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# Banking Sweet Spots

A Markaz M&A Potential Score "MMAPS" approach

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A key question facing Gulf Co-Operation Council (GCC) companies for 2008 and beyond is: "How to sustain growth?" Driven by high oil price and robust investment environment, GCC companies have been posting record growth in earnings. However, there comes a tipping point after which growth will have to be bought. This is where the potential of mergers and acquisitions in the region takes a center stage. We believe that the impetus to this nascent but burgeoning industry comes from internal pressure on companies to buy growth as well as keenness of foreign companies to have serious Middle East exposure. From a modest USD 812 million of deal values in 2003, the level reached a staggering USD 55 billion by the end of 2007. Key take aways from this include:

- Most of the deals are cash financed (77%) reflecting high liquidity
- GCC companies look for opportunities predominantly cross-border (foreign acquisitions)
- Acquisitions have been mostly cross-sectoral &
- Financial services, especially banks, have been the hot spot of activity

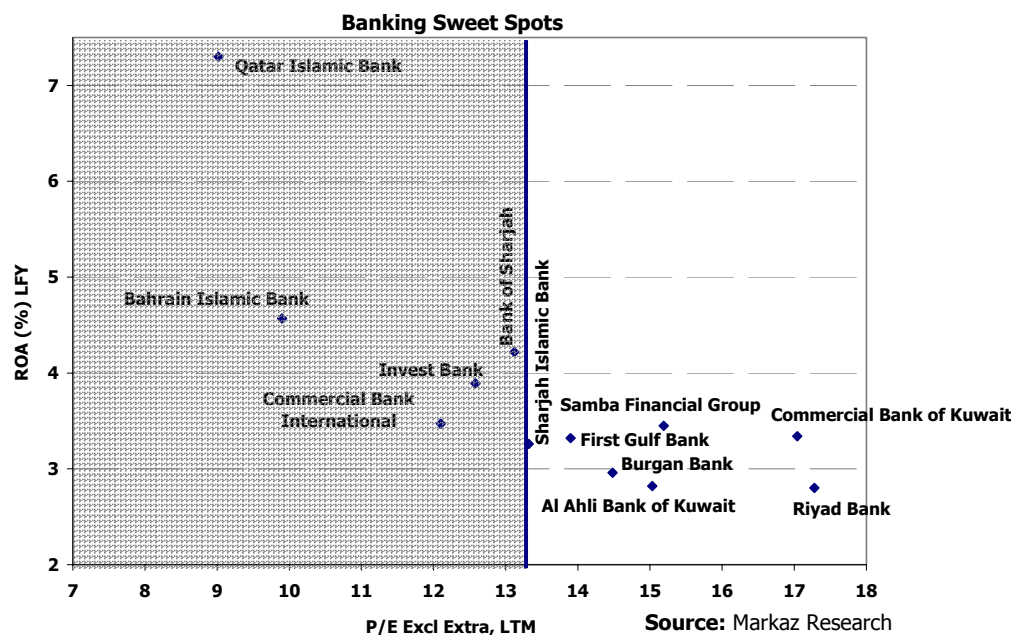
The growth in the M&A space has been aided by several enablers including high economic growth and the keen need for local companies to position for competition in an environment where protection wall has been slowly but steadily dismantled. However, there are several inhibitors to this growth that will act as unnecessary speed breakers to this process. Lack of regulatory progress especially the one governing M&A, reluctance on the part of family owned businesses to give in to external players, difficulty in valuing business, etc are but some.

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This research is an attempt to identify sweet spots (Figure: 1) within the most active sector (banking) through evaluation of companies on 4 dimensions (Performance, Valuation, Management policy & Ease of execution). We rank companies within the banking sector on the basis of "Markaz M&A Potential Score" (MMAPS). As the parameters are dynamic, the ranking is bound to change over time.

Figure: 1



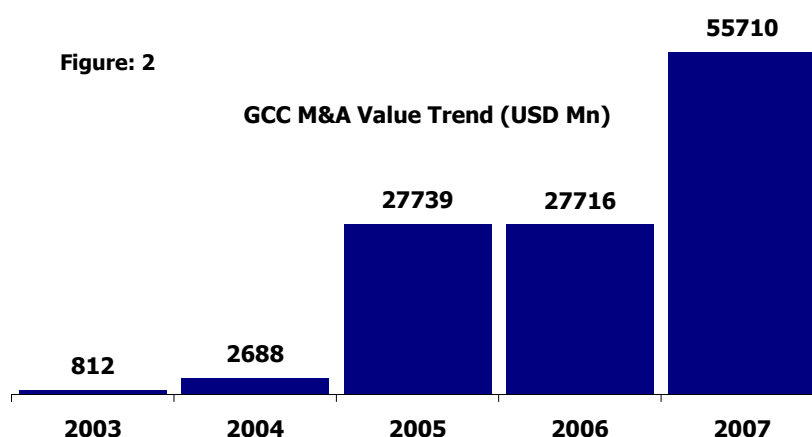
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M&A values have increased from USD 812 Mn to USD 55 Bn in the last five years.

