REAL ESTATE
EM Real Estate

Initiation of Coverage

EM Real Estate

When 'pipelines' become 'pipedreams'

Prestige projects are being consigned to history with the UAE real estate sector facing unheralded challenges. Solid pipelines are quickly becoming pipedreams with construction order books contracting sharply and development delays now commonplace. Speculators fuelled the market with 'easy' liquidity that has evaporated, just as developers commence deliveries that cannot be financed. The sector shakeout is likely to continue with direct markets possibly falling another 15%. We believe that the key theme for 2009 is sector consolidation, but initially in the private, rather than the public, arena. The sector is maturing at break-neck speed and we expect casualties.

- We initiate on the UAE real estate sector with a fundamentally cautious view. Real estate is capital consumptive and the market is currently capital constrained. Bridge finance is not an option if there are no end-users to take inventory or banks to fund it.
- Development delays are likely to dampen earnings. This and creating investment portfolios are likely to weaken revenue accounts. We think dividends are at risk – if not this year, then next, as cash constraints bite.
- We see the decline of occupancy rates and rents as affecting the carrying values of investment properties, just as companies are forced to take unsold stock into their portfolios.
- We expect average peak to trough falls of 40% in asset prices across the direct real estate sectors, against 25% average falls so far, but we believe that equities are pricing in more. We see absolute returns of c30% across our coverage universe.
- We initiate with a BUY recommendation on Emaar Properties.
- We are NEUTRAL on RAK Properties, Sorouh Real Estate and Aldar Properties.
- We initiate with REDUCE recommendations on Deyaar Development and Union Properties, a reflection of our current view on the Dubai market.

Chet Riley
+971 (0)4 428 4524
chet.riley@nomura.com
NI plc, London

Analyst Certification
I, Chet Riley, hereby certify (1) that the views expressed in this Industry Report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Industry Report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Industry Report.

February 17, 2009

Nomura International plc

http://www.nomura.com

Table of Contents

Investment thesis

"Let's face it, every Tom, Dick and Harry became a developer. Now is the time when you differentiate the men from the boys," Zabeel Investments' Executive Chairman Mohammed Al Hashimi, Reuters Middle East Investment Summit, 6 November 2008.

Sentimental headwinds prevail

We are initiating on the UAE real estate sector with a fundamentally bearish view on the direct property market, but we believe that there are pockets of value in the listed sector. We regard the relatively 'underdeveloped' Abu Dhabi as having better prospects than the 'overdeveloped' Dubai, but there appears to be a wider, possibly unwarranted, disconnect from equity market valuations that are starting to appear oversold to us. Our clear preference is towards early cycle developers with committed sales and unencumbered balance sheets – or at least access to committed facilities – and low or no gearing. Most of the companies in our coverage universe tick most of the boxes, but this is more a call on sentiment than fundamental equity valuations. We believe that there has not been enough of a sector shake-out yet (at least publically) to sort the 'men from the boys' and sector consolidation appears inevitable, in our view. Being on the wrong side of that trade might see equity wiped out and being on the right side may result in equity dilution.

We see value emerging…
… but too early to wade in

Real estate stock prices have fallen on average 80% over both the last 12 months and the last six months[1], so while we are not positive on a macro level, we can see absolute value uplift of c30% at current price levels. The implied market risk is probably too high if we assume these entities were to continue to operate as independent going concerns. We think that we are near the floor in equity pricing, but stock prices will not improve until liquidity (or some form of direct government intervention) is force-fed into the system. The issue, we believe, is the lack of obvious catalysts to attract capital back into the sector. At 0.3x spot book, Emaar is a proven developer, diversified into international markets with strong demographic fundamentals and is the Dubai Government's flagship (listed) developer, so there are enough positives to outweigh the negatives, in our view. Sorouh is our preferred Abu Dhabi based real estate company with what we perceive to be higher growth prospects, but at 1.0x spot book we regard it as still expensive relative to the sector (hence our Neutral stance).

No more finance

We view the sector as a homogenous basket. The market has relied too heavily on the (previously) easily 'funded off plan' sales market where speculators provided the working capital. But this passed the refinancing risk with each speculative 'flip', which has unwound sharply. Regionally, developers now face the situation where speculators can't sell or can't meet the final installments as developments complete. The end user market is being crimped by onerous (or no) bank lending terms, with banks trying to conserve already limited liquidity pools and reduce their sector exposure.

---

[1] In comparison, the S&P UAE market has fallen by around 75% over the last 12 months and 70% in the last six months.

The bank's triple exposure loaded the bases

The UAE mortgage market has historically been thin, but banks leveraged their lending exposure with a classic triple exposure (bridge financing the development start up, financing the contractor's bond, and financing the end user), clipping the ticket at each pass of the finance chain. The 'halcyon' days are over and the banking system has choked the desperately needed liquidity with developers now forced to provide incentives to gap bridge finance loans to clear inventory backlogs. The public sector has the tacit support of federal governments and also the ability to tap equity capital markets if need be – the private sector does not and we expect distressed asset sales and defaults to dominate news flow through at least the first half of 2009.

A new world order

Companies are being forced to evolve rapidly. We see the warehousing of unsold inventory for delivery into the rental market as a greater, but now unavoidable, challenge. The occupier market is rapidly weakening and capital markets may take years to recover (after all Singapore and Hong Kong are still below 1996 levels). Lower rents and occupancy, coupled with higher financing costs, will weaken revenue accounts, with the payback in rental significantly longer than the payback in sales. In terms of business evolution, we believe the next logical step would be to carve property assets into funds, but this assumes the demand exists. This would recycle equity to the group and ultimately the shareholders, but until this happens, capital is locked into lower returning investment portfolios.

The million dirham dividend question

Dividends are next on the agenda and the payment (or not) will be clarified in the upcoming round of AGMs in March and April. We see no economic benefit to stock dividends, but with cash a valuable commodity, a stock and cash hybrid is a possibility. Union Properties has previously paid a 10% stock dividend, which we expect will be repeated. Aldar has proposed a 25% increase in its dividend. Deyaar is yet to pay a dividend and Emaar and RAK Properties would extinguish around 20% of their cash holdings if they committed to last year's payout. We think that this is probably too high a price to pay in the current market; therefore we think it unlikely – but if they do hold dividends flat, investors would reap dividends of 10% and 17%, respectively.

End of the prestige projects

Current market conditions have introduced a dose of fiscal reality and financial discipline to the market. Catch-cry calls of "the biggest", "the best", "the tallest" etc that typified summer development launches are now gone. Economically unviable buildings now rank as pipe-dreams – they may come back to the market, but this is less likely. It is reported that over 45% of UAE developments, or around US$580bn in monetary terms (*Proleads, Feb 2008*), have either been halted or cancelled. Contractor order books are falling sharply and margins are settling at around 5%, having peaked at 20%. Building material prices are reversing rapidly in the global commodity sell-off, so some schemes may come back on stream, but only the most sensible designs will now pass muster and 'prestige projects' are probably consigned to history.

Lacking confidence

Liquidity, beyond monetary measures, is mostly about confidence. The whole world appears to be in recession and capital-rich countries have also discovered that their accumulated wealth is not enough to keep them unaffected. The collapse of housing bubbles is now a global event and the UAE has had one of the biggest bubbles. Therefore, it is a question of normalisation after a long period of excesses. Despite government plans to increase domestic spending and roll out fiscal stimulation packages, we believe that it will probably not be enough to resurrect property prices. We estimate another 15% of average price declines, adding to the 25% that the market has probably already fallen in 4Q08. This implies a peak to trough market decline of 40%.

Coverage Universe Business Models

We think that most UAE developers are, by and large, homogeneous – all are exposed to financing, liquidity and concentration risks and come associated with varying degrees of government support, although this might be through indirect shareholdings. With the exception of Emaar, most company operations are largely concentrated in the UAE (for the time being at least). The business models are in various stages of evolution, but we see a move toward the development of investment property portfolios, a drive towards more recurring income streams and most are looking to develop upstream or downstream ventures. UAE real estate companies have generally relied on a pre-sales funding model, but investment portfolios need to be funded by external debt or internal equity, with Aldar and Union properties being the most leveraged in our coverage universe.

Figure 1: UAE Real Estate coverage, business model summary

	M'cap US$bn	Free Float (%)	Government ownership	Foreign Ownership limits (%)*	Principal operations	Geographic Focus UAE	Internl. ops.	Vertically integrated	Relative gearing levels	Key Positives	Key Negatives
Emaar	3.3	68	Direct (32%)	49	Develop / Investment	Dubai	Yes	Yes	Medium	1. Significant government support 2. Proven track record, high quality 3. Large untapped landbank	1. Complexity of projects 2. Complexity of diversification strategy 3. Markets not conducive to equity release
Aldar	1.7	76	Indirect (25%)	40	Develop / Investment	Abu Dhabi	Limited	Yes	High	1. Strong government relationships 2. Creating sustainable income streams 3. Free option value with landbank	1. Development risk concentrated 2. Higher risk financing strategy 3. High cash burn rate, 12m headroom
Sorouh	1.6	78	Indirect (25%)	15	Develop	Abu Dhabi	Limited	Yes	Low	1. Low risk land sales business model 2. Timed capital markets well 3. Leveraged into Abu Dhabi market	1. Development risk concentrated 2. Complicated Sukuk financing structure 3. Lower recurring income streams
Deyaar	0.8	59	Indirect through DIB	0	Develop	Dubai	Limited	No	Low	1. Relationships with master developers 2. Flexibility in development programme 3. Entry into Saudi market a catalyst	1. Investors concerns re previous mgmt. 2. Earnings visibility limited 3. Investment closed to non-GCC
Union Properties	0.5	52	Indirect through EIB	15	Develop / Investment	Dubai	Limited	Yes	High	1. Early cycle developer 2. Development of investment portfolio 3. Upstream and downstream earnings	1. High gearing levels, funding policy 2. Concentration of assets 3. Cash constraints, 'strategic' refinancing
RAK Properties	0.25	95	Direct (5%)	49	Develop	Ras Al Khaimah	Limited	No	Low	1. AED 600m cash, no debt 2. Committed to strategic change 3. RAK resi. market less speculative	1. 80% balance sheet attrib, one project 2. Earnings volatility hard to smooth 3. Life after 'Mina Al Arab'?

*Source: Datastream, Nomura research *Deyaar allows 49% Gulf Cooperation Council (GCC) ownership*

UAE real estate summary pricing and valuation sheet

In line with Nomura's relative rating system, we benchmark our coverage universe against our expected emerging market price return of 35% and against each other. Our bias towards Abu Dhabi over Dubai is reflected in the ratings below. Our average absolute return is 30%.

Figure 2: Summary pricing sheet

Company	Price (AED)	Rating	Target Price	Est. price returns (%)	Spot NAV	NAV +1yr	Nomura Balance sheet metrics Spot P/NAV	Spot P/NAV +1yr	2009 GAV /EV	EV / Op. profits 2009E	2010E	Adjusted PE (x) 2009E	2010E	Nomura vs. Consensus Nomura EPS 09E	Consensus EPS 09E	Difference (%)
Emaar	2.00	Buy	2.87	44	6.49	7.40	0.31	0.27	4.70	2.1	1.0	1.8	1.6	1.08	1.45	-25
Aldar	2.55	Neutral	3.13	23	6.22	6.66	0.41	0.38	1.56	13.8	12.6	3.6	2.1	0.77	1.31	-41
Sorouh	2.36	Neutral	2.93	24	2.23	2.91	1.06	0.81	1.58	4.7	4.0	3.3	2.4	0.73	1.03	-29
Deyaar	0.52	Reduce	0.64	22	1.04	1.20	0.50	0.43	3.87	2.9	3.0	3.5	3.1	0.15	0.50	-70
Union Properties	0.65	Reduce	0.79	22	2.03	2.31	0.32	0.28	1.56	9.1	9.2	1.8	2.0	0.36	1.24	-71
RAK Properties	0.45	Neutral	0.66	46	1.60	1.69	0.28	0.27	4.36	2.2	3.1	2.5	2.2	0.19	0.37	-48
				30			0.49	0.42	3.13	5.7	4.9	2.6	2.0			-37

Source: Datastream, Nomura research Priced as at 13 February 2009

Target price methodology

We make a number of market and corporate specific adjustments to derive our target prices that are fundamentally based on our book value assumptions.

Figure 3: Target price methodology, summary

Company	NAV 12m, diluted	B/sheet Adj., fd.	Cyclical discount	Capitalised admin costs / rebate	Corporate adjustment (AED)	Target price	Corporate adjustment considerations
Emaar	7.29	0.79	-3.64	-1.98	0.40	2.87	International diversification, proven track record, low gearing, high PNVP/EV
Aldar	6.56	-0.06	-2.28	-1.09	0.00	3.13	Abu Dhabi based, high relative gearing, coherent strategy, low PNVP/EV
Sorouh	2.96	1.80	-1.67	-0.59	0.43	2.93	Abu Dhabi based, low relative gearing, coherent strategy, high PNVP/EV
Deyaar	1.33	-0.17	-0.53	-0.02	0.01	0.64	Dubai based, unconstrained balance sheet, catalysts, med PNVP/EV
Union Properties	2.27	-0.01	-1.01	-0.24	(0.20)	0.79	Dubai based, high gearing, tendency toward invest. portfolio low PNVP/EV
RAK Props	1.66	0.00	-0.75	-0.17	(0.08)	0.66	RAK based, concentration risk, revenue from 2009 high PNPV/EV

Source: Nomura research

Company recommendations

Buy

Buy
Price target AED 2.87
44% upside potential

Emaar Properties – It's not all about Dubai: Emaar is the largest and most liquid company under our coverage and benefits from strong government support. The company has a proven track record of development predominantly in Dubai. It is concurrently targeting significant international expansion into underserved markets with strong demographics including India, Egypt and Saudi Arabia. The company funds the bulk of its development programme though pre-sales and is now entering the second stage of its maturity cycle, targeting to derive 12-15% of net profits from recurring income streams. The company is consolidating and executing its current development plans, and we are expecting delays to the future programme. Emaar has low net debt gearing and we do not see any imminent refinancing issues. At current price levels, Emaar is trading at an adjusted 2009E P/E ratio of 1.8x and 0.31x book.

Neutral (on Abu Dhabi)

Neutral
Price target AED 0.66
46% upside potential

RAK Properties – Where to next? RAK Properties is based in the Northern Emirate of Ras Al Khaimah (RAK) and was founded by the RAK government, but now has a free float of c95%. Operations are principally located in RAK, but there are fledging overseas developments and associated land holdings. The company is still in the incubator stage of development with revenues currently generated from government grants, but revenues from completed sales should be booked from 2009. The strategy revolves around two major projects, Mina Al Arab and Julphar Towers. There is ample balance sheet capacity and AED 600m in cash gives the company some operational license. We believe that the key issue that the company must deal with is the size of the Mina Al Arab flagship development, the associated concentration risk and the future strategy (post Mina) that remains unclear. At current price levels, RAKP is trading at an adjusted 2009E P/E of 2.5x and 0.28x book.

Neutral
Price target AED 2.93
24% upside potential

Sorouh – Simple, but effective strategy. Sorouh is geared towards the Abu Dhabi's residential market and also enjoys strong government support. The business model is straightforward and until now has principally been a 'develop to sell' model generating one of the highest operating profit margins in the sector. A move from serviced land plot sales to residential and commercial turnkey sales is likely to aid revenue growth in the next two years with developments in the process of being handed over. The company is currently cash positive after arranging an AED 4bn Sukuk[2] in 2008, which has been secured over future receivables. This does pose some risk, but we think there is sufficient liquidity to execute the current development programme. At current price levels, Sorouh is trading at an adjusted 2009E P/E of 3.3x and 1.0x book, which makes the company one of the most expensive in the sector, but development growth prospects are also among the highest, in our opinion.

---

[2] Sukuk is an Islamic financial instrument compliant with Sharia law that prohibits the charging or paying of interest.

Neutral
Price target AED 3.13
23% upside potential

Aldar – taking stock. Aldar Properties is another Abu Dhabi-based developer with strong government ties and an ambitious development programme. The focus has shifted from land plot sales to residential sales and commercial development and a 'develop to own' model is emerging. The funding model is therefore different and there is a higher reliance on capital markets, which are currently shut. In the current market, the company appears comfortable, taking development stock on their book (for rental purposes), which it will sell if market conditions improve. In the meantime, there is a race to have Yas Island (Phase 1) complete for November 2009 to host the F1 grand prix and the delivery of 2200 hotel keys – so all eyes will be on this project. There is around 12 to 18 months of cash reserves, so enough current capacity, in our view. As one of the flagship developers in Abu Dhabi, we believe the downside is protected, but the execution risk is still high. At present price levels, Aldar is trading at an adjusted 2009E P/E of 3.6x and 0.41x book.

Negative (for Dubai)

Reduce
Price target AED 0.64
22% upside potential

Deyaar – a time for change: Deyaar focuses its operations in Dubai and has a clean capital structure. The largest shareholder is Dubai Islamic Bank with a 41% stake. It is principally a single tower developer, but gradually moving towards master developed schemes and international diversification. It is a self funded, early cycle developer targeting mid level accommodation. Without the benefit of free land grants Deyaar is a lower margin producer, but operating in the right space. The new senior management appears more strategically focused and as a result, delays to the development programme have recently been announced. A government-directed merger with Union Properties has been suggested and with a cleaner balance sheet, Deyaar may hold the upper hand if discussions were to proceed. A merger, however, may dilute near term prospects, in our view. Key catalysts for us would be an announcement regarding its expansion into Saudi Arabia, detailed plans to raise capital for its distressed asset fund (which it may partially seed with its own capital) and any lifting of foreign ownership restrictions would be viewed as positive. At current price levels, Deyaar is trading at an adjusted 2009E P/E of 3.5x and 0.50x book, so still expensive relative to the sector.

Reduce
Price target AED 0.79
22% upside potential

Union Properties – is liquidity an issue? Union Properties (UP) is another company that is concentrated on the Dubai real estate market; it was an early cycle developer with pipeline deliveries now crystallising, but into a weakening market. The company has a mixture of large-scale and single tower developments, but a higher concentration of units are being groomed for the investment portfolio that requires a higher level of financing (similar to Aldar) with gearing at 95% that is the highest in the sector. With refinancing markets shut, UP arranged a US$680m non-convertible bond to 'strategic investors' which shores up liquidity for now – but merger talk still concerns us and could be a catalyst for a rerating. The company is focusing on developing significant recurring revenues, a strategy we agree with. We think cash liquidity is still a core issue for UP and we will become more positive once we get clarity on this issue and the risks reduce. At present price levels, Union is trading at an adjusted 2009E P/E of 1.8x and 0.32x book.

Peer group comparison

Introducing our Property NPV (PNPV)/EV metric

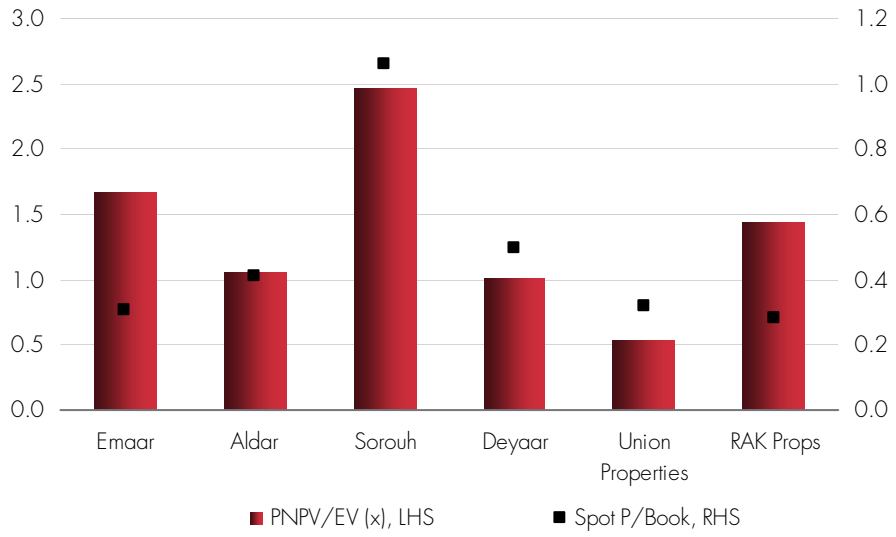
Although we derive target prices based on book value, we screen companies using a sum-of-the-parts DCF. For the purposes of our PNPV/EV metric, we only assess developments that are either: a) ongoing, or b) have a significant probability of a near-term start and delivery. On longer-term projects, we introduce a 'possibility factor' to mitigate for the likelihood of planning changes, failure to start and/or in the worst case a start but no delivery.

This establishes the PNPV for each company, which we express as a multiple of the enterprise value (EV). We also adjust for additional debt requirements required to finance construction and we calculate the value of investment properties by applying a capitalisation rate to the property NOI. We add both adjustments to our PNPV/EV equation, which we think adequately captures the existing or planned use of all property assets, while eliminating balance sheet distortions based on differences in capital structures.

We view our proprietary PNPV/EV as an indicative function of wealth creation, i.e. what does it cost today to buy tomorrow's growth; the higher the ratio, the better the stock growth prospects. Featuring strongly in our analysis are Sorouh and Emaar, but for different reasons. Sorouh is currently cash positive, lowering the denominator and Emaar has a significant development programme (which we assume is profitable), increasing the numerator. Relative to spot NAV, it looks as if Sorouh is trading at fair value, with Emaar trading well below book.

Our trading recommendations appear in line with our PNPV/EV ratios.

Figure 4: Property NPV/EV



Source: Datastream, Nomura estimates

Relevant accounting treatment – quick theory

Revenue recognition

Developers typically adopt different accounting standards, which affects revenue recognition and balance sheet valuation. Broadly speaking, revenues are booked on a 'percentage complete' basis – over the development life cycle[3], or on a 'contract complete' basis – on handover. The percentage complete method smoothes earnings, while complete contract provides more lumpy recognition, but is generally considered more conservative.

Investment property revaluation

Under IAS40, property companies can elect to hold investment properties (or designated for investment use) at book value or market value. Any revaluations (impairments) are accounted for through revenues. These non-cash, below-the-line earnings add earnings volatility, but give a better underlying view of liquidation value.

Cash remains the same

Generally we prefer contract complete and fair value accounting (assuming appraisals are independently and regularly verified), which we believe is an appropriate balance between earnings volatility and fair representation of asset worth.

As it is, a slice across company accounts is relatively meaningless, therefore we maintain adjusted EPS, which are more reflective of the cash EPS. Irrespective of accounting methodology, cash flows are exactly the same.

We summarise the accounting treatment adopted by companies in our coverage universe in the table below, but consider the detail in Appendix 1.

Figure 5: Key accounting methodologies and earnings / ratio impact

	Revenue recognition methodology	Fair value through P&L	Earnings volatility	P/E*	Investment properties* (IAS 40)	P/Book *	Development properties (held for investment)	Development properties (Trading)
Aldar**	Percentage complete	Yes	Less	Lower	Fair value	Lower	Cost	> cost, NRV
Deyaar	Percentage complete	No	Less	Higher	Depreciated cost	Higher	Cost	> cost, NRV
Emaar	Percentage complete	No	Less	Higher	Depreciated cost	Higher	Cost	> cost, NRV
RAK properties	Contract complete	Yes	More	Lower	Fair value	Lower	Cost	> cost, NRV
Sorouh**	Contract complete	Yes	More	Higher	Fair value	Lower	Cost	> cost, NRV
Union Properties	Contract complete	Yes	More	Lower	Fair value	Lower	Cost	> cost, NRV

*Source: Company data, Nomura research *on the basis that values have tracked upwards **Unit sales recognised on completion, land sales recognised early*

[3] This assumes a minimum payment has been made, the contract is binding, all risks and rewards of ownership are passed to the purchaser, etc

Balance sheet and funding

Aldar and UP are most highly geared

Aldar and Union Properties have the highest gearing, largely owing to their investment strategy of building up the investment portfolio with more development capex requiring to be funded from external financing. Most other companies employ a 'develop to sell' model where costs are (principally) funded by sales. There is now a migration towards 'develop to hold' models in the current market, so we expect sector debt levels to rise. Ironically, pre-committed debt finance is probably now safer than pre-sold funding, but we think there is a higher level of refinancing risk in Aldar and Union Properties.

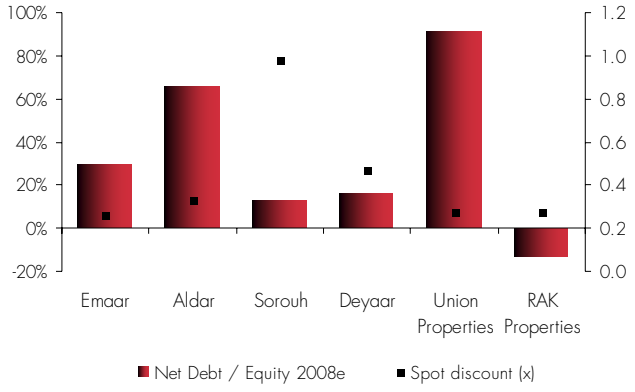
Emaar, Deyaar and RAK look the least expensive

At 4.7x GAV (ex. cash) to EV, Emaar, Deyaar and RAK Properties trade at the highest (i.e. least expensive) multiples in comparison to Aldar, Sorouh and Union Properties who trade at around 1.6x. We think this is reflective of the funding policy, with Sorouh an obvious outlier. But that this is because Sorouh is trading at book (and therefore a proportionately higher EV), while Aldar and Union Properties are trading at around 0.3x book.

Aldar and Deyaar will likely need more funds

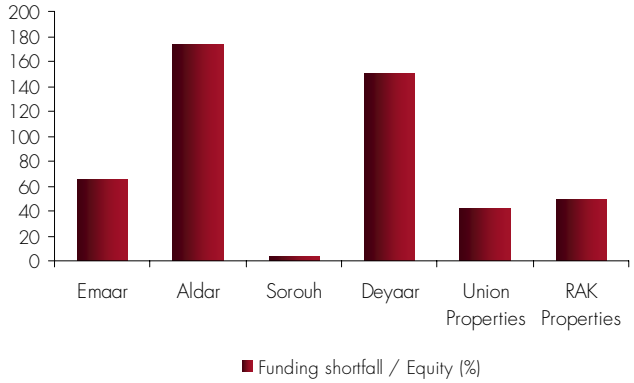
We calculate our funding shortfall after considering current cash less short-term debt, while adding back any year-end financing. From this we deduct all off balance sheet capital commitments and trade payables and assume that all receivables will be collected. It is a snapshot and does not consider future sales (which are drying up anyway) as part of the funding equation, but would contribute, in our view. Aldar and Deyaar appear to have the highest funding requirements, with the former having access to an AED 9bn government outstanding loan facility and the latter deferring the bulk of its unsold development programme, which mitigates the risk profile, in our opinion.

Figure 6: Net debt-to-equity, spot NAV discount



Source: Company data, Nomura estimates

Figure 7: Estimated funding shortfall/equity (%)



Source: Company data, Nomura estimates

Land gearing

Corporate real estate balance sheets in the UAE are more heavily geared to land holdings and developments than to income producing assets. This introduces another element of balance sheet risk (over and above financial leverage). We calculate that the residual value of land in a development is generally geared around 2.3x to underlying movements in the direct market (we detail our assumptions in Appendix 1).

We estimate Aldar and Union Properties to have the highest exposure to land values, which may be subject to balance sheet impairment (as both have mark to market models), but is likely to be protected by short-term incremental planning gains at least.

Where land values have not been separately disclosed, we make our own assumptions to strip out the land holdings from developments or investment properties.

Figure 8: Land gearing

	Emaar	Aldar	Sorouh	Deyaar	Union	RAK
Balance Sheet Date	Dec-07	Dec-08	Jun-08	Dec-07	Sep-08	Sep-08
Valuation of investment property	Book	Fair	Fair	Book	Fair	Fair
Investment properties	5,636	5,149	856	0	2,841	664
Development properties	16,194	22,934	2,756	5,141	10,206	1,318
Total property assets	**21,830**	**28,084**	**3,612**	**5,141**	**13,047**	**1,982**
Net debt	2,977	10,522	-2,962	-832	5,669	-681
Other net assets	18,336	-1,529	-1,466	136	-1,356	414
Residual equity value	**37,188**	**16,032**	**5,108**	**6,108**	**6,023**	**3,077**
Land (Dev,Inv,Held for resale) stripped out	**4,549**	**4,650**	**1,068**	**0**	**3,703**	**498**
Land value to total property value	21%	17%	30%	0%	28%	25%
Land value to equity value	12%	29%	21%	0%	61%	16%

Source: Company data, Nomura research

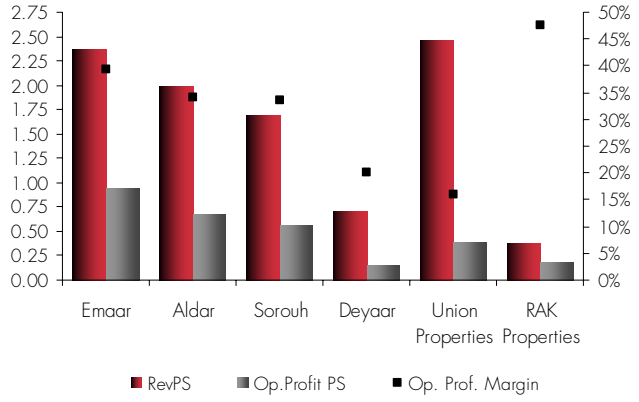
Revenue statement

We estimate that Emaar will return the highest EPS. Based on our 2009 and 2010 earnings estimates, the stock ranks as one of the lowest at 1.8x, but earnings are smoothed by the percentage complete method.

Union Properties also features on this basis, but a lot depends on the delivery of its near-term development pipeline that may be now converted into its investment portfolio, so earnings visibility is unclear after 2010.

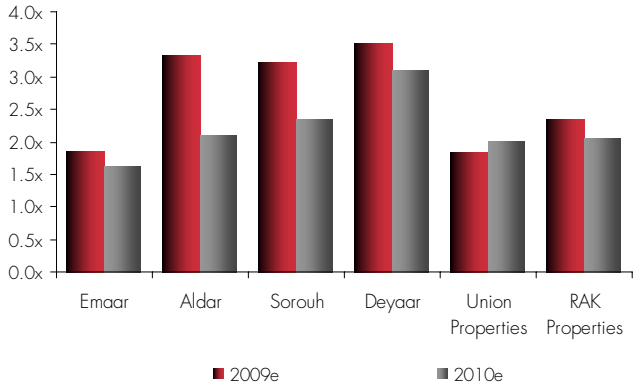
Our gross margin assumptions average about 40%, but Deyaar and Union Properties are lower at 20% as they do not benefit from free (or very cheap) federal land grants.

Figure 9: Revenues vs. operating profits, 2009e



Source: Nomura estimates

Figure 10: Adj. P/E ratio (x)



Source: Nomura estimates

Where are we versus consensus?

Consensus target prices too high?

We question current consensus target prices that average 300% upside across our coverage universe. Based on our target prices, we are on average 64% lower than consensus with an average price return of 30%. We agree that these are fundamentally inexpensive stocks, but we are attempting to ascribe 12-month trading values, not five year option values. We will review our target prices as market prospects start to move.

We expect consensus target prices to move down, before we move up.

Revenue estimates

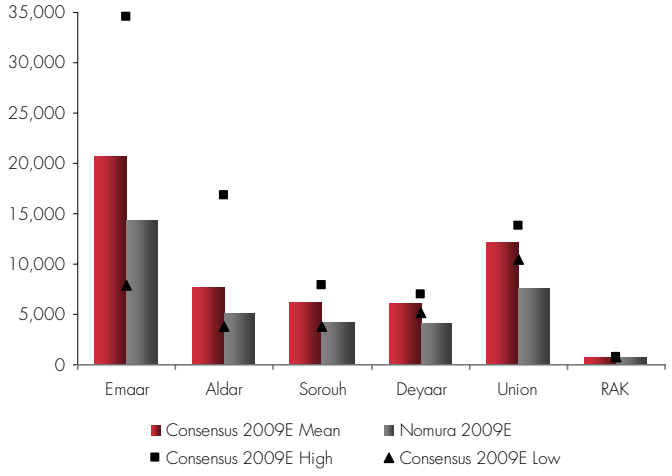
We are consistently below consensus in our revenue and earnings estimates (and generally near the bottom of consensus) but there is a large range in analyst forecasts. This is probably owing to a function of timing (with development schedules being delayed) and also poor revenue and earnings visibility (a wide range of developments at various stages of completion). Analysts have to attempt to sort through a large number of ever changing variables.

We admit that we are conservative relative to the street, but with development delays and the transition of property into investments rather than sales, we are comfortable with our forecasts.

Back to basics

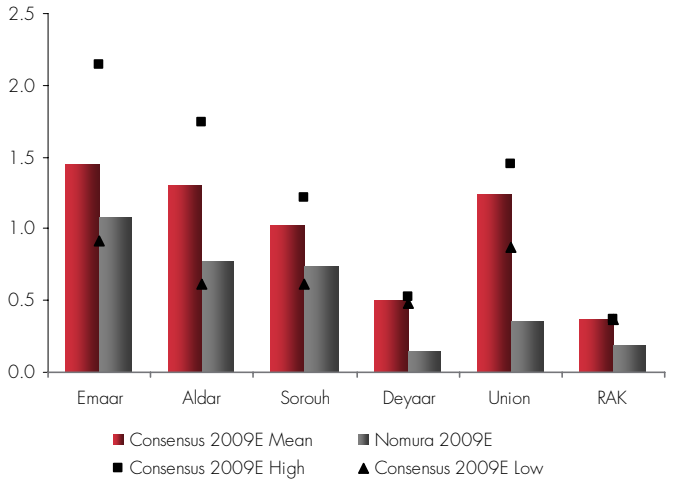
Either way, we think consensus estimates will be downgraded on the back of 2008 results notes. To benchmark ourselves against the street we use adjusted EPS (rather than basic), which normalises revaluation and other non-cash adjustments. Our estimates make a number of assumptions that include delays to the development programme, the transfer of developments for sale into developments for investment and recurring income from investment assets.

Figure 11: Revenues (m), 2009e



Source: Bloomberg, Nomura research

Figure 12: EPS, 2009e



Source: Bloomberg, Nomura research

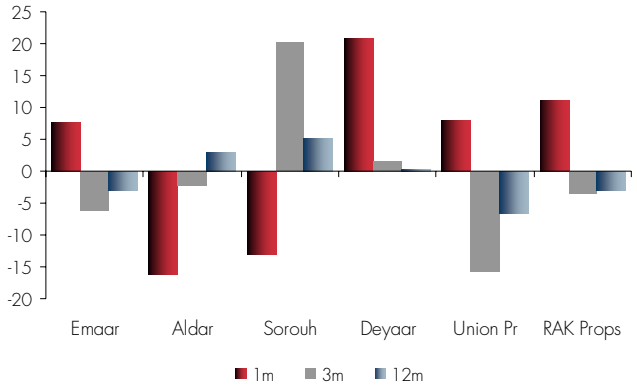
Recent share price performance

Until very recently, a distinct pattern of outperformance was noticeable from Sorouh over Aldar, but this has reverted recently. Both operate almost exclusively in Abu Dhabi, where prospects appear better than Dubai, yet the level of outperformance has been around 25% over the past three months.

Until very recently, Aldar has been performing inline with Emaar, with both being the liquidity focus of their respective exchanges (Emaar, DFM; Aldar, ADX). Deyaar continues to outperform Union Properties (both operate principally in Dubai); the former with cash and the latter, cash strapped, in our view.

Counter-intuitively, the Dubai-based stocks have reversed recent long-term trends and have been outperforming recently, which may signal that the market thinks them oversold and supports our overall thesis of absolute upside potential despite the weakening macro picture.

Figure 13: Relative share price performance (1m, 3m,12m), %



Source: Datastream, Nomura research

Free float, foreign ownership and significant stake holders

Most companies in the UAE restrict foreign ownership (FO) levels to a maximum of 49%. In November 2008, Sorouh cut its foreign ownership limit from 20% to 15%. Despite having a zero foreign ownership level, Deyaar does allow 49% Gulf Cooperation Council (GCC) ownership.

Given the current environment, we do not foresee companies increasing their FO quotas. In fact, the wider market trend in 2H08 has been to restrict FO levels further. Most property companies (listed) have large stake holders (government and/or founders and financial institutions) with free floats typically ranging from 52% to 80%.

We summarise the free float, foreign ownership and foreign investible limits and average trading volumes in the table below. Emaar, Aldar and Sorouh regularly feature in the highest daily values traded on their respective exchanges.

Figure 14: Free float and foreign ownership levels (as at 31 December), ranked by available market cap

	Free Float	FO Limit (%)	National ownership (%)	GCC (%)	Non-GCC (%)	Total non - national ownership (%)	Available for non - national ownership (%)	Avail. additional investment for non- nationals (AEDbn)	Average trading volumes shares (m)	Comment
Emaar	69%	49	82.1	8.8	9.1	17.9	31.1	4.36	32.5	31% owned by Dubai Government
Aldar	76%	40	75.1	2.2	22.8	24.9	15.1	1.58	17.6	9% Government, 15% Mubadala
Sorouh	82%	15	90.2	1.8	8.0	9.8	5.2	0.39	12.9	18% Al Joud and Government
RAK Properties	95%	49	74.4	14.7	10.9	25.6	23.4	0.23	13.8	5% Government
Union Properties	52%	15	92.2	1.7	6.2	7.9	7.2	0.16	12.1	48% owned by Emirates Bank (Int)
Deyaar*	59%	0	98.2	1.8	0.0	1.8	0.0	0.00	26.7	41% owned by Dubai Islamic Bank

*Source: ADX, DFM,Zawya, Nomura research *Deyaar currently allows 49% GCC ownership, but other foreign ownership restrictions apply*

Sector investment risks

Upside risks

Supply constraints: Supply is already being affected by construction delays and there is increasing pressure on master developers (from government bodies) to restrict supply even further, which would lessen the impact of stalling population growth.

Margin expansion after the contraction. A constructive dialogue between contractors (looking to protect order books) and developers (wanting to complete marginally viable projects) is emerging, with contracts renegotiated and both parties sharing the upside in construction material price falls. Developers have the upper hand.

Property prices undershoot, rents hold up. Property pricing (yields) gets to the point where the risk premium is attractive enough to encourage buy-to-let investors into the market. This provides an alternative and larger buying pool, increased liquidity and stabilised pricing.

Plan to own, buy to own, relaxed payment schedules regenerate demand. Developers are currently relaxing payment plans and offering additional purchasing options. At the fringes this may stimulate additional demand.

Improved credit conditions. Banks are unlikely to make new loans to developers, but improved credit conditions may make refinancing easier and restrictions on untapped credit lines may ease up.

Downside risks

Population growth reverses significantly. Our base case sees population growth stalling, but not reversing aggressively. However, a situation could develop where absolute population numbers fall if the construction, real estate and service industries (the most exposed) do not stabilise and there are large-scale redundancies of expats.

Credit markets remain closed for a protracted period. The UAE banking system is highly reliant on wholesale funding. High net worth individuals and expats generally keep or push their deposits offshore, so domestic banks are reliant on commercial paper and wholesale banking markets.

Liquidity does not return as expected. Central repo rates are at 1.50%, interbank lending rates are at 3.6%, and six month deposit rates are at 6.5%. This is not sustainable, in our opinion, and banks still remain dependent on international wholesale markets for funding. If international liquidity (and confidence) does not return, banks could face the possibility of state aid. This is not a good scenario, in our opinion.

Dividend cuts in the listed Real Estate sector. Developers are cash constrained. Although there will be domestic pressure to maintain dividends, we believe it is likely that companies may eventually have to cut dividends to conserve cash, with Emaar most at risk.

P/NAV of 0.44, dividend yield 7%

We estimate that the UAE real estate sector trades at 0.5x to spot (i.e. the current) NAV, but this includes the outlier, Sorouh, which is currently trading at its book. Many of our coverage companies do not even report an NAV, so for comparative purposes we calculate an adjusted NAV, which, among other things, includes excess revaluations on investment portfolios (if stated) and excludes goodwill (which is subject to impairment anyway).

We outline our full valuation methodology in appendix 2.

The average sector dividend yield as reported is 6.5%. This excludes Union Properties who have in the past paid a 10% stock dividend and Deyaar who will provide dividend guidance in March at its AGM.

