JANUARY 2012

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GCC Financial Market Quarterly

Pockets of strength emerge

The final three months of 2011 delivered another period of uneven progress in the GCC financial markets. The areas of greatest strength are increasingly evident in the fairly consistent momentum of bank credit in much of region as well as in the strength of the sukuk market. In other areas, however, the picture tends to be one of considerable volatility and continued vulnerability to persistent global economic uncertainty.

- **Increasingly consistent momentum in bank credit**. The regional dichotomy in bank credit persists, although Bahrain in the second half of 2011 joined Qatar, Saudi Arabia, and Oman in the group of countries where annual rate of loan growth has reached the double digits. The general health of the regional banks is likely to underpin continued positive momentum, although regulatory, political, and/or market challenges continue to limit near-term progress in the UAE and Kuwait.

- **IPOs remain the weak link.** The Saudi market has reasserted its position as the strongest regional market thanks to a fairly steady flow of listings as well as a growing number of follow-up issuances. In general, however, IPO activity in 2011 was sharply below the already depressed levels recorded in 2009-2010. Secondary markets remain vulnerable to external uncertainty and will likely make for a challenging environment for IPOs.

- **From bonds to sukuk.** The GCC conventional bond market experienced a pronounced rebound in the closing quarter of the year. Nonetheless, the structural growth drivers for sukuk now appear far stronger and, likely, durable. A number of blue chip names are actively considering issuance and plans by the Saudi government to enter the project finance field are understood to be well advanced. Some companies are even refinancing conventional debt through sukuk.

- **Government spending the most compelling alternative.** Alternative sources of funding remain under varying degrees of pressure with the exception of government spending which will continue to underpin key areas of economic activity also going forward. Syndicated loans are faced with increasingly structural challenges due to the ongoing retreat of many European banks from the market. Private equity activity is minimal and foreign direct investment will struggle to rebound significantly in the face of global uncertainty even if the regional growth prospects are benign.

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Bank credit: A more positive picture emerges

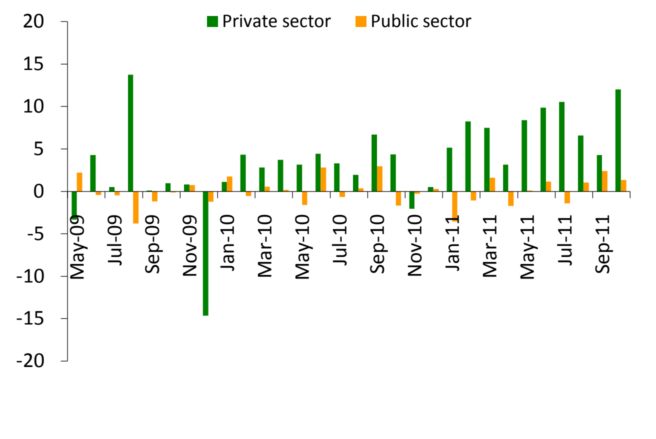
Bank credit in the GCC region has generally continued its cautious, albeit fairly consistent recovery. The strong performance of the regional economies, along with the generally robust health of the banking sector, has tended to support confidence and lending activity. By contrast, the highly uncertain global economic backdrop, along with regional pressures points, has checked the positive momentum. Although the positive trend is now in evidence virtually across the region, the pace of progress still varies a great deal with a robust recovery underway in Qatar, Oman, Saudi Arabia, and of late also Bahrain. The situation is far more subdued in Kuwait and the UAE.

Saudi Arabia: A recovery gathers momentum

Bank lending in Saudi Arabia attained a total of SAR891.6bn in November, up 15.1% on November 2010. Average lending during the three months to November was 10.9% higher than a year earlier. Continuing a pattern established during much of the past year, the positive momentum has been led by credit to the private sector. Private sector loans reached the level of SAR859.7bn in November, up 15.8% YoY. Lending to the public sector stood at SAR31.9bn, down 0.3% on November 2010.

