THE GCC DEBT MARKET REPORT

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June 2010

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1. Executive Summary

I. Scope of the Report

The report aims to address investors looking for investment opportunities in the Gulf Cooperation Council (GCC) debt market, with a special focus on the opportunities for debt financing in the small- and mid-sized companies. The report provides an overview of the debt market in the Middle East and GCC region together with discussion on key growth drivers, regulations and challenges for growth in the debt market, along with near, medium- and long-term outlook.

The report also includes a chapter on the opportunities in the GCC debt market for alternate financing companies like private equity or venture capital players, with information on the most promising sectors in the region.

II. Report Summary

The GCC debt market is at a very nascent stage compared to its international counterparts. Moreover, the debt market is largely unrepresented in the region's total capital market. However, the debt market in the region is expected to grow in medium- to- long-term, thereby offering attractive opportunities for investors.

- According to the International Monetary Fund (IMF), the debt market in the Middle East and North Africa (MENA) region stood at US$155.3 billion in 2008, accounting for a meager 0.2% of the total world debt market of US$83.3 trillion in 2008.
- The MENA debt market represented only 6.4% of the total capital market in the region in 2008, significantly lower than the world average of 37.6% for the debt market representation.

The GCC debt market has witnessed heightened activity in the past five years (2005 - 2009).

- The primary debt issuances in GCC have grown at a CAGR of 30.4% during 2006-2009 to US$72.8 billion in 2009.
- UAE dominated the bond issuances in GCC in 2009, with more than 50.0% share of the total bond issuances.
- Among the type of bonds, sovereign bond issuances (i.e. bonds issued by the governments) dominated the bond market landscape in GCC, constituting 56.6% of the total bond issuances (US$242.9 billion) in GCC during 2003-2009.
- Sukuk bond issuances grew at a CAGR of 39.7% during 2006-2009 to US$11.3 billion in 2009, compared to GCC conventional bond market's CAGR growth of 29.0% to US$61.5 billion in 2009 in the same period.

  The medium and long-term outlook of the GCC debt market remains promising owing to robust macroeconomic fundamentals of GCC.

- The strong growth outlook is boosted by robust macroeconomic fundamentals (high GDP growth rates particularly in the non-oil sector) coupled with a robust project finance market in the region.
- According to IMF, nominal GDP of the GCC economies grew to US$868.5 billion in 2009, at a CAGR of 11.9% during 2000-2009, with Qatar and UAE growing at CAGR 21.1% and 15.3%, respectively.
  – Saudi Arabia, the largest economy of the GCC region also grew, albeit a slower pace, at a CAGR of 8.7% during 2000-2009.

Strong macroeconomic fundamentals coupled with spiraling oil prices enabled the GCC economies to reinvest earnings in non-oil sectors, namely power, transportation and water to reduce their reliance on oil revenues.

- According to Middle East Economic Digest (MEED), GCC spent ~US$720.0 billion (cumulative total) on capital projects through 2000-2008. Although, UAE dominated the project activity, Saudi Arabia and Qatar also witnessed a large number of projects during the same period.

- Projects worth about US$2.3 trillion are either planned or currently underway in GCC over the next five to seven years, with UAE and Saudi Arabia commanding a lion's share (about 70%) of the total projects in the region.

- Additionally, Kuwait and Saudi Arabia, with projects worth US$250.0 billion and US$420.0 billion, respectively, planned or announced for 2010-2015, have the maximum potential for growth (as compared to 2005-2010 period) in the region.

  Despite a setback faced by sukuk in 2009, an increased allegiance towards Islamic finance products in GCC would enable growth in sukuk issuances.

  The GCC debt market is not immune from the global financial crisis and expected to face uncertainties in the near-term owing to investors' sentiments being impacted adversely due to the Dubai and the Greek debt crisis.

  Nevertheless, with the macroeconomic fundamentals of GCC remain intact; the medium and long-term outlook of the GCC debt market remains promising for the alternate financing companies.

- Cautious bank lending would also favor the alternative financing companies.

  – According to Zawya, after growing y-o-y by 48.9% and 30.2% in 2007 and 2008, respectively, gross loans and advances of the GCC banks (all listed banks - conventional and Islamic) increased marginally by 2.5% to US$505.3 billion in 2009 over 2008.

The alternative financing companies, like private equity players in the MENA region, have investable surplus of US$11.0 billion, representing about 52.0% of the total funds raised in 2009 in the region. The surplus is expected to deploy in the region in the medium-to-long term.

- The prime sectors for investment will be education, healthcare, food and food services and retail, owing to the focus of the GCC governments to develop these sectors.

However, there are some challenges which can adversely impact the debt market in the region, which include prospective delays in infrastructure projects, absence of long-term debt instruments, lack of a robust secondary trading market as well as uncertainties arising due to fear of corporate defaults.

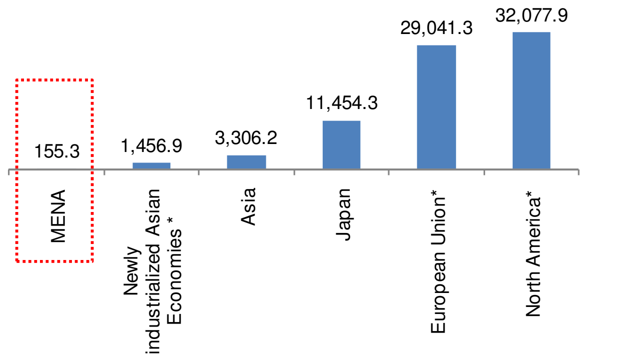
Nevertheless, we believe that an improved and clear regulatory structure would enable the growth of the debt market immensely. Initiatives like formation of a federal credit bureau in UAE and the Gulf bond and sukuk association in Dubai in January 2010 will make the debt market a regulated and effective regional credit market. Moreover, we also believe that bonds and sukuk with longer term maturities (to cater to the increasing project financing market) would also provide an impetus to the overall debt market in GCC.

2. Debt market in the MENA region

2.1. Overview

The debt market in the MENA region is relatively small when compared to its international counterparts – in both developed as well as developing countries. Notably, according to IMF, the debt market in the MENA stood at US$155.3 billion in 2008, accounting for a meager 0.2% of the total world debt market of US$83.3 trillion in 2008.

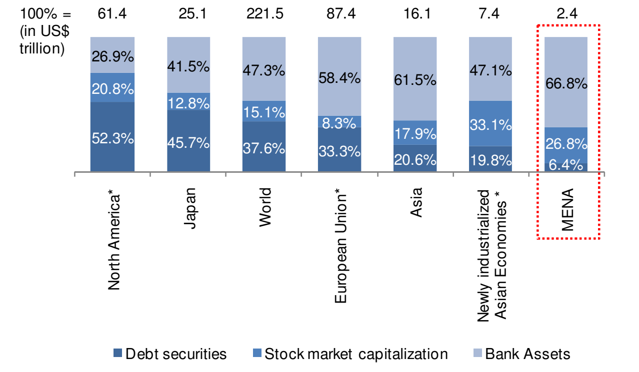
Chart 1: Global debt markets, US$ billion, 2008



*Source: IMF Global Financial Stability Report, April 2010, *Newly industrialized Asian Economies include Hong Kong SAR, Korea, Singapore, and Taiwan Province of China. European Union includes Denmark, Sweden, and the United Kingdom. North America includes Canada and United States*

Moreover, the MENA region's capital market (which includes bank assets, equities and debt securities) is primarily dominated by bank assets constituting 66.8% of the total capital market of US$2.4 trillion in 2008. The debt market in the MENA region is relatively underdeveloped as compared to its global peers, accounting for only 6.4% of the total capital market in the region in 2008, significantly lower compared to a world average of 37.6% for the debt market representation. The debt market has been grossly overlooked, and has not warranted enough attention of global bond / debt investors. The prospects of a developing local currency bond / debt market certainly present attractive opportunities for investors over the medium-to-long term.

Chart 2: Global capital market, US$ trillion, 2008



Source: IMF Global Financial Stability Report, April 2010.

2.1.1. Types of bond issuances in the MENA region

The MENA region debt/bond market can be broadly categorized as – 1) corporate and sovereign (government) bonds and 2) conventional bonds and sukuk.

The bond market in the African & Middle Eastern region is partially skewed towards sovereign bond issuances vis-à-vis corporate bond issuances, when compared to its developed market counterparts. Notably, according to the Bank for International Settlements (BIS), sovereign bonds worth US$51.4 billion were outstanding in Africa & Middle East as at 2009-end compared with corporate bonds worth US$44.1 billion outstanding as at 2009-end.

Chart 3: International bond outstanding, as at 2009 end, US$ billion

International bond outstanding (US$ billion)				
	Sovereign	Corporate	Financial Institutions	Total
Developed countries	1,712.7	2,770.9	20,135.4	24,619.0
Developing countries	516.5	248.5	567.3	1,332.3
Latin America & Caribbean	222.3	74.2	116.0	412.5
Asia Pacific	60.0	94.9	227.4	382.2
Africa & Middle East	51.4	44.1	97.7	193.2

Source: BIS, Quarterly Bulletin, March 2010

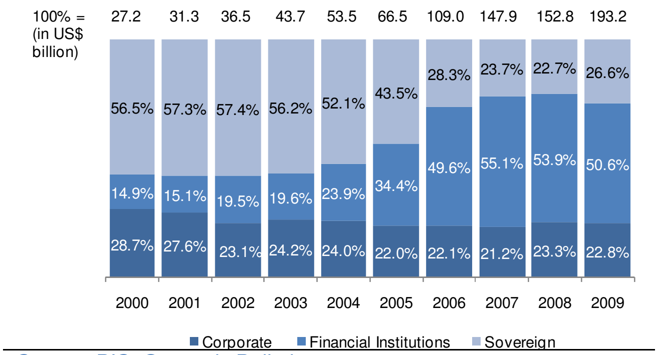
2.1.1.1. Corporate and sovereign bond issuances in the MENA region

Bond issuances in the Middle East (including Africa) grew at a steady pace during 2000-2009. According to BIS, the total bond outstanding in Middle East (including Africa) grew from US$27.2 billion in 2000 to US$193.2 billion in 2009, at a CAGR of 24.3% during the period.

Historically dominated by the sovereign bonds until 2005, the debt market in the region witnessed a notable change with the total debt outstanding of financial institutions (including that of commercial banks and other financial institutions) gaining a foothold in the region to garner ~50.0% share by 2006. The total debt outstanding of the financial institutions, corporates and sovereign grew at a CAGR of 42.4%, 21.2% and 14.3%, respectively, during 2001-2009, as per data from BIS.

Nevertheless, in uncertain times like the global financial turmoil of 2009, sovereign bond issuances gathered much more interest than other debts (due to lesser credit risk as compared to corporate bonds) as sovereign debt outstanding grew 47.8% year-on-year (y-o-y) to US$51.4 billion in 2009, more than double the growth rate of corporate debt during the same period (y-o-y growth of corporate bond issuances in 2009 was 23.6%).

Chart 4: Total debt outstanding in Africa & Middle East, 2000-2009, US$ billion

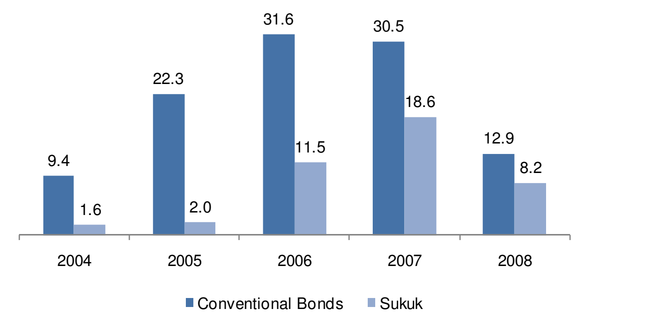


Source: BIS, Quarterly Bulletins

2.1.1.2. Conventional and sukuk bond issuances in the MENA region

Other than the conventional bond issuances, Sukuk (Islamic bonds) are also very popular in the MENA region due to investors' inclination towards Islamic finance products. According to Blominvest Bank, sukuk issuances grew to US$8.2 billion in 2008, at a CAGR of 49.9% during 2005-2008, as compared to conventional bond issuances which grew to US$12.9 billion in 2008 at a CAGR of 8.2% during the same period. This included a year of significant decline in sukuk issuances, which fell 55.7% in 2008 due to the global economic crises resulting in lower risk appetite of investors towards the less tested products like sukuk. However, in our view, an increased allegiance towards Islamic finance products would drive growth in the sukuk industry in the MENA region in the medium-to-long term.

