

17 March 2011

# Arabtec Holding

## 4Q review; outlook remains cautious

### Hold

**Target price**  
Dh1.45

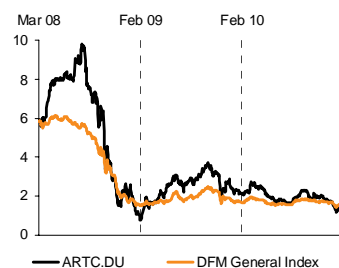
**Price**  
Dh1.37

**Short term (0-60 days)**  
n/a

**Market view**  
No Weighting

#### Price performance

|                | (1M)  | (3M)  | (12M) |
|----------------|-------|-------|-------|
| Price (Dh)     | 1.65  | 1.95  | 2.29  |
| Absolute (%)   | -17.0 | -29.7 | -40.2 |
| Rel market (%) | -7.3  | -20.9 | -28.8 |
| Rel sector (%) | -17.0 | -29.7 | -40.2 |


**Market capitalisation**  
Dh1.64bn (€319.45m)

**Average (12M) daily turnover**  
Dh47.95m (US\$12.45m)

 Sector: European-DS Tot Mrkt  
 RIC: ARTC.DU, ARTC.UH  
 Priced Dh1.37 at close 16 Mar 2011.  
 Source: Bloomberg

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**Arabtec's ability to minimise receivables provisions is crucial to its earnings potential and to its future success in Saudi Arabia and markets outside of the UAE. We remain cautious on both fronts and, so, maintain our Hold rating.**

#### Key forecasts

|                             | FY09A | FY10A | FY11F | FY12F | FY13F |
|-----------------------------|-------|-------|-------|-------|-------|
| Revenue (Dhm)               | 7,665 | 5,464 | 5,800 | 5,933 | 6,066 |
| EBITDA (Dhm)                | 925.1 | 704.7 | 679.7 | 670.2 | 738.4 |
| Reported net profit (Dhm)   | 494.9 | 307.1 | 258.0 | 233.9 | 266.4 |
| Normalised net profit (Dhm) | 494.9 | 307.1 | 258.0 | 233.9 | 266.4 |
| Normalised EPS (Dh)         | 0.41  | 0.26  | 0.22  | 0.20  | 0.22  |
| Dividend per share (Dh)     | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| Dividend yield (%)          | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| Normalised PE (x)           | 3.31  | 5.34  | 6.35  | 7.00  | 6.15  |
| EV/EBITDA (x)               | 1.92  | 2.06  | 1.72  | 1.48  | 0.98  |
| EV/invested capital (x)     | 0.62  | 0.50  | 0.39  | 0.31  | 0.22  |
| ROIC - WACC (%)             | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |

 Accounting standard: IFRS  
 Source: Company data, Rasmala forecasts

year to Dec, fully diluted

#### 4Q10 results below our expectations

Arabtec's total revenue for 4Q10 came in at Dh1,352m and EPS at Dh0.05, misses of 11.9% and 18.9%, respectively. The EPS miss was mainly on account of the revenue miss and higher-than-expected net profit attributable to minority interests (Dh34m vs 29m). Gross margin was almost in line at 15.4% compared to the 15% we expected. We maintain our 2011-13 forecasts.

#### We retain our concerns on potential provisioning

Arabtec's total impaired contract and trade receivables in 2010 rose 25.1% yoy to Dh1,554m from Dh1,242m in 2009. However, total balance sheet provisions fell to Dh265m in 2010 from Dh299m in 2009 and provisions to impaired receivables ratio fell to 17.1%, from 24.1% in 2009. Given Arabtec's high exposure to Dubai, its mainly GCC driven backlog, and the current regional unrest, we do not rule out further delays and potential for provisioning. Hence, we reiterate our concern about provisioning risk and estimate Dh120m worth of provisions for 2011 (24% of our ex-provisions earnings).

#### Tight liquidity may reopen Aabar option

Arabtec's recent decision to postpone the issuance of a convertible bond, owing to unfavourable market conditions, may lead management to ponder financing alternatives such as a stake sale to Aabar Investments (see our note *Flattish outlook despite overseas focus*, dated 10 March), which would likely be a potential dilution concern to existing shareholders.

#### Valuation – maintain Hold with target of Dh1.45 per share

We maintain our Hold rating on Arabtec with a target price of Dh1.45 per share. Our DCF-based target price implies a 2011F EV/backlog of 0.17x. The stock trades at an EV/backlog of 0.17x, lower than competitors such as DSI at 0.33x, on our estimates. We believe this discount is justified given Arabtec's high receivables risk and relatively large exposure to Dubai's civil construction sector.

