المجموعة المالية - هيرميس
EFG HERMES

EGYPTIAN RESORTS COMPANY

So Far So Good, But Tourism Prospects Remain key

25 NOVEMBER 2008

EGYPT | TOURISM

Short-Term Rec.:	Neutral	Current Price*:	EGP 1.80
Long-Term Rec.:	Buy	LT Fair Value:	EGP 5.53

CONTENTS

• **We Initiate Coverage on ERC with a LT Fair Value of EGP5.53.** ERC's stock currently trades at a significant 82% discount to our estimated NAV for the company. We used a sum-of-the-parts (SOTP) methodology based on discounted cash flow (DCF) to value ERC and its 70%-owned subsidiary. Our fair value comes at a 45% discount to our estimated NAV.

• **A Mixed-Use Resort Destination.** ERC, established in 1996, has purchased 32 million sqm in the Sahl Hasheesh area by the Red Sea from the Tourism Development Authority (TDA) to develop into an international resort offering upscale hotels and residential properties and retail shops to serve the town centers.

• **The Land Bank is Divided into Three Phases.** ERC sold 22% of the total area of Phase I and Phase II (12 million sqm), while no sales have yet been made in Phase III (20 million sqm). The average selling price per sqm for land sold in 2008 is estimated at USD135, a 73% Y-o-Y increase. ERC bought its land bank from the TDA for an average USD1.3 per sqm, and its only remaining land liability is for Phase III: EGP134 million, payable in installments until 2014e.

• **An Integrated Business Model.** The company develops a master plan for the destination and after developing infrastructure, sells plots to anchor developers in the hospitality business. ERC then exclusively provides utility and community management services. ERC holds a 70% stake in Sahl Hasheesh Company (SCH), established in 2007 to build the town centers for leasing and to build residential properties for sale. SHC has so far bought 0.6 million sqm of land from ERC.

• **2008 and Beyond:** 2008e KPIs are expected to be relatively strong, with sales estimated to be up 36% Y-o-Y and net profit up 11%. We conservatively forecast annual land sales averaging 0.6 million sqm from 2009e to 2011e and almost no appreciation in land prices in 2010e and 2011e. We estimate that prices will gradually rise from 2012e and grow at a 10% CAGR thereafter.

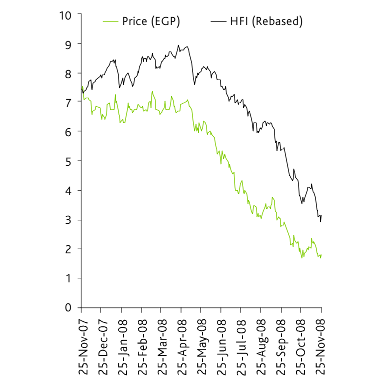
• **Valuation:** We used a conservative WACC of 19% for ERC (standalone) and 20% for SHC (11% RFR) and a 3% terminal growth rate for the recurring business segment. We believe the weakness in global tourism and real estate sector over the short to medium term and the lack of a track record for some of the company's business segments justify the high risk premium.

• **A ST Neutral / LT Buy Recommendation:.** We believe the stock holds potential value over the long term as: i) the destination reaches critical mass over the next few years, ii) when two of its three phases reach maturity, and sales and deliveries in Phase III pick up, building on the success of the first two phases. Our ST recommendation on the other hand reflects the current negative sentiments on real estate stocks and the slow European economy which is a major driver of Egyptian tourism and secondary homes sales.

COMPANY NOTE

December year end	*2007a*	*2008e*	*2009e*	*2010e*
Revenue	***351.6***	***479.2***	***438.3***	***468.7***
Operating Profit	*285.9*	*405.6*	*360.2*	*371.6*
EBITDA	*287.5*	*407.7*	*372.2*	*392.4*
Net Attrib. Income	*273.0*	*314.0*	*292.1*	*302.5*
EPS	*0.33*	*0.30*	*0.28*	*0.29*
DPS	*0.20*	*0.00*	*0.11*	*0.13*
Net Debt (Cash)	*(462.3)*	*(297.1)*	*(631.3)*	*(401.4)*
P/E (Attrib.)	***5.5***	***6.0***	***6.5***	***6.2***
EV/EBITDA	*3.7*	*3.9*	*3.4*	*3.8*
P/BV	*1.4*	*1.5*	*1.2*	*1.1*
P/CF	*15.0*	*5.8*	*6.3*	*6.0*
Dividend Yield	*11.1%*	*0.0%*	*6.2%*	*7.3%*
RoAE	*36.1%*	*27.2%*	*21.4%*	*18.8%*

Figures in EGP million unless otherwise stated



Estimates Changes					
	2007a	*2008e*		*2009e*	
(EGP mn)		*Old*	*New*	*Old*	*New*
Revenue	***351.6***	***N/R***	***479.2***	***N/R***	***438.3***
EBITDA	***287.5***	***N/R***	***407.7***	***N/R***	***372.2***
EBITDA Margin	*81.8%*	*N/R*	*85.1%*	*N/R*	*84.9%*
Net Attrib. Income	***273.0***	***N/R***	***314.0***	***N/R***	***292.1***

Stock Data	
Mkt. Cap./ Shares (mn)	*EGP1,890 / 1,050*
Av. Monthly Liqd. (mn)	*EGP643.0*
52 Week High / Low	*EGP7.6 / 1.6*
Bloomberg / Reuters	*EGTS EY / EGTS.CA*
Est. Free Float	*40%*

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PRICES AS AT 25 NOVEMBER 2008

EXECUTIVE SUMMARY

BACKGROUND - NOT A TYPICAL REAL ESTATE DEVELOPER, BUT A RESORT COMMUNITY MANAGER

Egyptian Resorts Company (ERC) is a master developer of resort communities established in 1996 to develop 32 million square meters (sqm) in the Sahl Hasheesh area into an international destination. This project encompasses international hotel chains, luxury real estate properties and downtown commercial centers. The company began trading on the Egyptian Exchange (EGX) in 2004. The main shareholders include Rowad Tourism Company (14.50%), Kato Investments (11.96%), Al Ahly Capital Holding (8.99%) and a free float (40.1%).

THE LAND BANK - 24% OF SALEABLE LAND SOLD, AVG. 2008E PRICE FORECAST AT USD135/SQM

ERC's total land bank is divided into three phases. It so far has sold 24% of its saleable area (7 million sqm out of 28.7 million sqm) to anchor developers who will develop their plots according to pre-approved designs within the timeframe specified. No land has yet been sold in Phase III. The average selling price per sqm for land sold in 2007 was UDS78 and is believed to have risen 73% Y-o-Y in 2008e. Land buyers pay 20-30% of the price as a down payment and the remainder in six to eight equal semi-annual instalments. ERC bought its land bank at a nominal average price of USD1.3 per sqm from the Tourism Development Authority (TDA) and has already paid its land liabilities for the first two phases. Payment for Phase III (EGP134 million) will be made in instalments until 2014e.

BUSINESS MODEL - FULLY INTEGRATED, NEVERTHELESS SIMPLE

ERC has a simple yet fully integrated business model: i) it develops a master plan for the destination through leading architectural firms, ii) it develops the infrastructure, which includes roads, electricity, communication and desalination water plants, in accordance with design guidelines and community management rules and regulations, ii) ERC then sells individual pre-designated plots to developers in the hospitality and real estate businesses, and iv) it then exclusively supplies utilities (water, electricity, communications) across the destination through its project partners and implements community management schemes. In January 2007, ERC established Sahl Hasheesh Company (SHC) to develop the downtown areas in Phase I and Phase II and to develop residential tourism properties in ERC's project. Until now, SHC has bought around 630,000 sqm of land in both phases. ERC holds a 70% stake in SHC.

FINANCIAL PERFORMANCE - STRONG, BUT WILL IT HOLD?

ERC financial performance has been relatively strong over the past couple of years as it rode on the back of Egypt's real estate and tourism boom. Average land sale prices grew by double digits annually to an estimated USD135 per sqm in 2008 from USD42 in 2005. As with other real estate companies, one should look at the full year results rather than interim figures, since the sale of land is a very lengthy process, and revenues tend to be lumpy and may not follow any recognizable pattern. Despite management being able to significantly increase land prices in 1H2008, we conservatively forecast that land prices will remain at USD135/sqm in 2H2008, with ERC selling in 2H2008 almost a similar amount of land sales in 1H2008, ending the year at 0.7 million sqm. We forecast 2008 revenues will grow 36% Y-o-Y to EGP479 million.

2009 AND BEYOND - WE FORECAST A 10% ANNUAL INCREASE IN LAND PRICES OVER 2012-22

We conservatively forecast a small increase in 2009 land sale prices of 7% to USD145 per sqm followed by almost no increase in 2010-11. We assume that prices will start to rise once again, albeit slowly, starting in 2012. Overall, we forecast a 2012-2022 CAGR for land prices of 10%. We have assumed a moderate slowdown in land sales over 2009-2010 to 0.6 million sqm per year, a target we expect management will be able to achieve in a difficult sales environment.