Chart 5: Sukuk and conventional bond issuances in MENA, US$ billion



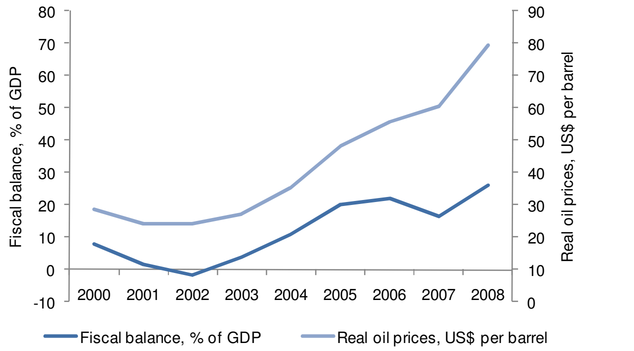
Source: Thomson One, Blominvest, Sep 2009

2.2. The GCC debt market

2.2.1. Overview

The debt market in the Gulf Cooperation Council (GCC) region is at a nascent and growing stage. Over dependence of corporate and government on bank borrowings, easy access to equity financing and strong liquidity position of the nations led by mounting oil revenues have lowered the debt requirement in the region. During the oil boom period from 2003 to 2008, the fiscal balance (difference between a government's total receipts and total expenditure) in the GCC countries strengthened due to buoyant growth in revenues, resulting in strong liquidity in the region.

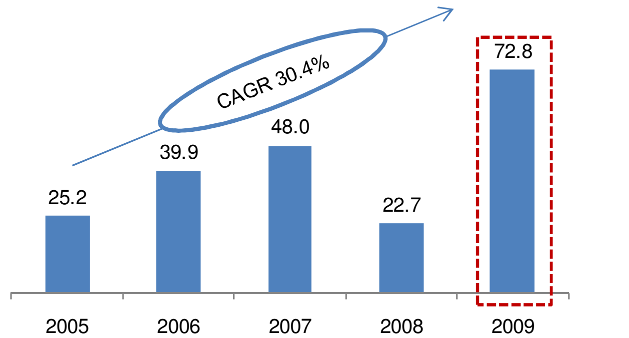
Chart 6: Fiscal balance and oil prices



Source: IMF, Finance & Development, March 2010

Nonetheless, persistent efforts of the GCC economies to reduce their overdependence on oil has led to investments in other sectors like real estate, financial services, transport etc., which led to the emergence of the GCC debt market as an attractive financing alternative. Notably, debt issuance in GCC witnessed strong growth and increased at a CAGR of 30.4% during 2006-2009 to US$72.8 billion in 2009 from $25.2 billion in 2005.

Chart 7: Debt issuance in GCC, US$ billion

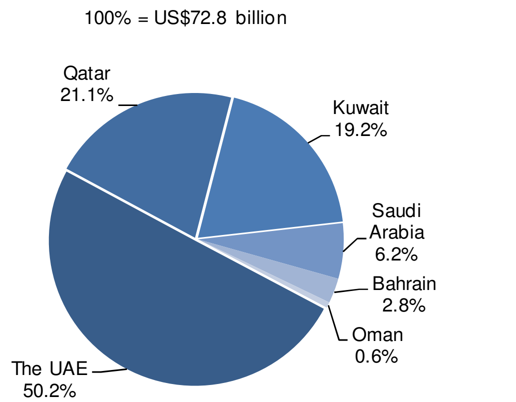


Source: Markaz Analysis, February 2010

2.2.2. Bond market-By geography in GCC

Since 2006, the UAE has been witnessing a majority share of debt issuance in GCC, due to a comparatively higher capital need led by mounting construction activities. According to Middle East Economic Digest (MEED), in April 2010, approximately US$1.0 trillion worth of projects are planned in the UAE. These are to be executed over the next 5-7 years, accounting for 44.0% of the total planned projects of US$2.3 trillion in GCC. Consequently, in 2009, UAE raised US$36.6 billion in debt, garnering a 50.2% share in the total debt issuances in GCC, followed by Qatar (US$15.3 billion, 21.1% share) and Kuwait (US$14.0 billion, 19.2% share).

Chart 8: Total bond issuance in 2009 in GCC

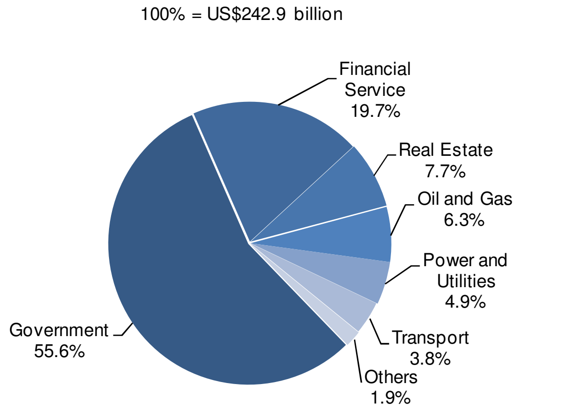


Source: Markaz Analysis, February 2010

2.2.3. Bond market-By sectors in GCC

Over the last six years (2003-2009), sovereign issuers (i.e. government sector) issued US$135.1 billion of bonds, thereby dominating the bond market in GCC with a 55.6% share. Other than the government sector, financial services and real estate sectors were the most predominant sectors and issued bonds worth US$47.9 billion and US$18.8 billion, respectively, during the same period.

Chart 9: Sector-wise bond issuance in GCC, 2003-2009



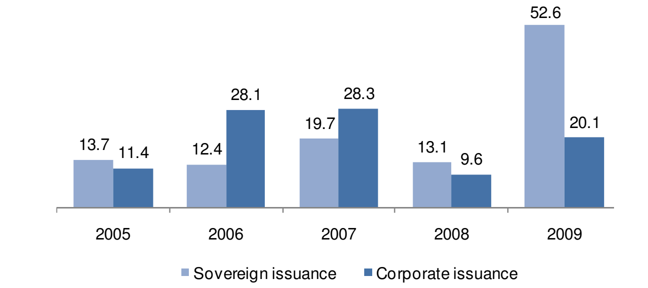
Source: Markaz Analysis , February 2010

2.2.4. Sovereign and corporate bonds in GCC

Sovereign bond issues have dominated the bond market landscape in GCC and accounted for more than 50.0% (average % share during 2005-2009) of the total bond issuance in the region. However, the above situation was quite different in 2006 and 2007, when corporate bond issuances dominated the GCC bond market with a 69.4% and 59.0% share, respectively, in 2006 and 2007.

The advent of the global financial meltdown in 2008, with its effect remaining in 2009, reduced investors' risk appetite and again tilted investor sentiment towards sovereign bonds owing to lower credit risk associated with sovereign bonds vis-à-vis corporate bonds, despite corporate bond issuances offering higher yield than sovereign bond issuances. Thus, sovereign bond issuances grew ~4 times y-o-y to U$52.6 billion in 2009 vis-à-vis corporate bond issuances growing ~2 times in the same year.

Chart 10: Sovereign and corporate bonds issuance in GCC, US$ billion



Source: Markaz Analysis, February 2010

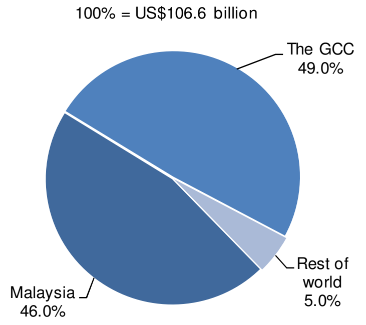
2.2.5. Conventional bonds and Sukuk in GCC

A strong demand from Muslim countries and conventional global institutions for Shariah-principled bonds has led to the growth of sukuk issuances globally.

Globally, the growth path of sukuk bonds can be seen through three phases. In the first phase (1996-2001), sukuk issues accounted for a negligible share in the total issuance, while in the second phase (2002-2007), there was strong growth in sukuk bonds led by spiraling oil prices and rapid economic growth in the GCC countries. However, the third phase from 2008 to September 2009, which witnessed the global financial crisis and Shariah compliance issues, saw a marked slowdown in issuance.

According to Watheeqa Capital, global sukuk issuances totaled a cumulative 747 issues with a total value of US$106.6 billion from December 1996 to September 2009, with activity concentrated in the Middle East (mainly the GCC countries) and South East Asia (mainly Malaysia).

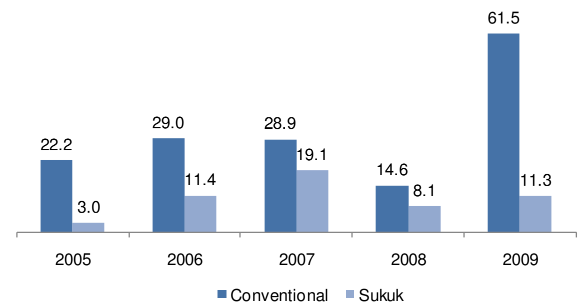
Chart 11: Global Sukuk issuance during 1996-September 2009



Source: Watheeqa Capital Company, March 2010

The sukuk market in GCC grew at a CAGR of 39.7% during 2006-2009 to US$11.3 billion in 2009. Moreover, global primary sukuk issuance increased 61.0 % y-o-y to US$25.1 billion in 2009, with GCC representing a 32.0% share in the global issuance market.

Chart 12: Conventional and Sukuk issuance in GCC, US$ billion



Source: Markaz Analysis, February 2010

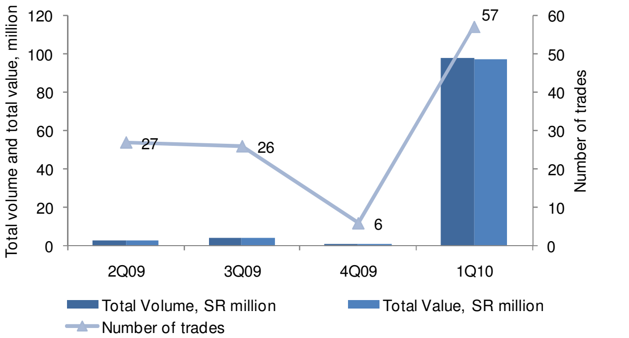
On the other hand, the GCC conventional bond market grew at a CAGR of 29.0% during 2006-2009 to US$61.5 billion in 2009. Moreover, in 2009, conventional bonds witnessed significant growth in the issuance value and reached US$61.5 billion from US$14.6 billion in 2008, to comprise 84.5% of the total issuances (The total value of conventional and sukuk issuances in GCC in 2009: US$72.8 billion) in GCC through 93 issuances in 2009.

2.2.6. Secondary debt market

With the secondary bond and sukuk trading platforms present only in Bahrain, Dubai and Saudi Arabia, the secondary debt market in GCC is still in its infancy. Consequently, the secondary debt market is characterized by lower trading activity and lack of transparency. Also, trading in sukuk remains limited in GCC as majority of the investors' hold the security until maturity.

However, according to the National Commercial Bank (NCB), Saudi Arabia, interest of investors in sukuk trading has, of late, been increasing in Saudi Arabia (secondary trading commended in Saudi Arabia in June 2009), with 57 sukuk trading activities on Saudi Arabian stock exchange (Tadawul) in 1Q10, as compared to merely 6 activities in 4Q09.

