The day after tomorrow*

A GCC perspective on the global financial crisis

“The basic rule of storms is that they continue…

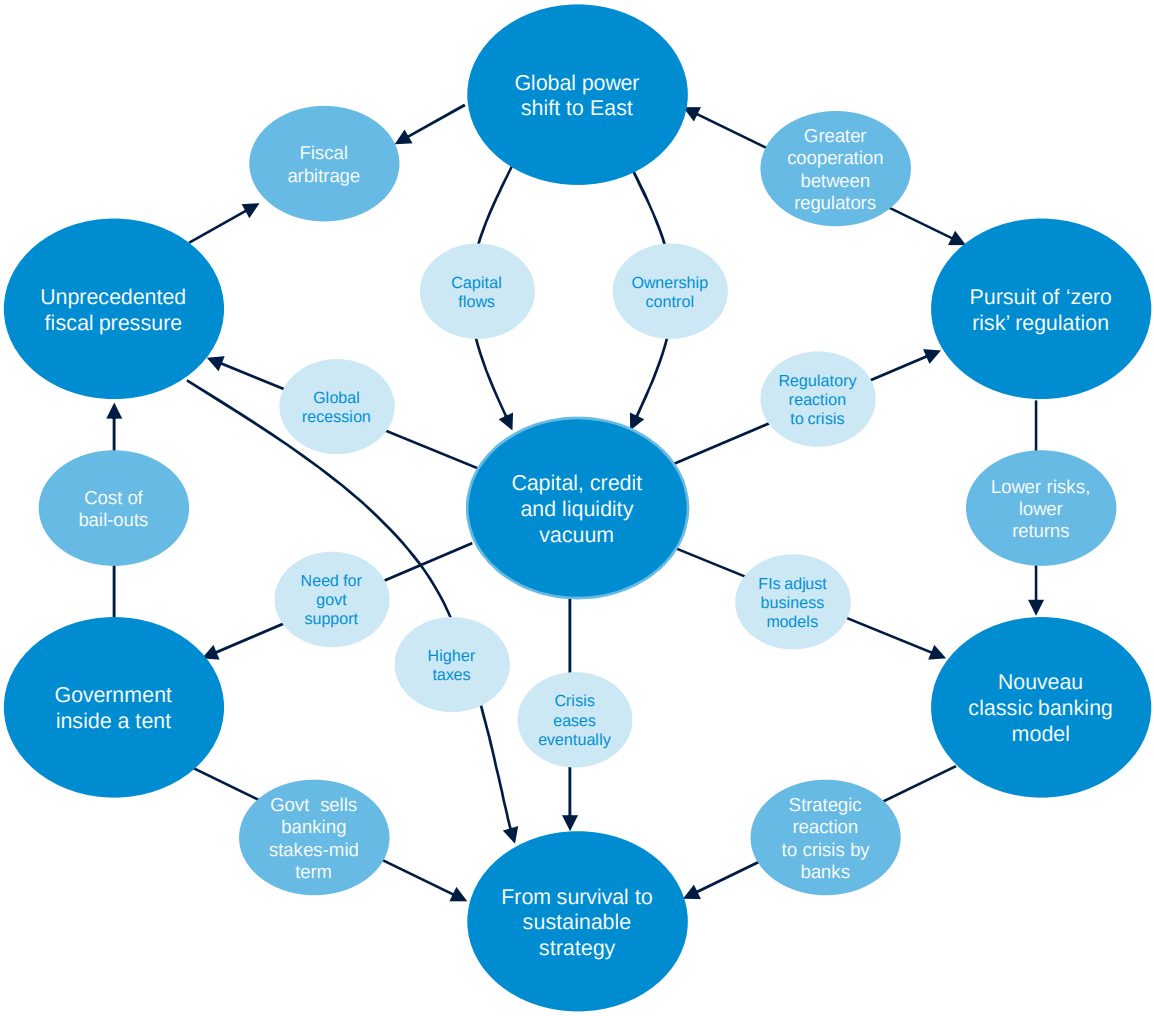
…until the imbalance that created them is corrected.”

The Day After Tomorrow (2004)

Contents

Executive Summary

Seven prominent themes emerge which are shaping the new financial world order



The seven global themes have a complicated set of political, economic and social interactions

The unique dynamics of the GCC countries render some themes extraneous…

Unprecedented fiscal pressure:

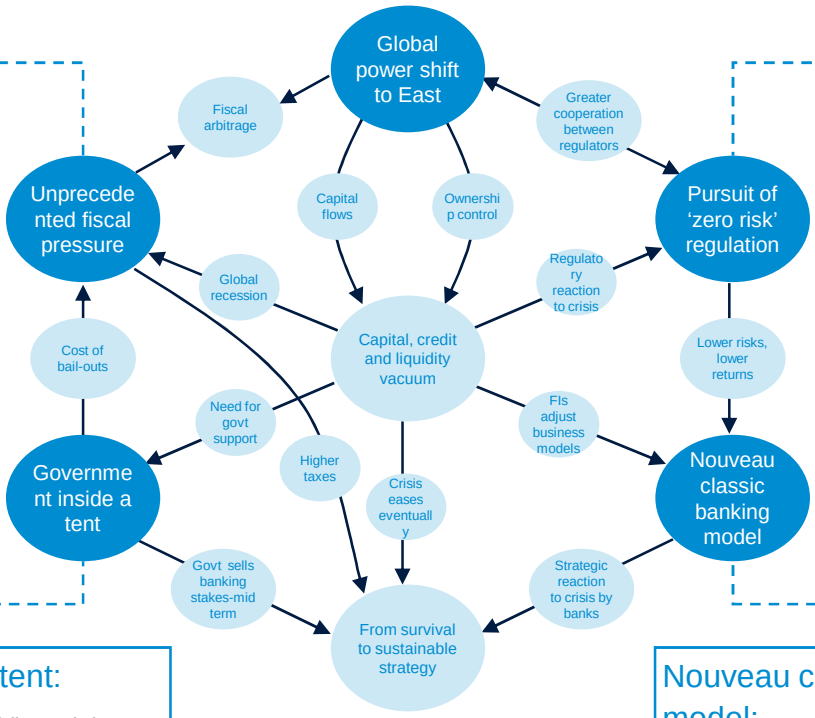
In most parts, Governments must address the impact of the bailout on their finances as well as public opinion and are dependent on tax revenues. However, the GCC countries have amassed huge surpluses to tide over any fiscal

Global power shift to East:

The long-term shift in financial power from the West to the East has been accelerated by the financial crisis. The GCC financial intermediaries have already seen the movement of markets for sometime now and have been investing in Asia for some time.

Pursuit of 'zero risk regulation':

In the GCC markets, the financial intermediaries in these countries have always been regulated and sophisticated products have not yet been introduced.



Government in a tent:

While nationalization of financial intermediaries is a new phenomenon elsewhere, the large banks in the GCC have always been state owned

Nouveau classic banking model:

Banking models in the GCC countries have always been classically focused with little or no sophistication in terms of products or business preferences.

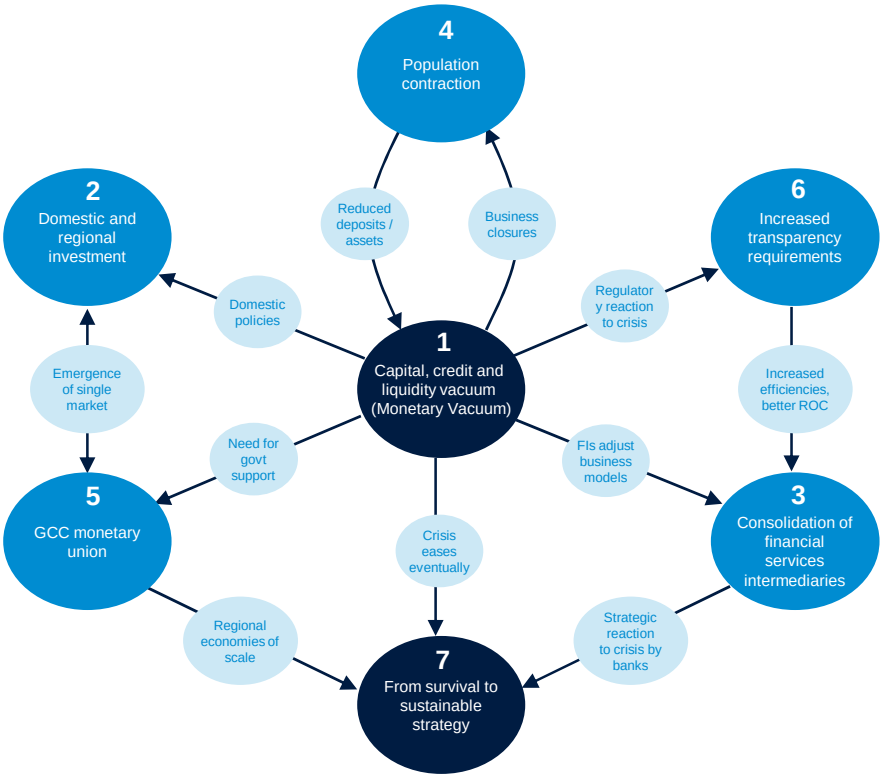
…while giving rise to its own set of pertinent themes

1 Capital, credit and liquidity vacuum

As in the rest of the world, the liquidity crunch has hit the GCC markets hard. With falling oil prices, asset valuations, reduced regional liquidity and with international funding sources drying up, the liquidity vacuum is being felt more than ever. Banks will need to find ways shore up liquidity before embarking on expansion plans.

2 Domestic and regional investments

GCC region has always historically invested outside the region. However, investment strategies now being followed are domestic and regional in nature. This trend will continue and the governments will look at encouraging this to retain available liquidity.