Figure 15: UAE Real Estate Sector valuation summary

Company	Price (AED)	NAV Dec-08E	Spot NAV Feb-08E	P/NAV	Spot P/NAV	Div. yield (%)
Emaar	2.00	6.33	6.49	0.32	0.31	10.0
Aldar	2.55	6.16	6.22	0.41	0.41	4.9
Sorouh	2.36	2.12	2.23	1.11	1.06	5.1
Deyaar	0.52	1.02	1.04	0.51	0.50	n/a
Union Properties	0.65	1.98	2.03	0.33	0.32	n/a
RAK Props	0.45	1.58	1.60	0.28	0.28	16.7
				0.51	0.49	6.5

Source: Datastream, Company data, Nomura research

A benchmarking exercise

The UAE is trading at a spot (current) p/book average discount of 50%, so on a relative basis is amongst the least expensive.

In Figure 16 we benchmark average p/book discounts from countries under our Nomura coverage universe. Currently, the average p/book in emerging markets, which we use as our country specific benchmark for UAE, is 0.65x. But the UAE is trading closer to Russia and the CEE than to India and China where demographic drivers remain strongest.

Figure 16: Average p/spot book multiples

Emerging		Asia		Europe	
Country	p/bk	Country	p/bk	Country	p/bk
India	0.75	Hong Kong	0.63	UK	0.56
China	0.90	Singapore	0.60	France*	0.60
Russia, CEE	0.30	Japan	0.55	Netherlands*	0.65
Average	0.65		0.60		0.60
Av. Discount (%)	35.0		40.0		40.0

*Source: Nomura research, * Netherlands and France consensus estimates*

The UAE is currently sitting half way between Indian real estate stocks and Russia/ CEE stocks, although Russia is skewed with our three coverage stocks trading at distressed levels with actual p/book levels of just 0.12x book. We do not think that the UAE will ever fall into this territory, primarily owing to the tacit support of the government.

We believe the pricing in India is more relevant than Russia, particularly because this is where a lot of opportunity capital is repatriated to. As the Indian residential market, which experienced a similar, but less aggressive, growth profile than the UAE, starts to sell off, we believe that there is a greater likelihood of Indian nationals repatriating capital rather than investing it locally.

Figure 17: Emerging market valuation comps

Country		Nomura rating	Analyst	Price	P/E	p/bk
India	DLF	Neutral	Aatash Shah	156.65	2.9	0.89
India	Unitech	Buy	Aatash Shah	30.2	4	0.99
India	Puravankara Projects	Neutral	Aatash Shah	40.9	4.4	0.64
India	Indiabulls Real Estate	Buy	Aatash Shah	98.85	43	0.5
India	HDIL	NR	NA	82.3	2.5	0.52
India	Sobha	NR	NA	83.25	3.7	0.56
India	Omaxe	NR	NA	46.9	5.8	0.54
India	Parsvnath	NR	NA	39.4	4.6	0.37
India	Mahindra Lifespace	NR	NA	117.4	8.4	0.59
India	APIL	NR	NA	27.7	3.4	0.21
India	**Average**				**8.3**	**0.58**
China	China Overseas	Buy	Wee Liat Lee	10.4	15.8	2.7
China	China Resources Land Ltd.	Buy	Wee Liat Lee	8.38	20.4	1.46
China	Country Garden	Neutral	Wee Liat Lee	1.73	6.6	1.31
China	Guangzhou	Neutral	Wee Liat Lee	7.47	3.3	1.53
China	Sino Ocean Land	Buy	Wee Liat Lee	3.88	6.6	0.96
China	Shimao Property	Neutral	Wee Liat Lee	5	5.1	0.79
China	Soho China	NR	NA	3.02	5.1	0.88
China	Agile property	NR	NA	3.13	1.8	0.82
China	New World China	NR	NA	2.1	4.1	0.28
China	Hopson Development	NR	NA	4.68	1.9	0.39
China	Guangzhou Investment	NR	NA	0.77	5.1	0.41
China	KWG Property	NR	NA	1.75	1.6	0.53
China	Green Town China	NR	NA	2.83	4	0.5
China	Shanghai Forte	NR	NA	1.18	3.8	0.51
China	Beijing Capital	NR	NA	0.99	2.5	0.4
China	**Average**				**5.8**	**0.9**
Russia	LSR	Buy	Mark Cartlich	0.575	NR	0.15
Russia	OPIN	Buy	Mark Cartlich	28	NR	0.11
Russia	PIK	Neutral	Mark Cartlich	0.625	NR	0.12
Russia / CEE	**Average**					**0.12**

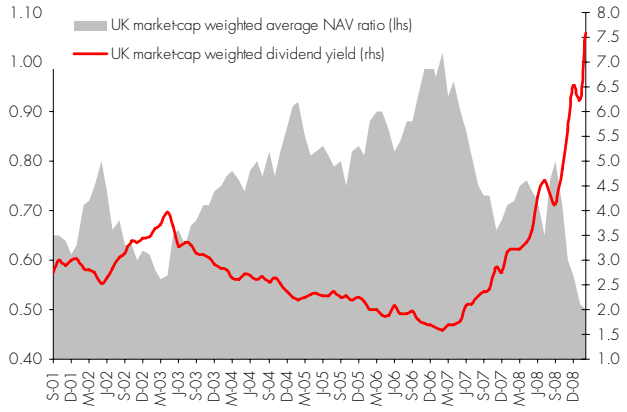
Note: where stocks are not rated we have used Bloomberg/Datastream estimates. P/BK is spot price/BK and P/E is 2009E
Prices as of market close, 16 February 2009
Source: Nomura research

Dividends are not a floor

Interestingly, scanning the wider and more established markets, we see Japanese REITs trading at similar levels, with a price-to-book of 0.55x and a dividend yield of 7.3% (versus 0.5x and 6.5% for our stocks under coverage), but the business models are completely different and REITS are by law required to distribute most of their earnings.

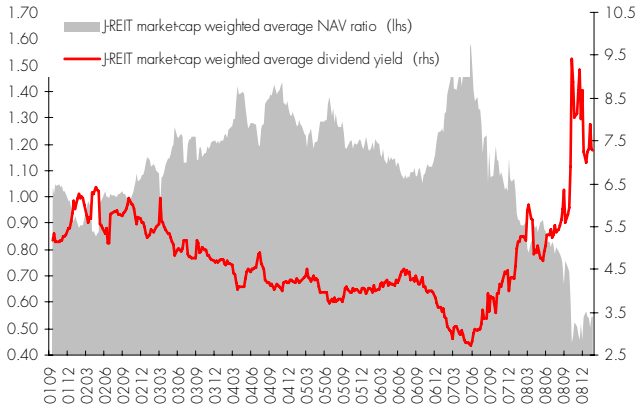
UK REITS are trading at 7.5% yields and Australian Listed Property Trusts (LPTs) at 16%, with both in the process of recapitalising the sector and dividend cuts are increasingly likely (in Australia), so we do not read much into dividend floors on valuation for the time being, but the sell off has been unilaterally global.

Figure 18: UK P/NAV and DY (%)



Source: Nomura research

Figure 19: Japan P/NAV and DY (%)



Source: Nomura research

Equities priced the fall in the direct market

Based on our local coverage universe, we estimate that the UAE is currently trading at 0.49x book, higher than Russian and CEE developers that are trading at between 0.1x and 0.4x book, respectively. This is a far cry from the 2.5x P/NAV multiples that UAE shares were trading at 12 months ago, and 1.5 to 2.0x P/NAV multiples six months ago.

Current market indicate poor prospects

P/NAV ratios normally trade at premiums when growth prospects appear highest and discounts when growth prospects are diminishing or negative. Based on the simplified assumption that shares should trade at NAV and taking into account average sector leverage of 30%, the market is implying that real estate will fall by 40%, which is probably fair in our view.

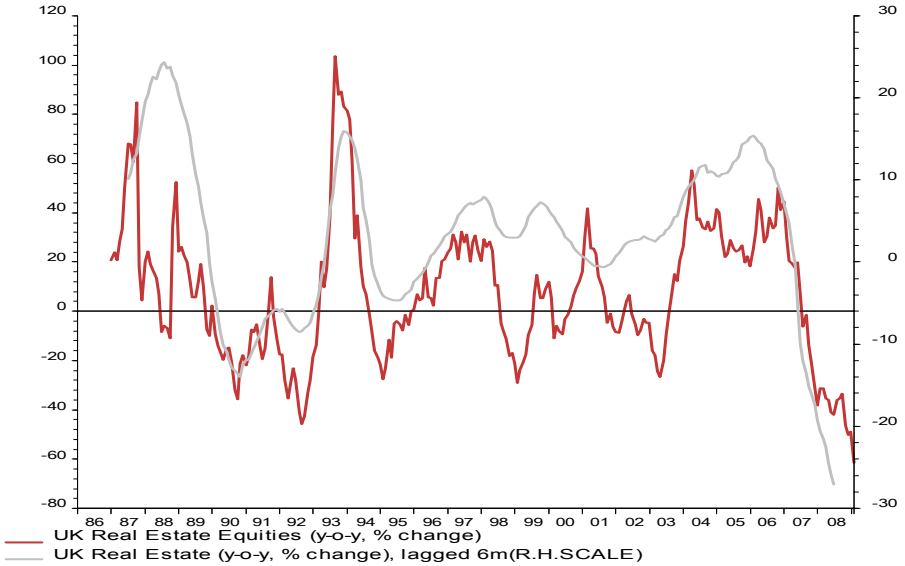
Another 15% down is implied

This would represent a further fall of 15% from the peak and give away all the gains made in 2007 and 2008. We think that there are likely to be pockets of obvious distress (high end), but we think the market has probably got another 10-15% to go, and if this is the case equities could stabilise at current levels.

Lagged effect

Typically, direct real estate pricing lags equity markets by six to nine months. Property appraisers and pricing data are backward looking by three months, while in contrast the equity markets tend to look forward by around six months (and generally with predictive success). We see this particularly in developed markets such as the UK.

Figure 20: UK Equity performance vs. UK direct real estate (y-o-y, 6m lag)



Source: Datastream, Nomura research

Market prices 50% fall in capital values

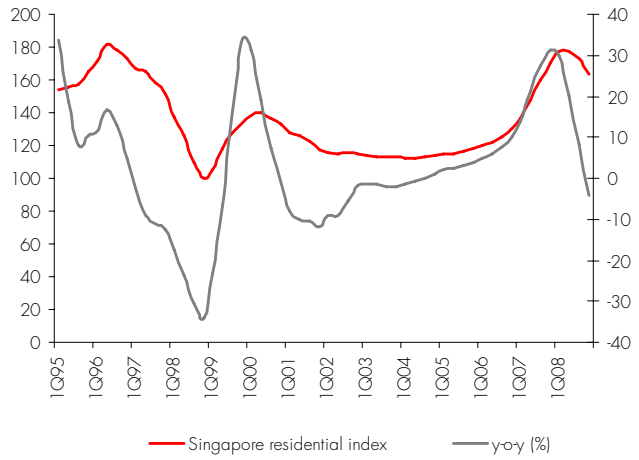
We think that there is greater volatility in emerging markets where construction and real estate sectors are more highly dependent on FDI, so the lagged effect may actually be shorter (with both equity and direct markets attracting and releasing FDI at similar rates), although we find limited data to support this.

Putting it into context

The last severe liquidity contraction was the Asian crisis of 1997, so we benchmark both the Singapore and Hong Kong residential price indices to get some context. In Singapore property prices barely touched their 1997 peaks in 2008 and have fallen around 5%. Through the late 1990s, however, peak-to-trough, the index fell 80% over a three-year period. In Hong Kong, over the same period prices fell far more sharply through 1997 and 1998, falling 60% and have never fully recovered. They are currently off 20% y-o-y, having rallied strongly the year before.

We maintain that the recent rise (and subsequent fall) of housing has been a global phenomenon but the UAE probably headed the excess with year-on-year price appreciation of 60-80%. We think the pattern more closely resembles Hong Kong where the sell-off has been more severe.

Figure 21: Singapore residential index



Source: Bloomberg, Nomura research

Figure 22: Hong Kong residential index

Source: CCI, Nomura research

Doubling up

Unlike most Western and Asian-Pacific markets (with the exception of Australia) where real estate does not dominate the indices, in the UAE real estate equities form a significant part of total market capitalisation (up to 40% at their peak) and dominate trading and liquidity flows (even after the 80% sell off). Share prices are therefore a function of market sentiment, liquidity and the trading prospects of the underlying assets. Direct prices have fallen on average 25% already; we think there is probably a 10% to 15% additional fall before they stabilise.

Two way flow

Real estate speculators, now stuck with property assets they intended to sell (but now cannot), are forced-sellers of shares to fund real estate instalments. Similarly, share investors receiving margin calls are forced sellers of property, which in itself creates a circular reference (with a downward spiral).

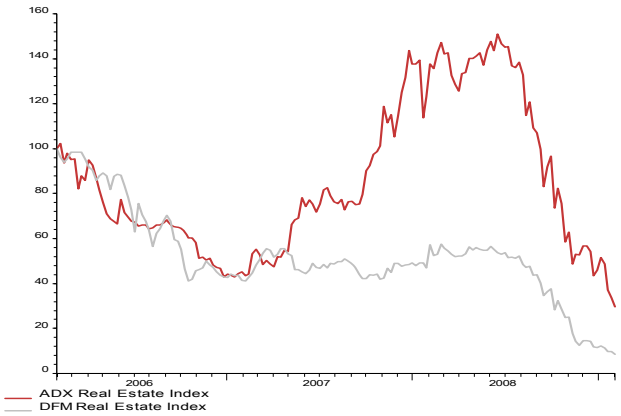
Fire-sales don't really count

Headline-grabbing 70% discount 'fire-sales' on the Palm Jumeirah probably misrepresent the real market, which should stabilise once the forced sellers have been forced out. Until this occurs and the finance market and the resale market can reset themselves, we do not see a recovery in share prices. We think share price falls now look overdone on the downside and should begin to stabilise. However, the headwinds have not petered out yet and we think that it is too early to be aggressively buying the sector as we are probably mid-cycle through the deleveraging process.

Share price recovery 4Q09

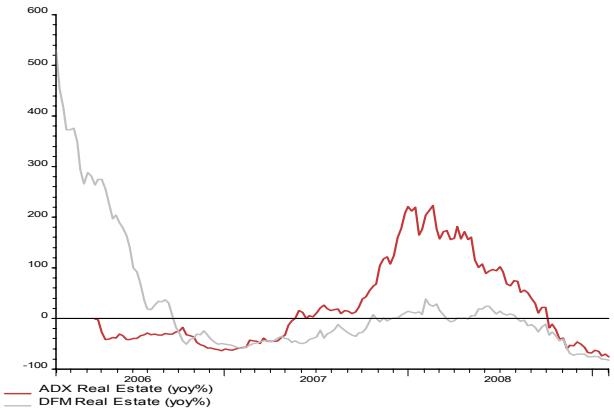
Although we think the fundamentals are still weak, we see two questions that need to be addressed to kick start the sector: 1) when does liquidity return (does the central bank under-write the real estate sector)? and 2) what about sector consolidation (we believe a government-inspired merger is probably inevitable). At this point, we would be positioning ourselves for a 4Q09 recovery.

Figure 23: DFM/ADX real estate performance



Source: Datastream, Nomura research

Figure 24: ADX/DFM performance (yoy%)



Source: Datastream, Nomura research

Stylistic Real Estate themes

Rational capital

In any orthodox real estate cycle, the quoted real estate sector is leveraged into the underlying economic growth prospects with property companies acting as suppliers of business, retail and residential accommodation. Over the long term, IRRs for real estate typically range from mid- to high single digits (mid-cycle). In an emerging market environment, IRRs rising to the mid- to high double-digit range are probably more appropriate. Master regional or international developers taking on lifestyle community projects inherently take on an additional degree of economic leverage, in our view. Not only are they exposed to the fundamental economic conditions, there is a greater degree of exposure to population growth (domestic and migratory) and tourism demand.

Capital intensive…

All real estate companies tend to be capital consumptive, but this varies greatly depending on the business model and strategy. Mature real estate companies generate stable positive cash flows with (generally) low capex requirements with only a small amount of 'revenue leakage' through occupancy and overhead costs. Development models, however, are significantly more capital constrained and subject to a multitude of additional risk factors (planning, construction costs, the sales and letting process, etc.) and capital costs that are considerably higher.

… and homogeneous

We make the generalised assumption in the UAE, that real estate companies are a homogeneous group, admittedly with some small variations. There are different combinations of financing, geography and sector specifics, but holistically these property companies are relatively similar. As they mature, we should see a higher degree of investment portfolio and business lines that support more recurring cash flow – which in turn can be used for internal financing at cheaper rates. The decision to buy into the real estate sector is therefore more of a macro call on market fundamentals and less geared to individual company specifics.

Spending for the public good

Master developers have been vested by government interests to control the real estate supply in their area of core operations. In Dubai, Nakheel, Emaar and Dubai Holdings collectively control around 70% of all supply coming to the market. They are granted large land tracts (free or heavily subsidised) and in return they bridge the funding gap between the government and the sub-developer and ultimately the end user. We think that this is an efficient use of public capital (land is free unless it is reclaimed) and a mechanism where public expenditure on necessary utilities and infrastructure can be stealthily privatised. So far so good.

The knife edge

The papers remain optimistic and the property blogs negative – the truth lies somewhere in the middle, in our opinion. We believe that Dubai is too big to fail and the government entities that effectively control the respective real estate markets know this. There is no cash and there will be more deleveraging, but we believe that liquidity will creep, albeit slowly, back into the market. In the main, the current tranche of developments are likely to be completed before developers call time out. We think the key is to back the developers that have a strategy at the end of the time out period.

The macro view – A call on oil, liquidity and confidence

Thanks to Alastair Newton, Political Analyst (+44 20 71023940) and Serhan Cevik, Economic Analyst (+44 20 75212357)

Normalisation

Liquidity, beyond monetary measures, is all about confidence. The whole world appears to be in recession and capital-rich countries have also discovered that their accumulated wealth is not enough to keep them unaffected. The collapse of housing bubbles is now a global event and the UAE has had one of the biggest bubbles. Therefore, we believe that it is also a question of normalisation after a long period of excesses. Despite government plans to increase domestic spending by 11% and the roll-out of fiscal packages to stimulate the economy, we think that it may not be enough to resurrect property prices.

Regional slowdown

We think all gulf economies will experience a sharp slowdown in economic growth this year. This is largely because of the oil channel, but we cannot overlook the unraveling of domestic excesses accumulated over the past six years. Credit growth and the unwinding of the real estate bubble will be other key drivers to economic growth in our view, and the UAE is experiencing these two economic pressures. In the UAE, our house view is that real GDP growth will slow to between 1.5% and 2%.

Political stability

Despite the prevailing economic conditions, the UAE remains politically stable (albeit with the increasing risk of expatriate unrest). We think the UAE authorities will continue to pursue liberal economic policies and maintain a pro-Western stance. Political power across the seven emirates that make up the UAE is set to remain in the hands of the current ruling families and we do not perceive any internal pressure for political reform. That said, economic developments in Dubai may result in some dilution of the additional bargaining power that it gained within the federal government in a federal cabinet reshuffle in February 2008. The current term of the 40-member advisory Federal National Council (FNC) is due to expire in February 2009, but we believe that the term will be extended for a further two years.

For the UAE as a whole, the economic slowdown has reduced inflationary pressures and, therefore, debate over whether to maintain the dollar peg that ran for most of last year. And we judge that it will also have further dampened already limited enthusiasm in the UAE for the GCC currency union, which we think will be delayed post 2010.

GDP growth 1.5% to 2%

We think the private sector will have to postpone (and eliminate altogether) some investment projects and, even though the authorities will try to increase public spending on infrastructure and in other areas, we estimate that the government budget really has no head-room. The call for the government's asset managers (SWFs) to invest locally is counterintuitive, in our opinion. The budget surplus is fast disappearing and trying to front-load spending could do more harm. Therefore, given how exposed the UAE is to these underlying risks, we expect real GDP growth to come down from 6.8% in 2008 to between 1.5% and 2% this year.

Credit contraction… We estimate credit growth to be 10% in 2009 (versus 50% in 2009) and demands on the financial institutions to 'ease up on real estate lending restrictions' appears more rhetoric than actual pressure, because the system remains bereft of liquidity despite the AED 120bn stimulus package and the claw back of around AED 110bn of overseas deposits.

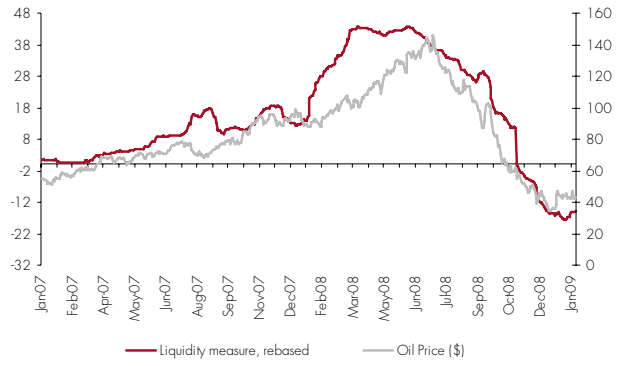
… credit freeze … A crisis committee has been called for by the Ministry of the Economy, suggesting further interest rate cuts, schemes to encourage deposit growth and the implementation of different interest rates to help stimulate the sectors most at risk, which would benefit the real estate sector. The problem remains the lack of liquidity (more so in Dubai than Abu Dhabi). Banks are required to repair their balance sheets and have tightened lending standards significantly (raising minimum income thresholds up to 100% and lowering LTV covenants to at best 70% from 90%).

The time of aggressive lending has ended and it may take between 12 months and two years to repair bank balance sheets, so we do not see any near-term catalysts to ease bank liquidity in the short term.

On a more macro level, we think this becomes a call on the oil price. We benchmark the excess liquidity in the UAE (a function of EIBOR and LIBOR) against the oil price. Over the past two years, the correlation is close to 1, which is logical, in our view. Higher oil prices have driven liquidity, with the potential dollar de-peg exaggerating the effect in early 2008. Deferring the de-peg led the first wave of speculative capital out of the country, which was then compounded by the falling oil price.

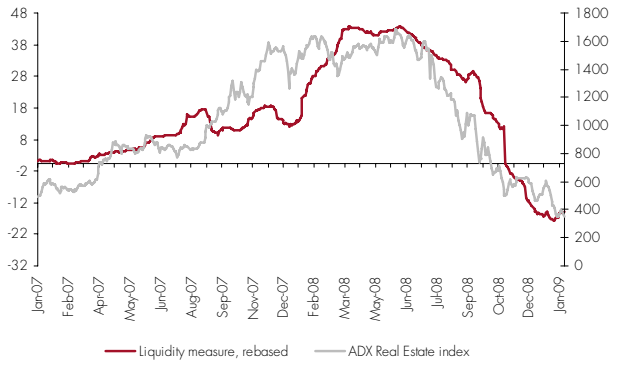
… credit thaw If, as we believe, the performance of real estate is a function of credit liquidity (the correlation is 0.85) and therefore by implication, the oil price, then our macro view becomes a partial call on oil price recovery. Our house view on oil prices is a recovery to US$60/bbl in 2009 rising to US$75/bbl in 2011. We believe that this is probably enough to alleviate, but not eliminate, some of the current tightness in bank liquidity and we doubt we will ever be in a situation where credit is quite so loose. We would expect to become more positive on the sector when we start to see significantly more liquidity.

Figure 25: UAE liquidity vs. Oil price (US$)



Source: Datastream, Nomura research

Figure 26: UAE liquidity vs. ADX real estate



Source: Datastream, Nomura research

Our strategic view on emerging markets

Emerging markets look inexpensive

Our global strategy team has a generally favorable outlook on aggregate emerging markets, which are currently showing the highest levels of equity market risk premiums over the last 10 years. Figure 27 shows that the emerging market risk premium is close to 600bp above the developed market. Historically, the point at which a premium such as this is reached tends to be followed by relative outperformance over the subsequent 12 months.

Still too early in the UAE

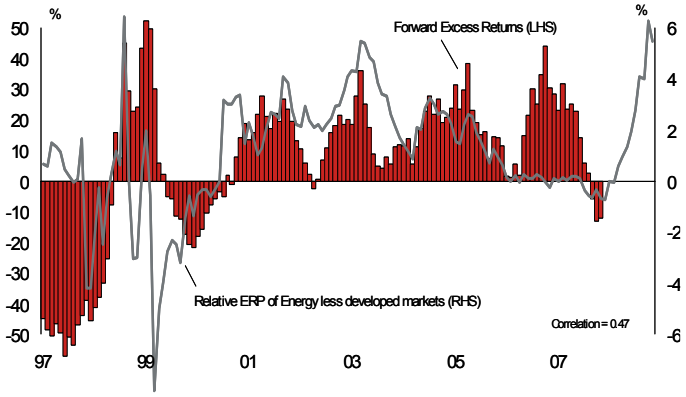
Admittedly, this is based on forward P/Es based on consensus estimates, which we think are inflated (we are c40% below consensus earnings on our coverage universe). While fundamental valuations look inexpensive to us, we think that there are limited near-term catalysts to boost market confidence. Funds have been flowing out of the region, but abating, using US mutual fund flow data as our market proxy. Therefore tactically we take a neutral market stance and will continue to monitor mutual fund flows for when flows start up.

We think the UAE market is further characterised by a high proportion of local retail investors (90% in our estimates) who were (probably) also participating in the speculative off-plan real estate market, so we regard this as a 'double whammy' of wealth destruction to pass through the domestic system.

Our house view is for a global 25% uplift in equity valuations for 2009 compared with a forecast for emerging markets of a 35% rise.

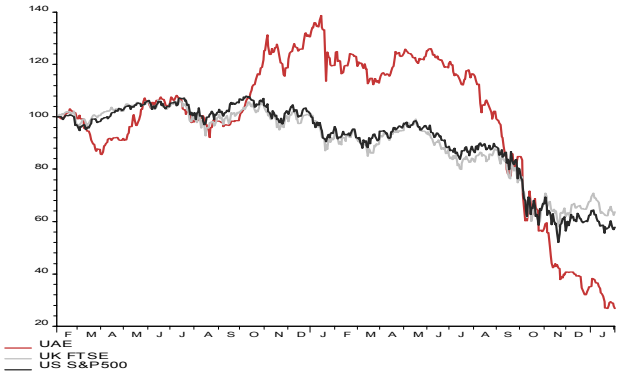
We think international emerging market money may seep back in a rather hierarchical manner, firstly in Turkey, then Russia, then possibly the GCC – although we see less risk in investing in the GCC region, backed by oil reserves.

Figure 27: Emerging markets' risk premium



Source: Nomura estimates

Figure 28: Local versus international price performance



Source: Datastream

Note: The equity risk premium is calculated as the difference between the market-cap-weighted earnings yield and the real bond yield for both FTSE World and FTSE AW Emerging Markets

Financing and balance sheet liquidity

Bridge finance models

Globally, concerns are all about funding and liquidity. Most real estate development models rely on pre-sales to fund development programmes. As markets become more competitive, so do financing terms and incentives, which introduce an additional 'risk gap' to the bridge financing model. The most common funding structure in the UAE is to accept a down payment and then installments over the construction period with a bullet payment (of up to 80%) at practical completion, but these vary significantly based on the developer and development type, with the less reputable developers (non-public listed), probably having to give away more incentives to attract buyers and compensate for the additional risk.

Low gearing in the sector

As at 3Q08 or FY2008, i.e. the last complete balance sheet date, Sorouh, Deyaar and RAK Properties were all cash positive. Union Properties had the highest level of equity gearing at 94% and also the largest short-term refinancing requirements. Union Properties will raise AED 2.5bn to refinance short-term debt (approved EGM, 22 January) with a convertible bond issue sold to selected 'strategic investors', which will be used to finance the completion of MotorCity. Aldar uses debt facilities to fund developments held for investment, but current cash holdings are sufficient to service short term debt and the company has an untapped government loan facility of AED 9bn against Yas Island Arguably this is one of the securest credit lines in the UAE.

Figure 29: Gearing levels

	EMAAR	ALDAR	SOROUH	UNION PR	DEYAAR	RAK PROP
Last reported	3q08	FY08	FY08	3q08	3q08	3q08
Short term, >1yr	4,258	2,683	1,840	3,311	626	0
Long term	4,800	19,905	1,989	2,516	2	0
Total Debt	**9,058**	**22,588**	**3,829**	**5,827**	**628**	**0**
Cash and cash equiv.	6,359	12,066	6,842	159	689	681
Net Debt	**2,699**	**10,522**	**-3,013**	**5,668**	**-61**	**-681**
Shareholders Equity	38,647	16,032	5,958	6,023	6,947	3,077
Net Equity gearing (%)	**7**	**66**	**-51**	**94**	**-1**	**-22**

Source: Company data, Nomura research

The liquidity trap

During the run-up in property prices over the past three years, the trend has been towards over-development (as a sector) coupled with increased sales competition that created favorable payment terms for purchasers.

Duration lag

This is fine when credit and bridge finance is readably available, but developers are now being caught in a liquidity trap. Contractors require payment on completed work certificates (which are already being held up) and purchasers can't raise the bank finance to service the outstanding installment payments. So developers must focus on the 'stringent control' of their receivables and payables, with payables on a shorter duration than receivables.

Financing the wrong properties

Different payment plans have been structured by company and by development. When banks were falling all over themselves to lend money, a 20% down and 80% final

installment structure was appealing. The market was rising and for a low capital outlay, speculators could flip the property and make a healthy profit. Less desirable developments could be made more attractive by the payment plan, but these are now the ones probably most at risk.

Balance sheet liquidity

In order to establish balance sheet liquidity, we deduct short-term financing requirements from available cash balances and deduct committed capital expenditure, which is reported off balance sheet (UP does not give quarterly updates and we use 2007 figures as a proxy).

Aldar gets credit for AED 9bn financing line

In Figure 30, we detail our balance sheet liquidity assumptions. We adjust Aldar's capital commitments downward to reflect the AED 9bn government sponsored facility for Yas Island, and we add the approved AED 2.5bn convertible bond of Union Properties. We do not adjust Emaar for the additional US$4bn that it has lodged prospectuses for. This will be tapped when required, but it is neither guaranteed nor underwritten.

Accounts payable and receivables are just alternate forms of short-term financing, so we include them in our estimates below.

We should deduct available credit lines, but these are not reported (generally) on a quarterly basis. We would, however, be surprised if all committed credit lines were still available unless guaranteed by the government, as in the case of Aldar.

Figure 30: Balance sheet liquidity (AEDm)

	EMAAR	ALDAR	SOROUH	UNION PR	DEYAAR	RAK PROP
Last reported	3q08	FY08	3q08	3q08	3q08	3q08
Cash	6,359	12,066	7,692	159	689	681
- less short term debt	-4,258	-2,683	-1,997	-3,311	-626	0
Cash / (Cash requirements)	2,101	9,384	5,695	-3,152	62	681
Additional financing	0	0	0	2,500	0	0
Estimated cash surplus (deficit)	**2,101**	**9,384**	**5,695**	**-652**	**62**	**681**
- less capital commitments	-19,750	-34,193	-3,501	-6,306	-2,611	-1,788
Advances and receivables	3,776	6,651	4,089	3,486	2,092	401
Payables and accruals	-11,584	-9,601	-6,524	-5,562	-2,511	-833
Funding Shortfall	**-25,457**	**-27,759**	**-241**	**-9,034**	**-2,968**	**-1,539**
Funding Shortfall / Equity (%)	66	173	4	150	43	50
Funding Shortfall ex rec/payables (%)	46	155	-37	116	37	36

Source: Company data, Nomura research

Based on current capex commitments, each of the companies shows a funding shortfall (with capex spread over one to fifteen years in some cases), so we calculate that they remain reliant on future sales or the capital markets.

More capital please

Based on current equity values, Sorouh appears to have the most balance sheet liquidity with Union Properties and Aldar the least. Even after repairing its current liabilities by the issue of a convertible, we still estimate a funding gap of 150% relative to the equity value.

In January, Emaar lodged listings for a US$4bn programme (US$2bn SUKUK, US$2bn euro MTN), but was likely to tap just US$2bn. It seems the company is doing the prep work just in case access is needed quickly, which may happen with the US$2.5bn Burj Tower refinancing due.

Value at risk

Short-term debt is a function of companies' delivery schedules. This is like walking a tightrope where the greatest risk of a 'short fall' is at the end of the process. Banks finance projects to completion and for not long thereafter. Developers must ensure the recovery of receivables on the handover of completed units before the need to repay debt financing, but banks are now less willing to wait. Delays to the development schedule could, in our view, trigger refinancing deadlines, which are more likely to be extended than cancelled. We think it unlikely that banks would want to stomach even more real estate exposure and forced sales in this environment would be unlikely to clear the debt owed.

Developers with negative free cash flow and reliance on short term debt funding are the most at risk, in our opinion. Recent central bank efforts to encourage liquidity have been moot at best with EIBOR still at around 3.6% and we think that existing loan facilities may not help; after all the bank cannot conjure up liquidity it doesn't have (despite taking the facility fees).

The most opaque area of the market is in the realm of the unlisted private developers. There have already been many reported cases of insolvency and we think that this number can only increase over the next six to 12 months, which will do nothing for confidence in the sector (in particular the pre-sale market).

Next step – dividend cuts?

Most UAE real estate companies do not disclose dividend policies. Dividend policy is simply the trade-off between retained earnings on one hand and the paying out of cash or issuing new shares on the other. We think there is a high risk of dividend cuts (if shareholders allow it) or alternatively an increase in stock dividends, where there is no transfer of economic benefit. A lot depends on board recommendations and whether they want to cash out existing shareholders or maintain cash. Arguably this is less relevant for companies like Aldar and Sorouh who are maintaining large cash balances, but Emaar may wince at having to hand over 20% of its cash.

Dividends probably too high

We benchmark the FY08 distribution (for the FY07 year-end) against the last reported available cash balance (Q308). We use this as a proxy for the current cash position, but suspect cash balances have fallen in Q408. The two highest yielding stocks are Emaar (10%) and RAK Properties (17%) and assuming a constant dividend payout, these two companies would be expending c20% of their reported cash base. This does not make sense in the current environment, in our view. RAK Properties has announced that it will not recommend a 2008 dividend to be paid.

Aldar has announced a 25% step-up in the 2008 dividend to AED 0.125 from AED 0.10 in line with its progressive dividend policy.

Figure 31: Dividend distributions

	Expected AGM	Possible ex-div	Current Price AED	FY07 dividend AED	Hist DY (%)	Reported cash (AEDm)	Est. dividend cost (%)	Div / Cash (%)
Emaar	18-Mar	22-Mar	2.00	0.20	10.00	6,359	1220	19
Aldar*	26-Mar	05-Mar	2.55	0.125	4.90	12,066	310	3
Sorouh	18-Mar	26-Mar	2.36	0.12	5.08	6,842	300	4
Union Properties**	21-Apr	01-May	0.52	n/a	n/a	159	n/a	n/a
Deyaar	18-Mar	n/a	0.65	n/a	n/a	689	n/a	n/a
RAK Properties	28-Mar	06-Apr	0.45	0.075	16.67	681	150	22

**Aldar has announced an AED 0.125 dividend. **Union Properties declared a 10% stock dividend*

Source: Company data, Nomura research

There appears to be higher concentrations of government and high net worth retail investors on company share registers and this carries an expectation (rightly or wrongly) that annual recompense for their equity is due; and probably more so, when share prices have sold off so quickly and so far, in our view.

We reserve our judgment regarding the sensibility of paying dividends (particularly out of equity) in these markets.

More stock dividends

With obvious cash constraints, the issue of stock in lieu of cash may become more prevalent. Matching the duration of cash outflows (to contractors) and inflows (from sales) is getting harder without bridging finance (external funding or internal cash reserves), so paying cash dividends may exacerbate the situation. To date, Union Properties is the only

company in our coverage universe to pay out of stock (and we expect it to continue). Arabtec recently approved a 1:1 stock issue in lieu of a 2008 dividend payment – but doubling the capital is an expensive way to finance dividend policy!

A bird in the hand…

We see no transfer of economic benefit from companies to stock holders with stock dividends. From a corporate perspective however, cash balances are held intact. This cash is more valuable to management as a going concern, than to shareholders wrapped up as part of a potential liquidation value.

… is worth two in the bush

Shareholder approval will be required through the upcoming AGM season, but we think company CFOs may try to bypass cash dividends by issuing stock (or a combination of a stock and less cash) over the coming year.

The worst-case scenario

We are almost (but not quite) at the point of no return in the UAE, and we think that government intervention may be required in the construction sector as well as the financial and real estate sectors. The three sectors go hand in hand and rely on each other, sitting on the same value chain.

Why the pessimism?

In almost all instances, construction companies must lodge bonds with banks, which protect developers from various forms of contractual default. The deposited bonds are typically in the range of 5% to 10% of the construction value and are then released once the contract is complete to the satisfaction of both parties. These bonds, however, are normally financed by banks.

No more work …

Recently, banks have started to require higher bond deposits and sometimes up to 50% of the contract value (as the risk of insolvency increases). Currently, the best rates seem to be around the 25% level. The pinch point comes when banks stop financing bonds altogether, which we think is already happening. At this point, even if developers did give a green light, contractors cannot finance the bond.

… no more business operations

Taking this to its logical conclusion, developers would complete the current order book, then shut down operations. We see this as a significant threat to our longer-term view of the market.

Back to the future

Precipitous circle

Construction cost inflation (and now deflation) has been a global, rather than a local, phenomenon, but the impact of rising raw materials and labour costs, coupled with shortages, had previously delayed the roll-out of many developments in the UAE, particularly the large-scale ones.

Apart from rising input prices, there were fundamental factors behind the recent construction cost inflation, including supply bottlenecks, resource industry consolidation and demand pressures in China, Asia and of course the Middle East. This has now unwound and contractors with previously full order books are now cutting margins to secure work. What was the developer's challenge is now the developer's boon, but most developers are unable to take advantage of this with suffocated lines of credit (self funded and bank lines) and no demand.

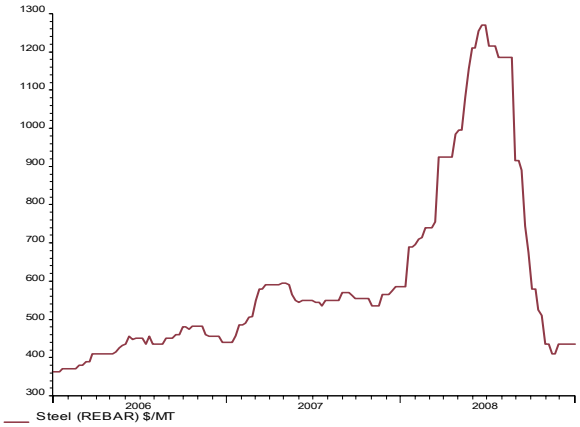
… local pressures easing significantly

Construction costs in the UAE rose at about twice the rate of inflation in 2007 and were up that much again in the first half of 2008 (our estimate) according to international real estate, infrastructure and construction consultants, EC Harris. There has, however, been a marked reversal in raw material pricing with commodities and basic materials selling off aggressively.

We estimate steel based products comprise around 15-20% of a building's framework and roof. Year on year, steel (we use REBAR as our proxy) finished the year 25% lower than it started and stabilised at around AED 1,850 (US$500). Cement-based products generally

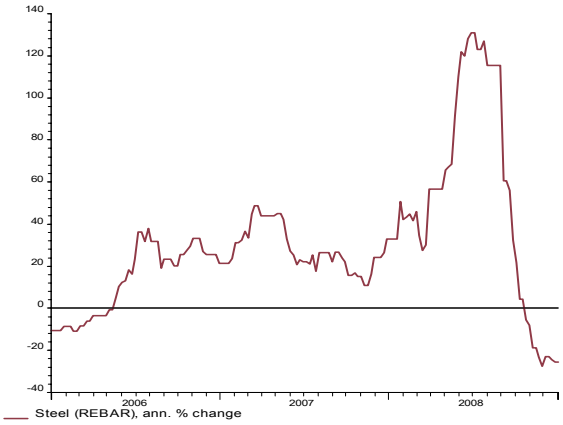
represent around 10% of construction (possibly higher in the UAE as high-end structures have higher cement capacity) and glass a further 5-10% depending on the type of development. Discounting labour costs of around 20%, we think basic materials incorporate around 40-45% of the entire build value.