DIVERSIFYING REVENUE SOURCES - SHC STARTS GENERATING LEASE REVENUE BY 2011

We forecast that in Phase I, SHC will start recording commercial lease revenue generated by retail shops as early as 2011 and real estate revenue starting in 2012. For Phase II, it should start recording both forms of revenue in 2013. We expect lease revenues to grow at a five-year CAGR of 77% to EGP555 million in 2016e. We also forecast that real estate revenue from the two phases will peak at EGP413 million by 2017. Since we do not assume that SHC will purchase more land in Phase III, we do not expect any revenues to come from the sale of residential units in that phase. We forecast that ERC's consolidated revenue will more than quadruple by 2015 to EGP3 billion, with non-land-sale-related revenues contributing a growing portion of the total, or 36% in 2015, up from an estimated 2% in 2008.

ERC's gross profit margin has been rising over the past two years, driven by rapid increases in land prices and fixed estimated costs per sqm. We expect a consolidated gross margin of 92% in 2008e, falling gradually to 82% in 2015e. We forecast that by the end of the year, ERC's 2008 net profit will have grown 11% Y-o-Y to EGP316 million. We forecast that net profit will grow at a six-year CAGR of 30% from 2008e to 2014e and cross the EGP1 billion mark in 2013e, with growing contributions to revenue from SHC and services.

LONG TERM BUY - WE INITIATE COVERAGE WITH A LT BUY AND A FV OF EGP5.53/SHARE

We used sum-of-the-parts (SOTP) methodology based on discounted cash flow (DCF) to value ERC, which combines the elements of both a master planner and a developer. We believe the DCF approach presents itself as the most appropriate way to capture long-term value in this company, given the large land bank that will be sold over a long timeframe and the 70% stake in a development company (SHC) which, besides developing real estate, will drive significant value from developing and leasing commercial property. We initiate coverage on ERC with an estimated LT Fair Value of EGP5,808 million, or EGP5.53 per share, and a ST Neutral / LT Buy recommendation. Our ST recommendation is based on the current weakness and volatility in global markets and the negative sentiment towards both the real estate and tourism industries. We believe the stock holds potential value in the long term, when the project reaches critical mass in the next few years, when Phase I and Phase II reach maturity stage and when Phase III sales and deliveries pick up, building on the success of the first two phases.

We believe that the newly appointed management's ability to weather the difficult times over the next 12-18 months will be put to the test. The challenge here is to continue to attract developers to the destination at a time when credit financing is difficult to raise and to carefully select those who will maintain the high standards essential to bring in the right clientele mix.

VALUATION ASSUMPTIONS - LOOKING FOR SIGNS OF IMPROVEMENT ON THE GLOBAL FRONT

Our valuation is based in the following assumptions: i) we have forecast that a significant portion of land sales will take place after 2011 following a pick-up in tourism and demand for secondary homes, ii) we did not include the 2.0 million sqm of land in Phase III that the company said SHC might buy. We believe that if SHC buys the land and market conditions are conducive enough to allow it to sell most of the residential units and lease most of the commercial properties, the upside risk to our valuation will be in the range of 10%-12%. iii) the success of the utilities and community management services (services revenue) is highly dependent on the success of the destination. We estimate that the services segment will contribute 14% of the valuation over our forecast horizon. Any slowdown in the activities of the destination would surely lessen the contribution of this segment.

Given the current market weakness and lack of visibility over the short term, we opted to assign a high discount rate for ERC and its subsidiary. Our risk premium is 8.0% for ERC (standalone) and 9.0% for SHC, and our risk free rate is 11% (Egyptian 9-year Treasury bond). We assigned a conservative 3% terminal value for the recurring business, the utilities ERC's management services and the lease of commercial properties by SHC. We believe the high risk premium is justified by the significant downside risks, including: i) an extended down cycle for real estate and global tourism, ii) Egypt's becoming a more expensive destination for tourists if the EGP continues to appreciate against the EUR, and iii) the inability of developers (real estate or hospitality) to fully sell their planned property and lease the commercial areas, hindering the destination from reaching critical mass, which is imperative for its success.

We examined the sensitivity of our valuation to changes in the discount rate and land price growth over our forecast horizon by varying the discount rate and the 2012-2022e CAGR of land prices by +/- 200 bps. We conclude that our valuation is more sensitive to changes in discount rates and slightly less sensitive to changes land sale prices over the long term. We also calculated the Net Asset Value (NAV) for ERC as a sanity check using the current land sale price of USD135 per sqm (2008e) and average infrastructure cost of USD20 per sqm. Our calculation resulted in a NAV/share of EGP10.15 (after deducting taxes and net debt), 1.4x higher than our estimated Fair Value for the land sales alone (EGP4.21 per share). If we apply a 70% discount to NAV, similar to that of global peers, which currently trade at discounts to NAV of 50-90%, the implied NAV becomes EGP3.04 per share, which is still 69% higher than the current share price.

I. COMPANY OVERVIEW

The current Land bank is 32 million sqm of land in Sahl Hasheesh

Egyptian Resorts Company (ERC) was established in April 1996 to be a master developer of resort communities. The company acquired 32 million square meters (sqm) of land in Sahl Hasheesh Bay on the Red Sea, 18 kilometers south of Hurghada International Airport, from the Tourism Development Authority (TDA) at an average nominal price of USD1.3 per sqm. Sahl Hasheesh area is 40 km south El Gouna and within close proximity to north of Makady Bay.

Not a real estate developer…

By selling land in its master-planned project to anchor developers, ERC plans to turn the Sahl Hasheesh area into an integrated resort destination that offers high-end hotels managed by international brand names, upscale residential apartments and villas and commercial areas to serve the town centers. All developers are required to get ERC approval for their own final master plans to ensure high quality development and uniformity.

…but more a master planner…

The transformation from a raw land bank to a functional destination in phases is taking place as follows: i) ERC develops a master plan for the destination using leading architectural and urban planning firms,

ii) It then develops the infrastructure in accordance with design guidelines and community management rules and regulations. The infrastructure includes roads, electricity, communication, desalination plants and waste water plants,

iii) ERC then sells individual pre-designated plots to developers and investors whose main businesses are hotel ownership and the development of luxury resort residential real estate properties,

iv) ERC then exclusively supplies utilities (water, electricity, communications) for the destination through its project partners and implements community management schemes.

Initially, ERC sold plots of land to individual buyers whose architectural plans ERC had to approve before they could begin developing their villas. ERC stopped selling land plots to individuals, as the process of approving the individual plans was time consuming and therefore not sustainable. To ensure quality and uniformity, ERC then agreed to develop the villas on the land plots it had already sold to individuals (relatively few in number).

…and soon to be a participator in value creation as a developer

In January 2007, ERC established Sahl Hasheesh Company (SHC) for the purpose of developing the downtown areas in Phase I and Phase II and the residential tourism units in ERC's project. ERC owns a 70% stake in SHC, which is not yet operational.

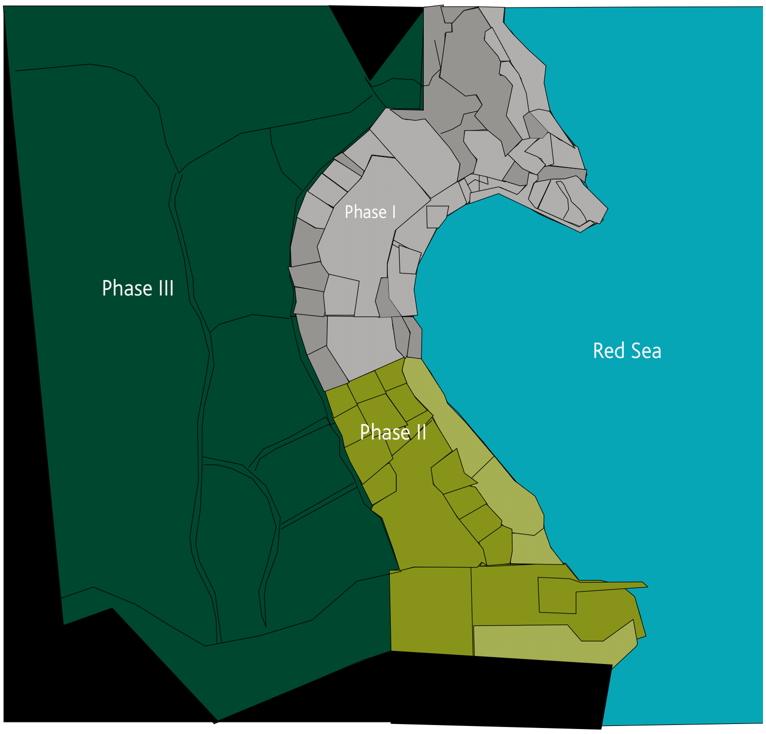
According to Sahl Hasheesh master plan, the land is divided into three phases as presented in the table below. Phase I and Phase II will include three branded 18-hole golf courses, according to the most recent master plan. Furthermore, all phases will be linked by artificially made water channels.

