Abu Dhabi Investment Environment

Executive Summary

- Abu Dhabi is the largest of the seven emirates that constitute the United Arab Emirates. The emirate has over 9% of the world's oil reserves and 5% of global natural gas reserves
- Capitalising on its strong hydrocarbon sector, Abu Dhabi's economy has grown through internal investments, diversifying gradually and investing surplus oil revenues overseas through some of the largest sovereign wealth funds in the world
- With a common history and strong ties, as key members of the UAE and with large capital cities separated by only an hour, Abu Dhabi and Dubai have proven to be twin cities with deep interdependencies; the crisis has challenged preconceptions that each emirate was an insular economic entity
- Abu Dhabi has experienced contagion from Dubai's leverage crisis as international financial markets perceive strong links between both emirates; Abu Dhabi's real estate market has felt the effects of the real estate crisis in Dubai, particularly the aversion to off-plan real estate and credit constraints; Southern Dubai has attracted a substantial amount of residential demand from Abu Dhabi-based workers
- The crisis has tested inter-emirate solidarity and Abu Dhabi has provided financial support to Dubai, although not with the ease that some market participants have expected
- The UAE's hydrocarbon GDP contracted 6.25% in 2009 due to lower oil production and prices; however Abu Dhabi's non-oil GDP grew 6% due to expansionary fiscal policies made possible by oil wealth
- The Abu Dhabi Economic Vision 2030 Plan aims to build a sustainable, diversified and competitive economy that will reduce GDP volatility and enlarge the enterprise base; the emirate will boost its industrial base (petrochemicals, plastics, metals) and the tourism and aviation sectors amongst others
- Abu Dhabi should be considered for inclusion in international diverse investment portfolios due to the emirate's strong growth prospects and stability anchored by hydrocarbon resources
- With a relatively small and illiquid stock market, direct investment in opportunities are an efficient way to gain exposure to the emirate; return performance will depend on deal selection (due diligence) and scrutiny of investments through reporting and control; finding the right local management talent and local sponsors/co-investors will be critical

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1. Introduction

This report looks at the investment environment in Abu Dhabi for the benefit of investors

This report analyses the Abu Dhabi economy and its investment opportunities from the perspective of a potential long-term investor. This report is not focused solely on real estate; instead we explore how the general economic situation in Abu Dhabi can benefit investors looking to gain exposure to Middle East assets directly.

This report is complementary to Isthmus Partners' September 2009 report "Dubai Real Estate Opportunities" available for download on the Publications tab on our website www.isthmuspartners.ae .

This report is targeted at funds and high net worth individuals (HNWIs) looking to gain exposure to the Abu Dhabi market, as well as asset owners looking to better understand the competitive landscape within their environment.

We focus on the key strengths and weaknesses of the Abu Dhabi economy, which gives rise to a number of potential opportunities in the emirate. The report starts with an overview of Abu Dhabi, touching on how it fits within the Middle East region, the GCC and the UAE. We explore Abu Dhabi's population mix, GDP growth and industrial mix.

We follow with a section detailing how Abu Dhabi has fared during the recent economic crisis. Here we concentrate on Abu Dhabi's economic performance, the state of the real estate market, implications for the banking sector and how Abu Dhabi has helped the UAE, and especially Dubai, through this difficult period.

The third section is a brief look at Abu Dhabi's major GDP contributing industries and its infrastructure. We focus on the hydrocarbon and hydrocarbon related industries, metals, construction, transport and logistics, the economic zones, and SMEs.

Finally we examine investment opportunities within Abu Dhabi. We discuss the diversification benefits of direct investments in Abu Dhabi along with the robust due diligence processes required to increase the probability of success. In conclusion, we look at a few investment ideas for the diversified international investor looking for direct investments.

2. Overview of Abu Dhabi

Abu Dhabi is the UAE's centre of political and industrial activities

Abu Dhabi is the largest of the seven emirates that constitute the United Arab Emirates. The emirate covers 87% of the country's total area. The city of Abu Dhabi is the capital of the UAE and the country's centre of political and industrial activities. It is the second largest city in the country by population after Dubai.

Abu Dhabi has one of the highest GDP per capita in the world

Abu Dhabi is very rich in natural resources: the UAE holds over 9% of the world's proven oil reserves and 5% of global natural gas reserves with Abu Dhabi owning 95% of the UAE's resources. Abu Dhabi is one of the largest oil exporters in the world and has significant oil revenues. The emirate has one of the highest GDP per capita in the world, is home to what is considered the largest sovereign wealth fund (ADIA) and is well positioned to continue growing despite the recent financial turmoil.

The emirate has advanced in infrastructure in the last decade

Over the last decade, Abu Dhabi has been transformed into a modern metropolis as significant infrastructure investments have been undertaken. Yet, Abu Dhabi has grown at a more conservative pace than its neighbour Dubai following a different development model. The recent financial turmoil has affected the emirates to different degrees, but Abu Dhabi is undeniably the strongest emirate financially.

The recent turmoil affected Abu Dhabi to a manageable extend

The burst of Dubai's property bubble and more recent problems with Dubai government related entities (GRE's) are affecting Abu Dhabi and its real estate market in particular through contagion of sentiment and credit constraints. Abu Dhabi's support for Dubai will play an important role in limiting the effects of the crisis on the UAE economy and speeding up the country's overall recovery.

Abu Dhabi is an important location for international investors

Abu Dhabi has strong economic fundamentals which have been tested in the crisis. The emirate is becoming a more mature economy given the lessons from the crisis and its forecasted GDP growth over the next five years is much stronger than for developed countries. It is thus an important location for international investors.

<u>GCC</u>

The UAE is a member of the United Nations, the World Trade Organization, the Arab League and the Gulf Cooperation Council (GCC).

Cross country investment barriers between GCC countries have disappeared as of 2008

The GCC includes some of the fastest growing and richest countries in the MENA region. The GCC was launched in 1981 whereby six countries sought economic integration at various levels. The GCC common market was launched in 2008 and grants national treatment to all GCC citizens and GCC firms in any member state. The common market strives to eliminate barriers to cross country investments and trade.

Map of GCC Countries

The GCC has a combined population of 38.6 million. As evident from the table below, UAE is the second biggest economy after the Kingdom of Saudi Arabia (KSA).

The UAE represents 12% of the GCC's population and 22% of GCC's estimated 2009 GDP

GCC Countries Key Statistics

Country	Size *(Sq Km)*	Population *(MM)*	GDP 2009 *(USD Bn)*	2009 GDP *(USD Per Cap)*
UAE	83,600	4.7	206.0	43,800
Saudi Arabia	2,149,690	25.7	428.0	16,700
Kuwait	17,818	3.0	134.0	44,700
Bahrain	1,189	0.8	20.7	25,900
Qatar	11,437	1.6	86.0	53,800
Oman	309,550	2.8	56.1	20,000
Total	**2,573,284**	**38.6**	**930.8**	**24,100**

Source: Nominal 2009 GDP and population estimates from BAML

The UAE's GDP per capita is considerably higher than Saudi Arabia's

The average GDP per capita in the GCC is forecasted at USD 24,100 in 2009. The UAE has one of the highest GDP per capita in the council and 2.6 times KSA's 2009 figure. According to the CIA World Factbook, the UAE will import USD 141 billion of goods and services in 2009 and KSA, with 5 times UAE's population, USD 86.6 billion. According to the IMF, the UAE and USA had the same average nominal GDP per capita in 2009.

The GCC is home to 40% of the world's proven oil reserves

The GCC has economic and strategic relevance globally because of its hydrocarbon production and wealth. In 2008, the GCC commanded 40% and 23% of the world's proven oil and gas reserves respectively, and contributed 23% and 8% to world oil and gas production respectively.

Oil and Gas Production and Reserves

	Oil				Gas			
Country	Daily Production ('000 Barrels)	% of World	Proven Reserves (Bn Barrels)	% of World	Production (Bn Cubic M)	% of World	Proven Reserves (Tn Cubic M)	% of World
GCC Countries								
UAE	2,980	3.6%	97.8	7.8%	50.2	1.6%	6.4	3.5%
Saudi Arabia	10,846	13.3%	264.1	21.0%	78.1	2.5%	7.6	4.1%
Kuwait	2,784	3.4%	101.5	8.1%	12.8	0.4%	1.8	1.0%
Bahrain	-	0.0%	-	0.0%	13.4	0.4%	0.1	0.0%
Qatar	1,378	1.7%	27.3	2.2%	76.6	2.5%	25.5	13.8%
Oman	728	0.9%	5.6	0.4%	24.1	0.8%	1.0	0.5%
Total GCC	**18,716**	**22.9%**	**496.2**	**39.4%**	**255.2**	**8.3%**	**42.3**	**22.9%**
Non-GCC Countries								
Russia	9,886	12.1%	79.0	6.3%	601.7	19.6%	43.3	23.4%
Iran	4,325	5.3%	137.6	10.9%	116.3	3.8%	29.6	16.0%
Iraq	2,423	3.0%	115.0	9.1%	-	0.0%	3.2	1.7%
Venezuela	2,566	3.1%	99.4	7.9%	31.5	1.0%	4.8	2.6%
Total World	**81,820**	**100.0%**	**1,258.0**	**100.0%**	**3,065.6**	**100.0%**	**185.0**	**100.0%**

Source: BP, 2008

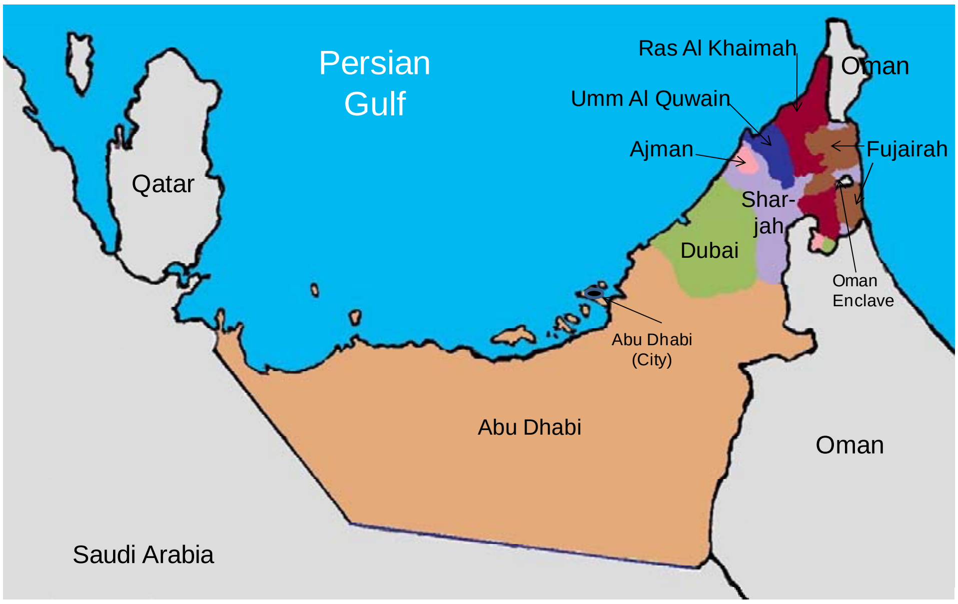
GCC is a region with global significance

The vast energy reserves ensure that GCC countries will play a key role in the world economy in decades to come. The oil-rich GCC countries have been capitalising on oil revenues by growing other economic sectors and gradually building more diversified economies as well as by investing billions of US dollars internationally in conglomerates and strategic sectors. As a consequence, the GCC countries are increasingly significant on the global financial map.

United Arab Emirates

The UAE was founded as a constitutional federation of seven Arab sheikdoms in 1971 and has a combined resident population of 4.8 million in 2008.

Map of the UAE's Emirates



The UAE has progressed rapidly in the four decades since the emirates union

In less than four decades, the UAE has become an internationally recognised nation, with a strong economy and significant business ties to many countries. The country has transformed from a tribal culture to an entrepreneurial success story.

