Global
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Global Investment House

Strategy

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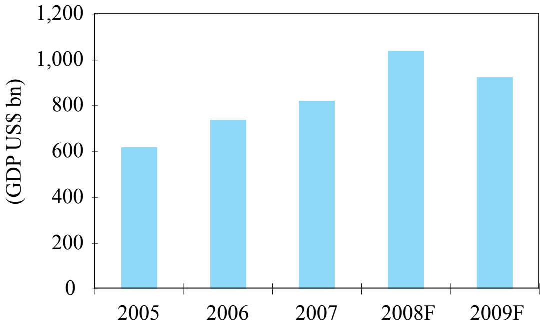
GCC

GCC Macroeconomics - *Changing paradigms*

For the GCC, 2009 will be a year of contraction. The combined size of GCC economies will increase from US$822.2bn in 2007 to about US$1.04tn in 2008 and it is likely to fall to about US$923.6bn in 2009. It is estimated that in nominal terms, GCC economies are likely to grow from about 11.3% in 2007 to 26.4% in 2008. The real growth is estimated to reach about 5.2% in 2008 while in 2009, the growth rate is likely to decline to about 2.4%.

Internal factors that include a credit crunch, lower growth in public spending, and lower growth in rental prices will lower inflation rates in 2009. Besides, imported inflation will reduce dramatically because of lower commodities prices and expected deflation in the developed countries. All in all, these factors should decrease inflation rates.

GCC Nominal GDP



We estimate inflation rates in the GCC countries to average 11.1% in 2008. Our estimate for 2008 indicates that Qatar experienced the highest inflation rate with 16.5%, while Bahrain experienced the lowest rate with 5.30%. However, our forecast reveals a major drop in inflation rates for all GCC countries in 2009.

In 2009, M&As will be driven by GCC governments initiatives to stabilize the real estate and equity markets and their efforts to boost market conditions. Furthermore, the relatively low valuations will encourage SWFs to acquire stakes in local as well as international companies. Similarly, low valuations and the pressure to maintain competitive cost base encourage companies to expand their business by vertical as well as horizontal mergers.

Earnings growth in 2009 is not expected to stand out as being exceptional, standing in the vicinity of 6 - 7%YoY for the GCC. Albeit, unlike 2008, the earnings in 2009 will not suffer from the substantial investment losses borne by the companies (banks, investment banks in particular and other portfolio-running companies in general), aggregate earnings and aggregate earnings growth will nevertheless be weighed down.

The GCC markets have started on the worst possible note as investors are wary over the result of 4Q2008 and 1Q2009, which is reasonably understandable. Assuming that the multiples maintain status quo (being conservative), if the markets just follow the earnings growth, we will expect a modest gain in the market returns in 2009.

We understand that the probability of such an occurrence in the 2H2009 exceeds by far the probability of the same happening in 1H2009. Moreover, the magnitude of the rally will be highly dependant on non-fundamental factors such as return of foreign investors and on the investor sentiment and confidence as well.

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GCC Economic Outlook

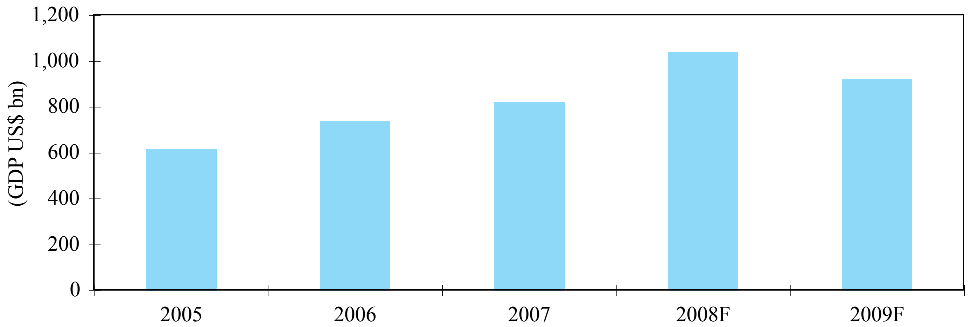
After witnessing a super-spike period during mid-2008 that reached a record high of more than US$140 per barrel, oil prices fell sharply towards the end of the year to trade at less than US$35 per barrel. This turnaround resulted in the collapse of five-years of bull-run in oil prices, which climbed from US$29 a barrel in early 2003 to a peak of US$147 a barrel in July 2008. The collapse of oil prices in the second half of 2008 was the result of a growing realization that the global economy will face a sharp slowdown in 2009, leading to a huge drop in demand for oil.

Oil prices averaged about US$94 per barrel for 2008 and it is forecasted that average prices are likely to reach at about US$60 per barrel for the year 2009. Sharp economic downturns in advanced economies have started spreading their effects on Asian economies which were previously considered recession-proof. On the back of this, world oil demand is also likely to fall in 2009. At the same time much depends on the growth rates of developing countries like China and India, but these countries have also started showing signs of a slowdown. Therefore, oil prices to remain in our predicted range for 2009 will also require timely intervention by oil producing countries.

Such a sharp fall in oil prices along with production cuts by OPEC will also have a significant impact on economic growth in the year 2009. The cumulative cuts imposed by OPEC in 2008 was 4.2mn barrels a day. At the same time, further cuts are not ruled out if oil prices sink further in 2009.

On the back of this, oil revenues, capital investments and current account surpluses in the GCC region are likely to witness a sharp deceleration in 2009, which will have a significant impact on the real economic growth of these countries.

Chart 01: GCC Nominal GDP



Source: ***Global*** *Research*

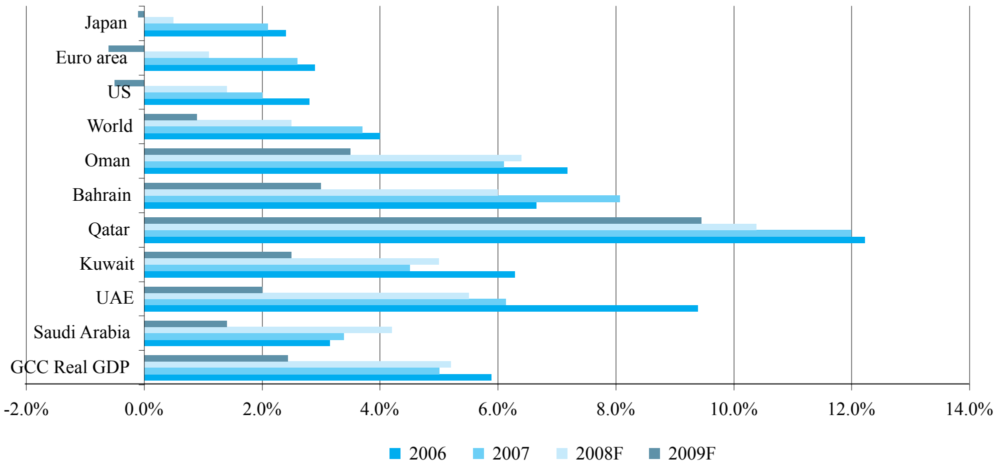
GDP - 2008 a year of super-normal growth, 2009 will be the year of contraction

The combined size of GCC economies will increase from US$822.2bn in 2007 to about US$1.04tn and it is likely to fall to about US$923.6bn in 2009. It is estimated that in nominal terms, GCC economies are likely to grow from about 11.3% in 2007 to 26.4% in 2008. However, in 2009 the combined nominal GDP of GCC countries is likely to witness contraction of about 11.1%. The real growth is estimated to reach about 5.2% in 2008 while in 2009, the growth rate is likely to decline to about 2.4%.

