



Company Update

EMAAR Properties

Rating: Market Perform

Several Questions Remain; Changing Rating to Market Perform

We rate Emaar as Market Perform. Previously, we had placed our rating for Emaar under review. While Emaar's preliminary 1Q09 results (more details on page 2) reflected the challenging situation prevailing in the Dubai property market, we were somewhat heartened by the company's return to profitability (albeit only modestly). As expected, Emaar also switched over to the "completed contract" method of accounting in line with the rest of its peers (Aldar, Sorouh, UPP). However disappointingly, the company did not disclose its balance sheet and cash flow statements for 1Q09. Thus, we did not get insight into Emaar's financial position and liquidity, which are key questions in the minds of investors. Given that the stock has gained 35% from its Feb. 18 low of AED1.74, investors would be wise to adopt a "wait-and-see" attitude on Emaar shares. *Consequently, we rate Emaar as a Market Perform for now, with a 12-month DCF-derived target price of AED2.68.*

Several key questions remain unanswered given the lack of conference call/disclosure of 1Q09 balance sheet/cash flow statements. (1) *Has Emaar received some funds from the \$5bn already doled out by the Dubai government?* We believe that Emaar could benefit from such a cash infusion given its weak net-cash position and the fact that it has been stretching out its payables. (2) *What is its cash position?* For perspective, Emaar had AED5.4bn in cash reserves and just AED829mm in cash net of short term debt as of end-FY08. Given that Emaar could spend around AED2bn in SG&A expenses in 2009, this net cash position could imply a significant shortfall in funding operating expenses in 2009. (3) *Has Emaar slowed its pace of cash burn on development properties?* In our view, the growth in development properties is essentially a cash drain on Emaar and we would like to see a slowdown in this account as the company adjusts to the prevailing downturn. Given that the quality of assets being booked in this account is suspect, we remain concerned about the potential for future write-downs. For reference, Emaar had AED19.2bn in this account at Dec. 2008 (under its prior "percentage of completion" accounting method). (4) *Is Emaar paying its contractors?* Emaar has been pushing off payments given its significant AED13.8bn in accounts payables balance as of FY08 (549 days outstanding and 150% of FY08 cost of goods sold). Therefore, we would be curious to see if Emaar has actually paid some of its outstanding payments due to contractors in 1Q09. (5) *What is Emaar's strategy going forward?* We are of the opinion that Emaar should become proactive with lowering prices for its unsold Dubai inventory in order to attract buyers. However, so far the company has lagged players such as Sorouh and Deyaar in such initiatives. Given that the company has not held an investor call since its 3Q08 results, we are still somewhat in the dark as to Emaar's plan of action for this year. While Emaar did not announce any new pricing moves in its 1Q09 press release, management did state that Emaar is focusing on "completing existing projects, while simultaneously exploring growth opportunities in new markets." We take this statement to mean that Emaar would emphasize Dubai projects that are in advanced stages, while deferring projects that are in early stages. (6) *Other questions about level of accounts receivables, customer defaults, etc. remain unanswered.*

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Equity Data						
Current Price (AED)	2.35					
Target Price (AED)	2.68					
Upside/downside	13.9%					
12 Mo. Performance	-80%					
Market Cap. (AED bn.)	14.3					
Enterprise Value (AED bn.)	18.1					
RIC	EMAR.DU					
Bloomberg	EMAAR.UH					
(AED Millions)	2007A	2008A	2009E	2010E	2011E	
Revenues	17,869	16,015	6,957	7,514	8,265	
Gross Margins	39.5%	42.5%	45.0%	43.0%	42.0%	
EBIT	5,223	4,703	1,322	1,352	1,653	
EBIT Margin	29.2%	29.4%	19.0%	18.0%	20.0%	
EBITDA	5,404	5,004	1,704	1,766	2,108	
EBITDA Margin	30.2%	31.2%	24.5%	23.5%	25.5%	
EPS	1.08	0.50	0.25	0.33	0.39	
PE	2.18	4.69	9.24	7.20	6.08	
Cash Earnings/Share	1.11	0.55	0.32	0.39	0.46	
P/Cash Earnings	2.12	4.26	7.41	5.96	5.10	

Note: FY07/FY08 financials based on prior accounting standard and thus not comparable with forecasts.



1Q09 Results Indicative of the Weak Real Estate Market; Slight Profit is a Positive, However

1Q09 revenues reflect lower deliveries as Emaar shifts to “completed contract” accounting; Emaar achieves slight profitability vs. 4Q08.

- **Revenues of AED1.5bn declined 16% qoq and 39% yoy given fewer handovers.** Management stated in the press release that Emaar had lower deliveries and fewer sales of completed units during the quarter. The company switched over to the completed contract accounting method for revenue recognition in 1Q09.
- **Gross margins improved sequentially but were down on a yoy basis.** Emaar reported GMs of 45.3% for 1Q09 versus 34.7% in 4Q08 and 46.9% in 1Q08.
- **Emaar returns to profitability in 1Q09.** The company posted a slight AED0.04 EPS number for the quarter. In 4Q08, Emaar actually recorded a loss of AED0.40 a share primarily due to an AED 2.7bn write-down (AED0.44/share) associated with inventory and goodwill of JL Homes in the US. In 1Q08, the company posted an EPS of AED0.15.

Emaar changes its accounting method for revenue recognition from “percentage of completion” to “completed contract”

Accounting change does not impact cash at all, while providing Emaar potentially with a “larger pool of revenues” to be recognized in the future.

- **This change in methodology brings Emaar in line with its industry peers in the UAE real estate sector.** That means that instead of recognizing revenues for a project based on the proportion of construction completed (and a minimum level of non-refundable deposit collected), going forward, Emaar would only be able to recognize revenues and profits once the project is handed over. Note that this rule change only applies to property sales as Emaar continues to conservatively record its land bank at cost (unlike Aldar that records non-cash revaluation gains every quarter by moving land to its investment properties account).
- **There is No impact on cash whatsoever.** It is important to note that a company’s cash balance changes when cash is either received or paid out. The accounting standard employed for revenue recognition has no impact on cash flows or the level of cash/debt at all.
- **Future revenues/profits are likely to fluctuate more on a quarterly basis depending on property handovers.** The percentage of completion method does tend to “smooth out” revenue/earnings, which is not possible under the completed contract rule.
- **Emaar could now recognize revenues that had been previously recorded on properties yet to be completed, a positive in our view.** Under its prior percentage of completion method, Emaar had recognized revenues from properties still under construction. Going forward under the rule change, prior period results will be restated to exclude those revenues, in effect allowing Emaar to recognize those revenues once the associated properties are handed over. One can clearly see this effect in Emaar’s 4Q08 and 1Q08 income statements, where the restated revenues of AED1.8bn and AED2.5bn are *lower* than the originally reported revenues of AED3.5bn and AED4bn. So net-net, revenues from prior periods would be restated to lower levels, allowing Emaar to record those revenues in the future depending on project handovers.



- **Emaar would no longer need to reverse any previously recognized profits associated with buyer defaults.** This is another positive in our opinion. Under the previous accounting method, in case of buyer default, Emaar would have had to take a charge or reversal in order to exclude any income recognized from that buyer in the past. Completed contract avoids this as revenues are recognized on property handovers and a default just lowers the overall revenue reported for *that* period.

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