3 Consolidation of financial services intermediaries

The first wave of consolidations have started in the region with financial intermediaries, money changers, brokerage companies looking at synergies to obtain economies of scale

4 Population contraction

is real in the UAE and somewhat muted right now in the GCC. With most GCC countries being expatriate driven, lowering liquidity availability and difficult business climate might lead to employee redundancies leading to population contraction.

5 GCC monetary union

Will help in realizing a common market in the GCC and encouraging movement of goods, services and labor. This will increase monetary velocity within the region. This alignment and expansion will become an imperative to growth

6 Increased transparency requirements

The extent of exposure of the domestic financial institutions to toxic investments overseas is still to be measured. Going forward we will see more regulatory pressures on transparency as well stricter governance norms.

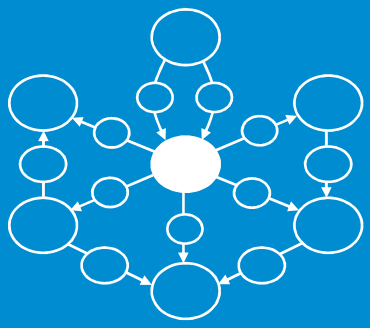
7 From survival to sustainable strategy

The winners from this crisis will be those that do what is required for survival, but also adapt to the realities of a new world.

Themes 1 and 7 are unchanged from our global themes

Summary of themes

Summary - Themes for the new financial order in GCC	Imperatives for players
Monetary vacuum Capital, credit and liquidity vacuum	• Grasp consequences (including unintended) of massive deleveraging • Refresh perspective on sources/uses of all types of financing • Only allocate scarce funds (capital/credit/liquidity) to truly distinctive institutional capabilities
Domestic regional investment Increased focus on domestic assets	• Follow your customer • Scale down of international ambitions • Focus on regional business
Consolidation of financial services Pursuit for building domestic financial institutions	• Understand synergies available in the market for acquisitions, mergers or sale • Revamp operations to improve efficiencies • Streamline businesses to focus on core competencies
Population contraction Repercussions on all sectors of economy	• Be close to the customers (individuals and corporates) • Manage delinquencies and payment cycles effectively • Review and scrutinize loan portfolio
Impact on GCC monetary union Unification of monetary policies calling for greater synergies within GCC markets	• Follow increasing trade across regional boundaries • Build on regional expansion strategies for growth • Formulate synergistic tie-ups with regional peers
Increased transparency Stricter norms for disclosures and information availability	• Design governance models to help prudent decision making and investments • Build efficient IT systems to handle increased regulatory requirements
Strategic Foresight From survival mode to sustainable competitive advantage	• Re-build trust and confidence among all stakeholders (and keep it) • Build robust approach to cope with a sustained level of uncertainty • Remember that many of the underlying forces shaping the future of financial services have not changed



Monetary vacuum

1

The very rapid growth in the GCC economies over the past several years is experiencing a sudden slowdown. At the core of the troubles lies the macroeconomic dynamics and collapsed oil prices, which declined more than 70% from their peak in July '07, and have brought about a big drop in overall domestic liquidity, first witnessed in a flight of capital and then by a collapse of asset prices.

Further, the global credit crunch has shut access to the international bond markets and funding sources. With deposits flowing back out of the system at the same time, this has precipitated a significant funding squeeze, in turn leading to pressure on lending growth. Foreign deposits mainly speculating on a currency revaluation have also been withdrawn with no signs of a revaluation in sight and also to shore up losses in home markets.

These pressures are expected to pull down already depressed asset prices in the region further.

The construction and property sector appears increasingly negative as economic conditions worsen, demand for construction and property falls and access to finance remains difficult.

Corporates with negative free cash flow and a reliance on short-term debt may have an imminent liquidity problem if headroom under bank lines is insufficient or their relationship banks are capital-constrained.

Going forward, we expect this trend to continue with cash strapped lending markets. However, federal intervention will become pertinent to re-inflate the economy.

Monetary vacuum

In the GCC, there are three key drivers of liquidity to meet the financing requirements of three sets of consumers

1 Oil

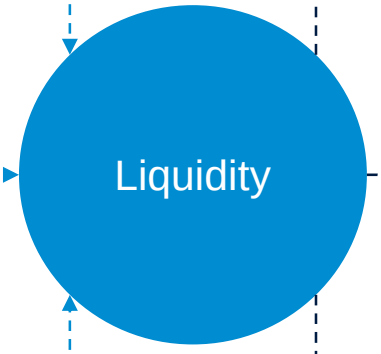
- Government expenditure driven by petrodollar monetisation is the biggest contributor to the liquidity in GCC markets
- In 2007 GCC oil revenues account for 83% of total government revenues

2 Banks and capital markets

- GCC bank balance sheets increased 150% since 2004
- This growth has put stress on the liabilities side of the banks' balance sheet
- Access to capital markets has increased in the recent past

3 Foreign Capital

- Increasing oil prices and the speculation on the revaluation of GCC currencies drove foreign capital into the region
- Reliance on foreign capital has more than doubled since 2004



1 Projects

- Driven by a boom in real estate investment (accounting for 67% of the total project value in 2008) , the GCC projects market topped $2 trillion in July 2008
- Saudi Arabia and UAE are the region's largest projects markets.

2 Businesses

- The business activity increased multifold on the back of property boom
- Due to cheap credit availability and abundance of equity, businesses have been highly capitalised and leveraged

3 Retail Consumers

- The total retail credit increased more than 150% since 2004
- Asset valuations soared on the back of easy access to liquidity

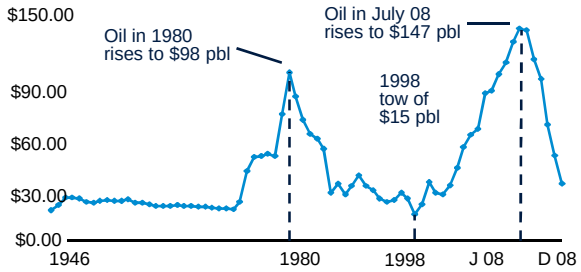
Source- Respective Central Banks; MEED Projects; PwC analysis

Monetary vacuum

In the wake of the financial crisis hitting the GCC, all the three drivers have undergone a downward spiral…

1 Oil prices have dropped dramatically

Inflation adjusted average crude prices (1946 – Dec 2008)

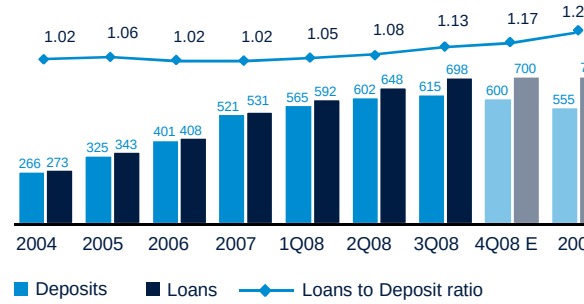


Source- WTRG Economics

- Crude oil demand has dropped all over the world, including the emerging economies such as China and India.
- With declining prices and supply cuts, oil revenues and the current account surplus for GCC states is likely to erode
- This has a huge impact on the government appetite for infrastructure spending and thus the available liquidity in GCC

2 Banks are facing severe stress on liabilities side

GCC banks- Loans and deposits (2004 –2009E) Figures in USD bn

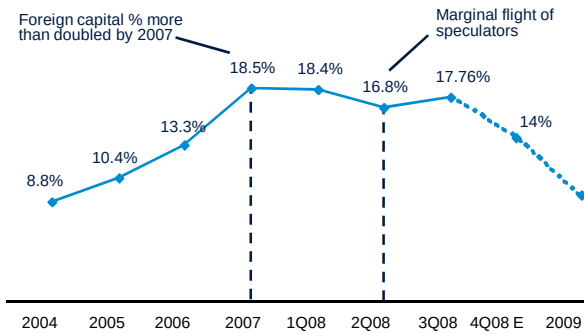


Source- Central Banks of GCC states; PwC analysis

- Growth in lending (28.5% CAGR) has outstripped the growth in deposits (25% CAGR) causing the stress on the liabilities side of the balance sheet of the banks
- This is further exacerbated by the withdrawal of deposits due to the anxiety caused by the global crisis and flowing out of hot money from UAE
- As a result of this skewed ratio, banks are trying to contain the lending; Some banks and finance companies (eg: Amlak) have stopped lending completely
- All this is leading to the liquidity crunch as banks lending is likely to flatten through much of 2009

3 Foreign Capital has left the region

Foreign liabilities as a % of total liabilities of commercial banks (2004-2009E)



Source- Central Banks of GCC states; PwC analysis

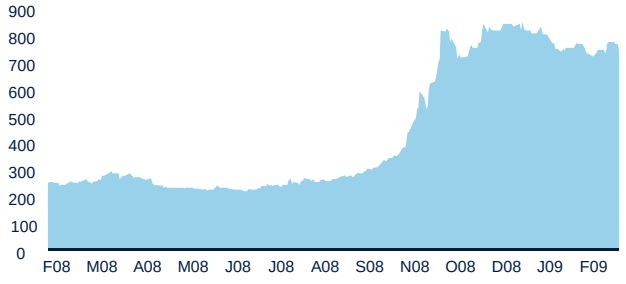
- The GCC banks do not have the asset size to fund the large projects that were announced by the GCC countries
- This resulted in a large part of projects being funded by foreign deposits – the chart above excludes any direct lending which will make foreign funding share even greater.
- Due to the crisis there has been withdrawal of foreign capital and no additional allocation to the region as foreign financial institutions face liquidity constraints at home
- UAE has had the highest reliance on foreign capital for funding and has been the hardest hit amongst GCC peers by the outflow of capital

