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## Research Update:

# Dubai Retail Real Estate Management Company Emaar Malls Group LLC Assigned 'BBB-' Rating; Outlook Stable

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## Research Update:

# Dubai Retail Real Estate Management Company Emaar Malls Group LLC Assigned 'BBB-' Rating; Outlook Stable

## Overview

- Emaar Malls Group LLC owns and develops large shopping malls and has stable rental income from high-quality assets in Dubai, United Arab Emirates, and we assess its business risk profile as fair and its financial risk profile as modest.
- We align the rating on the group with that on the holding company Emaar Properties, which fully owns Emaar Malls Group.
- We are assigning our 'BBB-' rating to the company.
- The stable outlook reflects our forecast that the group's rental income should allow it to maintain stable debt protection metrics and that its position within the wider group will likely remain unchanged, largely driving overall group performance and credit quality.

## Rating Action

On June 2, 2014, Standard & Poor's Ratings Services assigned its 'BBB-' long-term corporate credit rating to Dubai-based retail real estate operator Emaar Malls Group LLC (EMG). The outlook is stable.

## Rationale

Our assessment of the stand-alone credit profile (SACP) as 'bbb-' reflects our assessment of EMG's business risk profile as "fair" and its financial risk profile as "modest," according to our criteria. We also align the corporate credit rating with that on the holding, Emaar Properties, because of EMG's core status within the group.

Our assessment of EMG's business risk profile as "fair" reflects our view that the group's portfolio of income-producing retail assets will enable it to generate stable and predictable revenues from rent, supported by a high occupancy ratio above 90% and low exposure to development activities. EMG's portfolio is worth about US\$2.5 billion and comprises six large shopping centers of over 200,000 leasable square feet per asset, three neighborhood retail centers, and three assets under development--one extension, one redevelopment, and one greenfield. All are located in Dubai, United Arab Emirates (UAE).

We believe Dubai's retail market remains supported by high income per capita,

GDP growth of around 3.5%-4% in 2014, positive demographic growth of about 5% per year, and government initiatives to boost tourism, including increased airport capacity and Dubai winning Expo 2020, which are key drivers for EMG's revenues. Our view factors in EMG's strong market position in terms of size (about 5.9 million gross leasable square feet in total) and visits (17,600 footfalls per gross leasable square feet). We believe this is underpinned by very good quality standards, which provide the company with strong brand recognition. Our assessment also captures EMG's strong asset management and leasing capabilities. This is supported by a well-secured lease structure, an average lease of around 3.5 years, and income upside from the 14% turnover-based rental stream, although this may create some rent volatility, in our view.

Partly offsetting these strengths is our view of EMG's high revenue concentration in a single region (Dubai) where there are structural weaknesses and less-developed political institutions than countries with lower country risk. We also believe the high revenue concentration in one single asset, The Dubai Mall, which accounts for 84% of revenues, leaves the group very exposed to the risk of a market downturn in the area. This is further underpinned by the fact that about 40% of shoppers were tourists in 2013, which means that this segment of demand could be more cyclical and seasonal than demand from long-term residents, affecting retail sales through the year.

We view EMG's financial risk profile as "modest." Under our base-case scenario, we forecast that EMG will maintain high cash flow generation with funds from operations (FFO) to debt above 20% and strong capacity to cover interest, with an interest coverage ratio above 5x. This is supported by GDP growth in the 3%-5% range and a stable retail performance over the next 24 months. We believe the group's capital structure will remain low leveraged, with debt to EBITDA below 5x and loan to value (LTV) below 35%-40% as per its internal policy, which we view as commensurate with the rating.

We also acknowledge EMG's stability of cash flow and EBITDA stemming from its resilient income-producing asset portfolio and secured leases. Although we view the anticipated exceptional dividend distribution in 2014 as credit negative over the short term, we consider it in the context of the overall modest debt leverage and expect the group's free cash flow generation to remain positive in 2015 and thereafter. We also expect the dividend policy to revert to a more moderate payout ratio and the equity base to grow progressively, with debt to debt plus equity undepreciated at around 55%-60%.

