

United Development Company

Recommendation	ACCUMULATE	Risk Rating	R-4
Share Price	21.88	Target Price	25.50
Implied Upside	16.5%		

UDCD - Diving into 2016 Earnings and Beyond

We believe valuation has improved after shares dropped ~3%. We suggest investors look beyond headline earnings (showing y/y earnings drop) and a ~17% dividend cut. We remain constructive on growth prospects and highlight our expectation of improving metrics.

Highlights

- **Strong performance in 4Q2016 drives earnings beat.** UDCD net profit/EPS for 4Q2016 came in at ~QR172mn/0.48 vs. our estimate of ~QR157mn/0.44 (+9%). On an adjusted basis, the beat was even bigger with ~QR209mn/0.59 as a result of excluding ~QR37mn stemming from non-cash impairments as other losses from sale of financial assets (Fig 1).
- **Looking beyond the ~10% y/y drop in headline earnings.** We note that 2015's net income of ~QR690mn included ~QR120mn in non-cash or non-core earnings. Adjusting 2015/2016 earnings gives a clearer picture of the operating performance of the company with 2016 adjusted earnings/adj. EPS coming in at ~QR675mn/1.91 vs. ~QR570mn/1.61 in 2015.
- **~17% dividend cut to QR1.25/sh from QR1.50/sh supportive of LT metrics and growth prospects.** We note that we highlighted in our initiation report our preference for improving dividend payout ratios. This new dividend policy helps address our concern. We now expect 2017/2018 payouts of ~65%/61% vs. ~78%/72% previously. We view this new dividend policy as supportive of UDCD's future growth plans while reducing the need to lever up the balance sheet.
- **What's next for 2017/2018?** For 2017, we expect management to recognize the remainder of the revenue from the ~QR1.25bn sale of Abraj Quartier office tower, which closed in 4Q2016 (partially recognized by YE2016). For 2018, we expect additional Giardino Villa plot sales, which we view as high margin sales. We expect management to focus on the retail/commercial side of the business given its less variable income (and more sticky nature of tenants).
- **What is past is prologue?** We examined UDCD's share price performance around reporting periods covering the past 19 quarters (not including 4Q2016). We noticed that during the 60 trading days following reporting, shares averaged a ~10.8% gain in 10 occurrences and a drop of ~7.6% in 9. Should history repeat itself, we might expect pressure on the shares towards the ~QR20.50 level with a potential rebound to ~QR24.00 once the results are fully absorbed by the market (Fig 3). We note that at ~QR20.50, the shares would be trading at ~10.6x our 2017 adj. EPS, which is more than 1 standard deviation below the historical average of ~12.7x (Fig 3).

Catalysts

1) Revenue recognition from the sale of Abraj Quartier tower through ~3Q 2017; 2) Sale of Giardino Villa plots; 3) Clarity on development of a school and medical facility on the Pearl – timeline unknown; 4) Commercial/full operations at the third Qatar Cool plant in West Bay; and 5) Clarity on a second Qatar Cool plant in the Pearl – timeline unknown.

Recommendation, Valuation and Risks

- **Maintain Accumulate rating and QR25.50 TP.** The shares are currently trading at ~11.4x our 2017 adj. EPS estimate, which is at a ~17% discount to peers. We consider this an attractive entry point for new investors. We updated our model for the results and made minor revisions – our 2017 adj. EPS estimate changed to QR1.93 vs. QR1.91 previously (Fig 2).
- **Risks to our thesis.** General economic weakness, changes in interest rates and project finance risk. Finally, we would welcome clarity on future growth initiatives supporting recurring income, which is necessary to sustain the dividend long-term.