… resulting in a monetary vacuum

Rates have hardened

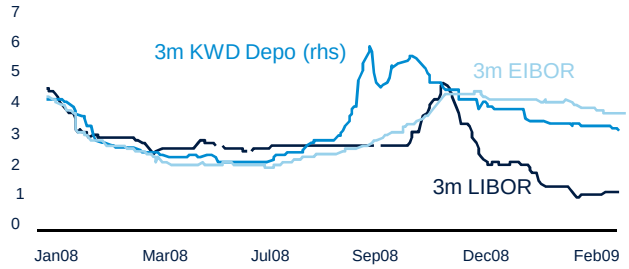
- Amidst the liquidity crunch, the rates of refinancing have shot up tremendously
- GCC interbank rates also shot up on global cues
- Due to Central Bank interventions worldwide, the interbank rates have been brought down, but the liquidity still remains very much trapped in the banking system as the banks are trying to shore up their balance sheets

GCC Corporates (GCCI) – HSBC DIFX Index: Spread over LIBOR (February 2008 –2009)



Source- HSBC DIFX

Movement of GCC Interbank rates with LIBOR



Source- Bloomberg

1 Projects are being cancelled / delayed

- Vast amount of the huge project requirements in GCC have been financed through short term funds
- The resulting maturity mismatch is causing the refinancing requirements
- Dubai will have to refinance about $6 billion of debt by the end of 2008 and a further $16 billion in 2009 - JP Morgan
- Due to hardening refinance rates, projects are facing cancellations/ delays
- Around $263 billion worth of real estate projects have been delayed or cancelled as the UAE's property sector is dealt a "worse than expected" blow by the global financial crisis- Morgan Stanley

2 Businesses are facing tough financing conditions

- The challenge to meet the refinancing requirements is particularly tougher for companies in states with least oil reserves (Dubai, Bahrain)
- Another indication of the toughening credit conditions is the downgrading off businesses in Dubai by rating agencies
- Moody's placed the ratings of all six government-related corporate issuers in Dubai on review for downgrade and Qatar's banking sector on negative watch.

3 Asset valuations have plummeted

- UAE (in particular Dubai) has suffered a freefall in asset valuations as retail customers feel the liquidity crunch
- UAE property defaults may cost US$25 billion- UBS
- Dubai property prices have dropped 25% from their September peak as banks reduced lending and speculators left the market because of the global financial crisis- Morgan Stanley

Monetary vacuum

We believe the businesses should brace up for testing monetary conditions, in short term, and proactively work towards developing multiple liquidity scenarios

What to expect?

Worldwide oil demand will drive the extent of fiscal pressure in GCC states

- Current low prices can be expected to be the bedrock for the rebound in oil demand
- Over the next year oil prices need to average out US$55/bbl to keep the current account surplus for GCC states, otherwise deficits would be funded by more borrowing, which could crowd out private sector borrowing and investment

Massive deleveraging by GCC banks

- Deleveraging by the Financial Institutions will result in further liquidity crunch
- As a result, lending will also continue to come down further

Foreign investment will become more scarce

- World over, capital will be directed towards pumping liquidity in local economies – 'flight to safety'
- Worldwide, governments will also get into action by promoting local investments

There will be more government intervention in the form of stimulus packages, rate cuts

- GCC governments, with their cushion of existing surpluses, will be in a relatively better position to intervene in local economies

What to do now?

1 Grasp consequences (including unintended) of deleveraging

- Understand the speed and scale of the deleveraging across the whole system (not just your institution) to understand range of outcomes and how to work with other stakeholders
- Recognize the obligation created by the government's support for the industry and long-term health of the economy and financial services industry
- Develop PR approach to reach out to public directly to create a dialogue about deleveraging activity

2 Refresh perspective on sources / uses of all types of financing

- Radically reassess access to wholesale funding sources (securitization, stock lending, repos - if any), quality of collaterals and internal cash generation
- Identify books of businesses which were debt-financed and now may need to be financed by equity as part of a portfolio rationalization
- Establish risk-adjusted cost of capital for the entire business and each line business taking into account the changing landscape, replacing previous inaccurate cost of capital measurements
- Ensure business model has a multi-faceted funding strategy – consider alliances, and exits from non-core businesses

3 Only allocate scarce funds (capital / credit / liquidity) to truly distinctive institutional capabilities

- Rather than across-the-board decreases in facilities, reassess clients very carefully based on risk-adjusted returns and ultimate client attractiveness once the economy recovers
- Review major business lines in terms of risk-adjusted returns and competitive positioning (evaluate working capital cycles, cash flow forecasting, MIS etc.)

Domestic and regional investments

2

The GCC economies have their fair share of investments overseas in varied asset classes. The Gulf's external portfolio - excluding the private assets of the region's ruling families - fell from almost $1.3 trillion in 2007 to an estimated $1.2 trillion in 2008.

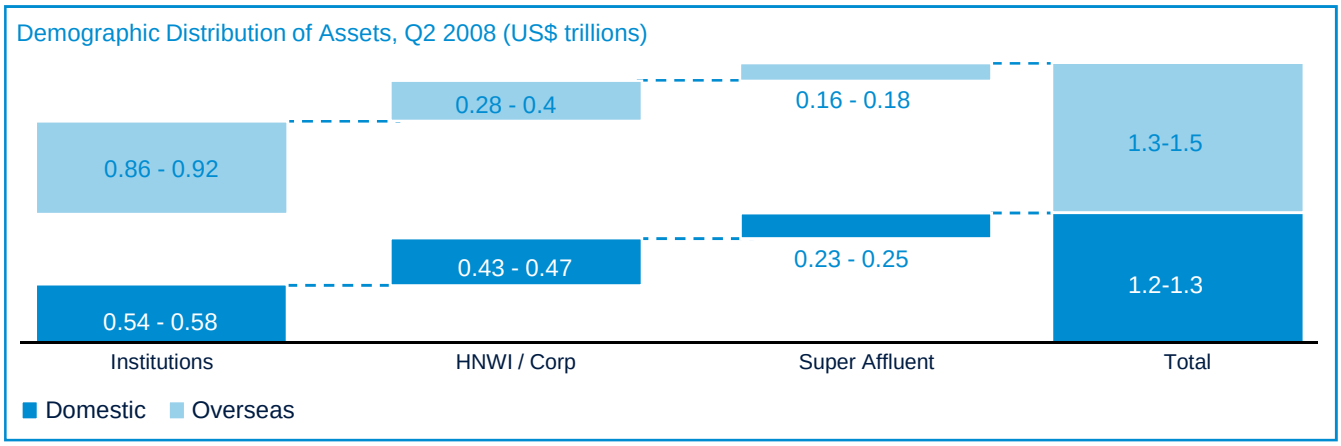
With economic pressures there are efforts to support domestic liquidity by placing government deposits with local banks and to support local equity markets. For e.g. the Kuwait Investment Authority has already indicated that it will invest in Kuwait's stock market. At current oil prices, some ambitious domestic investment projects either will need to be canceled or financed by selling existing foreign assets.

Most governments will now look at supporting their investments within the region in order to boost the slowing economies of the region. This behavior will be encouraged within the private sector as well and we will witness increased focus on domestic and intra-regional investment market.

The liquidity availability within the regional economies will grow with reduced capital flight out of the region leading to higher liquidity levels within the domestic economies. Banks and financial institutions will do well to recognize this trend early and align their strategy and focus going forward to a regional view. This will include all expansion strategies as well as improving regional efficiencies.

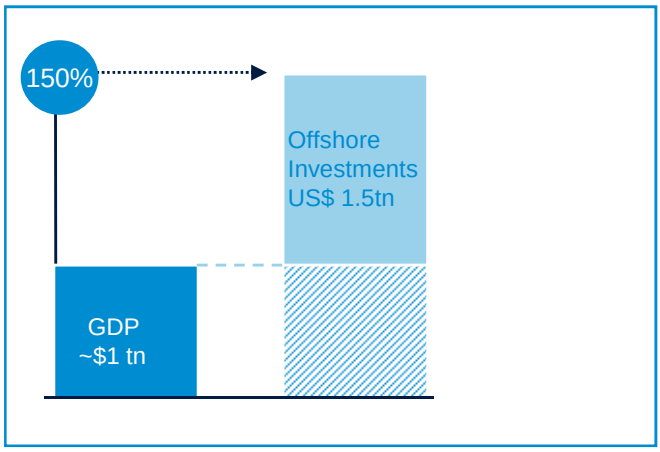
Lack of avenues to absorb the available capital within GCC and desire for portfolio diversification caused 54% of GCC wealth of nearly $2.8tn to be invested overseas

A large portion of the GCC estimated wealth is invested outside the region...

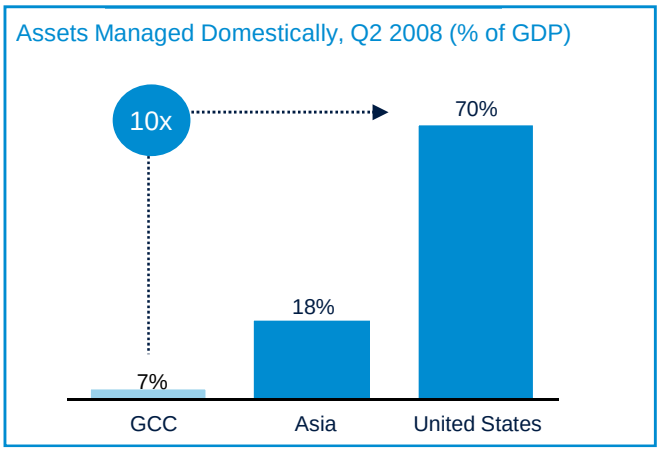


Source: PwC analysis based on market information

...representing high capital flight



There is low onshore funds management in the GCC



Wealth has been largely invested overseas due to:

- Limited investment opportunities: Historically, there has been a lack of local opportunities within the GCC. This situation changed over the last four-five years with establishment of local fund management houses
- Lack of capital markets: The capital markets in the GCC is a recent phenomenon. Traditionally there have been a handful of companies listed on the markets which are traded. Of late, there has been activity in the markets with more and more corporates getting comfortable with the idea of equity raising through the capital markets
- Low inter Arab investment: Between 1995 and 2007, the cumulative inter-Arab investment stood at around $95 billion (Dh348bn), less than five per cent of the overseas Arab assets
- Diversification of portfolios: The GCC markets did not provide a host of products and services which would help diversify portfolio risk
- Concerns about regional stability: This factor has been oft repeated as a driver for overseas investments

However institutions have seen valuations drop internationally and this may cause the flight to familiarity by these institutions, by investing in the domestic local markets

GCC Institutional wealth is down...

