

3 November 2011

**Hold**

**Target price**  
Dh1.00 (from Dh1.30)

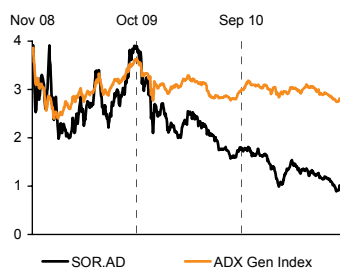
**Price**  
Dh0.99

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

**Market view**  
No Weighting

**Price performance**

	(1M)	(3M)	(12M)
Price (Dh)	1.08	1.26	1.70
Absolute (%)	-8.3	-21.4	-41.8
Rel market (%)	-6.7	-16.5	-35.4
Rel sector (%)	-9.0	-15.8	-40.9

**Market capitalisation**

Dh2.60bn (€514.10m)

**Average (12M) daily turnover**

Dh9.50m (US\$2.60m)

Sector: ADX Bank & Fin Index  
RIC: SOR.AD, SOROUH UH  
Priced Dh0.99 at close 2 Nov 2011.  
Source: Bloomberg

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# Sorouh Real Estate

## Reduce TP to Dh1.00; maintain Hold

**Sorouh's earnings missed our expectations on lower revenue from handovers and recognition of provisions primarily against investment properties. We maintain Hold, but reduce our target price to Dh1.00 as we cut our 2011-13F earnings by 22% mainly on lower margins and higher provisions.**

**Key forecasts**

	FY09A	FY10A	FY11F	FY12F	FY13F
Total property income (Dhm)	3,103	1,205	3,226	3,287	4,195
Net rental income (Dhm)	139.4	210.2	240.3	361.8	400.0
Normalised PTP (Dhm)	768.9	334.0	404.5 ▼	433.7 ▼	543.2
Normalised EPS (Dh)	0.30	0.12	0.13	0.14 ▼	0.17
Normalised PE (x)	3.27	7.99	7.46	7.13	5.70
Dividend per share (Dh)	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.00	0.00	0.00	0.00	0.00
Adj NAV per share (Dh)	2.41	2.31	2.42	2.56	2.74
NNNAV per share (Dh)	2.41	2.31	2.42	2.56	2.74
Disc/(prm) to adj NAV (%)	58.90	57.10	59.20	61.40	63.80
Net debt to tot ass (%)	3.26	3.72	9.10	11.00	4.08

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

year to Dec, fully diluted

Accounting standard: IFRS

Source: Company data, Rasmala forecasts

**Across-the-board miss due to lower revenue and provisions**

Total revenue was Dh890m, 26% below our estimate of Dh1,200m and 2% below the Bloomberg consensus estimate of Dh911m. The miss was due to lower-than-expected revenue recognised from handover of units at Sun and Sky Towers and construction of National housing. However, gross profit of Dh170m beat our estimate of Dh143m as the gross margin at 19% was above our estimate of 12%. SG&A expenses at Dh48m were lower than our estimate of Dh62m. Net profit of Dh67m missed our estimate of Dh109m by 38% as the company booked provisions of Dh51m primarily against its investment properties.

**Cut our 2011-13F EPS by 22% mainly on lower margins and higher provisions**

We reduce our 2011F revenue by 4% on lower handovers from Sun and Sky Towers and our 2012F revenue by 8% as we shift handovers from Tala and Gate Towers to 2013, which results in raising our 2013 revenue forecast by 12%. We lower our 2011 EPS forecast by 23% on higher provisions and lower revenues. We reduce our margins from sale of units in Tala and Gate Towers by 400bp to 15%. Downward revision to revenue and margins and higher provisions lead us to lower our 2012 earnings by 27%. Despite raising our revenue forecast, we cut our 2013 earnings forecast by 15% on lower margins and higher provisions.

**Maintain our Hold rating, but reduce our target price to Dh1.00 per share**

We reduce our target price to Dh1.00 per share from Dh1.30 per share as a result of reducing our 2011-13F EPS by 22%, but maintain our Hold rating. The stock has underperformed the broader ADX index by 31% ytd, but we believe that with property prices falling, headline risk remains in the form of future impairments and handovers may likely remain soft in the next six to nine months. We value the rental and hospitality portfolio at Dh0.50, 50% of our TP; the portfolio of projects for sale at Dh0.33, 33% of our TP and the construction segment and other assets at Dh0.17, 17% of our TP.