Figure 32: Steel Prices (2006-08)



Source: Datastream

Figure 33: Annual percentage change (2006-08)



Source: Datastream, Nomura research

Six months seemed a long time ago

Priced at the peak

But this masks the intervening period, mid way through 2008 where many UAE based developments were launched creating the 'steel shock', crimped by extremely tight supply chains and the price of steel peaked at AED 5,500 (US$1,500). This is when a number of construction contracts were priced and basic materials were trading at multiples of current prices. With land prices and basic materials then selling at premiums, sub developers are now at the mercy of the off-plan market. This is not a good place to be with any unsold inventory likely to remain on the balance sheet.

Labour excesses

Six months ago there was an acute shortage of labour, with contractors competing to recruit and develop resources to cope with project backlogs and escalating order books. The labour shortages have now evaporated and we are seeing redundancies (various newspaper reports suggest around 5,000 recently) and repatriations of workers across the entire real estate, construction and consultancy spectrum. This headline number is likely under-stated, with many boutique consultants releasing staff.

No longer home to 34,000 cranes

Rents on heavy equipment have also dropped by 30% in the past two months and there is now an oversupply of heavy equipment as private developments falter and public infrastructure projects (such as the Dubai Metro, Dubai Airport, etc) cannot absorb additional capacity.

Geared impact

So inputs prices are coming down and contractors' margins are being crimped, which is a relief for developers, but this is a double edged sword. The UAE economy is highly leveraged into the real estate cycle, which in turn drives construction. For us it is reminiscent

of Spain where construction and real estate were contributing around 20% of GDP (about the same as Dubai), but the economy was probably geared twice as much. Recently, US credit ratings agency Standard & Poor's estimated that the construction and real estate sectors account for almost 50% of Dubai's gross domestic product (GDP).

During the peak in August, per square foot construction costs were being quoted at AED 1,200, in Dubai they now average around AED 475psf to AED 500psf, with some developments being quoted at AED 350psf. This represents a fall of c60% in just six months.

Figure 34: Dubai construction costs (AEDpsf), average

Location	3q08 (AEDpsf)	1q09 (AEDpsf)
Dubai Marina	600+	450-550
Sheikh Zayed Road	550+	500-525
Jumeirah Village	550+	475
Business Bay	500+	425-450
Dubailand	550+	500
Rest of Dubai	450+	400

Source: Emirates Business research

Re-cycling

If developers start to bring developments back on stream (which we think unlikely), input demand increases — contractors, having shed staff in the downturn, will have to ramp up again and so the cycle continues.

2009 construction outlook – challenging at best

Cautious on 2009

Cash liquidity is the swing vote here. Developers cannot access lower input prices if they do not have the solvency (cash or access to finance) to kick-start new developments. Most ongoing developments were probably agreed to under fixed price contracts (ironically to mitigate risk of rising prices). Unless developments are sufficiently large enough to be phased (with subsequent phases taking advantage of lower prices), then the best that can be done is to slow delivery pipelines in the hope that unit sales and liquidity improves.

The emerging trend is to shelve developments and then retender. Contractors who were previously accepting 20% are returning to the margins of around 5%. We calculate that those developers that can pause and re-tender for developments not yet in construction can expect to save cAED 100m in material costs on a standard tower development. We expect those that cannot will try to squeeze concessions out of contractors — with the alternative being to cancel the contract.

10% on hold feels too low, 50% more realistic

A visual sweep around Dubai (and, in particular, the Business Bay area) shows a halt in a number of developments, but there is work still continuing – albeit not at breakneck speed. Developers (and contractors) are purposely slowing down development in the hope that current conditions are short-lived. MEED estimates of '10% on hold' have been replaced by Proleads' 45% estimates of development delays or cancellations, which equates to around US$580bn across the UAE. Dubai's Real Estate Regulatory Authority (RERA) disputes the number of reported cancellations and will host a conference the week beginning 16

February to disclose the 'real situation'. Either way this has been a very short, sharp, shock to the system.

Public spending will continue …

Intuitively, it feels like most of this is in the real estate, rather than the public infrastructure arena. One of the downsides of the real estate boom has been the reallocation of resources from public infrastructure activities. Logistics, road networks, utilities, sewage and electricity hubs are required to service the new build accommodation, yet these essential services appear to have been subordinated to real estate activities. Now one of the reasons buildings remain unoccupied is that they cannot be fully serviced. The demand for electricity, water and gas is such that there is not enough supply. This is characteristic of most of the UAE, but more so in Dubai and Abu Dhabi.

More water and electricity

It appears to us that it is a good time to redirect activities towards infrastructure and utilities using the current development hiatus as an enforced 'catch up' period. Admittedly, these are projects with a lower return and consequently higher pay back period, but are essential to future development.

The end of prestige projects

High profile delays include Dubai Waterfront, Dubailand, Trump International Towers on Palm Jumeirah, dredging at Nakheel's Palm Deira, Meraas' AED 350bn Jumeirah Gardens and the Nakheel Tower to name a few. Developments are now also being delayed as contractors disclose or declare themselves bankrupt. Two high profile examples in the Business Bay area are the ACI Real Estate, Boris Becker Business Avenue and Michael Schumacher Business Avenue as South Korean Construction firm, Shinsung Engineering and Construction requested court protection against bankruptcy.

Regulation – from a standing start

An evolutionary process

Dubai, which first opened the doors to foreign investment, has led the way in terms of real estate regulation and other Emirates are now following the lead. Abu Dhabi and Ajman have both announced the formation of separate Real Estate Regulatory Authorities (RERAs) which will run in parallel with the Dubai RERA (currently the only formal regulatory body in the UAE). This is the first stage of 'regulatory harmonisation' and a key step towards developing a de-facto UAE regulatory system, which is required if the UAE is to attract, or more importantly retain, foreign real estate investors.

These regulatory frameworks are designed to protect parties on both sides of the real estate transaction (sales and leasing) with policies framed to further regulate development activities (and obligations), mortgage and tenancy registration, escrow accounts to ring fence development proceeds and so forth. The aim is to add transparency to an opaque market and will generally include the monitoring of developments, the provision of rental indices, adjudication and dispute resolution and the monitoring of media advertising (i.e. sales of developments).

Regulatory arbitrage

We believe that increasing the regulatory system and transparency will ultimately shore up market credibility and confidence around securing the purchase of property rights. However, sustainable coordination is required in our view – this is coming, but the UAE is not there yet. Until such time, regulatory arbitrage risk remains, where the regulatory burden in one Emirate (Dubai) is greater than the rest and too much regulation, too soon, in the current climate may add to an already weak outlook. Unfortunately, as developers look increasingly likely to default on their commitments, the level of disputes that require arbitration is likely to continue to grow. Regulatory authorities may lack the vested power to act and this could undermine progress further.

Taking control of the Dubai situation

In response to current conditions, the Dubai government has set up a high level Realty Panel headed by H.E Mohammed Allabar (Chairman, Emaar), consisting of nine members. The committee will decide on the launch of future real estate projects. The panel has conducted a detailed supply analysis from information obtained from master and leading developers.

Other recent market developments (Dubai RERA unless stated)

'Flipping' consigned to history? RERA will introduce plans to reduce the amount of 'speculative flipping' but so far there is nothing concrete. Interim Registration Law (IRL, in effect since 31 August 2008) states developers cannot charge transfer fees on off-plan sales or resales and some developers are now requiring minimum installments to be paid before a transfer is granted. This was fine when there were plenty of buyers (speculators), but there is a possibility that these rules will be relaxed.

Developer's/Buyer's right on a default situation. If a buyer defaults, the developer will notify the Dubai Land Department who will allow a 30-day remedy period. If there is no remediation, the developer can choose to terminate the contract but retain no more than 30% of monies paid, as at date of termination. The legislation is confusing, but our

understanding is that it is 30% of actual monies paid – not 30% of the total purchase price – that can only be withheld, at this stage. RERA tried to 'vary' the law by administrative circular, but we understand this is not law (yet!).

Rental caps and rental index. The 5% rental cap legislation imposed in 2007 has expired. A publically available rental index, banding districts in Dubai, has been approved. It is now legally binding as it has been wrapped up into Royal Decree No 1.

Royal Decree No 1 for 2009, 19 January. It was decreed that there would be no rental increases for contracts struck in 2008. Those struck before 2008 could be adjusted based on a sliding scale based on the rental index, with no increases if rents are within a 25% trading range of the index. This is probably unjustified as we think market rents will fall, on average, 20% in Dubai.

Progress payments. RERA introduced a non-binding 'clause' that developers should not accept more than 20% of the cash consideration before construction has started. Remaining installments are then linked to the pace of construction. RERA has now set up an 11-member Development Trust Account Department to monitor the use of escrow accounts to ensure installments collected are not excessive and private investors can ascertain information on how individual developments are progressing. There is still debate as to whether this applies to government-sponsored developers.

Grading developers. To restore confidence, RERA is considering 'grading' developers based on their liquidity, market experience and completed projects (we think current market exposure must surely count). This is certainly good for the buyer, but this could be disastrous for the developer, in our view. Responsibility, we think, must also lie with the master developers' credit committees.

It has been reported that RERA will institute a regulation that would require developers to fully own the land before registering off-plan projects, which would, in our opinion, lead to a complete freeze in off plan developments in the current market *(The National,* 3 January 2009).

Freehold visas for foreign owners. Property developers in Dubai are seeking a review of the residential visa policy rules for foreigners linked to freehold ownership (*Gulf news*, 27 December 2008) again. The attempt is to shore up confidence and pull in a larger target market, but to date there has been no movement on this issue, although it now looks like residential visas will be granted to owners, but only on an ongoing six monthly basis which, if true, is a significant reversal in re-reversal.

One villa, one family rule. The one villa, one family law was enforced in the last quarter of last year in an effort to prevent overcrowding (it also included flat-sharing arrangements). It was enforced with power and service cuts and heavy fines to landlords. Recently it was reported (*24/7*, 2 February 2009), that this is now not the case and more than one family can share the same villa (provided there is no overcrowding).

Measuring supply is easy; measuring demand is not

We believe that the fundamental valuation of property should be relatively straightforward as it is just a measure between the demand and supply of rentable (commercial) or live-able (residential) space. Construction pipelines are quite visible and measurable and have a long gestation period, so the supply-side can be tracked – in fact some agencies make a living out of it. Demand, however, is more difficult to predict and dependent on a number of variables.

More on-stream supply in Dubai than Abu Dhabi

We estimate that 30,000 units have been added to Dubai's housing stock in 2008 and will be followed by 30,000 in 2009 and 2010 respectively, which is approximately half the current consensus and more in line with government planning forecasts. In Abu Dhabi, we forecast around 18,000 units to come on stream in 2009 and 2010 against a current estimated shortage of 28,000 units.

Don't confuse speculation and demand

Residential demand relies on population growth, the development of mortgage markets and the availability of credit. Speculation only adds liquidity and not demand, so the key driver for residential is the end user market. Demand for retail space (in mature markets at least) is influenced ultimately by consumer trends and tourism, and commercial demand (offices in this case) is linked to economic growth. We see tourism as a function of global demand.

Our general prognosis on each of the UAE sub sectors is as follows:

- Residential – capital values are already falling in the resale market; rents to follow
- Offices – headline rents will fall, incentives to increase
- Retail – rents to hold for the short term; concessions to fall on weaker consumer spends
- Hotels – occupancy rates to fall; heavier discounts and promotions

Figure 35: Sector overview

Sector	Dubai	Abu Dhabi
Residential	Cautious	Neutral
Office	Cautious	Neutral
Hospitality	Cautious	Cautious
Retail	Cautious	Neutral

Source: Nomura research

Caught in the middle

We project a pronounced slowdown in demand over the next two to three years, but this has been offset to a large degree by the cancellation/postponement of many development projects, which we estimate at 50%. Unfortunately, developers caught in the middle – nearing completion with no-one to sell space to – will feel the demand squeeze. Speculation is now a thing of the past, off-plan sales have dried up and the end-user

market is currently frozen, as buyers await better deals as prices fall and banks are not increasing the size of their loan books.

Mexican stand-off

The thaw comes when banks start to lend again and consumers start spending; but neither banks nor the consumer have the appetite, so we are currently faced with an uncomfortable stalemate.

Fundamentally we (just) favour Abu Dhabi over Dubai

In our Appendix 3 market analysis, we outline our views and assumptions on both the Abu Dhabi and Dubai real estate markets and the subsectors within. Abu Dhabi and Dubai are the two largest of the seven emirates.

Consensual view here

We view Abu Dhabi as better positioned than Dubai to withstand the current economic pressures. This is partly owing to the self-imposed development moratorium between 1999 and 2001, which led to a significant fall in construction, and little activity once the ban was lifted, resulting in the current under-supply of residential accommodation.

Some key localised real estate themes

Still an economic hub

Dubai remains the pre-dominate East-West hub. Dubai is strategically located midway between the Far East and Europe on the east-west trading routes, and between the former Soviet Union and Africa on the north-south axis, so is likely to continue to be a central focus point for trade, re-trade and commerce. This should continue to provide a degree of critical mass.

More expensive to visit and to buy

The FX trap. Apart from the speculative appeal, UAE real estate (and the equities market) attracted foreign currency on the possibility of a currency revaluation with the dollar-dirham de-peg and when this did not occur, speculative outflows drained liquidity. The recent dollar strength has now made investing in the UAE more expensive, which will affect overseas investors, with installments due.

Dubai has a more transient population

Ownership and employment patterns differ in Dubai and Abu Dhabi. The Dubai population is significantly more transient and renting is more conducive than putting capital at short term risk in a falling market. Abu Dhabi also offers a de-facto holiday destination, with a tighter (and more expensive) rental market, so there is probably a better case (just) for owner occupation. Abu Dhabi has a higher concentration of industrial and petro-chemical employees, whereas Dubai has a larger concentration of service employees. Population outflows are therefore more likely in Dubai than Abu Dhabi, in our view.

Where did the expats go?

Expat population growth may see near term reversal. Companies' expansionary plans are stalling and in some cases contracting. Expat redundancies equate to enforced repatriation in most circumstances (assuming you cannot pick up employment within the month grace period) and there is an associated multiplier effect (domestic help, schooling requirements, etc).

Not enough local buyers

UAE nationals only make up 20% of the population in the UAE. There has been a concentrated effort by developers to attract non-national purchasers to support the thin local market. Traditionally, many UAE nationals were gifted land and built privately, so the market and the next generation of young emirates are still feeding through the system. Many of the nationals who were buying were speculators, or at best investors. Non-emirates (largely from the sub-continent and other Middle Eastern countries) were enticed by offers of residency (which has now officially been removed).

Land will be handed back before repositioned

Repositioning stock mid-cycle is difficult. The mid-market remains underserved, but high land purchase prices mean that repositioning developments is economically unviable. There is the increasing prospect that uneconomic developments are cancelled with land handed back to master developers, sold as distressed assets or remain uncompleted.

End user confidence is the key

End-user confidence is now critical. The speculative froth has gone owing to the confluence of global factors (liquidity, credit, demand, recessionary pressures, etc) and increased regulatory burden (mortgage registration, escrow accounts, etc). End users have now become the target market, but there are a number of stifling factors. At some point end users will start buying again (when they think prices have hit their base) and banks will start lending again (when they sense the risk of default abates).

Margin contraction

Private developers forced to accept lower margins. The development risk appetite has always been skewed to Dubai where development planning has been considerably more laisse-faire than Abu Dhabi. Luxury developments attract higher margins, but our comprehensive demand supply analysis below clearly points to a mismatch. There is affordable demand and only high-end supply, so distressed developers could be forced (like the UK house builders in 2008) to accept lower margins and develop on behalf of the government, although we think the likelihood of this is currently low.

The government will support the sector

Government influence is stronger than ever. The reach of the government into the private sector cannot be under-stated. The entire supply chain has some form of government or quasi-government ownership and the three largest master developers in Dubai (Nakheel, Dubai Holding and Emaar) control 70% of the supply. In Abu Dhabi, Aldar and Sorouh are the leading master planners. The introduction of RERA (with Abu Dhabi also announcing the formation of a regulatory authority) is starting to deliver on protecting individuals' rights. The process is slow, but cannot be allowed to fail, in our view.

No cash

There is too much credit in the system and not enough cash. The UAE and Dubai in particular has financed itself on credit card debt. This has been the case for the past five years. Real estate and real estate equities have been leveraged through the cycle (and remain so). We are yet to experience the deleveraging cycle seen globally but it is starting to occur as properties are being handed back to developers. Local banks do not have access to retail deposit money and must fund themselves via wholesale markets, which are still shut, restricting real estate liquidity.

We provide a full market analysis in Appendix 3.

Company Profiles

Stock rating	BUY
Price (AED), 13 Feb	2.00
Price target (AED)	2.87
Upside potential, %	44%
Market cap, (AED bn)	12.2

Valuation	2009F	2010F
EPS (adj.)	1.08	1.23
P/E	1.8	1.6
Div. Yield, %	10.4	10.4
P/Book, x	0.27	0.24

Performance, %	-12m	-3m
Absolute	-82%	-47%
vs. sector	-3%	-6%

Sector DFM Real Estate
Source: Reuters, Nomura research

We initiate coverage on Emaar with a BUY rating and a 12-month price target of AED 2.87. This represents a potential upside of 44% from our current levels. At our target price, Emaar is trading at a 0.36x discount to NAV.

Corporate profile

Emaar is the largest publically listed, Dubai-based, master real estate developer in the MENA region with a current landbank of c519m sqm. It is a large-scale developer with a proven track record and international operations in 17 countries. The fair market value of the landbank is c. AED 70bn (proportionate ownership). Core growth is being established via a two-pronged strategy of geographical expansion and business segmentation.

Figure 36: Brief history and key events

Jun 1997	Established as a PJSC
1998	Two step capital increase: 1:1 rights issue; pref. issue of 65m shares to Dubai Govt.
Mar 2000	Listed on DFM, opens capital to foreign nationals
Nov 2000	Establishes Amlak Finance
Sep 2002	Dubai Bank established
Feb 2005	Launches Emaar Industries (PJSC with paid up capital of AED 200m
Jul 2005	Doubles capital via 1:1 rights issue
Dec 2005	Emaar-MGF Land private (JV) outlays US$4bn FDI in India real estate
Jun 2006	Acquires John Laing Homes, second largest privately held US homebuilder
Aug 2006	Acquires Hamptons International, a UK based realtor
Oct 2006	Emaar the Economic City IPO, incorporated and listed on the Saudi Stock Exchange
Nov 2006	Launches US$1bn Musharaka Islamic syndication
Mar 2007	Announces land for share swap with Dubai Holdings (2.36bn shares)
Feb 2008	Emaar MGF postpones IPO owing to adverse market conditions
Nov 2008	Dubai Mall officially opens
Nov 2008	Promotes 'Plan to Own' and 'Rent to Own' schemes to ease financing issues for buyers

Source: Company data, Nomura research

Business lines

Almost all of Emaar's current revenue streams come from the sale of developed land or residential units. For business purposes it classifies its activities in six segments, including the development and sale of residential units, land plots and leasing activities, construction and management of hotel and leisure facilities, malls and retail, education and healthcare and investments in financial services (proportionate contribution 5%). International activities currently contribute c11% to top-line revenues, but this is increasing as international operations become more established.

The UAE business is now maturing with recurring income developing over the next 2-3 years as significant retail (i.e. Dubai Mall, Marina Mall) and hotel operations (i.e. Address, Al Manzil, Qamerdeen) start to contribute to the bottom line. The company is targeting 12%-15% of group net profit from these recurring rental income streams.

Revenue business mix (%)	3q08
Residential Sales	83
Land Sales	8
Rental	2
Hospitality	1
Other	8

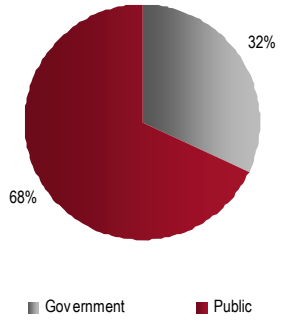
Operational mix	
Domestic	89
International	11

Source: Company data, Nomura research

Share holder structure

Emaar has a current free float of c68%. The largest shareholder is the Dubai Government holding a 32% stake. The foreign ownership limit is 49% against a current level of 18%.

Figure 37: Current shareholders



Source: Dubai Financial Market (DFM), Nomura research

Key senior personnel

H.E. Mohamed Ali Alabbar (Chairman) is a founding member of Emaar and is Chairman of the Executive and Nomination Committee. He is also chair of John Laing Homes, Hamptons International, Al Salam Bank and serves on the board of the Investment Corp of Dubai (ICD) and Noor Investment Group. H.E Alabbar is a very high profile and influential member of the Dubai community.

Mr Vinod Kumar Gomber (Group CEO) is responsible for the overall management of the Emaar Group of Companies with all regional CEOs reporting to him. Mr Vinod was the Executive Director and Group CEO of RSH, a distribution and retail group listed on the Singapore exchange, from 1994 to 2006.

Mr Issam Galadari (CEO UAE) has a civil engineering background with over 20 years experience and has been with Emaar since 2000. Mr Galadari serves on numerous boards including Amlak Finance, Emaar Financial Services, Emrill Services and additionally the MD and on the Board of Directors of the Bawadi JV.

Mr Naaman Atallah (COO Emaar Dubai) is responsible for business development. Mr Atallah has over 16 years of real estate and development experience and joined Emaar in 2004. Mr Atallah is also the CEO of the Bawadi JV.

Mr Fahad Al Rasheed (CEO, Emaar Economic City) joined in 2008 and was bought in to oversee the completion of King Abdullah Economic City. He is an administrator with several years working with the Saudi Arabian General Investment Authority promoting investments and managing Economic Cities.

Mr Amit Jain (CFO) joined Emaar in 2006 and is responsible for the financial management functions of all the business segments and treasury function of the group.

Valuation

We derive a target price of AED 2.87 based on a number of company-specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate issues, concentration and development risk. In addition, we also apply a cyclical discount of 45% based on Emaar's exposure to the Dubai real estate market where we remain cautious on near-term prospects.

The stock currently trades at a P/NAV of 0.31x relative to our normalised sector average of 0.44x. At our target price, the stock trades at a 0.36x discount to NAV.

Figure 38: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	1	Self funded model, net debt equity gearing 7%
Strategy	3	International expansion, healthcare and education
Growth prospects (PNPV/EV)	3	PNPV/EV at 1.3x
Corporate access, transparency, disclosure	0	
Concentration risk	0	Dubai based, International exposure
Development risk	-2	
Total Corporate adjustment	5	Reflecting our view on the above
Cyclical adjustment	-45	Dubai
Total discount	-40	Total discount to 2009E adjusted NAV

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 8.08 by a total of 40%. Added to this, we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our price target.

We also note there is significant un-booked land values, which we omit from our valuation below.

Figure 39: Target price calculation

Adjusted Corporate Value (m)	Emaar
Unadjusted book value (ex minorities)	44,394
less Balance sheet adjustments	4,841
Adjusted NAV	49,234
less Cyclical adjustment	(22,155)
+ / - Capitalised admin costs	(12,044)
+ / - Corporate adjustment	2,462
Adjusted corporate value	17,496
per share:	
NOSH (m)	6,091
Adjusted NAV +12m	8.08
less Cyclical adjustment	(3.64)
+ / - Capitalised admin costs	(1.98)
+ / - Corporate adjustment	0.40
Calculated target price	2.87

Source: Nomura research

Business model and strategy

Evolutionary

Emaar has grown strongly from a local master developer, to having one of the most expansive international landbanks globally with around 95% held offshore. The group is targeting to derive 60-70% of the top-line revenues from international operations by 2010, a consequence of the development run-off in Dubai as developments near completion. We believe this target is possibly too aggressive, given the current focus on delivering the current pipeline. The business model is geared towards expanding its international reach, primarily in emerging or growth markets, and partnering up with locals and government institutions

Proven track record

The diversification strategy is intended to increase the group's sustainable growth platform, by identifying growth opportunities and obtaining the first mover advantage, before new entrants crowd the market. Not quite a 'hit and run' strategy as infrastructure, support, education and healthcare hubs are added to the business mix. In practical terms, this model can spread resources thinly, increase the cost base unnecessarily and fail to concentrate development expertise where critical mass cannot be achieved, in our view. As a general rule, we prefer concentrated business models, rather than those models split both horizontally and vertically (i.e. a matrix approach), although this is symptomatic of most UAE real estate developers. Emaar does, however, have a proven track record in delivering good quality and complex schemes, which have involved a significant number of moving parts

Releasing value through IPOs

Taking a longer-term view, Emaar is developing its hospitality, healthcare, retail and mall business in parallel with the 'development for sale' businesses. It is anticipated that these maturing entities will be self sustaining and Emaar will realise value through public offerings. Emaar intends to retain controlling stakes and management control over each business segment. We think that this is an appropriate long-term strategy for the company and the capital released can be used to supplement more aggressive development plans.

Consolidation and execution

In the near term, however, the current strategy is focused on consolidation and execution, which is sensible, in our view. Revenue growth is likely to slow over the next few years, but we also see this as an opportunity for Emaar to take a leading consolidating role across the sector. Landbanks, which have been sold to developers, may come back on the books, but this will also give the company greater control of the Dubai supply line. But this is possibly more beneficial to the market than Emaar itself, in our view.

Risks

Like all UAE real estate companies, Emaar is exposed to a number of industry-specific, regulatory, geopolitical, financial management and liquidity risks. In addition, we consider historical share price volatility as a possible indicator of future stock-specific risk.

Complexity

With regard to Emaar, we would highlight in particular, the relative complexity of the business model, the inherent execution risk and the residual elements of the development pipeline that will require additional finance or bridge financing. The group controls c.25%

of the residential supply in Dubai so it is more exposed to underlying macro-economic factors.

Government support?

Mitigating these risks is the continued support of the government with a 32% shareholding, although this could open the risk to potential 'forced mergers' in a worst-case scenario. In addition, Emaar has a track record of executing difficult projects and has been able to keep access channels to debt markets open.

Cash flow and financial position

Cash neutral

Based on current development plans we think the forecast capex spend of c. AED 10bn p.a. can fall to around AED 6bn if projects get delayed. We assumed that with cash reserves of AED 6.4bn (as at 3Q08) and capex tracking at about the same level, additional funding would be required.

Get it while you can

Management stated that there 'were sufficient cash reserves' for two years even after assuming receivables could not be collected. There are committed lines in place and in January, the company arranged two credit lodgements of US$4bn (US$2bn in euro-denominated, medium-term notes and US$2bn Sukuk) that can be issued when required to aid liquidity. We believe the medium-term Sukuk is structured so it can be issued separately in tranches, which appears a good financing hedge. The loans will be irrevocably guaranteed by Emaar.

Balance sheet gearing 7%

The balance sheet is geared 7% (net debt gearing), with approximately 45% of refinancing required over the next 12 months and is likely to be swapped with medium-term notes (for which the prospectus was lodged in January). Emaar typically limits funding at group level to financing land acquisitions and initial infrastructure related construction. Additional funds are raised at the project level through pre-sales and project specific debt financing.

2008 FY results

Emaar released abbreviated results on 12 February. We will roll over our forecasts once full results have been released.

Where is the 'best in class' disclosure?

The results were abbreviated and disclosure is lacking, given that this is the largest real estate company in the UAE, supposedly committed to the best in class disclosure. At the time of writing this report there has been no announcement of a conference call. It would be an omission in our view if the company were not to hold a call.

The only way is down

Headline numbers showed a 15% fall in net operating profits from AED 6.6bn in 2007 to AED 5.6bn in 2008. Total revenues fell 10% year on year from AED 17.9bn in 2007 to AED 16bn in 2008. Headline EPS fell 54% from AED 1.08 to AED 0.50, but on an adjusted basis (stripping out non-cash goodwill and revaluation adjustments) were virtually flat (-2%) year on year, moving from AED 1.08 in 2007 to AED 1.05 in AED 2008.

Balance sheet reconstruction

At face value the 2008 preliminary results look disappointing, but were expected. The exceptional writedown of AED 2.5bn of the goodwill component of the WL Homes

acquisition effectively clears the balance sheet of any further goodwill impairments (we calculate a further AED 0.4bn). Stock inventory (also associated with the US business) has been written down by AED 1.1bn (AED 0.9bn in 4Q09). This has previously been recorded as the cost of doing business (i.e. in cost of revenues), but management has stripped it out and reported it separately.

AED 1bn rounding error?

There was no balance sheet data, except the disclosure of total assets of AED 61bn and shareholders' equity of AED 36bn. We have trouble reconciling the movement of equity, which is recorded as AED 38.6bn in 3Q08, and assuming the P&L loss for the quarter of AED 1.8bn, we are left with an AED 1bn discrepancy; we cannot explain this, so we think that this must be cash flow-related.

Figure 40: Emaar abridged 2008 results

	2008	2007	(%)	Comment
Revenues	16,015	17,869	-10	18% lower than previous three quarterly run rate
Cost of revenues	-8,120	-10,357	-22	12% higher than previous three quarterly run rate
Gross profit	**7,895**	**7,512**	**5**	
Margin (%)	49	42	n/a	
SGA	-2283	-2119	8	
Other income	807	1213	-33	
Operating profit	**6,419**	**6,606**	**-3**	
Associates	265	402	-34	
Impairment of properties	-1,084	-458	137	In 2007 impairments were classified in revenue costs
Impairment of goodwill	-2,523	0	n/a	Full write down in goodwill for JL Homes, as expected
PBT and minorities	3,077	6,550	-53	
Income tax expenses	3	-14	n/a	
Minority interests	-25	39	n/a	
PAT	**3,055**	**6,575**	**-54**	
EPS	0.50	1.08	-54	
Adjusted EPS	**1.05**	**1.08**	**-2**	Backing out revaluations and impairments

Source: Company data

All new developments in Dubai have been halted and the company will focus on rolling out the current development programme. This has been hinted at previously, but is also a consequence of the wider issue in Dubai.

Earnings estimates and financial summary

Emaar uses the percentage complete income recognition method that naturally smoothes the earnings profile. In terms of earnings development, it is the most mature company in our coverage universe, with earnings growth starting to slow as development momentum in the UAE tapers off.

The bottom line still rising albeit more slowly

Based on our assumptions we think full year profits will fall c. 12% in 2009. In preparing our estimates we have assumed that falling construction costs partially mitigate the lagged impact of falling sales and the run-off in the current development programme.

Delivery timetable more flexible

We have made a number of adjustments to the timing and the delivery of the development pipeline on the assumption that Emaar can slow the developments (to a degree) to match the current cycle. This has reduced our revenue estimates by c. AED 2bn for 2009. With so many developments (locally and abroad), there is a naturally smoothing effect, so earnings volatility becomes less relevant for Emaar than some of the other developers whose programmes are more concentrated, in our view.

Gross margins stabilising around 40%

Based on our estimates, we think gross margins will stabilise around 40%.

Finance charges

We assume incremental debt financing at 7.5% (which we use for the sector).

Dividend cut likely

Emaar's current dividend policy is to pay a minimum 20% of the nominal value of the shares (subject to relevant domestic and global conditions, projected growth and capital commitments). All of the factors mentioned are now bearing on the company, thus we believe that last year's AED 0.20 dividend payment (equating to a 10% yield) will probably be cut.

The cost was AED 1.2bn and would currently represent around 20% of current cash reserves, so we think it unlikely that this will be maintained. We think the company will start to generate considerable cash reserves if it can monetise the sales revenue that it has already booked. The board will discuss the dividend on 16 February and take it to the AGM in March 2009.

Goodwill hunting

The goodwill associated with WL Homes (US residential home builder) has now been fully impaired by AED 2.5bn, leaving a residual element of AED 0.4bn. This clears the balance sheet of most of the impairment risk, although there is still residual inventory that may be written off.

Tax charges are minimal

Emaar has international operations where some operations are subject to tax charges. We assume in our estimates a 10% tax charge on development profits in these jurisdictions.

Downside risk

We expect earnings to deflate in 2009, before increasing again on average in 2010 through 2012 when delayed development sales are phased in. In our opinion, there could be a further slowdown in local development activity, so we calculate that there could be more downside risk to our top-line revenue and net profit estimates.

Nomura estimates versus consensus

Our numbers are on average 35% lower than current consensus for 2009. The risk that the company now has is in monetising the sales it has made. Too many defaults may see stock come back on the books and the constructions costs will have to be paid out of capital rather than cash receipts.

Figure 41: Emaar, Financial Summary and Estimates (2007–12E)

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Gross revenues	17,566	16,019	14,453	16,924	15,472	18,420
Cost of goods sold	-10,640	-9,200	-7,388	-9,270	-8,929	-10,747
Gross Profit	**6,926**	**6,819**	**7,065**	**7,654**	**6,543**	**7,673**
S,G and A	-1,938	-2,283	-1,610	-1,643	-1,678	-1,715
Depreciation	-181	-196	-197	-198	-199	-201
Other net operating income	415	415	415	457	503	553
Core EBIT	**5,223**	**4,755**	**5,674**	**6,270**	**5,168**	**6,310**
Net financing income (costs)	242	30	99	338	655	829
Associates	402	262	262	340	476	524
Property revaluations	0	0	0	0	0	0
Mtm/provisions/non cash	0	-2,523	0	0	0	0
Other non-operating income	684	553	553	553	553	553
PBT	**6,551**	**3,077**	**6,587**	**7,501**	**6,852**	**8,216**
Taxes	-14	3	-20	-23	-21	-25
Exceptional / unusual items	0	0	0	0	0	0
PAT	**6,536**	**3,080**	**6,567**	**7,478**	**6,831**	**8,191**
Minority interests	39	-25	20	30	30	30
Attributable to equity holders	**6,575**	**3,055**	**6,587**	**7,508**	**6,861**	**8,221**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Investment properties	5,636	5,571	5,507	5,443	5,377	5,311
Development properties	16,194	15,644	13,224	14,081	13,995	22,162
PPE, Land held for sale	7,433	7,317	7,200	7,084	6,967	6,851
Total property assets	**29,263**	**28,531**	**25,932**	**26,607**	**26,339**	**34,323**
Receivables	3,634	10,836	13,991	14,791	14,192	15,703
Associates & Investments	13,668	13,668	13,668	13,668	13,668	13,668
Other assets	3,500	1,977	1,977	1,977	1,977	1,977
Cash and cash equivalents	4,727	5,727	5,727	6,727	13,227	13,227
Total assets	**54,791**	**60,739**	**61,294**	**63,770**	**69,402**	**78,898**
Total debt	7,704	11,969	5,349	536	270	1,615
Payables	6,177	5,603	7,410	8,408	8,664	9,811
Dividends payable	61	61	61	61	61	61
Other liabilities	3,661	4,081	4,081	4,081	4,081	4,081
Total Liabilities	**17,603**	**21,714**	**16,901**	**13,086**	**13,075**	**15,568**
Share capital	6,091	6,091	6,091	6,091	6,091	6,091
Reserves and retained surpluses	30,445	32,306	37,655	43,915	49,528	56,502
Minority interests	652	627	647	677	707	737
Total equity	**37,188**	**39,025**	**44,394**	**50,684**	**56,327**	**63,330**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	6,536	3,080	6,567	7,478	6,831	8,191
Depreciation and amortisation	181	2,719	197	198	199	201
Change in provisions / non-cash	21	0	0	0	0	0
Working capital / other	-765	-8,678	-1,586	180	928	-312
Cash flow from operations (a)	**5,973**	**-2,879**	**5,178**	**7,856**	**7,959**	**8,080**
(inc) decrease in PPE	-3,302	832	2,660	-825	26	-8,208
(inc) decrease in investments	-3,756	0	0	0	0	0
Change in other investing activity	0	0	0	0	0	0
Cash flow from investing (b)	**-7,058**	**832**	**2,660**	**-825**	**26**	**-8,208**
Free cash flow (a+b)	-1,085	-2,047	7,838	7,031	7,985	-127
Equity raised (repaid)	80	0	0	0	0	0
Debt raised (repaid)	2,981	4,265	-6,620	-4,813	-267	1,346
Dividends	-1,199	-1,218	-1,218	-1,218	-1,218	-1,218
Others	105	0	0	0	0	0
Cash flow from financing (c)	**1,967**	**3,047**	**-7,838**	**-6,031**	**-1,485**	**127**
Net change in cash (a+b+c)	883	1,000	0	1,000	6,500	0
Cash and cash equiv at year end	**2,132**	**3,132**	**3,132**	**4,132**	**10,632**	**10,632**

Key data

Year-end 31 Dec (AED)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EPS	1.08	0.50	1.08	1.23	1.13	1.35
DPS	0.20	0.20	0.20	0.20	0.20	0.20
BVPS	6.11	6.41	7.29	8.32	9.25	10.40
BVPS (adjusted)	12.69	13.41	14.29	15.32	16.25	17.40
Gross profit margin (%)	39.4	42.6	48.9	45.2	42.3	41.7
Core EBIT margin (%)	29.7	29.7	39.3	37.0	33.4	34.3
ROE (%)	19.8	8.2	16.0	16.0	13.0	13.9
Net debt / Equity (%)	8	16	-1	-12	-23	-18
LTV (%)	10	22	-1	-23	-49	-34

Valuation

Year-end 31 Dec	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
P/E (x)	1.85	3.99	1.85	1.62	1.78	1.48
P/BVPS (x)	**0.33**	**0.31**	**0.27**	**0.24**	**0.22**	**0.19**
Gross Property Assets / EV (X)	3.3	3.0	4.7	9.5	-72.5	115.1
EV / EBITDA (x)	2.8	3.7	2.0	0.9	-0.1	0.1
Dividend yield (%)	10.0	10.0	10.0	10.0	10.0	10.0

Source: Company data, Nomura estimates

Additional company information

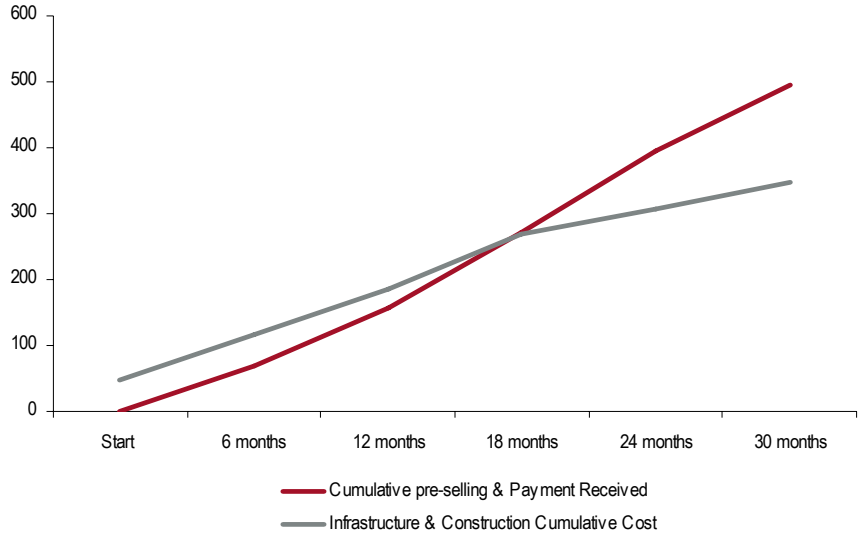
The funding model

The level of pre-sales typically required to trigger a development ranges 50-60%. At 70% pre-sales the development capex is generally covered. The typical payment plans used by Emaar is a deposit of 5%-10%, with the balance paid (quarterly) over the development lifecycle.

The remaining units are released progressively into the market. As a general rule, the strategy is to release units before completion rather than take them into inventory. In order to encourage sales, Emaar has recently re-launched it's 'plan to own' and 'rent to own' schemes to encourage sales. According to management, the plans have been well received and we see this as a hedge for both the vendor and purchaser. Although it is an incremental cost on the business, rents paid by prospective buyers act as a 'lock in', in the eventuality that they do buy, and provide income in the case that they do not buy.

Not all the rent counts towards to the purchase price, so the effective cost of funding is probably around 5% or 6% to Emaar, in our view. We show an example of Emaar's typical development funding model in Figure 42. This is representative of the wider pre-funding model used by most developers.

Figure 42: Emaar's typical development funding model



Source: Company presentation, Nomura research

Group structure

Emaar currently has over 70 subsidiaries to support local developments and internationally to support overseas expansion. In addition, the company has established a number of strategic partnerships with associated companies and entered into a number of joint ventures. We detail the group structure in the following table.