Estimated 2008 Gains and Losses of Gulf Funds, $billion (US$ billions, %)

Figures in US$bn, %	2007 (e)	New Inflow	Capital Gain / Loss	2008 (e)	Gain / Loss %
Abu Dhabi Investment Authority	453	59	-183	328	-40% ↓
Kuwait Investments Authority	262	57	-94	228	-36% ↓
Qatar Investment Authority	65	28	-27	58	-41% ↓
Saudi Arabian Monetary Agency	385	162	-46	501	-12% ↓
Other GCC central banks	116	-33	0	84	0% →
GCC Total	1281	273	-350	1199	-27% ↓

Source: Council on Foreign Relations (CFR) report in Jan 2009

** Not including new inflows*

There have also been reports of local and regional institutions focusing on investing in the domestic and regional markets and eschewing international expansion

ADIA investment of Citi down to half

The Abu Dhabi Investment Authority (Adia) is backing Citigroup to ride out the subprime storm, despite its 44 per cent loss since taking a US$7.5 billion (Dh27.5bn) stake in the world's largest bank in November, an Abu Dhabi investment fund manager said yesterday. While Adia's investment in Citi – its highest profile move to date – was initially hailed as a bold and potentially profitable rescue of a bank in distress, there is now little optimism about its prospects.

(Source, Asa Fitch) 02 July, 2008

Al Hilal bank to invest in the local markets

The Abu Dhabi based Al Hilal Bank has announced that it will limit its international expansion and will instead focus on the domestic economy. The bank, which is owned by the Abu Dhabi Investment Council stated that this directive is from the Council in order to invest further in the local economy…

(Source, New York Times) 21 December 2008

NBAD to selectively evaluate its international operations

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(Source, YaleGlobal) 22 October, 2008

KIA cuts global stocks exposure

A government report has confirmed that the Kuwait Investment Authority (KIA), the nation's sovereign wealth fund, has reduced its exposure to global stock markets since October, shifting assets instead into short-term cash funds. In a briefing to parliament, the government said KIA had cut the ratio of international share investments in a key fund in a bid to minimise the effect of the global financial crisis on Kuwait, the world's seventh-largest oil exporter.

(Source, Arabianbusiness) 25 January 2009

Domestic and regional investment is set to grow and governments will get into action promoting and protecting local investments

What to expect?

Wealth erosion with plunging global markets

- With a large portion of GCC wealth being invested in the western markets and a high capital flight, till date, the wealth erosion due to the western market collapse will become common place
- More and more investors will look at wealth preservation and risk aversion will become the norm in the short / mid term causing the flight to familiarity
- Institutions and individuals alike will feel the heat at the market globally continue to plunge

Greater domestic & regional portfolio allocation

- Given the declining global markets, while capital flight will reduce; there might be a review of diversification strategies of portfolios
- More and more portfolios will provide greater allocation to domestic / regional and emerging markets

Governments stimuli regional spending

- As governments try to arrest the economic halt, they will provide stimulus to the local economies
- Reserves and surpluses built over the years will be utilised to provide stimulus to local economies and to retain public spending at similar levels of the past

What to do now?

1 Follow your customer

- Move with the customer - greater allocation of portfolio being retained locally / regionally should be looked keenly and banks should develop local / regional competencies
- Develop synergies and alliances with regional industry participants to provide the customers pan regional access

2 Scale down international ambitions

- Many banks and financial intermediaries were looking at international expansion a year back. These included expanding in the western markets as well emerging markets to Asia and South East Asia. Moving forward, we believe the banks should tone down international ambitions and focus on regional expansion instead
- Most banks in the region are government supported / owned and governments will clearly encourage domestic and regional investments in the short / mid term

3 Focus on regional business

- Channelling regional businesses will be key to success in these times for banks and financial intermediaries
- Those having a pan regional presence will do well to align their regional operations to provide a seamless regional experience to the customers
- Also, Governments will be looking at pan regional players which could help movement of funds across borders

Consolidation of financial services

3

The financial services players in the GCC have witnessed unprecedented growth and profitability. However, given the recent lack of liquidity, the potential for organic growth has dramatically reduced.

Given the sheer numbers of financial institutions:

- Commercial banks, especially in UAE and Bahrain, are likely to see consolidation across the second and third tier banks due to scarcity of liquidity and a shrinking market place
- Brokerage companies will likely witness a wave of consolidation across the board as the market keeps shrinks and customer confidence nosedives.
- Investment companies have been a recent phenomenon, banking on the growing wealth in the region. However, with the recent crises the demand for these services is going to reduce.
- Consolidation may result from combinations of existing firms, growth among leading firms, or industry exit of weaker institutions.

UAE and Bahrain have a number of smaller sized banks…

UAE and Bahrain have the most number of banks...

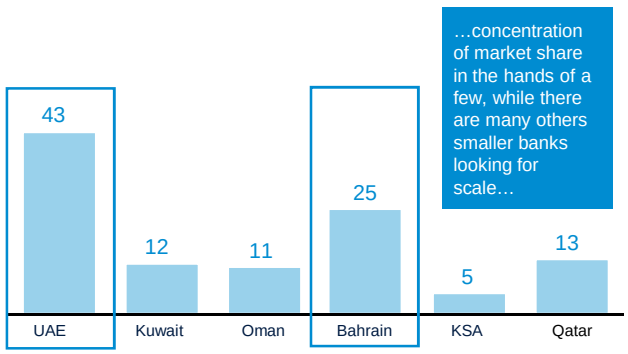
GCC Banks by country (number of players)

Central Bank Licensed	UAE	Kuwait	Oman	Bahrain	KSA		Qatar
Banks (local and foreign)	49	16	15	30	22	QCB Licensed	17
Specialised Banks	2	1	3	80		QFC Level 1 License	10
Rep offices	86			36		QFC Level 2-5	34

Source: PwC analysis based on market information

There are a number of banks especially in UAE and Bahrain which have very low market shares

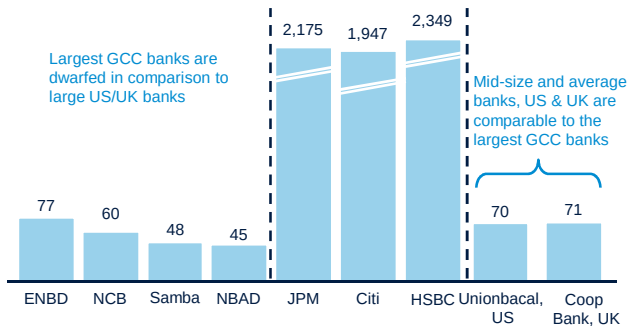
Number of banks with less than 4% market share (retail and corporate credit)



Source: Central Banks

The largest banks in the GCC are comparable to small/average size banks in developed markets

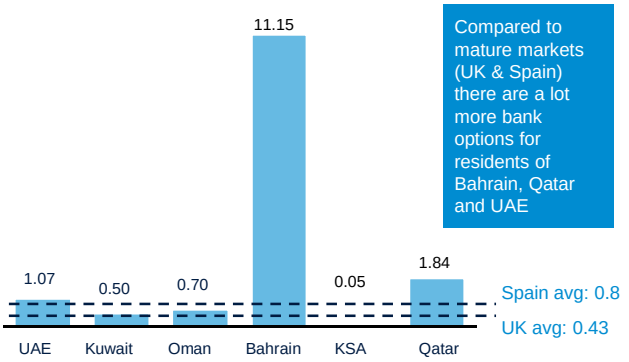
Largest GCC banks by asset size in comparison to global players (USD bn., 2008(e))



Source: PwC analysis based on market information

In-terms of banks per residents, Bahrain, Qatar and UAE provide most options to residents

banks per 100,000 residents



Source: Central Banks; Pwc Analysis

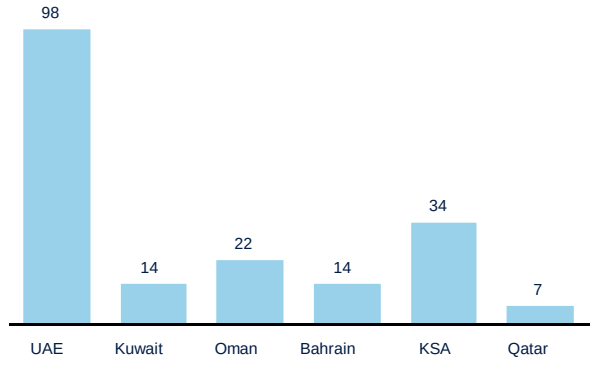
The banks are also facing fresh challenges not witnessed in the past

- Liquidity pressures: as discussed earlier in this paper, there are unprecedented liquidity pressures in the economy
- Shift from asset building to deposit focus: Coupled with the liquidity pressures is also a requirement of the banks to shore up deposits to deleverage and fix their loan-deposit ratios. This has lead to a movement from asset building to deposit focus. UAE banks specially have not seen a requirement of shoring up deposits earlier and hence the challenge is quite new
- Increasing competitive pressures: With potentially contracting population and tightening credit requirements, the banks are seeing growth opportunities diminish. This has led to unprecedented competitive pressures, especially amongst smaller banks
- Shareholder demand in these uncertain times: The profit percentages of the yesteryears are clearly passé. However, the shareholder / investor expectation of profitability might remain as other asset classes of the investor have nosedived
- Economies of scale has suddenly become very pertinent: Operational scale built in the heydays now appear to be very pertinent as growth will be difficult to get

Brokerage companies have found it difficult in recent times with plunging volumes

There are multiple brokerage companies in these countries

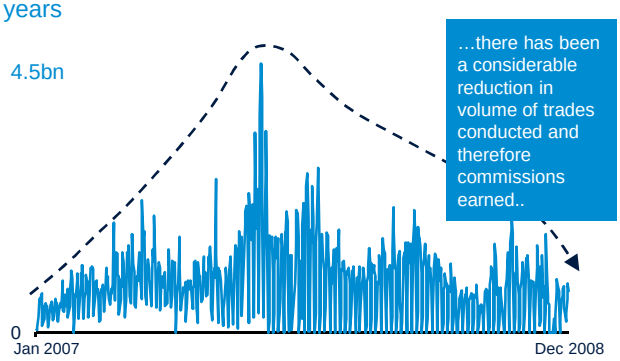
GCC brokerage companies by country (#)



Source: Respective stock exchanges

Brokerage companies are facing tough times with plunging volumes and indices...