The region's largest economy, Saudi Arabia is likely to report a nominal growth of 22.5% and a real growth of 4.2% in 2008. However, in 2009 the economy is likely to decelerate by about 12.2% in nominal terms and in real terms it is likely to grow by 1.4%. This would be the slowest growth rate for Saudi Arabia last several years.

Among the GCC peers, Qatar is likely to remain insulated though the growth rates are estimated to slowdown in 2009. It is expected that the nominal GDP of Qatar is likely to grow by 33.8% in 2008 and in 2009 the growth rate is likely to turn negative of about 0.8%. The real GDP growth of Qatar is estimated at about 10.4% and 9.4% in 2008 and 2009, respectively.

Chart 02: Real GDP Growth Rates of GCC countries



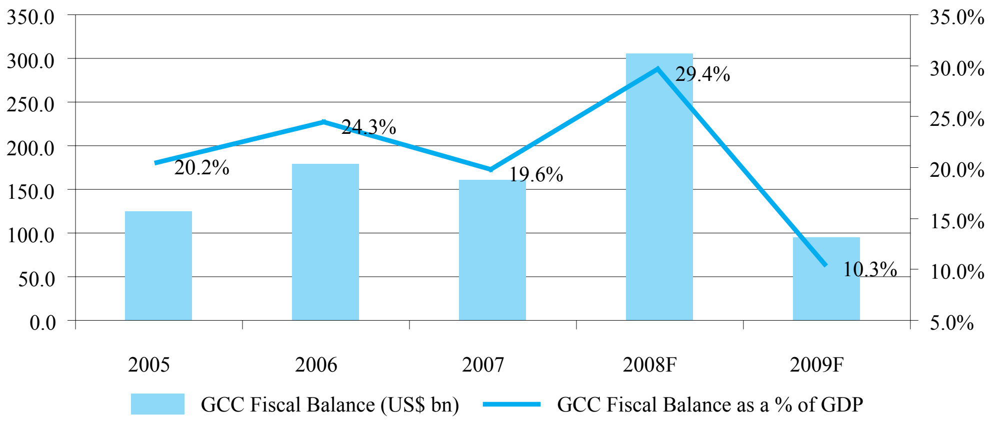
Estimates for GCC countries for 2008 & 2009 are Global's own estimates and for other countries are from World Bank Reports
*Source: World Bank and **Global** Research*

Among the GCC countries, Saudi will be the most affected in real terms in 2009 with growth rates expected to decline to 1.4%. Qatar will be less impacted, as compared to its GCC peers, with its real growth expected to decline from 10.4% in 2008 to 9.4% in 2009. In case of UAE, real growth rate is likely to reach 5.5% in 2008 and the growth rate is expected to shrink to 2% in 2009. The real GDP growth of Kuwait, Oman and Bahrain is set to reach 5%, 6.4% and 6% respectively in 2008 while in 2009, the real growth of these countries is likely to decelerate to 2.5%, 3.5% and 3% respectively.

Era of record surpluses are over…

Strong crude prices during 2008 are expected to widen fiscal surplus of GCC economies to a record high, which would be its highest ever fiscal surplus. The actual revenues could double the what budgeted for as crude oil prices averaged about US$90-plus for 2008 while budgeted revenues are based on average oil prices of about US$40-50. We expect that combined fiscal surplus of GCC countries to reach 29.4% of their GDP for 2008. The fiscal surplus is expected to reach about US$305bn. However, in 2009, declining oil prices are likely to have a significant impact on hydrocarbon revenues of GCC countries while the same time government expenditure should remain expansionary for further economic growth. Therefore, we estimate that in 2009, fiscal balance is likely to decline and reach about 10.3% of their combined GDP.

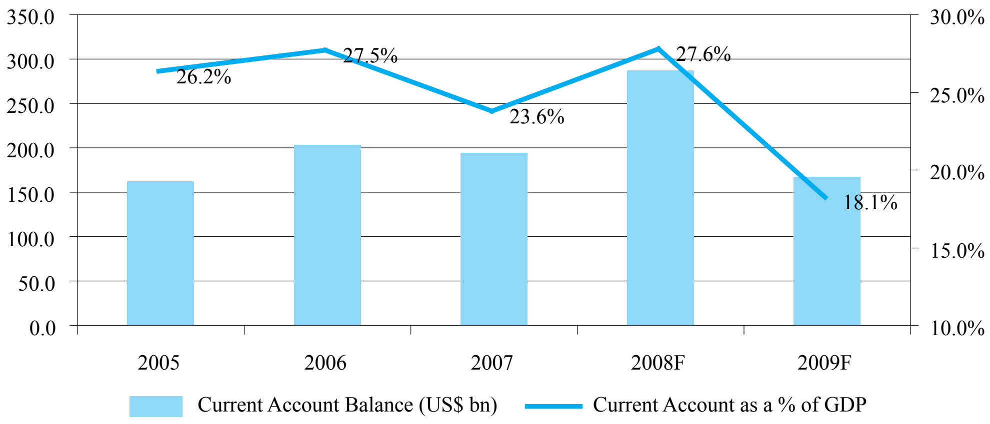
Chart 03: GCC Fiscal Surplus as a % of GDP



*Source: **Global** Research*

The loss of more than US$100 in oil prices in the second half of 2008 is expected to have a strong impact on the region's balance of payments in 2009. The oil exporters' current account surplus as a % of GDP is expected to moderate from 27.6%, estimated for 2008, to reach about 18.1% in 2009. It is based on the expectation that oil prices are likely to average out at about US$60 per barrel in 2009, if the prices remain in the sub-$50 range than it could have an adverse effects on the region's trade balance, however, chances of oil to trade in that range are less likely.