Key Financial Data and Estimates

	FY2015a	FY2016	FY2017e	FY2018e
Adj. EPS (QR/sh)	1.61	1.91	1.93	2.05
P/E (x)	13.6x	11.5x	11.4x	10.5x
CFPS (QR/sh)	1.78	2.22	2.25	2.44
P/CFPS (x)	12.3x	9.9x	9.7x	8.8x
Adj. EBITDA (QR mn)	784.7	920.9	949.4	1,011.5
EV/EBITDA (x)	14.1x	12.0x	11.1x	10.3x

Source: Company data, Bloomberg, QNBFS Research

Key Data

Current Market Price (QR)	21.88
Dividend Yield (%)	5.7%
Bloomberg Ticker	UDCD QD
ISIN	QA000A0KD6M9
Sector	Real Estate
52wk High/52wk Low (QR)	22.94 / 18.01
30-d Average Volume ('000)	280.8
Mkt. Cap. (\$ mn/QR mn)	2,128 / 7,747
Shares Outstanding (mn)	354.1
FO Limit* (%)	49.0%
Current FO* (%)	9.3%
1-Year Total Return (%)	21.7%
Fiscal Year End	December 31

Source: Bloomberg (as of February 8, 2017), * Foreign ownership (as of February 8, 2017) and includes GCC institutions

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Model Summary

Company Name:	United Development Co.	Price:	QR 21.88	Target Price:	QR 25.50
Ticker:	UDCD QD	Mkt Cap:	QR 7,747 mn	Dividend Yield:	5.7%
Recommendation:	ACCUMULATE	EV:	QR 11,050 mn	Total Expected Return:	16.5%

	FY2015a	FY2016	FY2017e	FY2018e
Earnings (in QR mn except Per Share Items)				
Revenue	1,440.6	2,390.8	2,148.0	1,833.1
Gross Profit	874.9	1,116.0	1,105.2	1,304.5
Adj. EBITDA	784.7	920.9	949.4	1,011.5
Adj. EBIT	709.5	818.9	846.7	891.0
Adj. Net Income	570.1	675.1	685.0	727.0
FD EPS	1.95	1.76	1.93	2.05
FD Adj. EPS	1.61	1.91	1.93	2.05

	FY2015a	FY2016	FY2017e	FY2018e
Cash Flow (in QR mn except Per Share Items)				
Operating Cash Flow	632.0	785.6	796.9	865.2
Cash from Operations	728.9	294.5	1,728.1	723.7
Cash from Investing	(1,394.6)	584.1	(142.3)	(542.3)
Total Capex	(607.4)	(449.7)	(160.0)	(560.0)
Simple FCF (CFO - Capex)	121.5	(155.2)	1,568.1	163.7
Cash from Financing	(715.8)	(837.3)	(860.8)	(417.0)
Total Dividends	457.6	544.5	442.6	442.6
FD CFPS	1.78	2.22	2.25	2.44

	FY2015a	FY2016	FY2017e	FY2018e
Balance Sheet (in QR mn except Per Share Items)				
Cash/Equiv.	2,277	1,566	2,291	2,055
PP&E	4,499	3,231	3,286	3,726
Investment Properties	8,705	8,861	8,861	8,861
Total Assets	19,138	18,723	16,440	16,872
Current Debt	1,377	1,245	534	460
Long-Term Debt	3,430	3,273	3,566	3,665
Total Debt	4,807	4,518	4,100	4,125
Total Liabilities	7,852	7,413	4,861	4,973
Owners' Equity	10,914	10,898	11,116	11,375

	1Q2017e	2Q2017e	3Q2017e	4Q2017e
Quarterly Estimates				
Revenue	561.2	572.5	603.2	411.1
Gross Profit	251.2	267.7	293.4	292.9
Adj. EBITDA	263.9	223.9	252.1	209.5
Adj. EBIT	241.1	197.6	225.5	182.5
Adj. Net Income	198.6	157.5	185.6	143.2
Cash from Operations	992.4	162.1	155.5	418.1
Cash/Equiv.	2,035.8	2,006.3	2,064.3	2,290.8
Total Debt	4,460.4	4,308.8	4,251.3	4,099.8
FD EPS	0.56	0.44	0.52	0.40
FD Adj. EPS	0.56	0.44	0.52	0.40
FD CFPS	0.60	0.54	0.61	0.50