Figure 43: Emaar, group structure overview*

Property development UAE	International	Retail and Hospitality UAE	Education and Healthcare UAE / International	Financial Services UAE
Subsidiaries:	Subsidiaries:	Subdiaries:	Subsidiaries:	Associates:
Emaar Dubai (100%)	Emaar Giga Karachi (Pakistan, 60%)	Emaar Malls Group (100%)	Emaar Education (dubai, 100%)	Amlak Finance (48%)
Emaar Utilities (100%)	Emaar DHA Islamabad (Pakistan, 70%)	Emaar Hospitality Group (100%)	Raffles Campus (Singapore, 100%)	Dubai Bank (30%)
	Emaar Middle East (Saudi Arabia, 61%)	Emaar Hotels and Resorts (100%)	Emaar Healthcare (Dubai, 100%)	Emaar Financial Services (38%)
Joint Ventures:	Emaar Misr for Development (Egypt, 100%)			Emaar Industries and Investments (40%)
Badwadi (50%)	Emaar Morocco (Morroco, 100%)			
	Emaar Properties (Canada ltd, 95%)			
Associates:	Emaar Gayrimenkal (Turkey, 60%)			
Emrill Services (33%)	Emaar IGO (Syria, 60%)			
Turner int. ME (50%)	Hamptons (UK, 100%)			
Umm Al Quwain Marina (38%)	WL Homes (US, 100%)			
	Associates:			
	Dead Sea Touristic REIC (Jordan, 37%)			
	Emaar MGF Land (India, 43%)			
	Emaar , Economic City (Suadi Arabia, 31%)			

*Source: Company data, Nomura research. * Note some subsidiaries and associate names have been abridged.*

The landbank

Emaar has a total landbank of 519m sqm (as at December 2007), so we expect a revised schedule when full-year results and presentations are published in March. The total landbank has a reported value of AED 118bn, but much of it (95%) is tied up overseas or in JVs with international partners. Emaar's proportionate share of the landbank is 252m sqm (around 49%) with a fair market value of AED 73m (or 62% of the reported landbank value). The distortion is attributable to the 22m sqm of land in Dubai (government granted) representing 5% in size, but worth 30% in value.

Average land prices in Dubai were calculated at AED 143psf; assuming an average 20% fall in residential prices would suggest a geared fall of c 50% in land, so we expect a reduced valuation as at the 2008 balance date. These valuations are not, however, included in the NAV, so we still regard this as option value.

In the UAE, the land holdings include 6.5m sqm of land in the Bawadi joint venture (with sole development rights) and c8m sqm in the neighbouring emirate of Umm Al Quwain, so the residual landbank in Dubai (its traditional centre of operations) is relatively low.

Land holdings in Libya, Algeria Tunisia and Indonesia were not valued as at the last valuation date with the land 'still under advanced negotiations'. We expect more clarity on this in the year-end update and we are advised that the Indonesian JV has been signed. The other sizeable representation in the landbank is the 58m sqm held in India, largely though its Emaar MGF association. A further 73.6m sqm in Turkey has been purchased for AED 1.4bn and added to the landbank.

Figure 44: Emaar, landbank* as at Dec 2007

Country	Land Area (m sqm)	% of landbank	AEDm	% of value	Implied land values AEDpsm	Implied land values AED sqft
UAE	22.3	4.3	34,312	29.0	1,541	143
India	52.8	10.2	58,713	49.6	1,113	103
Saudi Arabia	172.8	33.3	5,321	4.5	31	3
Morocco	18.9	3.6	821	0.7	44	4
Egypt	14.7	2.8	12,671	10.7	860	80
Pakistan	6.5	1.3	2,963	2.5	455	42
Syria	0.3	0.1	431	0.4	1,437	134
Turkey	1.8	0.3	480	0.4	268	25
Jordan	1.8	0.3	149	0.1	85	8
United States, Canada	2.9	0.6	2,402	2.0	820	76
Libya, Algeria, Tunisia, Indonesia	224.4	43.2	0	0.0	0	0
Total	519.1	100.0	118,263	100.0	n/a	n/a

*Source: Company data, Nomura research *Abridged version and contains full landbank and valuations.*

Key developments

The development strategy has changed recently to 'execution and consolidation', so plans in some of the fringe markets are unlikely to be developed in the near future, with most of the focus on finishing current and committed projects. We highlight key developments below:

Downtown Burj Dubai: This is Emaar's AED 73bn flagship, master development. It is a mixed use 500 acre community, including the world's tallest building (c820m), the world's largest mall (for now), an island community, 2,000 hotel room keys, 2,000 serviced apartments, 4.5m sqft of office space, 4.3m sqft of retail space and 4,200 residential units, which have been completed and are largely sold. The project commenced in 2004 and is scheduled for completion in 2014.

Bawadi: This is an AED 90bn, 50/50 joint venture project with Bawadi (a subsidiary of Dubai properties), which will consist of 19,000 freehold units, 870,000 sqm of commercial (office and retail) space and 10,000 hotels keys and serviced apartments. There will be a themed park and other recreational facilities. Bawadi has contributed the land value with Emaar expected to make an equivalent cash contribution, which we think is around AED 4bn, to help finance the project. In May 2008 the first phase of the residential community was launched and as of 30 June, 90% of units released were sold. This is another complex master development with many moving parts. It is expected to be completed by 2017.

Umm Al Quwain Marina: This is a planned waterfront community spread over 8m sqm in Khor Al Beidah, Umm Ai Quwain. There are expected to be 8,000 freehold units, three hotels and 150,000sqft of retail and community serviced space within the development. Construction began in 2007 and is expected to be completed in 2013. As at June 2008, c90% of the released units had been sold to the public.

King Abdullah Economic City (KAEC): KAEC is a US$100bn integrated development and one of Emaar's key partners is the Saudi Arabia General Investment Authority (SAGIA) The mixed use development will spread over 168m sqm on the Red Sea coast and will contain six key elements – a sea port, industrial zone, central business district, educational zone, residential communities and a resort district. The entire development is expected to be complete in 2025, but there are component parts that are currently being slowed.

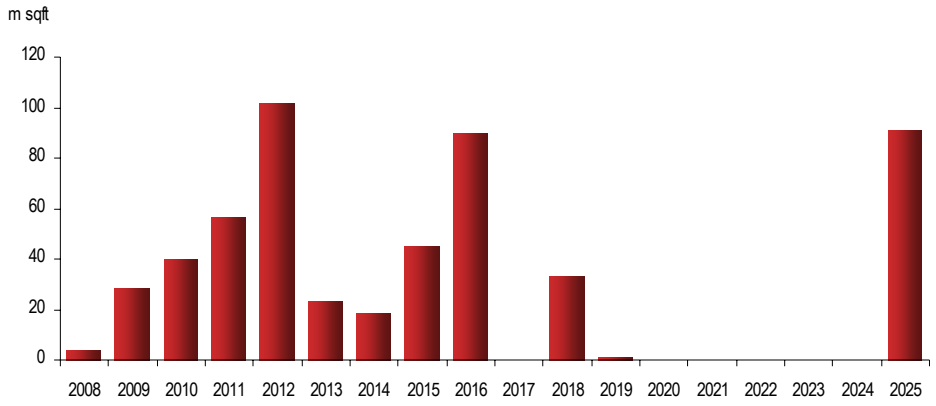
Emaar, The Economic City (4220.SE, not covered) is listed on the Tawadul Stock Exchange with Emaar taking a 31% stake. Founding shareholders own 39% and there is a free float of 30% with a market cap of c. AED 7.2bn (US$2bn).

India: Emaar is currently undertaking projects in Punjab, Delhi, and Andhar Pradesh. The 52.6m landbank is owned through Emaar's associate (Emaar MGF) in which it holds a 43% stake. Key development projects include Boulder Hills (76% jv with Andhra Pradesh, complete 2012), Mohali Hills (12m sqm master development, complete 2012), Gurgaon (11m sqm ,master development, phase completion from 2010 to 2012), Esplanade Chennai (0.05m sqm housing development, completion 2012) and the Commonwealth Games Village (Delhi, 200,000 sqm games village, complete 2010).

Other countries where Emaar have sizeable development programmes include Egypt, Pakistan, Turkey, Morocco, Jordan and Syria.

In addition, Emaar has signed various MOUs with governmental agencies in Libya and Algeria and has announced plans to develop a mixed use development in Tunisia. These projects are currently at the master planning stage so unless there is government pressure to the contrary, we think that these will probably be put on the back burner for now.

Figure 45: Estimated development delivery schedule (estimated attributable area)



Source: Company data, Nomura estimates

2010, 2011 will see phased deliveries

In terms of scheduling, 2012 is the development pinch point in our view, with most of the exposure overseas. But we have phased the 220m sqft due into 2010 and 2011, but there is limited granularity on the actual timings of these large overseas developments. In our model we assume that progress and therefore completion is split equally across the period. Although we admit the picture is distorted by the lack of phasing (i.e. we do not expect the whole of the KAEC to be delivered at the end of the completion period), it does provide us with a relative view on the time period between 2015 and 2025 when a large component of planned operations will be directed towards Saudi Arabia.

Aldar Properties

Stock rating	NEUTRAL
Price (AED), 13 Feb	2.55
Price target (AED)	3.13
Upside potential, %	23
Market cap, (AED bn)	6.6

Valuation	2009F	2010F
EPS (adj.)	0.77	1.22
P/E	3.6	2.1
Div. Yield, %	5.6	6.5
P/Book, x	0.3	0.3

Performance, %	-12m	-3m
Absolute	-76	-43
vs. sector	3	-2

Sector ADX Real Estate
Source: Reuters, Nomura research

We initiate coverage on ALDAR with a NEUTRAL rating and a 12 month price target of AED 3.13. This represents a potential upside of 23% from our current levels. At our target price, ALDAR would trade at a 0.48x discount to NAV.

Corporate profile

Aldar Properties is the largest integrated real estate development, management and investment company based in Abu Dhabi, where the concentration of its real estate activities is located. The company was formed in 2004 and currently has an investment property portfolio of AED 5.15bn, an announced development pipeline of c. AED 70bn and a 51m sqm landbank valued at c. AED 44.2bn.

Figure 46: Brief history and key events

Oct 2004	Formed as a private joint stock company
Apr 2005	Listed on ADX , capital (US$408m), 448x oversubscribed
Nov 2006	Aldar announces plans for Yas Island
Nov 2006	Signs JV with Laing O'Rourke Construction Group
Mar 2007	Aldar Funding issued US$2.53bn of convertible debt
June 2007	Current CEO , Mr John Bullough appointed COO
Dec 2007	Abu Dhabi Government issues AED 15bn facility to Aldar to finance Yas Island
Jan 2008	Signs JV with Besix to form management contracting company
Mar 2008	Signs JV with Readymix AD to supply concrete to Aldar developments
Apr 2008	Signs AED 2.2bn Ijara Facility
May 2008	Signs MOU with ARKAN building material supplier
June 2008	Issues AED 3.75bn Sukuk (due 2013)
Oct 2008	Senior leadership changes, John Bullough replaces Mr Ron Barrett as CEO
Nov 2008	Abu Dhabi Finance established by Aldar, Sorouh, ADCB, Mubadala, TDIC

Source: Company data, Nomura research

Business lines

Revenue business mix (%)	2008
Property dev. / sales	22
Land Sales	75
Investment properties	2
Unallocated	1

Source: Company data, Nomura research

Like most of its competitors, Aldar is still receiving most of its revenues against the sale of developed land plots, but we expect the sales of units to increase as the business enters stage two in the maturity cycle.

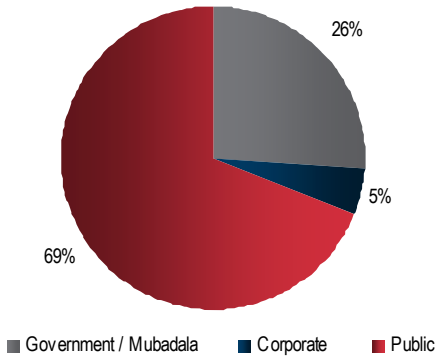
As part of its growth strategy, Aldar intends to develop its rental and property management activities as the company will retain most of its commercial and leisure developments and around one-third of the residential units under construction for its investment portfolio. We therefore expect the business mix to alter with recurring income increasing significantly from its current 1% of revenues to around 10% in 2012.

Around 85% of the total built up area (BUA) is residential and will be the most significant contributor to revenue over the next five years. This leaves the company exposed (as all are) to declining sales prices that have not yet been captured, with an increasing possibility of default on those that are still in early stages of development.

Share holder structure

Aldar has a current free float of c69%. The remainder is held by the Abu Dhabi Government or quasi government institutions. The largest shareholders are Mubadala 19%, ADIC (7%) and Abu Dhabi National Bank (5%). The foreign ownership limit is 40% against a current level of 23%.

Figure 47: Shareholder structure



Source: Abu Dhabi Exchange (ADX), Nomura research

Key senior personnel

Mr Ahmed Ali Al Sayegh (Chairman) is currently a board member of Mubadala, CEO Dolphin Energy and also a board member of numerous influential private and government associations, including UAE Offsets Group, Abu Dhabi Water and Electricity Authority, Etihad Airways and First Gulf Bank.

Mr John Bullough (CEO) was appointed in October 2008, having previously served as COO and has overall executive responsibility. Mr Bullough is a Chartered Surveyor by profession with 35 years of related property experience with a particular focus on retail property.

Mr Sami Asad (COO) was appointed in October 2008, having joined the company as technical director in September 2008. Prior to this appointment he was Deputy Vice President of Projects at Dolphin Energy for five years.

Mohammed Al Mubarek (CCO), the Chief Commercial Officer, is responsible for Sales, Leasing, Property and Asset and Facilities management. Mr Al Mubarak previously worked for Barclays Capital investment banking.

Mr Shafqat Malik (CFO) is responsible for Aldar's financing strategy. Mr Malik has over 10 years real estate experience, having previously served as finance director at Mapeley (not publically listed at the time) and held senior finance positions at Regus and Lease Plan, all based in the UK.

Valuation

We derive a target price of AED 3.13 based on a number of company specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate issues, concentration and development risk. In addition, we also apply a cyclical discount of 35% based on Aldar's exposure to the Abu Dhabi real estate market, where the current markets prospects appear better than those of Dubai, in our view.

The stock currently trades at a P/NAV of 0.41x relative to our normalised sector average of 0.49x. At our target price the stock trades at a 0.48x discount to NAV.

Figure 48: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	0	Reliance on cap. mkts, net debt equity gearing 66%
Strategy	3	Increasing its investment portfolio
Growth prospects (PNPV/PV)	2	PNPV/EV of 1.1x
Corporate access, transparency, disclosure	-1	
Concentration risk	-3	Abu Dhabi based
Development risk	-1	
Total Corporate adjustment	-0	Reflecting our view on the above
Cyclical adjustment	-35	
Total discount	-35	

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 6.5 by a total of 35%. Added to this we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our price target, but we note that there are significant un-booked land values that we do not include.

Figure 49: Target price calculation

Adjusted Corporate Value (m)	Aldar
Unadjusted book value (ex minorities)	16,921
less Balance sheet adjustments	(163)
Adjusted NAV	16,758
less Cyclical adjustment	(5,865)
+ / - Capitalised admin costs	(2,813)
+ / - Corporate adjustment	0
Adjusted corporate value	8,080
per share:	
NOSH (m)	2,578
Adjusted NAV +12m	6.50
less Cyclical adjustment	(2.28)
+ / - Capitalised admin costs	(1.09)
+ / - Corporate adjustment	0.00
Calculated target price	3.13

Source: Nomura research

Business model and strategy

Subsidisation via the government

Aldar is a master developer, enjoys a very strong relationship with the government and is considered a major contributor (about 45% of new supply) to the development of Abu Dhabi and surrounds as well as to the Abu Dhabi 2030 plan. Almost all of Aldar's landbank has been granted for free, but the 'quid pro quo' is the need to adhere to the government's 2030 mandate for the local market.

Capital consumptive

Aldar is essentially a 'develop to hold' model, having progressed from selling serviced land plots to raise funding for future, more capital intensive, residential developments. The model is capital consumptive (particularly in the early stages) and therefore there is a greater reliance on the capital markets to fund operations, with the group tapping the debt markets twice in 2008 and receiving a further government loan for the development of Yas Island.

Risk diversification

Aldar plans to develop its role as an investment manager (investing in domestic and international property ventures), develop its property asset management service and expand overseas – but it is early days yet and the key focus is delivering the current development pipeline, which is heavily skewed to residential (65%). The entry into international markets will likely be aimed at both developed and emerging markets (differentiating the company from many competitors) with a view to diversifying its emerging market risk. Either way we think a drive into international markets seems to be on hold for the time being.

In the near term the company should continue to marshal its resources and concentrate on the local developments, in particular Yas Island as the highest priority, in our view. We think the company may look to divest some of its holdings (but retain the management rights), so that capital can be repatriated and redeployed.

Vertical integration

Aldar has entered into a number of upstream business ventures to support its development pipeline (i.e. with suppliers, financial institutions and agencies) and is looking to downstream ventures to support the operations of the developed portfolio (hotel management, asset management JVs, leisure etc).

Risks

Like all UAE real estate companies, Aldar is exposed to a number of industry specific, regulatory, geopolitical, financial management and liquidity risks. In addition, we consider historical share price volatility as a possible indicator of future stock-specific risk.

With regard to Aldar, we would highlight in particular the concentration risk of developments skewed to the Abu Dhabi residential market, where prices may fall, and where there are low levels of recurring income, although this is being addressed with the establishment of an investment portfolio and alternate business strands. The buy to hold development model requires incremental funding that increases the refinancing risk.

This is mitigated, however, by the significant government backed shareholdings and the willingness of the Abu Dhabi government to loan on favourable terms.

Cash flow and financing

Developments partially funded

We think financing the development of the investment portfolio is the priority for Aldar. To date we estimate sales of land and residential units of c. AED 15bn, against current cash receipts of c. AED 9bn, which includes deposits and cash installments that have been paid. The above represents the typical self funding model; however, capex on investment properties cannot start to be reclaimed until completion and lettings are achieved.

Overlaying this, however, is the need to fund the investment portfolio development, which requires upfront funding (drawing down facilities), with the recovery payback loaded against rental income. To date, Aldar has issued two Sukuks instruments for a total of c. AED 13bn, repayable in 2011 (which has been partially redeemed by an equity issue) and in 2013 as well as a convertible non-interest bearing bond with a conversion price of AED 11.7 per share. The total carrying liability of these instruments as at 3Q08 is AED 11.5bn. On the interest bearing bonds, the redemption yield currently averages 15%.

No buy backs

Aldar will need access to the capital markets again, but will only do so when 'the window reopens and the price is right'. The company has stated that it will not retire or buy back debt or entertain any share buy backs with its current cash holdings.

As at FY08, Aldar had AED 22.6bn of outstanding borrowings (with AED 2.7bn due within 12 months), unused facilities of AED 10.9bn partially guaranteed by the Abu Dhabi government (AED 8.9bn outstanding on that facility) and a cash balance of AED 12bn (largely consisting of short term deposits).

Another AED 10bn might be handy

We estimate c. AED 10bn of cash receipts over the next 3 to 4 years against contractual obligations of c. AED 43.2bn. Currently, AED 6.4bn of revenues from the sale of property under construction has not been recognised. On this basis, we would assume additional cash requirements (additional sales and debt financing) of c. AED 10bn over the committed development period.

The company has about AED 23bn in cash and available facilities (secure) with perhaps another AED 4bn of receivables to come (not secure), but the recent cash burn is expected to fall to around AED 10bn this year with construction of Yas Island (racetrack, hotels, marina etc) the key focus. The company has stated that it has 'enough robust cash flows' for at least 12 to 18 months.

Aldar's stated financial strategy is to "finance its projects through a mix of shareholders' equity, pre-selling of units and debt finance … retaining sufficient cash reserves and liquidity to ensure that its personal obligations can be met on a timely basis" (*Sukuk Funding 2 Circular, June 2008*).

FY08: Results day

We have adjusted our earnings profile for Aldar based on the FY08 reports that have been published (January 29). This is one of the few companies who have reported full results at the same time as the preliminary release.

Financials FY08

The key driver of results were the increased sales revenue recorded from sales where during the year the group recognised revenue from sale of plots worth AED 4.1bn and residential units worth 1.1bn. The overall gross profit margin was in line with quarterly trends at 54%. From 3Q08 to 4Q08, sales revenue fell around 37%, but the company stopped sales in October 2008, before the Cityscape Exhibition, where there was already a softening in the market, according to management.

We calculate 4Q margins at 23% (from 61% in 3Q08) and present annual abbreviated results in the table below.

Figure 50: Abbreviated financial results

	2007	2008	
Gross profit	560	2,683	Primarily driven by increase in gross revenues of AED 5.4bn from the sale of property
Gross profit margin (%)	46	54	
SGA	-402	-926	Increased staffing levels owing to development ramp-up
Net financing	-38	156	Offset by cap. interest, includes associate and JV profits
Net operating profit	**120**	**1,914**	
Net operating margin (%)	10	38	
Revaluation gains	1,821	1,533	No revaluation in the fourth quarter
Profit for the year	**1,941**	**3,447**	
Earnings per share:			
Basic EPS	1.1	1.39	Headline EPS
Diluted EPS	0.78	1.03	Adjusts for dilutionary effect of convertible
Adjusted EPS	0.07	0.89	Clean EPS, ex non-cash adjustments and receivables
Diluted Adjusted	0.05	0.66	Adjusts for dilutionary effect of convertible
Balance sheet			
Gross property assets	11,660	28,084	Inv. properties(and under development), WIP developments
Net Debt	-2,892	-10,522	
Other net assets	-1,079	-1,529	
Equity	**7,689**	**16,032**	**2008 includes AED 3.56bn in non-interest bearing convertible bonds**
Net debt equity reported (%)	**38**	**66**	**Adjusted net debt/equity for convertible (112%)**
Net debt / GPA (%)	25	37	Adjusted net debt/GPA for convertible (50%)
NAV (fd), AED	**3.09**	**4.79**	

Source: Nomura research

Investment properties increased to AED 5.2bn from AED 3.3bn, which after adjusting for AED 288m of developments transferred into the pool, was a direct result of the fair value adjustment recorded of AED 1.5bn. There was only a marginal increase in revaluations in 4Q08. The company stated in its recent conference call that it could have taken some revaluation gains through the revenue statement (planning gains etc), but thought it prudent not to. Overall we expect asset values to fall in 2009.

Investment properties under development increased to AED 15.8bn (+268%), and properties under construction are now valued at AED 7.1bn, with AED 11.7bn spent on property developments throughout the year.

Adjusted NAV +36%

NAV, a key performance indicator, increased to AED 16.0bn from AED 7.7bn (+c109%), but of the AED 8.3bn increase, AED 5.5bn was related to early redemption of bonds (AED 1.94bn) and the equity raised through the issue of the non-interest bearing convertible bonds (AED 3.56bn). Another AED 1.5bn was attributable to the increase in property revaluations now held within retained earnings. We would consider the true increase in NAV excluding the convertible adjustments as still healthy at a 36% increase. Excluding the revaluations (to standardise against those companies using book value), we calculate a 17% year on year increase.

Cash balances held (excluding term deposits with maturities greater than three months and restricted balances) is AED 4.9bn. The retirement schedule of debt maturing in the current year is matched against the maturity of cash or cash equivalents to produce a ratio of 1.7x (AED 9.8bn in cash and equivalents vs. AED 5.7bn in maturing liabilities).

Holding hands

Trade receivables of AED 663m were past due, but 85% were in land sales (where current prices are still above purchase prices) and concentrated in five counterparties, and since the year-end a further AED 200m has been retired. There is more risk associated with the unit sale receivables and the company reports that it is taking 'productive steps' to help bring buyers and lenders together.

We do not have guidance on the maturity of contracted commitments, but we estimate that there is about AED 4bn of capacity to meet near-term contractual commitments as well as cash installments (still) coming in from sales, so the position appears covered for the next 12 months.

Financial earnings and estimates

Aldar recognises revenues on sales once 20% of installments have been collected and on completion on unit sales, with AED 6.4bn of revenues yet to be recognised.

In our forecasts we see the contribution of unit sales becoming more relevant as revenue from Saraya land sales run off, but there are still contributions of land from Yas Island and we expect the company to book more revenue from its Raha Beach and Raha Gardens developments.

We are assuming a 10% 'put back' on residential sales that have currently been made, mirroring the bridge financing that some companies are offering. We also assume sales prices fall by an average of 15%, which for us is a key revenue driver, although the company has stated it would be unfair to lower sales prices on units. Management appears comfortable taking the stock on their books (for rental) and then selling when market conditions improve.

Based on our modeling assumptions, we think headline revenues will continue to rise albeit at a moderated rate in 2009 as sales were curbed in the last quarter of 2008 with market conditions not getting easier in 1Q09. We expect revenues to increase in 2010 and peak in 2011, tapering off towards the end of our forecasting period as the current development programme draws to a close.

Gross margins stabilising below 40%

Gross profit margins in 2008 were c54%, but we expect a lagged fall as market conditions deteriorate with provisioning for bad debts also likely to increase. We estimate gross profit margins to stabilise at c40%, in line with our industry estimates.

Cash flow

We are allowing for cAED 20bn in capex on the development programme over the next 4 to 5 years, and estimate cash burn in 2009 to be around AED 10bn. We do foresee construction delays in timing and perhaps cancellations of projects not yet commenced, with elements of Raha Beach 'reprioritised' – but will adjust our forecasts as and when this is announced to the market.

Finance charges

Aldar's current debt profile has capitalised finance rates at 6.1%. We assume additional refinancing at c7.5%. We have modeled our refinancing assumptions based on repayment schedules provided in the FY08 accounts (where there is good disclosure on debt).

Dividend +25%

The stated dividend policy is for a progressive dividend to be paid. Management believes that there are enough cash resources to increase the dividend 25% to AED 0.125 (prospective dividend yield of 6.1%) with capacity to continue to increase dividends. We factor in a 15% rise in 2009 and beyond.

Balance sheet and gearing

We expect that balance sheet gearing will start to rise from current levels of c.65%, peaking in 2009 at c100%.

Asset deflation

Over the past two years, Aldar has booked c AED 3.4bn in asset revaluation gains on the investment portfolios and we would be surprised to see this rate continue. In 2009 we expect asset values to deflate on average 10%-15% in line with our general market view, but there will probably be planning gains to offset this. This would see a c AED 0.4bn fall in asset values in 2009, on our estimates.

This is non-cash and we strip this out of our adjusted earnings figure.

Our estimates versus consensus

Our estimates are on average c 41% lower than consensus and we see additional risks to our 2009 numbers if we do not see additional liquidity in the back end of 2009. We will track our 2009 estimates against quarterly returns and amend as necessary.

Figure 51: Aldar, Financial estimates and summary (2007–12E)

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Gross revenues	1,227	4,978	5,143	8,680	16,078	9,877
Cost of goods sold	-667	-2,295	-2,793	-5,092	-9,364	-6,036
Gross Profit	**560**	**2,683**	**2,351**	**3,588**	**6,714**	**3,841**
S,G and A	-402	-901	-1,036	-1,036	-1,036	-1,052
Depreciation	0	-25	-97	-97	-97	-97
Other net operating income	0	0	0	0	0	0
Core EBIT	**158**	**1,758**	**1,218**	**2,455**	**5,581**	**2,693**
Net financing income (costs)	-70	109	192	30	-51	-107
Associates	24	47	105	110	115	121
Property revaluations	1,821	1,533	-411	0	0	0
Unrealised mtm gains (losses)	8	0	0	0	0	0
Other non-operating income	0	0	0	0	0	0
PBT	**1,941**	**3,447**	**1,103**	**2,595**	**5,646**	**2,707**
Taxes	0	0	0	0	0	0
Exceptional / unusual items	0	0	0	0	0	0
PAT	**1,941**	**3,447**	**1,103**	**2,595**	**5,646**	**2,707**
Minority interests	0	0	0	0	0	0
Attributable to equity holders	**1,941**	**3,447**	**1,103**	**2,595**	**5,646**	**2,707**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Investment properties	3,328	5,149	4,744	4,751	4,758	4,765
Development properties	8,332	22,934	25,022	24,698	31,026	31,829
PPE, land held for sale, etc.	487	1,831	1,734	1,637	1,539	1,442
Total property assets	**12,148**	**29,915**	**31,499**	**31,085**	**37,323**	**38,036**
Receivables	2,496	6,651	5,272	6,376	12,074	9,914
Associates and JVs	239	875	914	958	1,008	1,063
Other assets	145	260	260	260	260	260
Cash and cash equivalents	7,616	12,066	10,066	8,066	8,066	8,066
Total assets	**22,644**	**49,767**	**48,011**	**46,746**	**58,731**	**57,340**
Total debt	10,562	22,588	27,803	23,693	27,703	25,488
Payables & customer advances	3,326	9,447	1,398	1,932	4,477	2,914
Dividends payable	8	23	65	113	168	231
Other liabilities	1,058	1,676	1,824	1,750	1,787	1,768
Total Liabilities	**14,954**	**33,735**	**31,090**	**27,488**	**34,134**	**30,402**
Share capital	4,464	6,321	6,321	6,321	6,321	10,065
Reserves and retained surpluses	3,225	9,711	10,600	12,937	18,275	16,873
Minority interests	0	0	0	0	0	0
Total equity	**7,689**	**16,032**	**16,921**	**19,258**	**24,597**	**26,939**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	1,941	3,447	1,103	2,595	5,646	2,707
Depreciation and amortisation	19	29	97	97	97	97
Change in provisions / non-cash	5	324	411	0	0	0
Working capital / other	-796	-2,449	-6,702	-867	-3,358	280
Cash flow from operations (a)	**1,170**	**1,351**	**-5,090**	**1,826**	**2,385**	**3,084**
(inc) decrease in PPE	-6,591	-13,357	-1,913	539	-6,093	-512
(inc) decrease in investments	-2,610	-5,043	0	0	0	0
Change in other investing activity	205	629	0	0	0	0
Cash flow from investing (b)	**-8,997**	**-17,771**	**-1,913**	**539**	**-6,093**	**-512**
Free cash flow (a+b)	-7,827	-16,420	-7,003	2,364	-3,708	2,572
Equity raised (repaid)	0	6,896	0	0	0	0
Debt raised (repaid)	12,784	10,049	5,215	-4,110	4,010	-2,215
Dividends	-138	-232	-278	-320	-368	-423
Others	-631	-489	66	66	66	66
Cash flow from financing (c)	**12,015**	**16,224**	**5,003**	**-4,364**	**3,708**	**-2,572**
Net change in cash (a+b+c)	**4,188**	**-196**	**-2,000**	**-2,000**	**0**	**0**
Cash and cash equiv at year enc	**5,059**	**4,863**	**2,863**	**863**	**863**	**863**

Key data

Year-end 31 Dec (AED unless state	FY07	FY08	FY09E	FY10E	FY11E	FY12E
EPS (fd, adj.)	0.18	0.98	0.77	1.22	2.47	1.27
DPS	0.10	0.13	0.14	0.17	0.19	0.22
BVPS	3.46	7.21	7.61	8.66	11.06	12.12
BVPS (adjusted)	3.43	7.14	7.54	8.59	10.99	12.04
Gross profit margin (%)	45.6	53.9	45.7	41.3	41.8	38.9
Core EBIT margin (%)	12.9	35.3	23.7	28.3	34.7	27.3
ROE (%)	35.4	29.1	6.7	14.3	25.7	10.5
Net debt / Equity (%)	38	66	105	81	80	65
LTV (%)	24	35	56	50	53	46

Valuation

Year-end 31 Dec	FY07	FY08	FY09E	FY10E	FY11E	FY12E
P/E (x)	40.4	2.7	3.6	2.1	0.9	2.0
P/BVPS (x)	**0.7**	**0.4**	**0.3**	**0.3**	**0.2**	**0.2**
Gross Property Assets / EV (X)	1.7	2.3	1.6	1.8	2.0	2.1
EV / EBITDA (x)	54.6	9.1	17.8	8.3	4.5	8.3
Dividend yield (%)	3.9	4.9	5.6	6.5	7.5	8.6

Source: Company data ,Nomura estimates

Additional company information

The landbank and development portfolio

Aldar's current property portfolio includes major developments and re-developments within Abu Dhabi such as Yas Island, Al Raha Beach, Central Market, Nareel Island, Noor Al Ain, Al Gurm Resort, and Al Mamoura, the Mubadala Development Company and Environment Agency Abu Dhabi Headquarter Building.

We estimate that the programme, if successfully completed, will deliver around 120m sqft of BUA into the region, over the next decade or so. Taking into account the bulk of the commercial portfolio and an estimated 45% of the residential portfolio, we think that around 28% of BUA is being planned for the investment portfolio. We estimate that this could generate sales of c. AED 75bn and gross recurring income of c. AED 5.5bn p.a., but we calculate that the full impact occurs in 2013 and beyond when hotel operations are fully included. The company intends to build 40 hotels.

All of the landbank, with the exception of land associated with Jimi Mall, has been granted by the government. The freehold grant is 99% with leaseholds on Jimi Mall and Central Island. The total land area is 38m sqm and is independently valued at AED 44.2bn by CBRE (Dec 07), but this excludes Motor World, which we think could be in the range of AED 2bn to AED 2.5bn.

We believe that the key focus for 2009 will be Yas Island, where Aldar is committed to hosting the finale of the Formula One Grand Prix in November, having committed to both the race track and seven hotels (four 5-star, one 4-star and two 3-star). This will add a further 2,250 rooms. This appears to be a pressing schedule and we will be interested observers mid way through the year to see how this development continues to progress. We do, however, expect the development to be completed in time for the grand prix in November.

Figure 528: Aldar Landbank (valued as at Dec 2007)

Project	Landbank (sqm)	Ownership	Valuation (AEDm)	Completion	Comment
Jimi Mall, Noor Al Ain	177,881	Leasehold (75yrs)	330		Jimi Mall completed, Noor Al Ain under development
Raha gardens, 4 phases	1,060,889	Freehold	192	2010	Phase 1 complete (280 villas), Phase 2 and 3 ongoing
Abraj Towers, 2 phases	47,172	Freehold	237	2009	Phase 1 complete (198 units), phase 2 ongoing, 50% jv sale to Etihad
Central Market	64,264	Leasehold (50yrs)	1,007	2011	88 floor resi tower, 60 floor office tower, 1.4m sqft retail, 920 hotel keys
Al Gurm	1,843,919	Freehold	27	2009	Mixed use, eco-friendly development
Raha Beach	5,562,493	Freehold	18,985	2019	11 communities, non nationals can buy on 99yr. lease
Nareel Island	689,542	Freehold	1,261	2010	Mixed use, 86 villas, 20 condos, 160 key 5-star hotel
Yas Island	24,848,472	Freehold	21,775	2014	Excludes 2.1m of land, mixed use scheme
Al Bateen	103,230	Freehold	421	2010	335 residential villas
Motor World	3,500,000	Freehold	n/a	2013	Not valued, car centre that will also house up to 30,000 residents
Total landbank	37,897,862		44,235		

Source: Company data, Nomura research

Any short term leases (Al Manoura and the Cleveland Clinic) have not been valued.

Waiting in the wings We believe Mina Zayed, a land plot of c7m sqm, is still in the development concept stage and as yet the land has not yet been granted. Furthermore, the company should report on the value of Motor World (particularly if it is looking to secure additional project finance), which will be a useful benchmarking exercise against the potential value of the Mina Zayed project – if it gets the go-ahead.

International exposure Aldar's first international expansion was announced in August 2007 via a tie-up with South Johor Investment Corp (SJIC) in a deal that represents the largest foreign real estate development in Malaysia. This was followed in October 2007 with plans announced to build a mixed-use development in Kazakhstan. In October 2008, Aldar announced that it was participating in the International Financial District (IFD) project in Malaysian via an investment spearheaded by Global Capital. Aldar, along with Millennium Development, will be the IFD developers and development managers.

This looks like a low risk entry point, in our view, but international expansion is still in the nascent stage.

Figure 53: Corporate structure and overview

Subsidiaries	Purpose
Addar Real Estate Services	Development of villas at Al Raha Gardens (99%)
Al Raha Infrastructure Company	SPV company to house financing facility
Al Raha Gardens Property	Develop annd manage the Al Raha Gardens project
Al Jimi Mall	Operation and mall management
Aldar Facilities Management	Run asset and facilities management of the business
Aldar Commercial Properties Development	Aldar CPD is currently dormant (As at June 2008)
Aldar Acadamies	Planning to deliver 20 schools with aggregate capacity for 30,000 by 2013
Farah leisure Parks management	Supervise, manage and operate theme parks (85%
Joint Ventures	**Details**
Aldar laing O'Rourke Construction	20 year JV, Aldar owns 51%, NAV AED 87m, May 2008 Strategic tie up with Arkan
Cocunut Island Development Company	50/50 JV with NCTH for development of Nareel Island
Aldar Ready Mix	50/50 JV with Ready Mix to establish and operate concrete plants to supply Aldar developments
Royal House	40/60 Jv with local developer
Fadar Retail	50/50 JV with Al Fahim Group to est. retail outets in GCC and wider MENA region
Abu Dhabi Motor Sports Management	40/60 JV with AD Exec Affairs Authority, manage and promote motor sports in the UAE
Other joint ventures	Besix (construction), Tabreed (cooling), ADCB and others (financial services), Siemens (IT and electrical infrastructure), Etihad Airways (Abraj Tower), Zabeel Investments (Golf Course development), Texturura
Investment in Associates	**Details**
Green Emirates Properties PJSC	20% stake, brokerage and property management services
Aseel PJSC	20% stake, Shariah compliant banking services for own and third party accounts
Dimarco LLC	34% stake, supply, installation, maintenance and operations management services on cooling and heating
Al Maabar	30% stake, finance, develop, manage and maintain real estate predominantly in the MENA region
Abu Dhabi Finance LLC	20% stake, in conjunction with ADCB and others, conventional mortgages, with paid in capital of AED 500m
Iskandar Holdings	19% stake, Investment vehicle for malaysian developments

Source: Company data, Nomura research

Additional outsourcing Aldar has recently announced the appointment of John Buck International to manage its commercial property portfolio. Most of John Buck International's work will initially be focused on the Al Manoura building that is leased to Mubadala. This will be followed by Baniyas Office Towers and Aldar's landmark headquarters building at Al Raha Beach.

John Buck International is a joint venture between Mubadala Development Company and The John Buck Company.

The debt might be an interesting alternative

Buy the debt? We also see potential value in buying the Sukuk bonds that are secured and therefore rank above the equity. Investors could buy the yield in the interim; we expect yield compression in the medium term as the market stabilises with capital appreciation as a result.

Figure 54: Bond and Sukuk finance profile

Financing profile	Instrument	Maturity	Net proceeds	Redeemed	Carrying liability	Conv. Price	RY yield (%)	Comment
Sukuk Al Mudaraba	Convertible	2011	9080	4694	4235	5.70	15.2	Holder: voluntary early redemption
Mubadala (related party)	Non-interest bearing convertible	2011	n/a	n/a	3563	11.73	n/a	Company provision for early conversion
Sukuk Al Ijara	Non-convertible bonds	2013	3750	n/a	3744	n/a	14.3	Coupon EIBOR + 175bps
					11551			

*Source: Company data, Nomura research *As at 2 February 2009*

The Sukuk Al Mudaraba, which has a profit rate of 5.67%, matures in November 2011 whereupon each 1000US$ certificate can be converted to 645.2 shares (subject to Aldar's acceptance or they pay market value), so this assumes a breakeven price on the convert of AED 5.70, which is about double the current share price. Therefore the 2013 non-convertible Sukuk looks better pricing for the time being. We caveat this analysis by admitting we are not credit analysts, but the bonds look to be trading well below their ascribed credit ratings.

Sorouh Real Estate

Stock rating	NEUTRAL
Price (AED), 13 Feb	2.11
Price target (AED)	2.93
Upside potential, %	24
Market cap, (AEDbn)	5.9

Valuation	2009F	2010F
EPS (adj.)	0.73	1.01
P/E	3.3	2.4
Div. Yield, %	6.9	7.6
P/Book, x	0.6	0.8

Performance, %	-12m	-3m
Absolute	-74	-20
vs. sector	5	20

Sector MSCI UAE
Source: Reuters, Nomura research

5yr Revenue plan (%)	2011
Residential Sales	69
Land Sales	17
Commercial Sales	11
Lease income	3

Source: Company data, Nomura research

We initiate coverage on Sorouh with a Neutral rating and a 12 month price target of AED 2.93. This represents a potential upside of 24% from current levels. At our target price, Sorouh is trading at a 0.62x discount to NAV.