Chart 13: Sukuk trading on Tadawul



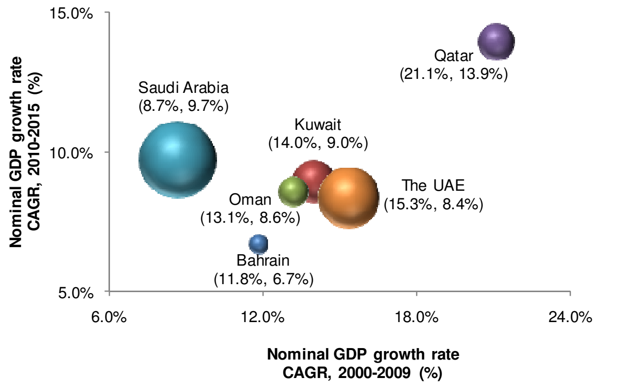
Source: Tadawul, NCB Research

3. Key growth drivers of the GCC debt market

3.1. Robust macroeconomic growth

Fuelled by rising oil prices, the GCC economies have witnessed notable growth in the past few years. According to the International Monetary Fund (IMF), nominal GDP of the GCC economies grew to US$868.5 billion in 2009, at a CAGR of 11.9% during 2000-2009, with Qatar and the UAE growing at CAGR 21.1% and 15.3%, respectively. Saudi Arabia, the largest economy of the GCC region (constituting 42.6% of the total nominal GDP of GCC in 2009), also grew, albeit a slower pace, at a CAGR of 8.7% during 2000-2009. The growth is expected to remain buoyant in the coming years with Saudi Arabia's GDP expected to continue to grow at the second highest pace in GCC (next to Qatar) at a CAGR of 9.7% during 2010-2015.

Chart 14: Nominal GDP in GCC



Source: IMF, World Economic Outlook, April 2010, Size of the bubbles indicate nominal GDP (in US$ billion) in 2009

Moreover, according to IMF, during 2010-2015 the GCC economies would continue to grow at an annual rate of 8.1%, more than double the growth rate of the advanced economies like US, UK and France. The robust macroeconomic fundamentals augur well for the growth of the debt market in GCC.

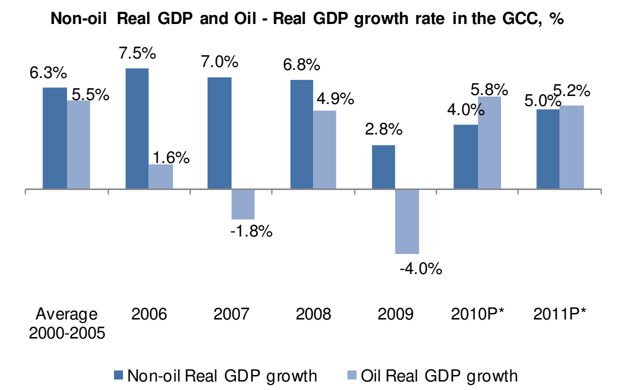
3.2. Non-oil GDP growth

While a majority of the GDP in GCC is derived from oil and oil-related businesses, the GCC countries, in their effort to diversify their economies, are channelizing their efforts to explore opportunities in other sectors like construction, transportation, manufacturing, logistics, etc. According to IMF, the non-oil sector real GDP in GCC grew at an average of 6.1% during 2000-2009 as compared to the oil sector-real GDP which grew at an average of 1.2% during the period. Moreover, the above trend (of the non-oil sector real GDP growing at a faster pace than the oil sector real GDP) is expected to continue in the medium-term in all the GCC economies. The continued growth in the non-oil sector (faster than the oil real GDP growth), would fuel growth in the capital requirement, including debt financing, in GCC.

Chart 15: Non-oil and oil real GDP growth rate in GCC, %

Non-oil Real GDP growth , %							
Country	Average 2000-2005	2006	2007	2008	2009	2010P*	2011P*
Bahrain	7.8	8.1	9.2	6.9	3.3	4.0	4.5
Kuwait	11.3	7.0	6.3	8.0	0.7	2.9	5.7
Oman	6.1	11.4	13.7	15.5	2.1	4.2	4.9
Qatar	10.0	19.9	14.5	14.5	8.0	11.5	11.0
Saudi Arabia	4.0	5.1	4.6	4.4	2.9	3.8	4.3
The UAE	9.5	9.5	9.1	6.3	1.0	0.7	2.3
The GCC	**6.3**	**7.5**	**7.0**	**6.8**	**2.8**	**4.0**	**5.0**

Oil Real GDP growth %							
	Average 2000-2005	2006	2007	2008	2009	2010P*	2011P*
Bahrain	4.1	-2.5	-0.9	-2.3	-6.6	2.7	2.3
Kuwait	16.2	2.9	-2.3	4.2	-7.5	3.5	3.5
Oman	0.8	-1.6	-1.6	6.4	5.9	5.7	4.3
Qatar	8.2	10.7	12.9	17.1	10.0	25.2	17.2
Saudi Arabia	4.3	-0.8	-3.6	4.2	-6.4	3.5	3.3
The UAE	3.9	6.5	-2.7	1.6	-6.3	3.3	5.7
The GCC	**5.5**	**1.6**	**-1.8**	**4.9**	**-4.0**	**5.8**	**5.2**



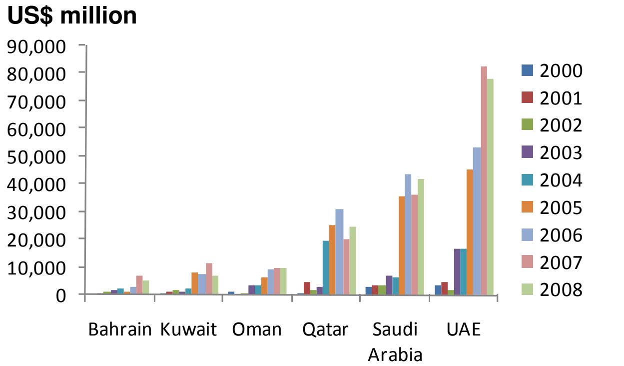
Source: IMF, Middle East & Central Asia Outlook, May 2010, P= Projected*

3.3. Vibrant project finance market

Strong macroeconomic fundamentals led the GCC economies to reinvest earnings in development of their key sectors like petrochemicals and industrials.

Additionally, in order to reduce its dependence on oil and gas, and other related industries, the GCC economies started to invest in other sectors namely power, transportation and water. According to MEED, GCC spent ~US$720.billion (cumulative total) on capital projects through 2000-2008. Although, the UAE dominated the project activity, Saudi Arabia and Qatar also witnessed a large number of projects during the same period.

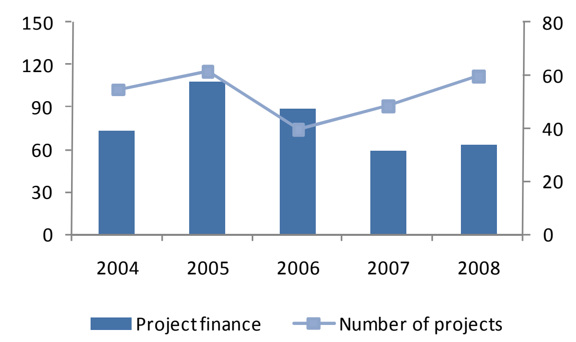
Chart 16: Value of projects awarded in GCC, 2000-2008, US$ million



Source: MEED

A large number of the above projects are financed through bonds or sukuk due to their longer tenure, as short-term funding cannot finance long duration projects and might lead to mismatches (pertaining to income generation versus debt repayment obligations) resulting in payment defaults. Notably, as per Blominvest Bank, about 60 projects raised ~US$63.0 billion of debt in the MENA region in 2008, an increase of 8.5% over 2007.

Chart 17: Project financing in MENA, US$ billion

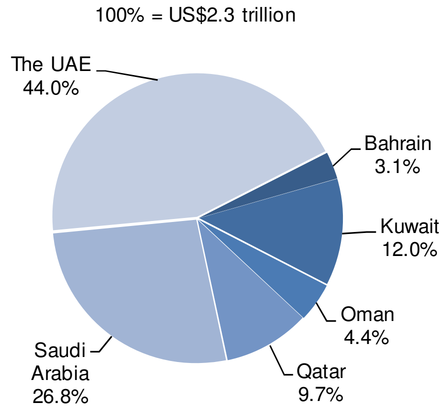


Source: Blominvest Bank, September 2009

With GCC countries continuing to have high levels of planned capital expenditure for various infrastructure projects, the need for project finance is expected to grow at a rapid pace in the medium-term. According to MEED, projects worth about US$2.3 trillion are either planned or currently underway in GCC over the next five to seven years. Notably, the UAE and Saudi Arabia command a lion's share of the total GCC projects (about 70%). In our view, the large project pipeline augurs well for the GCC debt market, with a large number of the above projects expected to be financed through bonds or sukuk.

According to MEED, project finance deals worth US$20.0 billion were completed in 2009 in GCC. MEED also expects the project finance deal value to increase 50.0% to US$30.0 billion in 2010 and to US$40.0 billion by 2011.

Chart 18: Projects planned or underway in GCC , US$ billion

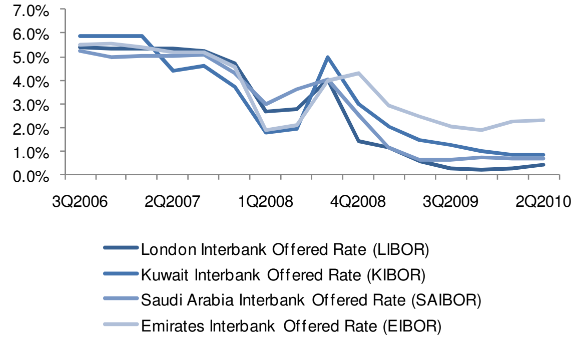


Source: MEED, Gulf projects (April 26, 2010)

3.4. Low interest rates

Low interest rate coupled with a creditor friendly environment has fuelled growth in the GCC debt markets. The GCC governments have been able to keep interest rate low due to healthy fiscal and current account balances. Moreover, post the global financial crisis, interest rates in the GCC countries have reached a near zero level. Additionally, raising debt for the GCC corporates has been relatively easier than for their international counterparts due to the inherent strength of the GCC corporates as well as the GCC economies.

Chart 19: Money market rates (3 month) in GCC, %



Source: Bloomberg

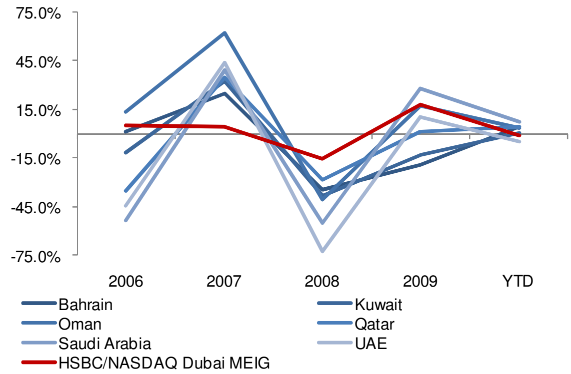
However, corporate defaults like those of Dubai World (the UAE) & Saad Group (Saudi Arabia) have raised worries about the creditworthiness of the large corporates in GCC. Consequently, sovereign debt issuances in GCC rose more than 4 times to US$52.6 billion in 2009 compared to US$13.1 billion in 2008, with the corporate bond issuances just about doubling to US$20.1 billion in 2009 from US$9.6 billion in 2008.

3.5. Volatile equity markets

The current volatility in the equity market returns coupled with risks attached with them has led to the growth of the debt markets in GCC in the past couple of years. Additionally, the global financial meltdown has led to investors seeking respite in the debt markets due to higher risk in the equity markets. Notably, the average annual return (weighted on basis of market capitalization) in the GCC equity markets has been -5.9% during 2006-year till date 2010. Also, the MSCI GCC Index (an index which gauges the six equity markets of GCC) posted -12.9% returns during the same period. On the contrary, HSBC/Nasdaq Dubai Middle East Investment Grade Index (MEIG), which tracks the return of an emerging Middle East Investment Grade bond portfolio consisting of USD/GBP/JPY/EUR denominated fixed/ floating rate vanilla sukuk/conventional bonds), generated ~2.0% return during the same period.

