

8 August 2011

Arabtec Holding

Margin pressure yet to alleviate

Hold

Target price
Dh1.30

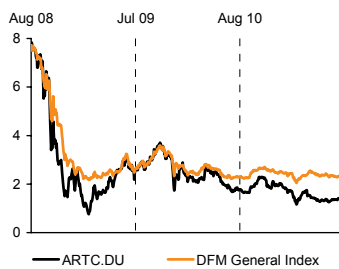
Price
Dh1.34

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	1.35	1.43	1.75
Absolute (%)	-0.7	-6.3	-23.4
Rel market (%)	0.2	-1.6	-24.8
Rel sector (%)	-0.7	-6.3	-23.4



Market capitalisation
Dh1.60bn (€305.90m)

Average (12M) daily turnover
Dh32.25m (US\$8.63m)

Sector: European-DS Tot Mrkt
RIC: ARTC.DU, ARTC.UH
Priced Dh1.34 at close 7 Aug 2011.
Source: Bloomberg

Analysts

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Arabtec's earnings missed our expectations as gross margin maintained its downward trajectory and was 210bp lower than our estimate of 13.3%. We believe project execution delays and a higher revenue contribution from the UAE are likely reasons behind further gross margin contraction during the quarter.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Dhm)	7,665	5,464	5,520	5,760	5,890
EBITDA (Dhm)	925.1	721.4	576.8	605.3	629.3
Reported net profit (Dhm)	494.9	307.1	241.6	233.8	255.2
Normalised net profit (Dhm)	494.9	307.1	241.6	233.8	255.2
Normalised EPS (Dh)	0.33	0.21	0.16	0.16	0.17
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)	4.05	6.52	8.29	8.57	7.85
EV/EBITDA (x)	1.88	2.18	2.17	1.65	1.06
EV/invested capital (x)	0.61	0.51	0.41	0.31	0.21
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

2Q11 results below our expectations; gross margin shows no signs of stabilisation

Arabtec reported revenue of Dh1,217m (down 2% qoq and 5% yoy), slightly below our estimate of Dh1,251m (Bloomberg consensus: Dh1,281m). Net profit before minority interest at Dh45m (down 18% qoq and 66% yoy) missed our estimate of Dh59m by 24% mainly due to lower-than-expected gross margin. Gross margin was 210bp lower than we expected at 13.3%. Arabtec's gross margin maintained its downward momentum, declining from 17.3% in 2009 to 11.2% in 2Q11 (13.3% in 1Q11). Its UAE-based precast and concrete production subsidiaries continued to make losses. Also, net profit after minority interest of Dh29m (up 9% qoq and down 74% yoy) missed our conservative estimate of Dh30m (Bloomberg consensus: Dh44m), despite attributing lower-than-expected net profit to minority shareholders at Dh16m vs our estimate of Dh28m.

UAE contributed 77% to total revenues during 1H11

The UAE contributed about 77% to total revenue during 1H11, despite its share in total backlog declining significantly from 64% at end-2009 to 42% at 2Q11 end. We believe this is mainly due to a delay in Arabtec's initiation of major projects in Saudi Arabia (Dh4,900m to construct 5,000 villas) and Kuwait (Dh900m, Kuwait University buildings) contributing roughly 42% to Arabtec's 2Q11 end backlog. In our view, it looks highly likely that delays in project execution and a higher dependency on the UAE are the major reasons for declining margins. We also highlight that going forward even with revenue mix shifting toward geographies like Saudi Arabia and Qatar, Arabtec may find it challenging to raise its profitability due to higher minority contributions in these two geographies (upto 55% in Saudi Arabia, 51% in Qatar).

Backlog declined 8% qoq to Dh13.9bn

Arabtec's backlog declined to Dh13.9bn in 2Q11 from Dh15.1bn in 1Q11. On the positive side, the receivables position improved further as receivables declined to Dh3.8bn (Dh4.0bn in 1Q11). We will revisit our forecasts and target price pending company feedback on its results. Until then, we maintain our Hold rating on the stock, with a target price of Dh1.30.

