Restructuring in The UAE

A Survey of Approaches and Lessons Learned

Executive Summary

- The UAE economy is recovering, particularly in industries such as tourism, manufacturing and logistics, and in businesses with links to Saudi Arabia
- Real estate and the banking sectors need fresh capital and restructuring; further real estate development cancellations are expected this year
- The legal system is perceived to be the best in the region and has certain provisions that aid restructuring, but there is a call for a bankruptcy law
- More experience in complex restructuring cases in the court system would provide greater confidence
- Investors are ready to invest in the country, even in challenging asset classes; however long due diligence processes, slow decision making and unrealistic pricing hinder investment activity
- As part of any restructuring process, a trusted baseline must be set for all stakeholders, including more robust financial statements and a better definition of key performance indicators
- Successful restructuring examples would serve to highlight the positives and overcome the negative stigma attached to restructuring activity
- With respect to restructuring, companies are not overly proactive and management can be over confident and may not have restructuring experience
- Post-dated cheques are required by banks as collateral of debt, and can be counterproductive as debtors leave the country rather than workout debt issues
- More recognition of NPLs and banks selling bad debts to work-out specialists will help free much needed capital
- Banks need more industry specialists, restructuring experts and empowered credit officers and should collaborate more on sharing borrower credit information
- A new insolvency law is in the works and should help resolve many of the issues encountered by restructuring specialists

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This report is due to the hundreds of responses for our online and paper questionnaire and the people who provided time to go through our detailed interview on the subject. We would like to thank all of those people, who have made this report possible, which will hopefully provide us with some insight from their experiences. In addition, we would like to especially thank the interviewees, whose in-depth understanding of the subject has given us the material to make this report rich in detail.

1. Introduction

Restructuring is the process of reorganising a company or asset. It may involve changing how a company is financed through balance sheet restructuring, or the reorganisation of operations including people, processes and IT, and may involve changes in strategy.

Primary information on restructuring is hard to obtain in the region

In February 2011, Isthmus Partners released a report on restructuring in the MENA region. It was difficult to obtain primary information pertaining to restructuring activity across the region. Though restructuring is a fairly opaque activity across the world, it may be more so in this region.

We need positive restructuring examples in the region to promote the activity

Restructuring is a complex and difficult process, and oftentimes it is done behind closed doors, as details will be confidential and each of the stakeholders will keep their positions guarded. However, we do find examples of successfully restructured companies after the process runs its course in the press and particularly in academic journals and case studies used within business schools. These serve not only to inform practitioners of best practices, but also to give us hope that restructuring can be a productive endeavour. Only through positive examples can stakeholders be persuaded to commence their own restructuring process with confidence, and to start recognising early the symptoms in their organisation that may prompt restructuring.

This report focuses on restructuring in the UAE

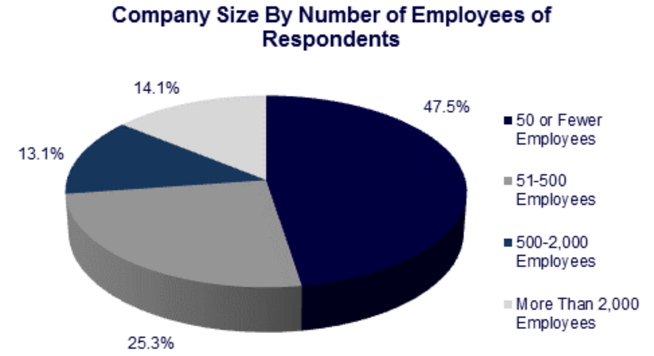
In the report we focus on restructuring in the United Arab Emirates (UAE), how it is carried out, the obstacles that must be overcome and some potential solutions for overcoming them. For a more comprehensive study on restructuring as a process please read our earlier report ("Restructuring in the MENA Region. A Practical Approach. February 2011"), which can be found on the Publications page of our website www.isthmuspartners.ae.

This report will be useful for people involved in restructuring companies and real estate within the UAE including bankers, consultants, owners and managers and also to policy makers that are exploring ways to make UAE restructuring more efficient.

2. Approach

The report contains responses to a survey from nearly 500 people living and working in the UAE

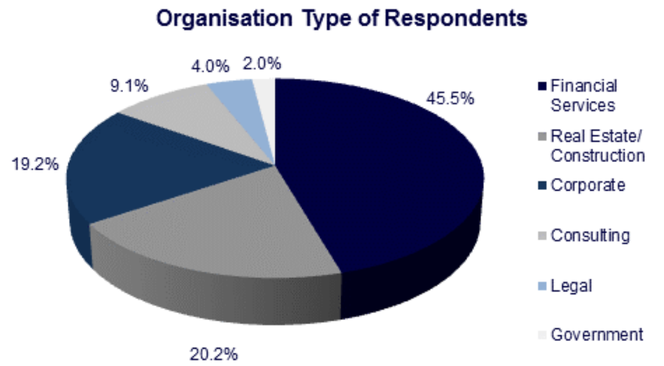
In this report we look at the combined experience of various actors in the restructuring space. First, we asked a range of people to provide a view on certain high level questions, which offers some quantitative data. We had nearly 500 respondents. The companies within which these people work vary in size. We focussed on small and mid-sized companies, which are often ignored in restructuring efforts. Nearly half of the respondents work in companies with less than 50 employees, and only 14.1% of our respondents are from large firms (more than 2,000 employees).



Source: Isthmus Partners

Survey respondents work in a variety of industries

The respondents' companies also vary in industry type. We have focused on where some of the main problems lie with just over 45% of respondents working in financial services, 20% in real estate and related industries and 19% in various companies in the UAE. The remainder of respondents are from the consulting, legal and government arenas.



Source: Isthmus Partners

Financial services employees include people who work within banks to administer client accounts, manage relationships, manage work-out of loans, etc., and those who work in investment funds. Real estate and related industries includes developers, contractors, brokers and consultants within the property sector. Corporate respondents work in various industries including manufacturing, logistics, media, retail, telecommunications and the automotive sectors.