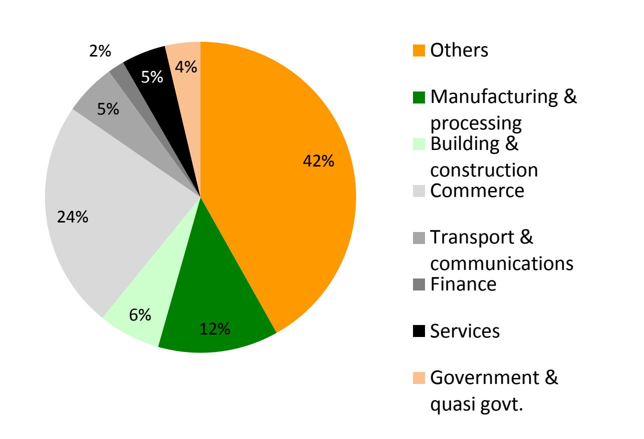
The increase in lending is reflective of the strong performance of the economy in 2011 with economic growth reaching 6.8%. A strong performance in the hydrocarbons sector was underpinned by resilient prices and increased production levels, partly in response to the production disruptions in Libya. Well-capitalized Saudi banks are generally well positioned to boost lending.

Saudi Arabia bank credit, monthly changes (SAR bn)



Source: SAMA

Sectoral breakdown of Saudi bank credit, 3Q11



Source: SAMA

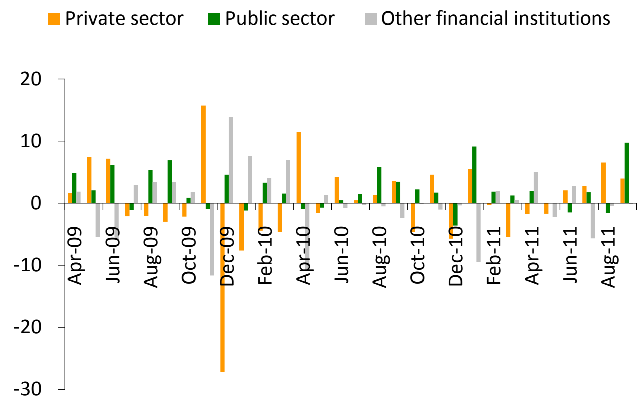
The UAE: Continued weakness

The progress of bank lending in the UAE has remained fairly subdued in spite of a clear rebound in economic activity. Overall bank credit in September 2011 reached AED998.4bn, just under 2.0% up on AED979.2bn a year earlier. The average figure for Q3 was up 1.4% YoY.

Bank credit to the private sector has remained fairly flat with a much more positive momentum observed in lending to the government. Lending to the private sector was AED732.2bn in September, which represented a modest 0.8% YoY increase. Lending to the public sector advanced by 13.2% to AED196.5bn.

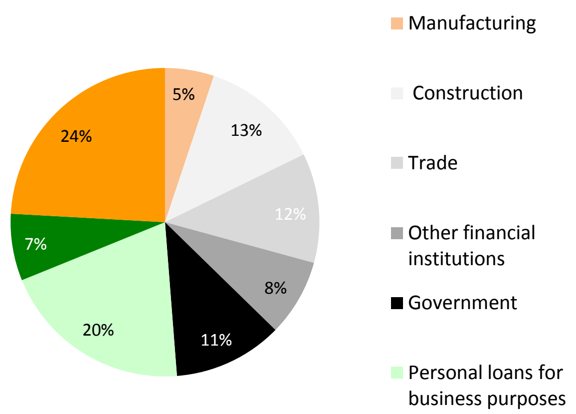
UAE bank credit has been depressed by a combination of localized economic weakness and regulatory challenges. The stricter new rules on bank credit have curbed the momentum in some areas. Lending has been further hit by the depressed property markets which continue to be marked by excess supply in many parts of the country. Also the broader financial sector in the UAE has been more sensitive to external shocks due to recurrent concern about leverage and potential refinancing challenges.