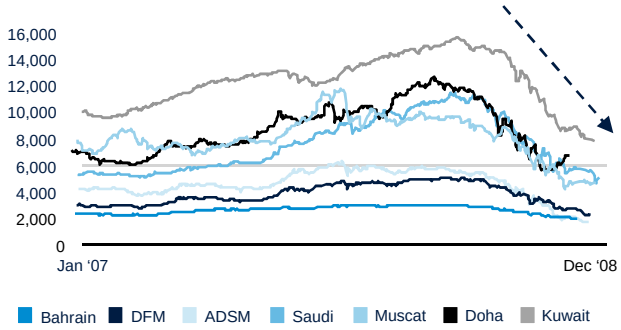
GCC stock markets trading volumes & indices for the last 2 years



Source: zawya

...and indices

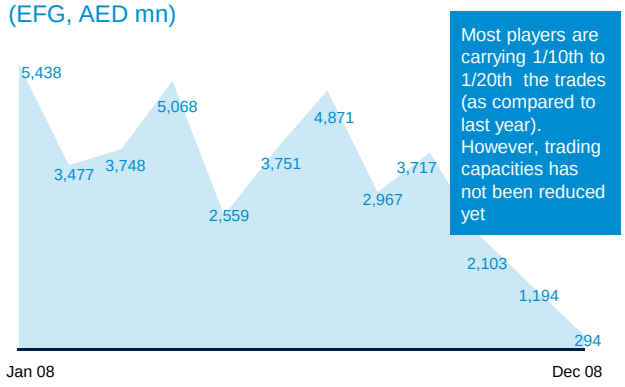
Largest GCC banks by asset size in comparison to global players (USD bn., 2008(e))



Source: zawya

In the UAE and KSA, most players are trading one twentieth of what they were a year back

Trading value of biggest player in UAE (EFG, AED mn)



Source: DFM, ADX, Pwc Analysis

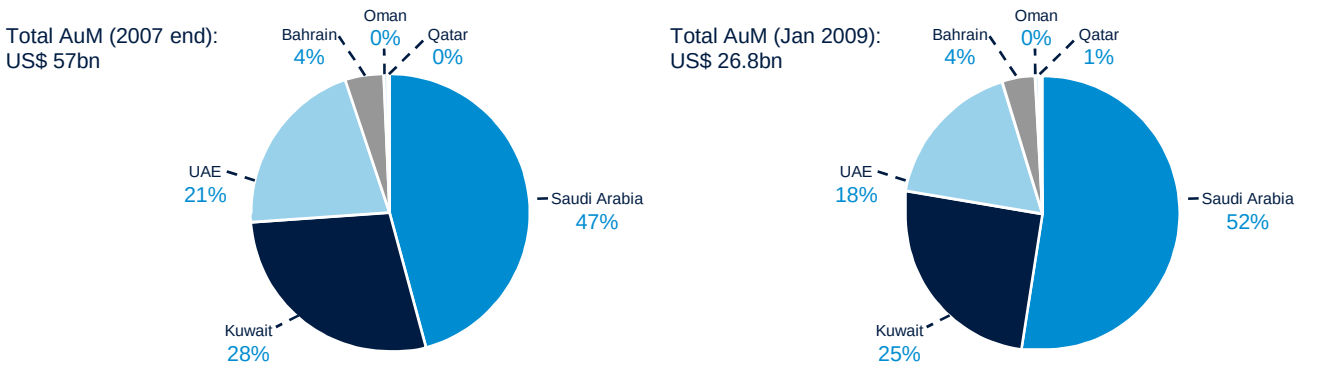
The Brokerage industry will need to bring in economies of scale to justify existence

- Low revenues per player / Losses posted: players in the market have a lower average revenue per player when compared to 2006 and 2007. These institutions built up capabilities in expectation of market growth, and now face redundancies across operations
- Lower capital market activity in the recent past: with the capital markets plunging across the GCC, less and less companies ventured to the markets to raise either equity or debt. In the last six months there have been hardly any new listings across the markets. The expectations of new listings is slim in the near term
- Players have provided huge customer margins and are now finding it difficult to obtain calls: brokerage companies across the GCC have provided huge margin trading facilities to customers, even with the regulators not endorsing the view. With the freefall in the markets the brokerage houses have not been able to make the calls in time and now stand with potentially high provisions
- Limited technology leverage: penetration of online trading is limited in these markets and only limited providers give pan GCC reach. Promotion of online trading will bring in operational cost efficiencies

Plunging wealth and risk appetite of customers has been challenging for investment companies - consolidation may be the answer for certain markets

AuM levels in the GCC have come plunging in the recent past...

GCC brokerage companies by country (#)



Source: zawya'; PwC information basel analysis

...with assets valuations for funds in each of the GCC countries falling

Declining AuM levels per player by country*

	2007 end	Jan 2009	
Saudi Arabia	US$ 26bn	US$ 14bn	↓ 45%
Kuwait	US$ 15.9bn	US$ 6.8bn	↓ 55%
UAE	US$ 12.1bn	US$ 4.8bn	↓ 60%
Bahrain	US$ 2.5bn	US$ 1bn	↓ 60%
Oman	US$ 177mn	US$ 118mn	↓ 41%
Qatar	US$ 199mn	US$ 137mn	↓ 28%

* Includes domestically incorporated open-ended mutual funds only; Bahrain has approx. $ 10bn in AuM from institutions and individuals – however, these assets are invested in funds managed abroad and are not included in this chart

With the boom times behind us, companies will need to reinvent

- Movement from equity markets: As expected investors have fled from the equity markets. Nearly 20% of the funds launched last year in the GCC were either Sukuk (7%), money markets (7%) or fixed income (3%) and the trend will continue as banks look to attract short term deposits. Investment companies need to re-look at their portfolios and provide adequate focus to less risky assets
- Lower returns for investment companies: with reduced market appetite, customers will look at mobilizing funds into safe havens and cash. This leaves investment companies with less asset pools which can be targeted and limited asset classes to be channeled into
- Synergize various divisions of the company: Investment companies are likely to look at synergizing their operations to deliver value and reduce operational costs e.g. we will see more and more asset management companies bringing their brokerage arms closer; advisory arms will work more closely with asset management divisions etc. These synergies can also be obtained through inter company collaborations

In light of the economic conditions, we believe consolidation in this sector is likely to happen

What to expect?

Banks (esp. in UAE and Bahrain) with low market shares could consolidate

- UAE and Bahraini banking sectors might witness a wave of consolidation in the mid term with consolidation seen in the mid tier and small banks
- The consolidation will be driven through internal requirement to achieve some economies of scale to be competitive in the new financial world

Greater domestic & regional portfolio allocation

- 'Over brokered' economies such as UAE and KSA might see convergence of brokerage practices across the board
- The smaller players can barely cover their general and admin expenses let alone cover the bad debts / provisions which they have witnessed in the recent past

Investment companies will see a more difficult environment

- Risky investment climate has given way to a risk averse environment wherein the investors have parked funds into cash, fixed income and government bond. Risk averse nature of investors will remain over the mid term

What to do now?

1 Understand synergies available in the market for acquisitions, mergers or sale

- Keep feeling the pulse of the market, if you believe in your operations and the long term prospects of your institutions, there can be some great deals in the market
- Understand synergies in the market place and if there are other companies looking for mergers. Be ready for the upturn in the market and to capitalize on the upturn.

