

Real Estate

3Q11 results preview

We expect results to remain a mixed bag, with contractors and Emaar likely to experience a seasonally soft quarter, Sorouh to report flattish results and Aldar to gain some momentum from commencement of deliveries at Al Zeina.

Table 1 : 3Q11 key forecasts

	Emaar	Aldar	Sorouh	Arabtec	DSI
Revenue (Dh m)	1,917	858	1,200	1,154	701
Gross margin	47.1%	25.8%	12.0%	11.2%	14.3%
EBIT margin	28.6%	-6.0%	6.8%	4.1%	6.1%
Net profit (Dh m)	408	138	109	28	49
EPS (Dh)	0.067	0.034	0.042	0.019	0.023

Source: Rasmala forecasts

We expect UAE property sector to remain range-bound

In light of the current uncertain global macroeconomic environment and lack of meaningful catalysts, we expect the UAE property sector to remain range-bound in the foreseeable future. Despite our positive view on Emaar Properties and Drake & Scull International PJSC (DSI) due to their relatively stronger balance sheets, stable cash flow trends and above-par execution histories, we believe these stocks may continue to experience high volatility tied to downside in the near term, driven by increasing investor risk aversion.

Results could likely be a mixed bag

We believe 3Q11 may be a soft quarter for contractors (Arabtec Holding and DSI), with revenue and earnings declining 4-5% given the potential impact from Ramadan and the holidays. For Emaar, too, we expect a seasonally soft quarter, as we forecast revenue from both recurring income portfolio and property sales will decline 5-6% qoq and pro forma earnings will decline 3.4% qoq. We believe momentum in revenue and earnings for developers such as Aldar Properties and Sorouh Real Estate would largely be a function of their deliveries at various projects during the quarter. We expect flattish results for Sorouh during the quarter, as we forecast deliveries at Sun and Sky towers to be in line with deliveries during the previous quarter. For Aldar, we forecast commencement of deliveries at Al Zeina will raise revenue 10.7% qoq and expect EPS growth of about 8.7% qoq.

Latest data reaffirms our view of declining house prices

As per the latest data released by property consultants, average house prices in both Dubai and Abu Dhabi continued to decline further during 3Q11. According to Asteco, average apartment sale prices in Dubai fell by 4% qoq; however, villa prices remained steady. Apartment sale prices remained stable in some of the better established locations, such as Palm Jumeirah and Jumeirah Beach Residence, but dropped significantly in lesser established locations, such as Discovery Gardens (down 10% qoq) and Jumeirah Lake Towers (down 7% qoq). According to JLL, average residential asking prices in Abu Dhabi declined by 7% qoq as new supply came in at Al Reem Island, Al Raha Beach and Yas Island. With further significant upcoming supply over the next 12 months in both Dubai and Abu Dhabi, sales prices would remain under pressure. We took the view in our 10 March 2011 report *Navigating the downturn* that prices would fall 25-30%. Now we expect prices in both Dubai and Abu Dhabi to fall about 20% more to reach a sustainable trough.

Important disclosures can be found in the Disclosures Appendix.

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3Q11 results preview

We discuss here our 3Q11 expectations for our stocks.

We forecast a seasonally soft quarter for Emaar. We expect total revenue to decline 5.6% qoq to Dh1,917m due to a 5-6% decline in both recurring revenue and revenue from property sales. We maintain our forecast EBIT margin at the 2Q11 level, but reduce the share of losses from associates by 33% to Dh50m. All the above forecasts combined together lead us to a pro forma EPS estimate of Dh0.067 (down 3.4% qoq). The company recognised impairments of Dh172m linked to Dubai Bank in 2Q11; however, in 3Q11, we forecast no further impairments.

Table 2 : Emaar 3Q11 preview

	3Q10A	2Q11A	3Q11F	yoy	qoq
Revenue (Dh m)	2,782	2,032	1,917	-31.1%	-5.6%
Gross margin	37.1%	47.6%	47.1%		
EBIT margin	21.4%	28.8%	28.6%		
Net profit pro forma (before impairments, Dh m)	613	422	408	-33.4%	-3.4%
Net profit (Dh m)	613	250	408	-33.4%	63.2%
EPS pro forma (before impairments, Dh)	0.100	0.069	0.067		
EPS (Dh)	0.100	0.041	0.067		

Source: Company data, Rasmala forecasts

For Aldar, we forecast commencement of deliveries at Al Zeina development on Al Raha Beach will raise revenue 10.7% qoq. We estimate gross margin of about 25.8% and gain from disposal of assets to the government of Dh361m, equivalent to the average gain realised during the past two quarters. All these assumptions lead us to an EPS estimate of Dh0.034 (up 8.7% qoq).