Chart 20: Equity market returns in GCC and HSBC Nasdaq Dubai MEIG Index total returns, %

Country	2006	2007	2008	2009	YTD
Bahrain	1.0%	24.6%	-34.7%	-19.2%	4.3%
Kuwait	-11.8%	32.0%	-38.7%	-13.4%	0.3%
Oman	13.2%	61.9%	-40.7%	17.1%	3.5%
Qatar	-35.5%	34.3%	-28.1%	1.1%	4.3%
Saudi Arabia	-53.2%	39.1%	-55.2%	27.5%	7.1%
UAE	-44.4%	43.7%	-72.4%	10.2%	-5.0%
Average	-21.8%	39.3%	-45.0%	3.9%	2.4%
Market Cap Weighted average	-38.0%	37.8%	-48.4%	14.3%	4.6%
HSBC/NASDAQ Dubai MEIG	4.9%	4.0%	-15.3%	17.9%	-1.3%



Source: Bloomberg, Dubai International Financial Exchange

3.6. Robust debt market required for economic growth

In spite of no pressing need among the GCC governments to borrow, a robust debt market is vital for economic growth to offer greater fiscal and monetary flexibility to regional economies. Moreover, an active debt market provides the government and corporate sector an alternative mode of financing as well as an asset class for diversification purposes. As per Salman Al Khalifa, Head of Global Markets, MENA, Deutsche Bank, an active debt market offers access to sources of capital to non-traditional regional investors, like pension funds and fixed income portfolios, which have historically focused on investing in government bonds.

Additionally, developed debt markets enhance transparency and accountability as governments, companies and projects financed through traceable bonds are subject to a constant scrutiny by the market participants.

4. Regulations in the GCC debt market

4.1. Lack of a clear regulatory framework

The debt markets regulations in the GCC countries are at basic stages and lack a clear regulatory framework. The governments and regulatory authorities need to take additional measures to accelerate the development of these markets. The sovereign benchmarks are largely missing as there has been no regularity in sovereign bond issuance in the four largest GCC economies (Saudi Arabia, the UAE, Kuwait and Qatar), partly due to the large oil-related fiscal surpluses. Only Bahrain and Oman have a system of sovereign bond issuances at regular intervals through their respective central banks.

In our view, to counter tighter bank lending, midsized companies in the GCC region would look for alternative forms of financing, such as bonds and private equity (PE) or venture capital funding. The leading industry experts also concur with the view point and believe that alternative financing sources will gain expected momentum in the coming periods despite increased spreads (which would increase the cost of bond financing).

4.2. Need to enhance the breadth and depth of the debt market with diversified and regulated products

Governments need to implement a proactive debt management program and ensure a large and diversified issuers' base. A focused issuance program of government securities is essential to establish benchmark for bonds. The Islamic finance industry must create guidelines to prevent the uncertainties that investors have over the structure of Islamic finance products and the underlying assets that are being used to create them.

Although the GCC countries hold a significant share of global sukuk market (estimated at US$130 billion, Dh477bn, as of April 2009), regulations and policy guidelines are relatively sparse, especially when compared to Malaysia, the largest sukuk market in the world. Malaysia has managed to create a success story of its sukuk market with proper regulatory measures and incentives. This has resulted in huge amount of cross-border investments from countries like Korea and Japan. Unlike GCC, rating for sukuk in Malaysia is mandatory. Besides, the Malaysian authorities have created a platform to quote sukuk on a daily basis through which investors can know the fair value of the debt instruments. The government in Malaysia has also incentivized issuances when it comes to the taxation aspect of it.

4.3. Legislative steps by the authorities to regulate the debt market in GCC

However, it is important to highlight that the GCC regulatory authorities are putting more emphasis on properly regulating the debt market in the region. In 2Q2010, Saudi Arabia established Tadawul sukuk market (market for listing, order submission, trade execution, clearing and settlement, and prices information dissemination of sukuk) as part of its aim to regulate the debt market in the economy. These developments are improving the prospects of sukuk becoming an attractive investment alternative, especially for the local and cross-border investors. Saudi Arabia, the largest economy in GCC, could become a major local currency issuer in the region, due to its potential local market size and funding and investment needs. Besides, Saudi Arabia is working on launching its first mortgage and finance law expected to publish in 2010.

Moreover, gradual improvements in GCC's regulatory and legal environments, coupled with more progress in the Islamic finance (particularly in sukuk structuring) will assist in establishing a strong debt market in the region.

In the following sections, we summarize the key features of debt market regulation in the GCC countries.

- **Bahrain:** The Central Bank of Bahrain regulates the debt securities market in Bahrain. The issuance of government debt securities is executed in coordination with the Ministry of Finance. Few of the key requirements of bond issuers in Bahrain are:

- A domestic bond issuer must be regulated by the Commercial Companies Law (21/2001).
- The issuer shall obtain the approval of the Central Bank of Bahrain (CBB) if the debt securities are either denominated in foreign currency or local currency, however, are being offered for subscription in international markets.
- Foreign bonds should be issued in accordance with the laws of their countries of origin.
- The bond issuer should have a minimum paid-up capital of at least US$10 million.
- The bond issuer must appoint a representative office in Bahrain to register bonds, distribute dividends, prepare reports and undertake other relevant matters.

• **Kuwait:** Ministry of Commerce and Industry regulates the bond market in Kuwait. Many amendments took place in the regulations governing trading and issuance of bond and other securities in the economy during 1990-2010. In the recent past, the Ministerial Order 133/1992 regulating the bond issuance in the country has been amended by various other ministerial orders amending or supplementing the basic regulations.

- As per the amendments, bond issuer requires bond ratings from one of the recognized international agencies before issuance.

In January 2010, Kuwait's National Assembly gave its initial approval to a bill (165-article of the Capital Market Law) aimed at forming an independent regulator to enhance transparency and combat illegal trading activities in the country. The proposal calls for the creation of a Capital Market Authority in-charge with the supervision and regulation of the stock market, as well as tough punishments for insider trading.

• **Oman:** The Capital Market Authority (CMA) of Oman regulates the debt market in the country. Depending upon the tenure of the bond maturity, the bond issuer has to obtain credit ratings in accordance with the rules prescribed by CMA.

- A company desirous to issue bonds exceeding US$25.9 million (RO10.0 million) shall produce credit ratings obtained from two different credit rating agencies.
- All issues of bonds with maturity exceeding 24 months shall be secured by company assets.
- If the maturity period of the bonds exceeds 5 years, the company shall give the bondholder the right to surrender the bonds after five years as of the date of issue and every five years thereafter, if the company's credit rating falls below the level indicating its ability to discharge its obligations.

• **Qatar:** The Qatar Financial Markets Authority (QFMA) regulates and supervises the Qatar Exchange. The regulatory body is implementing a new regulatory framework for Qatar's capital markets and the securities industry. QFMA is currently in the process of finalizing a new regulatory framework for financial disclosure, which is expected to take effect sometime in 2010. In addition to other enforcements, QFMA plans to issue new bond and sukuk listing and disclosure regulations in 2010, both of which are expected to be based on international reporting and disclosure standards.

• **Saudi Arabia:** The issuance of sukuk in the Kingdom of Saudi Arabia (KSA) is regulated by the Offer of Securities Regulations, issued by the Capital Markets Authority. The regulations do not provide any specific framework for the issuance of sukuk.

- Currently sukuk are being issued as a debt instrument under the broad definition of 'Debt Instruments' in the regulations.

- The Companies Regulations 1965, on the other hand, allows the issuance of bonds only by joint stock companies. Further, it restricts the maximum size of the bonds issued by a company to not to exceed its paid-up capital.

- The expected aggregate market value of the issue must be at least US$13.3 million (SR50.0 million) for any debt instrument.

- **The UAE:** The UAE bond market is regulated by the Dubai Financial Services Authority (DFSA) under the supervision of the UAE Securities and Commodities Authority (SCA).

  - In late 2008, SCA issued a circular stipulating that any listed company must obtain credit rating from a reputed authority before issuing bonds. It excluded government institutions from the new rules. Few important rules in the country are:

  - The domestic bond issuer should have a minimum paid-up capital of US$9.5 million (Dh35.0 million). Companies incorporated in the UAE must be in compliance with the UAE Commercial Companies Law (1984) as amended.

  - The foreign bond issuer should have a minimum paid-up capital of US$10.0 million.

  - The issuer must appoint a representative in the UAE to handle all matters related to the registration of the bonds, distribution of interest, submission of required reports to regulatory authorities and any other relevant matters.

  In June 2009, the Federal National Council passed a law to regulate public debt.

  - As per the law, the UAE Government can obtain loans of up to 45.0% of the country's gross domestic product (GDP), or less than US$81.6 billion (Dh300.0 billion), from abroad. The regulation also allows local governments of individual emirates to obtain loans that do not exceed 15.0% of their GDPs.

The law will assist in establishing a market for government bonds and private bonds in the economy.

Chart 21: Brief summary of the debt market regulatory framework in GCC

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	The UAE	Malaysia
Regulator	Central Bank of Bahrain (CBB)	Ministry of Commerce and Industry, Capital Market Authority (CMA)*	Oman Capital Markets Authority	Qatar Financial Markets Authority (QFMA)	Capital Market Authority (CMA)	The Securities and Commodities Authority (SCA), Dubai Financial Services Authority (DFSA)	Malaysia Securities Commission, Bank Negara Malaysia (the central bank of Malaysia)
Association	The Gulf Bond and Sukuk Association (GBSA)	GBSA	GBSA	GBSA	GBSA	GBSA	The Bond Dealers Association, The Financial Markets Association of Malaysia (ACI Malaysia)
Regulatory Law or Reference Work	Under Article 4 of the Central Bank of Bahrain and Financial Institutions Law 2006, Commercial Companies Law (Number 28/1975)	Capital Market Law 2010	Capital Market Law promulgated by Royal Decree No.80/98 and the Executive Regulations issued by Ministerial Decision No. 4/2001	Qatar Financial Markets Authority (QFMA) Law, 2005 (amended in 2007	Offer of Securities Regulations, Capital Market Law, 2003	The UAE Securities and Commodities Exchange Law, 2000	Securities Commission Act 1993 as amended by the Securities Commission (Amendment) Act 2000, Banking and Financial Institutions Act (BAFIA) of 1989
Minimum Capital Requirement for a bond issuer	Paid-up capital of not less than US$10 million	NA	For listing in regular markets, paid-up capital shall not be less than RO2 million (US$5.2 million)	NA	The expected aggregate market value of all securities to be listed must be at least SR50 million (US$13.3 million) for debt instruments	Minimum paid-up capital of Dh35.0 million (US$9.5 million) for domestic issuer, minimum paid-up capital of US$10.0 million for foreign issuer	NA

Source: Respective capital market regulators; Press release

NA – Not Available

* The Kuwait parliament passed the Capital Market Law to set up an independent regulatory body (Capital Market Authority) aimed at enhancing the transparency and combating illegal trading activities in the Kuwaiti stock exchange (KSE)

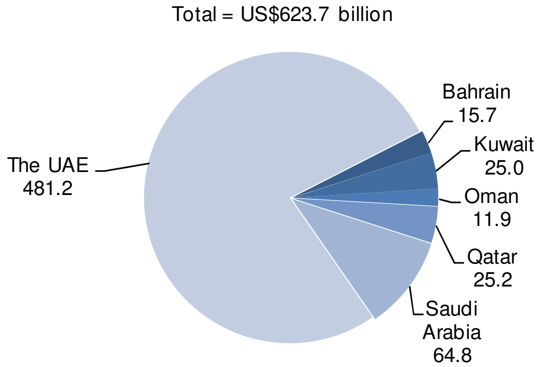
5. Challenges in the GCC debt market

5.1. Prospective delays in infrastructure projects

The future of a stable and mature debt market in the GCC region depends largely upon the implementation of high levels of planned infrastructure projects. As stated above, projects worth about US$2.3 trillion are either planned or currently underway in GCC, and are expected to complete in over the next five-to-seven years. However, the global financial crisis has led to project delays in the GCC. According to MEED, as of April 26, 2010, projects worth of US$623.7 billion were on-hold in the GCC.

In our view, any prospective delays or cancellations of these projects would reduce project financing requirements, thereby impacting the debt market adversely in GCC.