2 Revamp operations to improve efficiencies

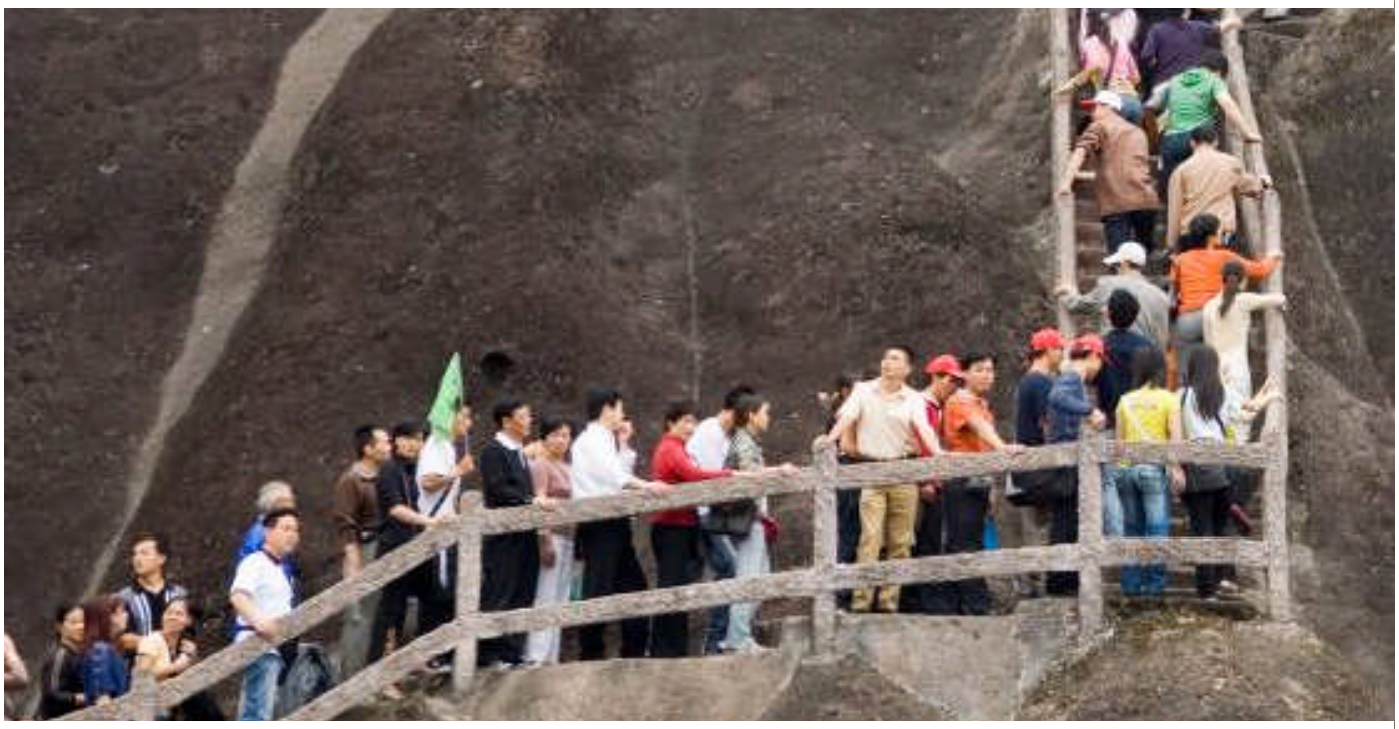
- Keenly diagnose your operations and understand any potential leakages within the business
- Understand if there are opportunities for operational effectiveness and implement effectiveness programs
- This will help you in luring potential mergers and improve valuations

3 Streamline businesses to focus on core competencies

- Channelling regional businesses will be key to success in these times for banks and financial intermediaries
- Those having a pan regional presence will do well to align their regional operations to provide a seamless regional experience to the customers
- Also, Governments will be looking at pan regional players which could help movement of funds across borders

Population contraction

4



The GCC plays host to a large expatriate population which is the workforce of the economy - In Kuwait, Qatar and UAE expatriates account for more than 65% of the overall population and this growth has been notable over the past five years.

The private sector has been playing an increasingly important role in job creation. However, the current economic and financial crisis puts recent gains at risk.

As businesses try to weather the ongoing economic crisis, we are now witnessing a growing trend of job cuts within the private sector (to start with)), particularly in Dubai and permeating to the rest of UAE and GCC. If this trend is left unchecked, it could seriously effect the economy. Given the link between a work permit and residency, any population contraction will have in a direct impact to the economy.

We believe, that the monetary easing and bailout plans focused on financial sectors will not be sufficient to support employment, as heightened uncertainty and tighter credit conditions may still pose difficulties for some firms, and hence force some firms to reduce employment. This might lead to population contraction in some of the countries in the GCC.

This poses a significant threat to the banks who have built deposit and asset bases on the back of the growing expatriate population. With the population moving, there could be a threat of rising delinquency (as we hear of people leaving the countries without paying off their debt as they no longer have the ability to service these debts).

In these uncertain times, banks will do well to stay close their customers and taking necessary measures required.

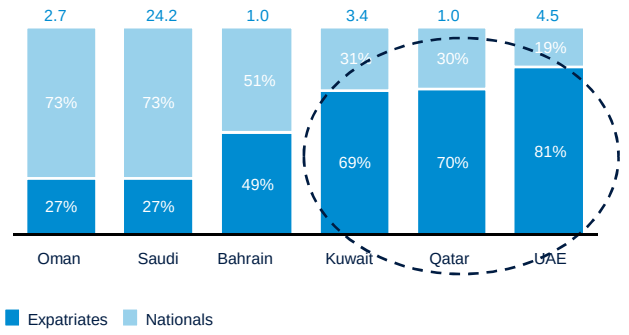
Population contraction

In GCC, expatriates form a large portion of the total population and are central to the economic activity

GCC countries have large expat population, particularly UAE, Qatar and Kuwait

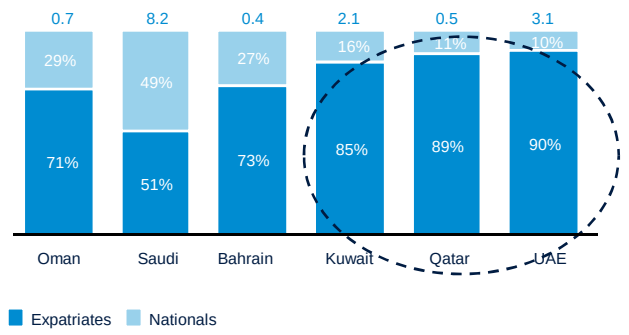
- In UAE, Qatar and Kuwait, the expatriates population is now more than 70% of the total population
- Accordingly, expatriate participation reflects in the workforce composition, where they form around 80-90% of the total workforce in these countries

Population % breakup for GCC states- 2007
(Figures in mn)



Source: Central Banks of respective states, Zawya, PwC analysis

Work Force % breakup for GCC states- 2007
(Figures in mn)



Source: Central Banks of respective states, United Nations, PwC analysis

Accordingly consumption depends on expatriates

Due to such high presence of expatriates in the population, the consumer demand in nearly all the sectors is highly dependent on them:

Real Estate

- The property boom in the real estate has been fuelled by the high growth of expatriates
- 62% of homes are occupied by expatriates in UAE. - Times Online

Retail

- The retail sector is highly dependent on spending by expatriates.
- According to UAE Ministry of Economy, an expatriate household on an average spends US$2610 on monthly basis.

Banking and Financial Services

- Expatriates play a huge part in the regional stock exchanges and in the Banking sector (loans and deposits portfolio)
- On DFM, 41-45% of the total value of stocks traded was by expatriates in January, 2009
- Other sectors such as Aviation, Education and Medical are also highly dependent on expatriate population

Others

- Other sectors such as Aviation, Education and Medical are also highly dependent on expatriate population

Population contraction

As the financial crisis has hit GCC states, jobs are being cut which is adding to the overall population contraction – particularly in the UAE

Jobs are getting slashed in the wake of the crisis and below headlines are becoming common by the day…

Dubai World Lays Off 100 Employees as Crisis Bites

Government-run holding company Dubai World said on Tuesday it laid off 100 employees as it restructures its workforce amid the deepening global economic downturn.

(Source- Khaleej Time) 11 February, 2009)

Bulk bookings on Indian carriers to fly 20,000 workers in March

Indian carriers flying to the UAE have received bulk bookings from construction firms in the country to fly out 20,000 of their workers

(Source- Emirates Business 24|7 08 February, 2009)

Qatar sees huge hike in abandoned cars

Doha has seen a 791 percent increase in the number of cars being abandoned on its streets and outskirts, it was…

(Source- Arabian Business 15 February, 2009)

Dubai-based Mashreq bank is to layoff four per cent of its workforce

"The redundancies reflect a lower level of market activity," said Islam Shikokh, Senior Vice-President of the company's human resources.

(Source- Emirates Business 24|7 06 February, 2009)

Damac Properties lays off 200 workers

Dwindling property sales have forced Damac Properties to slash 200 jobs at its Dubai office.

(Source- The National 10 November, 2008)

UAE: Project Cancellations Leave Arabtec Staff Insecure

Wave of project cancellations and delays are leaving staff at construction firm Arabtec uncertain over whether they will be made redundant.

A senior source at the company said that there was speculation that some 5,000 workers could be laid off in coming weeks.

(Source- Arabian Business 18 February, 2009)

Nakheel lays off 500 staff

Local developer Nakheel has laid off about 500 directly employed staff as a result of the global economic slowdown on Dubai.

(Source- MEED 30 November, 2008)

- Unofficial figures estimate 1,000 -1,500 people are leaving the UAE daily, as companies reduce head count to combat the slowdown felt from the crisis.
- A recent report by UBS said that Dubai's population could decline by 8% in 2009 and 2% in 2010.

Serious repercussions for the economy

- All the sectors (except oil) of the economy are dependent on the population for demand and/or production
- The effects of population decline are two pronged – drop in demand and restriction in supply; which translates into an overall contraction of the economy
- Although the full effect is yet to be felt, there are a number of indications of things to come

- 60% fall in property values predicted in UAE
- 50% slump in the price of luxury apartments on Palm Jumeirah of Dubai
- 25% reduction in luxury spending among UAE expatriates

Times Online

Population contraction is expected to continue – the impact should be factored into your business model going forward

What to expect?

Increased redundancies throughout the region

- Population decline will have a pro cyclical effect for suppressing demand and spending
- Currently the brunt of crisis is primarily borne by Dubai in the UAE, but if the crisis spreads across the region, it might effect the employment sector and thus the overall population

Increased protectionism for the local population

- As jobs become scarce, world over, the knee-jerk reaction of most governments will be to protect local jobs
- This will further compound the expatriate population decline as businesses will be forced to cut head-count and expat workers might be removed first.

What to do now?