Figure 1: ERC Land bank Breakdown

	Phase I	Phase II	Phase III	Total
Total Area (mn sqm)	6.0	6.0	20.0	32.0
Sellable Area (mn sqm)	5.2	5.4	18.0	28.7
% of total	87%	90%	90%	90%
Area Sold (mn sqm)	4.7	2.2	0.0	7.0
% of Sellable	90%	41%	0%	24%
Infrastructure	100% complete	60% complete 40% end of 2010	Start 2009 Finish 2020	
Construction	Hotels: end of 2011 Residential: end of 2012	Hotels: end of 2014 Residential: end of 2015	Start 2010	

Source: ERC

Figure 2: Map for ERC Land Plots and Plots sold*



*Shaded areas: sold plots as of August 2008
Source: ERC, EFG-Hermes

Status of Infrastructure development

The infrastructure work for Phase 1 is complete, with infrastructure costs of EGP159 million paid as of August 2008. Two hotels are operating, the Pyramisa Hotel since 2007 and the Old Palace since early 2008. As for Phase II, 60% of the infrastructure is complete at a cost until now of EGP115 million, with the remaining infrastructure cost budgeted at an estimated EGP130 million. ERC commissioned RTKL of the UK to draw up the master plan for both Phase I and Phase II and Bechtel International to act as project manager for infrastructure development. ERC is currently selecting a master planner for Phase 3.

Figure 3: ERC Time Line

1995	First plots of land acquired in Sahl Hasheesh area
1996 - 1997	Concept development and master planning for Phases I and II
1998	First plot sold for USD 37 / m²
1999	Infrastructure works commence
1999-2003	Aggressive marketing to counter tourism industry crash
2004-2007	Ongoing construction, sales and negotiations with prospective investors
2007	New management appointed
	First regional 4-star hotel begins operations
	Phase III design begins
	ERC submits offer for additional 14 million m² on Red Sea in “Bernice” (pending)
2008 Onwards	Build additional land bank
	Focus on development, community management, project

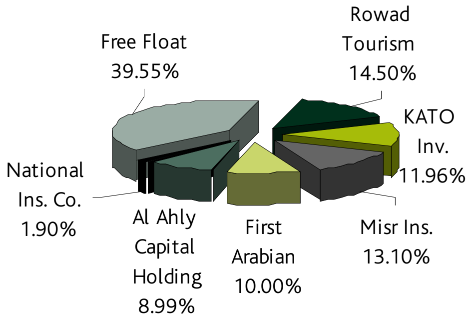
Source: ERC

II. SHAREHOLDING STRUCTURE

ERC, which is listed on the Egyptian Exchange (EGX), has a paid-in capital of EGP1.050 billion divided into 1.050 billion shares with a par value of EGP1 each. ERC did not make an initial public offering, but a number of the founding shareholders offloaded some of their shares to the public in late 2004. Since then, share liquidity has picked up significantly.

The state-owned National Bank of Egypt (NBE) was looking to sell the government's 24% stake in ERC in 2007 in a public auction. The auction was postponed to give interested buyers sufficient time to study the company and the sector, and NBE until now has not disclosed a new timeframe for the sale. We believe that this could create an overhang in the stock until the government announces its plans to sell its stake in ERC.

Figure 4: ERC Shareholding Structure



Source: ERC

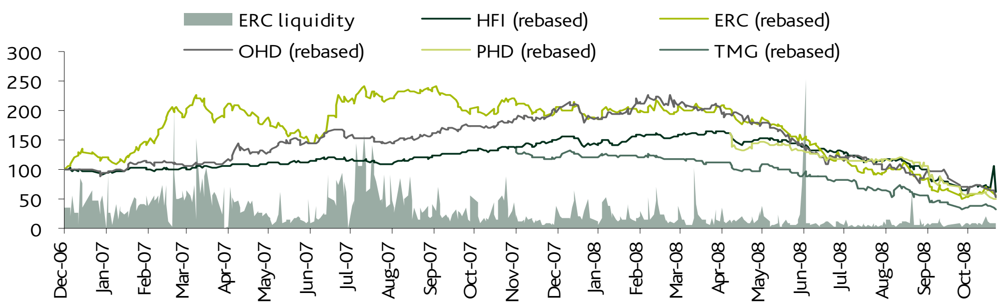
A new management committed to sustaining growth

In 2007, a new management team was appointed by the board to manage ERC. Its three top executives have collective experience in resort management, real estate and hospitality of over 30 years. This new team broadens ERC's management base and provides a wide range of experience that that should address the concern of some investors that the previous management's capacity was "too thin at the top".

STOCK PERFORMANCE

ERC's shares have been among the most liquid on the Egyptian Exchange (EGX) over the past 12 months, with average monthly liquidity of EGP735 million. Since January 2007, the stock performed significantly better than the HFI index and, until January 2008, it was also performing better than those of other real estate and tourism companies. With the major downturn on the EGX since May 2008, when investors reacted negatively to rising inflation and government policy changes, ERC fell victim to strong negative sentiment towards the real estate and tourism sectors and began underperforming the HFI index. By November 2008, the stock had fallen 79% from its peak of EGP8.17 in August 2007.

Figure 5: Performance of Selected Real Estate/Tourism Stocks on the EGX (Jan 2007-Nov 2008)



Source: Reuters, EFG-Hermes

III. BUSINESS MODEL

A Unique value proposition

ERC is one of a very few landowners and developers in the country that have acquired relatively large land banks at very low cost. ERC provides the infrastructure up to the site to be developed, and the developer merely has to plug in to the water pipelines, optical fiber communications network and electricity. This model should appeal to most anchor developers, as it limits their exposure to time-consuming infrastructure logistics. This business model provides for three main sources of revenue:

A) LAND SALE

So far, the main value generator is the sale of land plots

ERC sells the land plots to developers after first approving their designs to ensure that they meet the broader guidelines of the master plan. The developers pay 20-30% of the price as a down payment and the rest in six to eight equal semi-annual installments. ERC develops and delivers the infrastructure 90-120 days before the developers finish their projects. The transfer of land ownership does not take place until the developers complete their construction, thus helping ERC to eliminate speculative buyers and ensuring that developers are serious and committed.

ERC's infrastructure cost is around USD10 per sqm, which is more than covered by the down payment made by the buyers. This eliminates the need for ERC to resort to debt financing for the infrastructure.

B) UTILITIES

Utilities revenue: a steady stream of income, but critical mass is a pre-requisite

ERC expects to generate cash from the provision of utility services (water, electricity, communication) to developers and residents. The profitability of this business segment is highly dependent on usage levels. ERC provides the services to end users at a fee that does not decline as usage increases. The fee that ERC pays to the government, on the other hand, mainly for power and communication, does decline as usage rises above various thresholds. Higher usage by residential and commercial dwellings therefore translates into higher income and margins for ERC.

ERC also charges a community management fee for services such as security, waste disposal services and the upkeep and maintenance of public areas. These services should ensure a sustainable cash flow going forwards.

C) REAL ESTATE UNITS SALE AND LEASE

SHC will provide other sources of revenue starting with commercial leasing

ERC's subsidiary SHC has so far bought around 150,000 sqm of land in Phase I and 477,660 sqm in Phase II, which together will contain about 7,000 residential and commercial properties. SHC plans to buy a further 2.0 million sqm in Phase III to develop around 25,000-30,000 residential and commercial units. SHC is treated as a typical client of ERC and receives no preferential price treatment.

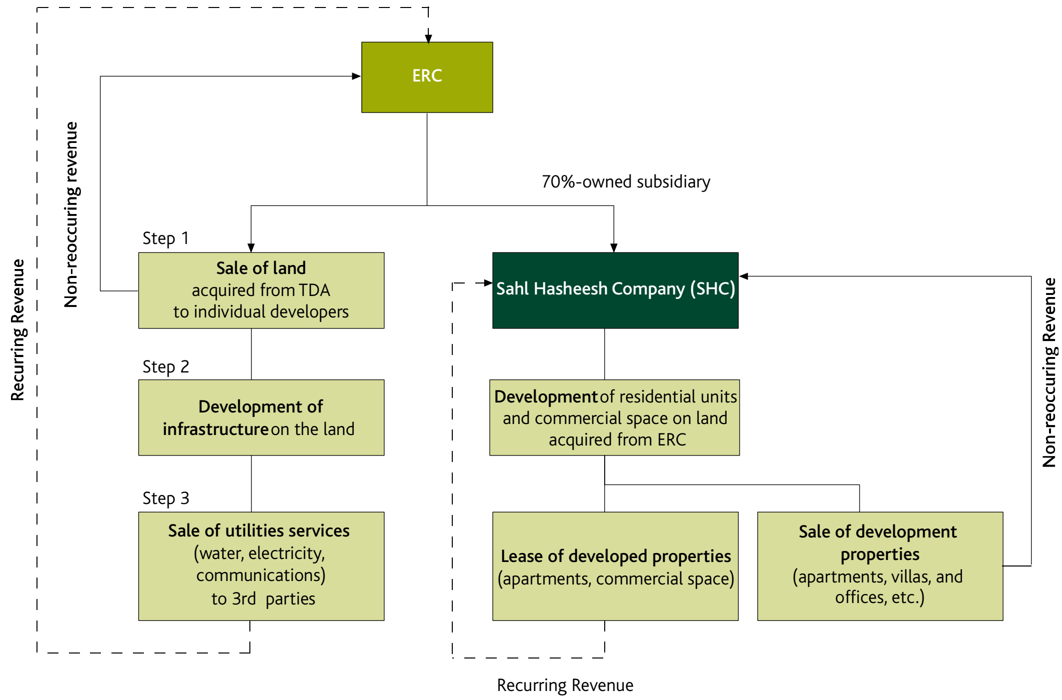
Clientele Base

ERC clientele base includes a mixture of renowned hospitality and real estate names including Travco (Iberotel), Baron Place, Trump Serrenia, Pyramisa, Tropicana and Palm Hills.