The report focuses on the UAE broadly and does not provide industry focuses

We do not distinguish between industries for two reasons. First, the amount of data and interviews that we have carried out do not allow us to provide sector by sector insights. Second, in this report we have focused on broad restructuring themes that are relevant across industries, and whereas some industries may have larger issues than others, it seems as if all industries have certain companies that require some level of restructuring.

We carried out 20 in-depth open-ended interviews

Second, we carried out interviews with six types of participants and asked questions on the economy as a whole, finance, and the restructuring process. In total, we carried out 20 in-depth interviews. The six groups are bankers tasked with managing loans (throughout the report we shall refer to these respondents as Bankers), legal counsel (Lawyers), real estate developers (Developers), managers and owners of businesses (Company Leadership), investors and funds (Investors), and Consultants. We deliberately formed these groups and asked them the same questions without providing guidance on which topic areas the answers should address. In this way we learned not only about different topics, but also the emphasis each group gives within specific topics. Our questions were open-ended and without time constraints to allow respondents to give extended answers.

The qualitative information contained in sections 3-7 are the result of the in-depth interviews

The interviews provide the majority of the information that is contained within this report. Sections 3-7 reflect the thoughts of interview respondents. The interviewees come from a varied background with both regional and non-regional respondents. The quantitative data from the questionnaires is used only to provide some broader context to those answers. Section eight reflects final thoughts from Isthmus Partners developed from the survey and interview process.

3. UAE Economy

The economy in general is picking up

The response on the state of the UAE economy is mixed and did not depend on which of the six groups were asked. Predominantly, the economy in general is thought to have improved; however, the boom times seen up to 2008 are not expected to come back anytime soon.

Industries such as retail, tourism and trade are leading the UAE's recovery

Bankers have seen weak banks absorbed, especially if government-owned as they are merged with stronger banks, and some indicate that provisions have been made for non-performing loans (NPLs). The oil price is not seen as low enough to hurt the UAE, but also not high enough to produce a huge windfall. Certain multinational companies based in Dubai, such as Emirates Airlines and DP World, are seen as being able to compete with global companies. Industries such as retail, tourism and trade are thought to be at the forefront of a recovery. The improvements are coupled with lower rents, more available human resources talent and more realistic salary considerations, which make operating a company cheaper. In addition, the UAE as a tax free regional hub is still an investor's preferred destination even if their target is to broaden their investment across the GCC, as investors look for sustainable growth.

The Northern Emirates are expected to continue to see challenging times

Of the emirates, Abu Dhabi is thought to be best placed as it has most of the oil wealth, followed by Dubai, which has seen a positive response over the last year in certain industries. Respondents that mentioned the Northern Emirates, which were few, indicated that they would continue to lag behind in the near to medium term.

Global issues may hinder the UAE's recovery

There is a general recognition that the UAE is tied to the global economy and the global outlook for 2012 is gloomy. The sovereign debt issues in Europe are foremost in people's minds and companies are starting to consider the implications locally. Of our six groups, Company Leadership are most negative on the economy. Many cite three to five years as the timeframe before high growth returns.

<u>Challenging Sectors</u>

Real Estate is a challenging asset class, but certain locations are seeing positive price movements

Real estate and related industries and the banking sector are thought to be the furthest away from recovery. Some Developers are seeing an increase in prices in well located areas, especially in high quality buildings in the Marina and around the financial district, and in villas on The Palm and Arabian Ranches. However, on average prices continue to fall and all six groups see this continuing over the next year, especially in commercial property. In the short term, the overhang of supply still looms large as demand for many properties and locations remains weak.

Subcontractors and real estate service companies are feeling the brunt of the downturn in development activity

A general improvement in real estate is not expected in the next three to five years, and some respondents expect 10 years of stagnation. Many respondents pointed to the knock on effect on sub-contractors and other industries servicing real estate clients, such as MEP (Mechanical, Electrical, Plumbing), façade, woodwork, landscaping and other sub-contractors. However, companies that provide security, catering, marketing, accounting and other services have also suffered payment delays or non-payment. Some of these companies have been forced to exit due to large working capital requirements (accounts receivable). Sub-contractors and services companies are struggling to find future work to replace the contracts lost from the real estate sector.

More projects are expected to be cancelled over the coming year

Deleveraging is continuing, but it is painful and slow. Most respondents find it difficult to see a solution out of the problem, but investors see the need for an orderly sell down of assets to raise capital to tackle cash flow issues and pay down loans. Currently, asset holders and banks are thought to be reluctant to go down this path, and are waiting for a general uplift in the economy. Bankers think that of the projects “On Hold” or “Progressing But Critically Delayed” in Dubai’s Real Estate Regulatory Agency (“RERA”) list of Approved Projects, most will eventually be cancelled. Therefore, the market will continue to see further development cancellations in the coming year, which may provide opportunities for fresh capital on more viable developments that are currently stagnant.

Trust in developments must be won back

Banks need to fully recognise their NPL position

Developers are also not optimistic about their industry and cite the lack of trust as one of the biggest issues that will need to be resolved in the near future. Without trust, few off-plan transactions (the driver of the pre-2008 boom) are being completed. Developers also say that they have to manage a shifting regulatory environment, which leads to doubts about interpretation of regulations and enforcement of rules.

Banking, seen as the other sector lagging in the recovery, is thought by all groups apart from Bankers as not recognising the true extent of their NPLs. Whilst a few Bankers have indicated that provisions have been made, others have stated that some practices are not allowing the full extent of required provisions to be recognised.

Banks are reluctant to sell down their bad debt

Investors are expecting banks to be forced eventually to recognise more NPLs and, in taking new provisions, to sell down certain loans. In the UAE, as in the region, banks are reluctant to sell loans at a loss, which has left capital tied up and smaller businesses are feeling the brunt with less credit available. Some of this will occur once more real estate developments are cancelled and it becomes obvious loans will not be repaid; more will occur once there is more stringent testing of NPLs. Of the most optimistic respondents, a 12-18 month recovery period is expected; however, most respondents are expecting two to five years before recovery.