### High Growth Industry....

Over the past five years, the GCC M&A total deal value has increased to a staggering USD 55 billion from a modest USD 812 million (Figure 2). Robust economic growth has forced companies to pursue inorganic growth strategies and may explain this phenomenal growth. The growth has also been aided by opening up of markets thanks to WTO requirements. However, the growth has not been orderly and is in fact extremely erratic. For eg. Year 2005 recorded a near 1000% growth while year 2006 witnessed a 0% growth. (Figure: 2) This clearly shows that the industry is highly deal dependent and hence any exercise to forecast the likely size of the industry in the short-term will be rendered fruitless.



Source: Markaz Research, Bloomberg

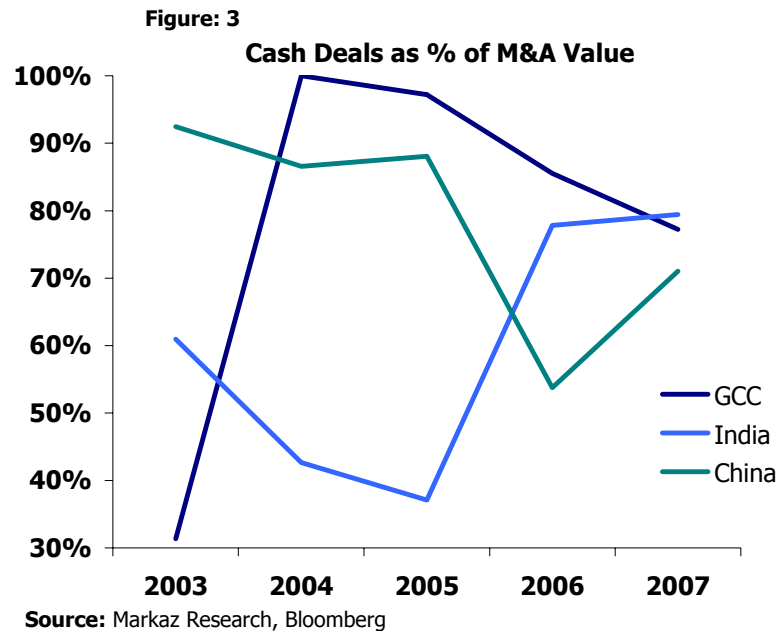
Despite this growth, the value as a percentage of the global deal value is still a minuscule 1% providing adequate upside. In terms of market capitalization, GCCM&A deal value is at 4%, as against the global average of 7%.

### Increasing cash financed deals....

77% of the deals are financed by cash.

It is interesting to note that nearly 77% of all deals were financed by cash, a trend in line with global average of 74% (Figure: 3). This indicates high levels of liquidity in the system and willingness on the part of companies to commit this cash for acquisition purposes. In terms of the value of deals, of the USD 55.7 Bn worth of deals in 2007, USD 43 Bn worth of deals were cash deals. The growth in the proportion of cash deals has increased from 31% in 2003 to 77% in 2007. (Figure 3)

Among the GCC countries, UAE leads the highest amount of deals closed in cash during 2007 at 74% followed by Saudi Arabia at 31%. In the case of Saudi Arabia, it can be mainly attributed to the USD 11.6 Bn deal between SABIC and GE Plastics.

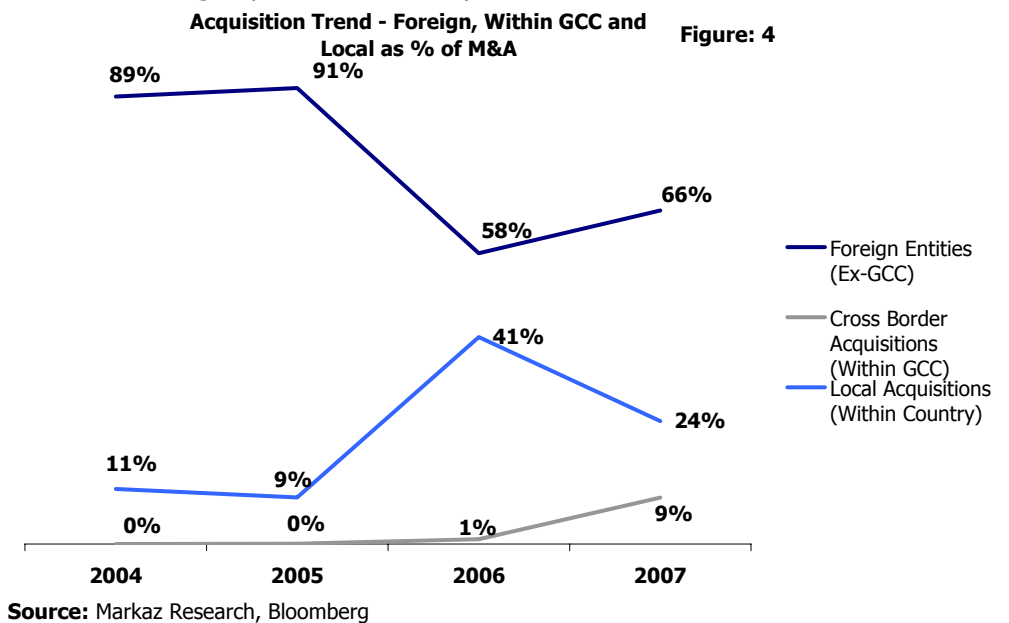


The number of foreign companies acquired have historically formed the majority.