Important disclosures can be found in the Disclosures Appendix.

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Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	7665	5464	5520	5760	5890
Cost of sales	-6338	-4637	-4750	-4994	-5151
Operating costs	-401.5	-105.6	-193.5	-160.8	-110.0
EBITDA	925.1	721.4	576.8	605.3	629.3
DDA & Impairment (ex gw)	-313.7	-296.9	-274.9	-285.1	-293.9
EBITA	611.5	424.5	301.9	320.2	335.4
Goodwill (amort/impaird)	0.00	0.00	0.00	0.00	0.00
EBIT	611.5	424.5	301.9	320.2	335.4
Net interest	-56.1	-41.7	-26.3	-35.4	-35.4
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	75.9	54.9	70.1	64.8	67.8
Reported PTP	631.2	437.7	345.7	349.6	367.7
Taxation	-39.4	-6.13	-4.54	-2.86	-3.15
Minority interests	-96.9	-124.5	-99.6	-113.0	-109.4
Other post-tax items	-0.00	0.00	0.00	-0.00	0.00
Reported net profit	494.9	307.1	241.6	233.8	255.2
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	925.1	721.4	576.8	605.3	629.3
Normalised PTP	631.2	437.7	345.7	349.6	367.7
Normalised net profit	494.9	307.1	241.6	233.8	255.2

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	820.5	766.2	943.8	1196	1526
Other current assets	6196	5419	4321	4110	3961
Tangible fixed assets	1363	1272	1267	1316	1363
Intang assets (incl gw)	447.7	390.6	343.7	297.7	251.7
Oth non-curr assets	283.7	832.1	847.4	847.4	847.4
Total assets	9110	8680	7723	7768	7949
Short term debt (2)	769.8	626.7	498.6	498.6	498.6
Trade & oth current liab	5231	4509	3440	3138	2954
Long term debt (3)	187.1	110.4	91.6	91.6	91.6
Oth non-current liab	194.7	332.1	260.1	260.1	260.1
Total liabilities	6382	5578	4290	3988	3804
Total equity (incl min)	2728	3102	3433	3780	4144
Total liab & sh equity	9110	8680	7723	7768	7949
Net debt	136.4	-29.2	-353.6	-606.0	-935.7

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	925.1	721.4	576.8	605.3	629.3
Change in working capital	-799.2	-293.0	-56.4	-91.5	-34.3
Net interest (pd) / rec	-56.1	-41.7	0.00	0.00	0.00
Taxes paid	-33.5	-9.72	-4.54	-2.86	-3.15
Other oper cash items	360.3	-15.9	29.9	29.4	32.4
Cash flow from ops (1)	396.6	361.1	545.8	540.3	624.3
Capex (2)	-300.1	-221.9	-246.0	-288.0	-294.5
Disposals/(acquisitions)	69.1	77.0	23.6	0.00	0.00
Other investing cash flow	-5.05	9.79	-0.16	0.00	0.00
Cash flow from invest (3)	-236.1	-135.1	-222.6	-288.0	-294.5
Incr / (decr) in equity	36.3	0.86	0.00	0.00	0.00
Incr / (decr) in debt	-298.6	-219.8	-146.9	0.00	0.00
Ordinary dividend paid	-21.7	-31.3	-10.5	0.00	0.00
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	0.06	-21.7	0.00	0.00	0.00
Cash flow from fin (5)	-283.9	-272.0	-157.4	0.00	0.00
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	-123.4	-45.9	165.8	252.3	329.7
Equity FCF (1+2+4)	96.5	139.2	299.7	252.3	329.7

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: Dh1.34, TP: Dh1.30): We value Arabtec using a DCF methodology, from which we derive our target price. 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 downside 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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