Macro Support

The government has been helpful through injecting liquidity and pushing through GRE restructuring plans

On the positive side, Bankers indicated that the liquidity injected into the financial system in 2009 and 2010 helped avoid a bigger downturn and a run on the local banks. The government has enforced the progressive restructuring of debt with certain painful plans being pushed through, mostly related to Government Related Entities (GREs) debt. GREs have sold some assets abroad to increase available capital.

However, more can be done. The two biggest issues respondents raised centred on the legal system and transparency. The legal system is thought to be too slow, unpredictable and unclear. We provide more information on this in section seven.

More macro-economic indicators are required to help businesses

In terms of transparency, all respondents would like to see more information made available to help them in their work. Developers, Consultants and Lawyers would like more information available on the economy. As the stock market is young and with little depth, and other indicators are limited, it is difficult for companies to gauge whether the country is really recovering and which products or services companies should provide.

To attract investment, respondents would like to see 100% foreign owned on-shore companies

Of the other improvements sought in the macro environment, Company Leadership, Lawyers and Developers would like the availability of 100% foreign owned companies in on-shore UAE instead of only through free zones. Many companies are incorporated in a free zone and working on-shore without agency agreements. Such companies are not pursued by the authorities, but many would like to have the ability to formally work in the UAE without the need for an agent or by giving 51% of the company to a UAE national unless it is a true partnership. Others have formed companies with 51% owned by a UAE national and a side agreement that stipulates alternative beneficial terms. However, these side agreements cannot always be relied upon in local courts, so owners are at peril of an adverse judgement. Lawyers suggest that the whole system become more transparent with companies being allowed a 100% foreign owner with a fee arrangement for opening and operating companies. This would be similar to the trade license currently paid for in a free zone, but potentially at a higher rate.

The cost environment needs to become more predictable

The unpredictability of the cost of business for regulatory reasons concerns some respondents. Developers point to the number of new costs that have appeared over time that are applied retrospectively, which means that during difficult times they become more burdened, e.g. interim registration costs. Company Leadership have also cited examples of unexpected costs.

Population growth is one way to aid recovery and provide a boost to real estate developers

An increase in the white collar worker population in absolute numbers would help drive real estate demand and demand for more products and services creating jobs. Respondents would like to see visas more readily available and a process for long-term stakeholder visas, especially considering some people have lived in the country for decades. Resident visas for property ownership has been announced in the local press recently, but the detail is not yet available, and no timeframe has been set for determining how any new laws will be implemented.

The private sector needs to take a bigger role in the recovery

Investors feel that the private sector could have a larger role in the economy with a more limited role for GREs. In the real estate sector a more limited GRE role is occurring de facto due to problems over the past few years with GREs in real estate.

Investment

Investors are interested in investments in the UAE particularly in hospitality, consumer, manufacturing, education, healthcare, and businesses with links to Saudi Arabia

Investors say they have appetite for assets in the UAE, particularly with exposure to Saudi Arabia. The Arab Spring has helped to bring capital flows into the UAE from the region (the UAE is perceived as relatively stable). Investors do not have preferences for any particular sector, preferring to be opportunistic. The improvement in certain industries has not gone unnoticed such as hospitality, consumer and manufacturing. Other industries have been long term favourites such as education and healthcare. Also, there is demand for more challenged assets classes, such as real estate, where completed buildings in good areas are sought after as are developments requiring last mile financing. Investors are prepared to purchase distressed loans from banks as portfolios or single names.

Many investors are deterred by the high prices set by owners

Companies that are performing well and provide good profitability are seldom for sale. Companies that either have growth potential or have current liquidity issues are being priced by owners as if growth has been achieved or restructuring is already successful. Investors find owners hold onto their companies until their nominal target sales price is achieved. With debt funds looking for IRRs in the mid- to high-teens at least and equity funds in the mid-20s plus, pricing in growth and successful workouts makes funds shy away. Investors looking for mid-sized investments in the range of USD 20-40 million find it difficult to source good opportunities. In addition, some family owners are reluctant to give up control or put robust corporate governance processes in place.

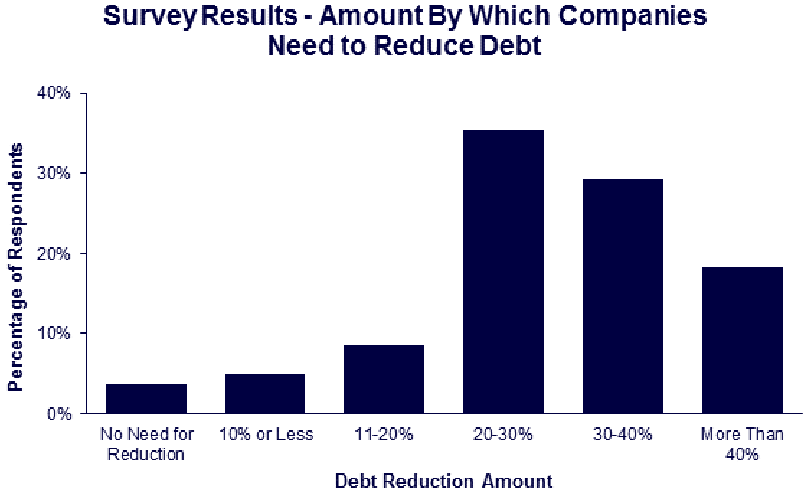
Most exits are limited to financial and strategic buyers with knowledge of the UAE

Finally, Consultants have raised concerns over the ability to exit an investment. Currently, IPOs anywhere are challenging, and in the UAE, public markets are thinly capitalized. Management usually do not have the capital available to purchase a company and debt is unlikely to be available in the foreseeable future for a Management Buy-Out (MBO). The only real options seem to be to sell to a financial or strategic buyer already familiar with the country.

4. Financial Leverage

Respondents feel companies on average need to deleverage by 20-40%

One of the key issues evident from the recent financial crisis felt around the world is the overuse of debt, and more importantly the inappropriate use of debt. In our questionnaire, we asked respondents how much on average do companies need to reduce debt. The answer lies between 20-40%.



Source: Isthmus Partners

However, averages usually tell less than the whole story. In our interviews, we found many respondents thought overleverage was an issue in the real estate sector and certain GREs; however, leverage in companies was very dependent on the ability and desire to raise debt. Investors state it is difficult to know how leveraged a company is, as it is too hard to obtain information, and usually they have to rely on financial information provided by the company itself.