**Focus on Foreign companies....**

The number of foreign companies acquired by GCC companies had historically formed the majority of the total acquisitions (Figure: 4). By foreign companies, we mean companies outside the GCC region. UAE has recorded higher than GCC average value of deals in the last three years in acquiring foreign (Ex-GCC) companies. This can be mainly attributed to global expansion by GCC companies.

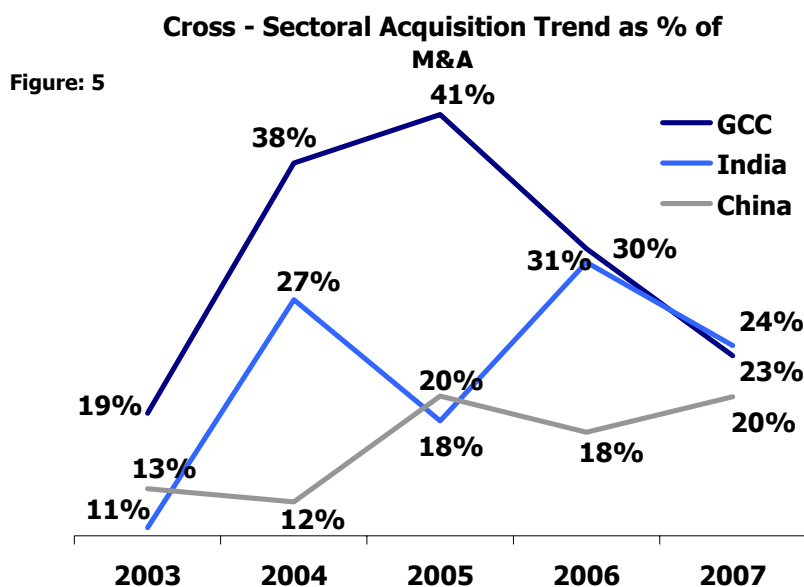
However, in the last two years, the level of foreign acquisition has reduced significantly and has been substituted by an increase in companies targeting acquisitions within the region. It is significant to note that the local acquisitions form the least share implying regulatory and other hurdles to cede control to groups within a country.



Companies in GCC are pursuing acquisitions across sectors.

### Cross – Sectoral acquisitions on the rise....

Companies in GCC were seen pursuing opportunities outside their sectors (defined as cross-sectors) though its share has been declining recently. As of 2007, cross sectoral acquisitions accounted for 24% of all transactions, a level more or less in comparison with China & India.(Figure 5). In 2007, UAE led the GCC in closing the highest number of deals across sectors worth USD 8.2 Bn. Of this, more than USD 4 bn worth of deals were closed by Dubai Holding and Dubai World put together.



UAE has led the GCC in closing the highest number of deals across sectors.

Source: Markaz Research, Bloomberg

### Drivers & Inhibitors of M&A

Drivers		Inhibitors
<b>Business Scenario:</b> High economic growth coupled with increased globalization will certainly help this industry	High	<b>Family owned business structure:</b> In the GCC, 5,000 family businesses with assets of \$500 Bn, account for 75% of the private sector. Historically, there has been a cultural inhibition towards regional M&A. The family groups have preferred to retain control and there has been little pressure on businesses to sell.
<b>High Cash levels:</b> Cash and cash equivalents constitute nearly 5% of total assets for GCC. Average debt to equity levels are nearly 60% lower in GCC compared to BRIC countries (Figures.6 &7)	will	<b>Valuation Challenge:</b> Given the fact that majority of the companies in the GCC are privately owned companies, the acquirers find it difficult to obtain a suitable benchmark for arriving at fair value, which otherwise could be determined through free market forces. The family owned business may not have proper financial and accounting disclosures, which also poses a challenge in due diligence process.

5000 family businesses with estimated assets of USD 500 Bn account for 75% of the private sector.