Typically, hospitality developers are more leveraged towards debt financing when developing their hotels while real estate developers base their business model on off-plan sales schemes.

The chart below describes the business model of ERC in terms of cash inflow and outflow.

Figure 6: ERC Business Model



Source: EFG-Hermes

WHAT'S NEXT?

ERC management has indicated that it will focus on the following areas over the coming few years:

Phase III Master Plan

ERC seeks to finalize the master plan for Phase III in 2008 and begin selling land plots by 2009 provided market conditions are conducive. The company wants to add value to the location by bringing in high-end hotel brands. It is providing standard designs that should help cut the developer's development cycle by three to six months as well as save costs, if the developer opts to use them.

Community and Utility Management

The company is working with world-renowned community manager, Ernst Body Corporate, to set up community management schemes for the entire resort and to handle the destination's maintenance and upkeep. ERC will continue investing in water desalination plants to allow for future capacity upgrades ensuring a comfortable supply cushion.

Diversifying into New Undeveloped Locations with Relatively High Return

Repeat the experience of Sahl Hasheesh?

The company will continue to seek profitable opportunities to buy cheap land at underserved locations to expand its business. ERC submitted a request to buy 14 million sqm of land at Bernice on Egypt's southern Red Sea coast. The management also showed interest in buying land along the Mediterranean on Egypt's North Coast. No further details on these two destinations are yet available. ERC's largest shareholder, Rowad Tourism Company (Rowad), owns 4 million sqm along the Gulf of Aqaba in Dahab in the Sinai Peninsula and along the northern Red Sea coast. ERC expressed interest in cooperating with Rowad in developing the land.

IV. BUSINESS DRIVERS AND RISKS

TOURISM

Egypt continues to be one of the cheapest destinations among its peers in terms of average room rates (USD41 in Hurghada, 2007, according to HVS), and it offers competitive second home prices of USD2,000-3,000 per sqm. Strong tourist arrivals remain key to healthy foreign demand, which constitutes the bulk of demand for secondary homes, especially in the Red Sea area.

Egypt tourist arrivals have grown 22% Y-o-Y to 11.1 million in 2007, with Europeans accounting for more than 50%. Occupancy rates have been as high as 76% in Sharm El Sheikh, 86% in Hurghada and 83% in El Gouna (Source: HVS and ODH).

The World Tourism Organization (WTO) announced that the growth of global tourist arrivals rose 3.7% in the first eight months of 2008, with signs of weakness showing in the months of June, July and August, falling below 2%. The WTO forecasts that growth in tourist arrivals for 2008 will be around 2-3%, versus its old estimate of 3-4%. The WTO expects tourist arrivals to slow down to 0-2% growth in 2009 as a result of recession in major tourism exporting countries, namely Europe and the United State. We believe that tourism arrivals in Egypt would continue to be strong in 2008, with arrivals forecast to grow around 9-10% to 12 million. Tourism companies have indicated that no reservations for November and December have been cancelled so far. Local tour operators nevertheless expect 1Q2009 hotel and flight reservations to weaken compared to 1Q2008. Therefore, we forecast the tourist arrivals might experience either stable or negative growth in 2009 as a result of the weakness in the European and Russian economies, the main inbound tourism markets to Egypt.

SECOND HOME MARKET

There has been strong demand for buying second homes in Egypt over the past years, driven mainly by Europeans attracted to: i) Egypt's competitive real estate prices that, despite a significant 100% appreciation over the past four years, remain relatively cheap, ii) its proximity to Europe, which with an average four-hour flight time is a medium-haul destination, iii) its moderate year-round weather, and iv) its relatively cheap living expenses versus competing destinations such as Greece and Turkey.

The economic slowdown in Europe is likely to reduce demand for second homes in Egypt for the next 18 months at least. We nonetheless believe that these attractions should help Egypt's weather the slowdown far better than other destinations in the region.

THE HOSPITALITY INDUSTRY

In the current environment of falling commodity and building material prices, we believe investors in the hospitality industry are willing to speed up the pace of construction provided the means of finance are available.

ERC management has indicated that the appetite of investors/developers has not yet abated, with interest from local and regional developers still strong. This is something that will be tested by time. ERC expects to raise the average selling price of land sales by 73% Y-o-Y, to end 2008 at an estimated selling price of USD135/sqm.

MULTI-DEVELOPERS RISK

Even though ERC has contractual agreements with developers to finish construction of their projects by specific deadlines, some of the smaller developers that lack the scale of the mega developers could delay or possibly even cancel their projects given the current economic slow down. We believe this represents a risk to the destination's attractiveness.

Furthermore, SHC, which is not operational yet, has no track record, and its value drivers are partially dependent on real estate unit sales, which are highly leveraged to the economic cycle.

FOREIGN EXCHANGE RISK

Since more than 50% of tourists coming to Egypt are Europeans, further appreciation of the EGP against the EUR makes Egypt less competitive than other destinations. The EGP has risen against the EUR by 11% since the beginning of October.

COMPETITION FROM OTHER DESTINATIONS

ERC might face competition from relatively mature destinations such as El Gouna or from destinations whose construction is ahead of Sahl Hasheesh's, such as Makadi Bay and Port Galib.

V. FINANCIAL ANALYSIS

NOTE ON ACCOUNTING PRACTICES AND FINANCIAL PROJECTIONS

Lack of historical track record is a significant risk to forecasts

Some of our forecasts have a significant element of risk, especially for the business lines where the company has no track record.

i) ERC's revenue stream so far has been driven predominantly by land sales, which are very irregular and very difficult to predict. The sale of individual plots is sometimes a lengthy process and can involve large, strategic plots. Such large transactions can lead management to restrict further sales in the short term. As a result, ERC's land sale revenue tends to be lumpy and may not follow a quarterly pattern.

ii) SHC is expected to generate revenue from commercial leases, a revenue source that is dependent to a certain degree on the occupancy of residential units and hotels in the vicinity.

iii) Intercompany transactions between ERC and its SHC subsidiary could result in distortions when financial statements are consolidated, making it difficult to extrapolate a trend.

All intercompany transactions are eliminated at the consolidated level

ERC fully consolidates its subsidiary, and thus any transaction at the level of SHC's income statements does not appear at the consolidated level of ERC due to inter-company eliminations. These transactions are: i) the purchase of land by SHC from ERC, and ii) the sale of utilities by ERC to SHC. From a balance sheet perspective, however, ERC's financial statements indicate that ERC records the land it has sold to SHC at cost. The cost of SHC's land bank is thus heavily undervalued on ERC's books despite the fact that SHC purchases its land at market prices.

SCH will be fully consolidated into ERC financials

We have assumed that SHC, which has not yet begun operations, will recognize its real estate revenues and costs according to the completed contract method, as do other developers in the market. We have assumed that SHC will focus on developing only Phase I and Phase II. Although ERC's management has indicated that SHC will buy 2.0 million sqm in Phase III, we have excluded this additional land from our forecasts. SHC expects to own a portfolio of commercial properties and sell residential units (second homes) on Phase III land. However, we have not included the 2 million sqm in our forecasts due to the lack of a crystallized master plan by SHC and the lack of short to medium-term visibility on the global outlook. We believe we will revise our financial forecasts upwards when SHC delivers a good track record in developing and leasing commercial properties and in selling residential units in Phase I and Phase II.

All SHC forecasts related to the speed of developing residential and commercial units, the sale of second homes and the lease of commercial properties are based on our own assumptions and are subject to change when the company releases its final master plan for Phase I and Phase II.

A. CONSOLIDATED REVENUES

ERC currently recognizes three types of revenues:

i) **Revenue from the Sale of Land**. This revenue is adjusted downwards to reflect the discount on receivables that are adjusted to the net present value (NPV). ERC discounts its land-related receivables by 10%.

ii) **Accrued Revenue**. This accounts for the difference between the value of cash installments paid in the accounting period and the discounted value of receivables related to these installments.

iii) **Revenue Generated from Sale of Utility Services.** This includes electricity, water and communications from properties already operating within the Sahl Hasheesh area (Phase I so far).