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

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**Table 1 : Revised forecasts overview**

Dh m	2011F			2012F			2013F		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	3,367	3,226	-4%	3,581	3,287	-8%	3,760	4,195	12%
Provisions/impairments	-55	-105	91%	-35	-80	129%	-20	-50	150%
Net profit	402	311	-23%	501	364	-27%	536	456	-15%

Source: Rasmala forecasts

**Table 2 : Sum-of-the-parts valuation breakdown**

	Value (Dh m)	Value per share (Dh)
Properties for sale	1,332	0.51
Investment properties	1,874	0.75
Hospitality	132	0.05
Construction	259	0.10
<b>Total value of the properties</b>	<b>3,598</b>	<b>1.37</b>
Other assets	438	0.17
<b>Total value of the assets except cash</b>	<b>4,036</b>	<b>1.54</b>
Net debt	-932	-0.35
Other liabilities	-797	-0.30
<b>Total equity value</b>	<b>2,308</b>	<b>0.88</b>
<b>One year target price</b>		<b>1.00</b>

Source: Company data, Rasmala estimates

We use a SOTP approach to derive our target price. The SOTP methodology is bottom up and examines the value potential by project and segment via respective DCFs, aggregating a collective value for the company's portfolio against its outstanding liabilities. Our DCF assumptions are highlighted below, with higher-risk projects receiving a 100-200bp increase in project WACC, with lower-risk or more stable revenue streams including rental portfolios accounting for discount rates 100-200bp below base-case WACC.

We use a WACC of 11.8% and our WACC estimate is based on cost of debt of 5.5% and a cost of equity of 13.5%. We derive our cost of equity using a risk-free rate of 4.0%, an equity market risk premium of 6% and a beta of 1.6. We use a terminal growth rate of 2% for our recurring income portfolio.

Key risks to our target price include impairments of investment properties and further project delays that could create headline risk and prompt consensus downgrades. Should the population surpass our conservative estimates we would likely witness better fundamentals, liquidity and property demand, providing upside risk.

## Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Net rental income	139.4	210.2	240.3	361.8	400.0
Prop development income	1177	526.8	2082	1586	2614
Other revenue	1786	468.2	903.5	1339	1180
<b>Total property income</b>	<b>3103</b>	<b>1205</b>	<b>3226</b>	<b>3287</b>	<b>4195</b>
Other costs	-2443	-838.0	-2826	-2791	-3620
EBITDA	659.7	367.1	400.0	495.0	574.7
DDA & Impairment (ex gw)	-278.4	-196.5	-40.3	-37.8	-40.0
EBITA	381.3	170.6	359.7	457.3	534.7
Goodwill (amort/impaird)	-29.8	-162.9	-36.9	0.00	0.00
<b>EBIT</b>	<b>351.5</b>	<b>7.79</b>	<b>322.8</b>	<b>457.3</b>	<b>534.7</b>
Associates (pre-tax)	-50.5	48.7	5.73	12.0	11.7
Net interest	-42.1	-43.6	10.2	-5.58	-1.98
Other pre-tax items	236.1	3.38	28.8	-30.0	-1.20
<b>Reported PTP</b>	<b>495.0</b>	<b>16.2</b>	<b>367.5</b>	<b>433.7</b>	<b>543.2</b>
Taxation	0.00	0.00	0.00	0.00	0.00
Minority interests	-12.2	-8.74	-56.3	-69.4	-86.9
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>482.8</b>	<b>7.44</b>	<b>311.2</b>	<b>364.3</b>	<b>456.3</b>
Dividends declared	0.00	0.00	0.00	0.00	0.00
Tot normalised items	-273.9	-317.9	-36.9	0.00	0.00
Normalised EBITDA	659.7	367.1	400.0	495.0	574.7
Normalised PTP	768.9	334.0	404.5	433.7	543.2
Normalised net profit	756.7	325.3	348.2	364.3	456.3

Source: Company data, Rasmala forecasts

year to Dec

## Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	1626	1135	917.7	718.9	1665
Props under dev	3778	5273	4709	4034	2063
Other current assets	4669	3942	3727	3607	3487
Investment prop	1240	1675	2876	3336	3383
Other non-current assets	2383	1609	1351	1369	1385
<b>Total assets</b>	<b>13698</b>	<b>13634</b>	<b>13581</b>	<b>13066</b>	<b>11982</b>
Short term debt (2)	989.9	12.5	5.86	5.86	5.86
Long term debt (3)	1083	1630	2148	2148	2148
Other liabilities	5500	5813	4881	3932	2305
<b>Total liabilities</b>	<b>7573</b>	<b>7456</b>	<b>7035</b>	<b>6085</b>	<b>4459</b>
Total equity (incl min)	6125	6178	6547	6980	7524
<b>Total liab &amp; sh equity</b>	<b>13698</b>	<b>13634</b>	<b>13581</b>	<b>13066</b>	<b>11982</b>
Net debt	446.7	507.5	1236	1435	489.1