Figure: 6

Cash & Cash Equivalents as % of Total Assets

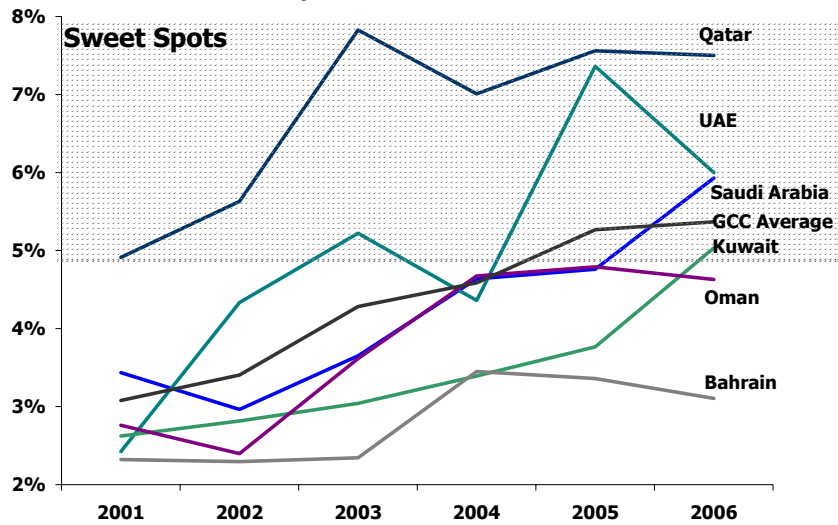
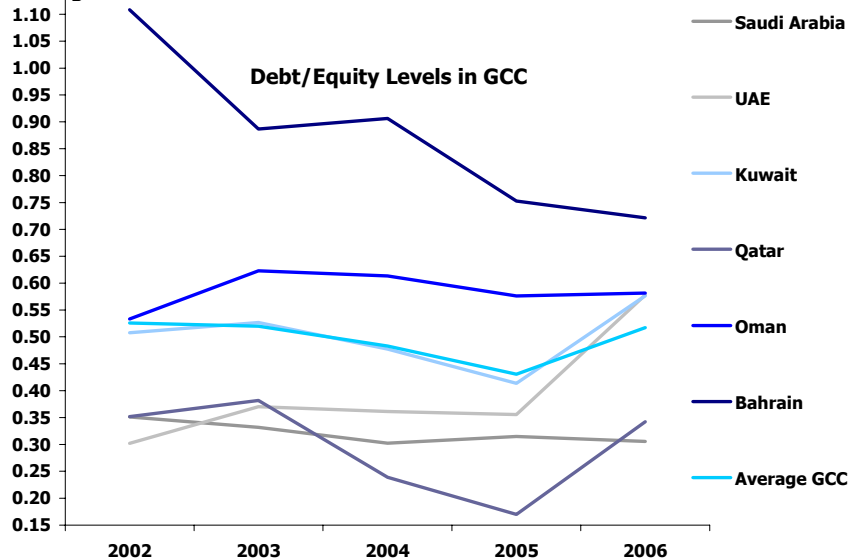


Figure: 7

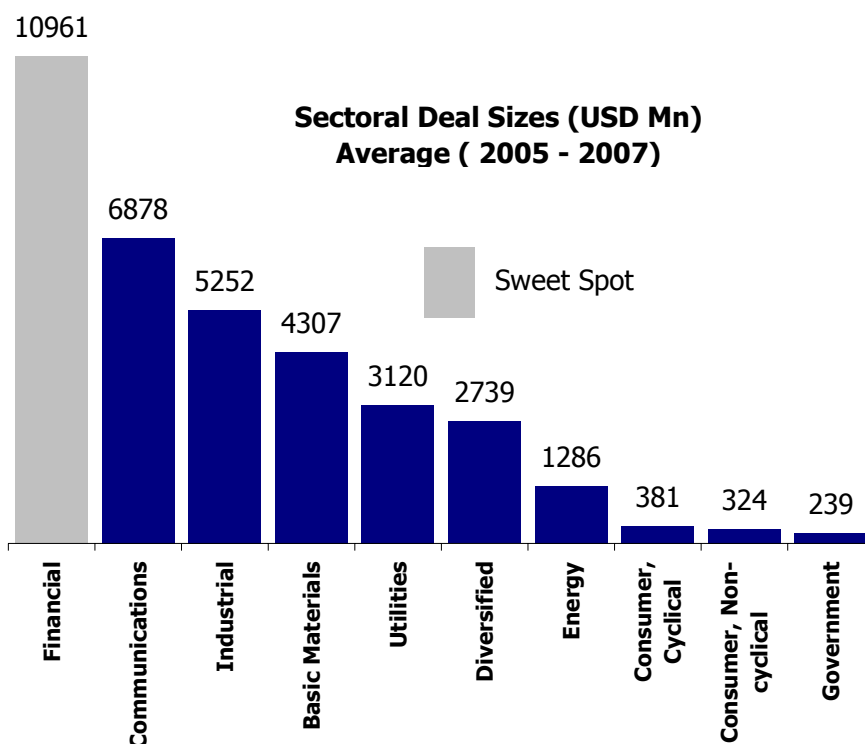


### Financial Sector – Sweetest of the Sweet spots

Financial Services, especially banking, dominate GCC in terms of market cap and hence dominates the M&A activity in the region. Average deal size for financial services at USD 11 billion is significantly higher than other sectors (Figure: 8). The competitive environment within the banking space has intensified, as cross-border barriers are gradually lowered. GCC Monetary Union and WTO requirements will eventually lead to opening of the banking sector. The bigger banks will benefit from the economies of scale, using their larger balance sheets to compete more aggressively, both domestically and regionally. The pressure of competition among the GCC banks is expected to lead to consolidation in the industry.