Chart 04: GCC Current Account Balance as a % of GDP



*Source: **Global** Research*

Lower oil prices and reduced oil production, coupled with a falling demand for goods and services will translate into a crash in the region's export income, trade surplus and overall current account surplus. This narrow fiscal as well as trade surplus will definitely have some impact on the liquidity position of these countries. On the back of this, some of the fresh investment projects are not likely to get materialized. At the same time projects which are there in the pipeline could also get delayed. However, accumulated surpluses over the last several years will provide a cushion to the public spending of GCC economies. Therefore, liquidity management could be the key to fund future projects.

Inflationary Pressures are likely to cool-off

In the last few months, the world witnessed a tremendous decline not only in equities, but also in commodities, as the global economies witness a recession that is turning out the worst in decades. Falling prices across international economies may lead to excessive deflation that could exacerbate the global economic condition even further. Deflation was not in the mind of the investment world in July of the year 2008 when everyone's concern was inflation led by exceptionally unprecedented high oil prices. The GCC countries were no different than the rest of the world. In the beginning of the year, inflation was a major concern, but rising prices will not be an issue in the new year of 2009.

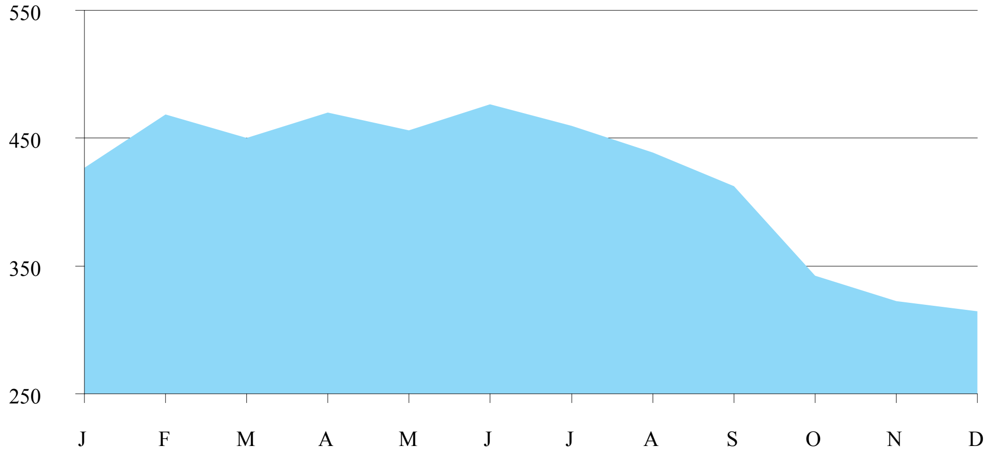
External and internal factors that had been fuelling inflation in the GCC countries are turning around. In terms of internal factors, three major factors are putting the brakes on inflation. First, the global credit crunch translated into a local credit crunch. This credit freeze in the GCC was due to the foreign investors withdrawing their cash out of the local markets. In addition, foreign borrowing was frozen, which required some firms to find alternative replacements. Locally, the investment sector was the most to be hurt from the frozen foreign credit market in which the banking sector was not able to cover the huge demand for credit resulting from the pull-out of foreign lending. Besides, banks were not ready to take the risk of lending, even though governments and central banks took wild measures, including pumping liquidity into the system, and loosing-up the lending requirements. The lack of liquidity is expected to continue into most of 2009.

Apart from the credit crunch, there is a sharp decline in oil prices. Even though OPEC had been cutting production, the free-fall of oil prices did not stop. Oil price reached its four-year low after breaking an all-time record in July of 2008, a price tag of US$147 per barrel. Oil prices are not expected to be high in 2009. As a consequence, oil producing countries, especially in the GCC, will experience a fall in revenues which will slow their spending capacities. Lower growth in public spending would decrease growth in business activities, as public spending in the GCC plays a big role in the economy. All in all, most countries will still be able to maintain their level of spending in the short term, even though they may record a budget deficit, thanks to surpluses accumulated during the previous years. However, any expansion plans might be put on hold.

Rental prices are also expected to cool down in the next year. Weighing heavily on the price indices for all GCC countries, rental increases will slow down in 2009. Prices had been skyrocketing in the past few years, which had been a major cause for higher consumer prices. For example, apartment rentals increased by 25% during 2005-2006, and by 18% during 2006-2007 in Dubai, according to Asteco. However, rentals prices will see a big drop in 2009 because supply next year will outpace demand. According to Colliers, supply for commercial space will be more than triple, reaching 5.6mn sqm in Dubai in the coming year.

External factor is mostly represented by imported inflation, which is expected to slow down for two reasons. First, Commodities ranging from energy, agricultural, livestock and metals are declining at a rapid pace. CRB Reuters, a broad commodity index, reached its peak in July, recording 481 points. Afterwards, the index declined by more than 34% at the end of 2008, reaching 314.7 points.

Chart 05: CRB Reuters index in 2008



Source: Bloomberg

Second, developed countries are expected to experience a drop in prices (deflation). Signs of deflation are showing up in the form of decreasing worldwide inflation rates. For example, UK inflation rate for October decelerated to reach 4.5% from 5.2% a month earlier. This .7% drop is the biggest drop in at least 11 years. Besides, the US experienced a substantial drop in inflation levels in October, when inflation rates dropped by 1%, which is the largest drop in 61years, to reach 3.7%. A major cause of deflation is a sudden drop in demand which is currently taking place. For example, the retail sale recorded a drop of 2.8% in October 2008, the largest in US history. Another major cause of deflation is the process of de-leveraging that the private and public sectors are experiencing at these times. The de-leveraging process slows down the velocity of money, i.e. the frequency of money spent during a specific time period.

Table 01: Inflation Rates in the GCC

	Bahrain	Kuwait	Oman	Qatar	Saudi Arabia	UAE
2008E	5.3%	10.2%	12.3%	16.5%	9.3%	13.1%
2009F	3.6%	7.0%	10.2%	11.5%	6.6%	9.1%

*Source: **Global** Research*

In summary, internal factors, that include credit crunch, lower growth in public spending, and lower growth in rental prices will lower inflation rates in 2009. Besides, imported inflation will reduce dramatically because of lower commodities prices and expected deflation in the developed countries. All in all, these factors should decrease inflation rates. In fact, slight decrease in inflation rates had been reordered in the GCC countries. For example inflation in Oman decreased by 0.8%, down from 13.4% in September to 12.6% in October.

We estimate inflation rates in the GCC countries to average 11.1% in 2008. Our estimate for 2008 indicates that Qatar experienced the highest inflation rate with 16.5%, while Bahrain experienced the lowest rate with 5.30%. However, our forecast reveals a major drop in inflation rates for all GCC countries. We an predict average inflation rate of 8.0% in 2009. The highest and lowest inflation rates will be recorded by Qatar (11.5%), and Bahrain (3.6%).