Chart 22: Value of on-hold projects in GCC, US$ billion



Source: MEED, Gulf projects (April 26, 2010)

5.2. Lack of benchmarks and dominance of short-term debt instruments

The GCC debt market is characterized with a lack of breadth, depth and liquidity, a low investor base and absence of a clear legal and regulatory framework. Other critical issues include the lack of a credit rating culture and benchmarks, unsatisfactory market transparency, dearth of long-term debt instruments and absence of a derivatives market for managing interest rate and credit risk. Recently, some bigger in value (more than US$500.0 million) sukuk and floating rate notes of banks have been issued (e.g. Emirates Airlines, Islamic Development Bank, Mashreq bank, Emirates Bank International, Abu Dhabi Commercial Bank) with a short tenure. On the government side, only Qatar and Bahrain have issued long-term Eurobonds, but not enough to form a yield curve benchmark across GCC bond markets. Moreover, an active government debt market with regular sovereign bond issuances covering all maturities creates a yield curve that serves as a benchmark to price other debts such as corporate bonds. However, the Gulf countries are awash with cash surpluses on the back of sustained high oil prices, and only a few regional governments (Oman and Bahrain) have felt the need to issue sovereign bonds at regular intervals.

The relatively short tenures of sukuk remain a constraint given the long durations of many of the planned investment ventures in GCC region. Most sukuk issues have maturities of three-to-five years, which reduces their competitiveness as compared to bank funding. It also acts as a disincentive to institutional investors with long-term liabilities. The financial crisis has highlighted the limitations of these short tenures bonds which require the GCC markets to focus more on issuing bonds with long-term maturities.

5.3. Lack of transparency and fear of prospective defaults

The debt market in GCC lacks overall transparency. The GCC countries need to enact new legislations to enforce stronger transparency and governance in their capital markets to restore investors' confidence that has been shattered by the global financial crisis. Due to the recent crisis in Dubai and Kuwait, investor's confidence in the bond market in the region has gone down. Investors and analysts remain concerned about the possibility of more sukuk defaults in the near-term. A few corporates (e.g. Dubai World) have defaulted on coupon payments and are finding it difficult to roll over debt maturing in near future, due to the liquidity constraints experienced after a steep fall in asset prices (especially real estate) during the credit crisis. Besides, tightening of lending norms by banks and other financial institutions have made it difficult for the corporates to restructure the debt on favorable terms, resulting in defaults. The global credit crisis and the prevalent opaqueness on the government support for debt burdened entities have further intensified the situation.

Though capital market authorities in GCC have issued their own corporate governance codes, the regulators need to give more emphasis on their implementation.

5.4. Lack of liquidity

As mentioned above, the secondary bond and sukuk trading platforms in the entire GCC region is available only in Bahrain, Dubai and Saudi Arabia. Due to the underdeveloped secondary markets, the debt instruments like bonds and sukuk are regarded as illiquid instruments in the GCC markets.

The debt instruments in the GCC markets are very thinly traded due to a lack of depth and transparency in the market, and unavailability of historical information about the trading activities of the debt instruments. For the whole year 2008, there were only 85 trades executed with a value of SR1.3 billion (US$345.9 million) in the region. In Saudi Arabia, secondary trading of sukuk commenced only in June 2009. In 1Q10, there were only 57 sukuk trading activities on Saudi Arabian stock exchange (Tadawul) compared to just 6 trading activities in 4Q09.

Currently, the GCC bond markets are an illiquid buy and hold market and often one can get better prices for GCC bonds in Hong Kong and London than in GCC itself. To improve the liquidity in the bond markets, the regulators in the region need to put a clear working settlement framework and clearing procedure in accordance with international standards (e.g. Euroclear, the world's largest settlement system for securities transactions, covering both bonds and equities), along with a rating culture which makes the involved credit risk transparent and accessible to investors.

5.5. Fears due to the sukuk issue disputes and Dubai World debacle

Investors sentiment was shaken by high-profile events such as the disputes associated with the US$100 million TID Global Sukuk issued by Kuwait's Investment Dar and the Dubai World debt moratorium. Both cases heightened market uncertainty and raised broader concerns about sukuk structures. The disputes have highlighted the need for widely accepted mechanisms for dealing with default-type situations. It is noteworthy to mention that both the disputes were handled in different manners without a common platform. TID filed for legal protection under Kuwait's Financial Stability Law due to resistance to its restructuring plans. However, Dubai World did not modify the terms of its sukuk due to the fear that the debt investors might sabotage the entire proposed deal with creditors. Also, Dubai World wanted to use the sukuk issue to be a part of their restructuring process without any modifications.

Further, the rising sovereign risk worries in Europe have increased investors' anxieties on the conventional bond trading. The widening spreads have caused potential issuers to move away from the debt market and the reversal in market sentiments has been relatively sharper in the case of sukuk.

5.6. Lack of a firm regulatory framework

Though the GCC member countries have regulatory bodies for their respective debt markets, they lack a clear legal and regulatory framework. Until recent times, debt markets in countries like Kuwait are regulated by the Ministry of Commerce and Industries. Some other GCC countries are also persisting with the out dated regulatory frameworks for debt markets.

5.7. Lack of skilled human resources

Deficiency of skilled human resource is potentially the most entrenched problem in establishing a robust debt market in the region. Although Saudi Arabia has a training exchange program with Malaysian Islamic finance educational and training institutes such as INCEIF (the International Islamic Centre for the Education of Islamic Finance), a lack of market familiarity with Islamic capital market products including sukuk and knowledge about Shariah standardization can have an adverse impact on the debt market in the region. The lack of proper knowledge can lead any statement from the Shariah Committees of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) or even the Islamic Fiqh Academy (IFA) to be misinterpreted or cause confusion, resulting in unfavorable consequences in the debt market.

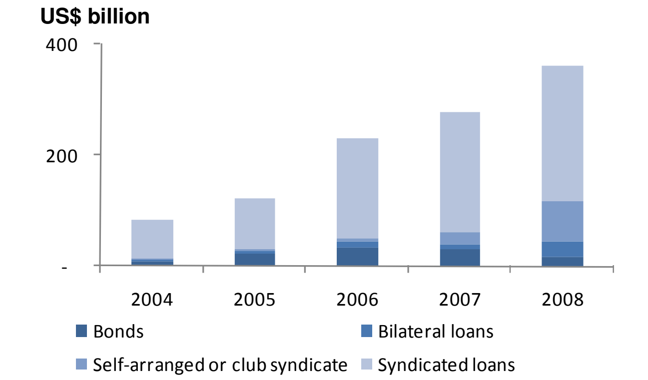
6. Opportunities in the GCC debt market

6.1. Cautious bank lending favors debt market

Bank loans - direct as well as syndicate have always dominated the MENA financing market with bonds constituting a very small portion of the total financing in the market.

The regional banks have been the front runners in disbursing loans to the corporate sector in the MENA region. According to Blominvest Bank, regional banks arranged ~45.0% of the total lead arrangers for debt in 2008.

Chart 23: Bonds and loans in the MENA region, US$ billion



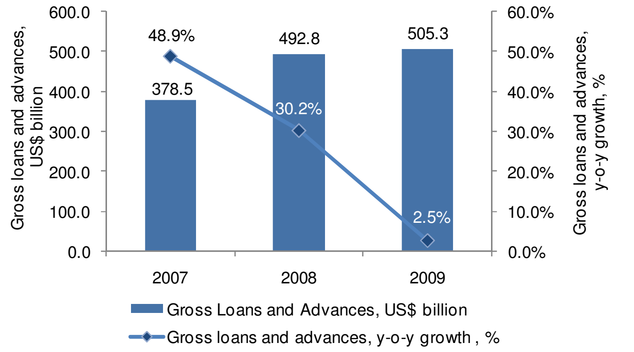
Source: Blominvest Bank, September 2009

Moreover, as per Blominvest Bank, from 2006 until 2008, the volumes of bilateral, self-arranged and club syndicate loans have increased, while corporate bond volumes have declined as self-arranged and club syndicate loans in particular, increasingly substituted bonds for general corporate financing purposes.

However, banks are less willing to lend directly across all kinds of loans, including syndicated loans, owing to the liquidity squeeze as well as the risk-averse attitude culminating from the global financial turmoil. Decline in oil prices since the peak of US$145/barrel in July 2008 coupled with declining real estate prices across GCC added to the negative outlook of the banks.

According to Zawya, after growing y-o-y 48.9% and 30.2% in 2007 and 2008, respectively, gross loans and advances of the GCC banks (all listed banks - conventional and Islamic) increased marginally by 2.5% to US$505.3 billion in 2009 over 2008.

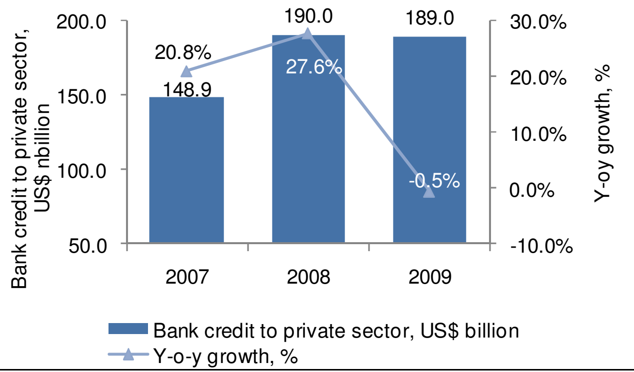
Chart 24: Gross loans and advances of the GCC banks, US$ billion



Source: Zawya

The declining trend of bank lending is also being witnessed in Saudi Arabia and UAE - the two largest economies of the region. According to Saudi Arabian Monetary Agency (Saudi Arabia's Central Bank), after a y-o-y increase of 27.6% in 2008, the total bank credit to public sector declined -0.5% y-o-y in 2009 to US$189.0 billion. However, bank credit to public sector also declined -12.2% y-o-y to US$7.5 billion in 2009, after an -14.5% y-o-y decline to US$8.5 billion in 2008.

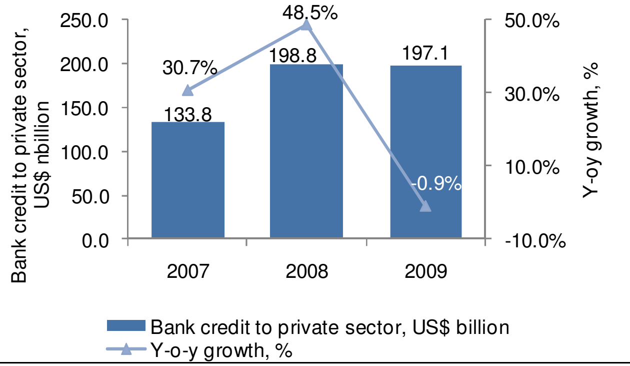
Chart 25: Saudi Arabia: Bank credit to private sector, US$ billion



Source: Saudi Arabian Monetary Agency

Similarly, according to the Central Bank of the UAE, the total bank credit to public sector declined -0.5% y-o-y to US$197.1 billion in 2009, after a y-o-y increase of 27.6% in 2008. Additionally, growth in bank credit to public sector declined, though not at the same pace as in the private sector. After growing 44.0% y-o-y to US$53.0 billion in 2008, bank credit to public sector in the UAE grew 20.6% y-o-y to US$63.9 billion in 2009.

Chart 26: UAE: Bank credit to private sector, US$ billion



Source: Central Bank of the UAE

As outlined above, the risk-averse outlook of the banks has affected the private sector immensely. In our view, to counter tighter bank lending, midsized companies in the GCC region would look for alternative forms of financing, such as bonds and private equity (PE) or venture capital funding. Moreover, as per industry experts, in the absence of bank lending, the small and mid-sized businesses are expected to explore the alternative financing forms, despite increased spreads (which would increase the cost of bond financing).

6.2. Opportunities due to diversification of the GCC economies

6.2.1. Diversification efforts of the GCC economies

The GCC economies have wisely used the gains from the spiraling oil prices by investing in large scale infrastructure and development projects as well as expanding non-oil sectors.