Corporate profile

Sorouh is another integrated real estate development, management and investment company based in Abu Dhabi, where the concentration of its real estate activities is located. The company was formed in 2005 with a current development pipeline of c. AED 60bn in sales value and landbank in excess of 46m sqm valued by Sorouh at AED 6.3bn (as at 31 December 07).

Figure 55: Brief history and key events

Sep 2005	Established as company, capital AED 2.5bn, IPO oversubscribed 176x
Sep 2005	Announces Shams Abu Dhabi, maiden real estate project
Mar 2007	Open to foreign investors with 20% foreign ownership restriction
Jan 2008	Forms JV with Tabreed to supply district cooling
Mar 2008	Forms strategic alliance with MGM and Rubicon to deliver entertainment platforms
Mar 2008	Announce JV with Goodman for development and mgmt of business parks in GCC
May 2008	Acquires strategic shareholding in LLJ property, an Abu Dhabi based realtor
May 2008	Acquires 60% of Pivot, a local construction company
Jul 2008	Issues AED 4bn Sukuk, securitised on future contracted receivables from sub-developers
Nov 2008	Ownership restrictions revised to 15% (from 20%)

Source: Company data, Nomura research

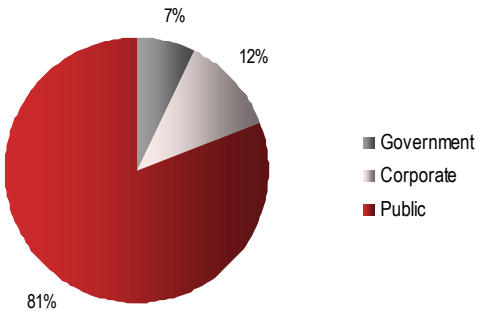
Business lines

Sorouh is a full-service property company split into three separate divisions (property development, property management and property related services). To date, revenues have been concentrated in land sales, but over the next five years residential unit sales will represent c70% of all revenues. This is principally a 'develop to sell' business model.

Shareholder structure

Sorouh has a current free float of c81%. The remainder is held by the Abu Dhabi Investment Council (7%) and Al Joud Investments (12%). The foreign ownership limit is 15% compared with the current level of 9%. The FO limit was recently reduced from 20% to 'dampen share price volatility'.

Figure 56: Shareholder structure



Source: Abu Dhabi Exchange (ADX), Nomura research

Key senior personnel

H.E. Saeed Eid Al Ghafli (Chairman) since inception in 2005. Prior to his current chair, he was Chairman of Al Rayaan investment and Chairman of Emirates Building Company.

Abu Baker Seddiq Al Khouri (Managing Director) has 13 years of experience working in the private equities portfolio of ADIA and prior to this experience in other private equity houses.

Mr Mounir Haidar (CEO) is an engineer with over 25 years of experience in real estate and construction. Prior to his current appointment, Mr Haidar has worked for Nakheel Parsons Corporations.

Mr Samer Abu Hijleh (COO) was appointed in November 2008 with more than 20 years of industry experience. Prior to joining Sorouh, Mr Abu-Hiljeh was a project manager at Bechtal.

Mr Gurjit Singh (Chief Property Development Officer) has over 25 years of industry experience involved in mega developments in the UAE and Asia. Previously he has worked for Sime Darby Group, one of Malaysia's largest multinationals and Singapore's Sentosa Leisure Group

Mr Ala' Khannak (CFO) has 28 years working in a variety of senior financial and banking roles. Prior to joining Sorouh he was the group CFO for Al Jaber Group and has preciously worked for Ernst and Young, Dar Al Mail Al Islamic Group, Arab Bank Group and Majid Al Futtaim Trust.

Valuation

We derive a target price of AED 2.93 based on a number of company specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate issues, concentration and development risk. In addition, we also apply a cyclical discount

of 35% based on Sorouh's exposure to the Abu Dhabi real estate market, where near-tem prospects appear better, in our view.

The stock currently trades at a P/NAV of 1.06x relative to our normalised sector average of 0.49x. At our target price the stock trades a 0.62x discount to NAV.

Figure 57: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	3	Mostly self funded model till date, net debt equity gearing of -51%
Strategy	3	
Growth prospects (PNPV/PV)	5	PNPV/EV at 2.7x
Corporate access, transparency, disclosure	2	
Concentration risk	-3	Abu Dhabi based
Development risk	-1	
Total Corporate adjustment	9	Reflecting our view on the above
Cyclical adjustment	-35	
Total discount	-26	

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 4.76 by a total of 26%. Added to this we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our target price, but we note there is significant un-booked land values that we exclude.

Figure 58: Target price calculation

Adjusted Corporate Value (m)	Sorouh
Unadjusted book value (ex minorities)	7,405
less Balance sheet adjustments	4,492
Adjusted NAV	11,897
less Cyclical adjustment	(4,164)
+ / - Capitalised admin costs	(1,481)
+ / - Corporate adjustment	1,071
Adjusted corporate value	7,323
per share:	
NOSH (m)	2,500
Adjusted NAV +12m	4.76
less Cyclical adjustment	(1.67)
+ / - Capitalised admin costs	(0.59)
+ / - Corporate adjustment	0.43
Calculated target price	2.93

Source: Nomura research

Business model and strategy

Evolution

Sorouh is a master developer with strong ties to the government, having been granted land tracts on favourable terms. The development model is skewed towards the sale of serviced land plots. It is a business model that generates high margins given the relatively low 'in

price' of the landbank. Sorouh prepares the plot infrastructure as part of the master plan that is then handed to sub developers. This allows higher returns than raw land sales, with some element of control and yet minimises capex spend. Land sales have previously been used to smooth the earnings profile and provide a liquidity buffer, but this appears less relevant going forward.

Early cycle developers

Sorouh made the bulk of its plot sales early in the cycle and is in the process of collecting the cash (although land price increases are transferred to the sub developers), which is a better funding model, in our view. In essence, sub-developers get the benefit of a capital (rather than funding) bridge in that current prices remain ahead of purchase prices – with developments remaining economically viable. There is still a risk, but it is lower in our view.

Subsidisation

The land sales business model has been a relatively low risk way to generate cash to subsidise, but not fully fund, the more capital intensive residential and commercial developments; this capital intensive part of the business should now increasingly contribute to future revenues. The company operates a relatively high density land distribution model (we estimate nearly 200%) to improve margins and will now target the provision of mid-market accommodation.

Risks

Like all UAE real estate companies, Sorouh is exposed to a number of industry-specific, regulatory, geopolitical, financial management and liquidity risks. In addition, we consider historical share price volatility as a possible indicator of future stock-specific risk.

With regard to Sorouh, we would highlight in particular the concentration risk of developments, skewed to the Abu Dhabi residential market, and the relatively low levels of recurring income. This is being addressed, but in the meantime, it requires additional financial leverage to fund any development of an investment portfolio.

Cash flow and financial position

Assuming the current development pipeline, the company has sufficient cash until the end of 2010 and beyond as receivables are collected. Development capex was expected to rise significantly over the next three years; we think around AED 20bn in total if all projects are held to schedule (but this is looking increasingly unlikely, in our view).

Cash depletion across 2009

Cash reserves of AED 6.8bn are likely to be depleted with AED 2bn in short-term debt to be paid across 2008 and 2009, and we assume around AED 5bn of development capex in 2009. We do, however, expect at least AED 4bn in cash receipts which should prevent any funding gaps. The cash allocation is being directed towards Abu Dhabi with overseas expansion slowing.

Core focus will be on the completion of Golf Gardens (400 units), with handover commencing in March 2009. Some AED 100m has been ring-fenced for Saraya and Shams infrastructure and work on Al Ghadeer will continue but at a slower pace than first anticipated.

Capital market timed well

The funding model to date has been a self-funded one, although small start-up loans have been attached to individual developments which required around AED 1.1bn. Sorouh accessed the Sukuk market for the first time in August 2008, securitising the receivables on land plot sales in Sayara and Shams totaling AED 5.7bn and raising AED 4.02bn with cAED 1.7bn dispersed into an infrastructure fund. This is the first securitisation raised based on future receivable income and was, fortuitously, at the peak of the credit market before the freeze at rates ranging from 1m EIBOR +200 to +300 basis points. We believe this was a very complicated securitisation (in terms of tranches and credit profiles etc) and the market is now closed.

This has given the group much needed liquidity at a time when others are starved of it.

FY08: Results day

Sorouh recognises revenues using the completed contract method. Land sales, however, are recorded once 25% of installments have been paid.

We have adjusted our earnings profile for Sorouh based on the FY08 reports published 29 January. Full financials have not been released and therefore we have not rolled over our year-end model.

Financials FY08

Results were driven primarily by increased sales revenue recorded from sales where, during the year, the group recognised revenue from sales plots worth AED 3.7bn. The gross profit margin was in line with quarterly trends at 57% (equivalent to Aldar), but contracting to 39% in the final quarter of 2008. Year-on-year gross profits were up 74%. The business has been developing on a consistent basis, but the momentum in these results is a signal of past sales, not future sales, and the fourth quarter profits slipped to just AED 46m.

Q4, momentum loss

Sales in the fourth quarter were at about 35% of the previous quarter's, with gross profit margins declining to 39% from 60% and EBIT margins from 49% to 11%. We think that it is unwise to place too much reliance on quarter on quarter results, but there has been a sudden halt in sales momentum (as with the market) and there may be an element of seasonality that adds more volatility, so we will monitor this closely in the coming quarters.

What was more telling in the preliminary statement is the mention that Sorouh gives to the current 'International Financial Crisis'. We think that the company has plenty of liquidity to meet obligations, and it has stated that it will deliver on the current pipeline. Projects not yet started will inevitably be delayed. It reports that each of its sub-developers in Shams and Saraya have been meeting obligations on time, with the company now 'constantly monitoring the performance and progress of these payments'.

Sorouh does not intend to make any provisions against its receivables, which are largely land based sales for the next three years. As the market slows, Sorouh intends to consolidate and become more of an asset gatherer (its own product).

The company has some equities exposure that totals approximately AED 117m in hedge funds, but most of the investment portfolio is in liquid term deposits with local banks. Some investments have been prudently marked to market and the company has chosen not to apply any revaluation to the investment property portfolio.

Results are summarised below:

Figure 59: Abridged financial results FY08

	2007	2008	%	
Gross profit	**1320**	**2,296**	**74**	**Land plot sales key driver (AED 3.7bn) vs. costs (AED 1.2bn)**
Gross profit margin (%)	*57*	*57*		
SGA	-265	-651	146	Significant increase in staff levels and sales and marketing effort
Net financing	70	40		Net income decreased owing to finance cost for ABS transaction
Other income	36	130		Transfer fees, dividends, late payments, associated companies
Net operating profit	**1161**	**1815**	**56**	
Net operating margin (%)	50	49		
Realised gains on disposals	49	4		Sale of investments in listed companies
Unrealised gains (loss) on disposals	47	-35		Fair market losses on investments
Minorities	0	74		
Profit for the year	**1,257**	**1,858**	**48**	
Earnings per share:				
Basic EPS	0.50	0.74	48	
Adjusted EPS	**0.46**	**0.73**	**56**	
Balance sheet				
Gross property assets	2,976	4,250		
Net Debt	1,225	2,842		Cash on hand AED 6.8bn, total borrowings AED 3.9bn
Other net assets	262	-1,133		
Equity	4,463	5,958	34	Assets not revalued, goodwill of AED 508m
Net debt equity reported (%)	-27	-48		
Net debt / GPA (%)	-41	-67		
NAV (fd), AED	1.79	2.38	34	

Source: Company data, Nomura research

The balance sheet is marked by the large cash holdings (AED 6.8bn) and receivables (AED 4.3bn), which will need monitoring for impairments, and property assets (AED 4.3bn). On the liabilities side, total borrowings of AED 4bn will see AED 1.8bn mature in the next 12 months. The trade payables and advances of AED 6.8bn, which seem high, are still covered by receivables and cash.

NAV +34%

NAV increased from AED 4.5bn to AED 5.96bn (+c34%), but we adjust for the increase in goodwill of AED 162m, so on an equivalent basis we estimate an NAV increase of 30% throughout the course of the year and this is without any asset revaluation adjustments.

Earnings estimates and financials

In the near term, revenue generation is consigned to land and unit sales with c10% generated from recurrent rental streams and asset management activities. Land sales recognise income early (after 25% of installments have been collected and development financing has been approved), while unit sales are recognised after practical completion and handover takes place.

Delivering 10,000 units

The strategy is now geared towards sales of turnkey units (residential and commercial), so we forecast a lag in earnings momentum until developments currently under construction are completed. To date, land sales have smoothed the revenue profile. Sorouh estimates that it will roll out c. 8,000 to 10,000 residential units to the market over the next four years.

Based on our assumptions, we think headline revenues will increase 13% in 2009 and 11% in 2010. Across our forecasting period, we expect earnings to be relatively flat. Our numbers are below consensus, but this takes into account lagged sales momentum and scheduled delays, but mitigating this we allow for falling construction costs of c10% in 2009, which is carried through our forecasting period.

Core contributors to short-term earnings will be Golf Garden residential units and land plot sales. At the results conference call, management was not in a position to give guidance on the 2009 outlook, but momentum is understandably slowing, so 2009 may be a year of consolidation.

Gross margins stabilising at below 40%

Gross profit margins to date have been strong at c60%, but we see these reversing as we expect falling sales prices with a lagged fall in commensurate development prices corresponding with an increase in the level of end user defaults (we estimate a 3% to 5% bad debt provision).

Finance charges

Sorouh is seeing incremental debt offered at LIBOR plus 300-400 basis points for an all in cost of c7.5% (which we model on refinancing).

Earnings deflate, then relate

Post 2012, our forecast period, we do see earnings tail off with developments completing and unit sales revenue gradually replaced by recurring income generated from the maturing rental portfolio and property management business lines. This is based on the assumption that we do not include estimates for Lulu or any of the overseas operations, which have not yet passed the design stage.

Dividend policy

The dividend will be determined by the board post release of audited FY results. We factor in a 10% rise in the dividend, but in the current market we believe that it would be more prudent to cut. The current dividend yield is 5%, but would put an AED 330m hole in the bank account, although this is not substantial against the AED 6.8bn cash it currently holds.

Market valuations

Lulu, Morocco and Egypt valuations are not included in the balance sheet.

Balance sheet

The maximum gearing ratio targeted by management is 100% (gross debt to equity) but we think it should settle in the range of 60% to 80% once the peak development periods in 2009 and 2010 fall. The Sukuk issue takes the gross gearing ratio to c65%, which is secured over the receivables of the Shams and Saraya land plot sales. Goodwill of AED 508m is partly associated with a related party transaction whereby Sorouh bought the rights and assignation of six real estate projects from ARI (owned by several directors and related parties) for a total consideration of AED 413m against net assets of AED 68m. We exclude any goodwill from our fair value calculations.

Our estimates versus consensus

Our estimates are about 29% lower than consensus estimates, and we think there is additional downside risk to our near term forecasts as developments are deferred.

Figure 60: Sorouh Financial Estimates (FY07 to FY12E)

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Gross revenues	2,321	3,723	4,229	4,692	8,761	11,348
Cost of goods sold	-1,001	-1,427	-2,482	-2,171	-5,372	-5,550
Gross Profit	**1,320**	**2,297**	**1,746**	**2,521**	**3,388**	**5,799**
S,G and A	-262	-645	-317	-321	-389	-435
Depreciation	-3	-7	-13	-16	-18	-20
Other net operating income	0	0	0	0	0	0
Core EBIT	**1,055**	**1,645**	**1,417**	**2,185**	**2,982**	**5,343**
Net financing income (costs)	70	40	231	116	70	150
Associates	18	51	61	67	73	81
Property revaluations	0	0	0	0	0	0
Unrealised mtm gains (losses)	96	-31	-1	0	0	0
Other non-operating income	18	79	50	50	50	50
PBT	**1,257**	**1,784**	**1,757**	**2,418**	**3,175**	**5,624**
Taxes	0	0	0	0	0	0
Exceptional / unusual items	0	0	0	0	0	0
PAT	**1,257**	**1,784**	**1,757**	**2,418**	**3,175**	**5,624**
Minority interests	0	74	73	100	131	233
Attributable to equity holders	**1,257**	**1,858**	**1,830**	**2,518**	**3,306**	**5,857**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Investment properties	853	857	900	944	987	1,031
Development properties	1,491	3,048	5,932	10,241	13,964	14,383
PPE, Land held for sale	633	344	101	106	108	107
Total property assets	**2,976**	**4,250**	**6,933**	**11,290**	**15,059**	**15,522**
Receivables	2,081	4,331	2,204	1,404	2,218	3,160
Associates and JVs	174	608	668	734	808	888
Other assets	532	908	754	754	754	754
Cash and cash equivalents	1,458	6,842	7,842	7,842	7,842	9,342
Total assets	**7,221**	**16,939**	**18,400**	**22,024**	**26,681**	**29,667**
Total debt	233	3,830	8,635	10,627	11,031	8,556
Trade payables/Customer Advances	1,881	6,783	1,813	1,430	2,832	3,086
Dividends payable	0	0	33	36	40	44
Other liabilities	643	368	514	441	477	459
Total Liabilities	**2,758**	**10,981**	**10,995**	**12,534**	**14,381**	**12,145**
Share capital	2,500	2,500	2,500	2,500	2,500	2,500
Reserves and retained surpluses	1,963	3,450	4,970	7,155	10,095	15,550
Minority interests	0	9	-64	-164	-296	-529
Total equity	**4,463**	**5,958**	**7,405**	**9,491**	**12,300**	**17,522**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	1,257	1,784	1,757	2,418	3,175	5,624
Depreciation and amortisation	3	7	13	16	18	20
Change in provisions / non-cash	235	-164	1	0	0	0
Working capital / other	-786	-786	2,279	-2,873	-8	228
Cash flow from operations (a)	**710**	**842**	**4,050**	**-439**	**3,185**	**5,873**
Net (inc) decrease in PPE	-926	-1,308	-2,399	-4,018	-3,386	-118
Net (inc) decrease in investments	163	-423	0	0	0	0
Change in other investing activity	83	0	0	0	0	0
Cash flow from investing (b)	**-680**	**-1,731**	**-2,399**	**-4,018**	**-3,386**	**-118**
Free cash flow (a+b)	30	-889	1,651	-4,458	-202	5,755
Equity raised (repaid)	0	0	0	0	0	0
Debt raised (repaid)	192	3,538	4,864	1,993	404	-2,476
Dividends	-217	-330	-363	-399	-439	-483
Others	0	0	0	0	0	0
Cash flow from financing (c)	**-26**	**3,208**	**4,501**	**1,593**	**-35**	**-2,959**
Net change in cash (a+b+c)	**4**	**2,319**	**6,152**	**-2,864**	**-237**	**2,796**
Cash and cash equiv at year en	**1,458**	**6,842**	**7,842**	**7,842**	**7,842**	**9,342**

Key data

Year-end 31 Dec (AED unless stated)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EPS	0.48	0.76	0.73	1.01	1.32	2.34
DPS	0.12	0.13	0.15	0.16	0.18	0.19
BVPS	1.79	2.38	2.96	3.80	4.92	7.01
BVPS (adjusted)	1.65	2.12	2.76	3.59	4.72	6.81
Gross profit margin (%)	56.9	61.7	41.3	53.7	38.7	51.1
Core EBIT margin (%)	45.4	44.2	33.5	46.6	34.0	47.1
ROE (%)	31.7	34.3	26.2	28.2	28.5	36.7
Net debt / Equity (%)	-27	-51	11	29	26	-4
LTV (%)	-41	-71	11	25	21	-5

Valuation

Year-end 31 Dec	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
P/E (x)	5.0	3.2	3.3	2.4	1.8	1.0
P/BVPS (x)	**1.4**	**1.0**	**0.8**	**0.6**	**0.5**	**0.3**
P/OCF (x)	8.5	1.5	-5.5	2.5	1.8	1.3
EV / EBITDA (x)	4.5	1.8	4.8	4.0	3.1	1.0
Dividend yield (%)	5.0	5.5	6.0	6.6	7.3	8.0

Source: Company data, Nomura estimates

Additional company information

Sorouh has indicated that it will start to mature the business and develop its role as an asset manager and investment manager as well as expanding into the AED 30bn facilities management sector. In addition, the company was keen to expand outside its traditional Abu Dhabi (and surrounds) geographic base internationally, but plans have probably been put on hold in the current market. Ultimately, the long-term stated goal is to generate 50% of revenues outside of the UAE – but we see limited expansion in the near term.

The group has land tracks in Egypt and Morocco, but these are currently held off balance sheet until planning is finalised and the transfer of land has been fully affected. There has been talk of a Saudi expansion and regardless of timing we agree that the international focus should concentrate on regions with high levels of local populations.

Completed projects

Sorouh has completed four residential developments at Oyoun Village, Khaidiya Village and the first phase of Sas Al Nakhl. Phase 2 is due for completion in 2009. These were not made available for sale and form the bulk of the investment portfolio, which we estimate will generate c AED 80m once Sas Al Nakhl phase 2 starts generating income.

Figure 61: Completed projects

Development	Type	Location	Area (sqm)	Number of units	Average rent per unit (AED)	Annual gross rent (AEDm	Average Occupancy (%)
Al Oyoun Village*	Resi	Al Ain	85,743	150	71,174	9.9	90
Sas Al Nakhl (phase 1)	Resi	Abu Dhabi	50,193	104	150,355	13.96	90
Khalidiya Village	Resi	Abu Dhabi	53,000	150	197,418	25.74	90
Sas Al Nakhl (phase 2)	Resi	Abu Dhabi	358,000	454	170,000	29.61	n/a
Totals			546,936	858	147,237	79.21	n/a

*Source: Company data, Nomura estimates *Nomura estimates*

Work in progress

Sorouh's developments form integral components for the long term urban development of Abu Dhabi and are closely linked to the Urban Planning Council (UPC) that intends to deliver 70,000 units as part of its 2030 plan. Sorouh owns land at strategic locations throughout Abu Dhabi upon which it acts as the 'master developer' in developing the master plans for the project. Apart from residential, these projects include the development of offices, retail, leisure, hospitals and school accommodation and play a critical role in the development of the community.

We summarise the key projects in the table below.

Figure 62: Current development schedule

Development	Type	Land Area (or BUA)) (000sqm)	Development Start	Development Finish	Development spend	Sales impact	Profit Impact	Company est. project value (AEDmn)
Shams Abu Dhabi	Master planned	1743.7	pre-Jan-07	Dec-10	2006-2009	2006-2008	2006-2011	9,400
Saraya	Master planned	131.6	Jan-08	Jan-11	2007-2009	2007	2007-2009	1,600
Al Ghadeer	Master planned	3000.0	Jun-08	Dec-20	2008-2020	2008-2016	2011-2025	23,000
Al Mashtal	Master planned	488.4	Jan-08	Jun-10	2008-2010	2008-2012	2010-2014	10,000
Golf Gardens 1	Master planned	341.7	pre-Jan-07	Dec-08	2006-2008	2006-2008	2008-2009	1,400
Golf Gardens 2	Master planned	123.5	Jan-08	Dec-10	2008-2010	Rental	2010 onwards	2,700
Sas Al Nakhl Village 2	Master planned	412.0	pre-Jan-07	Mar-09	2006-2008	Rental	2009 onwards	305
Danat Abu Dhabi	Single tower	4.4	Mar-08	Dec-10	2007-2010	2008-2012	2010-2014	413
Tala Tower	Single tower	n/a	pre-Jan-07	Jun-09	2006-2009	2006-2008	2009	516
Sky Tower	Single tower	18.1	pre-Jan-07	Jun-10	2007-2009	2006-2009	2009-2010	2,100
Sun Tower	Single tower	23.6	pre-Jan-07	Jul-10	2007-2009	2007-2009	2009-2010	1,200
Nagfa Mall	Single development	23.5	Jan-08	Sep-10	2008-2010	Rental	2012 onwards	650
Nagfa Hotel	Single development	155.6	Jan-08	Sep-10	2008-2011	Rental	2013 onwards	650
Gate District	Single development	112.3	Sep-08	Sep-11	2008-2011	2008-2009	2009-2011	8,500
Marina Towers	Single development	403.0	Jan-09	Dec-13	2008-2012	2008-2010	2010-2012	5,600
Abu Dhabi Aviation	Single development	112.5	pre-Jan-07	Mar-10	2006-2009	Rental	2009 onwards	361
		7,094						68,395
Average developed value psm		9,569						
Lulu		5,795	2009	2016				n/a
Total land under development		12,889						

Source: Company data, Nomura research

We estimate average construction yields in the low double digits, providing an average 25% margin and average land development costs of c. AED 800psf.

Latent value … There is considerable value in the development programme if it can be taken to completion. We estimate that the programme will cost c. AED 50bn (including interest and Sukuk profit distributions) and generate an NPV of c. AED 10bn (AED 4.0 p/share) over the course of the development lifecycle.

… with risks Our NPV estimate, however, is sensitive to a number of core variables, including cost of funding, construction costs, timing and receipt and sales progression and the potential for future default on sales, all of which tend to work in the same direction. We acknowledge that there are a number of moving parts here. We calculate that every 5% movement in underlying sales price represents +/- AED 0.5bn to the current NPV.

Stressed out We stress test our development model adopting the following scenario: we take our sales default assumption from 5% to 10%, increase interest rates and cost of capital by 200bps respectively, we postpone developments that have not yet started by two years and lastly, reduce sales prices by a further 10%. Combined, this decreases the NPV by around 60% to AED 3.5bn, which after deducting the attached debt and associated working capital gets us to a 'distressed' NPV valuation of c. AED 1.4 per share. This is about 50% of the current price.

Waiting in the wings

Al Ghadeer is part of the Seih Sederah land plot (located near the Abu-Dhabi/Dubai border). This will be a mixed-use development expected to be completed in 2013 and was valued by Sorouh at an estimated AED 14bn. As there will be significant infrastructure costs, units will be targeted at the mid to high end (to make the developments viable). Unit sales have commenced, but end users have been given a six month installment holiday, and the remaining units will be held back until market conditions improve, according to management.

Taking the revenue risk

Lulu Island covers 5.8m sqm located opposite the Abu Dhabi Corniche. The development will be low rise and mixed use, and is expected to house between 45,000 and 50,000 residents. The expected completion was 2016, but this may slip by a few years. This project alone, currently in the planning and massing stage with the UPC, is expected to have a project cost of AED 22bn. The company is still negotiating in tandem with Mubadala (its 40% partner) with the UPC and the company expects mobilisation on the infrastructure possibly before the end of the year. There is no land sale allocation for Lulu in 2009, with the company stating that it does not feel the need to mitigate revenue risk in 2009 by accelerating land sales.

Joint ventures and associates

Sorouh has entered into three joint ventures and made seven additional investments. These are in related industries or form part of the 'value chain' i.e. suppliers, contractors, real estate agencies, and finance houses (perhaps the most critical).

Developing vertical channel

In May 2008, Sorouh took 60% in Pivot Engineering. This was in an environment where contractors were dictating terms and restricting provision of services. At the other end of the food chain the company has an interest in Aseel, which provides Islamic financing and has recently entered into an agreement with RAKBank to establish a conventional financing route into its key developments on Shams. More recently, Sorouh was involved in the creation of Abu Dhabi Finance (with Aldar) with a 20% stake.

Figure 63: Sorouh JVs and investments

JV, investment or associate	Type	Stake held	Partner	Year	Focus	Comment
The Gate Towers, Shams District	JV	60%	Tameer	2006	Development	Tameer jointly responsible for construction costs etc, profit share
Abu Dhabi Business Park	JV	51%	Goodman	2008	Development	To develop industrial and business parks in the UAE
Aseel	Ass	20%	Various	2006	Finance	Provision of Sharia compliant mortgages and corporate loans
Al Maabar	Ass	20%	Various	2007	International	Int. development in conjunction with local partners, AED25bn pipeline
Green Emirates Properties	Ass	20%	Various	2007	Realty	Realty and real estate management, advisory, development in region
Bunya LLC	Ass	33%	Various	2006	Infrastructure	Management of infrastructure and liaison with local authorities
Real MAROC Fund	Stake	9%	Real Maroc	n/a	Housing	Provision of affordable housing in Morocco, 22,400 units for 2009
S&T Cool District Cooling	JV	50%	Tabreed	2008	Utilities	AED 700m district cooling plant for Shams island
Pivot Engineering	Stake	60%	Pivot	2008	Contracting	Access to project management and contracting skills
LLJ Property	Stake	40%	LLJ	2008	Realty	Property management, marketing, leasing etc., exclusivity on two Shams projects

Source: Company data, Nomura research

Deyaar Development

Stock rating	REDUCE
Price (AED), 13 Feb	0.5
Price target (AED)	0.64
Upside potential, %	22
Market cap, (AEDbn)	2.8

Valuation	2009F	2010F
EPS (adj.)	0.15	0.17
P/E	3.5	3.1
Div. Yield, %	0.0	0.0
P/Book, x	0.4	0.3

Performance, %	-12m	-3m
Absolute	-79	-39
vs. sector	0	2

Sector DFM Real Estate
Source: Reuters, Nomura research

We initiate coverage on Deyaar with a Reduce rating and a 12-month price target of AED 0.64. This represents a potential upside of 22% from current levels. At our target price, DEYAAR is trading at a 0.50x discount to NAV.

Corporate profile

Deyaar Development (Deyaar) was established in 2002 as the real estate arm of Dubai Islamic Bank and is a Dubai-based real estate development company with currently limited international exposure. It floated in 2007 and currently all operations are sharia-compliant. Deyaar has recently refined its 2009 strategy and announced some projects that are yet to be built (or in initial stages of construction) and may be considered for consolidation. We understand that some customers owning units in similar projects in comparable areas may be offered the option to transfer their ownership to projects that will be completed on a fast track basis. This consolidation would allow some projects to be phased out, which would reduce the planned development portfolio value of c. AED 26bn. The projects identified represent c. 25% of Deyaar's portfolio but may not actually represent a 25% contraction in the portfolio development. There has also been a recent management change.

Figure 64: Brief history and key events

2002	Established under the name Global Real Estate Development.
2004	Rebranded as Deyaar Development
Jan 2006	Acquires Omega Engineering , Eltro mechanical to expand facilities management capability
May 2007	Deyaar floats and listed on DFM in September, offers 55%,14x oversubscribed
Apr 2008	Then CEO Mr Zack Shahin resigns amid fraud allegations
Aug2008	Mr Markus Giebel appointed CEO, ex Vedera capital

Source: Company data, Nomura research

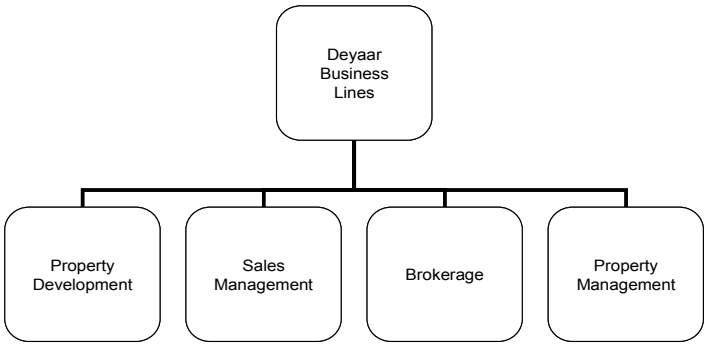
Business lines

Deyaar has four key business lines contributing to top line revenues. The most significant is the property development business; however, it also engages in property management (with over 16,000 units under management). There are some international projects in Lebanon, Kazakhstan and Turkey, but development roll-outs in the UAE will take centre stage. Deyaar has just announced plans to create a strategic unit seeking distressed sales.

Revenue business mix (%)	3q08
Property related activities	98
Other	2
Operations	
Domestic	94
International	6

Source: Company data, Nomura research

Figure 65: Deyaar Business Lines



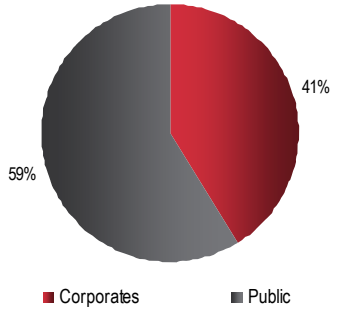
Source: Company data, Nomura research

Shareholder structure

FO restrictions likely to stay

Deyaar has a current free float of c59%. The largest shareholder is the Dubai Islamic Bank that holds approximately 41%. The company is Sharia compliant and does not currently allow Non-GCC foreign ownership. GCC ownership is limited to 49%, of which there is currently just 2%. Opening the register to foreign ownership could act as a demand catalyst, but we think that this is unlikely in the near term.

Figure 66: Shareholder structure



Source: DFM, Nomura research

Key senior board and operating personnel

H.E. Nasser Bin Hassen Al-Shaikh (Chairman) also serves on the board of Amlak Finance, is the vice chairman and CEO of the National Bonds Corporation and also has senior involvement in Dubai's Department of Finance. He is currently a board member of Dubai Real Estate Corporation (Government of Dubai), Dubai Islamic Bank and Dubai Aerospace Enterprise.

Mr Markus Giebel (CEO) was appointed in August 2008, having previously served as CEO and member of the board of directors at Vedera Capital, a UAE-based investment firm specialising in real estate and financial services.

Mr S. Krishnamurthy (CFO) was appointed in October 2008, having previously served as an SVP in Dubai Investment Group. Mr Krishnamurthy was previously CFO at IKEA (South Asia) and Jumbo Electronics. He has 18 years of professional experience.

Valuation

We derive a target price of AED 0.64 based on a number of company specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate issues, concentration and development risk. In addition, we also apply a cyclical discount of 45% based on Deyaar's exposure to the Dubai real estate market, where we remain cautious on near-term prospects.

The stock currently trades at a P/NAV of 0.50x relative to our normalised sector average of 0.50x. At our target price the stock trades a 0.54x discount to our inferred NAV.

Figure 67: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	2	Gearing at 8%
Strategy	0	
Growth prospects (PNPV/PV)	3	PNPV/EV at 1.1x
Corporate access, transparency, disclosure	1	
Concentration risk	-3	Dubai based
Development risk	-2	
Total Corporate adjustment	1	Reflecting our view on the above
Cyclical adjustment	-45	
Total discount	-44	

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 1.17 by a total of 44%. Added to this we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our price target, but we note that there are significant un-booked land values that we exclude.

Figure 68: Target price calculation

Adjusted Corporate Value (m)	Deyaar
Unadjusted book value (ex minorities)	7,711
less Balance sheet adjustments	(969)
Adjusted NAV	6,742
less Cyclical adjustment	(3,034)
+ / - Capitalised admin costs	(101)
+ / - Corporate adjustment	67
Adjusted corporate value	3,674
per share:	
NOSH (m)	5,778
Adjusted NAV +12m	1.17
less Cyclical adjustment	(0.53)
+ / - Capitalised admin costs	(0.02)
+ / - Corporate adjustment	0.01
Calculated target price	0.64

Source: Nomura research

Business model and strategy

Private developer

Deyaar is not a true master developer (but is moving towards large scale development) and has not benefitted from free government land. As a private developer, Deyaar has not typically entertained large, complex, or multi-use schemes, but is starting to do so now. Instead Deyaar has focused on purchasing serviced single land plots within wider master plans (Emaar, Dubai Properties, Nakheel), lowering the infrastructure risk and shortening the typical development lifespan. These are benefits but the disadvantage is below average margins with no free land options in the equation.

Seven developments delivered in 2009

Deyaar has positioned itself as one of the premier pre-launch developers (to satisfy master developers) and has an aggressive marketing strategy (to encourage customers) with perhaps the largest advertising spend in the listed sector. Incubated developments are now either in the process of being handed over, or nearing completion, so will clear some of

the balance sheet to allow new projects if the company chooses, but there is a strategic hold on unsold developments, which is understandable in this market. We understand that seven developments will be delivered in 2009. Those developments that remain unsold will now be delayed

Recurring cash is cheap source of financing

The business model is predicated on delivering mid-level affordable residential units largely based in new development areas in Dubai. The strategy is kept simple by producing similar style and sized developments that introduces a form of scale efficiency that would not otherwise be available to smaller developers. The operating business lines probably provide enough in the way of recurring profits to pay the corporate overheads with little capital input, so a small, but cheaper, source of corporate financing. In addition, Deyaar intends to expand its rental portfolio through some of its developments, adding about 30% to the bottom line recurring income stream. Adding a 'distressed asset fund' with minimal seed capital could add additional management fees, which should further offset corporate overhead costs.

Increasing international footprint

The company has indicated that it wants to increase its international footprint, which is more likely through third-party investment via local JVs. We think that in the near future the company will be targeting Saudi Arabia and Turkey. Currently, the international reach is limited (approximately 10% of revenues) and the aim is to move the number to around 40% international by the end of 2011, although any move into Saudi Arabia could increase this amount. Deyaar is currently in exploratory negotiations with a local Saudi Arabian firm to develop a US$5bn master community in Jeddah, which may crystallise in 2Q09. Management also states that it is 'looking at joint ventures in Turkey and many countries in the Middle East and North Africa.

Distressed sales

As part of the full-year preliminary results announcement, CEO Markus Giebel announced that Deyaar would look to set up a strategic unit to concentrate on the identification of distressed assets. The assets will be placed in a fund with capital input from both Deyaar and third party investors.

Risks

Like all UAE real estate companies, Deyaar is exposed to a number of industry-specific, regulatory, geopolitical, financial management and liquidity risks.

Lower 'revenue rake' key risk

There is concentration risk in the development programme, which is highly focused on Dubai and a number of projects are due for delivery in 2009. In the current market, we think that the final installment 'revenue rake' is most at risk. This culminates with the inability of the final purchaser to meet the final installment, particularly where deposits do not meet tighter banking lending restrictions and banks will not fund them further.

Mitigating factors

The company has stated that it is actively trying to mitigate these risks through a series of structured solutions. These include, but are not restricted to: risk profiling of its purchaser database, identifying 'at risk' clusters, actively seeking discussions with purchasers in conjunction with easing terms and/or providing bridge financing that satisfies bank lending covenants.

Cash flow and financing

Domestic operations funded

As at the year end, the company reports equity gearing of 8% and that they have secured funds for its current local projects. However, it states that it may wish to tap the market to finance its overseas expansion and strategic planning division (for the funding of distressed asset purchases).

Access to credit reasonably secure

Deyaar has perhaps the securest line of credit, owing to its relationship with Dubai Islamic Bank (with the possible exception of Union Properties (UP) and Emirates Bank, but UP has significantly higher gearing). The cash burn has been running at c. AED 1bn per annum, which has mostly been funded by the AED 3.2bn capital raise in July 2007 and has also allowed the repayment of c. AED 700m in expiring Islamic financing obligations.

Cash collection may be impaired

Contractual commitments were running at AED 2.6bn (3Q08) and, while there is not enough information in the presented accounts, we see a shortfall in the receivables and cash combined to cover all commitments. This is partially a function of timing, construction progress (i.e. when do account payables become accounts receivables), installment schedules etc. We estimate that forward sales in 2009 have probably generated around AED3bn and, if we work on the assumption of an average 40/60 split (installments versus final bullet payment), then AED1.8bn of cash could come in, but this is probably subject to a 10% impairment, in our view.

The suspension of (as yet) unsold developments will reduce the future revenues, but at the same time keep cash locked in the business. In 2008, the company had mooted the idea of raising an AED 5bn Sukuk, but this is off the table for the time being (as is a convertible issue). However, the CEO has suggested a range of alternative financing options (JVs, fund structures, other debt instruments etc). Although this might indicate a cash shortfall, we see this more as an attempt to exploit current market conditions and compared with most in the sector, we believe the company has more flexibility in the balance sheet.

2008 results day

Deyaar reported its full year results on 25 January, with the board approving the annual numbers on 21 January. As at 12 February, accounts were not lodged with the DFM and are awaiting final audit approval.

Not enough disclosure

Deyaar reported record growth with full-year revenues of AED 2.98bn up 136% on the previous year and profits of AED 1.1bn, up 104% on the previous year, although we find it hard to reconcile the annual results relative to the quarterly results. There was not enough information in the press release to make any meaningful comment. At the very least we think there should have been a consolidated revenue account that split revenues into sales, interest and revaluations. There was also no balance sheet data apart from gearing of 8%.