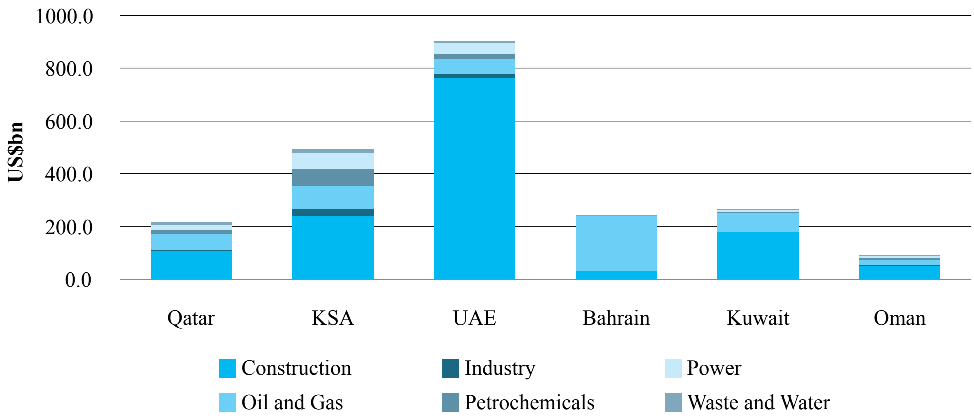
GCC Projects

Oil revenues in the past five years has facilitated the GCC accumulating more than US$1.5tn. The countries used a fraction of the revenues to spend on projects in order to develop and diversify the economy. GCC projects have reached US$2.54tn as of Jan. 05, 2009, a Y-o-Y increase of 57.5% from US$1.61tn. Most projects are invested in Real Estate, Oil and Gas, and Power.

Pre-crisis on Sept.1, projects planned or under way totaled US$2.16tn, Saudi Arabia and the UAE are the biggest project markets in GCC, their investments make up 72.6% of total projects in the GCC. Despite the fact that being extremely affected by the financial crisis through their capital markets and oil prices since Sept.2008, their project portfolios increased 9.01% in Saudi Arabia and 27.5% in the UAE. In the GCC the value of projects increased 17.1% during the same period, of the GCC countries Kuwait posted a 2.4% growth as opposed to Bahrain which increased 36.5% during Sept.1-Dec.15.

Due to the global crunch many projects have been delayed in the GCC mostly from real estate and oil and gas sector which make up 81.1% of total projects in the GCC. According to ProLeads, a research firm, there are 150 projects currently on hold, 88 are in UAE, 54 in Saudi Arabia and 15 in Kuwait. Reasons are attributed to increasing building materials cost, decreased liquidity and slowdown in the world economy. Major delayed projects include King Abdullah Economic City in Saudi Arabia, Asia Asia Hotel in Dubai, Palm Deira in Dubai, Jaber Al-Ahmad Hospital in Kuwait, Qatar Petrochemical Complex, and Aramco Dammam oil field.

Chart 06: GCC projects by Sector



*Source: MEED Projects, *As of July 2008*

2009 could be a year of delays and deferred projects, mostly for the private sector because of the lack of funding. For the month of December the OPEC crude price has averaged US$39.6/bl, while the break-even oil prices of the GCC is US$47/bl. If the oil averages at US$50/bl then GCC countries will post a very low budget surplus or will face budget deficits which will put a short term pressure on planning or on the execution of projects. Recently, Saudi Arabia announced the largest budget (2009) in its history showing that spending by GCC governments will still be strong and governments will be the leading entity to announce new mega projects.

The private sector could take a hit in 2009 due to the lack of funding and tight liquidity. Even though GCC policy actions are easing interest rates, still private entities are announcing new lay-offs and delayed projects. The major delays could be for the short term because the efforts made by central banks will provide more liquidity in the system and projects developers will continue their stopped track.

Prospects for private sector projects in 2009 are cloudy, construction sector unemployment could increase because of lay-offs, property prices could go down because of decreased demand and less liquidity will enter the sector because of investors backing out, thus reducing the pace of the projects activity. The more the delays, the more it will be costly on the developers. Companies of big real estate companies in GCC have started to lay-off workers, delay future expansions, and their stock prices have reached new all-time low including Emmar, Nakheel, ArabTec, Mazaya and Dar-AlArkan. But delayed projects also have shifted the demand to newly completed properties, especially in UAE.

Other sectors have witnessed a minimal hit, including petrochemicals. Kuwait has cancelled a US$17.4bn joint venture with Dow-Chemical. Abu-Dhabi also delayed the Integrated Gas Development due to technical problems. This project will transfer more than 700mn cubic feet. PertoRabigh of Saudi Arabia is delaying a polypropylene plant that could produce 700,000t/y to the end of 1Q2009. Oil prices which took a hit last year, could affect the fate of the oil projects. OPEC countries have reduced output to new historic levels, which shift their focus from building to delaying and waiting for costs to decrease. In Saudi Arabia, Aramco has delayed oil projects with France's Total and US Conoco Phillips. Also, Kuwait has a risk of cancelling Al-Zour fourth refinery.

On the other hand the power sector is still announcing new projects, Saudi Electricity is signing a new contract to power western Mecca, it also plans to award contracts in the next seven years amounting to SR122bn. According to MEED, Rabigh and Ras-Alzour projects in Saudi Arabia and Salalah project in Oman are scheduled to be awarded by early 2009. In Dubai, costs have affected the development of power stations. New delays has been made on power projects in Dubai due to rising cost. New real estate projects had put pressure on the Dubai Electricity and Water Authority (Dewa) to keep up with the pace of demanded power. But today a slowdown will give Dewa more time to develop projects, where its estimated that Dubai will need 15,000MW in 2015 from 5,000MW in 2007. In Qatar, General Electricity and Water Corporation (Kahramaa) is considering to expand its power network that will cost US$18bn in the next seven years. It is planning to build 29 high-voltage substations. By 2015 electricity demand will reach 10,000MW, thus we can see an increase in power projects activity.

Projects in the GCC continue to perform well and strongly, where in the 1st week of January, projects have increased by 57.8% in a year, which indicates a remarkable growth in one year. According to MEED, GCC projects have reached US$2.54bn as of January 5, 2009.

In the short term, projects markets in the GCC will take a slight hit due to the delays, but in the long term things should be bright because the GCC is built on strong macro-economic factors that will rehabilitate any projects problems. Moreover, government backed projects will continue to progress in 2009 as well.