According to Samba Capital, (an asset management, brokerage and corporate investment advisory services firm operating from Saudi Arabia), the GCC countries have been making serious efforts to diversify their economies. Saudi Arabia, Bahrain, Qatar and the UAE (Abu Dhabi) have developed their industrial sectors by leveraging their cheap natural energy sources, abundant capital, and a strategic geographic location between Asia and Europe. Thus, the output of petrochemicals, fertilizers, cement and aluminium has gradually increased with the manufacturing sectors' contribution to real GDP now ranging from 4.0% - 16.0% for countries in GCC.

Chart 27: Sectoral share of real GDP in GCC

Country	Manufacturing	Construction	Government services	Finance & insurance	Trade & hospitality	Transport & communications	Oil & gas	Other	Total
Bahrain	16.0%	0.0%	14.0%	27.0%	8.0%	9.0%	13.0%	13.0%	100.0%
Kuwait	4.0%	0.0%	17.0%	11.0%	5.0%	8.0%	43.0%	12.0%	100.0%
Oman	9.0%	7.0%	10.0%	12.0%	12.0%	10.0%	30.0%	10.0%	100.0%
Qatar	5.0%	8.0%	12.0%	9.0%	8.0%	5.0%	51.0%	2.0%	100.0%
Saudi Arabia	12.0%	7.0%	17.0%	13.0%	8.0%	6.0%	27.0%	10.0%	100.0%
The UAE	12.0%	6.0%	7.0%	6.0%	12.0%	6.0%	37.0%	14.0%	100.0%

Source: Samba Capital, April 2010

The GCC economies also plan to facilitate growth in the manufacturing sector through the development of industrial cities and free trade zones, particularly in Saudi Arabia (like the King Abdullah Economic City) and the UAE (like the Dubai Industrial City), as well as through an increased emphasis on improving the business and investment climate both for local and foreign investors.

Moreover, the GCC economies have also developed their services sectors with banking and financial services playing a major role in all the GCC economies, particularly in Bahrain where they contributed more than 25% of its real GDP. Increased liberalization (like privatization of certain public enterprises in the telecommunications, utilities and the banking sector) and improved regulatory regimes have facilitated the development of the services sector in GCC. Additionally, expansion of container port facilities (in the UAE, Oman and Bahrain) and the airline networks have led to the growth of trade and transport services in GCC.

The tourism sector has also grown rapidly, especially in the UAE (as a travel destination facilitated by the Dubai Shopping Festivals and Dubai Summer Surprises) and Saudi Arabia (due to religious destinations such as Makkah and Madinah - Holy place for Muslims). We believe that the growth in the tourism sector in GCC would entail increased investment in hotels (particularly 4-star and 3-star hotels) in the medium-to-long-term.

With continued efforts towards diversification, the GCC governments have outlined huge investments towards the growth of the non-oil sector in their recently concluded state budgets as under:

- **Kuwait 2010/2011 budgetary plans:** Kuwait unveiled the Kuwait Economic Development Plan, with an estimated expenditure of US$125.0 billion (KD37.0 billion) primarily to promote the non-oil sector of the economy. During the duration until 2013/2014, the development plan encompasses the new business hub, Silk City, with an estimated cost of US$77.0 billion, a major container harbor and a 25 km causeway, a railway and metro system and additional spending on new cities, infrastructure and services; particularly health and education. The development plan also includes expenditures of ~US$85.3 billion (KD25.0 billion) in the oil sector to raise production capacity and modernize current facilities. Most importantly, according to the budget, development spending worth US$16.3 billion (KD4.78 billion) would be disbursed in the first year (2010/2011)

- **Oman 2010 budgetary plans:** Oman has focused on education, healthcare and road construction sectors in the 2010 budget. The Omani Government has allocated ~US2.26 billion (RO874.0 million) for the education sector, ~35.0% of the total current expenditures of the civil ministries, an increase of US$214.6 million

(RO83.0 million) or 10.0% over the approved budget for the year 2009

- **Qatar's 2010/2011 budgetary plans:** Qatar has allocated US$9.74 billion (QR35.5 billion), ~30.0% of the total ~US$32.4 billion (QR117.9 billion) budgetary allocations, to upgrade its infrastructure - airport, seaport, roads, sewage systems and expansion of electricity networks. The Qatari budget allocated 15.0%, or ~US$4.75 billion (QR17.3 billion), of the total budget to the education sector with ~US$2.06 billion (QR7.5 billion) being set apart for creating new facilities and constructing academic buildings. Additionally, the healthcare sector has been allocated US$2.36 billion (QR8.6 billion) (7.0% of the total budget spending) with a majority of the outlay to be utilized for building new hospitals and other healthcare facilities

- **Saudi Arabia's FY2010 budgetary plans:** Saudi Arabia's FY2010 budget of SR540.0 billion (US$144.0 billion) is the largest in the Kingdom's history and reflects an increase of 14.0% compared to the 2009 budget. The key theme for FY2010 being education with a budgetary allocation of US$36.5 billion (SR137.0 billion) (more than 25.0% of the total budget) to develop universities in Dammam, Al-Kharj, Majmaa and Shaqra. The budgetary allocation (SR137.0 billion) is set to fund the King Abdullah Project for the development of public education by building 1,200 new schools and the completing more than 3,000 school buildings already under construction. Additionally, SR61.0 billion (US$16.3 billion, ~11.3% of the total budget) has also been set aside for healthcare, including the construction of eight new hospitals and the expansion of the 19 existing hospitals in the Kingdom

- **The UAE's 2010 budgetary plans:** The 2010 UAE budget has outlaid government spending of US$9.63 billion (Dh35.4 billion) with infrastructure and transportation (Airport Foundation, Dubai Air Wing, Municipality and tourism) being allocated US$4.75 billion (Dh17.45 billion, 49.0% of total spending), social sector and public services (health services, education, social development and social affairs) allocated US$2.20 billion (Dh8.108 billion, 23.0% of total spending).

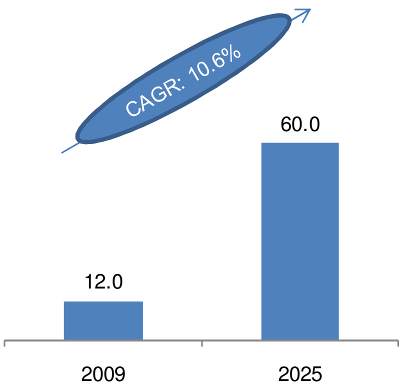
Thus, all the GCC economies plan to diversify their economies primarily by investing in the basic infrastructure (leading to growth in sectors like construction, real estate and retail, education and healthcare sectors).

6.2.2. Key sectors of growth in GCC

We outline below the growth prospects in the sectors (as enumerated above) that are expected to drive the growth in GCC in the medium-to-long-term based on analyst reports:

- **Healthcare**: The World Bank estimates the total health care spending in GCC countries will reach US$60.0 billion per year in 2025 from its current modest spending of US$12.0 billion.

Chart 28: The GCC healthcare spending, US$ billion



Source: World Bank

Moreover, according to Alpen Capital, a financial services advisory firm, the total GCC healthcare services market size (in revenue terms), valued at US$18.0 billion in 2008, is expected to grow to US$47.0 billion - US$55.0 billion by 2020, a CAGR of 9.1%- 10.7% in the period. Alpen Capital also highlights that the healthcare services industry is characterized by low private sector penetration, at

~25.0% in terms of the expenditure (in 2008) and is expected to benefit from increased private sector participation to help keep pace with increasing demand.

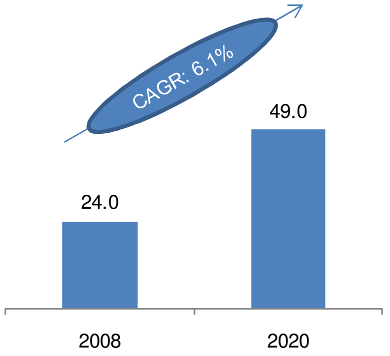
We believe an increased level of spending on the healthcare industry, as outlined in the GCC government budgets, would boost the domestic debt market as debt requirements of new companies and established companies are expected to increase in the medium-to-long term.

- **Education**: According to a World Bank report, over the past 40 years, MENA countries have dedicated on average 5.0% of their GDP (as compared to World Banks' sample of East Asia and Latin America countries average spending as a % of their GDP of 3.0%) and 20.0% of government expenditure to education, which is more than other developing countries with similar per capita income levels. As a result, the region has been able to improve equitable access to education at all levels (primary, secondary and tertiary education).

  However, in spite of achieving a near 100.0% enrollment in the primary education space, the MENA region lags behind its international counterparts (Latin America and Asia) in the secondary and tertiary education enrolments. Consequently, in 2000, the average number of years of schooling (for the population aged 15 years or more) in MENA (5.39 years) was lower than that of both the regions, Latin America (7.21 years) and Asia (7.28 years). Thus, the GCC governments have been increasing their allocation towards building quality educational institutes. The Qatar Education City (which has campuses of six US universities) and the US$2.5 billion King Abdullah University of Science and Technology in Saudi Arabia are examples of the government's commitment towards building quality educational institutions in the region.

- **Food and food services**: Water scarcity in GCC has been leading to costly domestic agricultural production and making GCC increasingly dependent on imports. As per Economist Intelligence Unit, aggregate spending on food imports is projected to grow to more than double to US$49.0 billion in 2020 from US$24.0 billion in 2008.

Chart 29: GCC food imports, US$ billion



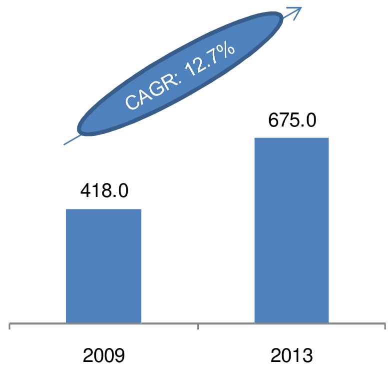
Source: Economist Intelligence Unit

  Consequently, the GCC governments and private investors are exploring agricultural land purchases all over the world, particularly in Africa, Central Asia, Southeast Asia, and Eastern Europe to ensure future food security.

  In our view, the hunt for farmlands across the world would increase the financing requirement in the sector, which is expected to be met by the debt market or through alternative financing channels like private equity or venture capital funding

- **Retail**: According to RNCOS, a global market research firm, the Middle East retail industry is poised to grow to US$675.0 billion in 2013 from US$418.0 billion in 2009 at a CAGR of 12.7%.

Chart 30: The MENA region retail industry, US$ billion



Source: RNCOS Market Research, April 2010

With an increased level of retail spending to be witnessed in the MENA/GCC regions in the medium-to-long term, the retailers are expected to infuse increased levels of financing including debt to fund their expansion plans.

6.2.3. Mid-size companies to provide impetus to GCC's growth in the long-term

Mid-size companies are expected to lead the growth momentum in the GCC region in the medium-to-long term owing to their massive potential to generate employment opportunities.

According to AT Kearney's (a global management consulting firm) 2009 report on SMBs in GCC, SMBs have the potential to create jobs at a rate ~ 4 times faster than the rate of larger corporations and create revenues and GDP at ~6 times faster than large corporations as successful SMBs growth is more exponential (also due to the low base effect vis-à-vis large corporations) than large blue chip and established business.

The above report also states that globally SMBs account for 85.0%-90.0% of the business sector contributing ~35.0%-45.0% to the global GDP and an estimated 40.0%-60.0% of total global employment. On the other hand, about 230,000 SMBs contribute ~33.3% of UAE's GDP and about 85%-95% of the total business sector in the UAE.

Finally, the report highlights that the SMBs would contribute about an additional US$100 billion to the GDP and about 2 million jobs in GCC in the medium term.

Thus, we believe, an increased number of SMBs being set up (as well as rampant growth in the already established SMBs) in GCC would entail increased debt financing requirements for these SMBs.