Emirates of the UAE - Key Statistics

Emirate	Size *(Sq Km)*	Est. Resident Population 2008 *('000)*	2008 GDP *(AED Bn)*	2008 GDP *(USD Bn)*	2008 GDP Per Cap *(AED)*	2008 GDP Per Cap *(USD)*
Abu Dhabi	67,340	1,559	519.9	141.7	333,483	90,867
Dubai	3,885	1,593	301.4	82.1	189,203	51,554
Sharjah	2,590	946	70.6	19.2	74,630	20,335
Ajman	259	237	11.0	3.0	46,414	12,647
Umm Al Qaiwan	777	53	3.6	1.0	67,925	18,508
Ras Al Khaimah	1,683	231	15.6	4.2	67,446	18,378
Fujairah	1,165	145	10.1	2.7	69,517	18,942
	77,699	**4,764**	**932.2**	**254.0**	**195,668**	**53,315**

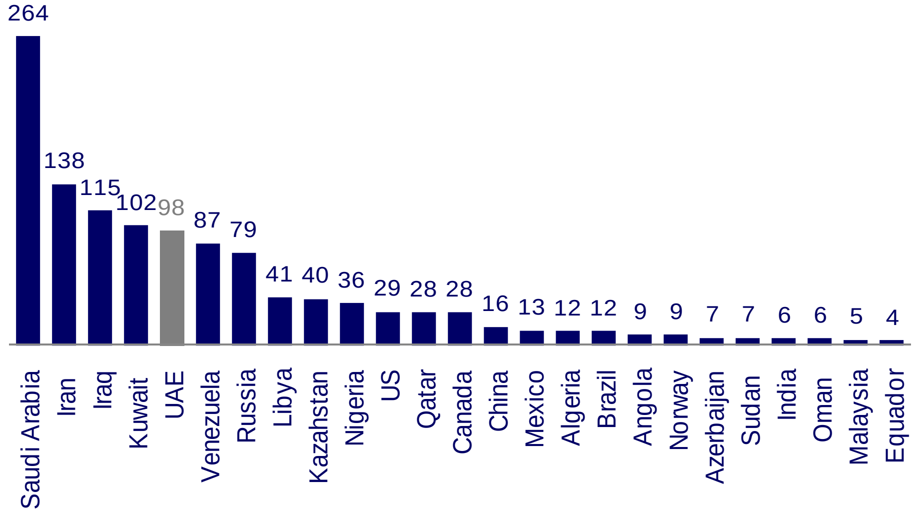
Areas excluding islands

Source: UAE Ministry of Economy (areas exclude islands)

Oil has provided the means to transform the country

The UAE economy was built on the back of hydrocarbon revenues. Oil and gas were first discovered in the region in 1958, when the then Trucial States were still under a British protectorate. Abu Dhabi exported its first cargo of crude in 1962 and Dubai in 1969.

Proven Oil Reserves, End of 2007 (bn barrels)



Source: BP 2008, Energyinsights.net

The UAE leadership had a strategic vision and embraced change

Following the country's constitution in 1971, oil revenues funded massive development programs across the emirates focusing on infrastructure expansion, education, job creation and opening up the economy to private sector involvement.

Expatriates are the backbone of UAE's workforce

The UAE economy has been able to grow at high rates through the labour of non-citizens. Millions of expatriate workers and professionals have been attracted into the country over the years. Non-citizens account for 80% of the UAE's population according to the 2005 census.

Population by Emirate, 2005 Census

Abu Dhabi is home to one third of UAE's population

Emirate	Total Population	Citizens	Non-Citizens	% Non-Citizens
Abu Dhabi	1,399,484	350,277	1,049,207	75.0%
Dubai	1,321,453	137,573	1,183,880	89.6%
Sharjah	793,573	138,272	655,301	82.6%
Ajman	206,997	39,231	167,766	81.0%
Umm Al Qaiwan	49,159	15,873	33,286	67.7%
Ras Al Khaimah	210,063	87,848	122,215	58.2%
Fujairah	125,698	56,421	69,277	55.1%
Total	**4,106,427**	**825,495**	**3,280,932**	**79.9%**

Source: UAE 2005 Census

Each emirate has autonomy with regards to its economic resources and fiscal policy

Each one of the seven emirates of the UAE has a high degree of autonomy with regards to its natural resources and fiscal policy. Certain decisions are taken at the federal level and the Central Bank supervises banks across the country. However, each emirate has been customising its economic policies over the years according to its own resources and strategy.

This resulted in an economic specialisation among the different emirates in the UAE: Abu Dhabi in energy-based industries; Dubai in commercial and financial services, telecommunications, tourism, logistics and trading; Sharjah in light manufacturing; and the northern emirates in agriculture, quarrying and cement manufacturing.

Abu Dhabi and Dubai run different models

On the federal and emirate level, UAE set the goal of developing a strong, growing, sustainable and thus diversified economy. The two largest emirates of the country have adopted different policies to that respect. Abu Dhabi, capitalising on its strong hydrocarbon sector, has been growing organically and diversifying gradually. Dubai on the other hand has pursued an aggressive diversification plan funded by leverage.

Non- hydrocarbon GDP now contributes two thirds of the UAE's GDP. According to the IMF, Abu Dhabi contributed approximately 60% of the UAE's total GDP in 2007 and Dubai represented two-thirds of the UAE's non-hydrocarbon GDP.

UAE GDP declined marginally in 2009 and will probably revert to growth in 2010

According to IMF data, over the period 2003-2007 the annualised increase in nominal GDP of the UAE was 22.8%. Dubai was the fastest growing emirate with a nominal growth of 29.2% over the same period. The impressive growth of the UAE economy was stalled in late 2008 as the global financial turmoil affected the country. However, the reduction in GDP in 2009 was moderate compared to developed countries. The country is expected to resume growth in 2010. According to Bank of America Merrill Lynch (BAML) research forecasts, the UAE will grow by 2% in real terms in 2010 and by a strong 4.9% in 2011.

UAE Macroeconomic Indicators

	2005	2006	2007	2008	2009F	2010F
Nominal GDP (AED bn)	493	601	762	960	846	910
Nominal GDP (USD bn)	134	164	208	262	231	248
Real GDP (annual change)	8.2%	8.7%	6.1%	5.1%	-0.7%	0.6%
Real Hydrocarbon GDP (annual change)	1.6%	6.5%	-2.7%	1.6%	-6.3%	2.7%
Real Non-Hydrocarbon GDP (annual change)	10.8%	9.5%	9.1%	6.3%	1.0%	0.0%
CPI inflation (average)	6.2%	9.3%	11.6%	11.5%	1.0%	1.5%

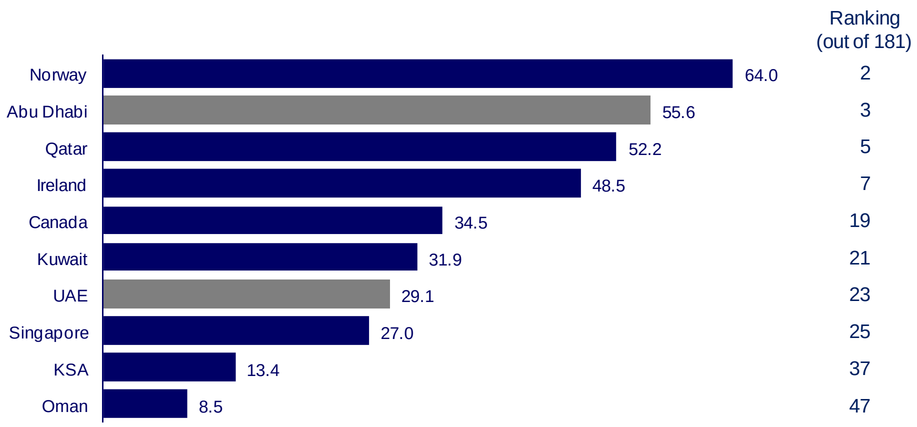
Source: IMF Country Report No 10/42, February 2010

Abu Dhabi

Abu Dhabi would be the second largest economy in the GCC on a standalone basis

Abu Dhabi occupies 87% of UAE's land, is home to 33% of the country's population, contributes around 60% to the UAE's GDP and has a GDP per capita of 1.8 times the national average. Abu Dhabi has one of the highest GDP per capita in the world. Even on a standalone basis, Abu Dhabi would be the second largest economy in the GCC after Saudi Arabia.

GDP Per Capital of Abu Dhabi vs Other Countries (Real 2005 USD '000)



Abu Dhabi had the 3rd highest GDP per capital in the world in 2005

Source: The Abu Dhabi Economic Vision 2030, Section I

Abu Dhabi's reserves will last for 150 years at current rate

Abu Dhabi has the advantage of owning 95% of the UAE's proven oil reserves and 92% of UAE's gas reserves. Based on current utilisation rates and no additional discoveries, Abu Dhabi's oil reserves will last for 150 years.

According to the IMF, UAE produced 2.62 million barrels of crude oil per day on average in H1 2008, 97% of which were produced in Abu Dhabi and only 3% in Dubai, Sharjah and Ras Al Khaimah combined.

Oil revenue for Abu Dhabi increased during the 2000s oil boom

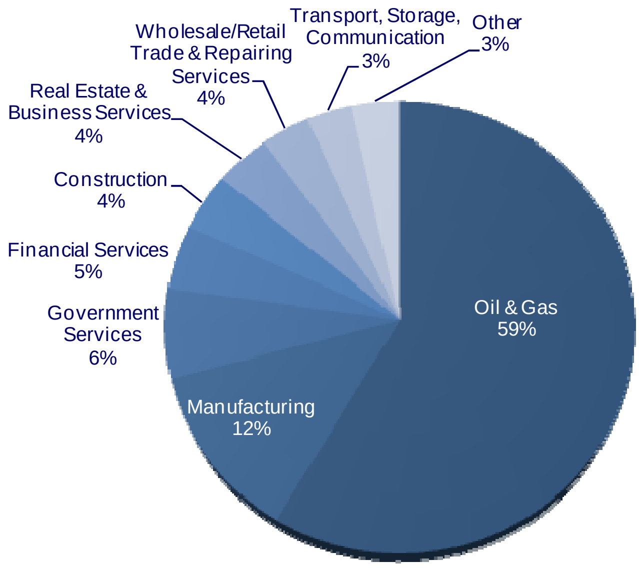
Oil exports generate significant income for the Emirate of Abu Dhabi. ADNOC, the emirate's state owned oil and gas entity, is one of the largest oil exporters in the world. In 2008, export revenue from oil and gas was AED 376.9 billion (USD 102.7 billion), but in 2009 this figure was reduced to AED 208.5 billion (USD 56.8 billion).

Abu Dhabi has built its economy around the hydrocarbon industry. Part of the oil income has been invested over the years in infrastructure and to transform Abu Dhabi into a modern metropolis. The government has intensified the diversification efforts in recent years capitalising on the 2000s oil boom and the increased inflows of foreign investment.

Abu Dhabi is investing in infrastructure and diversification

The emirate's strategy is to capitalise on the strong hydrocarbon sector and grow into other industrial sectors as well as tourism and aviation. A detailed analysis of the Abu Dhabi's economy, vision plan and sector dynamics will follow in section 4 of this report.

Breakdown of Abu Dhabi GDP, 2008F



Source : Information & Decision Support Center, Abu Dhabi Chamber of Commerce & Industry

Abu Dhabi is a strategic international investor

Abu Dhabi's international investments provide substantial annual income and mitigate the economy's concentration on oil

Abu Dhabi is home to some of the world's leading sovereign wealth fund investors. Although official figures on assets under management are not forthcoming, it is considered that the Abu Dhabi Investment Authority (ADIA) and Abu Dhabi Investment Council (ADIC) hold hundreds of billions of dollars of investments.

According to IMF, the UAE held an international investment position (IIP) with net assets of approximately USD 305 billion of international assets in 2009 and the great majority of them are owned by Abu Dhabi entities. The ratio of IIP net assets over UAE's GDP is 132%, compared to 105% for Singapore and 52% for Norway.

Abu Dhabi has traditionally invested a considerable amount of its oil revenues abroad, particularly the plentiful revenues of 2005 – 2008. This was deemed an appropriate economic strategy as the local economy was already overheating with money supply growing at high rates and inflation into double digits in 2006-8.

International investments provide a significant source of income to the Abu Dhabi government and reduce the volatility of the emirate's GDP and dependence on oil prices.

Abu Dhabi's and the UAE economy

Oil revenues created substantial surpluses in the last decade

Exports of oil and gas brought USD 102.7 billion to the UAE in 2008 and a projected USD 56.8 billion and USD 71.8 billion in 2009 and 2010 respectively, according to IMF.

The UAE has been investing billions of dollars in the economy

In 2008, the UAE's consolidated fiscal surplus reached a record high of AED 127 billion (USD 34.6 billion) due to strong oil and non-oil revenue even though consolidated government expenditure increased to a record of AED 198 billion (USD 54 billion). The UAE reported fiscal surpluses for four consecutive years from 2005-2008 (while previously it had several years of fiscal deficits due to low oil prices and a steady growth in public spending and infrastructure).