ERC HISTORICAL REVENUE

Land sales accounted for the majority of company revenue in 2007

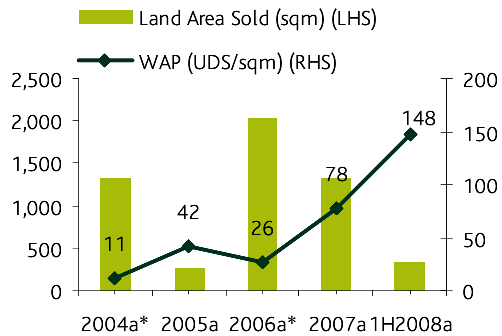
In 2007, total revenue grew 8.0% Y-o-Y to EGP352 million, of which EGP24.3 was accrued revenue from land sold in previous years. Revenue from land sales accounted for 99% of the total. The remaining 1% of revenue is attributed to services revenue, which was EGP2.6 million in 2007. The very low contribution of services revenue to the total was due to the operation of only one hotel in Phase I.

Service revenue grows strongly in 1H2008 due to land sales in 2Q2008

In 1Q2008, SHC bought a land plot worth EGP35.3 million, but due to eliminations at the level of consolidation, this transaction did not appear in 1H2008 income statement. The company posted total revenue of EGP6.3 million, of which EGP4.8 million was accrued and EGP1.5 million generated from services.

In 2Q2008, the company: i) sold around 261,000 sqm of land worth EGP217 million (net of discount on receivables), ii) recognized an additional EGP7.7 million in accrued revenue, and iii) and generated EGP2.3 million in revenues from services. The services segment grew by a strong 58% Q-o-Q and 515% Y-o-Y. In 1H2008, ERC generated EGP233 million in revenues, a decline of 8% Y-o-Y due to reasons discussed above.

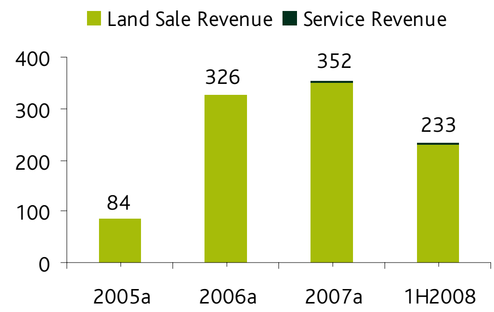
Figure 7: Weighted average price (WAP) of land and land sold



Source: ERC

*In 2004 WAP was low due to the promotional sale of a 1 mn sqm golf course at USD4.01 per sqm to a strategic investor. In 2006 WAP was low due to the sale of a vast volume of land to the Serrenia Marina and Golf project at USD20.70 per sqm

Figure 8: ERC Historical Consolidated Revenue



Source: ERC

ERC REVENUE FORECAST

We forecast ERC will end 2008 with a 38% increase in the top line

We forecast that ERC will generate consolidated revenues of EGP479 million in 2008, with land sale revenue accounting for 98% of the total. In line with management guidance, we forecast that ERC will end 2008 with an average sale price of USD135 per sqm (already achieved) and with sales of around 700,000 sqm of land from Phase I and Phase II.

Land prices increase, driving revenue growth in 2009

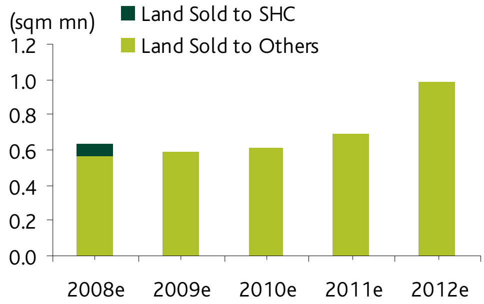
For 2009, we forecast ERC will record consolidated revenue of EGP438 million, of which EGP427 million is expected to be generated by land sales (net of discount on receivables and including accrued revenues from past land sales). We based our revenue forecast on a very conservative land sale assumption of approximately 0.6 million sqm versus the management guidance of 0.7 million sqm in 2009. We assumed a small 7% increase in land sale prices in line with the management guidance.

We conservatively estimate land prices to more double over our 14-year forecast horizon

We are conservatively forecasting no appreciation in land prices in 2010e and 2011e. We assume prices to begin rising once again, albeit slightly, starting 2012. From 2012 we are forecasting that prices will rise at a 10-year CAGR of c10%.

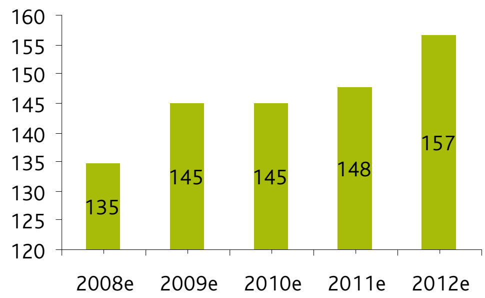
We forecast a moderate slowdown in the volume of land sales in 2010e and 2011e to 0.6 and 0.7 million sqm respectively, a target we expect current management will be able to achieve in a difficult sales environment. That said, we expect that management will target hotel developers for land sales, as their business model is not leveraged to the off-plan sales of traditional real estate developers.

Figure 9: Land Sold by ERC (2008e-2012e)
In million sqm



Source: EFG-Hermes estimates

Figure 10: Weighted Average Sale Price of Land (2008-2012e)
In USD, Unless otherwise stated



Source: EFG-Hermese estimates

SHC REVENUE FORECAST

Two additional sources of revenue will come on stream starting 2011e

ERC will start recording two other types of revenue when SHC completes the development of properties and begins leasing commercial areas and delivering residential units. We assume that SHC initially will be heavily involved in the construction of Phase I commercial and residential units starting in 2009e. We assume that commercial construction in Phase II will start in 2011e, so as not to stretch the contracting capacity of the company too much.

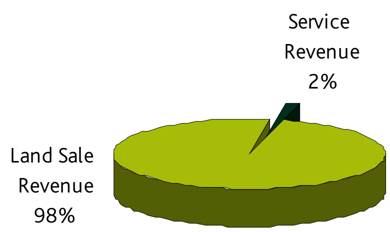
Commercial lease revenue by SHC is expected to grow at a 5-year CAGR of 77%?

We forecast that SHC will start recording commercial lease revenues generated by retail shops in Phase I as early as 2011e and in Phase II in 2013e. We expect commercial lease revenues to grow at a five-year CAGR of 77% to EGP555 million in 2016e.

We forecast that SHC will start recognizing real estate revenue in 2012e

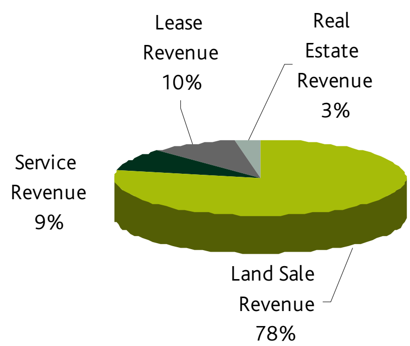
We estimate that SHC will offer around 2,600 residential units for sale in Phase I and Phase II. We expect revenue from the sale of units in Phase I to first appear on the consolidated income statement in 2012e, generating an estimated EGP29 million that year. Phase II is expected to start generating revenue from the sale of residential units in 2013e. We forecast that real estate revenue from the two phases will peak at EGP413 million by 2017e. Since we do not assume that SHC will purchase more land in Phase III, we do not expect any revenues to come from the sale of residential units in that phase. We may nevertheless revise our revenue assumptions upwards when SHC finalizes a master plan for the development of Phase III and records real estate unit sales and retail shop leases. We are also awaiting signs of improvement in the global outlook before becoming bullish on ERC's real estate and commercial business segments.

Figure 11: ERC Consolidated Revenue Breakdown in 2008e



Source: EFG-Hermes estimates

Figure 12: ERC Consolidated Revenue Breakdown in 2012e



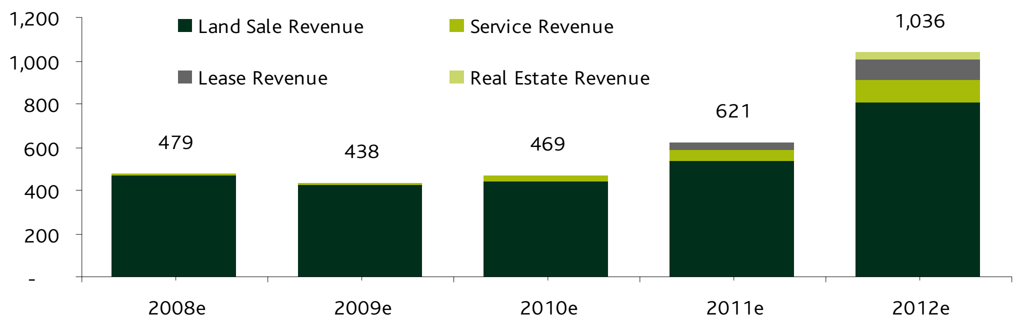
Source: EFG-Hermes estimates

CONSOLIDATED REVENUE

We forecast that ERC's consolidated revenue will reach nearly EGP2.5 billion by 2014e, with the portion of non-land-related revenues (commercial leases, real estate and services) growing to 32% from an estimated 2% in 2008e.