Financial services segment dominate the GCC M&A landscape.

Figure: 8



Source: Markaz Research, Bloomberg

46 commercial banks operate in the UAE alone.

The UAE banking sector is one of the least concentrated in GCC region with 46 commercial banks, 25 of which are foreign. The top bank of UAE, Emirates NBD accounts for 19.2% of total assets, while in other GCC markets the concentration level is much higher at the top banks. The UAE banking sector is already witnessing the consolidation, as indicated by the recent merger between the National Bank of Dubai and Emirates Bank. The deal valued at USD 3.7 Bn is also one of the largest in the banking M&A history in the region (Table: 1). The combined entity is the largest in GCC in terms of total assets, which may lead to competition among other GCC countries to match the size.

(Table: 1) Banking Sector M&A Transaction History - GCC Region				
Date Announced	Deal Type	Target Name	Acquirer Name	Announced Total Value (mil.)
2001	ACQ	INDUSTRIAL BANK OF OMAN	BANK MUSCAT SAOG	NA
2003	DIV	GRINDLAYS	SHAREHOLDERS	NA
2005	DIV	QATAR BANK QSC	DUBAI HOLDING	NA
2006	ACQ	DUBAI BANK	COMMERCIAL BANK OF KUWAIT	NA
2006	ACQ	BBK	ITHMAAR BANK BSC	401.41
2006	DIV	BAHRAIN SHAMEL BANK -\$US	SECURITIES HOUSE	40.99
2006	ACQ	BAHRAIN ISLAMIC BANK	EMIRATES BANK INTERNAT PJSC	3733.1
2007	ACQ	NATIONAL BANK OF DUBAI	UNNAMED BUYER	37.94
2007	DIV	BAHRAIN ISLAMIC BANK		

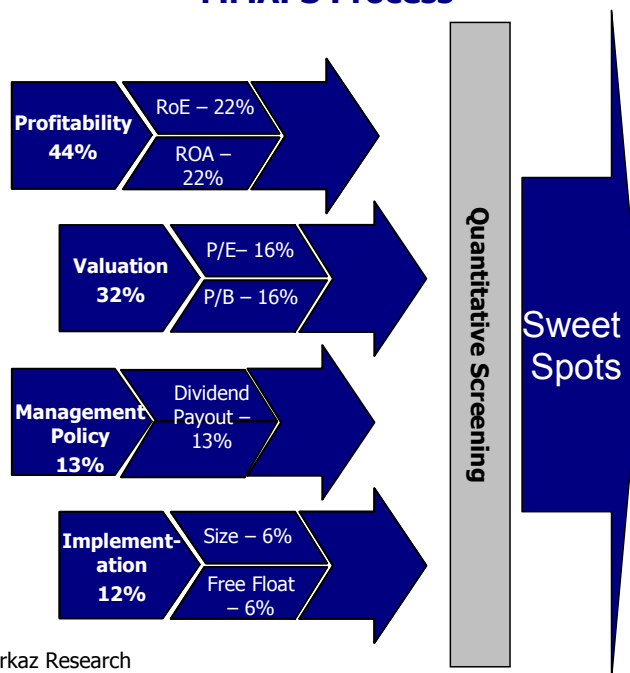
Source: Bloomberg, Markaz Research

“Markaz M&A Potential Score” Quantitative model has been built to identify possible sweet spots for M&A.

### Banking Sector-Identifying Sweet Spots

In this section, we attempt to identify sweet spots within the banking sector in GCC using a proprietary in-house model titled **Markaz M&A Potential Score** (MMAPS). The model takes into account 7 parameters across 4 dimensions (Figure 9). We have assigned higher weightings to profitability and valuations as they tend to drive the process strongly (Table 2).

Figure: 9 **MMAPS Process**



Source: Markaz Research

Companies are screened on 4 dimensions across 7 different parameters

**Table: 2 MMAPS Scoring Process & Parameters**

Parameter	Interpretation	Weight
Return on Equity (%)	Higher RoE preferred to lower RoE	22%
Return on Assets (%)	Higher RoA preferred to lower RoA	22%
Normalized Price to Earnings per share	Lower P/E preferred to higher P/E	16%
Price to Book value per share	Lower P/B preferred to higher P/B	16%
Dividend payout	Higher dividend payout preferred to lower dividend payout	13%
Size (as measured by market cap)	Lower sized companies preferred to higher sized	6%
Free Float	Lower free float companies preferred to higher free float as it eases the process of strategic negotiations with few shareholder blocks	6%

Source: Markaz Research

Companies are screened on these parameters based on mean levels prevailing within each country (Refer Appendix 3 for methodology of MMAPS). Our analysis considers only listed banks in GCC. Table-3 provides summary of statistics on these parameters.