Locally owned companies are less likely to take on debt

Bankers stated that it was traditionally unusual for local companies to take on debt, and the practice had been promoted by Western expatriates, who were more used to working with leverage. Bankers also felt that many of the managers that endorsed debt strategies and overleveraged expatriates have largely left the country.

Leverage has been used to expand into non-core areas

Consultants state some managers and owners branched out into non-core investments that were thought “hot” at the time, but that have since crashed, including real estate and the stock market. Companies that followed this route leveraged their core business to fund these new ventures with many of them worthless now leading to overleverage of the core business.

Company Leadership responded that debt is not such an issue for them, and many are solvent, as they did not take on debt. This has been for various reasons: some could not access debt, so have not become overleveraged, but mostly it is cultural and family-owned companies do not like to incur debt.

Accounts Receivables have blocked the value chain especially for smaller companies

Lawyers in their responses concentrated on accounts receivable as opposed to debt. They state that the problem lies in companies not paying, and the whole value chain clogging up, with some large companies being at the source of non-payment.

Deleveraging will be difficult and slow and many respondents could not see a real solution to the problem. Some companies will have to be allowed to fail and others will have to bring in new equity or sell down assets. This will inevitably realise paper losses and company owners are reluctant to go down this route at the moment.

Banks Doing Enough?

Whether the banks are helping the process produced a mixed response. As could be predicted Developers and Company Leadership said they were not, and some respondents' views of the banks are tinged with anger and frustration. Primarily, banks are not lending, but respondents also cite high fees and interest rates, inefficiency, a lack of understanding of their industry and their sheer lack of flexibility as other issues that banks must work on.

Borrowers are frustrated with the lack of bank lending

Many companies go through the lending process with banks, but then are told that lending is not possible. It is understandable if a bank's due diligence process finds concerns with a company so that the lending process is halted, but Company Leadership feel that bank committees make arbitrary decisions on lending, which have nothing to do with the strength of the borrower. It is difficult to see the link between the credit officers carrying out due diligence and the decision makers on the committees. Frustration is usually borne out of negative decisions with little or no detail as to why a borrower failed to be approved.

Banks need to become more internally efficient

Company Leadership and Developers point to the inability of banks to carry out simple tasks and internal issues as evidence of inefficiency, leading to higher fees. This may be due to poor employee training. Consultants agree that banks should look at reducing their costs, and not rely solely on high fees.

Respondents feel banks need more specialists with industry focus

Company Leadership would like banks to be more sophisticated and to have industry group specialists so that coverage bankers understand their needs better. This would avoid some of the issues of poor due diligence in initially making loans and such bankers would also be more adept at dealing with individual companies.

Banks need to be more proactive in helping their customers and focus less on PDCs

Lawyers concentrated on the intransigence of banks in workout situations. If there are few options available, banks are reluctant to negotiate, especially with smaller companies and are liberal in their requirement of post-dated cheques (PDCs), which leads many individuals to pre-emptively leave the country rather than face criminal proceedings. Banks are seen to be concentrating on growing revenue in their private wealth arms whilst avoiding dealing with their corporate or real estate divisions.

Investors unsurprisingly think banks should take more write downs, sell NPLs and move on to new business as capital is freed up. A bankruptcy law is called for and Investors state that Debtor in Possession (DIP) financing is required to facilitate workouts. Consultants support this view and claim bank executives need to make faster, less emotive decisions.

Banker Response

Banks work independently so club deals are difficult to achieve

Bankers indicated that banks are too individualistic. There are no club deals, and collection rather than restructuring is encouraged. Banks will try to get in first during restructuring to get paid back in full knowing there will be less to divide in the future. In this way, few banks exchange information, especially when large names are involved. A reliable credit bureau would help.

Credit officers find it difficult to be proactive given the current oversight processes

A few Bankers pointed to structural issues that stop banks from restructuring loans. Credit officers have stated their restructuring decisions are scrutinised closely by senior management and, in the case of government owned banks, government bodies. Particular focus is made on their relationships with borrowers rather than the legitimacy of a restructuring opportunity. Therefore, few credit officers are proactive.

Bankers feel PDCs are a key tool in their collection strategy

PDCs are a contentious point with many respondents, but some Bankers think removing PDCs altogether would lead to further bank difficulties. As unpaid PDCs lead to criminal proceedings, banks have a strong collection tool. Outside PDCs, the legal framework does not help banks to enforce efficiently, so without the ability to put borrowers in jail, some Bankers feel that borrowers, who are unwilling or unable to pay due to their own circumstances, would not have any incentive to pay.

Some banks are setting up restructuring teams to help their customers

Nevertheless, some banks are finally setting up restructuring teams to help their clients. The aim of these teams is to produce workout plans, and secondarily to make fees from restructuring. These teams are apparently employing restructuring experts. Only time will tell if such teams are successful.

5. Corporate Appetite for Restructuring

Management can be reactive and make emotion-based decisions, and more managers with restructuring experience are required

When asked if companies were doing enough to help restructure their businesses, most respondents answered 'no'. Restructuring requires experience and many managers simply have not experienced operating a company through a downturn. Consultants concur, but understand that companies are reluctant to pay them for their advice. Bankers indicate realistic plans have to be put in place with companies following through on implementation. Lawyers say few managers have a true understanding of a business as many expatriate managers leave after two to four years.

Restructuring plans can often be unrealistic

Politics can play a big part, especially in larger companies where managers manoeuvre to control larger parts of the business, readying themselves for when the next upswing occurs. Overly aggressive sales or cost reduction plans help people gain position, but in the long run many of these plans are too unrealistic to succeed.

Owners need to take a greater interest in companies requiring restructuring particularly if they make key decisions

Frequently, owners are unlikely to understand the financial position of their companies as management information is limited. Some owners lack interest in the business and are too often not available to make decisions. Consultants have similar experiences where clients hire them for advice and then are not available to listen to recommendations.

