Dec	Sales EGPm	Earnings EGPm	EPS EGP	FCFPS EGP	DPS EGP	PE	P/FCF
2006A	326	236	0.45	0.15	0.00	7.3	22
2007A	349	285	0.54	0.20	0.20	12.0	32
2008E	362	210	0.24	0.15	0.00	7.3	13
2009F	60	(4)	(0.01)	(0.05)	0.00	N/A	N/A
2010F	60	(4)	(0.01)	(0.05)	0.00	N/A	N/A

Implied land value of USD9/sqm at significant discount to realised sales prices of USD50-143/sqm. Further, this is high compared with the cost of the land purchase of USD2-3/sqm, (including cost + TDA commission). The risk to the implied land price stems from the possibility of the Tourism Development Authority "TDA" releasing other government lands in Red Sea resort areas at a similarly low cost. Basic economic theory tells us that when a company makes excess returns (as ERC's business model appears to do), new entrants will be encouraged to enter the fray until returns are normalised. We believe the market is currently ignoring the risk of further land grants.

Anaemic sales forecast. We estimate that ERC had negligible (possibly even zero) land sales during 4Q08 and 1Q09, and is bracing itself for a lean two-year period. ERC's unwillingness to come down from last sale price (USD143/sqm) will have a dampening effect on future sales as developers may have more attractive options in the region. We believe the market will take longer than management expects to clear at those prices, questioning their cash cushion calculations.

Delay in filing 2008 results. The Capital Market Authority "CMA" has given ERC an extension until 15 April to publish its 2008 results. If the company fails to meet this deadline, its shares will be suspended from trading on the EGX. We believe the company is discussing with auditors the "re-classifications" of costs and possible provisions where ERC is facing delays in settlements. Given the drawn-out discussions, we believe that the re-classifications could be more than just movement within the P&L and could include increased capitalisation of expenses through WIP or PIP, compounding ERC's already-aggressive revenue recognition policy.

Investment positives

- ▶ World's largest integrated resort project with a good land bank, south of Hurghada, a renowned Red Sea resort area. Further, the Hurghada International Airport is being upgraded and the project is located just 15 minutes from the airport.
- ▶ Attractive and highly profitable business model. Low cost base (USD2-3/sqm) for land and a self-financing mechanism in place.
- ▶ Diversified sources of revenue in the long run via utilities and community management.
- ▶ Egypt remains a top tourist destination (12.8m in 2008) attracting 25% of MENA tourist arrivals. Although a drop in tourism (10-20%) is expected in 2009-10, we expect this to pick again from 2011.

Investment negatives

- ▶ Current cash level of EGP350m (USD62.5m) is roughly enough to provide infrastructure for 3.5m sqm (<10% of total land bank, assuming a cost of USD18/sqm). We believe this may not be sufficient if management continues the "build it and they will come" policy, and ERC would have to look for additional finance (debt or equity) if sales remain anaemic.
- ▶ Release of Red Sea resort land areas by the TDA at a low price (USD2-3/sqm). Although there appears to be no immediate risk, the long duration of ERC's projects (15yrs) makes this a threat in our view.
- ▶ Aggressive accounting treatment of revenues (booking discounted future installment receipts at date of sale) will emphasise anaemic sales outlook.
- ▶ Competition from other Red Sea and Mediterranean resorts in the region.
- ▶ Delays in payment receivables from developers.

NAV valuation: We believe that in a NAV valuation, the value of unsold land plots (pre-infrastructure development) should give more weight to the replacement cost of land in similar areas (USD2-3/sqm), rather than rely wholly on post-development sales prices (USD50-143/sqm). Hence, we believe the current implied land value of USD9/sqm is fair. We have not added any valuation for the utilities and community management services as the business model is still in the early stages. Key risks to our recommendation come from faster-than-expected Eurozone economic recovery and the TDA deciding not to release any more land banks in Red Sea resort areas.

Fig. 1: Implied land value based on share prices as of 13 April 2009

	EGP m	Per share (EGP)	EGP/sqm	USD/sqm	Notes
Share price (13/04/09)		1.78			
Cash (latest)	350.00	0.27			Assume 20% discount for minority
Net receivables (3Q08)	191.00	0.13			Assume 30% discount
		0.39			
Value of land (Sahl Hasheesh)	1,460.00	1.39	52.33	9.34	
Available land bank (m sqm)*	27.89				

* including new 9m sqm of land
 Note: EGP-USD=5.60; Shares outstanding: 1,050m
 Source: Company data, NAEEM Research



Egypt

Spotlight

13 April 2009

Valuation Update

Analyst Certification

We, HISHAM HALALDEEN and ZEINAB EL BEHEIRY, hereby certify that the views expressed in this research report accurately reflect my personal views about securities and companies that are the subject of this report. I also certify that no part of my compensation, whether pecuniary or in-kind, was, is, or will be, directly or indirectly, related to the recommendations or views expressed in this research report.

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