Table 3 : Aldar 3Q11 preview

	3Q10A	2Q11A	3Q11F	yoy	qoq
Revenue (Dh m)	505	776	858	69.9%	10.7%
Gross margin	9.0%	33.4%	25.8%		
EBIT margin	-93.4%	1.9%	-6.0%		
Gain on disposal of assets held for sale (Dh m)	-	280	361		
Net profit (Dh m)	-731	127	138	n/m	8.7%
EPS (Dh)	-0.284	0.031	0.034		

Source: Company data, Rasmala forecasts

We expect Sorouh's revenue to remain flattish qoq at Dh1,200m, as we forecast handovers at Sun and Sky Towers to be in line with handovers during 2Q11. Sorouh's EBIT margin declined from 14.5% in 1Q11 to 6.8% in 2Q11, mainly due to a decline in gross margin from property sales from 18.6% to 6.4%, indicating margin pressure at Sun and Sky Towers developments. We maintain our forecast EBIT margin in 3Q11 at the same level as 2Q. Given our flattish qoq revenue and gross margin forecasts, we expect EPS also to remain relatively stable qoq, at Dh0.042.

Table 4 : Sorouh 3Q11 preview

	3Q10A	2Q11A	3Q11F	yoy	qoq
Revenue (Dh m)	371	1,218	1,200	223.4%	-1.5%
Gross margin	49.4%	11.9%	12.0%		
EBIT margin	29.8%	6.8%	6.8%		
Net profit (Dh m)	59	110	109	84.3%	-1.0%
EPS (Dh)	0.023	0.042	0.042		

Source: Company data, Rasmala forecasts

For contractors, we forecast a seasonally soft quarter due to Ramadan and the holidays. We forecast revenue for both Arabtec and DSI will decline by 5.1% qoq. In 2Q11, Arabtec's gross margin maintained its downward momentum, declining from 17.3% in 2009 to 11.2% (13.3% in 1Q11). Delays in project execution in Saudi Arabia and Kuwait and continued losses at UAE-based precast and concrete production subsidiaries were the primary reasons for further margin decline in 2Q11. Management expects to recognise no significant revenues from these projects

during 3Q11; hence, we maintain our gross margins at the 2Q11 level. We forecast minority interest to be about Dh16m, equivalent to 37% of the net profit before minority shareholders. We estimate EPS will decline 4% qoq to Dh0.019.

Table 5 : Arabtec 3Q11 preview

	3Q10A	2Q11A	3Q11F	yoy	qoq
Revenue (Dh m)	1,278	1,217	1,154	-9.7%	-5.1%
Gross margin	14.2%	11.2%	11.2%		
EBIT margin	2.8%	4.0%	4.1%		
Net profit (Dh m)	7	29	28	n/m	-4.0%
EPS (Dh)	0.006	0.019	0.019		

Source: Company data, Rasmala forecasts

In 2Q11, DSI's gross margin declined to 14.3% from 18.6% in 2010, due to revenue mix shift towards the lower-margin civil segment. With the civil segment contributing 45% of the end-2Q11 backlog, we expect the dependency on civil segment to remain high; hence, we maintain our gross margin for 3Q11 at the 2Q level. We estimate EPS will decline 4.6% qoq to Dh0.023.

Table 6 : DSI 3Q11 preview

	3Q10A	2Q11A	3Q11F	yoy	qoq
Revenue (Dh m)	432	739	701	62.2%	-5.1%
Gross margin	16.6%	14.3%	14.3%		
EBIT margin	6.2%	6.1%	6.1%		
Net profit (Dh m)	30	51	49	61.1%	-4.6%
EPS (Dh)	0.014	0.024	0.023		

Source: Company data, Rasmala forecasts

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

Aldar Properties (RIC: ALDR.AD, Rec: Hold, CP: Dh0.98, TP: Dh1.30): We value Aldar Properties using a sum-of-the-parts methodology, from which we derive our target price. Key risks to our target price relate to refinancing risk and Aldar's ability to fund near-term projects. Should the population surpass our conservative estimates we would likely witness better fundamentals, liquidity and property demand, providing upside risk.

Arabtec Holding (RIC: ARTC.DU, Rec: Hold, CP: Dh1.26, 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.

Drake & Scull (RIC: DSI.DU, Rec: Buy, CP: Dh0.81, TP: Dh1.15): We value DSI using a DCF methodology, from which we derive our target price. Key risks to our target price include project delays in the UAE that may reduce robust growth expectations from 2011 onward. Also, the company may need to reduce management's five-year earnings CAGR expectations.

Emaar Properties (RIC: EMAR.DU, Rec: Buy, CP: Dh2.46, TP: Dh3.00): We value Emaar Properties using a sum-of-the-parts methodology, from which we derive our target price. Key risks to our target price include potential delays in raising domestic and international capital as core market stresses still prevail and we expect a continued decline in house prices. Should handover materialise beyond our estimates and population surpass our conservative estimates, we would likely see better fundamentals, liquidity and property demand, providing upside risk.

Sorouh Real Estate (RIC: SOR.AD, Rec: Hold, CP: Dh0.89, TP: Dh1.30): We value Sorouh Real Estate using a sum-of-the-parts methodology, from which we derive our target price. Key risks to our target price include further project delays that could create headline risk and prompt consensus downgrades.

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