Changing senior management is not about blame; it is about pragmatically moving forward with the right people at the helm

Some companies are simply downsizing their workforce in order to reduce costs. Downsizing can be done without consideration of the needs of the business: either too many people are let go in the wrong areas, or the wrong staff are made redundant. Changing senior management is difficult and not always about blame; it is also about pragmatically moving forward and finding the right people who can make decisions on matters with which they have no emotional ties.

Decision making must be more decisive and quick

Investors, Lawyers and Consultants point to the lack of decision making as a core issue within companies. Companies are neither making decisions quickly enough, nor are they making the tough decisions required to move forward. Some of these decisions include having to sell down assets, especially non-core assets, and realising that a business has problems early to be able to make appropriate plans.

There are well run companies with proactive management that look for pragmatic implementation plans

There are of course exceptions to the above issues. One company respondent has seen his company be proactive throughout the downturn and focus on obtaining good economic data in the countries in which it operates to inform its business decisions. It has also worked over the last two years to develop a robust management information system that provides better data on business performance. Its owners have been hands-on, conservative both in business and financially, and have proactively made decision based on pragmatic and realisable implementation plans. They have taken long term views on various divisions understanding that some divisions will require support throughout this period, but promise to show positive results in the future. This company has seen few redundancies, and business has been relatively stable.

Shy Away

Respondents point to three main reasons why companies shy away from

More positive restructuring examples in the UAE are needed to promote the activity

restructuring. Firstly, culture plays a big part in resistance, due to the negative stigma of perceived failure. There are few examples in the region of successfully restructured companies and most owners lack knowledge of the process and are understandably emotionally tied to their businesses. Owners are normally secretive about their companies, and are unlikely to be proactive. In some cases they would fear talking to their banks lest their banks force them into restructuring, alerting others to their company's instability, which may lead to fewer customers due to concerns over fulfilment, and less attractive terms from suppliers that would worry about being paid.

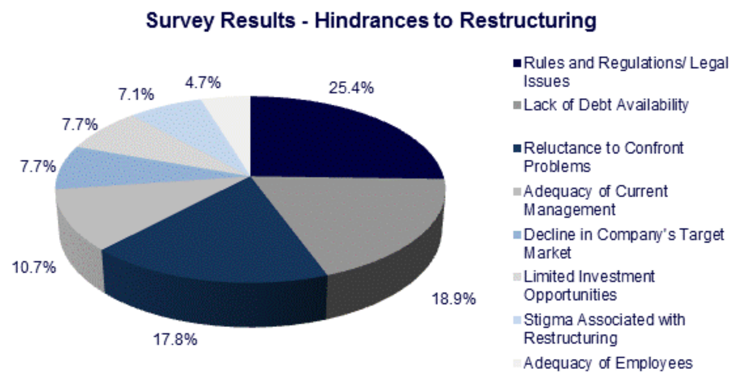
Managers can be over confident of their ability to steer a company into recovery

Secondly, managers are overconfident in their ability to manage their way out of the downturn. Many senior managers believe their understanding of the local market will help them operate profitably and many CFOs believe their skills in accounting will help them produce reliable financial plans. Some deny there is a reason to restructure or don't want to look unknowledgeable. However, restructuring requires specialised experience, and financial business cases require more than marketing plans translated into numbers. In addition, restructuring usually means some form of review of the past and at least an audit of financials. Some managers are reluctant to see such a review, as this may point to issues they caused, or they may find they have greater accountability in the future through better management processes.

New equity is difficult to raise

Finally, Company Leadership may find it difficult to sell assets they own, or raise new capital. Though there are many investors with available funds, there are far more opportunities that require investment. Some companies will find it difficult to raise financing in such an environment due to poor accounting standards or corporate governance issues.

In our survey, more than a quarter of respondents cited the legal and regulatory environment as a hindrance to restructuring. We talk more about these issues in section seven. Other important impediments included the lack of credit and a resistance of various stakeholders to confront problems. The adequacy of employees was the least concerning issue.

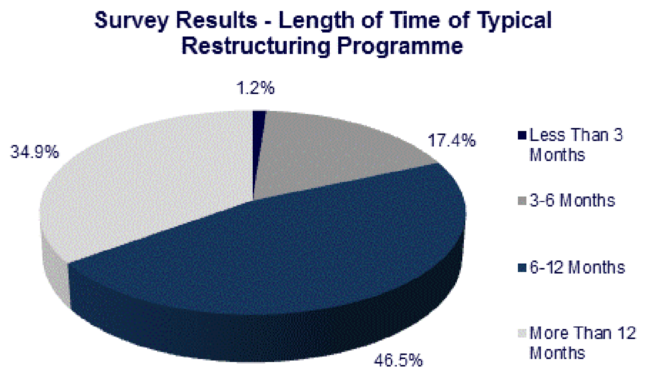


Source: Isthmus Partners

6. The Restructuring Process

Restructuring can be a long and arduous process

In our survey, just over 46% of respondents believed a workout plan would take 6-12 months to complete, with just fewer than 35% indicating a timeframe of over 12 months. Not surprisingly, as the size of company within which the respondents worked increased, the timeframe increased. Nearly 60% of respondent who worked for companies with more than 2,000 employees selected a timeframe of more than 12 months and none selected six months or less.



Source: Isthmus Partners

More planning is required to ensure a successful implementation

Many interview respondents provided answers that were expected when asked what a good restructuring process looks like. It is in the implementation that things start to fall down. Companies seem to want to get on with restructuring without taking the time to look at their current position before moving forward. Partly this is because they feel they know their position, and partly it is the eagerness to get back to growth. However, Investors, Lawyers and Consultants all stressed that time should be taken initially to determine the true as-is picture in operations, sales and marketing and particularly in finance and corporate governance.

Financial information usually needs to be vetted before making plans

Lawyers and Investors both regard financial statement information as weak; therefore it is advisable to have third party experts come in to verify the corporate accounts. The earlier this can be done, the more successful the process will be, as all stakeholders need a reliable set of financial statements. This cannot be carried out by the current auditors, as audits are usually viewed with suspicion and typically financial due diligence requires a different skill set from auditing.