#### Important disclosures can be found in the Disclosures Appendix.

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## Receivables provisioning risk lingers

Arabtec's total impaired contract and trade receivables increased to Dh1,554m in 2010 from Dh1,242 in 2009, a jump of 25.1%, whereas total balance sheet provisions fell to Dh265m from Dh299m in 2009. As a result, the provisions to impaired receivables ratio fell to 17.1% in 2010 from 24.1% in 2009. However, we believe Dubai's tight market liquidity and the ongoing regional unrest warrant a higher provisions cushioning. Therefore, we continue to factor in Dh120m worth of further provisions in our 2011 earnings estimate, which is equivalent to about 24% of the ex-provisions earnings.

**Table 1 : Contract and trade receivables breakdown**

| Dhm   | 2009         | 2010         |
|---|--------------|--------------|
| <b>Impaired contract and trade receivables</b>                      |              |              |
| - Current   | 461          | 116          |
| - Past due for more than 3 months                                   | 195          | 127          |
| - Past due for more than 6 months                                   | 586          | 1,311        |
| <b>Total impaired contract and trade receivables</b>                | <b>1,242</b> | <b>1,554</b> |
| <b>Unimpaired contract and trade receivables</b>                    |              |              |
| - Past due for less than 3 months                                   | 427          | 554          |
| - Past due for more than 3 months                                   | 891          | 147          |
| <b>Total unimpaired contract and trade receivables</b>              | <b>1,318</b> | <b>701</b>   |
| Provisions on balance sheet   | 299          | 265          |
| <b>Provisions as a % of impaired contract and trade receivables</b> | <b>24.1%</b> | <b>17.1%</b> |

Source: Company data

## Income statement

| Dhm                          | FY09A        | FY10A        | FY11F        | FY12F        | FY13F        |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue                      | 7665         | 5464         | 5800         | 5933         | 6066         |
| Cost of sales                | -6338        | -4637        | -4988        | -5162        | -5315        |
| Operating costs              | -401.5       | -122.3       | -132.2       | -101.1       | -12.1        |
| <b>EBITDA</b>                | <b>925.1</b> | <b>704.7</b> | <b>679.7</b> | <b>670.2</b> | <b>738.4</b> |
| DDA & Impairment (ex gw)     | -313.7       | -280.2       | -302.8       | -328.6       | -351.5       |
| <b>EBITA</b>                 | <b>611.5</b> | <b>424.5</b> | <b>377.0</b> | <b>341.6</b> | <b>386.9</b> |
| Goodwill (amort/impaird)     | 0.00         | 0.00         | 0.00         | 0.00         | 0.00         |
| <b>EBIT</b>                  | <b>611.5</b> | <b>424.5</b> | <b>377.0</b> | <b>341.6</b> | <b>386.9</b> |
| Net interest                 | -56.1        | -41.7        | -51.7        | -51.7        | -51.7        |
| Associates (pre-tax)         | 0.00         | 0.00         | 0.00         | 0.00         | 0.00         |
| Other pre-tax items          | 75.9         | 54.9         | 46.4         | 47.5         | 48.5         |
| <b>Reported PTP</b>          | <b>631.2</b> | <b>437.7</b> | <b>371.7</b> | <b>337.4</b> | <b>383.8</b> |
| Taxation                     | -39.4        | -6.13        | -3.18        | -3.19        | -3.26        |
| Minority interests           | -96.9        | -124.5       | -110.6       | -100.3       | -114.2       |
| Other post-tax items         | 0.00         | 0.00         | 0.00         | 0.00         | 0.00         |
| <b>Reported net profit</b>   | <b>494.9</b> | <b>307.1</b> | <b>258.0</b> | <b>233.9</b> | <b>266.4</b> |
| Tot normalised items         | 0.00         | 0.00         | 0.00         | 0.00         | 0.00         |
| Normalised EBITDA            | 925.1        | 704.7        | 679.7        | 670.2        | 738.4        |
| Normalised PTP               | 631.2        | 437.7        | 371.7        | 337.4        | 383.8        |
| <b>Normalised net profit</b> | <b>494.9</b> | <b>307.1</b> | <b>258.0</b> | <b>233.9</b> | <b>266.4</b> |