**Table: 3 Geographical Averages**

	No. of banks	Free Float	M.Cap USD (Mn)	Div Payout (%)	P/E	P/BV	ROE	ROA
Saudi Arabia	8	59%	13906	35	20	4	24	3
UAE	16	46%	4054	37	15	3	20	3
Kuwait	8	58%	9208	59	20	4	24	3
Qatar	7	64%	8139	30	16	3	25	6
Oman	4	34%	2626	54	19	3	20	3
Bahrain	7	34%	1579	49	14	2	14	2

Note: The figures represent averages for the year 2007

Source: Markaz Research

Based on the mean levels, banking companies within each country are screened on all the seven criteria in order to assess their attractiveness (Annexure-1). The screening results depict contrasting characteristics of banking scenario within each of the six GCC markets. On the whole 13 banks appear attractive out of a universe of 50 banks, with UAE offering adequate potential (Table-4). It must be noted that this is a quantitative screening criteria based on parameters that are highly dynamic. Attractiveness also includes other qualitative factors that will influence the final decision. While companies that are screened as sweet spots may look attractive from a quantitative point of view, there may be other hurdles including shareholding structure that may inhibit any prospective bidder. Annexure-2 provides the shareholding structure for sweet spots and it can be noticed that some of them have significant government shareholders which may severely constrain any prospective bidder.

14 Banks out of the 50 listed banks appear attractive.

**Table 4: Number of Banks Qualifying the Screening Process**

	Number of Banks Qualifying the Screening Criteria								Number of Banks Qualified at GCC Level
	No. of banks	Free Float	M.Cap USD (Mn)	Div Payout (%)	P/E	P/BV	ROE	ROA	
Saudi Arabia	8	4	5	5	5	4	6	3	2
UAE	16	9	11	5	10	8	7	9	5
Kuwait	8	3	6	4	6	6	5	2	3
Qatar	7	3	5	4	4	3	4	2	2
Oman	4	3	3	3	1	1	2	1	0
Bahrain	7	4	5	4	3	3	4	3	1
<b>Total</b>	<b>50</b>	<b>26</b>	<b>35</b>	<b>25</b>	<b>29</b>	<b>25</b>	<b>28</b>	<b>20</b>	<b>13</b>