Once a company's financial position is determined, focus needs to be on deleveraging and cash. Any restructuring of debt that solely relies on loans extensions is likely storing problems for the future, so a reduction in debt is required, whether that is from raising equity, selling assets to pay down loans, converting debt to equity, a bank forgiving some of the debt, or a combination of those activities.

Good management will need to oversee the process and be proactive.

More proactive management, support from their banks and a focus on underlying problems will help achieve successful restructuring

Business decisions need to be more objective and should focus on identifying underlying problems in a business in order to resolve those issues. It is likely that some workforce reduction would normally result. Any new strategies should have clear implementation plans with decision gateways and monitoring systems, which are for the benefit of the company. Some owners need to understand that their short term need for cash may not be a determinant of how cash is used, especially if cash from core businesses is used to keep pet projects alive.

Good managers will make tough decisions resolutely

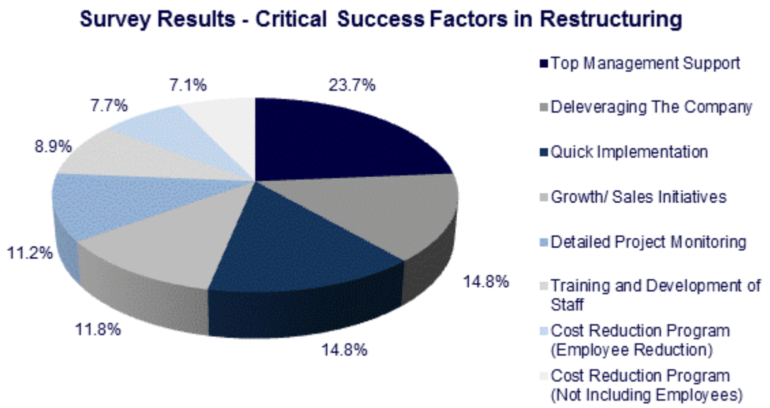
Good managers and owners will make tough decisions. These may include the above stated sale of assets, equity dilution or replacement of senior management. Decisions need to be made for the long term viability of the core business, even if that is to the detriment of cash starved promising new ventures. Some poor decisions may have been made in the past and these have to be unwound, which may require changes in management. There is a fine balance as some managers have been with companies for a very long period showing their loyalty to the company and owners. Only owners can make decisions on these types of people, but objectively the business must come first if it is to survive.

Changes must be communicated to all stakeholders with high level support

Restructuring entails some meaningful changes. These have to be communicated across an organisation. Not only do owners and senior managers have to be on the same page, others in the company need to understand what is going to happen and they need to see sponsorship from the highest levels. This will help all the employees to embrace change.

We talk about the legal framework in the next section, but many respondents have cited the lack of a clear and timely workout process through the legal system. Some form of bankruptcy law is called for.

The results from the survey seem to agree with many of the interview respondents' sentiments. Nearly a quarter of all respondents cited top management support as key to any successful restructuring. Interestingly few pointed to cost reduction programs or employee training as being very important.



Source: Isthmus Partners

7. Legal Framework

Obviously Lawyers spent most of their interview time discussing this section and their suggestions can be categorised into four main topics: a bankruptcy law, post-dated cheques (PDCs), the court system, and transparency. Overall Lawyers maintain that the UAE's system is the best in the region, but some state that due to lack of clarity and transparency and little consultation, the legal framework is improvable. Others indicate that the law has received some bad press, and though it lacks certain detail, it is better than perceived.

There are some provisions in current UAE law that can be used during restructuring

The country does have some provisions for insolvency, specifically there are sections written in the Commercial Code and Companies Code that enable companies to work through issues and even have a moratorium on debt, albeit with many exceptions. However, there are harsh penal elements and potential for personal liability. Though the building blocks are there, the law has not been thoroughly tested and decisions from judges with little experience in complex insolvency cases can be unpredictable. Some Lawyers state the laws have been drafted historically mainly for sole traders and are inappropriate for complex issues involving larger domestic companies, GREs or multi-nationals, or in some circumstances that now present themselves such as disputes in real estate.

A bankruptcy law is called for to help restructuring and orderly liquidations that address the numerous issues the market currently has to deal with

In unison all groups call for a more comprehensive bankruptcy law that will enable companies to go through a workout, or through an orderly liquidation. The list of limitations of current insolvency provisions that needs to be address is fairly lengthy, some of which are as follows:

- **Unavailable principals.** If an individual is running a business that has debts it is unable to pay, it is likely that individual will leave the country rather than face imprisonment. The individual then has very little incentive to return to the UAE. This is particularly true in real estate, where developers have left the country. The converse is also true where an apartment or villa buyer has left the country and is unlikely to pay their final instalments for the unit.
- **Enforcement.** It is difficult to enforce claims against a party, especially if it is a small claim, or a claim against a large entity. This not only applies to debt, but also payments to suppliers.
- **Reasonable penal system.** If a business fails, it is unfortunate, but as long as there is no fraud carried out, it should not criminalise business people, who have used their best efforts to ensure a business is successful. Any equity partner or debt provider is in the business of receiving profit or interest in compensation for risk that is taken. If the risk becomes unfruitful, that individual or organisation should bear losses.
- **Moratoriums on debt.** During a restructuring process, companies need time to correct issues within the business. Debt is sometimes so burdensome that managers are unable to focus on a restructuring plan, which does not help the company or debt providers.

- **Expediency.** The current system is thought to be too slow and a more efficient means to get to a resolution is required. This is particularly true in cases where one individual in the dispute is imprisoned until a resolution is achieved, while the other is not. The free individual is likely to ask for continuations as a bargaining tool.
- **Liquidation.** Companies need a rule book for orderly liquidations of assets, with an understanding of how different creditors are ranked.
- **Differentiation on size.** Due to some cases being more complex than other, which has some correlation to the size of the entities involved, new ventures, individuals and small companies should go through a different process, which may be quicker and simpler.
- **Federal law.** A single law that can be used throughout the UAE would be preferable to the myriad of codes within the free zones, different emirates and at federal level.
- **Better training.** Developers particularly stress there is a need for better training of front office staff, such as in the Land Department, as it is oftentimes difficult to ascertain the exact process in advance they have to follow during a dispute.