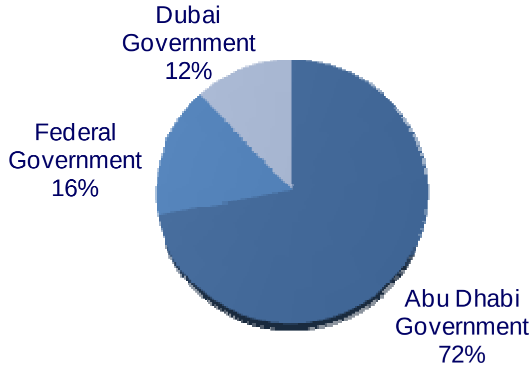
Abu Dhabi's expansionary fiscal policy has sustained growth during turmoil

A small fiscal deficit of 0.3% of GDP is predicted for 2009 due to lower oil prices and an expansionary fiscal policy by Abu Dhabi to counteract the economic slowdown. The IMF forecasts that the UAE will report a surplus in 2010.

For every USD 10/bbl increase in oil prices, UAE export revenues increase by USD 11 billion per annum, according to research by BAML. It should be noted that Abu Dhabi has excess oil generating capacity of 15-20% and could increase daily crude production further if OPEC raise production quotas. In 2007, 72% of the UAE's consolidated budget expenditures were attributed to the Abu Dhabi government, 16% to the Federal government and 12% to the Dubai government. The UAE as a whole and Dubai in particular have achieved a better degree of diversification in recent years, but the country's fiscal policy remains reliant on oil revenue from Abu Dhabi.

UAE's fiscal policy is reliant on Abu Dhabi

UAE Consolidated Budget Expenditure Shares, 2008



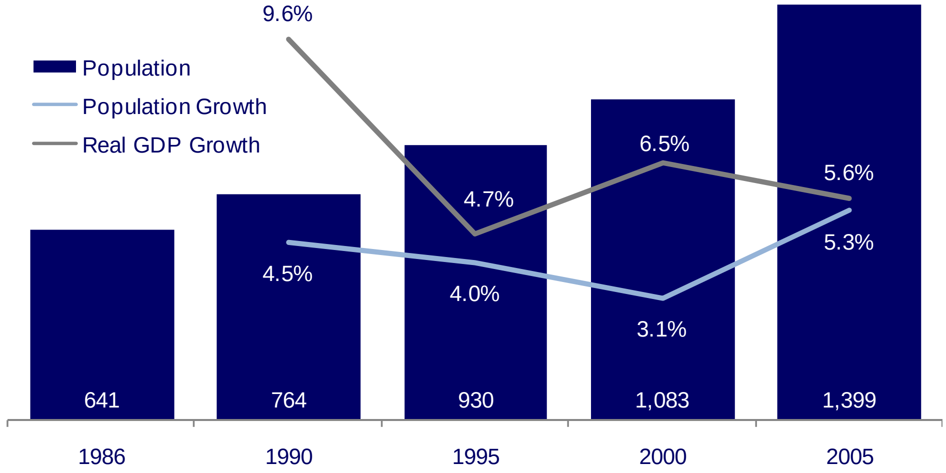
Source: IMF

<u>Abu Dhabi's Population</u>

Abu Dhabi's population has grown rapidly in recent years, primarily through immigration of expatriates. Resident population grew by a compounded average of 4.6% annually between 2001 and 2006. Between 2005 and 2008 the emirate grew at a faster annual rate of 6-7%.

Abu Dhabi's population has almost tripled in the last 25 years

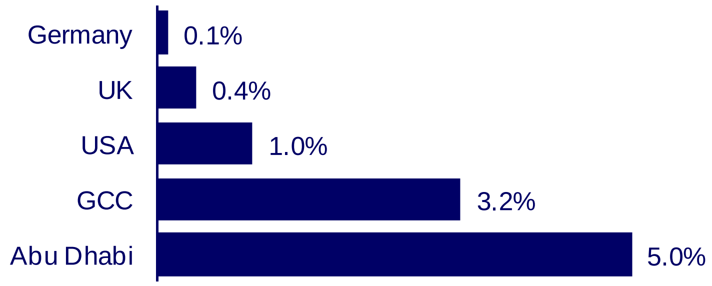
Abu Dhabi Emirate Total Population



Source: Abu Dhabi Statistical Yearbook 2000, Abu Dhabi Census 2005

The population in Abu Dhabi increased at significantly higher rates than the population of developed economies, as shown in the graph below. The comparison highlights that there is a real need behind the massive construction activity that has been undertaken over the last few years. According to Oxford Business Group, Abu Dhabi's population grew by a further 7.5% in 2008. Anecdotal evidence suggests that the population increased mildly in 2009 and 2010, as Abu Dhabi remains a net employer.

Population growth, CAGR 1997-2007



Source: Abu Dhabi Department of Planning & Economy

47% of the emirate's population lives in the capital

Urban residents comprise 69% of Abu Dhabi's total population and annual growth in the number of urban dwellers from 2001 to 2006 was 4.93%, slightly higher than the emirate's average. In 2008, the population of Abu Dhabi was largely concentrated on or nearby Abu Dhabi island. In the short to medium term, areas of growth are expected to be within Khalifa City A, Mohammed Bin Zayed City, Al Ain and the islands adjacent to Abu Dhabi.

Breakdown of Abu Dhabi Population

	2001	2006	2010F	2010F (%)
Abu Dhabi Municipality				
Urban	530,558	683,531	817,421	47%
Rural	141,076	177,415	212,168	12%
Al Ain Municipality				
Urban	258,292	320,051	382,742	22%
Rural	122,919	154,370	184,609	11%
Western Region	102,601	115,467	138,085	8%
Islands	14,808	12,657	15,136	1%
Total	**1,170,254**	**1,463,491**	**1,750,161**	**100%**

Source: Abu Dhabi Department of Planning and Economy

The Western region is less developed

Population growth within the emirate has not been even; the city of Abu Dhabi and secondly Al Ain outpace by far the Western region. Boosting less developed regions of the emirate is a government priority and the implementation of a series of measures is expected to advance growth rates in regional economies over the next few years.

The ratio of expatriates to total population is increasing

It is estimated that Emirati nationals comprise around 20% of the emirate's population in 2010, less than the 25% ratio they comprised in the 2005 census. Two thirds of nationals are under the age of 30.

A significant share of expatriates is labour of mostly Asian origin that work in the construction industry and is accommodated in labour camps. Most expatriates are aged between 20 and 40. Expatriate residents also include Africans, Europeans, North Americans and Latin Americans. Men outnumber women with a ratio of two to one.

Employed population over 15y by education status

	AD employees	%
Illiterate	118,697	15%
Can read and write	143,144	18%
Primary	94,408	12%
Preparatory	110,904	14%
Secondary	155,618	20%
Below University	39,116	5%
University	106,768	14%
Post Graduate	17,110	2%
Not Stated	973	0%
Total	**786,738**	**100%**

Source: Abu Dhabi Census 2005

3. Recent Developments

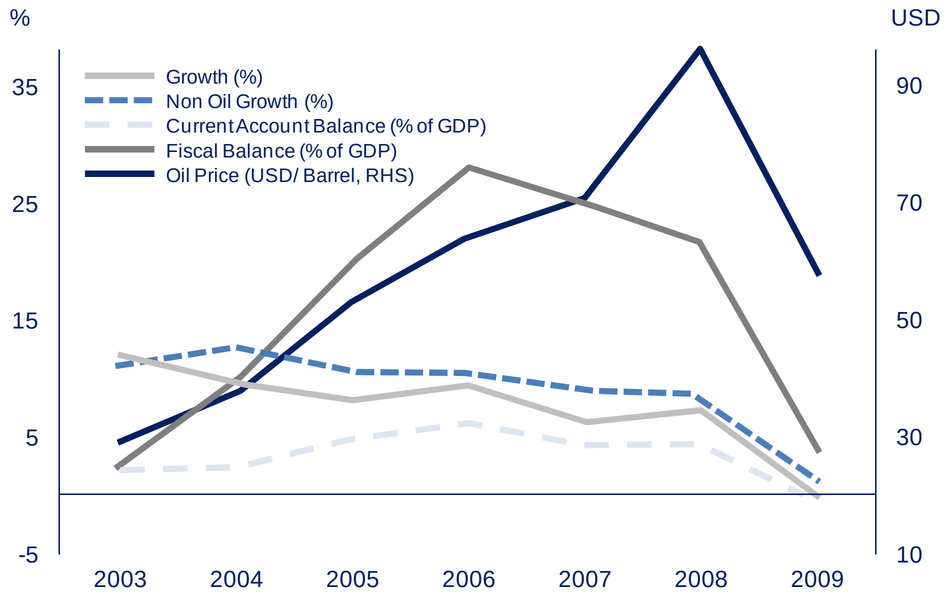
<u>UAE's performance during the turmoil of 2008-9</u>

In 2008-9, the UAE economy was hit by a series of negative factors

Over the last two years, the world has experienced a deep financial crisis. The UAE has been greatly affected by the combined effect of the global credit squeeze, the reduction of oil prices, the slowdown in global trade and logistics activity, and the crash of property markets at the end of 2008.

The oil growth engine (centred in Abu Dhabi) and the non-oil growth engine (centred in Dubai) were hit at the same time driving the country into mild negative real GDP growth in 2009, forecasted at -0.7% by the IMF, after many years of impressive growth.

UAE Performance, 2003 - 2009



Source: IMF, Feb 2010

Despite recent years diversification achievements the UAE economy is sensitive to oil price fluctuations

Hydrocarbon GDP, which comprised approximately one third of UAE's GDP, contracted by 6.25% due to a decline in oil prices and production cuts imposed by OPEC, but non-oil GDP grew by 1% in 2009. Non-oil GDP attributed to Dubai and the Northern Emirates (60% of total UAE non-oil GDP) has contracted by 1% but Abu Dhabi counteracted the decline. Abu Dhabi's non-oil GDP (40% of total UAE non-oil GDP) grew by an impressive 6% thanks to the expansionary fiscal policy and generous public sector investment spending by the emirate.

Dubai has been hit severely and Abu Dhabi experiences a soft lading

The financial crisis has affected Abu Dhabi and Dubai, the largest two emirates of the country, in varying degrees. Dubai has been hit hard while Abu Dhabi is experiencing a softer landing.

Dubai financed its growth with leverage (debt for GREs and off-plan sales for property developers) and borrowing has left the emirate vulnerable to shocks. The emirate experienced the burst of the property bubble in late 2008 with residential property prices falling by 50% over the subsequent year. The construction and real estate sectors that account for 25% of its GDP were further hit by the unavailability of bank credit and lack of buyers for real estate. The trade and services focused economy of the emirate suffered also from the overall contraction in world trade.

Sharp real estate devaluation, credit squeeze and debt burden are burning issues for Dubai

Dubai is facing difficulties in servicing its large debt burden. The IMF estimates that Dubai Inc and the Dubai government have outstanding debt (bonds and syndicated loans) of USD 93 billion maturing in the next five years. In November 2009, the government of Dubai announced a six month standstill on repayments of DP World (DW) in order to restructure USD 26 billion of payment obligations.

The restructuring of Dubai's GREs has shaken international investors confidence

The announcement has shaken international investor's confidence. There was a spill-over effect on Abu Dhabi's GREs which experienced an increase in credit spreads after the announcement by DW.

Abu Dhabi during the crisis

Abu Dhabi is not immune to the crisis and Dubai's issues

Though at the beginning of the financial crisis many participants expected that Abu Dhabi could be immune to shocks, the reality is that the crisis has affected Abu Dhabi though to a smaller degree.

Abu Dhabi's real estate sector has good supply and demand fundamentals

In the real estate sector, Abu Dhabi has expanded more conservatively and has a better match of demand with supply. In many segments of the property market, Abu Dhabi is still undersupplied. Yet the UAE's capital experienced a reduction in real estate prices in 2009. Prices in prime residential properties have fallen up to 40% between Q3 2008 and Q3 2009, according to Colliers. Rental levels have fallen by an average 18% in the first three months of 2009, but had previously increased by 14% in Q4 2008. Occupancy rates in Abu Dhabi are almost 100% and supply of completed property (rather than off-plan) cannot satisfy demand.

Southern Dubai is a substitute market and affects Abu Dhabi's real estate pricing

Yet rental prices have been dropping since Southern Dubai has emerged as a substitute to Abu Dhabi. Rents for apartments of similar quality are 20%-40% lower in Dubai Marina, which is 100 km away from Abu Dhabi. The reduced cost of living combined with the more vibrant expatriate lifestyle in Dubai lead many young professionals that work in Abu Dhabi to live in Dubai and commute daily to Abu Dhabi. For as long as the Dubai market remains oversupplied and rents and sales prices fall, there will be a significant effect on the Abu Dhabi market. The close proximity of the two cities imposes a correlation in prices, especially in the residential sector.