A portfolio revaluation was undertaken, but the net increase/decrease was not disclosed.

Nine launches in 2008

Driving results were the launch of nine separate projects and under the percentage complete method, Deyaar can start to book revenues once the development is beyond the preliminary stage (and the buyer is committed).

We have adjusted our earnings profile for Deyaar based on the FY08 headline numbers, but will not roll over our numbers until full accounts have been lodged where we will make additional comment.

Figure 69: Deyaar, 2008 results summary

AED (mn)	2007	2008	%	Comment
Full year revenues	1,259	2,973	136	Headline numbers only, nine new project launches
Full year profits	540	1,104	104	No visibility on 'below the line' or non-recurring items
Net profit margin	43%	37%	n/a	
Q408 revenues	617	676	10	As above, momentum slowing into the quarter?
Q408 profits	216	343	59	

Source: Company data, Nomura research

Earnings estimates and financials

Deyaar uses the percentage complete method to recognise income.

We assume that Deyaar can maintain the bulk of the revenues currently booked with the company working hard to protect revenues, although we assume that around 10% of the properties may come back to the company, depending where they are relative to the collection profile.

We also factor in an average further 15% decline in prices in 2009, which is likely to affect releases. The company has already stated that a number of developments will now not be released, which will dampen the bottom line. This will possibly result in an impairment of property, but does not affect our adjusted EPS calculations.

Earnings peak in 2009 for now

Based on our sales assumption and delivery profile, we still see revenue growth from this year to next of c35%, but this is dependent on the roll-out of new projects that are now subject to change. We have therefore made some adjustments to our roll-out schedule on those developments that were to start in 2009, but will probably now be delayed. Our assumptions also take into account lagging sales momentum but mitigated by falling construction costs of c15% in 2009, which is carried through our forecasting period.

As a result of the delayed delivery schedule, the company will be able to extend the current development programme (by reconstituting warehoused development plans), so we see the peak in revenue sales in 2010, largely generated through the momentum of 2007 and 2008, before revenues start to tail off.

Finance charges

We assume a finance rate of 7.5% on incremental borrowings, which is our base assumption for the sector.

Dividend policy

Dividend policy is not communicated by management and determined by the board post release of FY results in the March AGM. We assume no dividend for 2008.

Our estimates versus consensus

Our estimates are about 70% lower than consensus estimates

Figure 70: Deyaar, financial summary and estimates

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Gross revenues	832	2,987	4,129	4,235	4,021	3,291
Cost of goods sold	-504	-2,253	-3,201	-3,244	-2,979	-2,433
Gross Profit	**329**	**734**	**928**	**992**	**1,042**	**858**
S,G and A	-113	-100	-94	-95	-96	-96
Depreciation	-3	-3	-4	-32	-60	-59
Other net operating income	0	0	0	0	0	0
Core EBIT	**212**	**631**	**830**	**864**	**887**	**702**
Net financing income (costs)	32	20	37	115	150	182
Associates	0	0	0	0	0	0
Property revaluations	0	0	0	0	0	0
Mtm gains (losses)	4	0	0	0	0	0
Other non-operating income	169	0	0	0	0	0
PBT	**418**	**651**	**866**	**980**	**1,038**	**884**
Taxes	-1	-2	-3	-3	-3	-3
Exceptional / unusual items	0	0	0	0	0	0
PAT	**416**	**649**	**864**	**977**	**1,034**	**881**
Minority interests	-6	-6	-7	-7	-8	-9
Attributable to equity holders	**411**	**643**	**857**	**970**	**1,026**	**872**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Development / Inv. properties	5,141	4,934	4,818	4,917	5,420	5,696
PPE, Land held for sale	27	38	49	59	68	76
Total property assets	**5,167**	**4,973**	**4,867**	**4,976**	**5,488**	**5,772**
Receivables	1,448	2,227	1,920	2,818	2,862	2,325
Associates and JVs	540	1,040	1,440	1,740	2,040	2,340
Other assets	969	969	969	969	969	969
Cash and cash equivalents	1,250	750	3,250	5,179	6,406	7,259
Total assets	**9,374**	**9,959**	**12,445**	**15,683**	**17,765**	**18,665**
Total debt	418	1,906	2,623	4,789	5,770	6,406
Payables & Contract cost accruals	2,843	1,200	2,107	2,201	2,269	1,651
Other liabilities	5	5	5	5	5	5
Total Liabilities	**3,266**	**3,111**	**4,734**	**6,994**	**8,043**	**8,061**
Share capital	5,687	5,778	5,778	5,778	5,778	5,778
Reserves and retained surpluses	411	1,054	1,911	2,880	3,907	4,779
Minority interests	10	16	23	30	38	47
Total equity	**6,108**	**6,848**	**7,711**	**8,688**	**9,723**	**10,604**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	310	651	866	980	1,038	884
Depreciation and amortisation	3	3	4	32	60	59
Change in provisions / non-cash	2	0	0	0	0	0
Working capital / other	-1,489	-2,465	1,128	-944	-176	-312
Cash flow from operations (a)	**-1,174**	**-1,811**	**1,999**	**68**	**921**	**631**
(inc) decrease in PPE	-12	232	185	-4	-375	-114
(inc) decrease in investments	-485	-500	-400	-300	-300	-300
Change in other investing activity	24	0	0	0	0	0
Cash flow from investing (b)	**-474**	**-268**	**-215**	**-304**	**-675**	**-414**
Free cash flow (a+b)	-1,648	-2,079	1,784	-237	246	217
Equity raised (repaid)	3,178	91	0	0	0	0
Debt raised (repaid)	-845	1,488	716	2,166	981	636
Dividends	0	0	0	0	0	0
Others	107	0	0	0	0	0
Cash flow from financing (c)	**2,440**	**1,579**	**716**	**2,166**	**981**	**636**
Net change in cash (a+b+c)	**792**	**-500**	**2,500**	**1,930**	**1,227**	**853**
Cash and cash equiv	**1,250**	**750**	**3,250**	**5,179**	**6,406**	**7,259**

Key data

Year-end 31 Dec (AED unless stated	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EPS	0.07	0.11	0.15	0.17	0.18	0.15
DPS	0.00	0.00	0.00	0.00	0.00	0.00
BVPS	1.07	1.20	1.36	1.53	1.71	1.86
BVPS (adjusted)	0.90	1.03	1.19	1.36	1.54	1.69
Gross profit margin (%)	39.5	24.6	22.5	23.4	25.9	26.1
Core EBIT margin (%)	25.5	21.1	20.1	20.4	22.1	21.3
ROE (%)	10.8	10.0	11.9	12.0	11.3	8.7
Net debt / Equity (%)	-14	17	-8	-4	-7	-8
LTV (%)	-16	23	-13	-8	-12	-15

Valuation

Year-end 31 Dec	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
P/E (x)	7.3	4.7	3.5	3.1	2.9	3.4
P/BVPS (x)	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**
Gross Property Assets / EV (X)	3.8	2.2	3.9	4.1	4.9	5.4
EV / EBITDA (x)	9.9	6.5	2.8	2.9	2.5	2.8
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company data, Nomura estimates

Other company information

Management

A new CEO was appointed in August 2008.

Mr Geibal has actively engaged with the media over the last three months and has been relatively candid on his views of the real estate market through his own column. We think this media strategy has worked to deflect the negative fallout of some elements of the company's previous strategy.

We think the company needs to work hard to realise the full value of that portion of the development programme that is being handed over this year and next. The Dubai residential market will be difficult over 2009 and so we look to management to successfully negotiate these.

We have seen enough evidence of the current management to believe that they are at least aware of, and responsive to, the challenges ahead.

A potential catalyst

Breaking into Saudi Arabia will likely be a near-term catalyst. The company expects to make an announcement in the near term regarding the US$5bn JV to build a master-plan city in Jeddah. Although we have yet to be convinced of 'industrial city' concepts, the fundamentals in Saudi Arabia are stronger than in the UAE, in our view. Assuming a 50/50 JV, the deal would represent around a 35% increase to the current development pipeline, but potentially more when we get clarity on which developments are being held back from the market, deferred at the construction stage or cancelled outright.

Development concentrated in Dubai

We estimate the group has plans to develop (over a cumulative period of 10 years) approximately 22m sqft of net sellable area (NSA) and has two developments underway specifically earmarked for rental in Barsha and DIFC for a further estimated 0.8m sqft. The significant portion of NSA is associated with the Waterfront development (25%) and IMPZ (13%) and in Business Bay (30%).

We calculate average gross profit margins of c 25% currently, but the pressure is probably on the downside if we factor in potential sales price decreases versus construction cost decreases.

Both have deflated and probably kept in line with each other, but the company will now require additional financing and the possibility of defaults (or bridge financing) may weigh slightly on margins.

Figure 71: Deyaar, development summary

Location	Time Horizon	Est NSA (sqft m)	Est. Cost (AEDm)	Est. Sales (AEDm)	Est. NPV (AEDm)	Dev by cost (%)	Dev by NPV (%)
Jumeirah Lake Towers	2006-2009	0.60	600	873	208	3	2
Business Bay	2007-2011	6.35	7,138	11,534	3,516	31	42
Dubai Silicon Oasis	2008-2012	1.62	1,944	3,387	1,065	9	13
TECOM	2006-2011	0.35	350	509	142	2	2
Deyaar Park (Jebel Ali)	2008-2011	2.00	2,000	3,091	855	9	10
IMPZ, Dubaitech	2008-2013	3.55	3,002	4,292	825	13	10
Waterfront	2008-2016	5.60	5,600	7,644	1,136	25	13
Int./ other / rental	2007-2011	2.28	2,207	1,761	718	10	8
	NOSH	22.4	22,841	33,090	8,465	100	100
Per share	5,778		3.95	5.73	1.47		

Source: Company data, Nomura research

NPV and sensitivity

Based on our assumptions, we calculate an NPV value on the development programme of AED 4.2bn, or AED 0.74ps, taking into account project delays that have been announced. We adjust our base case to account for higher leverage, development delays and sales slippage (depending on the size of the scheme), increase the WACC by 200bps to allow for increased borrowing costs and lower prices on average 20%. Lastly, we scale up construction costs by 5%, although we think this is unlikely.

The net effect sees our projected development NPV drop by a factor of two to around AED 3.2bn (AED 0.56ps). This is almost what the market is pricing Deyaar at the moment.

Union Properties

Stock rating	REDUCE
Price (AED), 13 Feb	0.65
Price target (AED)	0.79
Upside potential, %	22
Market cap, (AEDbn)	2.0

Valuation	2009F	2010F
EPS (adj.)	0.36	0.32
P/E	1.8	2.0
Div. Yield, %	N/A	N/A
P/Book, x	0.3	0.3

Performance, %	-12m	-3m
Absolute	-86	-56
vs. sector	-7	-16

Sector DFM Real Estate
Source: Reuters, Nomura research

We initiate coverage on Union Properties with a REDUCE rating and a 12-month price target of AED 0.79. This represents a potential upside of 22% from current levels. At our target price Union Properties is trading at a 0.32x discount to NAV.

Corporate profile

Union Properties (as Union Property Private) was formed in 1987 and floated as a public company in 1993 as the first property developer in the UAE. While the main activities relate to investment property and development with a pipeline of c. AED 9bn (with a reported sales value of AED 12.5bn) and landbank of 55m sqft, Union Properties has diversified its income stream into facilities and property management services.

Figure 72: Brief history and key events

1987	UPP is formed to manage and own properties previously owned by Union Bank
1993	Company floated and rebranded as Union Properties
1996	Acquires controlling interest in Thermo, an electro mechanical company
2000	Launches new corporate identity and rebrands itself
2001	Formed Properties Investment , Regus management agreement formed
2002	EDARA LLC (project management services) and ServeU LLC (facilities management) created
Aug 2005	Allows 15% foreign ownership
Jun 2007	Concludes AED 2.75bn 3yr loan facility
Jan 2009	Approval sought for AED2.5bn convertible bond issue

Source: Company data, Nomura research

Business lines

Revenue business mix (%)	3q08
Construction	83
Prop. management / sales	12
Hospitality / other	5

Source: Company data, Nomura research

Union Properties (UP) activities can be broadly summarised into four core operations: property investment, management and sales, property development and contracting services, and hospitality. Direct property activities contribute 95% of the revenues (construction being 85%), while hospitality services and others contribute just 5%. The company complements its property investment, development and management business units with project management, interior design and fitouts, district cooling, facilities management and hospitality. In addition, UP has a significant instant office business (through Regus).

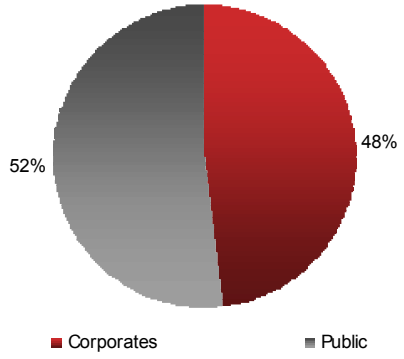
Union Properties also obtains a significant contribution below the operating line from its strategic JV with Dubai Investments and other associated subsidiary investments. Edara is the project management arm of the business, ServeU the facilities management arm, Thermo is UP's mechanical, electrical and plumbing contractor and Emirates District Cooling Company (Emicool) is a joint venture designed to build and install district cooling plants.

The investment property portfolio is valued at AED 2.8bn, which is a combination of a management desk top valuation and some properties valued independently by Cluttons. As at 3Q08, investment properties were revalued upwards by AED 457m, but we would be surprised if there were no future impairment charges.

Shareholder structure

Union has a current free float of c52%, of which Ghobash Trading and Investment owns 5%. The largest shareholders are Emirates Bank (48%). The foreign ownership limit is 15% against a current level of 7%.

Figure 73: Shareholder structure



Source: DFM, Nomura research

Key senior personnel

Mr Anis Al Jallaf (Chairman) is also the current Chairman of Dubai Investments, Fanar Group and Tamra. He is a board member of Emirates Banks Association and Arabtec Construction, a member of the Dubai Council for Economic Affairs (DCEA) and Vice Chairman of Al Jallaf Investments.

Mr Simon E. Azzam (CEO) joined Union Properties in 1987 and took charge as Chief Executive Officer in 2001. He is an Associate Member of the Chartered Institute of Buildings.

Mr Elias Adas (Chief Construction Officer) joined Union Properties in 1996 with 25 years of construction industry experience in both the Gulf region and North America. He is currently a member of PMI.

Ms Lesley Sayle (Chief Property Officer) joined Union Properties in 1992 and manages the company's entire portfolio. This includes the sale and rental properties. Ms Sayle has extensive real estate experience in the UK and Spain and is also a board member of Properties Investments.

Mr Zaid Ghoul (CFO) joined in 2006 with over 17 years experience as a CFA and has previously served with Arthur Anderson (then Ernst and Young) and was the Director for Corporate Finance and Lead Advisory Practice in the Middle East.

Valuation

We derive a target price of AED 0.79 based on a number of company-specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate

issues, concentration and development risk. In addition, we also apply a cyclical discount of 45% based on Union Properties' exposure to the Dubai real estate market, where we remain cautious on near-term prospects.

The stock currently trades at a P/NAV of 0.32x relative to our normalised sector average of 0.49x. At our target price the stock trades a 0.35x discount to our year-end NAV estimate.

Figure 74: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	-3	Net debt equity gearing of 94%
Strategy	1	
Growth prospects (PNPV/PV)	1	PNPV/EV at 0.5x
Corporate access, transparency, disclosure	-3	
Concentration risk	-3	Dubai based
Development risk	-2	
Total Corporate adjustment	-13	Reflecting our view on the above
Cyclical adjustment	–45	
NAV discount	-54	

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 2.25 by a total of 54%. Added to this we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our price target, but we note that there is significant un-booked land values that we exclude.

Figure 75: Target price calculation

Adjusted Corporate Value (m)	Union Props
Unadjusted book value (ex minorities)	6,939
less Balance sheet adjustments	(41)
Adjusted NAV	6,898
less Cyclical adjustment	(3,104)
+ / - Capitalised admin costs	(748)
+ / - Corporate adjustment	(621)
Adjusted corporate value	2,425
per share:	
NOSH (m)	3,060
Adjusted NAV +12m	2.25
less Cyclical adjustment	(1.01)
+ / - Capitalised admin costs	(0.24)
+ / - Corporate adjustment	(0.20)
Calculated target price	0.79

Source: Nomura research

Business model and strategy

Evolution

Union Properties' business strategy has evolved over the past few years following a strategic review as a result of declining margins in the contracting business. The property

investment model has been streamlined and a series of acquisitions of related businesses (or interests) have allowed the company to become more vertically integrated.

More emphasis on recurring income

Almost all of its property or related holdings are concentrated in Dubai. Recently, the company entered into a partnership with the Formula One brand to 'internationalise' its F1-themed parks, and therefore leverage the relationship to gain international exposure. The business model is more highly geared to recurring income streams than most in the UAE real estate sector, but a lot of the current exposure remains largely with the construction or contracting arena. We do, however, expect this to change, with the company likely to inventory unsold development space for the rental market and this should increase recurring income and subsequently decrease the risk profile.

Additional sources of income

Union Properties has entered into agreements with a number of third party contractors that include (but are not restricted to) Regus – for the provision of temporary offices space and work stations and Marriot Hotels, which provide an alternate source of recurring income streams.

Where to now?

The current development programme tapers off through 2009 to 2012 when most are currently scheduled to finish (which introduces an element of reinvestment risk). With sales in the market slowing rapidly, preferential payment plans and discounted terms are being offered to clear residual stock, and whatever is left will likely be rolled into the investment portfolio. In addition, discounts on sold stock are being offered for early payments. The company targets a mixture of high and mid level affordability units, which may have an insulating effect from current market conditions.

Collecting on cash commitments

Union Properties was an early cycle developer and is now in the process of collecting cash commitments as deliveries start to take place. We understand that most sales occurred early in the development life-cycle (at lower than current market prices), which lessons the risk of default (and making bank financing easier). We understand that the company is now offering discounts to customers for early payment, which we see as a direct attempt to lock in buyers and extract cash earlier. Early indications are that banks will lend on this scheme (it essentially lowers the LTV ratio for the bank) and should assist in collecting outstanding cash commitments, but this squeezes the development margins.

Risks

Like all UAE real estate companies, Union Properties is exposed to a number of industry specific, regulatory, geopolitical, financial management and liquidity risks. In addition, we consider historical share price volatility as a possible indicator of future stock-specific risk.

With regard to Union Properties, we would highlight in particular the concentration risk of developments in Dubai where prices appear to be falling, and a relatively high level of exposure to units that remain unsold. These will now be injected into the investment portfolio, which may increases the need for medium term funding. Refinancing is therefore a key risk that is being mitigated by the recent AED 2.5bn non-convertible bond sale to 'strategic investors'.

Cash flow and financing

Equity gearing 90%

Current equity gearing stands at c. 90%, the highest in our coverage sector. Capex is annualising at around AED 8bn for 2008, but we forecast it to be significantly lower in 2009 as development capex runs out (delivery year for a substantial portion of the development programme).

Cash receipts will increase once developments are handed over, with some discounted by 10% for early-bird payments. We understand that banks are happy to lend on these terms given that the incentive lowers the bank's risk, but time will tell. In the meantime, this reduces the developer's profit margins.

Operations don't cover capex

We calculate that AED 3.3bn of debt is due to be refinanced by the end of 2009 (less any 4Q08 repayments. Based on the 3Q08 results (with year end results not yet published) cash outflows on investment activities outstripped cash inflows from operations by AED 2.3bn. This was funded by both a decrease in available cash and increase in term loans.

Bond issue

On 22 January, the company held an EGM to approve the issuance of up to AED 2.5bn of non-convertible bonds to strategic investors, but the terms are yet to be determined. We assume that the proceeds will be used to refinance current facilities.

Refinancing due

In 2007, the company arranged facilities amounting to AED 3.7bn (drawn to AED 1.6 bn at year-end). The facilities are secured over property titles, and in the case of project financing, the receivables due. The larger AED 2.7bn facility is also subject to a debt-equity covenant. Outstanding amounts on both facilities are due to be paid in quarterly installments (the AED 1bn facility from March 2009 with the AED 2.7bn facility from September 2009).

We regard the biggest potential near term risk as liquidity and the possibility of a forced merger (with Deyaar) has been reported in the press but so far denied by the company. (First reported *Zawya*, 13 October 2008).

2008 results day

As at the date of submission, Union Properties had not reported the 2008 full-year results. We will comment separately on these results once released.

Earnings estimates and financials

Union Properties recognises revenue on a completed contract method.

Union Properties is an early cycle developer and therefore the bulk of the revenues will start to hit the accounts in 2009 and 2010. In our modeling assumptions we have made some adjustments for the development delivery schedules (as we have for all of our coverage universe).

Delays impact near term revenues

The impact of delaying the handover of some developments (largely from 2009 to 2010) has smoothed our estimated earnings profile. If we were to assume that developments were handed over as scheduled, 2009 revenues could top AED 10bn, but we have now refined our estimates to AED 7.5bn.

The business remains low(er) margin, principally owing to land costs on developments and the higher percentage of investment properties currently held in the portfolio. We estimate that investment properties held for recurring rental could increase to c. AED 7bn by 2010 which could generate an extra AED 550m in recurring NOI (allowing for operating costs and vacancy).

In this market, it is increasingly difficult to estimate what will be sold and what will be warehoused. We currently assume AED 350m will be recurring income from investments, so the difference suggests that c. AED 2bn worth of property will be added above our current estimates. The net effect will lower sales revenues by this amount, but the company has a larger recurring base going forward, adding longevity and reducing the business model risk to a degree, in our opinion.

SGA

We break our SGA assumptions into two core components: the first is general admin costs that we inflate a nominal 2% p.a.; and the second is sales and marketing expenses. We make the assumption that 85bps of total sales are directed towards advertising and sales costs.

Capitalising interest

We assume marginal cost of financing at 7.5%. We assume that 80% of all interests costs are capitalised, hence the relatively low level of interest registered through the revenue statements. Again, if development properties held for sale are reclassified to investment properties and therefore debt financed, interest costs will increase proportionately once the building is completed.

Asset revaluations

The company keeps investment property assets at market value and the portfolio was independently valued as at 30 June 2008, which resulted in a fair value gain of AED 231m. Subsequently, management conducted a desk top valuation on additional properties (land plots and properties held for undetermined use) in the third quarter to book a further AED 225m. The total revaluation has been booked through the third quarter and will be revalued at year-end.

Stock dividend to continue

The company currently pays a stock dividend that was equivalent to 10%. We think that this will be repeated in the current year, but record dividends as nil as we do not see any economic transfers of benefit to shareholders from a stock dividend.

Operating cash flows

Operating cash flows should be positive from 2009 as projects are delivered, but this is dependent on the company managing to collect on its receivables by collecting the final installment.

Figure 76: Union Properties, financial summary and estimates

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Gross revenues	2,922	3,172	7,535	7,073	6,033	10,424
Cost of goods sold	-2,395	-2,722	-6,164	-5,800	-5,056	-8,425
Gross Profit	**527**	**450**	**1,372**	**1,273**	**976**	**1,999**
S,G and A	-115	-117	-127	-135	-143	-152
Depreciation	-8	-37	-43	-50	-56	-63
Other net operating income	0	0	0	0	0	0
Core EBIT	**405**	**296**	**1,201**	**1,089**	**777**	**1,784**
Net financing income (costs)	-66	-90	-136	-120	-116	-63
JVs	38	20	20	20	20	20
Property revaluations	308	453	-256	0	0	0
Profit on sale of property	1	0	0	0	0	0
Other non-operating income	-2	202	2	2	2	2
PBT	**684**	**883**	**832**	**991**	**683**	**1,743**
Taxes	0	0	0	0	0	0
Exceptional / unusual items	0	0	0	0	0	0
PAT	**684**	**883**	**832**	**991**	**683**	**1,743**
Minority interests	0	0	0	0	0	0
Attributable to equity holders	**684**	**883**	**832**	**991**	**683**	**1,743**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Investment properties	2,814	3,453	3,404	3,626	3,851	4,088
Development properties	3,993	10,046	10,131	10,139	11,003	8,501
PPE, Land held for sale	376	439	496	546	590	627
Total property assets	**7,183**	**13,939**	**14,031**	**14,311**	**15,444**	**13,217**
Receivables	3,264	3,814	2,260	2,204	2,575	2,265
Associates and JVs	222	332	442	552	662	772
Other assets	342	342	342	342	342	342
Cash and cash equivalents	88	88	88	88	88	1,588
Total assets	**11,098**	**18,514**	**17,163**	**17,496**	**19,111**	**18,184**
Total debt	3,379	10,613	9,035	8,063	8,314	6,900
Payables/Customer advances	2,402	1,704	1,101	1,418	2,100	846
Dividends payable	0	0	0	0	0	0
Other liabilities	93	91	89	86	84	82
Total Liabilities	**5,874**	**12,407**	**10,224**	**9,566**	**10,498**	**7,827**
Share capital	2,778	2,778	2,778	2,778	2,778	2,778
Reserves and retained surpluses	2,447	3,330	4,162	5,152	5,835	7,579
Minority interests	0	0	0	0	0	0
Total equity	**5,225**	**6,107**	**6,939**	**7,930**	**8,613**	**10,356**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	684	883	832	991	683	1,743
Depreciation and amortisation	38	37	43	50	56	63
Change in provisions / non-cash	18	0	0	0	0	0
Working capital / other	-505	-2,103	618	-152	-197	-1,420
Cash flow from operations (a)	**235**	**-1,184**	**1,493**	**889**	**542**	**386**
(inc) decrease in PPE	-2,142	-5,960	175	173	-704	2,618
(inc) decrease in investments	13	-90	-90	-90	-90	-90
Change in other investing activity	5	0	0	0	0	0
Cash flow from investing (b)	**-2,123**	**-6,050**	**85**	**83**	**-794**	**2,528**
Free cash flow (a+b)	-1,888	-7,234	1,578	972	-251	2,914
Equity raised (repaid)	0	0	0	0	0	0
Debt raised (repaid)	1,649	7,234	-1,578	-972	251	-1,414
Dividends	0	0	0	0	0	0
Others	0	0	0	0	0	0
Cash flow from financing (c)	**1,649**	**7,234**	**-1,578**	**-972**	**251**	**-1,414**
Net change in cash (a+b+c)	**-238**	**0**	**0**	**0**	**0**	**1,500**
Cash and cash equiv at year end	**-597**	**-597**	**-597**	**-597**	**-597**	**903**

Key data

Year-end 31 Dec (AED unless stated	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EPS	0.13	0.14	0.36	0.32	0.22	0.57
DPS	0.00	0.00	0.00	0.00	0.00	0.00
BVPS	1.71	2.00	2.27	2.59	2.82	3.38
BVPS (adjusted)	1.69	1.98	2.25	2.58	2.80	3.37
Gross profit margin (%)	18.0	14.2	18.2	18.0	16.2	19.2
Core EBIT margin (%)	13.9	9.3	15.9	15.4	12.9	17.1
ROE (%)	14.0	15.6	12.7	13.3	8.3	18.4
Net debt / Equity (%)	63	172	129	101	96	51
LTV (%)	46	76	64	56	53	40

Valuation

Year-end 31 Dec	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
P/E (x)	5.1	4.6	1.8	2.0	2.9	1.1
P/BVPS (x)	**0.4**	**0.3**	**0.3**	**0.3**	**0.2**	**0.2**
Gross Property Assets / EV (X)	2.4	1.6	1.7	1.9	2.0	2.5
EV / EBITDA (x)	11.1	35.5	8.2	8.1	11.4	3.6
Dividend yield (%) *	0.0	0.0	0.0	0.0	0.0	0.0

*Source: Company data, Nomura research *Dividends have previously been paid at 10% of the IPO in stock*

Additional company information

Union Properties also has a number of upstream and downstream subsidiaries that we list below.

Figure 77: Union Properties, Selected subsidiaries and joint ventures

Subsidiaries	Ownership (%)	Principal activities
Thermo LLC	100	Electro-mechanical maintenance contractor
ServeU LLC	100	Facilities management, security, MEP and energy management
Edara LLC	100	Property management services
Dubai Autodrome LLC	100	Building, management and consultancy for motor sport development
OITC Thermo WLL	85%	Electro-mechanical maintenance contractor (Qatar)
Speedcar Series Limited (BVI)	100	International motor racing services
Joint ventures	**Ownership (%)**	**JV Partner and Activities**
Properties Investment ltd.	50	Property investment and development related activities
Emirates District Cooling LLC	50	M'sharie, Construction, installation, operation of cooling systems

Source: Company data, Nomura research

Additional partnerships

In addition to the above, Union Properties has entered into two strategic partnerships. The first is with Regus to offer flexible workstations. The partnership currently has 500 available stations with a plan to double capacity over two years to 1,000. The group has entered a management agreement with Marriot Hotels (and now Ritz Carlton we presume). The Marriot will operate the 356 key Renaissance Hotel and the 250 key Courtyard (both in Motorcity). Adding the 340 rooms and 121 executive apartments in Limestone House, total hotel rooms are expected to reach 1,067.

Key developments

MotorCity: This is based on a 'motoring' theme and includes residential, business, sports and leisure opportunies. There are five separate project components: the Dubai Autodrome, F1-X, Business Bay Motorcity, UPTOWN MotorCity and the green Community MotorCity which are being developed over a total area of 38m sqft. Construction of the residential units in the Green Community MotorCity and UPTOWN MotorCity are due for completion and handover in 2009. This is probably the largest and most complex project in the Union Properties' stable and progress looks like it is line with the delivery timetable, with some units (we think UPTOWN is the most advanced) within encased projects becoming available imminently. In the UPTOWN development the sales were 'phased out' given the sized of the project and to, apparently, catch the rise in prices.

Control Tower: This is a 38 story tower located in Business Park MotorCity and has been offered on a freehold basis. The first phase of sales was launched in February 2008. The tower comprises 13 retail spaces and 146 flexible office spaces ranging from 3,000 sqft to 14,000 sqft.

Index Tower: This is a standalone 80 storey multi-purpose tower comprising 25 floors of office, 40 floors of apartments, 7 floors dedicated to penthouse suites and 3 levels for

exclusive retail outlets. It is located within the DIFC master-plan. It is likely that this development will be completed by mid- to late 2009 assuming the current rate of progress.

Limestone House: Limestone House is another development contained within the DIFC masterplan and located adjacent to the main DIFC precinct, offering high end serviced apartments. The building appears to be in the finishing stages with all concrete work complete, MEP substantially complete and interior finishes being rolled out simultaneously. Scaffolding indicates work on the exterior continues. The development also includes a 340 room hotel to cater for the DIFC and would draw traffic from the nearby Emirates Towers. In addition, the development will also include 121 executive apartments, presumably to cater for long stays, which we think is a needed initiative.

On the Limestone and Index Tower developments, Union Properties started selling units at approximately AED 1,750psf. Prices peaked at AED 4,000psf, but have subsequently retreated in the current market.

Green Community West: This is a master planned development built on over 100ha of land with a selection of different sized villas down to two bedroom apartments. The development is located within the Dubai Investment Park (DIP). The project has sold out in phases very quickly, with the company choosing not to raise sales prices as aggressively as the market, which should mitigate the default risk on the development, in our opinion.

Stressed out

We perform the usual stress test on our NPV calculation of the development programme.

On our base-case scenario, where we think prices fall on average 15%, defaults top 10% but mitigated as construction prices fall by the same amount, we derive an implied NPV on the development (for sale) programme of AED 4.1bn (AED 1.45 p/share) and this excludes the value of the investment portfolio.

Under our stress test, we decrease office values by 30%, and mixed use and residential by 15%. We increase the future default on sales to 15% and assume an additional 200bp on the risk premium; as a result the NPV falls to 2.5bn (AED 0.81 p/share) but this still gives no recognition for the standing portfolio that we estimate equates to c. AED 0.65 p/share.

RAK Properties

Stock rating	NEUTRAL
Price (AED), 13 Feb	0.46
Price target (AED)	0.66
Upside potential, %	46
Market cap, (AEDbn)	0.9

Valuation	2009F	2010F
EPS (adj.)	0.18	0.20
P/E	2.5	2.2
Div. Yield, %	16.7	16.7
P/Book, x	0.26	0.24

Performance, %	-12m	-3m
Absolute	-82	-44
vs. sector	-3	-3

Sector ADX Real Estate
Source: Reuters, Nomura research

Revenue business mix (%)	3q08
Government grants	87
Finance income	7
Investment income	6

Source: Company data, Nomura research

We initiate coverage on RAK Properties with a Neutral rating and a 12-month price target of AED 0.66. This represents potential upside of 46% from current levels. At our target price, RAK Properties is trading at a 0.28x discount to NAV.

Corporate profile

RAK Properties (RAKP) is a real estate development and investment company founded by the Ras Al Khaimah government in February 2005. RAKP has an estimated landbank of 6.5m sqm and is developing projects worth approximately AED 13bn, with a further potential AED 2bn in the pipeline. Operations are principally located in the Northern Emirate, but the company has begun a process of international expansion.

Figure 78: Brief history and key events

Feb 2005	Established by RAK Government
Oct 2005	Lists on ADX, sold 55% equity stake raising AED 1.1bn, Paid in capital AED 2bn
Nov 2005	RAK Govt allows 100% freehold ownership for RAK Properties' projects

Source: Company data, Nomura research

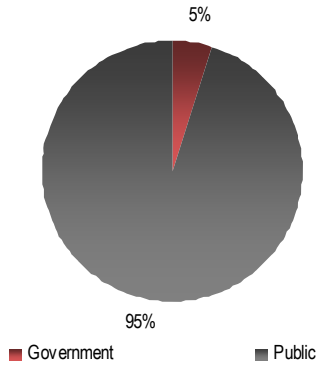
Business lines

The company is still at the incubator stage and is yet to generate any meaningful revenues. Revenues from land plot and unit sales are recognised on completion and therefore we don't see any meaningful revenues until 2009. Currently, the only real estate revenue being recognised is associated, but as yet unrealised, profits from the development work on government granted land at the Mina Al Arab development. The company does have an investment group that also generates revenue, but it is not core operations.

Shareholder structure

RAK has a current free float of c95%, and although the Ras Al Khaimah government retains less than 5% of shares outstanding, RAKP enjoys the privileges and access from sovereign association. RAKP is subject to a foreign ownership restriction of 49%. The company has over 22,000 shareholders on the register.

Figure 79: Shareholder structure



Source: Zawya, Nomura research

Key senior board and operating personnel

Mr Mohammed Hasan Omran (Chairman) is also Chairman of Etisalat.

Mr Abdulaziz Abdulla Al Zaabi (BOD) is also the general manager of the Real Estate Bank, the entity which now includes the merged Tamweel, Amlak Finance and Emirates Bank.

Mr Mohammed Sultan Al Qadi (Managing Director/CEO), former general manager of Etisalat, and currently CEO of Investment Development Office (IDO), which is a RAK government investment vehicle.

Mr John Heck (Executive Vice President) joined in 2007 and is responsible for all project management. Mr Heck is the former regional Managing Director at Halcrows where he was responsible for developing key infrastructure projects within the UAE/GCC. He has over 30 years regional experience.

About Ras Al Khaimah

Ras Al Khaimah (historically known as Julphar) is the UAE's most northern emirate situated 90km north of Dubai with a current population of approximately 250,000 people. The economic focus has been on developing its industrial sector and it is the UAE's largest cement producer. Ras Al Khaimah has the fastest growing free zone trade area with 4,700 companies currently registered as at the end of 2008 with approximately US$15bn inflows. The industrial hub is popular with a significantly lower cost base than Dubai and Abu Dhabi.

The area traditionally has not been one to attract foreign speculators as was the case with Dubai and more latterly Abu Dhabi; therefore price increases have been relatively more stable, development less frenetic and the investor base more long term.

RAK Properties — Valuation

We derive a target price of AED 0.66 based on a number of company specific assumptions including: capital structure and gearing, strategy, growth prospects, corporate issues, concentration and development risk. In addition, we also apply a cyclical discount of 45%, although we note the exposure to both Ras Al Khaimah and Abu Dhabi real estate markets where fundamentals appear better than Dubai, in our view.

The stock currently trades at a P/NAV of 0.28x relative to our normalised sector average of 0.49x. At our target price the stock trades at 0.39x.

Figure 80: Defining the discount (range is +5% to -5%)

NAV Discount	%	Comment
Gearing and capital structure	2	Cash positive
Strategy	-3	Unclear post Mina Al Arab , await clarification
Growth prospects (PNPV/PV)	2	PNPV/ EV multiple 1.4x
Corporate access, transparency, disclosure	1	
Concentration risk	-3	Mina Al Arab in RAK constitutes 80% of the b/sh
Development risk	-4	As above
Total Corporate adjustment	-6	Reflecting our view on the above
Cyclical adjustment	-45	
NAV discount	-50	

Source: Nomura research

As a result, we discount our 2009E estimated adjusted NAV of AED 1.66 by a total of -50%. Added to this, we make an adjustment for corporate overhead costs, which we capitalise and deduct to derive our price target, but we note that there is significant un-booked land values that we exclude.

Figure 81: Target price calculation

Adjusted Corporate Value (m)	RAK Props
Unadjusted book value (ex minorities)	3,329
less Balance sheet adjustments	0
Adjusted NAV	3,329
less Cyclical adjustment	(1,498)
+ / - Capitalised admin costs	(350)
+ / - Corporate adjustment	(166)
Adjusted corporate value	1,314
per share:	
NOSH (m)	2,000
Adjusted NAV +12m	1.66
less Cyclical adjustment	(0.75)
+ / - Capitalised admin costs	(0.17)
+ / - Corporate adjustment	(0.08)
Calculated target price	0.66

Source: Nomura research

Business model and strategy

Evolution

RAK Properties, originally founded by the RAK government, acts in a similar manner for Ras Al Khaimah as Emaar does for Dubai and Aldar for Abu Dhabi. The landbank was granted free of charge courtesy of H.H. Sheikh Saud bin Saqr Al Qassimi. The strategy currently revolves around two major projects, Mina Al Arab and Julphar Towers, located in the emirate coupled with two smaller developments in Abu Dhabi. These projects will be delivered into the market over the next 9 to 12 months and provide the working capital necessary for the AED 12bn Mina Al Arab project.

The company is 'cash rich' and has no debt associated with any of its current projects (or at the corporate level), which in the current market allows the company significantly more

flexibility. Mina Al Arab is large enough to be phased, and several components (i.e. the hotels) can easily be deferred. There are several pipeline projects that we do not expect to go ahead in the current climate, and the company has diversified some of its local risk by investing directly in other properties regionally and abroad. The company has a minority (26%) stake in RAKEEN, the RAK Investment Authorities' property development arm and has significant investment in a number of private equity ventures.

Income imperative

Currently, there are no plans to build out an investment portfolio (as this would require incremental capital financing), but if space is released back to the company (i.e. sales that do not complete), it could be used to seed the portfolio. Developing an asset management business would be a 'light footprint' approach way to generate additional income against limited capital input – and this is a largely untapped market in RAK.

The pig in the python

The core focus for the company must now be the delivery of Mina Al Arab, in whatever form the eventual development takes. Even putting political considerations aside (after all this is why the company was formed), the project presents too much concentration risk, in our opinion. The project is too big for the current scope of the company and is the proverbial 'pig in the python'. We think RAK Properties will successfully deliver this project, within the current remit before repositioning itself. This may be too much for the risk appetite of traditional property investors, but could prove to be an entry point into a capital light model that could generate high returns.

Strong balance sheet

We think RAK Properties is one of the better positioned companies in our universe, i.e. no debt, cash positive, flexible development design schedules coupled with government support. The investor base to date has been less speculative, has (on average) a higher vested interest in the properties, and therefore the income at risk is lower in our view. We think the payback will be through the equity and not the yield, so last year's surprise dividend may not be repeated; but if it is, investors would be getting a c.15% yield to hold the stock, based on current price levels.

Risks

Like all UAE real estate companies, RAK Properties is exposed to a number of industry specific, regulatory, geopolitical, financial management and liquidity risks.