PDCs can be counterproductive if principals flee the country

As mentioned previously, Bankers believe that PDCs are a necessary mechanism to ensure payment. However, Lawyers note cases where individuals have left the country due to PDCs and would like to return to resolve issues, but only if the threat of imprisonment is removed. Banks have proved obstinate on this subject; therefore the individuals have not returned to try to resolve issues, and banks have not been paid back. Without a demonstrable case of fraud, most respondents believe PDCs are counterproductive. Lawyers add that any new bankruptcy law would be less effective if PDCs are not decriminalised, as banks would prefer to use the criminal system over any new civil law.

Greater experience is required in the court system

Lawyers state greater experience is needed within the court system, as both judges and advocates struggle to cope with modern, complex issues raised in restructuring. As much of the required law is not codified, a substantial amount is left to judges' subjective decisions, which are not always borne out of years of experience in conducting such cases.

Some public information is kept private, which hinders discovery

Transparency is an issue in a number of ways. Firstly, there is a lot of public information, which is kept private. For instance, lawyers are not able to go to the Land Department and find out who owns certain land or property, which does not allow lawyers to carry out a complete conveyance exercise. Another case of public information being private relates to physical company addresses. If a court awards a claim against a company, and only the post office box is known, it is impossible to enforce. Free zones will not provide information on their tenants.

Secondly, Lawyers would like to see greater consultation on new laws that will help them understand which laws may be implemented in the future, so they can prepare for them, and help the drafting process to ensure more detail is provided in codification, particularly if a law will be applied retrospectively.

Lawyers would like to see greater consultation on new laws

Boards and director accountability needs clarification

The law is still emerging and much is yet to be written

Finally, Lawyers would like to see clarification over the duties of directors. Boards should be more involved in disputes, as witnesses in cases are usually low level employees. Boards and directors should have more accountability.

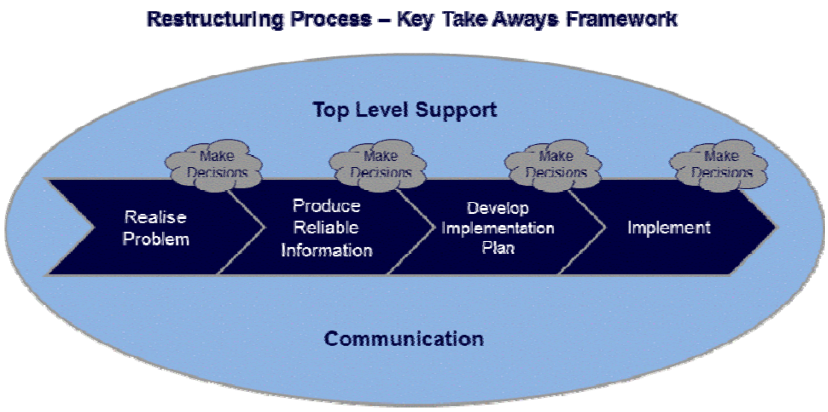
Apart from restructuring issues, Lawyers have cited the need for a more uniform system. With so many free zones, and differences in federal and Emirate laws, it is challenging for them to advise their clients.

Other groups have echoed various points made by Lawyers and Investors would like to see better rights for minority shareholders. Many Developers and Company Leadership are frustrated by the lack of clarity, stating that it is difficult to either understand what processes should be followed or have an idea of what outcome the legal system would bring. Oftentimes, Lawyers indicate clients are excited about press releases on new laws that have not yet been promulgated. Investors state they would find it difficult to invest in opportunities that may require future legal action due to the lack of clarity over the legal environment.

8. Conclusions

Respondents have cited issue recognition, decision making, top level sponsorship, and communication as key attributes in a successful restructuring process

Recommendations that respondents proposed classically fit into a general framework for successful restructuring, where companies need to accept the business has issues, develop the right information internally to understand the current position, develop plans to resolve identified issues and then carry out those plans. It is very difficult to move forward in a restructuring process without making decisions, some mundane and a few tough, otherwise the whole process will grind to a halt. Top management and owners must be seen to support the restructuring process to give it legitimacy. That support along with progress reports, and key decisions should be communicated to all stakeholders, who will all be needed at various points to ensure success.



Source: Isthmus Partners

Catalysts must be found to push for the recognition of problems

We have seen that companies find it difficult to realise a problem for various reasons: the negative stigma associated with restructuring, banks not willing to help, lack of knowledge, over confidence, etc. Companies need to find ways to overcome this. Some help may ensue after macro events, e.g. banks being forced to recognise their NPLs, or fewer customers buying a company's product or service, and some will have to transpire through the forethought and drive of owners and managers. Whatever the catalyst, there must be recognition before the process can start and the longer the delay, the less likely restructuring will be a viable option, and the less value that will remain in the company.

Restructuring must be based on a solid baseline with robust financial and performance information

Once a company recognises the need for change, the company needs to baseline its current performance. Some companies have good information, but it seems that many do not, even if financials are audited. If external help is required, companies should obtain such services, but they need to ensure they understand the objective of hiring external help before engaging them. Companies have to be aware that this can be a lengthy process, especially if the financial information is not well stored.

Implementation plans should concentrate on cash and deleveraging, core business and the right employees

Implementation plans need to look at the business, employees, processes and systems, controls, etc. A review of the current company situation should help to inform the restructuring team where problems lie, but from respondents answers it seems that certain tasks need to be taken into consideration: focus on cash and deleveraging, putting the right people in the right jobs, focus on the core business, some downsizing, etc. Deleveraging is complicated by the fact that banks must do more than simply extend loans. Some write downs may be necessary. On the other hand, owners must look at introducing new equity, which may dilute their holding, or selling down non-core assets to raise capital.

Decisions will be required throughout the restructuring process

Finally, plans must be implemented. There are cases, which Consultants have cited, where reports are written, and plans are drawn up only for owners not to be available to make decisions on whether to move forward. Implementation normally consists of a number of phases; therefore owners will need to be involved throughout the process to keep abreast of progress and make further decisions.