Source: Company data, Rasmala forecasts

year ended Dec

## Cash flow statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	659.7	367.1	400.0	495.0	574.7
Change in working capital	-3215	-965.9	-316.8	-154.8	465.0
Net interest (pd) / rec	42.1	43.6	-10.2	5.58	1.98
Taxes paid	0.00	0.00	0.00	0.00	0.00
Other oper cash items	926.8	106.0	2.09	-35.6	-3.18
<b>Cash flow from ops (1)</b>	<b>-1586</b>	<b>-449.2</b>	<b>75.1</b>	<b>310.2</b>	<b>1039</b>
Capex (2)	-397.6	-497.1	-682.9	-503.4	-90.9
Disposals/(acquisitions)	0.33	4.40	0.14	0.00	0.00
Other investing cash flow	380.3	1075	5.36	33.2	49.7
<b>Cash flow from invest (3)</b>	<b>-17.0</b>	<b>582.2</b>	<b>-677.3</b>	<b>-470.2</b>	<b>-41.1</b>
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	-91.7	1592	511.1	0.00	0.00
Ordinary dividend paid	-330.1	-5.71	-6.63	0.00	0.00
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-1887	-2192	-119.8	-38.8	-51.7
<b>Cash flow from fin (5)</b>	<b>-2309</b>	<b>-606.0</b>	<b>384.7</b>	<b>-38.8</b>	<b>-51.7</b>
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
<b>Inc/(decr) cash (1+3+5+6)</b>	<b>-3912</b>	<b>-473.0</b>	<b>-217.6</b>	<b>-198.8</b>	<b>945.7</b>
Equity FCF (1+2+4)	-1984	-946.2	-607.8	-193.2	947.7

Source: Company data, Rasmala forecasts

year to Dec

## Company description

Sorouh Real Estate PJSC (Sorouh) is the second-largest public real estate developer in Abu Dhabi by market cap. The company was listed on the Abu Dhabi Securities Exchange through its IPO in 2005. Sorouh is engaged in property investment and development and property management, and in providing retail and hospitality services in Abu Dhabi. While Sorouh currently operates predominantly in the state of Abu Dhabi in the United Arab Emirates (UAE), it has diversified geographically with its Agora Madinat & Resort project in Morocco and a project in Egypt (still in the pre-development phase). Sorouh enjoys a close relationship with the Abu Dhabi government, which indirectly owns 7% of its shares. Government backing comes in the form of close to zero-cost land grants, development approvals, and financial backing.

Hold

Price relative to country



## Strategic analysis

Average SWOT company score:

3

Revenue breakdown, 2011F

### Strengths

Refinancing risk mitigated via early payment of sukuk, cash inflows and outflows right-aligned at least in the near term, engaged on key government projects that may cushion revenue volatility.

4

### Weaknesses

Similar to Aldar and other developers in Abu Dhabi, funding needs could escalate beyond a 12-month horizon or shortfalls may be pulled in earlier if economic conditions continue to deteriorate.

3

### Opportunities

Diversifying into the commercial sector away from residential and land sales may strengthen business model and enhance valuation.

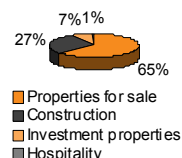
3

### Threats

Uncertainty on handovers, rolling receivables and other provisions risks may have an impact on headline results.

2

Scoring range is 1-5 (high score is good)



Source: Company data

## Market data

### Headquarters

Abu Dhabi Mall, East Tower, 5th floor, Tourist Area, Abu Dhabi - UAE

### Website

www.sorouh.com

### Shares in issue

2625.0m

### Freefloat

93%

### Majority shareholders

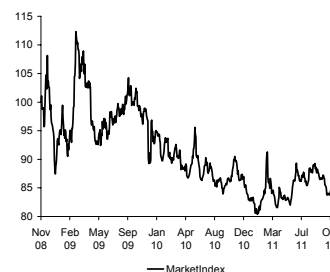
Al Joud Investment (12%), Abu Dhabi Investment Company (7%), 0 (0%)

## Country view: United Arab Emirates

## Country rel to M East & Africa

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation of RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



## Competitive position

Average competitive score:

3-

Broker recommendations

### Supplier power

Low - New residential project activity in the UAE is sharply down as most projects are on hold, delayed or cancelled, thereby putting pressure on contractors.

2-

### Barriers to entry

High - In the domestic market, which is already oversupplied, there remains very little appetite to fund new developments.

4+

### Customer power

Medium - transaction activity is low as market sentiment remains soft.

3-

### Substitute products

Low - Sorouh is engaged in government-supported projects and mid-range housing schemes in addition to its core focus of high-end property.

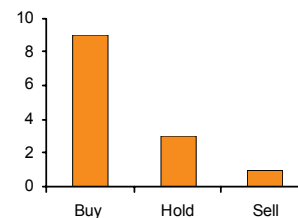
2-

### Rivalry

Low - We believe Sorouh is a smaller niche player compared to the larger developer Aldar, with relatively little competitive risk.

2-

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

## 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

**Sorouh Real Estate (RIC: SOR.AD, Rec: Hold, CP: Dh0.99, TP: Dh1.00):** 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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