The banking sector has been adversely affected

The banking sector in Abu Dhabi has been affected by the deep property crisis in Dubai, the property correction in Abu Dhabi and the international credit squeeze. Additional to Abu Dhabi real estate exposure, many banks are exposed to Dubai property assets and real estate developers. The central government has moved proactively in easing the banking liquidity problem and restoring confidence in the system. The measures undertaken are detailed in the next chapter. However, the recent standstill announcement by DW and the related restructuring of liabilities could have further effects on the banks as they hold a portion of DW's debt obligations.

Devaluation of real estate assets and possible losses on Dubai's GREs restrict credit availability

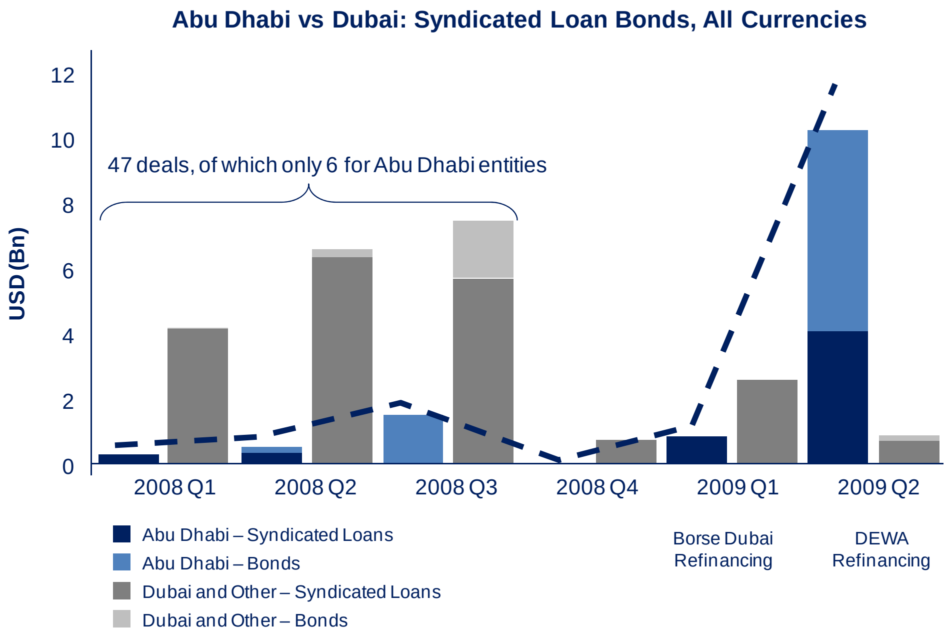
While the property sector in Abu Dhabi is performing relatively better, overexposure of local banks to UAE real estate related assets makes lending difficult. The possibility of large losses derived from the property sector has resulted in the banks' reluctance to lend to other sectors or increase credit exposure. Lending rates have come down in the recent months and officials deem the banking function to have normalised, but there is a persistent unavailability of credit.

Abu Dhabi carries on its expansion plan and benefits from reduced construction costs

Other sectors of Abu Dhabi's economy are performing well. The return of oil prices to the USD 70-80/bbl level has boosted oil revenues. Industrial demand and revenues have fallen due to the slowdown in global economic activity and local construction, but investments in this sector continue. Abu Dhabi will capitalise by increased industrial export revenues once the global economy resumes expansion. In the meanwhile, the emirate benefits from carrying out its infrastructure investments at reduced cost due to the drop in the price of construction materials and labour costs.

Abu Dhabi has access to international funds

While it is difficult after the DW announcement for Dubai to tap the markets, Abu Dhabi has good access to new funds albeit at somewhat more expensive rates due to the Dubai 'contagion'. In March 2009, Abu Dhabi's first bond issue in two years raised USD 3 billion, which was two times oversubscribed.



Source: IMF, February 2010 report

<u>Implications of the crisis on the banking sector:</u>

The banking sector has been affected by the crisis in the UAE. The banks have been reluctant to recognise losses, write down portfolios or clean up their balance sheets. 18 months into the crisis (starting in the UAE in Q3 2008), the banking system is still constraining credit. The banks are reluctant to lend not only to real estate related firms but also to firms in other sectors, except for the most creditworthy borrowers; thus slowing the recovery process for the economy as a whole.

According to the Central Bank, non performing loans (NPLs) stood at 4.6% of total gross loans in November 2009. UAE banks raised their provisions for NPLs to AED 33.6 billion in February 2010, up 75% from the AED 20.9 billion of NPLs they had recognised in February 2009.

The handling of non-performing loans is crucial

There is a need to deal with the potential increase in loan losses and have adequate recognition of non-performing loans. International funds interested in buying out distressed portfolios are looking into the opportunity, but to our knowledge, the above factors and unwillingness of many banks to deal with the situation hinder transactions.

A number of issues hinder the development of an active secondary market for distressed loans

The UAE banking system is dominated by majority government owned banks that are closely related to the quasi sovereign corporates. According to BAML, the expected support from the banks to the GREs will absorb the available liquidity and the private sector will be squeezed further. BAML expects that the restructuring of Dubai's GREs will adversely affect domestic banks and businesses both in Dubai and Abu Dhabi and deems that federal level measures are necessary.

UAE banks aggressively increased lending in the years before the crisis

The banking sector has grown aggressively over the years before the recent crisis reporting a CAGR of 32% between 2003 and 2008. Bank credit to UAE residents grew at a CAGR of 25% from 2000 to 2007 and by 40% from Q3 2007 to Q3 2008. Real estate mortgages grew by a CAGR of 77% between 2004 and 2007 and by 90% in 2007 only.

The immense credit expansion was fuelled by the rapid property boom in the UAE, the global credit expansion and a vast amount of 'hot money' (estimated at USD 57 billion) flowing into the country in the form of funds expecting the appreciation of the dirham against the dollar.

In Q2 2008, UAE banks already had a loan portfolio greater than deposit levels and in the summer of 2008 hot money fled the country as the appreciation of the dirham to the dollar became unlikely. Following the collapse of Lehman Brothers, banks faced the triple problem of unavailability of credit in the interbank market and soaring interbank borrowing costs (doubling to 4%), reduction in the deposit base and a significant decrease of a loan's collateral value due to declining property prices.

The situation has been better for Abu Dhabi banks and worse for Dubai banks as the former have a concentration in the industrial sector that dominates the emirate's economy, while the latter are heavily exposed to real estate assets.

The Central Bank has successfully pursued federal policies that supported the banking system

The Central Bank of the UAE has successfully taken a number of measures to provide liquidity and restore confidence in the financial sector:

- In September 2008, the Central Bank lowered the repurchase rate following the US Federal Reserve's example and established an AED 50 billion (USD 13.6 billion) facility through which banks could borrow against their current accounts and eligible securities. It should be noted that in the UAE there are a limited number of banking products that can be used as collateral in repo transactions. In the UK and US the greater sophistication of products enabled banks to gain liquidity from central bank facilities against real-estate backed 'repo-able' assets.
- In October 2008, the Central Bank provided an AED 70 billion (USD 19.1 billion) liquidity support scheme in the form of 3-7 year

term deposits to banks willing to increase their capital adequacy ratios to 11% in 2009 and 12% in 2012.

- In October 2008, the government further announced that it guaranteed bank deposits for a period of three years.
- In December 2008, the Central Bank introduced a dollar/dirham swap facility for UAE banks that improved dirham liquidity.

Additional capital was injected to Abu Dhabi based banks

At the emirate level, in February 2009, Abu Dhabi boosted the emirate's banks by injecting AED 16 billion (USD 4.4 billion) of capital.

The capital injections from the federal and Abu Dhabi governments have boosted the UAE's capital adequacy ratio from the lowest in the GCC before the crisis to the highest. Deposits grew by 13% from Q3 2008 to Q1 2009 and capital reserves increased. The banks reported profits in the same period, which highlights the importance of the NPL valuation issue.

The Central Bank has shown its ability to tackle issues: borrowing costs have decreased from their peak in 2008 and banks have resumed lending. Yet, it cannot be said that the banking sector is functioning normally. Banks are still shut to the real estate sector. The issue of NPL valuation, deleveraging of real estate exposure and the Dubai Inc restructuring will continue to affect the sector and the availability of credit.

There are more than 25 different banks operating in UAE and consolidation is expected in the sector in the following couple of years.

<u>UAE is a united economy: Abu Dhabi's support to Dubai</u>

UAE's economy has strong fundamentals

Despite recent turmoil, the UAE has a vibrant economy that benefits from a strong aggregate external creditor position, excellent infrastructure and business conditions and a strategic geopolitical location.

UAE is a net external creditor

The UAE's external creditor position stands at over 100% of GDP, which is one of the highest of the 186 countries that fund the IMF. UAE's international investment position was USD 437 billion of assets and USD 132 billion of liabilities in 2009, a net position of USD 305 billion or 132% of GDP. The majority of assets are held by Abu Dhabi based entities.

Dubai has a long way to recovery but will emerge

Abu Dhabi continues the broadening of its industrial base and, according to local press, grew its employee base in 2009. Dubai has a tough way ahead to tackle the issues of reviving its property market and servicing debt but it has a sound growth outlook in the longer term. The UAE's economy will be affected by the recovery progress in Dubai and Abu Dhabi will need to support (implicitly and/or explicitly) its neighbour over the difficult period.

Abu Dhabi has already pledged USD 20 billion in a support fund for Dubai

So far Abu Dhabi has proven its support for Dubai. In February 2009, Dubai announced a USD 20 billion bond programme, the first tranche of which was subscribed by the Central Bank. The first tranche amounted to USD 10 billion. In December 2009, the Abu Dhabi government and two banks (Al Hilal Banks and NBAD) pledged a further USD 10 billion financial support, partly to facilitate Nakheel's repayment of its Dec 2009 Sukuk. Most recently, USD 9.5 billion has been promised to Dubai World, the majority of which will be given to Nakheel. USD 5.7 billion will be provided by Abu Dhabi and the remainder will come from the Dubai government.

Non commercially viable entities will default and this is the sign of a healthy economy

Abu Dhabi has indicated that the government and the emirate will continue supporting troubled GREs given that they are sustainable businesses. Help will not be provided to entities that are not commercially viable as this would burden the federal balance sheet without merit and induce moral hazard incentives.

Issues related to transparency, the legal system and the deleveraging process need to be addressed

Abu Dhabi's support will define the recovery process but there are a number of issues that the UAE needs to handle on the federal level:

- **There is still a lack of transparency.** Dubai Inc and government related entities do not need to publish consolidated financial statements. There is no official debt data at the emirates or federal level.
- **The young legal system has gaps in law interpretation.** There are open issues in important topics such as ownership rights and strata law for common properties, insolvency for GREs and corporates, and enforcement procedures for property and NPLs.
- **Uncertain deleveraging process.** The deleveraging process on the emirate, GRE and bank levels is uncertain and results in conservative bank lending policies and an imposed deleveraging at the corporate balance sheet level. A well thought out plan is needed on the federal level for banks to value assets, clean books and create space for additional credit exposure.

Tackling inefficiencies will make the economy stronger for the long term

Some measures have already been taken that ensure that the UAE will emerge as a more mature economy from the crisis. Economic and statistical databases are currently being developed at the emirate and federal level to increase transparency.

An important initiative was the establishment of the Fiscal Coordination Committee. The committee will coordinate fiscal policy, develop multi-year expenditure plans and introduce debt management units on the federal level. This is an important step in rationalising investment decisions and long term policy on a centralised federal level and avoiding credit bubbles and systemic risk in the future. The committee will release a federal budget every three years starting in 2011 for the 2011-2013 period.

Enforcement precedents will be useful for benchmarking

On the legal side, there are many cases currently under review by Dubai and Abu Dhabi courts and the country will soon have enforcement precedents. Although precedents are not binding in the UAE, they can help provide some assurance to claimants through past results.