Bankruptcy Law

A new bankruptcy law is in draft and when enacted, will help resolve a number of issues currently faced during restructuring

There has been some progress made in the provision of an insolvency law, with a draft law ready for review at a federal level. Legal firm Herbert Smith recently released an update indicating that the law will address some of the issues brought up in this report including:

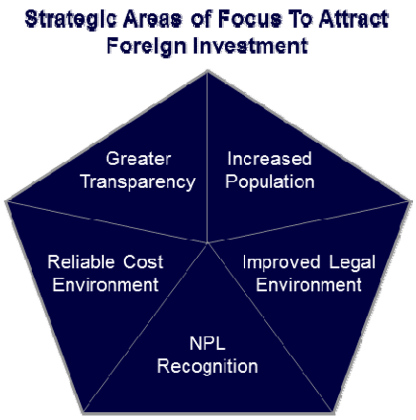
- Avoidance of pre-bankruptcy transactions
- Personal liability or disqualification for negligent or reckless directors and managers
- Fast track/simplified procedures for smaller cases
- The possibility of "pre-pack" sales of businesses as going concerns, in appropriate cases
- Special exemptions where creditors are holding financial collateral (e.g. security over cash deposits or listed securities)
- The possibility of dividing creditors into classes for the purpose of achieving a composition (although it is not currently clear whether "out of the money" creditors groups can be bound into a composition plan without their consent)
- The establishment of a roll (or panel) of expert bankruptcy practitioners (Bankruptcy Expert Roll) to administer and advise on cases
- The ability of the government treasury to fund cases where the assets of the debtor appear insufficient to cover the costs of the insolvency process

However, other issues such as the criminal nature of PDCs and how to deal with unavailable principals will need to be addressed.

Attracting Investment

Investors are available to invest even in the most challenging asset classes

There are certainly investors out there. Even in difficult asset classes, investors are ready to inject fresh capital and in order for some industries to improve, particularly real estate, foreign investment is required. Most respondents indicated that in the UAE a few key changes at the macro level could help to attract more foreign investment and expertise.



Source: Isthmus Partners

Investors would like to see a clearer legal system

First, better transparency and a clearer legal system. Investors are looking for more information about the country in order to better test their assumptions. Nearly all respondents say the country needs a federal bankruptcy law. It is uncertain what model that law will take, but a detailed rulebook is required, and more importantly implemented with an even hand.

Costs need to become more predictable

Business feasibility studies would be helped if costs, at least for public services or regulatory requirements, were more predictable. Currently, models have to include large buffers to cope with costs that may appear through new laws that are implemented retrospectively.

A larger population would create demand

The population is small and many investors are investing with a view to expand into other countries in the region. If the UAE were to attract a greater population, this would help the country with new demand and soak up some real estate supply.

Banks need to recognise NPLs

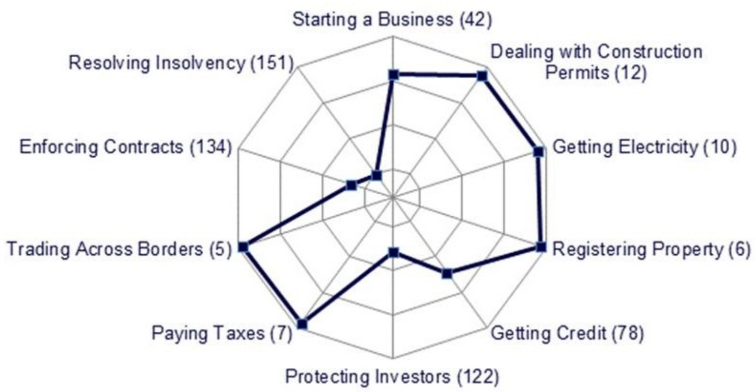
Finally, banks must be forced to recognise NPLs. Japan's lost decade was in part due to capital in the system not being released, as banks were reluctant to recognise bad debt, which limited the amount of new credit they could provide. In the UAE, as banks extend tenors of loans to companies that are unlikely to ever pay back in full, companies continue to survive, but in doing so tie up bank capital and create issues in the value chain where suppliers remain unpaid.

Doing Business Report

The World Bank and IFC's Doing Business report concurs with many of our findings

The Doing Business reports by the World Bank and the IFC compare the regulatory environment for local entrepreneurs to open and run small to medium-sized businesses across 183 countries. The ranking by topics of the "Doing Business 2012" report UAE supports our conclusions. These ranking are summarised in the spider chart below.

Doing Business Ranking (Out of 183)



Note: the objective of the spider chart is to increase its area

Source: Doing Business 2012, The World Bank, IFC; Isthmus Partners Graph

The UAE's overall ranking for ease of doing business is 33. While the UAE has relatively very strong rankings for trading, property registration, tax environment, supply of electricity and starting a business, it has relatively weak rankings in investor protection, contract enforcement and insolvency resolution.

A stronger insolvency regime together with an improved court system would increase the UAE's competitiveness and make it an even more attractive investment destination.

Final Thoughts

Though this reports points out a number of issues that respondents raised during our interviews, we found that many respondents remained positive about the medium term economic outlook and pointed to UAE's advanced legal system and business environment compared to the region.

Overall the UAE has a positive economic outlook, and many of the issues our respondents have brought up are being addressed

As illustrated by the World Bank/ IFC report, many processes from registering property to starting a business and the ability to use the country as a hub from which to trade are powerful enticements to set up and operate a business. The no tax environment is an additional boon. Of the issues our respondents have pointed out, many are being addressed by the authorities, and we can already see certain industries performing better.

About Isthmus Partners

Isthmus Partners is a UAE based boutique that offers management consultancy advice in the corporate mid-cap and real estate sectors. It is owned by two partners with a wealth of principal finance and consulting experience from 25+ years in investment banking and management consulting. In the mid-cap sector, Isthmus Partners advises its clients' management on financial strategy, business development, restructuring and growth. The partners have worked on a number of new venture proposals. Isthmus Partners also works with a number of institutional funds to provide consulting advice on their portfolio or target companies.

In the real estate sector, Isthmus Partners advises management on the financial strategy of real estate developments, from feasibility studies to late stage projects. The partners have worked on restructuring real estate developments.

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

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

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