UAE bank credit, monthly changes (AED bn)



Source: Central Bank of the UAE

Sectoral breakdown of UAE bank credit, 3Q11

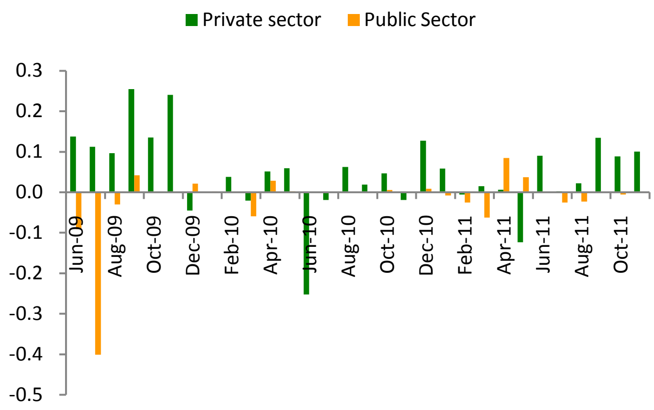


Source: Central Bank of the UAE

Kuwait: Minimal progress

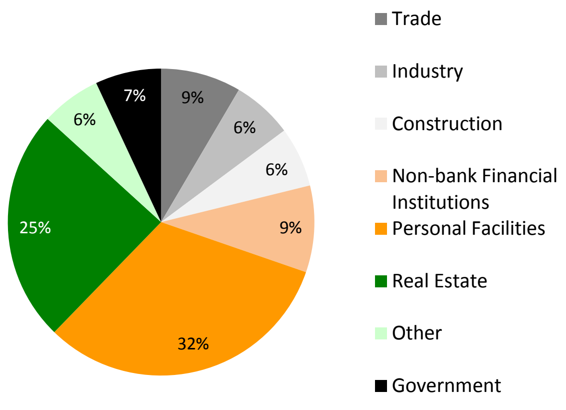
The progress of bank lending in Kuwait has remained very modest by regional standards. Total bank credit in November 2011 reached KWD27.4bn, up 1.9% on KWD27.0bn a year earlier. The three-month average to November was up 1.5% YoY. Private sector credit attained a total of KWD25.6bn in November. This marked a 2.1% YoY increase. Lending to the public sector stood at KWD1.9bn in November, a 0.9% drop on a year earlier. This reflects the persistent delayed in the implementation of development projects in the past year

Kuwait bank credit, monthly changes (KWD bn)



Source: Central Bank of Kuwait

Sectoral breakdown of Kuwaiti bank credit, 3Q11

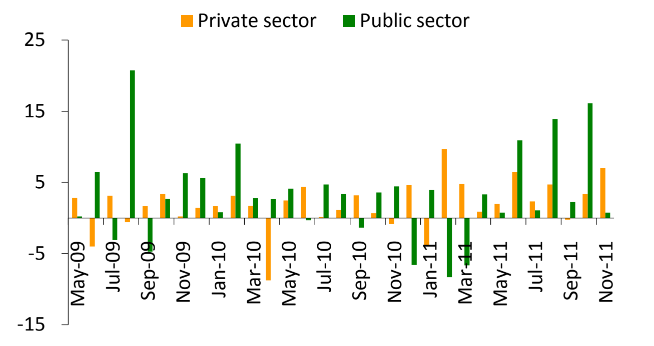


Source: Central Bank of Kuwait

Qatar: Leading the way

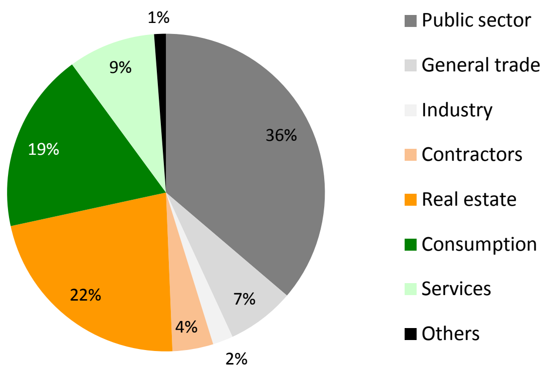
Gas-rich Qatar remains very clearly the regional leader in terms of bank lending growth. Overall bank credit rose by an annual 23.5% to a total of QAR368.9bn in November 2011. The average rate of increase in the three months to November was 22.26%. Private sector credit growth in November reached an annual 22.3%, taking the total figure to QAR227,85bn. Public sector credit, by contrast, rose by a remarkable 28.6% YoY to QAR141.0bn. This highlights the important role of the national banking sector in funding public sector projects and other activities which account for 38.2% of overall bank credit. Also private sector credit has responded well to Central Bank efforts to boost lending.