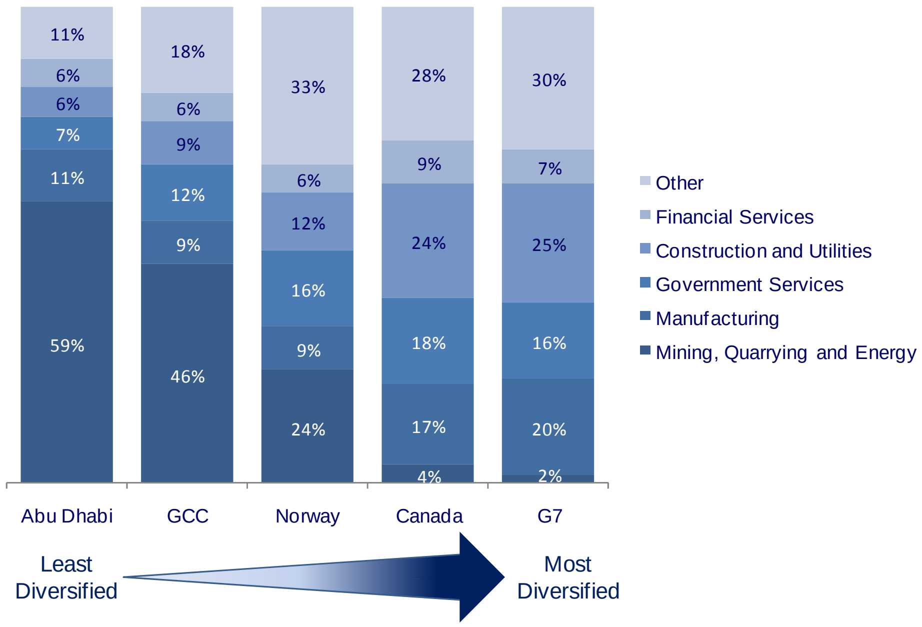
According to the local press, the UAE is also considering the introduction of VAT in couple of years to increase government inflows and reduce the volatility of the budget to export-generated revenues.

4. Abu Dhabi: A thriving economy

The oil sector dominates economic output

With a GDP of AED 520 billion (USD 142 billion) in 2008, the emirate of Abu Dhabi is a strong economy. Yet, Abu Dhabi is one of the most concentrated economies in the GCC, as the oil sector dominates economic output. The hegemony of the oil sector induces high volatility in the economy.

GDP Breakdown by Economic Sector (Real 2005 USD)



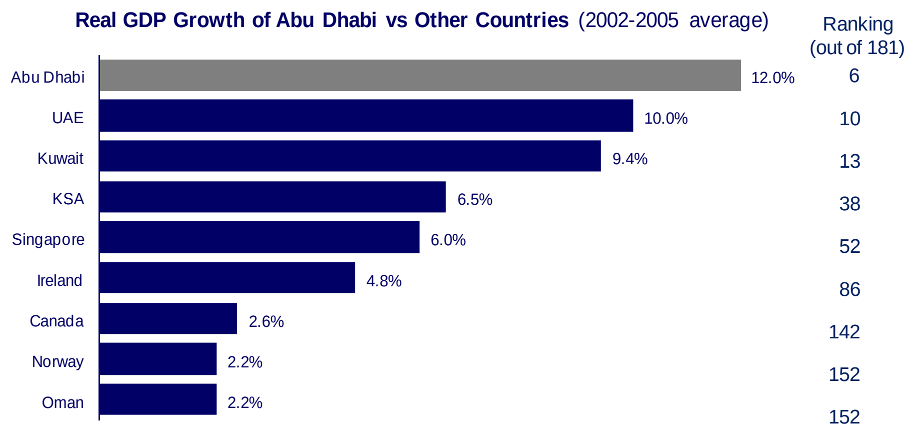
Source: Abu Dhabi Statistical Yearbook, IMF, Abu Dhabi Economic Vision 2030 Section

Norway is a diversification example for Abu Dhabi

To put the graph above in context, it should be noted that Norway and Abu Dhabi produce similar quantities of oil. Yet the energy, mining and oil sector contributed only 24% of GDP in Norway in 2005 compared to 59% for Abu Dhabi.

Diversifying the economy has been a leading government goal

Abu Dhabi's GDP is overly sensitive to fluctuations in the oil price. It is difficult to shape optimal market policies in an economy that is greatly affected by exogenous shocks. During the oil boom in the 2000's, Abu Dhabi achieved unprecedented levels of growth. Diversification has increased considerably and the emirate has invested large amounts of capital in broadening the economic base.



Source: Abu Dhabi Statistical Yearbook, WDI, Abu Dhabi Economic Vision 2030 Section

GDP volatility has reduced considerably but remains high

The Abu Dhabi economy has become more stable as GDP growth volatility has fallen from 30% in the 1980s to 8% in 2005. This is still high as the average GDP volatility in 2005 was 3% for GCC countries and 1% for developed countries, according to WDI (World Development Indicators online).

Abu Dhabi has intensified efforts embracing the two pillars of diversification and privatization, introducing strategic measures and undertaking substantial new investments in industry, real estate, tourism, aviation and other sectors. Abu Dhabi targets an annual growth of 7.5%.

Economic Vision 2030 is the emirate's master diversification plan

The emirate published in 2009 the 'Abu Dhabi Economic Vision 2030' outlining its economic priorities for the coming years and its policies over the next two decades to achieve its goals. The plan envisages a population of 3.1 million for the emirate by 2030, an 80% increase from an estimated 1.7 million people in 2009.

Abu Dhabi is more than a strong energy hub

Petrochemicals, metals, tourism and aviation are growth sectors

Following the recent global financial turmoil, some market participants characterised this plan unrealistic under the new global financial landscape. Abu Dhabi is deemed internationally to be in a better position than Dubai because of its oil reserves and sustained revenue source. However, Abu Dhabi is not merely a strong energy hub. Abu Dhabi has laid the fundamentals to emerge as an exemplary model of diversification and economic stability. Abu Dhabi's aim is to stimulate non-oil sectors rather than to reduce activity in the oil sector. It is increasing its industrial base (petrochemicals, plastics, metals) capitalising on the availability of resources. In addition, it is looking to boost the tourism and aviation sectors amongst others.

Abu Dhabi is developing its infrastructure

Abu Dhabi has been investing in infrastructure for decades including the sea port, the road networks, the airport and future projects such as an oil pipeline to be delivered in 2011 and the planned light rail network. We believe that Abu Dhabi is consistent with its long term plan, but many areas will probably take longer than the envisaged 20 years to reach target levels.

To put the progress that has been made in the different sectors into context, we first briefly outline the Abu Dhabi government's goals.

Economic Vision 2030 Plan

Abu Dhabi aims to build a sustainable, stable, diversified and competitive economy with a broad enterprise base across different sectors. The emirate pursues the following main objectives:

The industry sector is the is the key diversification pillar

- **Reduce GDP volatility through diversification.** Abu Dhabi aims to stimulate the non-oil sectors rather than reduce activity in the oil sector. Abu Dhabi focuses in capital-intensive, export-oriented sectors like petrochemicals where it has a competitive advantage because of hydrocarbon resources.
- **Enlarge the enterprise base.** Abu Dhabi's economy is currently dominated by large enterprises. The so called 'national champions', referring to Abu Dhabi's large companies of the likes of ADNOC and Mubadala, contribute 75% of Abu Dhabi's GDP. The emirate aims to stimulate a more vibrant SME market that has an important contribution to the GDP and attract foreign direct investment beyond the industrial sector in fields like technology.

Small and medium enterprises should play a bigger role in Abu Dhabi's economy in the future

- **Enhance competitiveness and productivity.** Abu Dhabi has set out to boost the SME sector, carry out integrated regional development plans, and optimise the workforce. Abu Dhabi seeks to create a balanced social and regional economic development by further improving education, increasing the participation of women in the workforce, attracting and retaining skilled professionals and expanding growth in all the regions of the emirate and not only the city.

4.1 Sector Analysis of Abu Dhabi Economy

Abu Dhabi has laid the foundations for long term organic growth

In the following section we look at the developments of the emirate in many key sectors of economic activity and the foundations that foster organic long term growth and give a competitive advantage to Abu Dhabi in the region.

Abu Dhabi aims to become the Middle East hub for industrial and manufacturing companies seeking to capitalize on the numerous opportunities that the emerging economies of the region offer. The government envisages exploiting the emirate's competitive advantage in the energy sector and command a larger share of the hydrocarbons value chain.

According to the Abu Dhabi Chamber of Commerce, investments in industrial projects reached AED 39.8 billion (USD 10.8 billion) in 2008.

Energy

Abu Dhabi implemented a pioneering structure in the oil sector

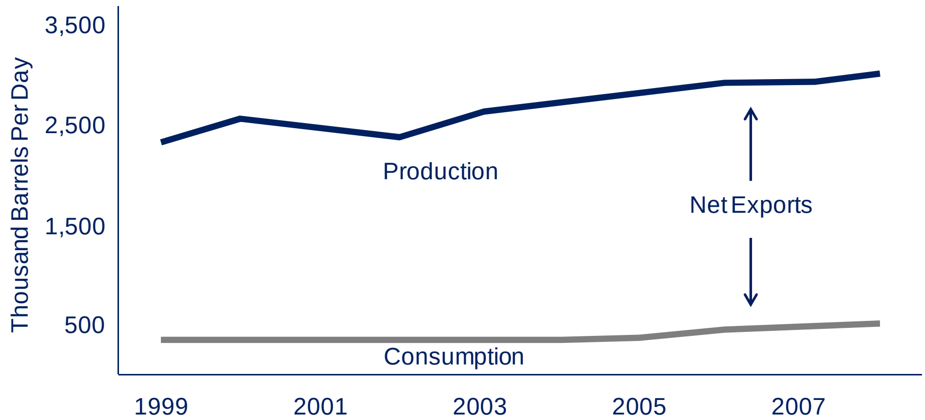
Abu Dhabi was the first Gulf oil producer to have retained foreign partners on a production-sharing basis. The Abu Dhabi National Company (ADNOC), established in 1971, is the largest state owned company in the emirate and operates through 17 subsidiaries in the oil and gas sectors. It is estimated that around 40% of the sector is owned by foreign companies from Japan, UK, France and other countries. Major foreign investors include British Petroleum (BP), Petrofac, ExxonMobil, Total and Japan Oil Development Company (Jodco).

ADNOC is one of the largest oil exporters in the world. It is one of the largest recipients of US federal contract dollars, receiving a total of USD 918.3 million in 2008 alone.

Abu Dhabi is currently operating below capacity because of OPEC's oil production quotas

In 2008, the UAE produced three million barrels per day of total oil liquids, of which 85% was crude oil and 15% natural gas liquids. Around 20% of the oil production is consumed locally and 80% is exported. The majority of oil production is exported to Asian countries with 40% going to Japan. Following OPEC's decision to cut production targets in late 2008, the UAE's average daily crude production has fallen by 15% and the sector operates below capacity.

UAE Oil Production and Consumption, 1999-2008



Source: US Energy Information Administration, Independent statistics and analysis

Abu Dhabi's daily production capacity will increase significantly by 2020

The UAE is a mature oil market, with limited recent exploration success. Most new near-term projects are focused on further development of known fields. There are several important expansion projects (Upper Zakum, Umm Shaif, Asab-3, Nasr oil fields) currently undertaken through partnerships between ADNOC and foreign companies. Project completion ranges from 2012 to 2019 and will significantly increase the daily production capacity by 30%-40%.

Abu Dhabi invests multi-billion dollars in the upgrade of its oil sector

The emirates have a network of domestic pipelines linking fields with processing plants and exit ports for trade. The Abu Dhabi Crude Oil Pipeline (ADCOP) is currently under construction by China National Petroleum Corporation (CNPC) on a USD 3.2 billion contract. The ADCOP pipeline will have a total length of 250 miles and a capacity of 1.5 million barrels per day. The pipeline will allow the UAE to pump about 60 percent of its crude exports to Fujairah port on the Gulf of Oman, avoiding the strategic shipping chokepoint at the Strait of Hormuz. The port of Fujairah is one of the world's three largest bunkering ports. The pipeline is scheduled to start trial operation at the end of 2010.

Petrochemicals

Petrochemicals is the key sector of focus in Abu Dhabi's diversification programme

The petrochemicals sector includes chemical fertilisers, polymers and other petrochemical products. Abu Dhabi is set to become a powerhouse in petrochemicals, building on the cost advantages related to hydrocarbons local supply. Multiple petrochemical projects are currently in the pipeline.

Abu Dhabi is home to Fertil (Ruwais Fertiliser Industries). Fertil was set up as a JV between ADNOC and Total in 1980 at an equity share of two to one. Chemical fertiliser is a big business in the Middle East with production in MENA accounting for 12% of the world's total capacity. Fertil is located at the Ruwais industrial zone, 235 km away from the city of Abu Dhabi and is undergoing ambitious expansion plans that will double its production capacity in the next few years.