Source: Company data, Rasmala forecasts

year to Dec

## Balance sheet

| Dhm                               | FY09A       | FY10A       | FY11F       | FY12F       | FY13F       |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Cash & market secs (1)            | 820.5       | 1049        | 1331        | 1511        | 1778        |
| Other current assets              | 6196        | 5505        | 4535        | 4234        | 4078        |
| Tangible fixed assets             | 1363        | 1303        | 1452        | 1585        | 1704        |
| Intang assets (incl gw)           | 447.7       | 397.9       | 351.9       | 305.9       | 259.9       |
| Oth non-curr assets               | 283.7       | 542.0       | 542.0       | 542.0       | 542.0       |
| <b>Total assets</b>               | <b>9110</b> | <b>8796</b> | <b>8212</b> | <b>8177</b> | <b>8363</b> |
| Short term debt (2)               | 769.8       | 744.5       | 744.5       | 744.5       | 744.5       |
| Trade & oth current liab          | 5231        | 4569        | 3616        | 3247        | 3052        |
| Long term debt (3)                | 187.1       | 116.5       | 116.5       | 116.5       | 116.5       |
| Oth non-current liab              | 194.7       | 258.9       | 258.9       | 258.9       | 258.9       |
| <b>Total liabilities</b>          | <b>6382</b> | <b>5689</b> | <b>4736</b> | <b>4367</b> | <b>4172</b> |
| Total equity (incl min)           | 2728        | 3108        | 3476        | 3810        | 4191        |
| <b>Total liab &amp; sh equity</b> | <b>9110</b> | <b>8796</b> | <b>8212</b> | <b>8177</b> | <b>8363</b> |
| Net debt                          | 136.4       | -187.8      | -469.8      | -649.6      | -917.4      |

Source: Company data, Rasmala forecasts

year ended Dec

## Cash flow statement

| Dhm                              | FY09A         | FY10A         | FY11F         | FY12F         | FY13F         |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|
| EBITDA                           | 925.1         | 704.7         | 679.7         | 670.2         | 738.4         |
| Change in working capital        | -799.2        | -159.9        | 16.6          | -67.7         | -39.6         |
| Net interest (pd) / rec          | -56.1         | 0.00          | 0.00          | 0.00          | 0.00          |
| Taxes paid                       | -33.5         | -6.13         | -3.18         | -3.19         | -3.26         |
| Other oper cash items            | 360.3         | -5.54         | -5.26         | -4.19         | -3.13         |
| <b>Cash flow from ops (1)</b>    | <b>396.6</b>  | <b>533.2</b>  | <b>687.9</b>  | <b>595.1</b>  | <b>692.4</b>  |
| Capex (2)                        | -300.1        | -212.5        | -406.0        | -415.3        | -424.6        |
| Disposals/(acquisitions)         | 69.1          | 26.6          | 0.00          | 0.00          | 0.00          |
| Other investing cash flow        | -5.05         | 9.82          | 0.00          | 0.00          | 0.00          |
| <b>Cash flow from invest (3)</b> | <b>-236.1</b> | <b>-176.1</b> | <b>-406.0</b> | <b>-415.3</b> | <b>-424.6</b> |
| Incr / (decr) in equity          | 36.3          | 0.00          | 0.00          | 0.00          | 0.00          |
| Incr / (decr) in debt            | -298.6        | -95.9         | 0.00          | 0.00          | 0.00          |
| Ordinary dividend paid           | -21.7         | -24.6         | 0.00          | 0.00          | 0.00          |
| Preferred dividends (4)          | 0.00          | 0.00          | 0.00          | 0.00          | 0.00          |
| Other financing cash flow        | 0.06          | 0.00          | 0.00          | 0.00          | 0.00          |
| <b>Cash flow from fin (5)</b>    | <b>-283.9</b> | <b>-120.5</b> | <b>0.00</b>   | <b>0.00</b>   | <b>0.00</b>   |
| Forex & disc ops (6)             | 0.00          | 0.00          | 0.00          | 0.00          | 0.00          |
| <b>Inc/(decr) cash (1+3+5+6)</b> | <b>-123.4</b> | <b>236.5</b>  | <b>282.0</b>  | <b>179.8</b>  | <b>267.8</b>  |
| Equity FCF (1+2+4)               | 96.5          | 320.6         | 282.0         | 179.8         | 267.8         |

Source: Company data, Rasmala forecasts

year to Dec

## Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

## Valuation and risks to target price

**Arabtec Holding (RIC: ARTC.DU, Rec: Hold, CP: Dh1.37, TP: Dh1.45):** We value Arabtec using a DCF approach implying a fair value of Dh1.45 a share. Upside risks to our target price include Arabtec successfully reducing its Dubai ex-government receivable exposure and the company growing its Saudi backlog faster than the decline in its UAE backlog. The main risks include rising provisions on Dubai receivables and weaker-than-expected traction in high-growth foreign markets including Saudi Arabia, Qatar etc.

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