Figure 13: ERC Revenue by Type (2008-2012e)

Total Revenue in EGP million



Source: EFG-Hermes estimates

B. COSTS

How does ERC account for cost of sale in its income statement?

ERC recognizes the cost of land sold by assigning an estimate cost comprising the cost of raw land, infrastructure development costs and the sales commission paid to the Tourism Development Authority (TDA) for each square meter sold. The estimated cost per sqm, which is assigned by ERC's project consultant, is different for each phase, given the variant infrastructural requirements of phase and increases (decreases) in the cost of building materials such as steel and cement. ERC estimates the cost per sqm for Phase I at EGP56.15 and for Phase II at EGP40.91. ERC is obliged to pay the TDA USD1.75 per sqm every time it sells a plot.

Phase III cost/sqm is expected to be more than double that of the first two phases

ERC's project consultant has not yet provided an estimate of cost per sqm for Phase III. In our forecast, we assume a cost of EGP110 per sqm (cUSD20), significantly higher than that of the other phases, to reflect mainly the following: i) the rising cost of raw materials, and ii) the large number of water bodies, canals and landscaping expected to be included in Phase III and which will require costly investments.

How does ERC account for the cost of sale on its balance sheet?

Since ERC sells land plots with infrastructure not yet complete, it records a provision on its balance sheet (estimated development cost) for costs to be incurred for plots already sold that it reduces as it develops the infrastructure. When a phase is complete, any remaining balance (which indicates an additional profit/loss) is reversed directly to retained earnings.

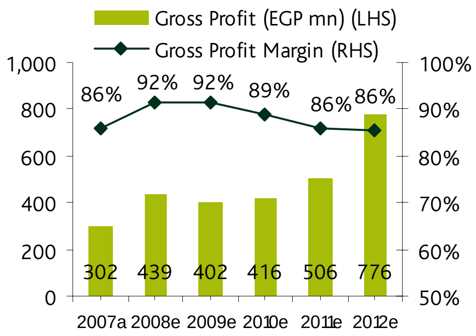
C. GROSS PROFIT MARGIN

ERC's gross profit margin has risen over the past couple of years, driven by rapid increases in land prices and a fixed estimated cost per sqm. In 2007, the company recorded a gross profit margin of 86%, 10 percentage points higher than in the previous year. In 1H2008, the margin widened to 92%. The margin for services was 25% in the first half of the year, which was the first time ERC recorded services revenue. Since ERC bases its cost of sale on estimates, the gross profit margin for the year does not reflect the actual cost incurred at the time of sale.

Margins are expected to drop due to the increase in contribution from other revenue sources

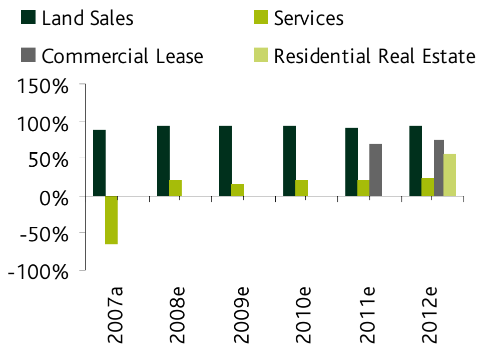
The accrued revenue from sale of land has no corresponding cost and may temporarily distort the gross profit margin in any accounting period. We believe that the gross profit margin will gradually narrow as revenues other than those generated by land sales (such as service and construction revenue) begin contributing more to ERC's total revenue. Pressure on the gross profit margin of land sale will increase starting in 2010e when, according to our assumptions, ERC starts selling land plots in Phase III, which has a higher cost of sale than the previous phases. We expect a consolidated gross margin of 92% in 2008e, falling to 89% in 2010e and, gradually, to 82% in 2015e.

Figure 14: Gross Profit and Gross Profit Margin (2007a-2012e)



Source: ERC, EFG-Hermes estimates

Figure 15: Gross Profit Margin by Type of Revenue (2007a-2012e)



Source: ERC, EFG-Hermes estimates

D. SG&A EXPENSES

SG&A expenses have increased over the past two years and in 1H2008 soared 121% Y-o-Y to EGP20 million. The significant rise in expenses was due to a one-off expense related to a bonus given to the former top management that is not expected to recur. We forecast that SG&A expenses will reach EGP31.5 million in 2008e, implying 113% Y-o-Y growth. We believe that as SHC expands its operations, ERC will have to exert significant marketing and management efforts to sustain strong Y-o-Y growth. Our forecasts assume that consolidated SG&A expenses will grow at a four-year CAGR of 13% to EGP51 million in 2012e. We would revise this forecast upwards if SHC were to purchase land plots in Phase III, as the company will have to exert bigger administrative and marketing efforts to manage the land bank.

E. FX GAINS AND LOSES

ERC is exposed to FX risk, as most sales are made in USD

ERC is exposed to FX gains and losses, as most of its sales are in USD while it reports its results in EGP. The sale of land plots priced in USD leads to the accumulation of USD receivables that are recorded in EGP on the balance sheet. Remaining land liability for Phase III and sales commissions, both payable to TDA, are also paid in USD and translated into EGP on the balance sheet. Accordingly, the appreciation of the EGP against the USD has contributed to significant FX losses on ERC's financial statements in the past. In 2007, losses quadrupled to EGP9.2 million, while in 1H2008, in contrast, FX gains soared to EGP16.9 million.

The recent gradual appreciation of the USD against the EGP is likely to minimize these loses in the near future. Since our forecasts do not include any revaluations of receivables due to difficulty in predicting currency movements in the current volatile environment, we believe that our forecast and valuation are subject to some FX risk. Much of the infrastructure equipment purchased by ERC (such as water desalination plants, water treatment plants, communications equipment) are purchased in USD and therefore provide a partial natural hedge against FX risk.

F. TAXES

The tax holiday that ERC obtained when it was incorporated expired in 2008. In 2Q2008, the effective tax rate was 19.2%, and we assumed the same effective tax rate on ERC's standalone profits in our forecasts going forwards. SHC was granted a tax holiday upon its incorporation that will expire in 2018e. We believe that this exemption will induce SHC to recognize most of its real estate revenues before its tax expiration.

G. CONSOLIDATED NET PROFIT

Like those of other real estate developers, ERC's quarterly results are not a true measure of performance

ERC's quarterly net profit figures have been very volatile over the past years and should be treated with caution when assessing the company's interim operational performance. Net profit after minority interest rose 21% Y-o-Y to EGP285 million in 2007.

In 1H2008, ERC recorded a net profit of EGP139 million, all driven by the significant land sales the company recorded in 2Q2008. Since the company did not record any land sale transactions to other developers than SHC in 1Q2008, it recorded a net loss of EGP7.6 million in the first quarter of the year on the consolidated level.

2008 bottom line is expected to grow by 11% Y-o-Y

We forecast that ERC's net profits will grow 11% Y-o-Y in 2008e to EGP316 million. For 2009e, we expect the bottom line to decline 7% to EGP295 million based on our conservative land sales assumptions and small increase in land sale prices. We forecast that net profit will grow at a five-year CAGR of 27% from 2008-2013e, with a growing contribution to the bottom line from SHC and community management & utilities.

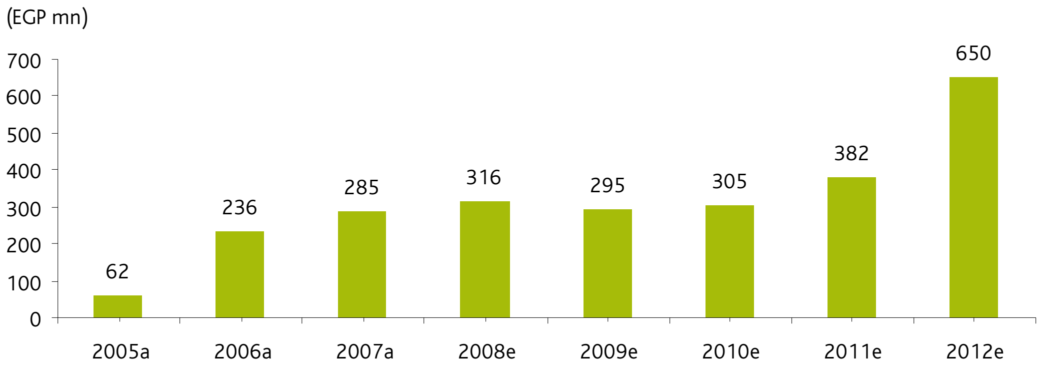
Visibility beyond 2009 is low…

Since we have very little visibility beyond 2009, we forecast a slowdown in revenues and net profit in 2010e to reflect the expected weakness in demand for investments from developers. We estimate the bottom line will grow by a mere 3% to EGP305 million in 2010e before picking up gradually again in 2011e.