Table 02: GCC projects in 2009

(US$ mn)	Jan 5.2009	Dec 22.2008	% Chg.	Jan 5. 2008	YoY Chg. (%)
Bahrain	64.3	64.2	0.2	27.9	130.5
Kuwait	303.6	303.9	-0.1	275.0	10.4
Oman	107.1	107.2	-0.1	50.7	111.1
Qatar	222.6	222.4	0.1	156.7	42
Saudi Arabia	618.1	615.3	0.4	390.2	58.4
UAE	1,232.3	1,231.2	0.1	714.5	72.5
GCC Total	**2,548.0**	**2,544.3**	**0.1**	**1,615.0**	**57.8**

Source: MEED Projects

Foreign Direct Investments (FDI)

FDI Inflows in GCC continued to grow and rose by 20% in 2007 to US$43.0bn as per the UNCTAD report with much of the FDI inflows in 2007 concentrated in two countries: Saudi Arabia and the UAE together accounting for 87.5% of the total FDI in the region. Qatar also experienced a significant rise in inflows in 2007 (more than seven times higher than in 2006). The rise in FDI investments is mainly on account of a growing number of energy and construction projects, as well as a notable improvement in the business environment in 2007. Also, high oil prices in the past few years have continued to boost economic growth rates in GCC which encouraged governments to spend heavily on infrastructure, particularly for revamping water and energy industries and services, often in collaboration with private investors, including foreign ones.

Table 03: FDI Flow in GCC (in US$bn)

Country	FDI Inflows			FDI Outflows		
	2005	2006	2007	2005	2006	2007
Kuwait	0.2	0.1	0.1	5.1	8.2	14.2
Saudi Arabia	12.1	18.3	24.3	0.1	1.3	13.1
UAE	10.9	12.8	13.3	3.8	10.9	6.6
Qatar	1.3	0.2	1.1	0.4	0.1	5.3
Bahrain	1	2.9	1.8	1.1	1	1.7
Oman	1.7	1.6	2.4	0.2	0.3	0.6
GCC	**27.3**	**35.9**	**43.0**	**10.7**	**21.8**	**41.5**

Source: World Investment Report

FDI outflows from the region in 2007 also witnessed similar trends and increased by 90% to reach US$41.5bn, nearly four times the figure of 2005 with Kuwait, Saudi Arabia, UAE and Qatar accounting for almost 95% of the total outflow. Acquisition of General Electric Co.'s GE Plastics business by Saudi Basic Industries Corp., for US$11.6bn in May 2007 accounted for 28% of the flow. However, the largest cross-border acquirers were from the United Arab Emirates, followed by firms from Saudi Arabia and Qatar. SWFs based in the sub region have also accounted for a major proportion of FDI. Intraregional FDI in Greenfield projects was also significant, along with investments in developing countries, especially China, India and Malaysia.

The GCC countries have built up a substantial windfall from oil exports since 2002 when global oil prices started to rise. This has enabled them to accumulate a huge stock of net foreign assets, estimated at around US$1.8trillion as per IIF estimates, and to implement their diversification strategy away from oil and gas production. Although the United States has attracted the largest share of investments from GCC countries, a growing number of GCC investors are now moving to Asia, particularly China and India, to diversify their investment portfolios.

A growing amount of GCC capital is being invested in various sectors such as banking, telecom, real estate and manufacturing in West Asia and North Africa, including export-oriented manufacturing activities to supply the European and West Asian markets, as a result of accelerating liberalization, privatization, and the increasing use of Islamic financial instruments. Egypt, Tunisia and Morocco are among the most attractive host countries in North Africa for investors from West Asia, particularly from the GCC countries.

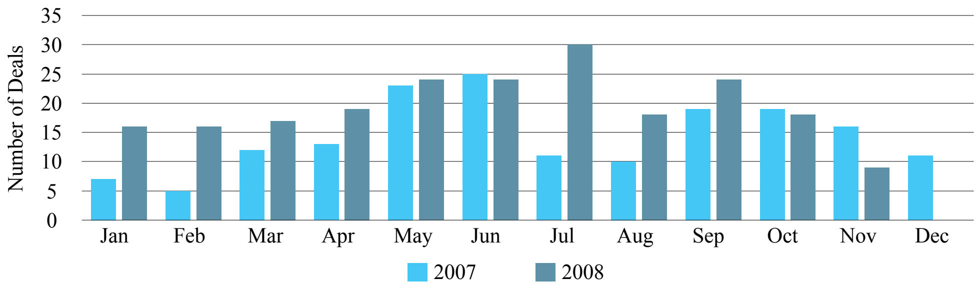
General trend in policy changes over the past few years suggests an easing of FDI restrictions and a more welcoming climate for foreign investment, especially in non-oil industries. In Saudi Arabia, the Supreme Economic Council shortened the list of areas that are closed to FDI in March 2007. The United Arab Emirates announced in March 2008 a new company law to allow100% foreign ownership of companies in some sectors (compared to the existing 49% limit) outside the free trade zone.

Although the global financial crisis had a limited impact on FDI flows in 2007, it is significantly impacting 2008. All developed economies are slowing down and going into recession so both inflows to and outflows from these countries may decline. The ongoing international financial crisis will likely lead to some decline in international FDI in 2008, but the GCC countries have good chances to resist this trend, as the need for large energy and construction projects as well as favorable reforms in the legal framework have made them more attractive FDI destinations. However, FDI growth would be at a significantly lower rate.

Mergers & Acquisitions

The global economic meltdown has caused a slow-down in many sectors leading to muted prospects of financial activities in 2008 and mergers and acquisitions (M&A) were no exception. In fact, there were many cancellations of M&A deals in 2008 as people became reluctant and cautious while uncertainty became the theme of the fourth quarter of 2008. According to Dealogic, 1,309 deals worth US$911bn were terminated in 2008, out of which 140 deals were terminated in October alone.