6.2.4. Sources of debt supply - challenges faced by mid-sized business enterprises

The liquidity squeeze has crippled the growth plans of the small- and mid-size businesses in GCC as these businesses are primarily in the early stages of growth. With the GCC banks treading cautiously, the small and mid-size businesses appear to be too risky for banks to lend to, and too young for the large regional funds to invest in. According to Dun & Bradstreet's report on SMEs (Small and Medium Enterprises) in the UAE in 2008, banks generally reject 50%-70% of credit applications from SMEs due to the higher risk and SMEs inability to meet loan conditions.

However, these small- and mid-size companies are in a dire need to expand their businesses, which requires infusion of substantial financing offering immense opportunities to the non-banking finance companies and alternative investment vehicles.

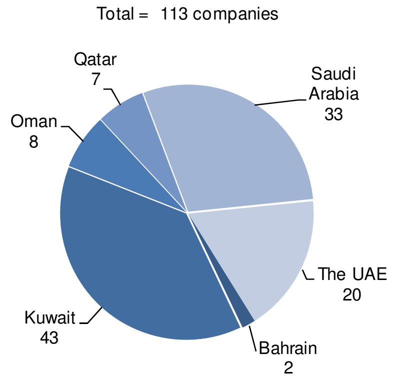
6.2.5. Opportunity assessment for non-banking (private) financing companies in GCC

To assess the opportunity for the non-banking (private) financing companies in GCC, we have analyzed the debt-equity ratio (defined as the total debt divided by total equity) of all listed companies in the GCC stock markets.

- We have defined small- and mid-sized businesses as companies with market capitalization less than US$3.0 billion but more than US$100.0 million

- The above defined peer set includes companies across all sectors except banks, insurance, financial services companies and venture capital firms as debt requirements for these companies are entirely different
- Companies with an increasing trend of debt-equity ratio from 2006 till 2009 have been analyzed for opportunity assessment
- We have shortlisted 113 companies (out of the 687 companies listed on the GCC stock exchanges)

Chart 31: Geographic breakup of peer set

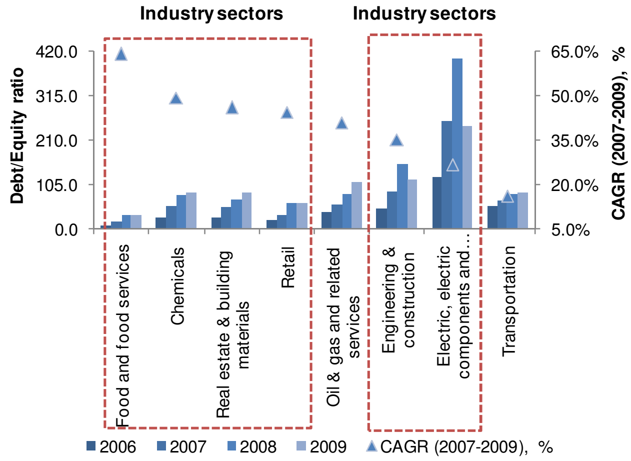


Source: Bloomberg, Bayina Advisors

According to our analysis of the peer set defined above, non-banking finance companies could target opportunities in the following two areas:

1. Assist in raising debt for small- and mid-sized companies with low levels of debt-equity ratio (less than 100.0% of the total equity) and could need additional finance for expansion, etc.
2. Help restructure debt or facilitate debt repayment for small- and mid-sized companies with high levels of debt-equity ratio (more than 100.0% of the total equity) and growing at a CAGR lower than the average growth of the sector of their presence (CAGR of less than 40.0% in 2007-2009)

Chart 32: Debt-Equity ratio of the peer set, sector-wise breakup



Source: Bloomberg, Bayina Advisors

In our view, the most important sectors for the non-banking finance companies for new debt issuance would be:

- **Food and food services -** Average debt-equity ratio of the sector in 2009: 31.42%, growing at a CAGR of 63.8% in 2007-2009
- **Chemicals -** Average debt-equity ratio of the sector in 2009: 84.94%, growing at a CAGR of 48.9% in 2007-2009
- **Real estate & building materials -** Average debt-equity ratio of the sector in 2009: 82.84%, growing at a CAGR of 45.8% in 2007-2009
- **Retail -** Average debt-equity ratio of the sector in 2009: 58.26%, growing at a CAGR of 44.1% in 2007-2009

In our view, the most important sectors for the non-banking finance companies for debt restructuring and debt repayment facility services would be:

- **Engineering and construction -** Average debt-equity ratio of the sector in 2009: 115.41%, growing at a CAGR of 34.8% in 2007-2009
- **Electric, electric components and equipments -** Average debt-equity ratio of the sector in 2009: 242.42%, growing at a CAGR of 26.6% in 2007-2009

7. Key recent events impacting the GCC debt market

7.1. Impact of Dubai debt crisis 2009

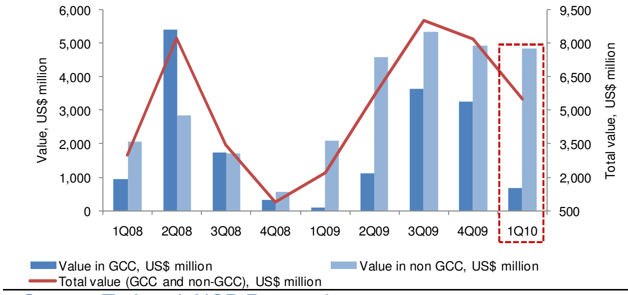
The Dubai crisis began as a result of the real estate bubble burst, which delayed the payment of US$59.0 billion debt on Dubai World for six months, including the US$3.5 billion sukuk repayment of the property developer Nakheel, due in December 2009.

The Dubai World debt represented ~75.0% of the Emirate's total debt of US$80.0 billion. During the 2005-08 boom periods, Dubai World embarked upon strong expansion plans and financed its construction activities through huge borrowings from banks. However, with the onset of global slowdown and real estate crisis the world over, there was a huge shortage of demand, though the supply remained robust leading to bubble in the real estate market. Consequently, the Dubai real estate market properties prices plunged significantly due to which Dubai World sought a debt standstill of US$26.0 billion in November 2009.

The Dubai debt crisis adversely impacted the debt issuance volume in the bond market, primarily the sukuk bonds, and widened the CDS spread. This was primarily on account of rising uncertainty in the market, sovereign risk concerns and restructuring worries.

The default in the sukuk repayment led to the decline in the GCC sukuk issuances. According to the National Commercial Bank, Saudi Arabia (NCB), the GCC sukuk issuances declined 81.0% q-o-q to US$625.0 million in 1Q10 owing to higher spreads and lower pricing issues on the supply side. However, as the credit risk associated with Dubai crisis was country- and borrower-specific, the crisis did not impact the demand and rating implications for sukuk issuances in the other regions of the world.

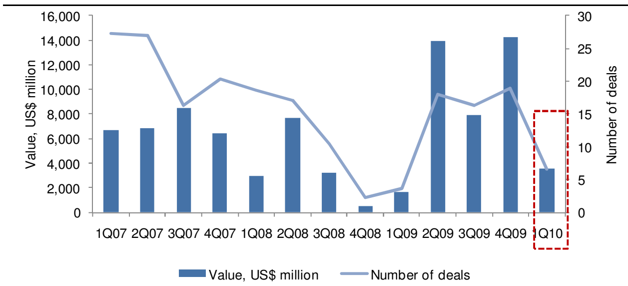
Chart 33: Global sukuk issuances



Source: Tadawul, NCB Research

Markedly, the global financial turmoil did not deter growth in the conventional bond market as the GCC government extensively relied on debt financing to fund their fiscal stimulus. Notably, conventional bonds issuance increased to US$37.8 billion in 2009 from US$14.4 billion in 2008. However, fears and uncertainty emanating from the Dubai crisis led to a substantial decline in conventional bond issuance in GCC as it declined ~75.0% q-o-q to US$3.5 billion in 1Q10 from US$14.2 billion in 4Q09.

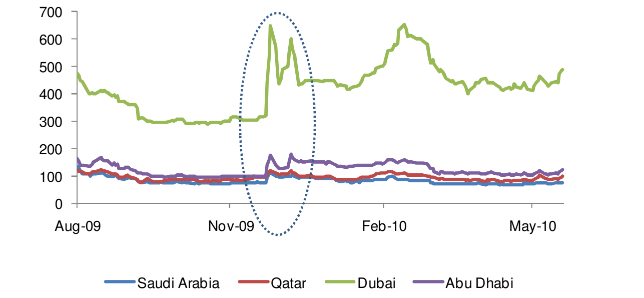
Chart 34: Conventional bond issuances in GCC



Source: NCB Research, 2010

The regional debt market received a setback with a sharp widening of the CDS spreads after Dubai World requested a six-month moratorium on its repayment obligations. Notably, Dubai's five-year CDS spread escalated by more than double and reached a peak of 647.0 basis points (bps) on November 27, 2009, from 294.18 bps on October 27, 2009. Consequently, all GCC countries experienced significant widening in the CDS spread.

Chart 35: CDS spread on GCC bonds, bps



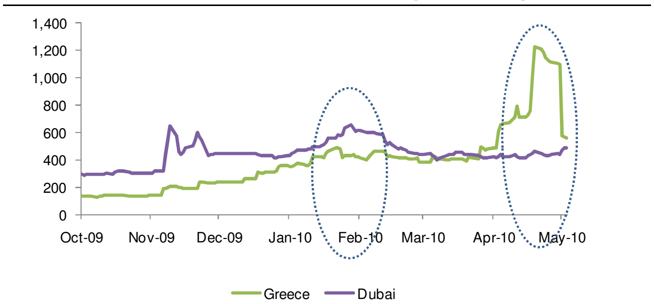
Source: Bloomberg

However, the debt restructuring plan of US$26.0 billion announced at the end of November 2009 led to narrowing of the Dubai CDS spread to 569.56 bps. Additionally, the repayment of Nakheel sukuk and US$10.0 billion bailout by Abu Dhabi in December lowered the risk uncertainty and stabilized CDS spread with 446.95 bps at the end of December, 2009.

7.2. Greek crisis

GCC was not immune to the recent sovereign debt crisis in Greece, which negatively impacted investor sentiments across the globe. Consequently, subdued debt activities by the European banks and bonds (key lenders in the GCC credit markets) impacted the GCC debt market in particular. Moreover, the decline in the oil prices owing to the Greece crisis has impacted the liquidity of the government which has further escalated the credit constraint in the region. According to Moody's investor Services, the Greece debt crisis could cause credit spread to widen with a subsequent increase in the borrowing cost, thereby declining the bond activities in the GCC market.

Chart 36: Dubai and Greece CDS spreads, bps



Source: Bloomberg

As a result of the crisis, in the mid of February 2010, the Dubai CDS spread reached 651.3 bps from 422.87 bps in mid- January 2010. However, the CDS spread began to stabilize thereafter and reached 488.1 bps on May 21, 2010, due to the US$1.0 trillion EU rescue plan announced by the EU governments. Nevertheless, in May 2010, the Greece CDS spread reached the peak of 1,226.0 bps while the CDS spread in Dubai witnessed a moderate movement. In our view, worsening debt concerns in other Euro zone countries like Portugal and Spain can create a global worry and negatively impact the GCC region in the short-to-medium term.

7.3. Negative impact on credit ratings

The Dubai World debt crisis coupled with the sovereign crisis in Greece negatively impacted the debt credit ratings in GCC. According to Moody's, the average rating in GCC has deteriorated from A1 (debt quality: upper-medium grade) in 2008 to Baa1 (debt quality: medium grade risk) in 2009 owing to uncertainties regarding the debt repayment ability of the corporates coupled with ambiguity regarding the degree of support to be received by the government.