…but growth is certain over the long term

We forecast that consolidated net profit will cross the EGP1 billion mark in 2013e, with growth derived from the growth of all the business segments.

Figure 16: ERC's Consolidated Net Profit (2004a-2012e)



Source: ERC ,EFG-Hermes estimates

H. DIVIDENDS AND PAID UP CAPITAL

We expect ERC to start paying significant cash dividends in the near future

In May 2008, ERC approved a cash dividend of EGP0.2 per share on 2007 profits, implying a payout ratio of 61% on 2007 earnings and a dividend yield of 10%. The company has a history of distributing share dividends, which effectively raised its paid-up capital from EGP210 million in 2006 to EGP1,050 million in 2Q2008. The increase was necessary for ERC to meet certain capital requirements which should put the company in a more favorable position to increase its land bank size. We believe that a strong accumulation of cash in subsequent years will allow ERC to adopt a more aggressive cash dividend policy. We estimate that ERC will not pay dividends in 2008 and will prefer to retain some cash in preparation for a potential slowdown in the industry. We assume ERC will distribute 45% of net profit in 2010e.

I. NET DEBT/CASH POSITION

ERC does not have any interest-bearing debt other than the outstanding land purchase liability for Phase III, payable to the TDA, of EGP134 million. ERC has fully paid the TDA the land cost for Phase I and Phase II. The liability for Phase III is expected to be fully paid by 2014e, according to ERC. The liability bears 5% annual interest.

ERC's cash position in 2Q2008 was EGP428 million, bringing the company's net cash position to EGP294 million. Given its expected cash pile in the coming 14 years, which is our forecast horizon, we believe that ERC will have no need to resort to external financing.

VI. VALUATION

VALUATION METHODOLOGY

Why DCF?

We used sum-of-the-parts (SOTP) based on a discounted cash flow (DCF) methodology to value ERC, which combines the elements of a master planner and a developer. While the main value driver in both businesses is the land bank value, we believe their cash flow patterns are different. We believe the DCF approach is the most appropriate to capture long-term value given the company's large land bank, which will be sold over a long timeframe, and its 70% stake in a development company, SHC, which besides developing real estate should drive a significant value from developing and leasing commercial property.

However, as a sanity check on our DCF valuation, we examined the value of ERC's land bank based on NAV calculation, which we discuss at the end of this section.

For the purpose of valuation, we did not assume any intercompany eliminations between ERC and SHC and valued both companies separately on a cash flow basis. To arrive at the Fair Value of ERC, we added the proportionate equity value of SHC (70%) to ERC's standalone valuation.

Given the nature of the business models of the two companies and the sheer size of the land bank, we extend our forecast period through 2022e. This introduces significant risk to our forecasts given the uncertainty inherent in such a long time frame.

VALUATION ASSUMPTIONS

We initiate coverage on ERC with an estimated LTFV of EGP5.53 per share and a LT Buy

Based on our DCF methodology, we arrive at an estimated equity value for ERC of EGP5,808 million, implying EGP5.53 per share, which represents significant upside potential to the current market price of EGP1.80. We value ERC's standalone business (excluding SHC) at EGP5,241 million, or EGP4.99 per share (out of which approximately EGP0.78 is the value of the services alone), and Sahl Hasheesh at EGP811 million, with ERC's proportionate stake (70%) at EGP568 million, implying EGP0.54 per share.

We initiate coverage on ERC with a ST Neutral / LT Buy recommendation. Our ST recommendation is based on the current weakness and volatility in global markets. With sentiment for both the real estate and tourism industries negative at the moment, we believe that ERC will continue trading at a significant discount to our Fair Value for the short to medium term, until the global outlook shows signs of improvement and remedies are underway. We believe the stock holds potential value in the long term, when the project reaches critical mass over the next few years, when Phase I and Phase II reach maturity stage and when, building on the success of the first two phases, Phase III sales and deliveries pick up.

Main Valuation Assumption:

i) **Land Sales:** This is the major contributor to our valuation, accounting for 76% of the total. We forecast that a significant portion of land sales will take place after 2011e, when we expect a pick up in tourism and in demand for secondary homes. This undoubtedly introduces a significant element of risk should the upturn of the cycle take longer than anticipated. As mentioned earlier, we based our 2008 forecasts on management's guidance for land sales (0.7 million sqm) and land prices increase (73% Y-o-Y). Given the project's long timeframe, we do not believe there will be a material impact on our valuation if management is not able to meet its target for the year.

ii) **SHC:** We did not include the 2.0 million sqm of land in Phase III that management indicated SHC might buy in the near future. We estimate that 25,000-30,000 residential and commercial units will be built on this land, a very challenging number to sell under the current circumstances, we believe. The upside to our valuation if we include the 2.0 million sqm is approximately 10%-12%.

iii) **Utilities & Community Management:** The success of the utilities and community management services (services revenue) is highly dependent on the success of the destination. We forecast that the services segment will contribute an estimated 14% of the valuation over our forecast horizon. Any slowdown in activities of the destination would surely impact the value of the service segment.

iv) **High Risk Premium:** We opted to use different risk premiums (RP) for both business segments to reflect the high risk associated with working in the two industries in a down cycle. Our risk premium for ERC (standalone) is 8.0% and for SHC is 9.0%. We based our risk free rate on the yield of a 9-year Egyptian Treasury bond, which is currently 11.0%.

We believe that our high cost of equity for the two segments is justified given the uncertainty in global financial markets and the impact of the turmoil on the world's economies over the coming 12 months at least, and given the company's lack of a track record in some of its business segments. As the global outlook improves, and the appetite to buy real estate improves, we will revisit our assumptions to reflect our greater confidence in the company's future operations.

v) **A Conservative Terminal Growth Rate for the Recurring Business:** We assigned a terminal growth rate (TGR) of 3.0% for the utilities services provided by ERC and the lease of commercial properties by SHC. We believe these segments hold significant value over the long term but are highly leveraged on the ability of the destination to reach critical mass.

Our DCF valuation implies an EV/sqm for ERC (standalone) of USD38 based on the remaining sellable area of 21.2 million sqm. SHC's EV/sqm came at USD233, which is significantly higher than ERC's, mainly due to the high commercial component that SHC is expected to build.

Figure 17: ERC and SHC Standalone Valuations*

(EGP mn)	2009e	2010e	2011e	2012e	2013e →
ERC Stand Alone Valuation					
Cash Inflow	525	286	464	758	1,048
Cash Outflow	(152)	(296)	(335)	(407)	(547)
Net Cash Inflow	**374**	**(10)**	**128**	**351**	**501**
WACC	19.0%				
Terminal Growth Rate	3.0%				
Discounted Cash Flow	333	(7)	81	185	222
EV	**4,947**				
Net Debt	(294)				
Equity Value	5,241				
SHC Stand Alone Valuation					
Cash Inflow	-	7	77	199	357
Cash Outflow	(67)	(113)	(236)	(328)	(271)
Net Cash Inflow	**(67)**	**(106)**	**(159)**	**(129)**	**86**
WACC	20.0%				
Terminal Growth Rate	3.0%				
Discounted Cash Flow	(59)	(78)	(98)	(66)	37
Equity Value	811				

Source: EFG-Hermes

Figure 18: Summary Valuation

			% of Total
ERC Stand Alone Equity Value: (A)	5,241		90%
Number of Shares	1,050	EGP4.21-value of land sales	
LTFV per Share (ERC Stand Alone)	4.99	EGP0.78-value of services	
SHC Equity Valu:	811		
ERC Stake in SHC	70%		
SHC Equity Value Attr. to ERC: (B)	568		10%
SHC LTFV per ERC share	0.54		
Total Equity Value (A+B)	5,808		100%
Total LTFV per Share	5.53		

Source: EFG-Hermes

SENSITIVITY ANALYSIS

We applied two types of sensitivity analyses for our valuation for the discount rates and land sales price over our forecast horizon.

We varied the discount rate for ERC by +/-200 bps: Our valuation shows moderate sensitivity to changes in the discount rate for ERC. If we increase the discount rate by 200 bps, ERC's value drops 11.8%. If we decrease it by 200bps, its value increases 14.7%.

We varied the 2012-2022e CAGR of land prices by +/- 200 bps: If the CAGR is increased by 200 bps, our valuation rises 6.7%. If the price CAGR is decreased over the same period by 200bps, the value per share falls 5.8% from our base case scenario.

Conclusion: Our valuation is more sensitive to changes in discount rates and slightly less sensitive to changes in land sale prices over the long term.