ADPP will be one of the largest industrial parks dedicated to plastics globally

In the polymers segment, Abu Dhabi Polymers Park (ADPP) is a key project as it is a dedicated industrial cluster for plastics companies. Located 20 km north of Abu Dhabi, it spans 4.1 sq m of land and will have up conversion capacity of up to 1 million tonnes per year. ADPP is expected to generate up to USD 4.5 billion in investments by 2016. It envisages becoming the world's largest plastics conversion cluster, producing over one million tonnes/year of plastics in 50 conversion units by 2012.

Several billion dollar projects are currently underway in the sector

The Madeenat ChemaWEyaat development is the largest petrochemicals project in Abu Dhabi with a total production of over 10 million tonnes of olefins and other petroleum derivatives. Completion for the first complex is expected in 2014 at a cost of USD 10 billion.

Further projects include expansion of the Bourouge polylefins complex in Ruwais, a melamine project in Ruwais, the Elixier JV between ADNOC and the German Linde for the production of industrial gases and others.

A possible barrier to rapid growth of the fertiliser and petrochemical sector is the shortage of natural gas in the region.

Abu Dhabi has also been investing abroad in the petrochemicals sector. In 2009, IPIC bought the Canadian Nova Chemicals for USD 2.3 billion

Metals

Several new and expansion projects are underway in the metal sector by public and private initiative

According to the Central Bank, the value of UAE base metal exports was AED 5.2 billion (USD 1.4 billion) in 2007 and AED 1.8 billion (USD 490 million) in Q1 2008. Emirates Steel Industries (ESI) is the largest steel factory in the UAE and is 100% government owned. It is strategically located at the recently developed Industrial City of Abu Dhabi. The factory utilises the latest technology to produce reinforcing bars for the construction industry. Despite the recent economic turmoil, ESI is undertaking a number of expansion projects and is also looking into acquisitions in the sector to capitalise on the decrease in valuation prices.

The world's largest aluminium shelter will soon operate in Abu Dhabi

Emirates Aluminium, a JV between Mubadala Development Company and Dubai Aluminium, is developing the world's largest single-site aluminium shelter in the Khalifa Port Industrial Zone. The first phase, at a cost of USD 5.7 billion, is expected to be completed in 2010.

GCC companies are investing in the sector

Abu Dhabi Basic Industries Corporation (ADBIC) and Bahrain's Midal Cables Limited established a strategic partnership in 2009 to build a USD 100 million aluminium rod and conductor plant. The cluster will be strategically located between Abu Dhabi and Dubai and focus on base metals such as aluminium, steel and copper.

Production capacity will increase significantly by 2015

Many more projects are currently under development in the sector that will significantly boost the production capacity and range of products. Abu

Dhabi will benefit from increased export revenues as global economic activity picks up and demand for metals increases.

Construction

The construction sector contributed AED 21 billion to Abu Dhabi's GDP in 2008

The construction sector contributed 4.2% to Abu Dhabi's GDP in 2008, according to ADCCI. Between 2002 and 2007 the construction sector grew at an annual rate of 17%, reaching a value of AED 20 billion (USD 5.4 billion) in 2007 and an estimated AED 21.3 billion (USD 5.8 billion) in 2008.

Construction activity is still strong as there are massive infrastructure projects under development

The pace of growth has slowed due to the financial crisis but the sector is still performing well. Abu Dhabi has the advantage of liquidity and the government has increased spending on infrastructure to support growth. There are massive government or government-related investments in shipyard, seaport, airport expansions, healthcare, education, major road upgrades and transportation. Infrastructure investment makes up a significant and growing proportion of construction activity for Abu Dhabi and the greater GCC region.

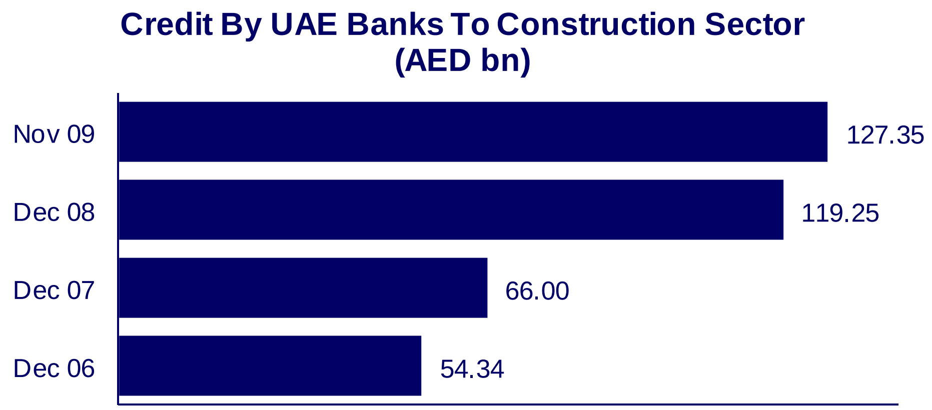
Construction activity in the GCC remains strong

According to Middle East Business Intelligence February 2010 bulletin, the Middle East's construction sector is expected to post an annual growth rate of 3.5% over the next five years to place ahead of Europe and North America, and third behind Asia. The Gulf in particular has around USD 1.35 trillion worth of active civil building projects.

Growth in real estate construction has slowed down but fundamentals are good

On real estate construction, Abu Dhabi still has growth prospects. Despite the fall in prices, the market is widely undersupplied and the delivery of new units is expected to be absorbed smoothly.

The sector has been relying on credit and is affected by tighter lending conditions. National banks are very cautious in extending their already large exposures to the real estate sector which creates funding issues for some projects.



Source: Central Bank Monthly Statistical Bulletin, November 2009

The government and the royal family are the master developers for many projects and as they avail liquidity, they are expected to carry on development according to schedule and restructure where needed.

Smaller developers and sub-developers are facing tougher conditions.

The fall in construction prices benefits contractors and the government

Construction companies are benefiting from a significant decrease in construction prices. Construction demand is being driven primarily by government consumption and its efforts to promote the emirate as a leading business and tourism hub via improvements in infrastructure and major construction projects. The emirate is exploiting the opportunity to meet its ambitious infrastructure targets at discounted prices and is awarding multi-billion construction contracts for various projects that still draw many international construction companies to the region. The emirate has employed the PPP (Public Private Partnership) model for a number of projects in the last few years and such initiatives are on the increase.

Many ambitious projects are currently underway and will transform the emirate according to the Economic Vision 2030

Indicatively we list the emirate's 10 largest construction projects as of Q2 2009, which are worth a combined AED 764 billion (USD 208 billion) according to Proleads GCC research. The transportation and logistics sections also include multi-billion projects currently underway in the emirate:

1. **Khalifa City.** It has a master-plan budget of USD 40 billion, will include all federal ministries, local government offices and embassies, and will be completed in phases by 2030.

2. **Yas Island.** A USD 39 billion tourist development including residential accommodation, hotels, beaches, marinas, golf facilities as well as the already operational Yas Marina Circuit which hosts the Abu Dhabi Grand Prix.

3. **Saadiyat Island.** A USD 28 billion offshore development including 29 hotels, three marinas, 8,000 residential villas and more than 38,000 apartments. The project also includes museums, concert halls, three harbours, a park and a golf course.

4. **Burooj Properties.** A USD 24 billion real estate community in Abu Dhabi including 11 residential towers, offices, 4 hotels and a retail mall.

5. **Masdar City.** A USD 22 billion project which will be the first zero-carbon, zero-waste, car free city in the world dependent on solar energy.

6. **Al Raha Beach complex.** A USD 18.5 billion project under development on reclaimed land which includes 50 high rise and a number of low rise buildings hosting 120,000 people.

7. **Ghantoot Green City.** A USD 10 billion project including commercial centres, hotels, residential, warehousing and light industrial areas. It was still in the planning phase in early 2010.

8. **Al Reem Island.** A USD 7.8 billion mixed use community next to the bridge connecting Al Reem Island to Abu Dhabi city, which will include several 40-50 storey buildings and two 80-storey buildings. It aspires to be the central business district of Abu Dhabi.

9. **Sheikh Mohammed bin Zayed City.** A USD 6.5 billion project that will include 374 residential and commercial buildings, associated infrastructure and entertainment facilities.

10= **MGM Grand Hotel.** A USD 3 billion project to build a hotel with 1,200 rooms and many facilities.

10= **Abu Dhabi Light Railway.** A USD 3 billion project to deliver 350 km of track.

Transportation

Existing transportation facilities cannot accommodate Abu Dhabi's growth

Abu Dhabi enjoys an extensive road network, but due to the rapid growth in population, there are significant congestion issues. The emirate currently invests billions of dollars in extending and improving the infrastructure and is developing an urban public transit system.

Abu Dhabi has announced an ambitious transportation network and most projects are in the advanced planning stage

In 2009, Abu Dhabi released detailed proposals for its transportation plan. Under its Abu Dhabi Plan 2030, Abu Dhabi aims to create a low-carbon public transportation system. The plans include a high capacity 131 km metro system, a regional light railway, a comprehensive tram network, a ferry link to Dubai and three zones of personal rapid transit. Personal rapid transit - a network of small vehicles that run non-stop on specially built guideways – will be used in Masdar City, Capital City and Lulu Island.

Abu Dhabi is also investing in inter-emirate connections and connections to other GCC countries. The expansion of the Mafraq-Ghweifat road that connects Abu Dhabi to Saudi Arabia has been planned. The USD 2.5 billion project will be structured as a PPP and is currently in the bidding stage.

An inter-emirate network will be developed by 2020

A federal railway system to link the emirates was approved in 2009. However, the tenders for construction are expected to commence in 2015. The network will include a double track rail service built from Ruwais in Abu Dhabi to Fujairah at a cost of AED 11 billion (USD 3 billion) over two phases. The first phase of the project will focus on creating an industrial railway, which will take five years to complete.

The connection of the federal railway to the planned GCC network will facilitate trade

The second phase will be a passenger rail line that links all seven emirates. The network will eventually link up with the GCC network whose construction will start in 2010. The GCC railway network will run for 1,000 km near the Gulf coast, extending from Muscat in Oman to Kuwait City and passing through the UAE, Qatar and Saudi Arabia at speeds of up to 180kph.

Abu Dhabi is currently undertaking a massive industrialisation plan and investments in downstream petrochemical projects. The emirate is expected to witness a sharp growth in manufacturing activities in the coming years that will require a speedy and efficient transportation and distribution network. Abu Dhabi is efficiently targeting massive amounts of capital in optimising the emirate's transportation and logistics systems.

Logistics

The emirate's growth drives the expansion of logistics facilities

Abu Dhabi uses both sea and airports. Abu Dhabi is currently served by three main sea ports. The Mina Zayed, the main gateway for container and general cargo vessels, the Musaffah in the heart of the Industrial City and the Freeport which caters for oil rigs, small vessels, tugs, barges and service crafts.

The Musaffah port serves Industrial City of Abu Dhabi, which includes the soon to be operational plastics dedicated cluster of companies in Abu Dhabi Polymers Park.

Mina Zayed has reached capacity and is inconveniently located close to Abu Dhabi's city centre contributing to the capital's traffic congestion problem. Volumes in the port have increased substantially so all operations of the port will be shifted to the Khalifa Port, a AED 9.1 billion (USD 2.5 billion) project currently under construction, which is expected to be completed by 2012.

Abu Dhabi's new port is under construction and will include one of the world's largest industrial zones

The Khalifa Port and Industrial Zone (KPIZ) is located midway between the cities of Abu Dhabi and Dubai and will be one of the world's largest integrated industrial zones. KPIZ will be close to the Jebel Ali port belonging to Dubai which is one of the top ten cargo ports in the world but as both ports will be operated by DP World, they are expected to be complimentary rather than competitive.

Abu Dhabi has two big airports, the Abu Dhabi international airport and Al Ain international airport as well as several domestic small airports.

Abu Dhabi has undertaken a massive expansion project for its main airport

Abu Dhabi added a third terminal to Abu Dhabi international airport in 2008, a USD 300 million project that increased the airports capacity from nine to 12 million passengers annually. The Midfield terminal complex, an estimated USD 6.8 billion project whose first stage is expected to complete in 2011, will significantly expand the capacity of Abu Dhabi airport to 20 million passengers annually and greatly increase its cargo capacity.

Dubai's airport was the world's 11th largest in terms of cargo traffic and 20th largest in terms of passenger traffic in 2008. Abu Dhabi International Airport is not included in the top 30 list by volumes of passengers and cargo, but has one of the top fastest growth rates globally.

Aircraft movements in Abu Dhabi airport increased by 13.3% in January 2010 compared to January 2009. Cargo saw a significant rebound of 25.6% over the same period and passenger numbers were up 11%.