With regard to RAK Properties, we would highlight in particular the concentration risk of developments in Ras Al Khaimah and in particular the Mina Al Arab master development that represents c80% of its balance sheet value. The company also has a number of private equity interests that may prove illiquid if the company needed to realise its investment. The strategy post the completion of Mina Al Arab is not yet clearly defined, which poses a medium term risk to the investment case, in our view.

Cash flow and financing

More cash coming

RAK is in the fortunate position of have cash on the balance sheet with no debt. As at 3Q08, the cash balance was AED 681m, but we suspect this is closer to AED 600m as at the year-end. As at Sep 2008, total sales on properties have been recorded at AED

3.2bn, although none of this has been recognised as revenue yet, but cash upfront of 50% is generally required on sales with the remainder payable on completion.

Two projects are due for completion in 2009: Julphar Tower will be released by 3Q09, which should generate a further c. AED 300m in cash; and RAK Towers in Al Reem Island, which is just awaiting infrastructure from the master developer (Tamour) to be put in place, and should generate a further c. AED 80m-90m in cash (we base this estimate on current sales to date with 50% to come), although this may now slip into 1Q10.

Funding will be needed

We estimate that, under the current plans, development capex of around AED 2bn-3bn per annum needs to be spent on Mina Al Arab, but we suspect only around AED 2bn is committed based on current sales (AED 1.8bn as at 3Q08), with the remainder flexible and deferrable. We estimate around c. AED 7bn in additional funding requirements over the next three years, assuming the same sales profile (i.e. 50% of upfront payments and cash generated from the delivery of Julphar and RAK Towers).

However, we reiterate our view that RAK properties could manage itself without access to capital markets if it chose to do so, but this would involve cutting back the current development plan, in our view.

2008 results

Write-downs

At the time of writing, RAK Properties had lodged its preliminary results in an abbreviated statement. Net operating profits rose 30% to AED 435m (AED 0.22 per share), but net profits fell 24% to AED 379m (AED 0.19 per share), primarily as a result of write-downs taken across the investment book.

Sales momentum slowing

The full year sales value booked was AED 2.1bn, which represents a 4Q08 sales value of AED 273m, having previously recorded AED 1.8bn as at 3Q08, with sales momentum slowing down. The sales are not recognised until completion. RAK Towers, Julphar and Precinct 4 in Mina Al Arab are expected to be handed over in 2009, so sales revenue will therefore be booked.

No dividend?

RAK has implemented a cash preservation policy and 'is taking all measures possible to ensure the company's financial position is not affected despite the economic downturn'. Being cashed up helps and the company has indicated that it will not recommend a 2008 dividend, which we think is prudent.

The current NAV as stated is AED 1.56 per share. Financial statements were not filed and there is limited information in the preliminary statement. We will review the financials when released and comment more fully at that time.

Earnings estimates and financials

RAK Properties uses the contract complete method for revenue recognition.

Government guaranteed profits?

Until now, the only property related revenue received by RAK has been by way of government grants. This is a non cash method of recognising profits on land granted for free as development capex is expended. As the developments completions start to hit the account, we see the government grants becoming less relevant.

Two near term releases

In making our revenue forecasts we assume that Julfar Towers is released to the market during 2009 (although likely to be in the back half) and RAK Towers in 1Q10. Total sales to date recorded on Julfar (as at end 3Q08) and RAK Towers totaled c. AED 720m, and we expect that 4Q08 sales didn't add much to these developments (the AED 273m was probably skewed to Mina Al Arab). This forms the basis of our revenue build-up in 2009 and 2010. While we make the assumption that excess space will be sold, the alternative would be to seed an investment portfolio to add incremental rental income – but we do not allow for this in our estimates.

Subsidisation

We reduce the government grant over our forecasting period given that there is little visibility as to how the grant is attributed and when development land is released. There is the run-off risk that, as units in Mina Al Arab start to get released, the compensated profits attributable to government grants may reduce accordingly with the grants booked toward the cost of the development. We assume that this is an exercise in revaluation and forward recognition only, therefore the net effect over time should be near zero.

Sales progress on Mina

Sales to date (3Q08) on Mina Al Arab total AED 2.5bn and in our assumptions we phase the scheme over the four-year period, but we note that there is flexibility in the delivery of each of the distinct components of the master plan.

Wave profile

Given that the company recognises the bulk of its revenues on completion and that there are limited projects to smooth the earnings profile, we assume a lumpy profit pattern, but this is mitigated (to a degree) by investment earnings. In addition, the company can adjust the timing of the programme to smooth earnings, but we still see a slight wave to the earnings progression. We forecast profits falling slightly in 2009, with revenues from RAK towers slipping into 2010 and the significant revenues for Mina Al Arab not hitting the revenue account until 2012, but the two initial phased releases should add revenue in 2010 and 2011 respectively.

SGA

SGA expenses are a function of development activity where we see an almost one to one correlation. Headcount will be reduced if developments taper off and increased when developments are ramped up. We expect staff costs to increase c10% on average as Mina accelerates and we forecast peak sales and marketing efforts in 2010 and 2011.

Interest

We think the company will require some degree of external finance to bridge the gap between construction and cash receipts. We assume a standard marginal rate of debt (7.5%) in the current market. We understood that the company was initially looking to

launch a Sukuk, which may have led to lower financing costs, but the securitisation market remains closed. We think any new finance will be structured conventionally when required. If financing is not secured, we would expect some elements of the project to be delayed indefinitely.

We also assume that up to 90% of finance costs will be capitalised.

Dividends Dividend decisions are deferred to the board and there is no stated dividend policy that we are aware of. In 2008, the board approved a 7.5% dividend on the IPO price, which was paid out of capital (as government grants are non-cash earnings). As part of the current cash preservation policy, we assume no 2008 dividend, but with a return to AED 0.075 per share payments in 2009 as revenues are released. We will revise this on clarification from the company.

Figure 82: RAK Properties financial estimates and summary

Income statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Gross revenues	294	425	745	1,133	1,494	4,060
Cost of goods sold	0	0	-343	-659	-858	-2,520
Gross Profit	**294**	**425**	**402**	**473**	**636**	**1,540**
S,G and A	-40	-54	-57	-61	-66	-66
Depreciation	-1	-1	-2	-2	-3	-3
Other net operating income	0	0	0	0	0	0
Core EBIT	**252**	**370**	**343**	**410**	**567**	**1,471**
Net financing income (costs)	77	42	13	1	-33	-24
Gain on sale of investments	43	0	0	0	0	0
Property revaluations	79	65	-69	0	0	0
MTM derivatives/Provisions etc	29	-101	0	0	0	0
Other non-operating income	15	0	0	0	0	0
PBT	**496**	**376**	**287**	**411**	**535**	**1,447**
Taxes	0	0	0	0	0	0
Exceptional / unusual items	0	0	0	0	0	0
PAT	**496**	**376**	**287**	**411**	**535**	**1,447**
Minority interests	0	0	0	0	0	0
Attributable to equity holders	**496**	**376**	**287**	**411**	**535**	**1,447**

Balance sheet

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Investment properties	377	871	1,061	1,276	1,443	1,564
Development properties	865	1,499	1,698	2,250	3,337	2,304
PPE, Land held for sale	4	8	11	14	16	18
Total property assets	**1,246**	**2,378**	**2,771**	**3,541**	**4,797**	**3,885**
Prepayments & Receivables	317	263	325	413	803	1,309
Non current investments	387	690	690	690	690	690
Current investments	194	93	93	93	93	93
Cash and cash equivalents	1,130	630	630	630	630	830
Total assets	**3,274**	**4,053**	**4,509**	**5,367**	**7,012**	**6,807**
Total debt	0	847	756	1,493	2,568	1,342
Trade Payables,customer advances	370	76	335	195	381	106
Other liabilities	1	1	1	1	1	1
Total Liabilities	**370**	**924**	**1,092**	**1,689**	**2,950**	**1,449**
Share capital	2,000	2,000	2,000	2,000	2,000	2,000
Reserves and retained surpluses	904	1,280	1,417	1,677	2,062	3,359
Minority interests	0	0	0	0	0	0
Total equity	**2,904**	**3,280**	**3,417**	**3,677**	**4,062**	**5,359**

Cashflow statement

Year-end 31 Dec (AEDmn)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Net income before tax and MI	496	376	287	411	535	1,447
Depreciation and amortisation	1	1	2	2	3	3
Change in provisions / non-cash	-294	-388	-181	-200	-150	-100
Working capital / other	-439	-255	167	-271	-279	-855
Cash flow from operations (a)	**-236**	**-267**	**275**	**-58**	**108**	**496**
(inc) decrease in PPE	13	-628	-183	-530	-1,033	1,081
(inc) decrease in investments	-134	-303	0	0	0	0
Change in other investing activity	0	0	0	0	0	0
Cash flow from investing (b)	**-120**	**-931**	**-183**	**-530**	**-1,033**	**1,081**
Free cash flow (a+b)	-356	-1,197	91	-588	-925	1,577
Equity raised (repaid)	0	0	0	0	0	0
Debt raised (repaid)	0	0	0	0	0	0
Dividends	-133	-150	0	-150	-150	-150
Others	0	0	0	0	0	0
Cash flow from financing (c)	**-133**	**-150**	**0**	**-150**	**-150**	**-150**
Net change in cash (a+b+c)	**-489**	**-1,347**	**91**	**-738**	**-1,075**	**1,427**
Cash and cash equiv at year end	**1,130**	**630**	**630**	**630**	**630**	**830**

Key data

Year-end 31 Dec (AED unless stated)	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
EPS	0.17	0.21	0.18	0.21	0.27	0.72
DPS	0.08	0.00	0.08	0.08	0.08	0.08
BVPS	1.45	1.64	1.71	1.84	2.03	2.68
BVPS (adjusted)	1.45	1.64	1.71	1.84	2.03	2.68
Gross profit margin (%)	n/a	n/a	30.7	29.3	36.2	36.4
Core EBIT margin (%)	n/a	n/a	69	44	42	37
ROE (%)	18.2	12.2	8.6	11.6	13.8	30.7
Net debt / Equity (%)	-39	7	4	23	48	10
LTV (%)	-91	9	5	24	40	13

Valuation

Year-end 31 Dec	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
P/E (x)	2.6	2.2	2.5	2.2	1.7	0.6
P/BVPS (x)	**0.31**	**0.27**	**0.26**	**0.24**	**0.22**	**0.17**
Gross Property Assets / EV (X)	-9.3	3.1	3.8	2.7	2.2	4.2
EV / EBITDA (x)	-0.9	3.0	3.0	4.3	5.0	1.0
Dividend yield (%)	16.7	0.0	16.7	16.7	16.7	16.7

Source: Company data, Nomura estimates

Additional company information

Identity crisis?

RAK Properties has indicated that it will be considering its strategic focus in 2009 (*Company presentation,* October 2008). Apart from Mina Al Arab, the remaining developments currently in progress will be completed and (hopefully) sold so the business needs to start developing life after Mina Al Arab. We expect to hear more on strategic focus, liquidity events and potential exit strategies in the coming months, but we think the company may look to position itself in emerging markets rather than traditional GCC markets where it has no real competitive advantage.

Diversification?

The balance sheet currently has c. AED 2.4bn of property assets (made up largely of land and development plots) and a further AED 394m in non-current investments and AED 448m in current investments.

These investments are split geographically (GCC, Mena, Levant, and SE Asia), by asset class (long term strategic investments, private equity, hedge funds, marketable securities, structured notes and cash) and by industry (real estate, financial services, telecommunications, energy, transportation, infrastructure etc.). This exposes the company to additional investment risk (particularly private equity) in the current market, but at the same time may help to open markets that would be otherwise inaccessible. We think a sensible strategy would be start to roll out of current investments, as maturities and duration allows, into more liquid instruments and we believe this is currently the case.

Kitchen sinking

As at 3Q08, RAK Properties had created an AED 50m provision for unidentified losses in its securities portfolio. The market has fallen further since the reporting date and we think it would be prudent to take further provisions. We do not know the full extent of the investment portfolio (as it is not publically available), but we would expect similar levels of writedowns in 4Q08 from 3Q08 levels.

Current projects

The current pipeline consists of three key projects: Mina Al Arab, Julphar towers and RAK Tower. A forth project, Julphar Residence situated in Al Reem Island, Abu Dhabi was launched at Cityscape 2008. In addition, the company has land holdings in Georgia and Tanzania with plans to develop residential blocks – but we think this is unlikely in the current environment.

We highlight the development programme in the table below.

Figure 83: RAK Properties, core development table

Development	Location	Status	Completion	Costs (AEDmn)	Sales* (units)	Sales* (AEDm)	Additional details
Mina Al Arab	RAK	Above ground	2012	11,250	1,625	2,444	~5,500 units, 8 hotels (4 flags), 2 phase completion
Julphar Tower A	RAK	Topped off	2009	400	546	343	468 office units, combined 3 levels retail, c70% sold
Julphar Tower B	RAK	Topped off	2009	incl above	incl above	incl above	Residential building consisting of 349 apartments, freehold
RAK Towers	Abu Dhabi	Finishing	2010	300	159	375	Awaiting release by master developer, 100% sold
Julphar Residence	Abu Dhabi	Launched	2012	150	n/a	n/a	G + 24 residential tower, Al Reem Island

*Source: Company data, Nomura research *sales as reported at 3q08*

Taking the NPV route

Latent value …

We believe that there is still value in the development programme if it can be taken to completion. We estimate that the programme will cost c. AED 13bn (this assumes debt to finance the project) and generate an NPV of c. AED 2.3bn (AED 1.15 p/share).

… with risks

As usual, we caveat our assumptions, noting that they are subject to a number of moving parts. These include cost of funding, construction costs, timing and receipt and sales progression and the potential for future default on sales, all of which tend to work in the same direction. We calculate that every 5% movement in underlying sales price represents +/- AED 100m to our estimated NPV.

The stress test

We stress test our development model adopting the following scenario: we take our sales default assumption from 3% to 10%, increase interest rates and cost of capital by 200bps respectively, we postpone developments that have not yet started by two years and lastly, reduce sales prices by 15%. Combined, this decreases the NPV by around 50% to AED 1.1bn, which after deducting the attached debt and associated working capital gets us to a 'distressed' valuation of c. AED 0.55 per share, close to current levels, which sets our worst case floor for us.

Mitigation

Under the existing plans offered by RAK Properties, customers pay a deposit to reserve their purchase and then sign a sale and purchase agreement, where we believe 50% is usually required to be paid. Under a default scenario customers at this stage would be required to forfeit 40% of the sale price (effectively everything), which appears to be an effective hedge against default, in our view.

Food for thought

We understand that if any units were to be put back to the company, they could form the seed investments for an investment portfolio. This would need external financing but the assets would then come at a 40% discount; grossing the yield well past the borrowing costs. This could be a cheap way to finance a recurring income stream if the company was prepared to take the balance sheet risk (given that there is currently no debt).

Taking this step one stage further, we assume that the asset management function will be done internally, so the running costs of managing the investment portfolio could be subsidised, if a third party asset management service was also instituted.

Appendix 1- Accounting standards – apples and oranges

Inconsistent approaches

Accounting for property companies can be difficult and even more so for developers. Here we consider the industry's inconsistent application of different accounting standards pertaining to income recognition and asset valuation under IAS 40. When combined, the treatment of these two can distort company valuation ratios, making cross-valuation comparisons difficult and less relevant.

Income recognition

Where income is received for developments, companies can choose to recognise revenue using a 'percent complete' method or a 'contract complete' method. The cash flows in both methodologies are exactly the same but stated revenues and hence profits can differ markedly. The percentage complete method tends to overstate earnings in the early stages of the development process and understate them in the latter part of the project (the reverse is usually true of the completed contract method). A recent IFRIC 15 interpretation will now require PropCos to report revenues using the contract complete methodology, but this can vary by jurisdiction. This is retrospective from 1 January 2009.

Points to note

- Completed contract method (CCM) introduces more earnings volatility
- CCM can produce smaller net worth as profits are not recognised until the end
- The percentage of contract method involves estimates (some subjective)

Revaluation

IAS 40 allows enterprises to revalue properties held for investment or at cost, which is depreciated and can be impaired. In both cases the 're-measurement' is taken to the revenue statement in the relevant accounting period, distorting earnings and earnings based metrics (pre-IFRS revaluations were taken directly to equity). In more mature markets, most companies voluntarily report an adjusted earnings figure, stripping out the non-cash mark to market adjustments to present a cleaner, more comparable EPS.

We summarise the key accounting methodologies used by our coverage universe as follows.

Figure 84: Key accounting methodologies and earnings/ratio impact

	Revenue recognition methodology	Fair value through P&L	Earnings volatility	P/E*	Investment properties* (IAS 40)	P/Book *	Development properties (held for investment)	Development properties (Trading)
Aldar	Percentage complete	Yes	Less	Lower	Fair value	Lower	Cost	> cost, NRV
Deyaar	Percentage complete	No	Less	Higher	Depreciated cost	Higher	Cost	> cost, NRV
Emaar	Percentage complete	No	Less	Higher	Depreciated cost	Higher	Cost	> cost, NRV
RAK properties	Contract complete	Yes	More	Lower	Fair value	Lower	Cost	> cost, NRV
Sorouh	Contract complete	Yes	More	Higher	Fair value	Lower	Cost	> cost, NRV
Union Properties	Contract complete	Yes	More	Lower	Fair value	Lower	Cost	> cost, NRV

**On the basis that values have tracked upwards*

Source: Company data, Nomura research

We are not challenging companies' disclosure or auditors' interpretation here (as both are legitimate); we merely point out the distorting impact on multiples that reporting can have, which we can then adjust for.

Income recognition is not the same as cash flow

The key issue in accounting for service and construction contracts is the allocation of revenues and costs based on percentage (of contract complete) or when it is delivered. It appears to us that income recognition becomes a function of the auditor.

Figure 85: Pre-conditions for income recognition

Completed contract - Conditions	Percentage completed - Conditions
- Significant risks and rewards of ownership passed to the purchaser of the property	- A sale agreement is consummated or signed
- the group no longer retains the full management rights associated with normal property ownership	- The buyer's investment, by percentage, is adequate to suggest a full commitment to pay
- The amount of revenue can be measured reliably	- Construction is sufficiently progressed beyond a preliminary stage
- The costs incurred or to be incurred can be measured effectively	- The buyer is committed and not entitled to a refund with the exception of a non-delivery clause
- it is probable that the economic benefits associated with the transaction will flow through the seller	- The aggregate sales proceeds and costs can be reasonably estimated

Source: Company data, Nomura research

Transfer of ownership key

1) Contract complete: Revenue from the sale of land is recognised when the equitable interest in the land vests in the buyer, i.e. on handover. During the construction phase, cash advances are treated as creditors. If the revenues are recorded early (as in the case of Sorouh who record the revenue on land sales after just 25% to 40% of the advances have been made), the offsetting balance is transferred to accounts receivable.

Smoothes the earnings profile

2) Percentage complete: The percentage complete method is an accruals based form of income recognition where revenues (and associated costs) are smoothed over the lifecycle of the development and more significantly over very long project spans such as the mega developments. The method used to determine the stage of completion will depend on the nature of the contract.

Cash flows remain the same

In both cases, the cash flow is the same, with working capital adjustments absorbing the balance between the revenue recognised and the cash received; however the reported revenues and hence profits can be markedly different. We therefore prefer cash flow multiples in benchmarking exercises.

IFRIC 15 (3 July 2008) now interprets that the percentage complete method does not fully represent the effect when revenues should be recognised i.e. that the equitable interests in a property are not transferred uniformly. With effect from 1 January 2009, those companies (Emaar, Aldar, Deyaar) may have to retrospectively apply the contract complete methodology on some of their income (we understand the UAE may not be affected).

Income recognition is not a significant issue, in our view

Using a pure DCF methodology, there would be no effect, but for those modelling DCFs based on revenues as a proxy for cash receipts – as is usually the case – the timed delay of revenue recognition would lower the NPV value. In reality, there is no change to the cash economics and hence business valuation – so we do not regard this as significant.

Accounting for revaluations

The treatment of investment properties is more relevant

Investment property is property held by the economic owner to earn rentals or for capital appreciation and the cost of the property can be reliably measured. In real estate, property can be held for disposal, held for sale and held as developments – but these fall outside the scope of IAS 40.

IAS 40 permits the enterprise to choose between a fair value and cost model. Once taken, the decision applies to all investment property held.

Fair value: Investment property is usually revalued by independent appraisers on the basis that the property could be exchanged between knowledgeable willing parties in an arm's length transaction. Revaluation gains or losses must be included in net profit or loss during the period in which it arises.

At cost: Investment property is accounted for like property plant and equipment (PPE), i.e. cost less depreciation and impairments. Depreciation and impairment charges are included in the net profit and loss.

The cash economics of the business remain the same, but price and NAV multiples do not. Price earnings multiples do not represent underlying cash earnings and price/book metrics are subordinated based on the strength of the current cycle, i.e. on an upward leg of the cycle, the carrying cost of property is understated, therefore the price/book looks more expensive and vice versa. Additionally, the asset and equity returns are unnecessarily distorted.

In a 'hot' property market, accounting at book is more conservative; conversely a market valuation in a cooling market is deemed more conservative.

We illustrate the two accounting methodologies in the table below.

Figure 86: Simplified revenue and balance sheet accounts

Item	Cost basis	Fair value basis	Comment
Net operating profit	100	100	Assumes 10% yield
Revaluation		50	Assumes 5% capital uplift
Depreciation	-20		Assumes 2% depreciation on book
Net profit	80	150	
At period beginning			
Property assets	1000	1000	
Liabilities	500	500	Assumes 50% LTV in both scenarios
Equity	500	500	
At period end			
Property assets	980	1050	Revalued property assets
Cash	100	100	Rents received
Liabilities	500	500	No change to current debtt
Equity	580	650	
Net debt / Equity (%)	86	77	Based on the period end gearing
P/E (x)	6.3	3.3	
ROE (%)	16	30	Geared impact of earnings
ROA (%)	8	14	

Source: Nomura research

Non cash and non recurring should be stripped out

Unlike Europe where there is an EPRA-adjusted earnings result or the US where there is (relatively) consistent Funds Available for Distribution (FAD) on offer, UAE property companies do not report adjusted (i.e. 'near' cash) earnings.

EPRA adjusted earnings (i.a.w. '*EPRA Best practice recommendations', May 2008*) strip out any revaluation movements on investment property and investment interests (non-cash), profit and losses from disposals of investment properties (non-recurring), goodwill impairments, derivative movements and other associated taxes.

Caveat emptor

Admittedly, much of the revenue from developers is by definition 'one off' and by nature non-recurring, but if we strip aside that argument and focus on the 'adjusted earnings', we can compare valuation multiples on a more even footing.

Appendix 2: Nomura valuation methodology

Global benchmarks

Earnings multiples, net asset values (NAVs) and dividend yields are the common REIT/REOC valuation methodologies, yet none can be universally applied, largely because of different global REIT legislations and the various real estate land laws that makes global comparisons increasingly difficult (see Appendix 1: Accounting standards — apples and oranges).

In Japan, dividend yields are the primary valuation benchmark, while in Singapore, investors use dividend yield supported by NAV analysis. In Europe, UK, China and India, NAV dominates valuation, while Australian investors focus on DCFs and dividend yield, and in the US, investors turn to FFO (earnings) multiples and estimated NAVs (currently they are precluded by law from valuing balance sheets). The benefits of dividend yields are that they are readily available and easily compared across companies; however, the advantages end there. Dividend yield gives little perspective on where a stock is trading relative to its underlying real estate value, earnings and ability to pay dividends from recurring cash flow.

We prefer NAV

Our preferred method of valuation/comparison is the NAV approach; after all, this takes into account independent third-party appraisal values based on commercially sensitive lease, payment and construction terms that analysts do not see[4]. In valuing real estate companies, we have previously considered various EVA® (i.e., the incremental spread between the ROCE and COCE) and DCF approaches (i.e. rents are treated as corporate coupons until the lease expiry with the asset value then realised), but both are susceptible to manipulation and are overly sensitive to the WACC calculation.

Long-term discounts for developers where overheads are higher

Trading at parity?

'Cross cycle', we believe that tax free REITs (in mature markets) should trade relatively closely to their NAVs for two reasons: 1) tax leakage is minimal; and 2) property is generally marked to market on a regular basis. We estimate that corporate overheads create at least a c5% discount when the asset base is relatively passive and constant, but up to 20% for development REOCs where managements are typically more active.

Developing value

We can argue that active management implies higher returns, but developers are also more highly leveraged into the economic cycle. In the UAE, balance sheets are generally carried at book with most property assets a 'work in progress' and designated for sale, so arguably the book value of property is less relevant than the development profits that can be made.

Developing property markets

Developing markets such as China, India and Russia are not only characterised by the emerging nature of their economies, but also by the fact that a higher proportion of a property company's activities are focused on developments (usually skewed towards residential to alleviate shortages associated with urbanisation and demographic pressure).

[4] The caveat here is that the 'one-size fits all' share price discount to NAV metric is reliant on the opaque process of third party portfolio valuations which inevitably requires a judgmental input from the appraiser.

Although GCC economies are not 'emerging', their real estate industries are, so we draw the closest parallels with those developing markets quoted above.

Earnings are not a reliable measure

Typically, these development models do not have ready access to recurring rental income, have large development funding requirements and are both operationally and financially leveraged into the economic cycle, and the earnings visibility is often confused, opaque and unpredictable.

UAE: Sum-of-the-parts is common, but we prefer NAV

Keeping up with the Jones'

In the UAE, with developers predominantly at the embryonic stage, the most common valuation methodology among analysts is the traditional 'sum of the parts', where developments are valued using discounted cash flows (DCFs) or residual land value approaches (RVAs), with forecasted surpluses discounted to present value.

Sum of the parts

Recurring rental income streams are 'capitalised', using an NOI yield and we apply a multiple to additional income streams (management fees, fund performance fees, etc), with more secure incomes streams trading at higher multiples than less secure ones. Subsidiaries and associates are generally given their market value if traded, and book value if not.

Not enough disclosure

The simple truth is that there is not enough publically available information to do anything but a cursory bottom up analysis of most property developments. We do, however, model our coverage universe on this basis (i.e. by development), but this is more to prove revenues than actual values.

It is increasingly difficult to determine average land, infrastructure and construction costs (by development and developer) as well as the associated sales, timing and release data; but at least we can stress test the development's viability based on simple input parameters, which we think is the most sensible approach.

Maintaining the NAV datum

We therefore prefer NAVs (which are auditable) as our predominant valuation basis and adopt a more 'top down' rather than 'bottom up' approach to valuing UAE real estate companies. We still consider earnings capacity and earnings longevity, but make the implicit assumption that this is captured (to some extent) in the NAV. Business models are now beginning to evolve where recurring income is increasing as investment portfolio's grow, so while headline revenues will fall, the earnings quality should improve.

Our target price methodology

Our share valuations therefore become a gauge of the NAV, revenue streams, asset management skills, gearing and capital structure, investor issues, operating restrictions, and capital market conditions and growth prospects. The forecasted NAV establishes the current liquidation value, while our adjustments establish our current equity value. The liquidation value is therefore not the same as the equity value.

Figure 87: Target price methodology

Target price calculation	Basis of Measurement	Comment
Forecast NAV, balance sheet	Hard	Forecast NAV +1y, fully diluted
+ Market value adjustment	Soft	Mark to market of investment portfolio
- Goodwill	Hard	Subject to ongoing impairment, therefore excluded
Forecasted Adjusted NAV	=	Adjusted forecast NAV, Fully diluted
- Net corporate overhead costs	Hard	Isolated from direct property costs
+ / - corporate issues	Soft	Corporate governance, disclosure, track record etc
+ / - market premium / discount	Soft	Our view on the cycle
Target Price	=	As described

Source: Nomura research

Forecasted adjusted NAV

We make an adjustment for the implied value of investment property over the carrying value if these assets are held at depreciated book value and we deduct any goodwill, which we assume would be impaired in a liquidation value.

Net corporate overheads

We think corporate costs are a standing overhead against the running of the business and should be capitalised (we use our WACC calculation) if we value the entity solely by reference to the NAV. In our calculations, we isolate the central overhead costs from the pure real estate costs (selling costs, project costs written off etc) to compensate for development exposure and by applying a 25bp asset management charge across investment assets (which is our proxy outsourcing charge).

Corporate issues

We reward (discount) companies based on 'soft' corporate issues that include transparency, disclosure, access to management, quality of publically available information (i.e. website, news, regulatory announcements), free float, liquidity, foreign ownership limits. We also take a view on growth prospects, concentration risk and current strategy. This is a subjective view where we consider both positives and negatives.

Market premium (discount)

We think the cycle is still in decline and therefore a market discount to prevailing NAVs is applied. We apply a 45% discount to Dubai based developers and a 35% discount to Abu Dhabi-based developers, based on our view of current market conditions. We will revise this assumption when (and if) market liquidity and demand returns.

Free call options not included

What we exclude from our target price methodology are 'gratis' landbank valuations. Free land gives flexibility, but it comes with hidden costs. It is generally land given to master developers at nil or nominal cost by federal governments, with the intention of creating significant future developments, and generally excluded from company balance sheets until development plans are sufficiently massed. It is, in effect, a free call option.

Land is only useful if there is something on it!

Some companies do report independent land appraisers' valuations in the notes (i.e. Emaar with AED 73bn), but what is the value when there is no willing buyer and the land is usually tied to government objectives? To have value, land must be serviceable (i.e. complete with infrastructure) with willing buyers (sub-developers) or financed (end users or banks). This entails the working-up of infrastructure and services, which represent additional carrying costs that the developer must absorb until the titles can be transferred. Until this happens, it is land with limited use and little (if any) liquidation value.

Figure 88: Company WACC

Company calculated WACC	WACC
Emaar	12.3%
Aldar	13.5%
Sorouh	13.2%
Deyaar	14.1%
Union Properties	12.5%
RAK Props	13.1%
Average	12.9%

Source: Nomura research

WACC – Reworking the formula

To determine our cost of equity capital we use a modified variant of the traditional CAPM based on the following:

$CoE = Rf+(ERMP*PB_L)$

Risk free rate of 3.6%: We use the sovereign (or similar) bench mark rate

Equity risk market premium of 7%: We assume the long term average excess return required from emerging markets is 400bps more than developed markets. Our strategy team currently see a 600bp risk premium over developed market, suggesting an ERMP of 9%.

Property beta: We replace the traditional beta (which is just a regression of share price performance) with our own 'property beta' to recognise operational risks that are higher in development models with lower earnings visibility and higher capex requirements.

Leveraged property beta: We then apply leverage to our property beta (the traditional CAPM excludes the capital structure in the COE calculation). With more debt, the legal rights to company assets become subordinated to debt holders, increasing the risk borne by equity holders. We therefore calculate a leveraged cost of equity.

Calculating land values – a geared effect

Land values are directly geared into real estate values. In the UAE, most developments are carried at cost in corporate balance sheets (with some providing market valuations by independent appraisers or management desk top valuations). Carrying costs are capitalised when work commences, but ceased if work stops and lodged as a corporate expense.

In the simplified table below, we show that the geared effect of a 10% fall in development value amounts to a c23% fall in the value of the underlying land. Given the long gestation period, the residual value is usually deferred at the current financing rate to give a NPV – which we omit in our simplified analysis – but applying the WACC is probably more correct anyway.

For simplicity, we assume development costs remain the same, but in reality the residual value of the land is a function of both values and construction cost inputs. Land values may therefore actually rise if the cost inputs fall further than the GDV.

When residual values fall below cost value, they will be impaired but the developers' margins will already have been eroded by this stage.

Figure 89: Simplified RVA for land values

	T + 0	Adj	T +1	Comment
Gross development value	1000	-10%	900	Total calculation of all cash inflows once the development is complete
Less development costs				
Construction, infrastructure	-300	0%	-300	Market cost and includes external infrastructure costs associated with plans
Professional fees	-50	-10%	-45	Services provided by architects, surveyors, engineers planning supervisors etc
Financing	-32	-1%	-31	Cost of borrowing capital required to complete development
Contingency costs	-38	-1%	-38	Unforeseen cost over-runs can be made on all costs or just construction and fees
Sales, marketing, incentives etc	-100	-10%	-90	Approximately 10% of projected revenue, includes incentives
Total development costs	-520	-3%	-504	
Developer's profits	-200	-10%	-180	Typically 20% on GDV or 20% on total costs
Total	-720	-5%	-684	
Deduct purchaser's costs	n/a	n/a	n/a	Agents' fees, legal fees and taxes if applicable
Residual Land Value	280	-23%	216	Residual value after deducting costs

Source: Nomura research

Appendix 3: Direct market analysis

Residential overview

In Abu Dhabi, the residential market is still marked by a shortage of housing stock (28,000 units). In Dubai, the confidence crisis matches the credit crisis. Speculative investors have exited the market and with them gone, vital credit required to kick start developments has been choked. Ultimately, smaller private developers will be forced into accepting lower prices to compete with forced sellers in the secondary market, rather than warehouse unsold stock for the long term.

Investment market

The residential real estate sector in UAE has seen extremely high price appreciation of over 200% over the last five years. Easing restrictions on foreign ownership, the move to freehold and free zones and automatic roll-over of long lease entitlements were designed to encourage ex-pats (en masse) to invest capital locally rather than expatriate it overseas.

Speculation (flipping of properties during the development process) that led to quick profits fuelled the cycle further, but there are no end users to bear the final cost. This was gearing on gearing and RERA recently introduced legislation to 'discourage' speculation.

A trawl through local newspapers and real estate magazines quickly gives current sales prices and financing terms (40% of all media advertising is real estate related), but historical evidence is difficult to find. We have created our own pricing index using information compiled from real estate agency Better Homes and other property research houses, which we intend to keep updated.

The market is very thin, with the media quoting headline grabbing sales data numbers (60% to 70% falls in villas on the palm for example), but we think that this is unrepresentative of the current picture. We will wait to see how the index develops, but we think that the real underlying fall is more like 20-25% than the 5%-10% average indicated. We expect pricing to come back a further 15% before stabilising.

The averages probably mask the true picture. On a more granular basis, we see the index showing the peak (October/November 2008) to trough (January 2009): on a granular level, we have a seen a peak to trough decline for villa prices in Palm Jebel Ali of 27%, a 26% decline in Palm Jumeirah; and an average 40% decline for apartment prices in the Burj Dubai area.

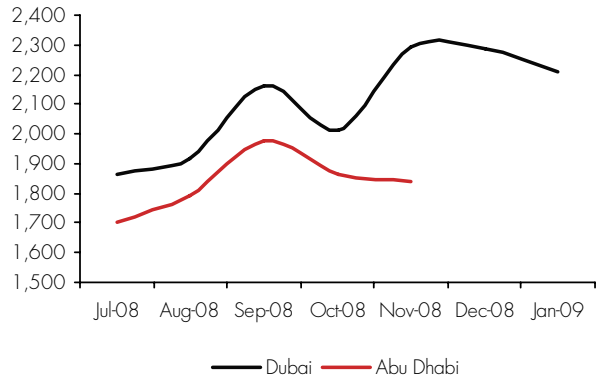
Figure 90: Dubai pricing (AED psf)

Villa prices (AED psft)	Peak (Oct/Nov)	Current	Movement
Jumeirah Village	1,165	1,061	-9%
Arabian Ranches	1,773	1,530	-14%
The Palm Jebel Ali	1,799	1,316	-27%
The Palm Jumeirah	4,455	3,300	-26%
Average	2,298	1,802	-19%
Apartment prices (AED psft)			
Dubai Land	1,433	1,277	-11%
Down Town Jebel Ali	2,795	2,239	-20%
Jumeirah Lake Towers	1,888	1,888	0%
Greens	2,239	2,200	-2%
Business Bay	2,203	2,170	-1%
Dubai Marina	2,265	2,031	-10%
The Palm Jumeirah	3,534	3,250	-8%
Burj Dubai Downtown	4,401	2,629	-40%
Average	2,595	2,211	-12%

Source: Better Homes, Nomura research

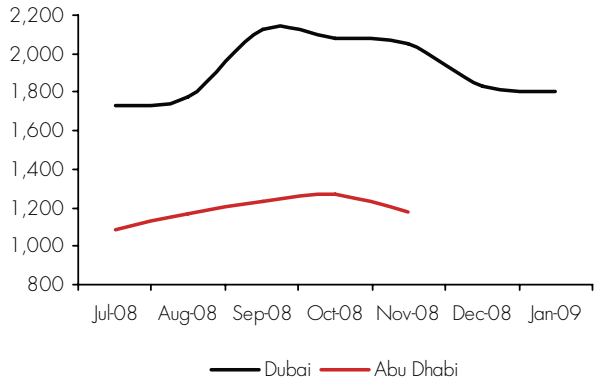
Colliers, a leading real estate advisory agency in the region, estimates that annually prices in Abu Dhabi increased 89% (Q407 to Q408) and 37% in Dubai, but this was mainly in the first half of 2008. In 3Q08, prices stabilised somewhat but fell in the last quarter by an average estimated 15%.

Figure 91: Average apartment pricing (AED sqft)



Source: Better Homes, Nomura research

Figure 92: Average villa pricing (AED sqft)



Source: Better Homes, Nomura research

Residential rental markets also falling

The rental markets are harder to gauge, with vacancy of *available* space still tight in both emirates.

'Phantom' space

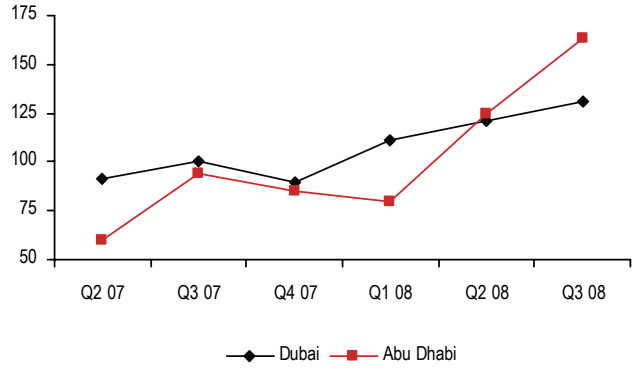
Colliers estimates vacancy rates of just 1% and it is probably around 6% in Dubai, in our view, but there is also a lot of stock that has been purposely held from the market.

This is partly owing to the natural lag in occupancy where 12 months non-refundable payments slow the transition from rented space to purchased accommodation. There is also the speculative effect where units are held for sale and it is easier to sell vacant than let and also the number of international buyers who leave units unoccupied. Space should come back to the market reasonably quickly now that the investment market is shut and it makes sense to capture the interim income to mitigate the loss in capital values.

At some point, a portion of this, unquantifiable, black space, prevalent in Dubai, but not so in Abu Dhabi, will find its way to the market. This is in addition to the developments that are likely to be handed over in 2009 and 2010. Based on our assumptions below we estimate rents will fall on average 25%-30% from their 3Q08 peak.

Landlords are increasingly going to have to make concessions to onerous tenancy agreements. Annual rent cheques have typically required bank financing in the form of personal loans. There will be increasing pressure on landlords to accept (at least) quarterly post dated cheques.

Figure 93: Average rents (AED sqft, p.a.) and average leasing terms



Annual rental increase: Abu Dhabi +65%, Dubai +25%

Rental increases are now capped

Average yields: Abu Dhabi 7.7%, Dubai 6.9%

General letting terms: Rents annually in advance. Landlords responsible for maintenance, service charges and air conditioning charges.

Prognosis: Rents fall on average c.25%, payment terms less onerous, more new builds come on the market in both Abu Dhabi and Dubai.

Source: Asteco, Colliers, Nomura research

Residential demand and supply analysis

In the following analysis, we present two scenarios for both emirates, a base case and a worst case based on falling population and demand, and increased delays from the base case, which actually present relatively similar outcomes.

No matter how we cut it, Dubai is still developing at a far greater rate than Abu Dhabi and supply is likely to outstrip demand.

Even in our worst case where we assume negative population growth of 5%, we think there will be further development delays. What looked to be an over-supply situation actually shows the reality closer to equilibrium (but the worst case does not differ materially (now) from our base case, i.e. the profiles are the same.

We estimate that up to 50% of planned developments will be delayed in our base case and up to 60% in our worst-case scenario (which is ultimately a balancing figure). We take these assumptions in tandem because we would expect government imposed restrictions to reduce the threat of overdevelopment and we see that currently occurring in Dubai.