Chart 07: Number of M&A Deals

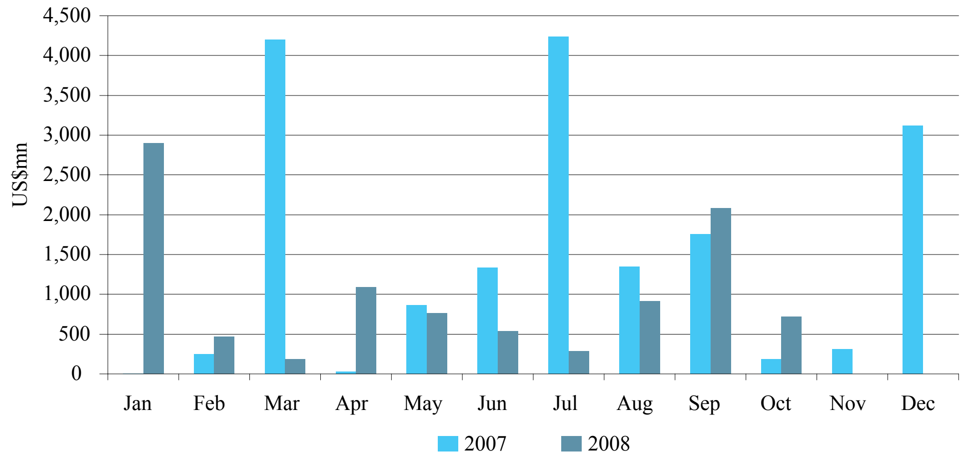


Source: Bain and Company

Looking at GCC, the total estimated value of announced deals dropped by 34.3% to US$9.2bn during the first three quarters of 2008, compared to US$14.0bn during the same period of 2007.

According to Bain and Company, despite this decline in the value of M&A transactions in 2008, the number of deals in the GCC increased to 188 during the first three quarters of the year, a 50% increase compared to the number of deals during the same period in 2007.

Chart 08: M&A Deals Value



Source: Bain and Company

Among GCC members, the UAE holds the largest share of M&A transactions in the first three quarters of 2008, which stood at 53% followed by Qatar at 12.4%. In terms of value, the UAE also leads the Gulf in the value of deals with almost 75% share of the US$9.2bn total. The value of deals in the UAE was 50% of the total value of deals in the GCC during the same period of 2007.

Table 04: Some Major M&A Deals in 2008 in the GCC

Target Name	Target Country	Acquirer Country	Acquirer Name	Announced Total Value (US$ mn)
OGER TELECOM LTD	UAE	Saudi	SAUDI TELECOM CO	2,850
PEARL ENERGY LTD	Singapore	UAE	MUBADALA DEVELOPMENT CO	833
SAUDIA CARGO	Saudi		CONSORTIUM	723
UNITED ARAB BANK	UAE	Qatar	COMMERCIAL BANK OF QATAR	601
DALMA ENERGY LLC	UAE	Saudi	GULFCAP FZC	446
BAHRAIN SHAMEL BANK	Bahrain	Bahrain	ITHMAAR BANK BSC	227
COMMERCIAL INVESTMENT CO LLC	Saudi	UAE	DUBAI INVESTMENT GROUP LLC	136
DOHA MARINE SERVICES	Qatar	Oman	RENAISSANCE SERVICES SAOG	124
REDINGTON GULF	UAE	Bahrain	INVESTCORP BANK	98

Source: Bloomberg

M&A Trends in 2008

A good number of cross border transactions have been witnessed in 2008, which indicates that M&A activity is open for more global diversity and the potential for new deals is approachable by more participants.

Sector wise, the financial services industry was the most popular deal target and accounted for the largest transactions. The fall in stock prices of many major financial institutions has attracted many investors (SWFs, Holding Companies, Investment Firms, etc) to seize the opportunity and acquire major stakes in these institutions.

An important factor which contributed to the M&A activity in the GCC is the private equity and LBO deals. The region saw major private equity funds focused on investing within the region and looked out for deals in family businesses and other public and private sector entities.

In the fourth quarter of 2008, M&A activity has sharply declined mainly because of the lack of liquidity and the ambiguity of the future. The corporate ratings and valuation have been constantly and swiftly changed which increases hesitation among M&A participants.

M&A Outlook

In the short term, we expect to witness an increase in the M&A activity in the region. The real estate, banking and financial services are likely to be the main sectors witnessing most of the activity. Corporate consolidations among small to midsized firms is expected to occur in order to survive the current crisis and benefit from economies of scale and joining forces. The anticipated consolidations maybe forced, like when the UAE government merged Amlak and Tamweel, the country's two largest mortgage providers, as well as being strategic.

Private equity funds are expected to continue their major role in the M&A market despite current market circumstances. Private equity investments continue to generate consistently higher returns than most public equity markets and bond markets. The most profitable times to invest in, have been those when the market has been facing a challenging period.

In 2009, M&As will be driven by GCC governments initiatives to stabilize the real estate and equity markets and their efforts to boost market conditions. Furthermore, the relatively low valuations will encourage SWFs to acquire stakes in local as well as international companies. Similarly, low valuations and the pressure to maintain competitive cost bases encourage companies to expand their business by vertical as well as horizontal mergers.

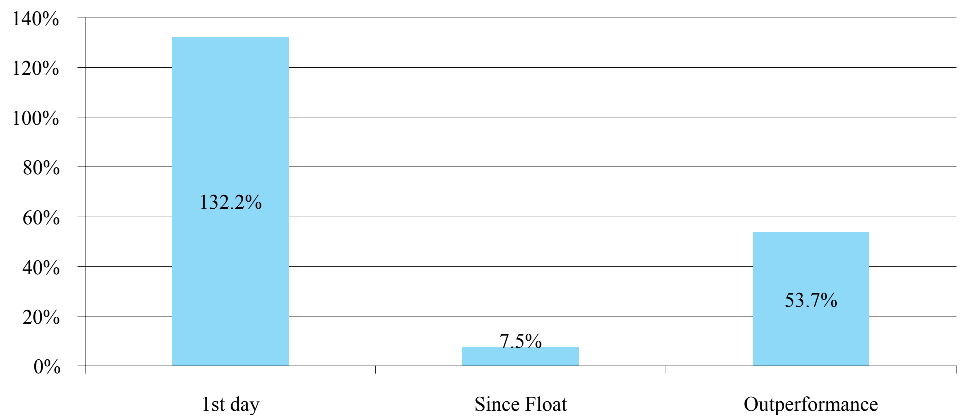
On the other hand, the credit crunch and lack of liquidity will be the main obstacle facing the M&A market. Also, global market turmoil and uncertainty may cause M&A participants to hold back until market conditions are more lucid.

GCC IPO

In 2008, the GCC region experienced 25 IPOs, raising approximately US$11.7bn in. The average oversubscription ratio was 23.1x, and the average amount raised was US$466.9mn. In fact, the IPO market in the GCC was one of the strongest in the world, up until the end of 3Q2008. 6 out of the largest 20 IPOs in the world were conducted in the GCC. 22 out of 25 companies had been already listed in their respective bourses.

All of the newly listed 22 companies increased in value during the first day of trading except for one company. The average first day returns was more than 132% for the 22 companies. After the closing of the year 2008, 8 companies out of the 22 companies listed this year ended in a positive notch. The overall average returns for newly listed IPOs for the year 2008 was 7.5%. However, 21 shares outperformed their benchmarks. The average return spread for the 22 companies was 53.7%.