1 Be close to the customers

- Monitor each customer's (as well as his employers') financial health closely to avoid any last minute surprises
- Be alert in the hitherto less affected sectors and economies, and keep a close tab on the customers there as well
- Recognise the opportunity now to build a long relationship with customers

2 Review and scrutinize loan portfolio

- Review the loan portfolio of customers factoring in the current crisis and subsequent employment scenario in their risk assessments
- Rationalise the loan portfolio in the light of this risk review
- Revisit the risk ratings of businesses in the light of population contraction

3 Proactively manage delinquencies and payment cycles effectively

- Work with the customers towards smaller payments cycles
- Strengthen the collections mechanism to manage delinquencies

Impact on GCC monetary union

5

The GCC Monetary Union is likely to usher in greater stability in terms of the region's spending power in international markets. In pursuance of their goal, the Gulf States have liberalized their external trade, and all the member states have joined the World Trade Organisation (WTO) and their coming together in a single bloc will increase the regions collective voice in the international arena.

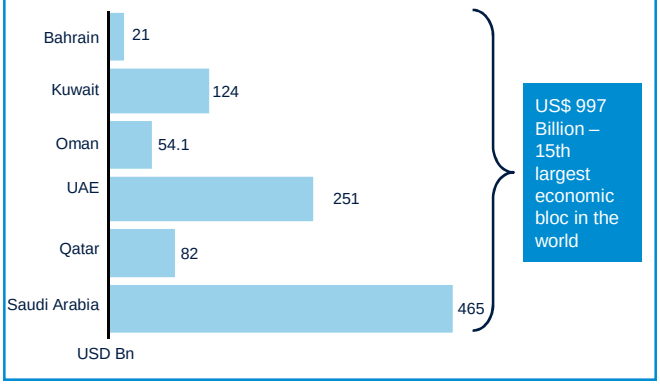
The GCC monetary union will give boost to regional trading and promote economic diversification in a region dominated by the hydrocarbons sector.

However, a couple of tricky issues are yet to be addressed, and the chief among them is what the exchange rate arrangement will be with the currencies outside of the GCC. Secondly, the amalgamation, which will be between huge economies such as Saudi Arabia and UAE, and smaller ones such as Qatar and Oman, will acquire consistent political acumen and a level-playing field for all the respective countries as they come down to share their sovereignty and resources for the collective good of the region.

All eyes will be on how the European Union weathers this financial crises and the GCC union will most likely take learning from the current crises.

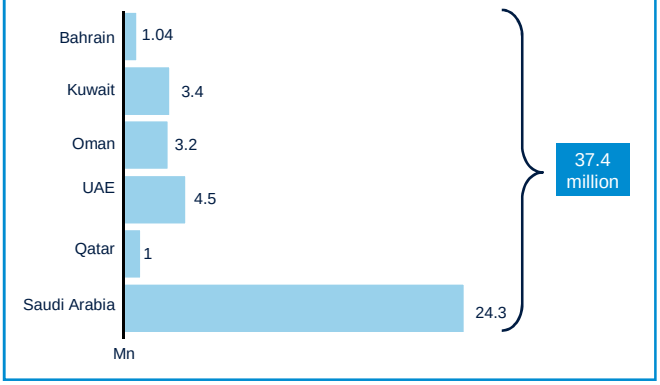
The combined GCC economies come together as a large economic bloc…

GDP of selected regional Countries, 2008 (e)



Source- Central Banks of respective states, Zawya, PwC analysis

Population of GCC Countries, 2007



Source: zawya

High GDP for the region combined with large growing population – resulting in high GDP per capita

Impact on GCC monetary union

…however, we believe the GCC governments will take lessons from EU experience w.r.t. this financial crisis

Benefits of the monetary union

The benefits for the GCC monetary union are:

- Creation of a common regional market with free movement of goods and services
- Creation of common labor market – movement of labor across countries
- Common currency and therefore standardized banking regulations
- Creation of jobs in the small and medium sector enterprises

Learning from EU experience

- Learnings from the EU experience raises a number of questions:
- Ability to coordinate a common response and solution
- Extent of assistance to lesser developed economies
- Fiscal discipline and budget
- Stimulus packages by governments and protectionism

There might be a slow-down or rethink on some aspects of the monetary union, however, we believe the majority of the elements will not change

Monetary union presents opportunities to various businesses to expand into the region…

What to expect?

Slight slowdown in the pace of achieving monetary union

- GCC states are all trying to grapple with the crisis and the efforts for forming monetary union might take backseat.
- In addition, the current economic conditions of high uncertainty would make establishing a common currency and subsequent pegging an onerous proposition.

A better model incorporating learning from the European experience

- GCC Monetary Union has got the opportunity to observe the issues and responses of EU nations in the wake of the crisis, which would enable it to produce an evolved model

Greater flow of goods and services across the region

- Flow of goods and services will increase multifold with the unification of GCC markets.
- The foreign institutions would also find the unification attractive investment

What to do now?

1 Follow increasing trade across regional boundaries

- Monitor capital, labour and commodity movements to identify potential opportunities that can be tapped in the wake of unification of markets
- Identify the demographic change in the overall industry as a result of wider population base

2 Build on regional expansion strategies for growth

- Be proactive in developing strategies for operation across the region
- Research and identity the potential sectors and groups to be targeted in the new scenarios
- Align the portfolio to cater to the wider range of the market across region

3 Formulate synergistic tie-ups with regional peers – take note of learnings from EU example

Increased transparency

6

GCC nations have long aspired to be the business hub in the world economy. They have taken steps to attract businesses to set up their operations and regulations have been eased to allow foreign players to establish in the region. Consequently strong governance models and disclosures have not adequately developed in the region.

GCC region has been flush with liquidity over the years, owing to the oil surpluses. Therefore, a great need for seeking capital has not been largely felt. Consequently strong governance models and disclosures have not adequately developed in the region.

As the current crisis has hit GCC states – with liquidity not going to be easily available, there will be greater reliance on obtaining funding from multiple sources. This will give rise to greater transparency as potential investors will demand increased transparency.

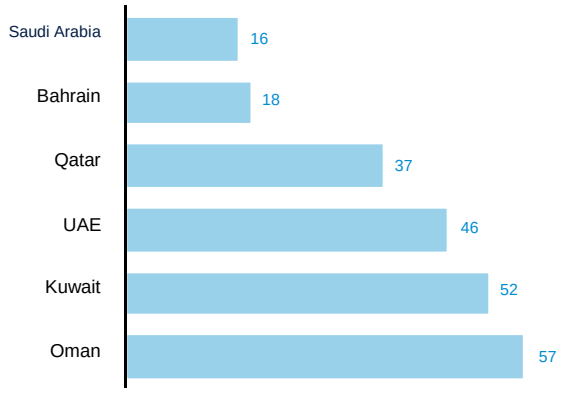
Businesses will need to strengthen their governance frameworks and address investor concerns regarding greater transparency.

Improvements in transparency and governance have been challenges for the GCC region

Over the years, operating environment for businesses in GCC has improved…

- Increasing global integration of the GCC economies with the world economy has helped open up the economies as they have attracted foreign investment
- The business climate has improved over the years
- Presence of international financial centres in the region (DIFC, QFC etc.) have enhanced the business environment
- In the annual World Bank 'Doing Business' survey of 2009 for regulatory environments, the GCC members rank in the top 35% of all countries surveyed.
- The Global competitiveness rankings published by World Economic Forum in 2008 has rated all GCC countries in top 45 countries (out of 131 countries)

Doing business rankings (1 = best, 178 = worst)



…but the governance practices and…

- 42.3% of companies combine the function of chairman and CEO.
- 56% of boards have no more than one independent director, a situation that makes proper oversight difficult
- Most companies view disclosure from a compliance point of view, rather than see it as an effective tool for managing stakeholder relations and adding value to their business.
- Only 50% of listed family-owned enterprises (FOEs) had adopted a family constitution, while only 25% had family councils in place. Three-quarters of FOEs said their boards are composed of a majority of family members.

Hawkamah -IFC CG Survey 2007-08

…transparency issues leave a lot to be desired

- 1/3 of GCC companies (of these 2/3 companies ar ein Saudi/Kuwait) do not publish an annual report in English
- 19% of GCC companies do not have website
- Only about 2% of companies hold analyst meetings or conference calls
- 91% of companies don't preannounce results publication dates
- Only 23% of companies publicly preannounce their AGM dates
- 59% of GCC companies (of these 98% are Bahraini) don't trade every day
- Most provide financial statements, but could improve nonfinancial disclosure. Minority include Management Discussion (28%)

Hawkamah – TNI BASIC Survey, August 2008

Recent Real Estate corruption cases in UAE highlight issues related to transparency and governance

Former VP arrested

VP is the latest in a number of executives at government-controlled companies to be arrested in the crackdown.

Executives at some of the leading companies have been arrested over the past couple of months in connection with the investigation into alleged financial irregularities.

(Source, Arabian Business 21 October, 2008)

Probe into Dubai $100m fraud allegations

Police are investigating fraud allegations against the chairman of one of Dubai's largest private real estate companies as dozens of aggrieved investors claim he defrauded them of more than $100m.

(Source, Financial Times 11 January, 2009)

Increased transparency

These uncertain times provide a good opportunity to win the confidence of investors

What to expect?

Investors will seek for strong governance fundamentals more than ever

- Crisis has caused the world over a severe dent in investor confidence.
- A cautious approach warranting a hard look at governance framework will be key to investment now on

Regulators will demand more information from companies

- Regulators the world over are under tremendous pressure as the crisis is seen to be caused due to the lack of oversight
- Expect more stringent norms from regulators with respect to governance and transparency

There will be improvement in internal efficiencies as availability of information improves

What to do now?