Figure 94: Dubai Residential units, base case …

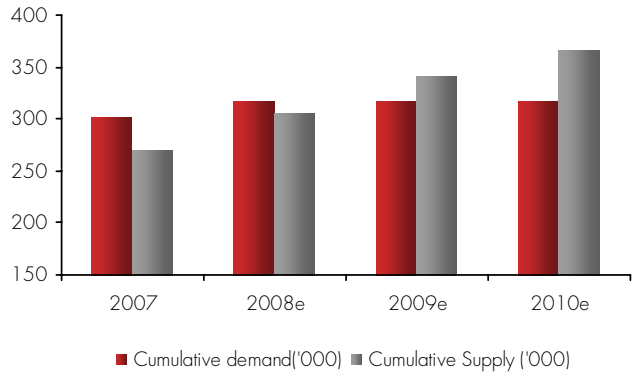


Figure 95: … worst case, negative pop growth

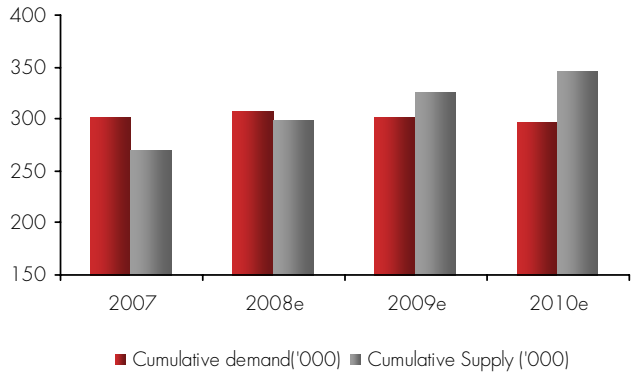
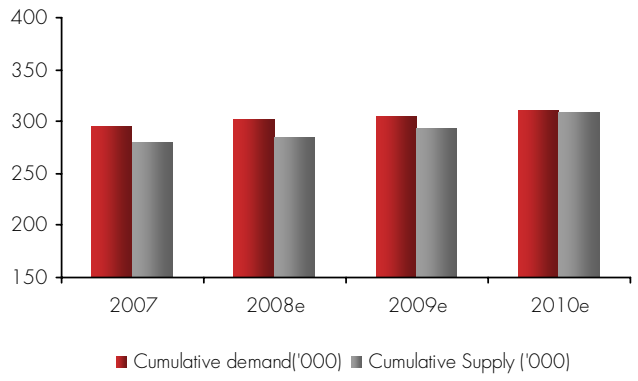
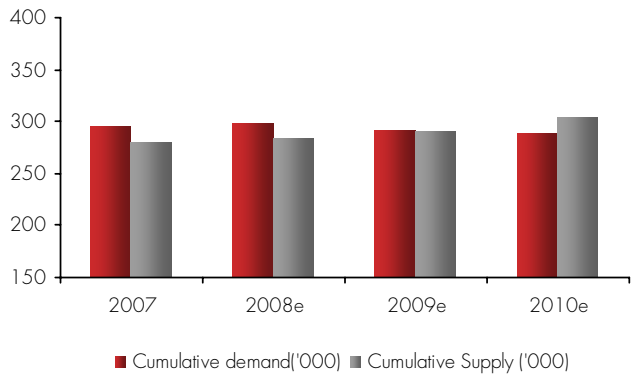


Figure 96: Abu Dhabi Residential units, base case …



Source: Colliers, Nomura estimates

Figure 97: … worst case, negative popn growth



Source: Colliers, Nomura estimates

Office overview

In the office space sector, we expect companies to now (probably aggressively) reassess their 2009 space requirements. Those with expansionary mandates have probably already pulled their orders, but currently occupied space will most likely retain their tenants. The market remains frozen; landlords are not pushing tenants to renegotiate leases with concerns that they may have to accommodate lower rents, and tenants are not moving to new space at the moment because rents remain stubbornly high. Supply of good quality office space remains tight, but we see rental pressures easing in Dubai as space comes available in 2009.

- We are cautious on Dubai's office market (we estimate rents to fall c20-30%)
- We are more positive on Abu Dhabi's office market (we estimate a stable rent environment)

Key issues

We see two key differentiating factors.

If we build it, they will come

The first factor is the planning regimes. Dubai has adopted a very laissez-faire planning regime (relatively speaking), where the goal was to create critical mass and as quickly as possible to let momentum feed on itself. It is now, when demand is slowing considerably, that these office buildings are coming to the market. We find it hard to see where the net new demand is going to come from. In Abu Dhabi, the pace of construction has been more controlled and separated from the existing centre into centralised clusters (Plan Abu Dhabi 2030).

Multi levels of ownership

The second factor is that there is a significantly larger density of 'strata-titled' buildings[5] in Dubai than in Abu Dhabi, where single ownership is more prevalent and is our preferred choice. We estimate that up to 85% of the current office space under development in Dubai is being funded by multi-ownership (similar to residential unit sales). Abu Dhabi is in the process of establishing strata law, so on balance there are more single tower owners. The distinction for us, however, is that strata title units are generally less valuable and also add successive layers of leverage into the market, which will need to de-leverage at some point. At each pass of the 'sub-division', there is another margin and another level of debt is applied and increases the risk of default along the purchaser chain.

Coupled with lower values

At the end of the development, the developer must set up a reliable management structure to ensure that service charges, management fees, common areas etc are maintained properly. This is a good source of additional income for the developers, but reduces the investor's NOI yield and the investment value.

[5] Strata title is a form of community title that allows for the horizontal and vertical subdivision of property into separate titles.

Notwithstanding other concerning issues such as sinking service charge pools, leasing activity by asset managers (i.e. who gets priority in a competitive market), we see the fragmentation of space as the most serious issue. We think this reduces competitiveness and, if presented with choice, prospective tenants would almost always take space in a single, rather than a multi-owned, building, in our view.

White elephants

We think this will be a serious issue for Dubai. Development areas across 20 Free-zones (with nine more planned) such as International City, Sports City, Motor City, Media City, DIFC and Business Bay are all ongoing, although not at break neck speed. The bulk of this has been pre-sold and therefore may be completed, but the demand is no longer there. Many of these projects, we think, will lay empty once complete.

Demand and supply

Abu Dhabi —Urban Planning Council puts space at 15m sqft, rising to 27m sqft by 2013

Dubai — Current office space of c40m sqft, with Colliers projecting this to rise to 80m sqft by 2013

We think both of these estimates will be revised downwards in coming quarters

Prime vs. the rest

The issue we see with both Abu Dhabi and Dubai is that two-thirds of the current stock is sub-prime. All current developments are prime, 'Grade-A' quality space that will improve the general quality and vacancies are running at c2% currently, well below the frictional 5% required for rental growth.

Until the end of Q408 rents had been growing strongly. Rents grew strongly in 2008 at around 20% and 30% in Abu Dhabi and Dubai respectively, but we think this will start to unwind in Dubai over 2009 as space frees up.

There is, however, still a supply 'pinch point' in Abu Dhabi. Anecdotally, we are hearing that companies are revising their space requirements (in Dubai) downwards and there is more available space that is putting immediate pressure on rents, which we think have fallen on average by c15%. Investments are now being shown with 10% yields, but these are as yet un-let buildings with rental guarantees in sub-prime locations. If we benchmark this against the UK and factor in longer lease durations, triple net leases (where the tenant absorbs all costs) and better locations then 10% looks expensive. We think office assets could therefore fall peak to trough at least 40%.

Figure 98: Office performance data (Q408)

	Average Rents (AED/sq ft pa)	Average Price (AED/sq ft pa)	Yield	Occupancy (Primary Grade)
Dubai	360	4000	8.1%	98%
Abu Dhabi	250	2950	8.4%	99%

Source: Colliers, Nomura research

Pent-up demand will help

One thing supporting the Dubai case is the amount of pent-up 'invisible' demand from tenants occupying inefficient space and looking to move – but only at the right price. At present, the rental differential between the very poor space (at say AED100 p/sqft) and current markets rates (averaging AED400 p/sqft, but peaking at AED 700 p/sqft) is too great, i.e. a restack is cheaper than a move. As Dubai rents begin to decline, poor quality space will be recycled for better quality space.

The relinquished space is then either recycled or repositioned – a feature of a maturing market.

We present our demand and supply analysis below based on an assumption that the average workspace per person is 150 sqft. We assume project delays or cancellations of up to 50% per annum for the next two years.

Figure 99: Dubai Offices, base case …

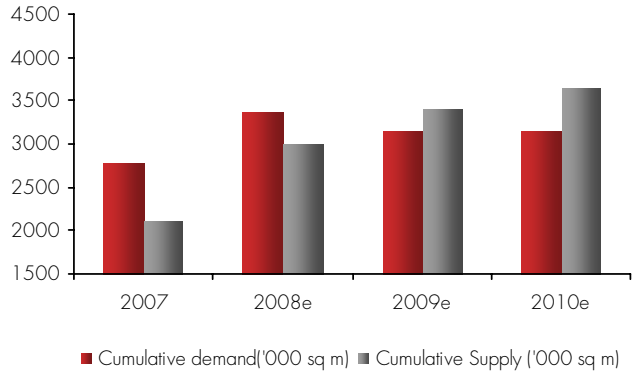


Figure 100: … worst case

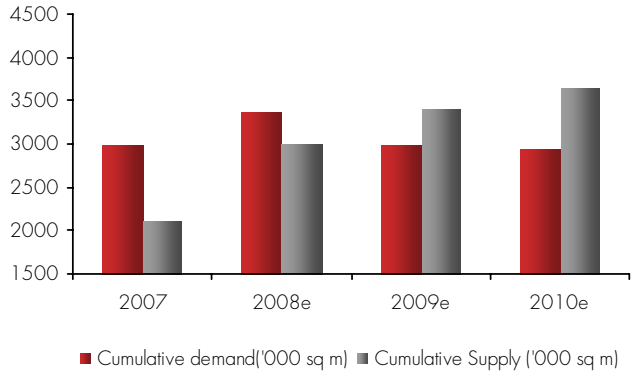


Figure 101: Abu Dhabi Offices, base case …

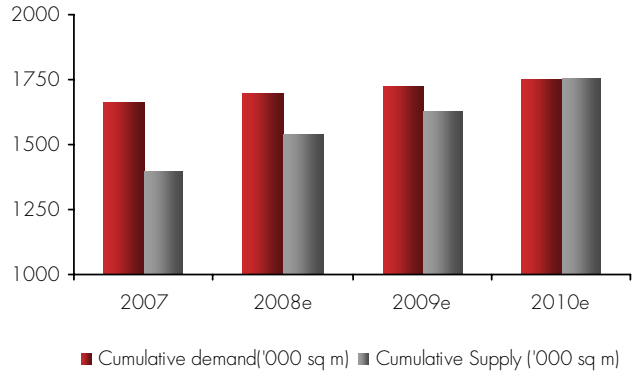
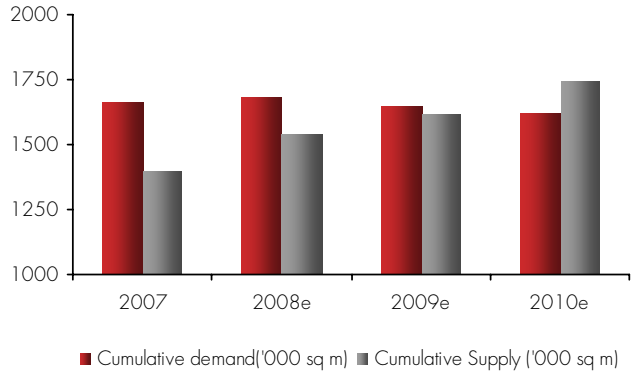


Figure 102: … worst case



Source: Colliers, Nomura estimates

Source: Colliers, Nomura estimates

Retail and hospitality overview

Like the rest of the UAE real estate sector, both the retail and hospitality sectors have grown strongly over the past five years with visitors growing at a CAGR of 8% between 2002 and 2007. Both the Dubai 2015 and Abu Dhabi 2030 plans have ambitious targets for tourist development over the next five years.

The hospitality sector

We think that the hospitality sector is likely to be affected by slower growth in tourist numbers coupled with an increase in rooms over the coming three years. Also corporate tourists, who make a major percentage of the Abu Dhabi tourist market, are likely to be reduced in number as a result of slower economic growth and lower corporate earnings. *Average occupancy rates are likely to fall and discounting will become more prevalent.*

The Abu Dhabi Tourism Authority (ADTA) plans to aggressively promote tourism. It is developing an international marketing campaign focusing on culture, sports and eco-tourism (For example, Formula One , Ferrari Theme Park on Al Yas Island, Cultural district on Saadiyat Island, etc.)

Dubai continues to attract tourists by promoting itself as an exciting shopping destination offering best-in-class hospitality. Dubai has also emerged as a key participant in the meetings, incentives, conferences and exhibitions (MICE) industry, with over 100 major international exhibitions being held in the emirate. However, corporate tourists account for 75% of current market demand in Abu Dhabi and around 30% in Dubai, according to Colliers.

Thus with corporate growth likely to slow, we expect to see a significant reduction in tourist numbers from this segment. We think Dubai's target of 15 million tourists by 2015 is ambitious, particularly given the threat or delay or cancellation of themed parks (Dubailand, Nakheel's Worlds of Discovery etc.).

Targeting expectations

We expect the usual construction delays. Even so, the new build hotels (Atlantis, Dubai and themed water park for example) aren't necessarily making the splash intended. Rooms were expected to triple in Dubai (from around 30,000 to 90,000) in five years and double in Abu Dhabi (from around 11,000 to 20,000). Occupancy rates in 2007 and 2008 were reported at levels around 85% (DTCM) which we think is unsustainably high. In terms of room targets, Dubai looks especially aggressive, in our view.

."Figure 103: Hotel performance indicators

	Number of rooms*	5* Occupancy Rate	Average Room Rate (AED)	RevPAR(AED)
Dubai	40,000	92%	1,308	1,157
Abu Dhabi	11,500	91%	1,069	926

*Source: Colliers, Nomura research, * Nomura estimates from various industry sources*

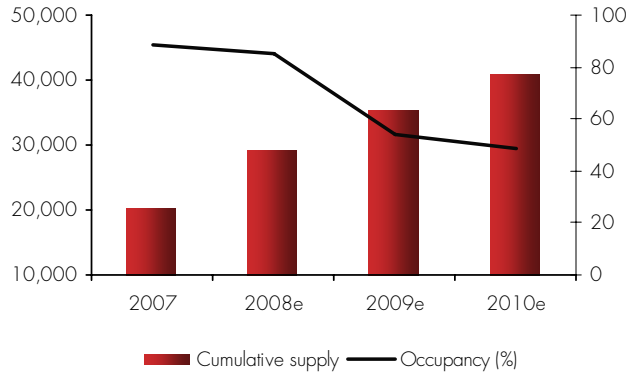
Falling occupancy

We expect hotel occupancy rates to fall significantly from current levels with tourist levels and corporate tourists already falling. The litmus test will be the month long Dubai shopping

festival (ending on 15 February) and the exhibition season that will be in full swing during 1Q09, and latterly 3Q09 when the key tourist season commences.

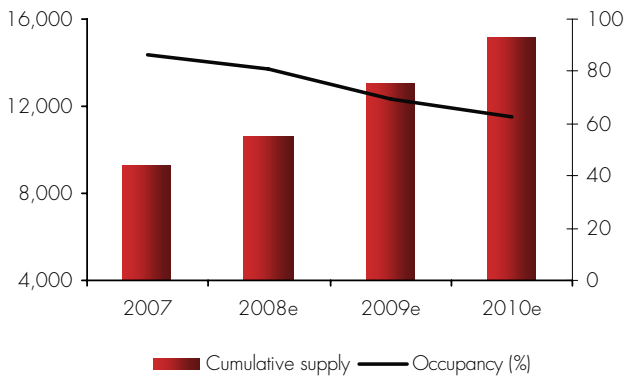
According to the global authority for hotel real estate Lodging Econometrics's (LE) construction pipeline report for the Middle East, Dubai represents 39% of all the pipeline rooms in the Middle East, which would add a further 6,100 rooms to the inventory.

Figure 104: Dubai, hotel rooms and occupancy (%)



Source: Colliers, Nomura estimates

Figure 105: Abu Dhabi, hotel rooms and occupancy (%)



Source: Colliers, Nomura estimates

We have estimated on average a construction delay of 40%-50% per annum to calculate the number of additional rooms to come on stream through the development pipeline. We have based our occupancy ratios on one tourist per room, which we admit is unrealistic but this adjusts for corporate travelers and UAE residents travelling internally and therefore does not capture official tourist statistics. In both Dubai and Abu Dhabi, occupancy rates are expected to fall considerably and below 65% (our breakeven threshold).

Based on the above assumptions, we estimate tourism would have to grow at an annual rate average rate of 20% in Dubai (from 7m in 2008 to 10.1m in 2010) and a more modest 5% in Abu Dhabi (from 1.9m in 2008 to 2.1m)

The retail sector

The retail sector (consisting of shopping malls) looks weak with a lot of supply coming into the market while we expect consumer to fall. Malls have a long gestation period, up to 5 years at times, so the supply is easy to measure. The UAE runs the risk of over-developing the market and fragmenting existing footfall. The benefit of iconic malls is that you can trap tourist dollars, but the FX trade now makes Dubai less attractive as a shopping destination.

Retailers are likely to come under increasing pressure with the falling discretionary consumer spend, which in turn affects the ability to pay rents at current levels. The luxury market is paid in plastic, the staples in cash, which will impact the high end luxury retailers – even in the Middle East.

Most malls (the new ones at least) are brimming with foreign luxury good retailers, with all of them required to trade with local partners as part of their licensing agreements. In Dubai, there have been recent examples of small units in large shopping malls being vacated – with no signs of replacement tenants.

Rents will hold in the near term, but concessions will suffer as a result of lower turnover. We expect that rents in the medium to long term will begin to fall as space becomes less economical.

The market

Air conditioned malls are just covered high streets

According to Colliers, shopping mall supply accounts for over 70% of total retail GLA, with non mall GLA representing less than 0.4m sqm in total activity and difficult to measure (souks and market places). In Abu Dhabi, malls encompass 60% of the addressable market, with 0.3m sqm in non-mall retail space. There are no high streets with the obvious benefit of shopping malls is that they are covered and air conditioned and provide free parking facilities.

Figure 106: Key performance indicators

	Existing GLA (m sqmt)	Average Rents(AED/sq ft pa)	Average Monthly Footfall(m)	Average Lease Term
Dubai	2.2	410	1.5	Three years
Abu Dhabi	0.82	324	0.9	Three years

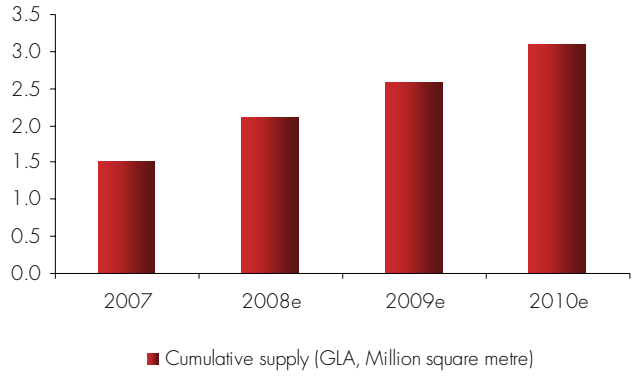
Source: Colliers, Nomura research

Aggressive growth plans …

Dubai is seeing the emergence of new formats like 'Destination shopping malls' such as the Mall of the Emirates and the recently completed Dubai Mall (Emaar) in November 2008. Modern shopping malls and various events like the Dubai shopping festival has made Dubai a shopping hub for the entire Middle East region.

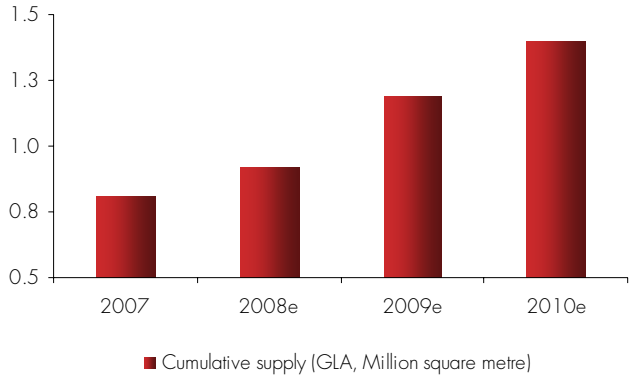
Competition is expected to intensify with a number of new malls opening up in the near future. The Mall of Arabia (phase 1) expected in 2010 will have a GLA of 4m sqft and in excess of10m sqft when completed, surpassing the Dubai Mall. Market estimates indicate a 35% increase in Dubai mall space and a 55% increase in Abu Dhabi mall space over the next three years (from current levels).

Figure 107: Dubai malls (GLA), supply estimates (m sqm)



Source: Colliers, Nomura research

Figure 108: Abu Dhabi malls, supply estimates (m sqm)



Source: Colliers, Nomura research

… need higher per capita spending to hold steady

Both Abu Dhabi and Dubai are planning to increase GLA by c20% per annum over the next two years. Abu Dhabi is set to increase GLA by 0.5m sqm to 1.4m sqm million square meters by 2010. Dubai is set to increase GLA by c1m sqm to c3m sqm. In order to maintain the current status quo, sales must also grow at similar rates (i.e. 20% per annum) which is only achievable by either growing the addressable market or increasing the per capita spend. We think both these scenarios are unlikely.

Colliers estimates a total retail spend of US$8bn for Dubai and US$2bn in Abu Dhabi. We estimate a per capita spend therefore of US$901 and US$576 for Dubai and Abu Dhabi, respectively, taking into account current population and tourist estimates for each emirate.

Appendix 4: Nomura's property glossary

Definition of real-estate related technical terms and abbreviations are as follows:

Available Space New and second-hand office space that is being actively marketed for occupation and/or uncommitted office space that is under construction/refurbishment and due for completion within six months.

Availability The volume of available space in square feet (see 'NIA').

Beta A measure of a security's volatility, or systematic risk, in comparison with the market. The beta coefficient is calculated using regression analysis, and is the tendency of a security's returns to respond to swings in the market. Within the context of the UAE, we think that systemic risk attached to the level of the respective development programmes are more relevant with market pricing patterns yet to be established.

CRE Commercial Real Estate.

Capital Asset Pricing Model ('CAPM') A model describing the relationship between risk and expected return CAPM says that the expected return of a security equals the risk-free rate plus a risk premium.

Capitalisation rate The yield at which the net income from an investment is discounted to ascertain its capital value at a given date.

Category A Landlord's fitting-out works, including carpeting raised floors, suspended ceilings, air conditioning and lighting.

Committed Space Contracted to be leased or sold.

Conversion Factor To convert from sq m to sq ft, multiply by 10.764.

Development Surplus Excess of latest valuation or sale price over the total development cost.

Dilapidations Those items of disrepair that arise through breach of contract, especially by one of the parties to a lease, giving rise to a right to damages or remedial action.

EMRP Equity market risk premium is the difference between the expected rate of return on the market and the risk-free rate.

EPRA European Public Real Estate Association. A professional body set up to promote, develop and represent the European listed real estate sector.

ERV The estimated open market rental value of lettable space as determined annually by the company's valuers.

Equivalent Yield The rate at which the current rental income and anticipated future income following the next rent review (based on the current estimated rental value) must be discounted in order to equate to the current capital value. The equivalent yield is often used by buyers and sellers of investment real estate to determine the current market price.

Free Zones An area designated as a Free Zone under relevant UAE legislation to encourage investment in that area by offering incentives and freedoms, not associated with other parts of the UAE or GCC.

FFO Funds from Operations is a widely used performance measure for real estate companies, defined as net income (computed in accordance with GAAP), excluding gains (or losses) from sales of real estate, plus depreciation and amortisation, and after adjustments for unconsolidated partnerships and joint ventures (*NAREIT White Paper, 2002*).

FRI Lease A lease that imposes full repairing and insuring obligations on the tenant, common in the UK.

Grade A In relation to a building or office space that is either new or completely refurbished and has not, before letting or sale, been occupied. It may also mean that the buildings or space have air conditioning and other modern facilities.

Gearing (net) Total borrowings, corporate bonds and Sukuk instruments less short-term deposits and cash, as a percentage of equity shareholders' funds.

GDV Gross Development Value is the value of the proposed development as if it were completed now.

GLA Gross Leasable Area. A term used almost exclusively for retail developments defined as the total floor area designed for tenant occupation and exclusive use.

IAS 40 An accounting standard that permits property companies to hold their investment property assets at fair market value and record them at depreciated cost.

IFRS International Financial Reporting Standards, introduced in January 2005.

Initial Yield The ratio of rental income (net of outgoings) to current value.

Interest cover Number of times interest payable is covered by operating profit and interest receivable.

Joint Venture An entity in which the group holds an interest on a long-term basis and which is jointly controlled by the group and one or more partners under a contractual arrangement, whereby decisions on financial and operating policies essential to the operation, performance and financial position of the venture require each partner's consent.

LPT	The Australian REIT regime: Listed Property Trusts, but similar offshore property investment companies are being established in the UK, which tend to be relatively passive owners of property.
Loan to value ratio ('LTV')	Net debt expressed as a percentage of total value of the group's properties.
Life for like net rental income	The percentage change in net rental income for completed properties owned throughout the current and prior year and after taking into account exchange translation movements.
Like for like or underlying real estate valuation	The change in value during the year for properties held at the current year-end after taking into account capital expenditure and exchange translation movements.
Long Lease	A lease of more than 50 years granted for a premium.
Mortgage Ratio (or Loan to Value ratio)	Gearing ratio defined as the ratio of net debt to asset value.
NAV (adj, fd)	Shareholders' funds adjusted for deferred tax and revaluation uplifts divided by the number of fully diluted shares.
NAREIT	National Association of Real Estate Investment Trusts, the US REIT industry trade body
NLA	Net leasable area is the retail area that rental payments are based on and excludes common areas and areas attached to plant and equipment.
Off plan sales	The practice of marketing housing or commercial units based on an architectural plan of the property before the structure is built
Open Market Value, 'OMV'	Open market value is defined in the RICS Red Book as the best price at which a sale of an interest in real estate would have been completed unconditionally for cash consideration on the date of valuation assuming, among other things, a willing seller and a reasonable transaction period.
Over-Rented	Space that is let at a rent above its ERV.
Passing rent	The annual rental income receivable, which may be more or less than the ERV (see over-rented and reversionary).
Pre-Sale	An agreement between a developer and a purchaser whereby the purchaser contracts to purchase a building following construction (see off plan sales).
Pre-Let	A lease signed with a tenant prior to completion of a development.

Prime building	Prestigious buildings with rents above average for the area. Normally fitted to the highest specifications catering for the premium office users (see also grade A).
REIT	Real Estate Investment Trust: in principle a tax-exempt real estate investment vehicle, which relays the underlying performance of the real estate as efficiently as possible to the investor.
REOC	Real Estate Operating Company — conventionally taxed as distinct from a REIT where such regimes exist.
RERA	Real Estate Regulatory Agency (of Dubai). A regulatory agency established in July 2007.
Red Book	The valuation manual of the Royal Institution of Chartered Surveyors (RICS) adopted by independent property appraisers.
Rental Value Growth	Increase in the ERV, as determined by the company's valuers, over the 12-month period on a like-for-like basis.
Residual value Approach (RVA)	Determines the value of a property where there is development potential. Total costs including all construction, fees, interest and an allowance for the developer's profit are deducted from the estimated gross value of the completed development.
Return on Shareholders' Equity	Increase in diluted net asset value per share plus dividends for the year expressed as a percentage of diluted net asset value per share at the beginning of the year.
Revenue – Contract complete	Revenues are recognised when the equitable interest in the land or property sold is transferred to the buyer.
Revenue – Percentage complete	An income recognition method whereby revenues (and associated construction costs) are smoothed over the lifecycle of the development, assuming certain pre-conditions are met.
Reversionary	Space where the passing rent is below the ERV.
Reversionary Potential	The open-market rental value divided by the contract rent.
RICS	The Royal Institution of Chartered Surveyors.
Strata titles	A form of community title that allows for the horizontal and vertical subdivision of property into separate titles.
SIIC	French REIT regime: Société d'investissement immobiliers cotes.
SICAFI	Belgium REIT regime: Société d'investissement a capital fixe en immobiliere.

Total Development Cost	All capital expenditure on a project including the opening book value of the real estate on commencement of development, together with all finance costs.
Total Investment Real estate Return	Valuation surpluses (if measured), profit or loss on real estate sales and net rental income expressed as a percentage of the opening book value of an investment real estate portfolio.
UITF 28	Under accounting rules the balance sheet value of lease incentives given to tenants is deducted from real estate valuation and shown as a debtor. The incentive is amortised through the profit and loss account to the first rent review.
UPC	Urban Planning Council of Abu Dhabi, produced "Plan Abu Dhabi 2030" and urban structure policy framework.
Weighted Average Cost of Capital (WACC)	Market cost of debt and cost of equity capital (calculated assuming equity risk premium and beta factor) applied to fair value of debt and equity market capitalisation and then suitably weighted (quoted pre-tax).
VAT	Value-added tax - may be adopted by the UAE in 2010.

Other Authors:

Mark Cartlich (NI plc, London) (44) 20 7102 0701 Mark.Cartlich@nomura.com

Important Disclosures:

Mentioned Company	Ticker	Price	Price Date	Stock / Sector Rating
Aldar Properties	ALDR.AD	AED 2.39	12 Feb 2009	Neutral / Neutral
Deyaar Development	DEYR.DU	AED 0.50	11 Feb 2009	Reduce / Neutral
Emaar Properties	EMAR.DU	AED 2.01	12 Feb 2009	Buy / Neutral
RAK Properties	RPRO.AD	AED 0.45	11 Feb 2009	Neutral / Neutral
Sorouh Real Estate	SOR.AD	AED 2.36	11 Feb 2009	Neutral / Neutral
Union Properties	UPRO.DU	AED 0.63	11 Feb 2009	Reduce / Not Rated

All share prices mentioned are closing prices unless otherwise stated.

Rating and target price changes

	Rating		Target Price	
	Old	New	Old	New
ALDR.AD	Not Rated	Neutral	N/A	AED 2.87
DEYR.DU	Not Rated	Reduce	N/A	AED 3.13
EMAR.DU	Not Rated	Buy	N/A	AED 2.93
RPRO.AD	Not Rated	Neutral	N/A	AED 0.64
SOR.AD	Not Rated	Neutral	N/A	AED 0.79
UPRO.DU	Not Rated	Reduce	N/A	AED 0.66

ISSUER SPECIFIC REGULATORY DISCLOSURES

Online availability of research and additional conflict-of-interest disclosures:

Nomura Japanese Equity Research is available electronically for clients in the US on NOMURA.COM, REUTERS, BLOOMBERG and THOMSON ONE ANALYTICS. For clients in Europe, Japan and elsewhere in Asia it is available on NOMURA.COM, REUTERS and BLOOMBERG.

Important disclosures may be accessed through the left hand side of the Nomura Disclosure web page http://www.nomura.com/research or requested from Nomura Securities International, Inc., on 1-877-865-5752. If you have any difficulties with the website, please email researchportal@nomura.co.uk for technical assistance.

The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by Investment Banking activities.

Distribution of Ratings:

Nomura Global Equity Research has 1370 companies under coverage.
32% have been assigned a Buy or Buy rating which, for purposes of mandatory disclosures, are classified as a Buy rating; 35% of companies with this rating are investment banking clients of the Nomura Group*.
47% have been assigned a Neutral rating which, for purposes of mandatory disclosures, is classified as a Hold rating; 62% of companies with this rating are investment banking clients of the Nomura Group*.
21% have been assigned a Reduce or Sell rating which, for purposes of mandatory disclosures, are classified as a Sell ratings; 14% of companies with this rating are investment banking clients of the Nomura Group*.
As at 06 January 2009.

**The Nomura Group as defined in the Disclaimer section at the end of this report.*

Explanation of Nomura's equity research rating system in Europe, Middle East and Africa, US and Latin America for ratings published from 27 October 2008:

The rating system is a relative system indicating expected performance against a specific benchmark identified for each individual stock. Analysts may also indicate absolute upside to price target defined as (fair value - current price)/current price, subject to limited management discretion. In most cases, the fair value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as discounted cash flow or multiple analysis, etc.

Stocks:

- A rating of "1", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
- A rating of "2", or **"Neutral"**, indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
- A rating of "3", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
- A rating of **"RS-Rating Suspended"** indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the company.

Benchmarks are as follows: **United States:** S&P 500, MSCI World Technology Hardware & Equipment; **Europe:** Please see valuation methodologies for explanations of relevant benchmarks for stocks (accessible through the left hand side of the Nomura Disclosure web page: http://www.nomura.com/research); **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

Sectors:

A **"Bullish"** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next 12 months.
A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.

Benchmarks are as follows: **United States:** S&P 500; **Europe:** Dow Jones STOXX® 600; **Global Emerging Markets (ex-Asia):** MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Price Target – Current Price) / Current Price, subject to limited management discretion. In most cases, the Price Target will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.

- A rating of "1", or "**Buy**" recommendation indicates that potential upside is 15% or more.
- A rating of "2", or "**Neutral**" recommendation indicates that potential upside is less than 15% or downside is less than 5%.
- A rating of "3", or "**Reduce**" recommendation indicates that potential downside is 5% or more.
- A rating of "**RS**" or "**Rating Suspended**" indicates that the rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Nomura is acting in an advisory capacity in a merger or strategic transaction involving the subject company.
- Stocks labeled as "**Not rated**" or shown as "**No rating**" are not in Nomura's regular research coverage.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008):

Stocks:

- A rating of "1", or **"Strong buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 15% or more over the next six months.
- A rating of "2", or **"Buy"**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "3", or **"Neutral"**, indicates that the analyst expects the stock to either outperform or underperform the Benchmark by less than 5% over the next six months.
- A rating of "4", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
- A rating of "5", or **"Sell"**, indicates that the analyst expects the stock to underperform the Benchmark by 15% or more over the next six months.
- Stocks labeled **"Not rated"** or shown as **"No rating"** are not in Nomura's regular research coverage. Nomura might not publish additional research reports concerning this company, and it undertakes no obligation to update the analysis, estimates, projections, conclusions or other information contained herein.

Sectors:

A **"Bullish"** stance, indicates that the analyst expects the sector to outperform the Benchmark during the next six months.
A **"Neutral"** stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next six months.
A **"Bearish"** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.

Benchmarks are as follows: **Japan**: TOPIX; **United States**: S&P 500, MSCI World Technology Hardware & Equipment; **Europe**, by sector — *Hardware/Semiconductors*: FTSE W Europe IT Hardware; *Telecoms*: FTSE W Europe Business Services; *Business Services*: FTSE W Europe; *Auto & Components*: FTSE W Europe Auto & Parts; *Communications equipment*: FTSE W Europe IT Hardware; **Ecology Focus:** Bloomberg World Energy Alternate Sources; **Global Emerging Markets:** MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008:

Stocks:

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.

- A rating of "1", or "**Strong buy**" recommendation indicates that upside is more than 20%.
- A rating of "2", or "**Buy**" recommendation indicates that upside is between 10% and 20%.
- A rating of "3", or "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A rating of "4", or "**Reduce**" recommendation indicates that downside is between 10% and 20%.
- A rating of "5", or "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

A "**Bullish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A "**Neutral**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

Price targets

Price targets, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any price target may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimate

NOMURA

DISCLAIMERS

This publication contains material that has been prepared by the Nomura entity identified on the banner at the top or the bottom of page 1 herein and, if applicable, with the contributions of one or more Nomura entities whose employees and their respective affiliations are specified on page 1 herein or elsewhere identified in the publication. Affiliates and subsidiaries of Nomura Holdings, Inc. (collectively, the "Nomura Group"), include: Nomura Securities Co., Ltd. ("NSC") Tokyo, Japan; Nomura International plc, United Kingdom; Nomura Securities International, Inc. ("NSI"), New York, NY; Nomura International (Hong Kong) Ltd., Hong Kong; Nomura Singapore Ltd., Singapore; Nomura Australia Ltd., Australia; P.T. Nomura Indonesia, Indonesia; Nomura Malaysia Sdn. Bhd., Malaysia; Nomura International (Hong Kong) Ltd., Taipei Branch, Taiwan; Nomura International (Hong Kong) Ltd., Seoul Branch, Korea; or Nomura Financial Advisory and Securities (India) Private Limited, Mumbai, India (Registered Address: 2nd Floor, Ballard House, Adi Marzban Path, Ballard Pier, Fort, Mumbai, 400 001; SEBI Registration No:- BSE INB011299030, NSE INB231299034, INF231299034).

This material is: (i) for your private information, and we are not soliciting any action based upon it; (ii) not to be construed as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such offer or solicitation would be illegal; and (iii) based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon as such.

Opinions expressed are current opinions as of the original publication date appearing on this material only and the information, including the opinions contained herein, are subject to change without notice. If and as applicable, NSI's investment banking relationships, investment banking and non-investment banking compensation and securities ownership (identified in this report as "Disclosures Required in the United States"), if any, are specified in disclaimers and related disclosures in this report. In addition, other members of the Nomura Group may from time to time perform investment banking or other services (including acting as advisor, manager or lender) for, or solicit investment banking or other business from, companies mentioned herein. Further, the Nomura Group, and/or its officers, directors and employees, including persons, without limitation, involved in the preparation or issuance of this material may, to the extent permitted by applicable law and/or regulation, have long or short positions in, and buy or sell, the securities (including ownership by NSI, referenced above), or derivatives (including options) thereof, of companies mentioned herein, or related securities or derivatives. In addition, the Nomura Group, excluding NSI, may act as a market maker and principal, willing to buy and sell certain of the securities of companies mentioned herein. Further, the Nomura Group may buy and sell certain of the securities of companies mentioned herein, as agent for its clients.

Investors should consider this report as only a single factor in making their investment decision and, as such, the report should not be viewed as identifying or suggesting all risks, direct or indirect, that may be associated with any investment decision.

NSC and other non-US members of the Nomura Group (i.e., excluding NSI), their officers, directors and employees may, to the extent it relates to non-US issuers and is permitted by applicable law, have acted upon or used this material prior to, or immediately following, its publication.

Foreign currency-denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of, or income derived from, the investment. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies, effectively assume currency risk.

The securities described herein may not have been registered under the U.S. Securities Act of 1933, and, in such case, may not be offered or sold in the United States or to U.S. persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements of such Act. Unless governing law permits otherwise, you must contact a Nomura entity in your home jurisdiction if you want to use our services in effecting a transaction in the securities mentioned in this material.

This publication has been approved for distribution in the United Kingdom and European Union as investment research by Nomura International plc ("NIPlc"), which is authorised and regulated by the U.K. Financial Services Authority ("FSA") and is a member of the London Stock Exchange. It does not constitute a personal recommendation, as defined by the FSA, or take into account the particular investment objectives, financial situations, or needs of individual investors. It is intended only for investors who are "eligible counterparties" or "professional clients" as defined by the FSA, and may not, therefore, be redistributed to retail clients as defined by the FSA. This publication may be distributed in Germany via Nomura Bank (Deutschland) GmbH, which is authorised and regulated in Germany by the Federal Financial Supervisory Authority ("BaFin"). This publication has been approved by Nomura International (Hong Kong) Ltd. ("NIHK"), which is regulated by the Hong Kong Securities and Futures Commission, for distribution in Hong Kong by NIHK. Neither NIPlc nor NIHK hold an Australian financial services license as both are exempt from the requirement to hold this license in respect of the financial services either provides. This publication has also been approved for distribution in Singapore by Nomura Singapore Limited. NSI accepts responsibility for the contents of this material when distributed in the United States.

No part of this material may be (i) copied, photocopied, or duplicated in any form, by any means, or (ii) redistributed without the prior written consent of the Nomura Group member identified in the banner on page 1 of this report. Further information on any of the securities mentioned herein may be obtained upon request. If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. The sender therefore does not accept liability for any errors or omissions in the contents of this publication, which may arise as a result of electronic transmission. If verification is required, please request a hard-copy version.

Additional information available upon request.

NIPlc and other Nomura Group entities manage conflicts identified through the following: their Chinese Wall, confidentiality and independence policies, maintenance of a Stop List and a Watch List, personal account dealing rules, policies and procedures for managing conflicts of interest arising from the allocation and pricing of securities and impartial investment research and disclosure to clients via client documentation.

Disclosure information is available at the Nomura Disclosure web page: http://www.nomura.com/research