**LFY: Latest Financial Year; LFI: Last Financial Interim**

Source: Markaz Research

## Appendix 1: Banking Statistics & MMAPS

Summary of Criteria Used										
S. No	Name of the Bank	Country	Free Float	Market Capitalization USD (m)	Dividend Payout Ratio(%)	P/E Excl Extra	Price to Book Value	ROE	ROA	MMAPS
1	Commercial Bank of Kuwait	Kuwait	80%	7679	72	17.04	3.89	23.8	3.34	94%
2	Commercial Bank International PSC	UAE	30%	946	0	12.1	2.2	23.74	3.47	88%
3	Qatar Islamic Bank (S.A.Q.)	Qatar	NA	3114	19	9.02	2.45	28.26	7.3	81%
4	First Gulf Bank	UAE	40%	7601	12	13.9	2.76	21.02	3.32	81%
5	Al Ahli Bank of Kuwait	Kuwait	45%	4359	59	15.03	3.65	26.12	2.82	78%
6	Samba Financial Group	Saudi Arabia	50%	19560	45	15.19	4.11	29.13	3.45	78%
7	Masraf Al Rayan (Q.S.C.)	Qatar	55%	4228	0	26.16	2.98	27	15	72%
8	Bahrain Islamic Bank B.S.C.	Bahrain	20%	790	23	9.9	1.73	19.1	4.57	72%
9	Burgan Bank	Kuwait	60%	4184	69	14.48	3.18	24.48	2.96	72%
10	Sharjah Islamic Bank	UAE	55%	1528	55	13.32	1.81	13.92	3.26	72%
11	Bank of Sharjah	UAE	60%	1031	77	13.12	1.65	18.39	4.22	72%
12	Invest Bank P.S.C.	UAE	72%	994	52	12.58	2.14	18.03	3.89	72%
13	Riyad Bank	Saudi Arabia	75%	13875	66	17.28	3.95	23.92	2.8	72%
14	Al Baraka Banking Group (ABG)	Bahrain	28%	1432	41	9.94	1.25	13.54	2.27	66%
15	Gulf Bank	Kuwait	30%	7262	54	14.87	3.95	29.33	2.85	66%
16	Commercial Bank of Dubai P.S.C.	UAE	80%	3864	36	15.06	2.98	21.84	3.81	66%
17	Al Rajhi Bank	Saudi Arabia	55%	31680	10	18.42	5.03	29.46	5.61	66%
18	Bank Aljazira	Saudi Arabia	55%	3405	17	15.86	2.72	18.11	4.3	66%
19	National Bank of Umm Al Qaiwain	UAE	70%	1653	99	18.19	3.52	21.28	4.91	63%
20	Doha Bank (Q.S.C)	Qatar	NA	3326	54	13.05	3.34	29.01	3.58	56%
21	Ahli Bank (Q.S.C.)	Qatar	60%	1036	34	12.58	2.47	22.15	2.39	56%
22	Arab Banking Corporation (B.S.C.)	Bahrain	12%	1280	50	10.24	0.69	6.35	0.54	56%
23	National Bank of Bahrain BSC	Bahrain	51%	1724	62	15.64	2.67	17.85	2.32	56%
24	The Bank of Kuwait & The Middle East	Kuwait	25%	2152	79	11.93	2.13	19.08	2.66	56%
25	National Bank of Oman	Oman	20%	2319	36	20	3.83	21.38	3.49	56%
26	Banque Saudi Fransi	Saudi Arabia	70%	12975	39	17.95	4.33	26.26	3.02	56%
27	Oman International Bank S.A.O.G.	Oman	65%	900	56	12.33	2.14	19.54	2.8	50%
28	Abu Dhabi Commercial Bank	UAE	35%	6906	63	12.76	2.24	18.1	2.23	50%
29	The National Bank Of Ras Al Khaima	UAE	47%	1693	20	15.49	3.94	28.43	4.05	50%
30	BBK B.S.C.	Bahrain	25%	1320	64	16.56	2.1	14.14	1.58	47%
31	Bank Dhofar	Oman	30%	1130	58	19.06	3.93	22.37	2.76	47%
32	Kuwait Finance House	Kuwait	60%	24498	25	22.64	5.96	31.8	4.31	44%
33	National Bank of Abu Dhabi	UAE	30%	9967	20	14.61	3.26	24.78	2.08	44%
34	Union National Bank	UAE	40%	3425	27	10.77	1.92	18.7	2.43	44%
35	Arab National Bank	Saudi Arabia	60%	11223	0	23.15	4	26.6	2.85	44%
36	The Saudi British Bank	Saudi Arabia	39%	14650	58	21.07	5.27	26.29	2.91	41%
37	Qatar National Bank SAQ	Qatar	50%	12044	31	15.77	3.16	22.49	2.69	34%
38	Bahraini Saudi Bank BSC	Bahrain	55%	199	62	18.52	1.32	7.27	1.93	34%
39	Saudi Hollandi Bank	Saudi Arabia	72%	3881	49	33.18	3.2	9.96	0.9	34%
40	National Bank of Kuwait S.A.K.	Kuwait	85%	20436	52	17.67	3.24	19.93	2.83	31%
41	Mashreqbank psc	UAE	13%	10303	2	19.91	3.94	22.37	2.95	28%
42	Abu Dhabi Islamic Bank	UAE	30%	2773	21	17.03	1.88	18.77	1.91	28%
43	United Arab Bank PJSC	UAE	64%	1600	24	27.8	4.58	17.79	3.85	28%
44	Qatar International Islamic Bank Q.S.C.	Qatar	NA	26111	1	19.73	3.95	25.37	5.23	22%
45	Ahli United Bank B.S.C	Bahrain	46%	4310	40	18.43	2.02	16.78	1.64	22%
46	Dubai Islamic Bank PJSC	UAE	45%	9204	19	13.52	3.25	19.87	2.56	22%
47	The Commercial Bank of Qatar (Q.S.C.)	Qatar	90%	7115	40	18.6	3.51	20.59	3.4	19%
48	BankMuscat (SAOG)	Oman	20%	6157	64	23.91	3.78	17.78	2.35	19%
49	National Bank of Fujairah	UAE	25%	1375	31	15.59	2.81	19.19	3.1	13%
50	Boubyan Bank K.S.C	Kuwait	80%	3096	0	44.54	6.03	14.54	2.98	6%

Source: MSCI Barra, Zawya Investor, Reuters Knowledge, Markaz Research

Note: Figures for End 2007

## Appendix 2: Sweet Spots Shareholding Structure

Major Shareholder Details of Banking Sweet Spots					
Name of the Bank	Country of Domicile	Major Share Holder 1 (Holding)	Major Share Holder 1 Country	Major Share Holder 2 (Holding)	Major Share Holder 2 Country
Commercial Bank of Kuwait	Kuwait	Al Sharq Holding (23.11%)	Kuwait	NA	NA
Commercial Bank International	UAE	Gulf Livestock Company (11.26%)	UAE	Emirates International Investment Company (10.24%)	UAE
Qatar Islamic Bank	Qatar	NA	NA	NA	NA
First Gulf Bank	UAE	HH Sheikh Tahnoun Bin Zayed Bin Sultan Al Nahyan (5.60%)	UAE	Nahda Investment Company (5.12%)	UAE
Al Ahli Bank of Kuwait	Kuwait	Behbehani Group (24.36%)	Kuwait	Kuwait Investment Company (9.90%)	Kuwait
Samba Financial Group	Saudi Arabia	Public Investment Fund (23.25%)	Saudi Arabia	General Organization for Social Insurance - Saudi Arabia (11.62%)	Saudi Arabia
Masraf Al Rayan	Qatar	Kuwait Finance & Investment Company (7.23%)	Kuwait	Issam Youssef Jinahi (2.50%)	Bahrain
Bahrain Islamic Bank	Bahrain	Al Madar Finance and Investment Company (40%)	Kuwait	Islamic Development Bank (13%)	Saudi Arabia
Burgan Bank	Kuwait	Kuwait Projects Company (50.24%)	Kuwait	Public Institution for Social Security (6.11%)	Kuwait
Sharjah Islamic Bank	UAE	Government of Sharjah (27%)	UAE	Kuwait Finance House (20%)	Kuwait
Bank of Sharjah	UAE	Government of Sharjah (20%)	UAE	Mubarak Abdulaziz Al Hassawi (9%)	Kuwait
Invest Bank	Bahrain	Global Private Group (15.05%)	UAE	Al Mazroui Group (6.08%)	UAE
Riyad Bank	Saudi Arabia	Government of Saudi Arabia (51.3%)	Saudi Arabia	NA	NA