Figure 19: Sensitivity Analysis

	ERC (Standalone) Risk Premium				
2012-2022 Price CARGR	4.0%	6.0%	8.0%	10.0%	12.0%
6.0%	6.5	5.6	4.9	4.3	3.9
8.0%	6.9	6.0	5.2	4.6	4.1
10.0%	7.4	6.3	**5.5**	4.9	4.3
12.0%	7.9	6.8	5.9	5.2	4.6
16.0%	9.1	7.8	6.7	5.9	5.2

Source: EFG-Hermes

We examined the impact on our valuation if ERC does not sell land in Phase III during our forecast horizon. We did not include any cash inflows that Phase III would generate and we excluded any costs associated with the development of its infrastructure. We also excluded the land liability of EGP134 million that ERC would have to pay for this phase to the TDA.

Our valuation for the company in this exercise dropped 48% to EGP2.91 per share. This significant decline is attributed to the following: i) 65% of the sellable area for Phase I and II is already sold, and iii) Phase III represents 63% of the total selling area for the whole projects, which implies that a large portion of the valuation is driven by this phase.

NET ASSET VALUE (NAV)

How do we calculate the NAV?

NAV Methodology:
i) We based our NAV valuation on the land price for 2008 (USD135/sqm) to get the market value of the unutilized land bank (21.2 million sqm)

ii) We subtracted infrastructure costs, estimated at USD20/sqm, for the duration of the entire project, taking into account the infrastructure cost of Phase III which we estimate will be double the infrastructure cost per sqm for Phase I and Phase II.

iii) We subtracted all non operational costs for Phase III, such as taxes (20%) and the land liability.

Our calculation results in a NAV/share of EGP10.15, 1.4x higher than our estimated Fair Value for the land sales alone (EGP4.21 per share). In a down cycle, it is very typical to see the DCF value coming below the estimated NAV, since the appreciation in land prices over our projection period (10% CAGR) is significantly less than the discount rate used to discount the net cash flow of the operation (20%).

Peers trading at 50-90% discount to NAV; we chose an average of 70%

If we apply a 70% discount to our NAV calculation, to reflect those of global peers in the industry, the NAV per share falls to EGP3.04, which is still 69% higher than the current share price. Given the difficulty of estimating a NAV for companies that we do not cover, we assumed that most of the real estate developers in our comparable universe are trading at or near their NAV at the peak of cycle. We then divided the current market capitalization for these developers by the peak-price market capitalization and used this as a proxy for the discount to NAV. As table 21 shows, most of the real estate developers trade at a discount to their NAV of 50-90%. We are aware that ERC is not a real estate developer, and due to its unique business model, it was very difficult to find global peers for comparison. That is why we chose real estate peers as a proxy for our exercise.

We opted not to use the discount to NAV in estimating a long-term fair value for ERC due mostly to the subjectivity in the choice of the discount that should be applied to the NAV. We believe for companies with no annual recurring cash flow (REIT-like), the discount to NAV becomes a very subjective and a less methodological way to value the assets especially for non-homogenous asset. This applies to the ERC's large land bank, with each phase, arguably, having different value.

Figure 20: NAV Calculation

NAV Calculation (EGP million)	
Market Value of Land	15,815
Infrastucture Cost	(12,141)
Taxes	20%
Net Debt	-294
Net Asset Value	10,654
NAV / Share	10.15
Peer Disocunt	70%
NAV after Peer Discount	3.04
Current Share Price	1.80
P / NAVper Share (after Discount)	**-41%**

Source: EFG-Hermes

Figure 21: Discount to NAV of Global Peers

Company Name	Country	Curr.	Land bank (mn sqm)	Market Cap (USD mn)	Price close	Price - 52 Wk High	% change	P/E
DLF Limited	India	INR	53.3	7,996	231.45	1,225	-81%	4.94
China Overseas Land & Investment Ltd.	China	HKD	23.6	9,341	9.26	19.22	-52%	16.52
Emaar Properties PJSC	UAE	AED	519.0	5,472	3.30	15.85	-79%	3.06
Dar Al Arkan Real Estate Development Co.	Saudi Arabia	SAR	9.0	3,819	19.90	60.75	-67%	7.13
Aldar Properties PJSC	UAE	AED	34.0	3,294	4.70	13.65	-66%	6.03
Emaar The Economic City	Saudi Arabia	SAR	168.0	2,538	11.20	28.75	-61%	N/R
Barwa Real Estate Company QSC	Qatar	QAR		1,680	23.30	94.00	-75%	10.01
Sorouh Real Estate PJSC	UAE	AED	283.0	2,028	2.98	11.15	-73%	5.93
Hysan Development Company Limited	China	HKD	0.4	1,611	12.00	25.95	-54%	3.2
Unitech Limited	India	INR	80.0	1,406	42.75	546.8	-92%	4.18
Chinese Estates Holdings Limited	China	HKD	2.7	1,551	5.30	16.10	-67%	1.47
Deyaar Development PJSC	UAE	AED	1.8	1,274	0.81	3.05	-73%	N/A
Union Properties PJSC	UAE	AED	4.1	1,074	1.29	5.72	-77%	5.77
Cyrela Brazil Realty SA Empreend Part	Brazil	BRL	9.4	1,055	6.90	32.00	-78%	5.81
						Average	**-71%**	**6.17**

*Prices are as at 17 November 2008
Source: RKIM

Financial Statements (December year end)

(EGP mn)	1H2007	2007a	1H2008	2008e	2009e	2010e	2011e	2012e
Income Statement								
Land Sales Revenues	252	349	229	471	427	444	536	812
Services Revenues	0	3	4	9	12	25	53	95
Lease revenues	-	-	-	-	-	-	32	100
Real Estate Revenues	-	-	-	-	-	-	-	29
Total Revenues	**253**	**352**	**233**	**479**	**438**	**469**	**621**	**1,036**
COGS	(37)	(49)	(18)	(40)	(37)	(52)	(83)	(143)
Gross Profit	**215**	**302**	**214**	**439**	**402**	**416**	**538**	**893**
GP Margin	85%	86%	92%	92%	92%	89%	87%	86%
SG&A	(9)	(15)	(20)	(32)	(29)	(24)	(36)	(51)
EBITDA	**207**	**288**	**195**	**408**	**372**	**392**	**502**	**842**
EBITDA Margin	82%	82%	84%	85%	85%	84%	81%	81%
Depreciation	(0)	(2)	(1)	(3)	(8)	(18)	(37)	(43)
EBIT	**206**	**286**	**194**	**405**	**364**	**374**	**465**	**798**
Net Interest Income (Expense)	1	11	9	18	3	4	7	12
FX Gains (Losses)	(0)	(9)	(17)	(17)	-	-	-	-
Other Income (Expense)	0	0.1	(3)	(2.2)	1.1	1.1	1.1	1.1
EBTMI	**207**	**288**	**183**	**404**	**368**	**379**	**472**	**811**
Taxes	(0)	(3)	(41)	(83)	(72)	(77)	(94)	(144)
EBMI	**206**	**285**	**142**	**321**	**296**	**303**	**379**	**667**
Minority Interest	0	(0)	(3)	(4)	(1)	3	3	(17)
Net Income	**206**	**285**	**139**	**316**	**295**	**305**	**382**	**650**
Balance Sheet								
Cash		462	428	431	741	481	299	337
Net A/R		329	368	368	499	646	939	1,191
Work in Progress		123	311	311	306	457	606	715
Other Debit Balances		66	20	23	25	28	31	34
Total Current Assets		**980**	**1,127**	**1,133**	**1,477**	**1,518**	**1,780**	**2,183**
Fixed Assets		35	35	33	89	175	332	530
Projects Under Construction		58	70	70	70	73	93	130
Net A/R		180	216	382	214	277	235	298
Total Assets		**1,253**	**1,447**	**1,618**	**1,850**	**2,043**	**2,441**	**3,141**
Estimated Development Cost		61	62	66	63	69	86	99
Liabilities to TDA		34	23	23	36	36	37	40
Taxes Payable		2	41	23	72	77	94	144
Other Credit Balances		39	32	36	38	40	42	45
Total Current Liabilities		**136**	**159**	**148**	**208**	**221**	**258**	**328**
Liabilities to TDA		10	149	152	125	95	66	38
Deferred Tax		0	1	1	1	1	1	1
Deferred Revenue		-	-	-	-	29	181	366
Minority Interest		16	79	81	82	79	76	93
Net Worth		**1,090**	**1,060**	**1,236**	**1,529**	**1,713**	**1,955**	**2,410**
Total Liabilities and Net Worth		**1,253**	**1,447**	**1,618**	**1,944**	**2,138**	**2,536**	**3,236**
Cash Flow Statement								
COPAT				324	300	316	408	698
Change in WI				(413)	73	(325)	(233)	(207)
Cash Flow After Change in WI				**(89)**	**373**	**(10)**	**175**	**491**
CAPEX				(2)	(64)	(104)	(194)	(241)
FCF				**(91)**	**309**	**(114)**	**(19)**	**250**
Financing				58	-	(147)	(164)	(213)
Non-operating Cash Flow				1	1	1	1	1
Change in Cash				**(32)**	**310**	**(260)**	**(182)**	**37**

Source: ERC, EFG-Hermes estimates

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