1 Design governance models to help prudent decision making and investments

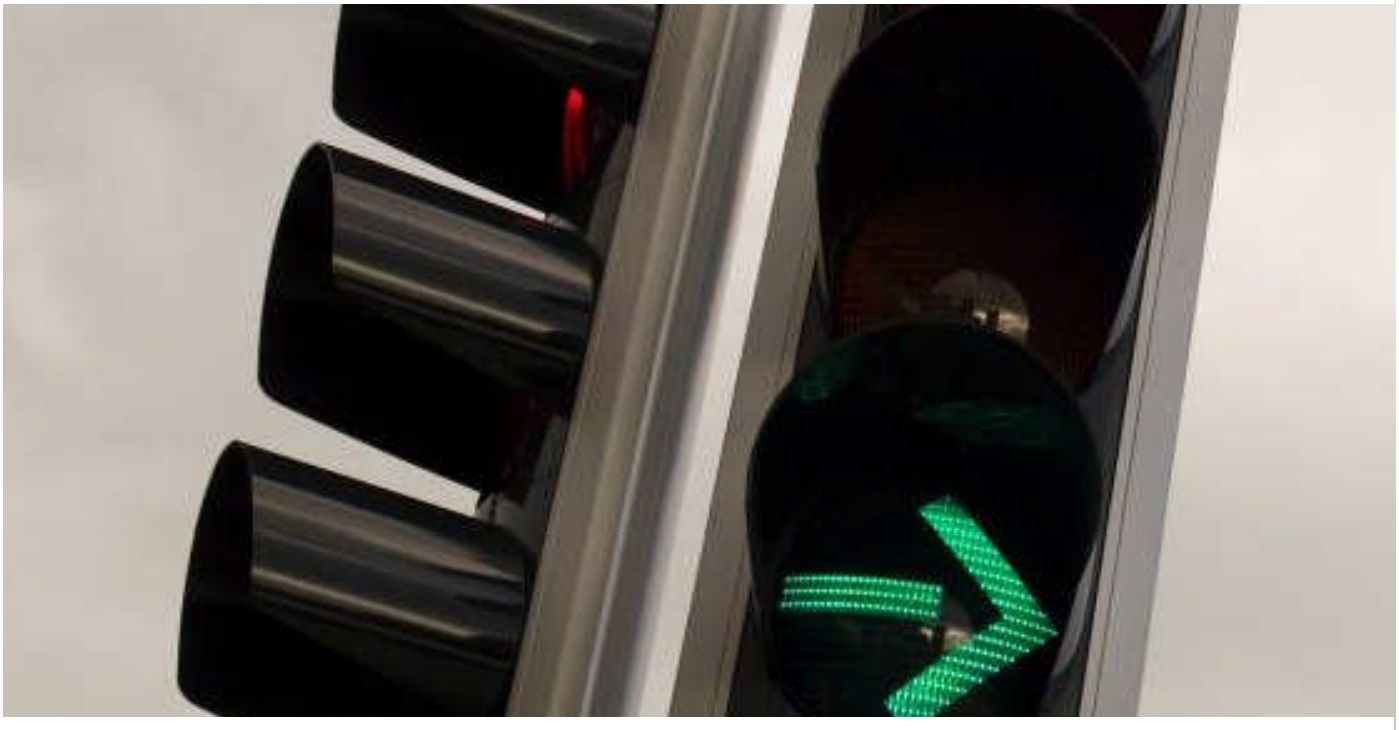
- Understand that the current financial crisis world over is more a crisis of 'confidence' than the crisis of 'funds'
- Design strong governance structures protecting the rights of shareholders ensuring an independent BOD with adequate mechanisms for internal checks and controls
- Reach out to the investors keeping complete transparency with respect to the ownership structures
- Educate stakeholders about their rights and responsibilities

2 Function behind glass doors

- Work with the regulators towards meeting the transparency and disclosure requirements
- Voluntarily disclose financial and non financial information to investors as a confidence building measure
- Establish reporting requirements by involving all stakeholders and implement the same.
- Invest in IT systems to provide relevant MIS to all stakeholders
- Ensure checks and controls are in place to have independence in reporting

Strategic Foresight

7



The winners from this crisis will be those that do what is required for survival, but also adapt to the realities of a new world. Financial institutions must resist the tremendous urge to become completely reactive at the expense of longer-term considerations. At the same time, financial institutions must adjust to the realities of doing business in a world where the interest of multiple stakeholders – governments and society in general – have become more important.

To get financial institutions working, a sustainable business model is needed. Most institutions are stuck in survival mode, when their executives need to be taking decisions now on where the business will be in two or three years' time. It is difficult for chief executives to focus on the longer-term and there is a risk that many organizations will not address the problem now, which will put them at a competitive disadvantage in the future.

Financial institutions must recognize that the future will not be like the past. The shift in economic and political power from the West to the East is a long-term shift and will bring with it a completelydifferent pattern of investment, consumption and global trade.

While it is easy to lose sight of longer term trends during a crisis, the underlying forces shaping the future of financial services have not changed.

To remain competitive, financial institutions must incorporate these powerful long-term trends into their sustainable business strategies, and they must do it sooner rather than later.

The current crisis and the ensuing uncertainty has caused most of the financial institutions to go in a 'survival' mode…

Typical responses of Financial Institutions in the wake of the crisis…

Shelving expansion plans

- New markets entry/New product launches are being delayed
- Mergers and acquisitions have been put on hold

Tightening credit facilities

- The lending norms have been made stringent
- Some financial institutions have completely ceased providing credit facilities

Cutting down Sales and marketing expenses

- Marketing and advertising budgets are being pruned
- Incentives of the sales force are being revisited

Relegating technology investments

- New technology initiatives have been reprioritized lower down the order
- Hardware and software costs are being renegotiated with existing vendors

Focussing on milking existing customers

- Service fees charged to customers are being increased
- Interest rates charged to existing customers are being hiked

Pricing of risk

- Under-pricing to overpricing of risk
- Historical risk benchmarks may not provide the best result

Laying off employees

- Jobs are getting slashed by the day
- Salaries of existing employees are getting cut
- Workforce management has taken a backseat

Cutting down on Customer Relationship costs

- Freebies offered to attract customers are being cut
- Customer servicing costs are being relooked at resulting in reducing value added services

…highlight the short term view of things

- The current crisis has caused huge erosion in the confidence of stakeholders in financial institutions world over (including GCC)
- Nobody is certain of the period this crisis is going to last
- In an environment of such turmoil, the financial institutions (along with the other businesses) are forced to focus on immediate survival
- The day to day operational sustainability has assumed huge importance which is causing 'Reactive' responses to the issues caused by worsening situation
- In the process, the nature of the responses is compromising the long term objectives of the institutions themselves
- Also a few responses by financial institutions (like tightening credit) are working at cross purposes to the government efforts to ease the crisis which is causing the crisis to worsen even further

… but the winners will be those who have long term sustainable strategy

What to expect?

New opportunities will be available world over due to the crisis

- The crisis has changed the competitive landscape world over presenting attractive opportunities
- The crisis has caused shift in economic power to the East and has huge potential needing to be tapped

Intense scrutiny will be there from all the stakeholders

- Financial Institutions have lost much credibility in the current crisis
- Varied sets of stakeholders - shareholders, government, employees and customers will examine each and every step thereby making managing them more difficult
- Risk appetite of the financial institutions will be reduced, as a result

Greater flow of goods and services across the region

- Uncertainty will play a major role in business plans and valuations

What to do now?

1 Remember that many of the underlying forces shaping the future of financial services not changed

- Focus on base planning exercises, recognizing that the underlying forces driving the industry will continue:
  - (i) trade and globalization,
  - (ii) advancing technologies will continue to change financial services and
  - (iii) shift in power and money from West to East
- Understand fundamental drivers of change, including recognizing that the overall financial services industry in developed markets will experience slow growth and therefore the funding available in the region is likely to diminish

2 Re-build trust and confidence among all stakeholders (and keep it)

- Design internal process to align stakeholder interest as far as possible
- Communicate in a forthcoming, consistent and clear fashion including making transparent the competing demands
- Apply more conservative and transparent accounting and valuation
- Strive for an appropriate level of Board involvement

3 Build a robust approach to cope with a sustained level of uncertainty

- Maintain a degree of financial flexibility (large amount of free and liquid assets)
- Build flexibility into the operations to cope with fluctuations – e.g. compensation, arrangements with suppliers, etc.
- Seek outside experts routinely to refresh thinking and perspectives on the range of possibilities
- Design capital structure to cope with wider fluctuations and explain to investors how this will increase risk-adjusted returns, even if the headline ROI number looks lower

Summary of themes

Summary - Themes for the new financial order in GCC	Imperatives for players
Monetary vacuum Capital, credit and liquidity vacuum	• Grasp consequences (including unintended) of massive deleveraging • Refresh perspective on sources/uses of all types of financing • Only allocate scarce funds (capital/credit/liquidity) to truly distinctive institutional capabilities
Domestic regional investment Increased focus on domestic assets	• Follow your customer • Scale down of international ambitions • Focus on regional business
Consolidation of financial services Pursuit for building domestic financial institutions	• Understand synergies available in the market for acquisitions, mergers or sale • Revamp operations to improve efficiencies • Streamline businesses to focus on core competencies
Population contraction Repercussions on all sectors of economy	• Be close to the customers (individuals and corporates) • Manage delinquencies and payment cycles effectively • Review and scrutinize loan portfolio
Impact on GCC monetary union Unification of monetary policies calling for greater synergies within GCC markets	• Follow increasing trade across regional boundaries • Build on regional expansion strategies for growth • Formulate synergistic tie-ups with regional peers
Increased transparency Stricter norms for disclosures and information availability	• Design governance models to help prudent decision making and investments • Build efficient IT systems to handle increased regulatory requirements
Strategic Foresight From survival mode to sustainable competitive advantage	• Re-build trust and confidence among all stakeholders (and keep it) • Build robust approach to cope with a sustained level of uncertainty • Remember that many of the underlying forces shaping the future of financial services have not changed

“The Chinese use two brush strokes to write the word crisis. One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger, but recognize the opportunity.”

John F. Kennedy

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If you would like to discuss any of the issues raised in this paper please speak with your usual contact at PricewaterhouseCoopers or one of the following authors of this paper:

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