EMG's 'bbb-' SACP currently equals the rating on the group headed by Emaar Properties, and we consider that the final ratings on both should remain closely aligned. This is because we view EMG as a "core" entity for Emaar Properties because it is integral to the group's current identity and future strategy. We view Emaar properties current and contemplated ownership in EMG as high. We believe there are important economic incentives for Emaar Properties to retain EMG's controlling shares because they contribute up to 46% of its EBITDA, and provide more stable revenues and higher margins with the same debt leverage. We also feel that there should be a long-term

commitment from the group toward its subsidiary because both entities share the same regional focus and name, and EMG could represent a strong brand image vehicle for Emaar Properties. Still, we acknowledge EMG's management's strong commitment to operating independently and some credit positive protections of minority shareholders within the contemplated governance structure, such as the independent board of directors and majority vote of independent members, which is required in any resolutions.

## **Liquidity**

We classify EMG's liquidity as "adequate," as defined in our criteria. We expect the group's ongoing liquidity sources to meet its funding needs by more than 1.2 x over the next 12 months.

Principal liquidity sources include:

- UAE dirham (AED) 1.4 billion of cash balances on Dec. 31, 2013.
- Projected positive FFO of AED1.5 billion-AED2.0 billion in 2014.
- AED5.5 billion of bank loan signed on May 21, 2014.

Principal liquidity uses include:

- No short-term debt maturities.
- Maintenance capital expenditures of AED100 million.
- AED3.5 billion of bank loans to be repaid in advance by the proceeds of the AED5.5 billion new seven-year bank loan.

## **Outlook**

The stable outlook on EMG reflects our view that it will continue contributing a large share of Emaar Properties' consolidated recurring revenues from leasing activities while maintaining, on a stand-alone basis, low debt leverage within its contemplated capital structure. We forecast ratios of debt to EBITDA of less than 5x and LTV below 35%-40%, commensurate with the current SACP. Additionally, we consider the debt-to-EBITDA ratio of less than 2x as commensurate with our current assessment of the group's credit profile and the corporate credit rating on Emaar Properties.

## **Downside scenario**

We could consider downgrading EMG if Emaar Properties failed to maintain its adjusted debt-to-EBITDA ratio at less than 2x or adequate liquidity, or if its cash flow from operations unexpectedly turned negative. This could result from sharply weakening demand for real estate in Dubai or the group's potential adoption of a more aggressive financial policy. We consider that any significant deterioration of EMG's SACP would likely result in a weaker credit profile for the group, unless the group was prepared to mitigate such adverse developments through equity increases or other measures aiming at reduction in debt leverage.

## Upside scenario

Rating upside for EMG is contingent on a higher credit assessment for the group. This could occur, for example, if we saw an increase in Emaar Properties' recurring revenues large enough to mitigate fluctuations in operating cash flows and working capital of development-related activities and if the group maintained adequate liquidity. Credit metric targets will depend on Emaar Properties' business risk profile as a majority developer or property investment company. But we would expect the targets to correspond to at least our "modest" category, as per our methodology, also under less favorable market conditions than those currently prevailing in Dubai.

## Ratings Score Snapshot

Corporate Credit Rating: BBB-/Stable/--

Business risk: Fair

- Country risk: Moderately High
- Industry risk: Low
- Competitive position: Fair

Financial risk: Modest

- Cash flow/Leverage: Modest
- Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral ("no impact")
- Capital structure: Neutral ("no impact")
- Liquidity: Adequate ("no impact")
- Financial policy: Neutral ("no impact")
- Management and governance: Satisfactory ("no impact")
- Comparable rating analysis: Neutral ("no impact")

Stand-alone credit profile: bbb-

- Group credit profile: bbb-
- Entity status within group: Core ("no impact")

## Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Key Credit Factors For The Real Estate Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012

## Ratings List

New Rating

Emaar Malls Group LLC

Corporate Credit Rating

BBB-/Stable/--

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