Chart 09: Return Characteristics for Listed IPOs in 2008



*Source: Zawya & **Global** Research*

Companies in the region are eagerly planning to enter the IPO market. It is estimated that as many as 48 companies in the GCC had already assigned an IPO manger for their listings, and another 78 GCC companies plan to have their IPOs by 2011. However, the impact of the global crisis was apparent in the region, as many companies had already postponed their IPOs indefinitely citing market conditions as a direct cause. In fact, there were no IPOs in the 4Q2008. The latest IPO was for Kuwait Telecommunication Company (Viva) which closed its subscription window in the mid-September.

Oil prices effect

Even though OPEC had been cutting production, the free-fall of oil prices did not stop. Oil price reached its four-year lows after breaking an all-time record in July of 2008, a price tag of US$147 per barrel. Crude Oil price is not expected to return to its previous high level this year. As a consequence, oil producing countries, including the GCC, will experience a fall in revenues which might slow their spending capacities. Lower growth in public spending would decrease growth in business activities, as public spending in the GCC plays a big role in the economy.

However, most countries will still be able to maintain their level of spending in the short term, even though they may record a budget deficit, thanks to surpluses accumulated during the previous years. For example, Saudi Arabia, which recently announced its budget for 2009, projects to incur a budget deficit of SAR65bn (US$17.3bn), the first in six years. Other GCC countries are expected to experience the same economic environment. On the other hand, any expansion plans might be put in hold.

Investment Companies hit hard

Investment companies were the hardest to be hit by this financial crisis. The current credit crunch had also reached the GCC region. Many companies in the region are not able to find alternative sources to finance their foreign debt, as foreign banks lack liquidity. Besides, local banks are not able to absorb the sudden increase in demand for corporate lending, not because of the shortage in liquidity, but because of the unwillingness to lend in a turbulent market condition. Currently, the financial services sector in the region does not have enough liquidity to enter the capital market, let alone an IPO market.

Expectations dictate the timing

Expectations play a vital role in the IPO market. Companies are willing to go public when they expect market conditions to at least stabilize, if not boom, and companies tend to shy away with the first sign of market trouble. Currently, the sentiment in the market is negative, and most of the newly listed companies, which increased in price, dropped below their subscription price.

Therefore, we expect the IPO market in the GCC region to be relatively calm in the first half of the year 2009 and later increase gradually in the second half of the year. Currently, there are 10 companies that plan to IPO their shares in the first quarter of this year, of which one company has a specific date for its offering. Like Naseej, many of these IPOs date of offering are expected to be revised accordingly.

Corporate Earnings…

2008: The best of times, the worst of times

The GCC markets saw a bullish rise, followed by an incessant plummet; in a nut-shell, the best and the worst of market conditions in 2008. Oil prices reached a zenith at over US$145 per barrel during the first half of 2008 and the near-bottom at US$40 per barrel. While market conditions worsened in the second half continuing seamlessly in 2009, the new year may very well see the same cycle repeat itself, only in the reverse order, as per our expectations.

2009: Rising from the ashes

The earnings growth of 2008 stood to lose in 2 significant ways. Firstly, 2007 was a year of exceptional earnings growth leading to a higher base for future growth comparisons and secondly, unlike in 2007, companies bore massive investment losses in 2008 leading to diminished absolute earnings figures. The two factors worked in unison to adversely impact earnings growth potential for 2008. Moreover, the different GCC stock markets fell 30% - 60% during 2008, leaving a lower probability and diminished room for further decline, moving further into 2009.

Earnings growth in 2009 is not expected to stand out as being exceptional, standing in the vicinity of 6 - 7%YoY for the GCC. Albeit, unlike 2008, the earnings in 2009 will not suffer from the substantial investment losses borne by the companies (banks, investment banks in particular and other portfolio-running companies in general), aggregate earnings and aggregate earnings growth will nevertheless be weighed down. This will emanate from the expected decline in the petrochemical sector profitability amidst lower average oil prices and cut in production and from the normalized single digit growth in the GCC banking and investment companies sector. This can be construed from our estimates that if contribution of the petrochemical and the investment companies sector is removed from total GCC profitability, the year 2009 in fact shows a higher growth (7%YoY).

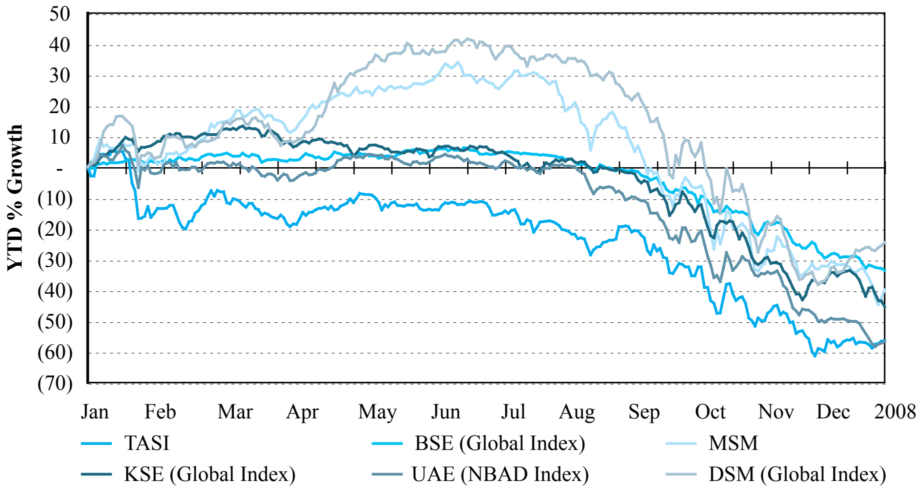
Table 05: Expected earnings growth

	2008E	2009E
SAUDI ARABIA	-5%	4%
KUWAIT	-28%	9%
UAE	10%	8%
QATAR	44%	12%
OMAN	12%	9%
BAHRAIN	2%	8%
GCC	-3 to -4%	6 – 7%

*Source: **Global** Research*

We believe that 2008 took the near-full brunt of the worsened economic crisis and that the markets have absorbed the expected pessimism surrounding the global and local economic arena. Some after-effects will nevertheless be visible in the first couple of months owing to corporate results, which are not expected to be good by any standards. Beyond that markets are not expected to react to the same story again while on the other hand will react largely to other fresh developments. Moreover, it can safely be assumed that while news regarding further economic degradation may not impact the markets significantly, any news regarding economic improvement will be taken as a positive surprise and hence may form the basis for a fresh rally in the stock markets.