**Source:** Zawya Investor, Markaz Research

### Appendix 3: MMAPS Methodology

#### Step 1: Compare the banks with averages (Illustrative Model provided below)

Saudi Arabia							
Parameter Weights	6%	6%	13%	16%	16%	22%	22%
Company	Free Float	Market Capitalization USD (m)	Dividend Payout Ratio(%)	P/E Excl Extra	Price to Book Value/Share	ROE	ROA
Al Rajhi Bank	55.00%	31,679.58	10.47	18.42	5.03	29.46	5.61
Samba Financial Group	50.00%	19,559.74	44.54	15.19	4.11	29.13	3.45
The Saudi British Bank	39.00%	14,649.81	57.54	21.07	5.27	26.29	2.91
Riyad Bank	75.00%	13,874.82	66.01	17.28	3.95	23.92	2.8
Banque Saudi Fransi	70.00%	12,974.78	38.84	17.95	4.33	26.26	3.02
Arab National Bank	60.00%	11,223.17	0.14	23.15	4	26.6	2.85
Bank Aljazira	55.00%	3,404.96	16.77	15.86	2.72	18.11	4.3
Saudi Hollandi Bank	71.50%	3,880.75	48.54	33.18	3.2	9.96	0.9
<b>Average</b>	<b>59.44%</b>	<b>13906</b>	<b>35</b>	<b>20</b>	<b>4</b>	<b>24</b>	<b>3</b>

Selected Companies Screen							
Criteria	Less than Average	Less Than Average	More than Average	Lesser Than Average	Lesser Than Average	More Than Average	More Than Average
	Al Rajhi Bank			Al Rajhi Bank		Al Rajhi Bank	Al Rajhi Bank
	Samba Financial Group		Samba Financial Group	Samba Financial Group		Samba Financial Group	Samba Financial Group
	The Saudi British Bank		The Saudi British Bank			The Saudi British Bank	
		Riyad Bank	Riyad Bank	Riyad Bank	Riyad Bank	Riyad Bank	
		Banque Saudi Fransi	Banque Saudi Fransi	Banque Saudi Fransi		Banque Saudi Fransi	
		Arab National Bank			Arab National Bank	Arab National Bank	
	Bank Aljazira	Bank Aljazira		Bank Aljazira	Bank Aljazira		Bank Aljazira
		Saudi Hollandi Bank	Saudi Hollandi Bank		Saudi Hollandi Bank		

#### Step 2: Compute scores by weighting the parameters as shown above

MMAPS	
Samba Financial Group	78%
Riyad Bank	72%
Al Rajhi Bank	66%
Bank Aljazira	66%
Banque Saudi Fransi	56%
Arab National Bank	44%
The Saudi British Bank	41%
Saudi Hollandi Bank	34%

## Markaz Research Offerings

Strategic research			Sector Research		Quantitative Research			Newsletters
Title	Release Date	Research Highlights	Title	Release Date	Title	Release Date	Research Highlights	Daily Morning Brief KSE Market Weekly Snapshot KSE Weekly Review (Technical Analysis) Weekly Private Equity Update Weekly International Market Update
GCC Equity Funds: The Asset Allocation Challenge	Sep-06	Issues behind asset allocation for GCC equity funds.	Syria Real Estate	Apr-07	GCC Equity Funds	Since May - 07 (Monthly)	Asset allocation strategy for GCC stock markets using an in-house proprietary model.	
GCC Leverage Risk: How real it is?	Nov-06	Examining the risk behind increased exposure of the GCC financial system to stock market.	Saudi Arabia Real Estate	Jul-07	GCC Asset Allocation and Volatility (MVX)	Since Jul - 07 (Monthly)	Launch of Volatility Index for the six GCC markets, EM and S&P.	
GCC for fundamentalists: A top-down framework	Dec-06	Establishing a framework involving fundamental variables affecting GCC stock markets.	Qatar Real Estate	Sep-07				
Managing GCC Volatility: Strategies and Tactics	Feb-07	Devising risk-based portfolio strategy.	Lebanon Real Estate	Dec-07				
Derivatives Market in GCC: Cutting a (very) long market short	Mar-07	Examining the need for derivatives market in GCC.	Jordan Real Estate	Mar - 08				
To Leap or To Lag: Choices before GCC Regulators	Apr-07	Examining the evolution and progress of GCC capital market structures.						
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