* Bloomberg consensus estimates; calculated if more than 3 observations are present

NA: Not Applicable

nmf: Not Meaningful (typically refers to negative or exceedingly large values)

Source: Bloomberg, QNBFS Research

	FY2015a	FY2016	FY2017e	FY2018e
Valuation				
Adj. EV/EBITDA	14.1x	12.0x	11.1x	10.3x
Peer Average*	15.9x	21.0x	14.5x	9.0x
Adj. P/E	13.6x	11.5x	11.4x	10.5x
Peer Average*	13.9x	14.5x	13.7x	9.8x
P/CFPS	12.3x	9.9x	9.7x	8.8x
Peer Average*	9.7x	12.4x	15.0x	8.8x

	FY2015a	FY2016	FY2017e	FY2018e
Metrics				
Leverage and Debt Service				
Net Debt/adj. EBITDA	3.2x	3.2x	1.9x	2.0x
Debt/Capital	26%	25%	26%	25%
Debt/Equity	0.4x	0.4x	0.4x	0.4x
Interest Coverage	5.4x	6.7x	6.6x	7.2x
Profitability				
Adj. ROA	3.0%	3.6%	3.9%	4.4%
Adj. ROE	5.3%	6.2%	6.2%	6.5%
ROC	5.4%	6.0%	6.3%	6.8%

	FY2015a	FY2016	FY2017e	FY2018e
Dividend Payouts				
Adj. Net Income	80%	81%	65%	61%
Operating Cash Flow	72%	69%	56%	51%

	FY2015a	FY2016	FY2017e	FY2018e
Growth				
Revenue	(24.4%)	66.0%	(10.2%)	(14.7%)
Adj. EBITDA	(16.4%)	17.4%	3.1%	6.5%
Reported Net Income	10.2%	(9.6%)	9.9%	6.1%
Adj. Net Income	(16.1%)	18.4%	1.5%	6.1%
Operating Cash Flow	(17.0%)	24.3%	1.4%	8.6%