Abu Dhabi International Airport Traffic

	Sep-08	Sep-07	% Change	Q1-Q3 2008	Q1-Q3 2007	% Change
Passengers	709,070	578,884	22.5%	6,671,245	5,018,494	32.9%
Aircraft Movements	7,653	6,878	11.3%	69,041	59,762	15.5%
Cargo (Tons)	31,272	29,084	7.5%	268,009	233,509	14.8%

Source: Abu Dhabi Airport Company, 2009

Abu Dhabi's airport has grown in 2009 in passenger and cargo volumes

Both Abu Dhabi and Dubai's airports reported growth in 2009, during a year that the global aviation industry was hit sharply due to the financial crisis and the swine flu. Abu Dhabi airport's busiest destination is London followed by Bangkok, Doha, Manila and Bahrain.

Aviation, aerospace and defence is one of the key areas of focus under the 2030 plan and the government is targeting 7.5% annual growth. The

Aerospace and defence are main pillars for Abu Dhabi's diversification plans

private business jet segment is thriving in the emirate with a few companies operating in the sector.

In Q3 2009, Mubadala announced that it had signed a long term strategic aerospace agreement with Boeing to develop mutually beneficial initiatives in various areas including composite manufacturing, engineering, R&D, commercial maintenance, repair and overhaul, military maintenance and sustainment, and pilot training. In Q1 2009, Mubadala had announced that it is in initial stages of forming a JV with the US company Sikorsky Aerospace Services in order to develop a military-aviation maintenance centre.

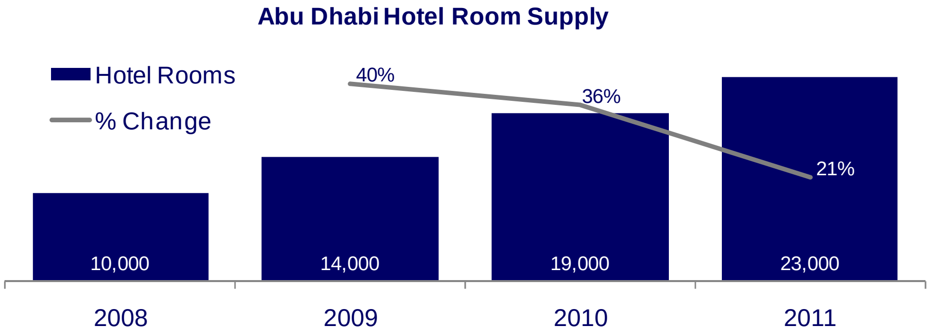
Tourism

The number of hotel guests has doubled in the last five years

Abu Dhabi is investing considerably in the tourism sector as a means of diversification. The number of hotel guests has doubled within the last five years from 960,000 in 2004 to 1.5 million people in 2009. The government has undertaken big initiatives in tourism infrastructure including the airport expansion and iconic master developments, such as Sir Bani Yas Island (home to the Yas Marina Circuit already hosting the Abu Dhabi Grand Prix) and Saadiyat Island (home to the Abu Dhabi Louvre and Abu Dhabi Guggenheim that will be completed in 2012).

There is a sizeable increase in the sector's capacity with the number of hotel rooms as well as serviced apartments rising rapidly.

The supply of hotel rooms is increasing considerably



Source: Colliers, Abu Dhabi report, Q3 2009

More than USD 60 billion will be invested in the tourism sector from 2007 to 2012

According to the Abu Dhabi Chamber of Commerce 2008 Private Sector Indicators report, the fixed accumulated investment in the tourism sector was AED 30 billion (USD 8.2 billion) from 2001 to 2007 and the forecast future fixed investment from 2007 to 2012 in the sector is AED 230 billion (USD 62.7 billion).

Abu Dhabi focusing on the high end leisure segment

Abu Dhabi has traditionally been more of a business tourism centre, but is set to become a major leisure destination with a focus on the low volume, high end segment.

According to the Abu Dhabi Tourism Authority (ADTA), after registering consistently double digit annual growth for five years, the number of hotel guests rose by 2% in 2009. This is a reasonable performance given the international financial crisis and the considerable slowdown in worldwide tourism. Abu Dhabi had 1.54 million hotel guests in 2009, which stayed for an average of three nights. The activity in the sector picked up towards the year end with a 16% increase in hotel guests in Q4 2009 compared to Q4 2008.

The increased supply of rooms has been driving down RevPAR

RevPAR declined by 12% in 2009 as the supply of rooms in Abu Dhabi significantly increased with 12 hotels being completed and approximately 3,800 new rooms becoming available. Occupancy levels fell to 71% from 81% in 2008. 42% of the demand is attributed to UAE, 6.3% to UK, 4.4% to USA and 4% to Indian nationals.

Abu Dhabi has good growth potential in the hospitality sector

ADTA targets a 10% increase in hotel guests in 2010 and looks to attract 2.3 million guests in 2012. Abu Dhabi benefits from a diverse landscape including 400 km of coastline and 200 islands and is diversifying efficiently into the cultural, marine leisure, sports and eco-tourism high end segments.

4.2 Further Developments

Economic Zones

Several specialised free zones operate throughout the emirate

Abu Dhabi has been developing specialized economic zones in strategic locations across the emirate to attract foreign investments. Abu Dhabi aims to be the hub for industrial companies that do business in the MENA region.

Abu Dhabi's free zones are well occupied; ICAD1 and ICAD 2 host 560 companies and there is a waiting list for ICAD3

Zonescorp, a government backed entity, is the biggest free zone developer in the emirate. Industrial City of Abu Dhabi zone 1 (ICAD1) and ICAD2 are operational, ICAD 3 is almost complete, ICAD 4 and ICAD 5 are in the development/planning phase. Al Ain Industrial City 1 (AAIC1) and AAIC2 are also operational. The ICAD and AAIC zones have been built using the public-private partnership (PPP) model.

ICAD1 and ICAD2 are 100% occupied and host over 560 companies. ICAD 1 hosts medium to heavy manufacturing companies, while ICAD 2, which opened in 2007, caters to oil and gas, chemicals, engineering and processing companies. ICAD3, which specialises in companies involved with construction materials, engineering and chemical compounds will be fully handed over by the end of 2010 while some plots have already been delivered. ICAD3 is currently being leased and there are many companies on the waiting list. The zone is expected to be fully occupied at handover underlining that the demand for industrial space in Abu Dhabi remains buoyant in 2010.

The development of free zones facilitates foreign investments in the emirate

Free zones offer integrated facilities, utilities, logistics and communications infrastructure. Zonescorp has introduced workers' residential cities within the zones and simplified the process and reduced the time to set up a company in 2009 to facilitate foreign investment. Free zone companies enjoy benefits such as duty free exports to GCC countries and signatories of the Greater Arab Free Trade Agreement, duty free import of machinery and raw materials, and competitively priced utilities.

The Mussafah Industrial Area includes six specialist zones and is 30 km from Abu Dhabi city centre. The Ruwais industrial complex, 240 km west of Abu Dhabi, is home to many petrochemical companies.

SME support

SMEs have a smaller contribution to Abu Dhabi's economic output compared to other countries

Small and medium sized enterprises (SMEs) are a small, but significant component of the Abu Dhabi economy, contributing 25% to the emirate's GDP. SMEs contributed 51% of output in the UK and 48% of output in the US in 2005.

The dominant role of large companies in Abu Dhabi's economy is related to the oil hegemony. Nevertheless, the government is undertaking initiatives to stimulate SME growth and broaden the country's enterprise base. A larger number of economically active companies diversify concentration risk as well as fuels competition, productivity, employment and innovation.

The government is undertaking initiatives to boost SMEs growth

To that end, the Abu Dhabi government established the AED 1 billion (USD 270 million) Khalifa Fund to provide financial and professional assistance to UAE national entrepreneurs. The fund provides zero and low interest loans and venture capital of AED 3-5 million (USD 820,000 to USD 1.4 million), incubation services and advice to SME owners. In 2008, the fund offered AED 246 million (USD 67 million) of capital for 154 new industrial and service enterprises. The fund is targeting 100 investments in 2010.

In Q1 2009, the Abu Dhabi Council for Economic Development emphasised the importance of supporting SMEs through the economic crisis by restructuring their commitments and injecting capital where needed. A number of UAE banks currently offer banking products at favourable terms for SMEs.

Foreign Direct Investment

Abu Dhabi targets a 23% contribution of foreign direct investment to GDP by 2030

According to the Abu Dhabi Statistics Centre, foreign direct investment (FDI) in Abu Dhabi reached AED 31.5 billion in 2007. Real estate and rents contributed the largest share with 38%, followed by water and electricity with 20%, and financial intermediation and insurance with 15%. Approximately 8,770 new companies were registered in Abu Dhabi in 2007, 68% of which had a commercial license and 1% of which has an industrial license.

Abu Dhabi aims to achieve a 7 to 9% annual growth in FDI resulting in a 23% share of GDP by 2030. Many commentators believe the 2010 target might not be reached, but Abu Dhabi's goal is to achieve sustainable growth over the long run.

The UAE remains the top destination for FDI in the GCC

According to fDiMarkets, UAE continues to attract more than half of the FDI projects in the GCC region. There were 363 FDI projects for the year to November 2009 in the UAE, less than 2008 and more than 2007. In 2009, greenfield projects declined by 20% in the UAE.

Abu Dhabi is undertaking initiatives to create a friendly environment for foreign investments

In order to stimulate FDI, Abu Dhabi focuses on improving the laws governing investments and in particular industrial investments, as FDI plays a key role in Abu Dhabi's diversification plan. Abu Dhabi is also participating in the preparation of the new federal UAE investments law which, according to some sources, may gradually allow full ownership to foreign investors in specific projects in core economic sectors.

In February 2010, Abu Dhabi's Department of Economic Development announced that it signed agreements with 14 governmental establishments in various sectors including telecommunications to end investment barriers. According to Reuters, a dedicated investment agency will be set-up to serve the needs of international investors by the end of 2010.

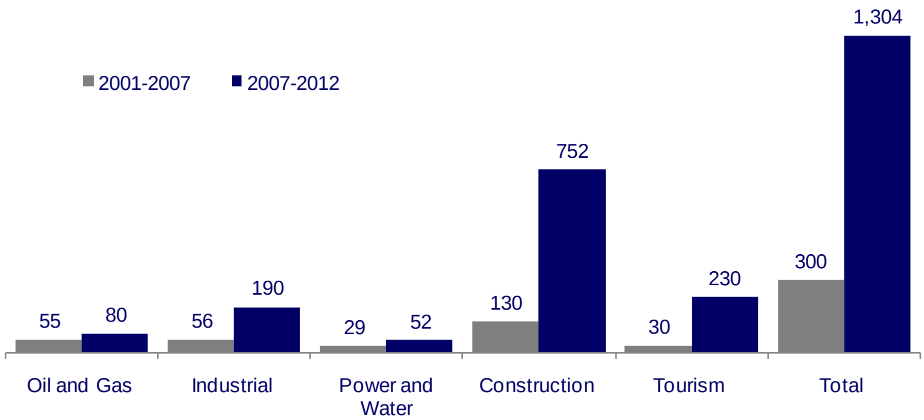
Abu Dhabi's ranking as a destination for doing business has been consistently improving

These initiatives are expected to enhance the UAE's ranking in the World Bank's Doing Business Index and the World Economic Forum's Competitiveness Index. The Doing Business survey ranks 183 world economies based on 10 indicators of government regulation including the time and cost required to meet official rules for starting and operating a business, trading across borders, paying taxes, and closing down a business. In 2010, the UAE ranked 33rd, improving on 2009's rank of 47th. The better ranking reflects new measures that are being undertaken to enhance the investment environment such as the abolition of minimum capital requirements for new businesses. It should also be noted that the reduction in rents and property prices in Abu Dhabi should further reduce some barriers for new companies.

Massive amounts of private and public funds are being invested in Abu Dhabi growing its economy

According to the Abu Dhabi Chamber of Commerce and Industry total gross fixed capital formation in the emirate, including public and private investments exceeded AED 300 billion from 2003 to 2008. It is estimated that total investments during 2006-2014 will reach AED 1.5 trillion with the infrastructure and construction sectors attracting AED 830 billion, industrial projects attracting AED 200 billion, and oil and gas projects attracting AED 175 billion.

Fixed Accumulated Investment and Forecast Future Investment in Abu Dhabi (AED bn)



Source: Abu Dhabi Chamber of Commerce and Industry, 2008

5. Investing in Abu Dhabi

In this section we look at the prospects for investing in Abu Dhabi. We explore the need for a well diversified portfolio to have an exposure to emerging markets and how Abu Dhabi provides a good environment for emerging market investments. We examine how to approach Abu Dhabi investments and finally look at some investment ideas that could prove interesting.