Chart 10: Comparison of GCC Indices



With valuation multiples at extremely low levels, we believe that going forward, these multiples may improve, though not to the same levels as before, but improve nevertheless. The upward re-rating of multiples following the current downward re-rating due to prevalent market conditions may be construed as one of the factors that will provide the equity markets with a much needed respite, in 2009. The expectations however depend strongly on the premise that oil does not slip further and that market sentiments do not deteriorate further, dramatically.

Telecom and Infrastructure to Lead Earnings Growth

We expect the collective GCC bottom-line to exhibit a growth of 6 - 7%YoY in 2009 with the banking sector exhibiting the highest contribution as has been the case previously.

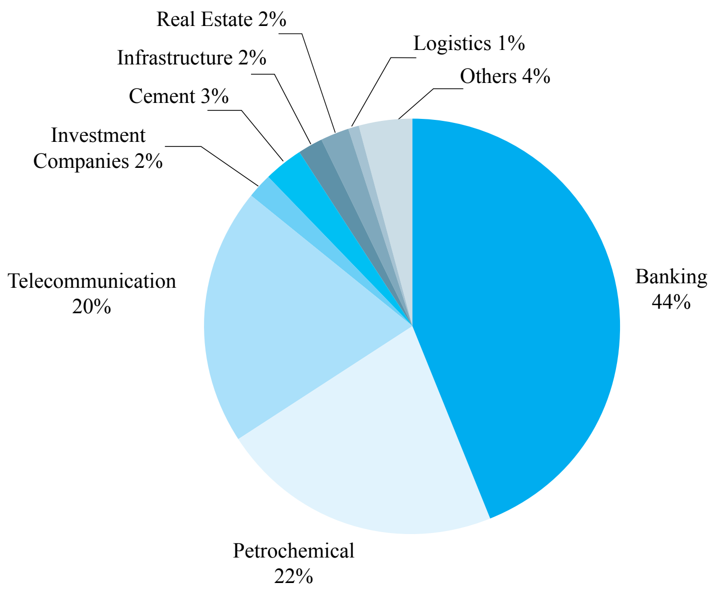
Table 06: Sector Wise Earnings Growth Figures - 2009E

	YoY
Banking	9%
Petrochemical	-9%
Telecommunication	16%
Cement	7%
Investment cos.	4%
Infrastructure	34%
Real Estate	-13%
Logistics	-1%

*Source: **Global** Research*

The banking sector, as a whole, may no longer be termed as the regional favourite in 2009. Despite the healthy growth of approximately 9%YoY, its earnings growth will be over-shadowed by the telecommunications and the infrastructure sectors. The infrastructure sector, may very well materialize as an emerging sector in terms of earnings potential in the likes of 34%YoY in 2009, however with limited companies to invest in, under this sector, investments are likely to spill-over into the telecommunication and then to the banking sector.

Chart 10: Contribution to total GCC earnings



*Source: **Global** Research*

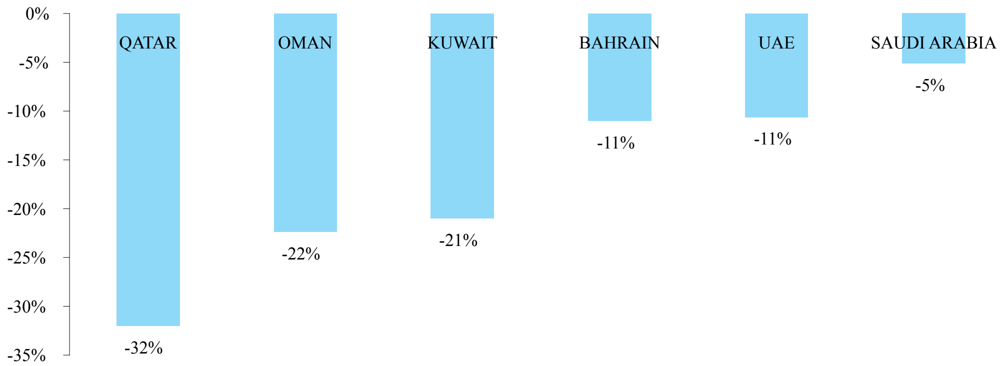
When to expect the so-expected?

The first half of 2009 seems too early a time for GCC markets to recover from the turmoil they went through starting in the last quarter of 2008, which has continued into the present year. With muted full year earnings lined up, starting end of January and lasting till mid-March, expectations and actual realization of such results will naturally keep the markets from performing positively. The first quarter can therefore simply be anticipated to pass by without any major upward movement in the index. Investors are anticipated to remain cautious thereafter till the declaration of the 1Q2009 results and the equity markets then should see a consolidation phase which may last till the end of the 1H2009. We believe that the ground-conditions will be ripe for any upward rally to take place in the 2H2009 and that any such movement in the 1H2009 will come as a very positive surprise.

The dilemma that inhibits accurate vision

The analyst community pays special attention to earnings and their outlook and "visibility". However, given the current situation where thing are opaque, there is very little room to predict as to what will the earnings in the 1H-2009 be, let alone their quality. What is more or less taken in the picture is a very bad 4Q2008 which will have a spill-over effect in 1Q2009. We expect a modest increase in 2009 earnings keeping in mind that the worst might have come in 4Q2008 and will come in 1Q2009 and thence forward we might see a revival of some sorts in the 2H2008 (including oil prices, which are an important factor in the GCC and the world economies).

Chart 11: YTD returns of Stock Markets



Source: ***Global*** *Research*

The GCC markets have started on the worst possible note as investors are wary over the result of 4Q2008 and 1Q2009, which is reasonably understandable. The Qatar market is the worst performer, so far, as it has declined by 32% by Jan 21, 2009 (Just 14 trading sessions!!). Ironically, Qatar is the economy that is expected to be the best performer in terms of GDP growth in 2009. Similarly all the other GCC markets are down as well over concerns relating to the economy and corporate earnings. However, we feel that this might not be the case for the full year of 2009 and we might see a modest increase in the earnings.

The GCC markets have always traded at a premium to the international markets in terms of valuation multiples, however, this time they are in-line or below the emerging market multiples. Assuming that the multiples maintain status quo (being conservative), if the markets just follow the earnings growth, we will expect a modest gain in the market returns in 2009 in the vicinity of 6 – 12%YoY, based purely on the conservative estimates. However, as we write this report, all the GCC markets are down, ranging from a minimum of 5% (Saudi market) to a maximum of 32% (Qatar market) and to reach those kinds of modest gains from current levels will require a strong rally in the market. While we understand that the probability of such an occurrence in the 2H2009 exceeds by far the probability of the same happening in 1H2009. Moreover, the magnitude of the rally will be highly dependant on non-fundamental factors such as return of foreign investors and on the investor sentiment and confidence as well.

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