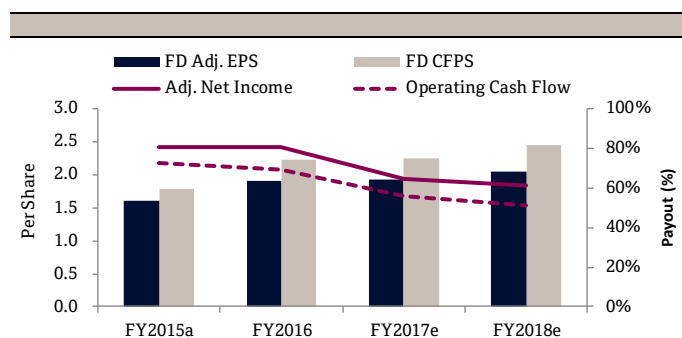


Fig 1 – Historical quarterly results vs. QNBFS estimates

	Unit	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016	QNBFS Est.
Financial Results							
Total Operating Revenue	QR mn	210.5	458.1	353.4	500.2	1,079.1	607.4
Gross Profit	QR mn	64.0	310.2	187.7	212.2	405.9	218.7
Gross Margin	%	30%	68%	53%	42%	38%	36%
Adj. EBITDA	QR mn	33.4	310.7	138.5	168.8	302.9	231.2
Adj. EBITDA Margin	%	16%	68%	39%	34%	28%	38%
D&A	QR mn	(17.5)	(17.5)	(17.9)	(18.7)	(47.9)	(20.9)
Adj. EBIT	QR mn	15.9	293.2	120.6	150.0	255.0	210.3
Adj. EBIT Margin	%	8%	64%	34%	30%	24%	35%
Net Interest Expense	QR mn	(22.2)	(22.0)	(22.2)	(21.3)	(20.7)	(40.3)
Adj. EBT	QR mn	(6.3)	271.3	98.4	128.7	234.3	170.0
Adj. EBT Margin	%	(3%)	59%	28%	26%	22%	28%
Reported Net Income (Attrib. to Common Equity)	QR mn	94.5	258.9	72.9	119.8	171.6	156.9
Reported Net Income (Attrib. to Common Equity) Margin	%	45%	57%	21%	24%	16%	26%
Adj. Net Income	QR mn	(24.8)	258.8	89.7	117.8	208.8	156.9
Adj. Net Income Margin	%	(12%)	56%	25%	24%	19%	26%
Cash/Equiv.	QR mn	2,277.3	1,645.4	1,610.1	1,544.0	1,565.9	2,389.4
Total Debt	QR mn	4,806.7	4,738.2	4,733.1	4,633.5	4,517.9	4,466.1
Operating Cash Flow (Before WC)	QR mn	(0.1)	253.0	103.3	129.1	300.2	186.1
Operating Cash Flow (Before WC) Margin	%	(0%)	55%	29%	26%	28%	31%
Total Dividends Paid	QR mn	1.9	516.8	19.4	7.7	0.6	-
Current Net Income Dividend Payout Ratio	%	66%	77%	116%	100%	87%	89%
Current Adj. Net Income Dividend Payout Ratio	%	80%	93%	149%	124%	81%	87%
Per Share Items							
Reported EPS - FD	QR/sh	0.27	0.73	0.21	0.34	0.48	0.44
Adj. EPS - FD	QR/sh	(0.07)	0.73	0.25	0.33	0.59	0.44
CFPS (ex. WC)	QR/sh	(0.00)	0.71	0.29	0.36	0.85	0.53