5.1 Diversification Benefits

A well diversified portfolio should have exposure to international, emerging market, private equity and real estate investments. Abu Dhabi is an ideal location to provide some of that exposure.

Investors can benefit from international exposure through emerging markets, as much of the world GDP is developed outside traditional markets

Much of the world's GDP is generated from outside traditional developed markets and many emerging markets are setting up their own stock exchanges. This provides an opportunity for funds to capture emerging market exposure. However, it is important to note that not all stocks listed on these new domestic stock exchanges benefit from the liquidity exchanges can bring. A large proportion of shares listed on emerging market exchanges are relatively illiquid.

Abu Dhabi is an emerging market, but has strong fundamentals garnered from wealth in hydrocarbon resources

Abu Dhabi, even though it is an emerging market, has certain characteristics that make it somewhat akin to a developed market. First, Abu Dhabi has very deep pockets due to its hydrocarbon bounty, which will help it ride through economic crises more easily. We can see this today with the way Abu Dhabi is faring compared to its regional counterparts. Secondly, Abu Dhabi is committed to providing greater amounts of infrastructure that will foster faster economic progression. Though the region is facing hardships from the credit crunch, Abu Dhabi has the resources to push forward with its planned metro systems, railway systems, road networks, sea port developments, airport enhancements, etc. However, Abu Dhabi will continue to provide returns that are in line with emerging markets, due to market perception, geo-political risk, an evolving legal framework, etc.

Direct private equity investments provides an investment with low correlation with traditional securities

For direct exposure to certain industries, private equity can provide robust returns that have low correlations with developed market stocks. There are many illiquid listed shares on emerging market stock exchanges, and with listed companies investors have little to no control over management unless they have a controlling stake. Therefore, it can be argued that investors should invest in private equity and take an active involvement in a company's affairs, which could be carried out directly or through third parties, such as a fund or advisors. Investors that wish to understand their investments more thoroughly can opt for direct investments into companies, but need a local team to properly due diligence any investment and continue to monitor it throughout the investment period.

Real estate provides both investment diversification and a hedge to inflation

Real estate not only provides diversification benefits, but also offers a hedge against both expected and unexpected inflation. Currently, real estate is out of favour as an asset class. However, local real estate markets have fallen steeply and the asset class should be considered with a rigorous approach based on rental yields and absorption analysis.

5.2 Approach

In our "Dubai Real Estate Opportunities" report, which is available from the publications page on Isthmus Partners' website (www.isthmuspartners.ae), we have provided a fairly detailed view of how to go through due diligence in the region. Therefore, we will only touch upon the main tenets of robust due diligence, which is certainly a must for investments that are both illiquid and within an emerging market.

Due diligence is an iterative and time consuming process

The first item to note is the iterative nature of due diligence. As analysts carry out due diligence through reviewing documents, analysing accounts, interviewing key personnel, as so forth, more questions will arise. This in turn leads to more documentation to review, numbers to analyse and personnel to interview. Sometimes it is difficult to understand the right questions to ask until the analyst is some way through the due diligence process. Other times there is a need to continue digging to unearth issues that may be hidden. This process can be laborious, long and oftentimes requires some investment. However, any time and money spent at this stage will be rewarded in the long run through better deal selection and the avoidance of problem investments.

Gathering information about investments in Abu Dhabi can be difficult

In Abu Dhabi, requested information on an investment may not be forthcoming straight away. Some regions have better data than others. For instance, provision of statistical information on population and the economy is better in Dubai than in Abu Dhabi. In addition, some iteration may be required to understand where problems may exist. If an analyst is required to go through individual receipts to really understand an investment, then that is the approach that must be taken. In the end, if a real picture of an investment cannot be built, whether that is due to uncertainties in the market uncovered during the due diligence process, or the lack of support provided by management, then investors may need to make the decision to walk away.

A focus on cash flows is key to understand business drivers, and risks and issues

Any investment is characterised by its cash flows and the probability of achieving them. Model sensitivity and scenario planning are important tools in understanding the key drivers for any investment, which leads an analyst to determine significant risks and issues. The key drivers point to real business levers that are affected by customers, suppliers, competitors, substitute products, etc. Once identified, risks and issues form part of the qualitative decision making process that compliments any financial analysis. Becoming comfortable with risks and issues is an important milestone in understanding the investment risk any investor is willing to take and the required return as reward for taking on that risk.

Cash flows also point to the sustainability of financing throughout the investment lifetime. As many in the region have discovered, loan to value on any asset is only half the story. Financing must also be serviceable and downside cases will show to what degree any cash flow provides a cushion against finance serviceability.

Security packages are a must, but legal enforcement rights are evolving

Provision of security packages in Abu Dhabi and in the region as a whole is complicated by evolving legal frameworks and uncertain enforcement processes. This is compounded by falling asset values, both in real estate and within the corporate world. Strong legal advice on legal structures must be sought.

Management teams must be vetted and provide demonstrable experience in the business area an investor wishes to fund

Even in the developed world, investments are only successful if management teams are able to deliver the proposed business plan. Therefore, it is only reasonable to vet the management team that effectively is entrusted with an investor's capital. With a direct investment approach, investors are better able to scrutinise management teams and monitor their progress against plans. In the region, it can be difficult to find the right people to manage a business or a real estate development; though there are numerous candidates for each job.

No doubt there are a number of success stories within the region through the resourcefulness and hard work of both local business people and expatriates. Those people can be invaluable sources for further successes. However, entrepreneurs and new management teams can also provide some dynamism to the region, and investors need to spend some time to understand their desires, motives, capabilities and stamina to determine if they are the people to deliver on a business plan.

A key consideration when investing in the UAE pertains to establishment issues, whether in a free zone, on-shore in a limited company or through a branch. On-shore investing requires local sponsors. In many cases the sponsors can be a source of capital, local experience and contacts, and should be carefully selected. Establishment issues are critical and adequate legal advice should be sought when setting up in the UAE.

A good implementation plan includes an incentivised management team and clear milestones

Finally, we will make a note on implementation. It is not enough to have a great idea or a vision to take a company to the next level. It will only happen if the implementation is viable, which means the management team is suitably incentivised and motivated, that staff can adequately deliver, and systems are in place to ensure people are aligned and know what their roles are as part of the greater organisation. A well thought out implementation plan not only helps provide all these things, but it also helps investors monitor an asset against a benchmark and provides a baseline against which employees and management can be measured and rewarded. For more detail on implementation, please review Isthmus Partners' report "Venture Capital: A Pragmatic Approach" available on our website www.isthmuspartners.ae.

5.3 Investment Ideas

Most investment ideas for Abu Dhabi require exits in the medium to long term

Abu Dhabi mainly provides medium to long term investment opportunities. There are of course opportunistic shorter term investments, which could provide some quick returns and we will touch upon these. However, Abu Dhabi will spend the next five to 15 years transforming itself into a world class metropolis through infrastructure investments, opening itself up to further foreign investment, diversifying its income base and hopefully embracing entrepreneurism. With that in mind, to tap into the undoubted growth that will accompany this investment, investors need to think about ideas that can capture some of Abu Dhabi's future economic transformation and grow at very high rates.

Medium to long term investments are inherently illiquid

In order to capture mid- to long-term value, investors need to invest for the mid- to long-term. This means many of the investment opportunities will be illiquid and will require investing in capex and working capital before becoming cash positive.

Over the last few years, as liquidity has dried up, many investors have tried to take capital out of their illiquid investments, such as real estate. The trading mentality of real estate investors in the UAE demonstrated investors did not really perceive the long term nature of real estate assets. Their equity positions were not deep enough to cope with liquidity problems and leverage was overly relied upon. Investors' actions have only gone on to exacerbate the region's illiquidity and construction related problems. In order to avoid a similar result in the future, investors need to understand the real risks behind illiquid assets, and calculate cash flows on a conservative basis to determine the cushion required throughout the investment period and not just focus on an initial commitment and end of period value creation.

Opportunistic ideas

Opportunistic ideas are most likely to be in the real estate and non performing loan areas

The biggest area of pain in Abu Dhabi is undoubtedly the real estate sector. A number of projects are overly leveraged and prices and rents have fallen steeply since the peak. However, Abu Dhabi's real estate supply is not as heavy as Dubai's and delivery of completed developments will decelerate. Some projects have been or are likely to be cancelled or delayed.

As supply has not caught up with demand in certain areas, rents have not fallen to the same extent as rents in Dubai. Therefore, at realistic prices, senior or mezzanine funding of late stage developments can provide good returns especially if structured with upside options. There are many hazards in this type of investing though. Security can be hard to pin down, liabilities can be difficult to estimate, end user buyers of residential units or commercial space can be in financial difficulty exacerbating the cash flow situation, etc. Therefore, it is critical that a full and thorough due diligence process is carried out.

The credit crunch created by the real estate bubble has spread to all industries. Therefore, non performing loans (NPLs) may be bought at a discount and serviced as a portfolio. However, Abu Dhabi and regional banks are wary of realising losses on their loan books. Therefore, it can be difficult to buy these loans especially as a sale would trigger further bank recognition of losses and damage capital bases, which may be difficult for regional banks.

These opportunistic investments are not necessarily short term investments. Most would be short to medium term at best, as real estate still takes time to develop and corporate turnarounds take time to accomplish.

Larger Investments

Larger investments will be concentrated in more established business areas

We have focused on three areas in which larger investments can capture larger markets: petrochemicals, financial services and healthcare. Abu Dhabi's GDP is largely derived from its hydrocarbon resources and related petrochemical industries. The emirate is looking to capture more of the petrochemical market as it develops its oil fields further and expands into downstream industries to capitalise on economies of scale and scope. Investments in relevant technologies and partnerships with GREs in this area have the capacity to create value especially in the knowledge intensive areas.

Most financial services are in the nascent development period in Abu Dhabi. Retail banking is probably the most advanced, but peripheral services that augment banking are still not readily available. For instance, retail and SME credit reporting agencies are only just becoming more prevalent, back offices are inefficient, and IT systems could be improved.

Insurance is lacking the sophistication that is required to correctly underwrite risks. For instance, car insurance is based primarily on the type of car and a percentage of its value. This disregards the risk of the primary cause of accidents: the driver.

Health insurance is a strong bet across the region, not just Abu Dhabi. Starting services in Abu Dhabi, however, may provide a footprint that can be mirrored in other countries. The UAE does not have a welfare state, and most of the emirate is populated by expatriates; therefore there is a definite need and a large market. Any company looking to start operating would need to focus on robust underwriting standards and processes, and customer service. Both are lacking in the industry.

Moderate Investments

Moderate investments will be concentrated in new ventures, expansion capital and SMEs

Moderate investments can be made in a number of sectors that will be established or grow as Abu Dhabi realises its plan to become a world class metropolis. Here, we would expect investors to work with entrepreneurs to start new businesses, or strong management teams to provide expansion capital or funds for management buyouts.

As Abu Dhabi evolves, so will its economy. As it diversifies, so will its income base. There are some industries that Abu Dhabi will focus on, such as tourism and manufacturing, and others that will spring up as needs force the market to develop solutions. Therefore, investors are welcome to target areas in which Abu Dhabi is keen to invite investment, or to look at the general development of a certain location to try to predict demand for certain products and services.

In this investment sector it is important to enforce the due diligence areas we mentioned above, especially pertaining to cash flows, management, and implementation. Also, it is crucial that the investor understands the local market or has consultants that can provide in-depth advice.

Both the larger and moderate investment ideas will require a long-term commitment to Abu Dhabi. Abu Dhabi is sure to welcome such investment, and as the legal framework becomes more mature, infrastructure is further developed, and the investment environment becomes easier for direct investment, exits will become more profitable and liquid.

About Isthmus Partners

Isthmus Partners is a UAE based consultancy that offers consultancy advice on SME private equity and real estate assets. It was founded and is owned by three partners with a wealth of principal finance and structuring experience from 25+ years in investment banking and management consulting.

In the real estate sector, Isthmus Partners advises on and structures deals in the late stage development segment. The partners have worked on restructuring a number of real estate deals in Dubai including The World, Sports City, The Marina, and The Waterfront.

In the SME private equity sector, Isthmus Partners focuses on new ventures, expansion capital and buyouts. The partners have worked on a number of new venture proposals based on product and materials manufacturing across the GCC, tourism and software. They have also worked on expansion financing and buyouts for an interior design firm and in the alternative energy sector.

Isthmus Partners' services include investment project health checks through financial due diligence, feasibility studies, monitoring of ongoing projects to ensure greater control through cash flow monitoring models, and advice on sources of financing.

For more information and to find more of our available reports please visit our website, www.isthmuspartners.ae.

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