Chart 37: Selected Moody's Investors Service Rating downgrade in the UAE

Company	Year of issuance	Initial Rating	Rating (as on December 31, 2009)
Dubai Electricity & Water Authority DEWA Funding Ltd	2008	A1	Ba2
DIFC Investments DIFC Sukuk Center	2007	A1	B2
DP World DP World Sukuk Ltd	2007	A1	Ba1
Dubai Holding Commercial Operations Group DHCOG	2007	A1	B1
Jebel Ali Free Zone JAFZ Sukuk Ltd	2007	A1	B1

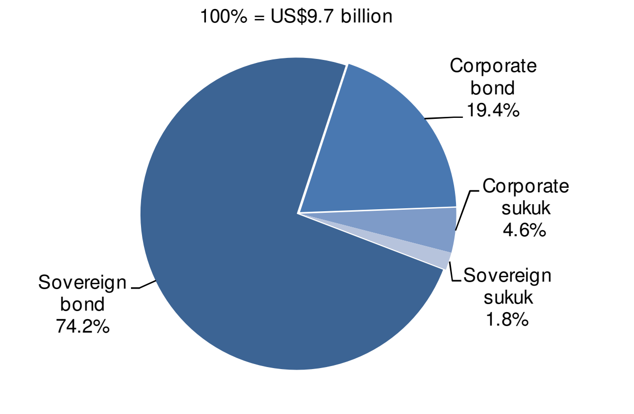
Source: Markaz Research Report

8. Outlook

8.1. Short-term outlook

During 2010 (January 2010 – April 2010) several bond issues in GCC have offered stability to the GCC debt market. Particularly, Bahrain's US$1.25 billion sovereign bond issue (initially aimed to raise US$1.0 billion), and bonds from high-rated lenders such as National Bank of Abu Dhabi and Banque Saudi Fransi in March 2010, along with Dubai Electricity and Water Authority's US$1.0 billion bond issue in April 2010, provided the much needed respite to the GCC debt market.

Chart 38: Key sukuk and conventional bond issuances in 1Q10, US$ billion



Source: NCB Capital, April 2010

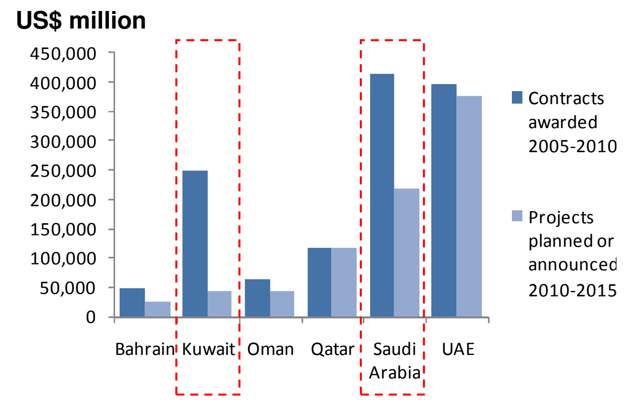
However, with only Qatar's sovereign sukuk of US$1.4 billion (expected to be launched in June 2010) being announced in GCC till date, there is no visibility over the potential pipeline of the sukuk bond issuances in the near-term. In our view, the GCC debt market would continue to face uncertainties arising due to the Dubai and the Greek debt crisis as broad investor sentiments haven't recovered completely.

8.2. Medium-term to long-term outlook

Despite the current market conditions not being completely in favor of the GCC debt markets, experts and analysts foresee massive potential in the GCC debt market in the medium-to-long term.

The reasons for the strong growth outlook are robust macroeconomics (high GDP growth rates particularly in the non-oil sector) coupled with a robust project finance market, particularly Saudi Arabia plans to boost its production and refining capacity through new investments of US$170.0 billion over the next five years, and around US$53.0 billion in water projects over the coming 15 years. Also, the state-owned Qatar Petrochemicals Company (Qapco) plans to invest US$12.0 billion to raise its production from the current 18 million tons per year to 30 million tons by 2014. According to MEED, Kuwait and Saudi Arabia, with projects worth US$250.0 billion and US$420.0 billion respectively planned or announced in 2010-2015, have the maximum potential for growth in projects market in GCC

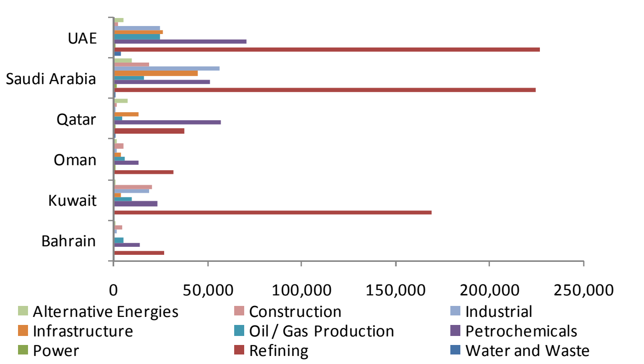
Chart 39: Value of the GCC projects by status, US$ million



Source: MEED, 24 May 2010

According to MEED, in spite of projects spread across all sectors in GCC, construction remains the largest sector with the maximum value of planned and un-awarded projects in all the GCC countries, except Qatar where infrastructure sector receives the largest share of planned and un-awarded projects.

Chart 40: Breakdown of planned and un-awarded projects by country and sector, US$ million



Source: MEED, 24 May 2010

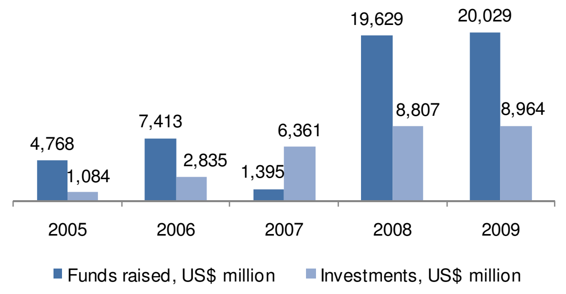
In our view, the GCC debt market is expected to receive a boost from the investment plans of corporations in the region (spanning across varied industries) which are likely to pick momentum in the medium-term as the global markets settle.

Moreover, the range of debt instruments (conventional bonds and sukuk) available in the GCC region along with varying maturities is expected to attract more international investors.

Private equity and venture funds are also expected to provide impetus for growth in the GCC/MENA region as the private equity players in the MENA region have investable surplus (known as dry powder in private equity parlance) of US$11.0 billion, representing about 52.0% of the total dry powder (total funds raised) in 2009 in the region.

We believe that the private equity players would focus on deploying the above mentioned dry powder in the region in the medium-to-long term. We also believe that the prime sectors which would attract majority of the dry powder will be education, healthcare, food and food services and retail owing to the focus of the GCC governments to develop these sectors.

Chart 41: Cumulative fundraising and investments in the MENA region by PE firms, US$ million



Source: Global Investment House

In our view, long-term fundamentals of the region are intact and favor the growth of the debt market. Nevertheless, an improved regulatory structure would enable the growth of the debt market immensely. Additionally, initiatives like creation of a federal credit bureau in the UAE and creation of the Gulf bond and sukuk association in Dubai in January 2010 would create a regulated and effective regional credit market. Moreover, bonds and sukuk with longer-term maturities to cater to the increasing project financing market would also provide an impetus to the overall debt market in GCC.

ABOUT BAYINA ADVISORS

9. About Bayina Advisors

Bayina Advisors is an independent Investment Banking and Advisory House Specialized in the Middle East and Africa Region. The firm is led by a team of seasoned bankers with experience in Equity Capital Markets, Debt Capital Markets, Leverage Finance, M&A, and financing and structuring advisory.

Bayina Advisors - Platform overview

Issuer Clients

CAPITAL MARKETS Advisory	• Leveraged / Acquisition Finance • Public Bonds/Convertibles • Mezzanine / Subordinated Debt • High Yield Private Financing • IPO's / Equity Private Placements
CORPORATE FINANCE	• Mergers & Acquisitions • Corporate Finance Advisory • Debt Advisory • Ratings Advisory
Treasury Services	• Treasury Risk Management • Derivatives and Structured Products • Liquidity Management
Alternative Investments	• Private Equity investments • Real Estate Developments • Turnaround Business Support

Investor Clients

Core Industry Sectors

Energy & Utilities Infrastructure & Transportation	Telecom & Media Real Estate	Financial Institutions Travel Tourism And Hospitality

Selected Team Credentials - Selected Transactions Mandated or Closed for Team Members…

Equity Capital Markets

Abyaar Real Estate Development أبيار للتطوير العقاري	KD 29m US$ 110m	Financial Advisor and Lead Placement Agent Placement of shares for a Kuwaiti Real Estate Company **July 2008**
DUBAI INVESTMENTS challenging the norms	AED 858m	Lead Manager & Receiving Institution Rights issue **May 2008**
VELCAN Energy	EUR 60m	Financial Advisor for Equity Private Placement Equity Private Placement for a alternative energy provider **October 2007**
du	AED 2.42bn	Lead Manager & Receiving Institution IPO and Listing **September 2006**
DUBAI INVESTMENTS challenging the norms	AED 858m	Lead Manager & Receiving Institution IPO and Listing **March 2006**
Dragon Oil	US$ 167m	Lead Manager – Gulf IPO **April 2005**

Mergers & Acquisitions and Corporate Financing Advisory

Sole Financial Advisor Sale/increase of shareholding to/by Middle Eastern investors **Ongoing**	EUR [250-400]m	**Agro-Industrial Company**
Sole Financial Advisor Acquisition of European retail chain **Ongoing**	GBP 50m	**UAE Retailer**
Financial Advisor Advice on the financing of mixed use developments including hotels, residential, commercial and retail **September 2007**	GBP 50m	مركز دبي التجاري العالمي DUBAI WORLD TRADE CENTRE
Financial Advisor Financial advisory for a number of mixed-use developments **November 2006**	AED 49bn	TATWEER A member of DUBAI HOLDING

Securitization

Joint Lead Manager & BookrunnerPre-sale contracts of real estate development **Ongoing**	USD 1.4bn	**Project Omega**

…Selected Team Credentials - Selected Transactions Mandated or Closed for Team Members

Debt Capital Markets

Emirates NBD
US$ 135m
Financial Advisor and Exchangable offer LT2 for 3yr Senior FRN
April 2009

NAKHEEL
AED 3.6 bn
Joint Lead Manager & Bookrunner
2 year DIFX listed Sukuk Al-Ijarah FRN facility
April 2008

حكومة دبي GOVERNMENT OF DUBAI
AED 6.5 bn
Joint Lead Manager & Bookrunner
5 year DFM listed fixed and floating MTN Programme
April 2008

Emirates NBD
AED 1.1bn
AED 440m
Joint Lead Manager
5 year FRN & 10NC5 LT2
March 2008

Government of Ras Al Khaimah RAK Investment Authority
US$ 325m
Joint Lead Manager & Bookrunner
5 year Sukuk Guaranteed by the Government of Ras Al Khaimah
November 2007

NAKHEEL
US$ 1.85bn
Sub-underwriter & Joint Lead Arranger
5 year Syndicated Ijara Facility
August 2007

NBD بنك دبي الوطني
US$ 500m
Joint Lead Manager & Bookrunner
Lower Tier 2 FRN
October 2006

Emirates
AED 1.8bn
Joint Lead Manager & Bookrunner
7 yr Floating Rate Notes due 2013
July 2006

Loan Syndication

GEMS EDUCATION – Educating for Brilliant Futures
US$ 100m
Sole Bookrunner & Lead Arranger
Syndicated Term Loan for a leading education provider in the UAE
November 2007

ALRAYAN Investment
AED 275m
Sole Financial Advisor & Lead Arranger
Infrastructure Project Finance
Financing of a labor accommodation
November 2008

Other Credentials

Public Offering

موانئ دبي العالمية DP WORLD
العثيم OTHAIM
بنك البلاد BANK ALBILAD
حلواني اخوان HALWANI BROS
SAUDI PAPER MANUFACTURING CO.
ONE
الاتصالات السعودية SAUDI TELECOM
Government of Ras Al Khaimah RAK Investment Authority
VELCAN Energy

Private Placements/ Rights Issue/ FRN's/Sukuk's/M&A

حكومة دبي GOVERNMENT OF DUBAI
ASTON MARTIN
NAKHEEL
الطيار Al-Tayyar
Emirates NBD
ABRAAJ CAPITAL أبراج كابيتال
Emirates
DUBAI INTERNATIONAL FINANCIAL CENTRE
NBD بنك دبي الوطني
هيئة كهرباء و مياه دبي DUBAI ELECTRICITY & WATER AUTHORITY

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