NA: Not Applicable
nmf: Not Meaningful

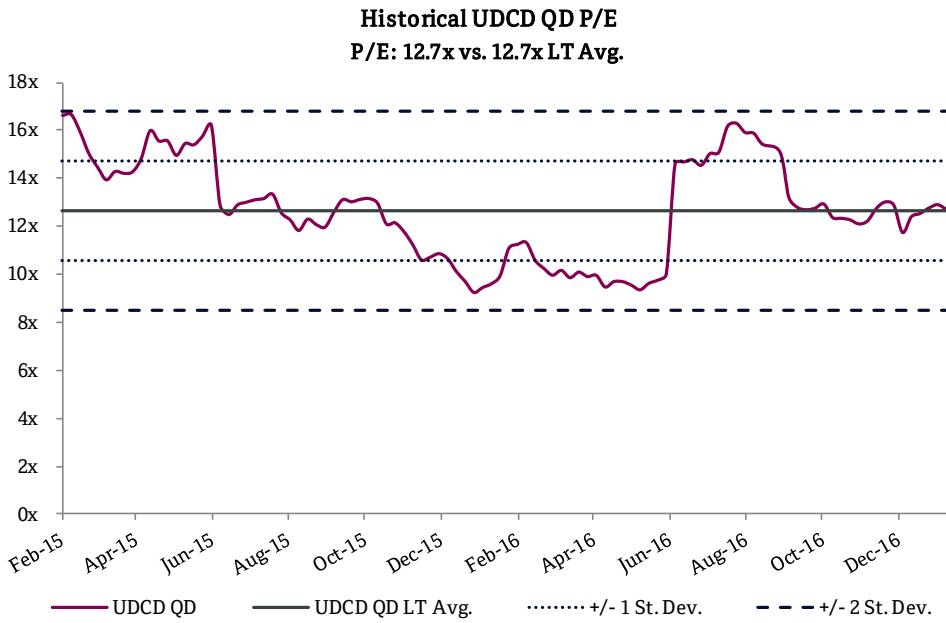
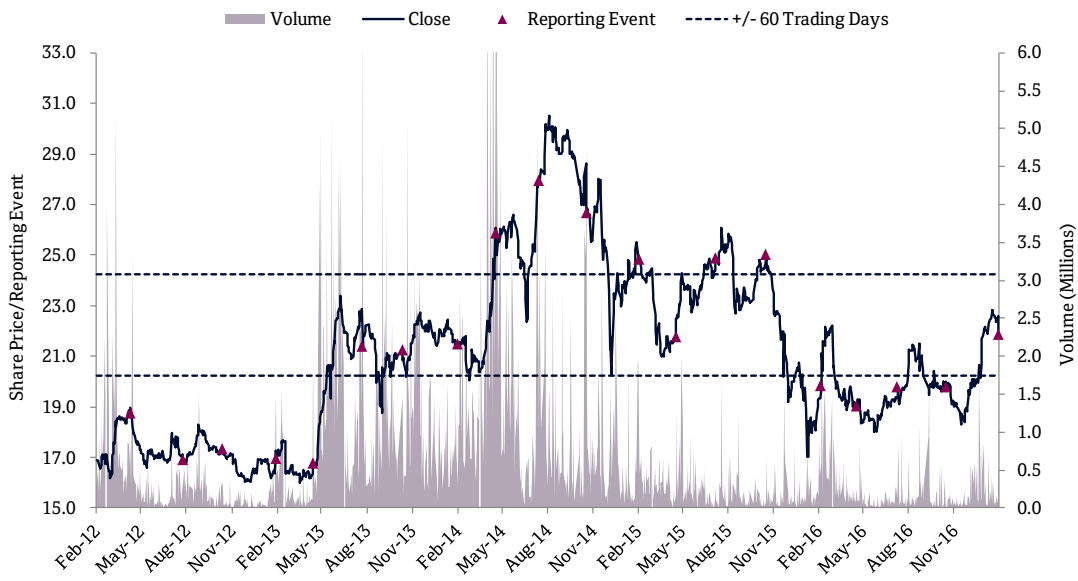
Source: Company reports, QNBFS Research

Fig 2 – Our 2017 revised vs. prior earnings estimates

	Unit	2017e		Δ
		Revised	Prior	
Financial Results				
Total Operating Revenue	QR mn	2,148.0	2,138.3	0%
Gross Profit	QR mn	1,105.2	1,020.2	8%
Gross Margin	%	51%	48%	
Adj. EBITDA	QR mn	949.4	956.8	(1%)
Adj. EBITDA Margin	%	44%	45%	
Adj. Net Income	QR mn	685.0	677.1	1%
Adj. Net Income Margin	%	32%	32%	
Total Debt	QR mn	4,099.8	3,865.4	6%
Total Dividends Paid	QR mn	442.6	531.1	(17%)
Current Adj. Net Income Dividend Payout Ratio	%	65%	78%	
Per Share Items				
Adj. EPS - FD	QR/sh	1.93	1.91	1%
CFPS (ex. WC)	QR/sh	2.25	2.17	4%

Source: QNBFS Research

Fig 3 – Historical share price performance following earnings events



Source: Bloomberg, QNBFS Research

Detailed Model Summary

Income Statement		Unit	2013	2014	2015	2016	2017	2018
Revenue	QR mn		2,081	1,906	1,441	2,391	2,148	1,833
COGS	QR mn		(1,148)	(731)	(566)	(1,275)	(1,043)	(529)
Gross Profit	QR mn		933	1,175	875	1,116	1,105	1,305
Gross Margin %	%		44.8%	61.6%	60.7%	46.7%	51.5%	71.2%
G&A	QR mn		(230)	(287)	(312)	(303)	(280)	(280)
Total Operating Expenses	QR mn		(269)	(236)	(90)	(195)	(156)	(293)
Adj. EBITDA	QR mn		664	939	785	921	949	1,011
Adj. EBITDA Margin %	%		31.9%	49.2%	54.5%	38.5%	44.2%	55.2%
D&A	QR mn		(112)	(84)	(75)	(102)	(103)	(121)
Adj. EBIT	QR mn		553	855	709	819	847	891
Adj. EBIT Margin %	%		26.5%	44.9%	49.2%	34.3%	39.4%	48.6%
Interest Income	QR mn		22	23	35	37	19	21
Interest Expense	QR mn		(84)	(148)	(131)	(123)	(129)	(124)
Net Interest Expense	QR mn		(62)	(125)	(96)	(86)	(110)	(104)
Earnings Before Taxes	QR mn		490	730	613	733	737	787
Adj. Net Income	QR mn		404	679	570	675	685	727
Adj. Profit Margin %	%		19.4%	35.6%	39.6%	28.2%	31.9%	39.7%
WA Basic Shares Outstanding	mn		354.1	354.1	354.1	354.1	354.1	354.1
WA FD Shares Outstanding	mn		354.1	354.1	354.1	354.1	354.1	354.1
FD EoP Shares Outstanding	mn		337.2	354.1	354.1	354.1	354.1	354.1
Adj. EPS - FD	QR/sh		1.14	1.92	1.61	1.91	1.93	2.05
CFPS (ex. WC)	QR/sh		2.27	2.15	1.78	2.22	2.25	2.44
CFPS	QR/sh		3.16	4.45	2.06	0.83	4.88	2.04
Balance Sheet			2013	2014	2015	2016	2017	2018
Cash/Equiv	QR mn		2,002	2,823	2,277	1,566	2,291	2,055
A/R	QR mn		1,729	1,464	1,386	2,265	863	1,023
Inventories	QR mn		3,096	1,665	1,370	2,018	354	422
Total Current Assets	QR mn		6,848	5,970	5,033	5,849	3,508	3,500
PP&E	QR mn		3,824	4,001	4,499	3,231	3,286	3,726
Total Long-Term Assets	QR mn		11,917	13,244	14,106	12,875	12,932	13,371
TOTAL ASSETS	QR mn		18,765	19,214	19,138	18,723	16,440	16,872
A/P	QR mn		2,313	2,671	2,664	2,589	455	541
Total Current Liabilities	QR mn		3,775	3,472	4,215	4,000	1,155	1,167
Total LT Liabilities	QR mn		4,243	4,622	3,637	3,413	3,706	3,806
TOTAL LIABILITIES	QR mn		8,018	8,094	7,852	7,413	4,861	4,973
Non-Controlling Interest	QR mn		315	347	373	412	463	523
Issued Capital	QR mn		3,372	3,541	3,541	3,541	3,541	3,541
Retained Earnings	QR mn		4,057	4,099	4,258	4,498	4,642	4,823
TOTAL OWNERS EQUITY	QR mn		10,432	10,772	10,914	10,898	11,116	11,375
Cash Flow Statement			2013	2014	2015	2016	2017	2018
Operating Cash Flow	QR mn		803	761	632	786	797	865
Non-Cash Change in WC	QR mn		317	816	97	(491)	931	(142)
CFO	QR mn		1,120	1,577	729	294	1,728	724
Capex	QR mn		(494)	(316)	(607)	(450)	(160)	(560)
CFI	QR mn		(455)	(510)	(1,395)	584	(142)	(542)
Net Change in Debt	QR mn		(2,519)	(1,075)	(1,938)	(649)	(418)	26
Dividends	QR mn		(345)	(346)	(458)	(544)	(443)	(443)
CFD	QR mn		(1,040)	(524)	(716)	(837)	(861)	(417)
FX Translation	QR mn		-	-	-	-	-	-
Net Change in Cash	QR mn		(375)	544	(1,381)	41	725	(236)
FCF	QR mn		626	1,261	121	(155)	1,568	164

Source: Company reports, QNBFS Research

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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