Qatar bank credit, monthly changes (QAR bn)



Source: Qatar Central Bank

Sectoral breakdown of Qatari bank credit, 3Q11

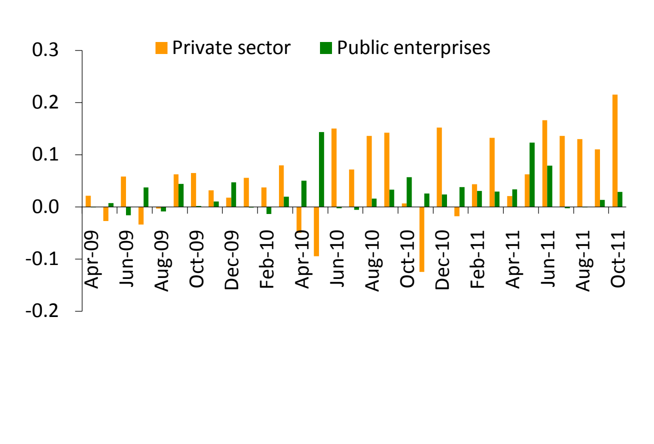


Source: Qatar Central Bank

Oman: A public sector-led boom

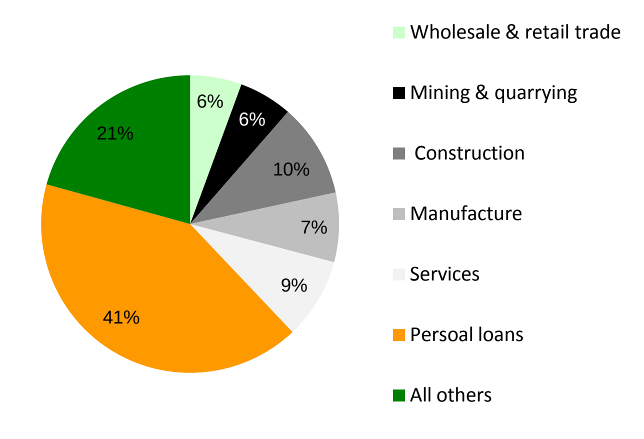
Bank credit in the Sultanate has continued its robust expansion led above all by the private sector. Overall bank credit in October stood at OMR11.8bn, some 13.4% above the level recorded in October 2010. The figure for the three months to October was up 12.9% YoY. Credit to the private sector attained a total of OMR10.6% in October, up 10.8% YoY. Credit to the government and public enterprises rose by a remarkable 41.8% to OMR1.3bn.

Oman bank credit, monthly changes (OMR bn)



Source: Central Bank of Oman

Sectoral breakdown of Omani bank credit, 3Q11

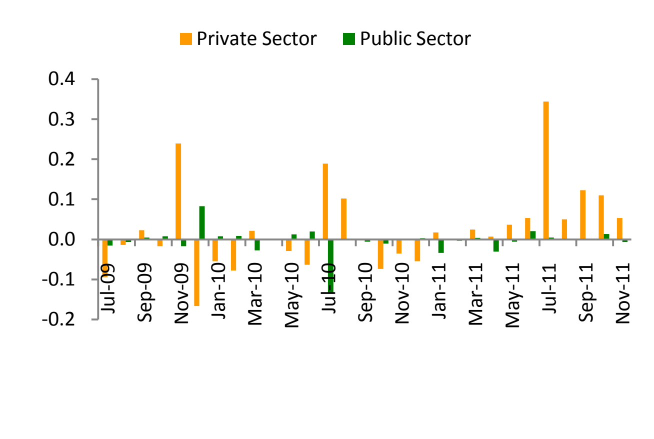


Source: Central Bank of Oman

Bahrain: A pronounced turnaround continues

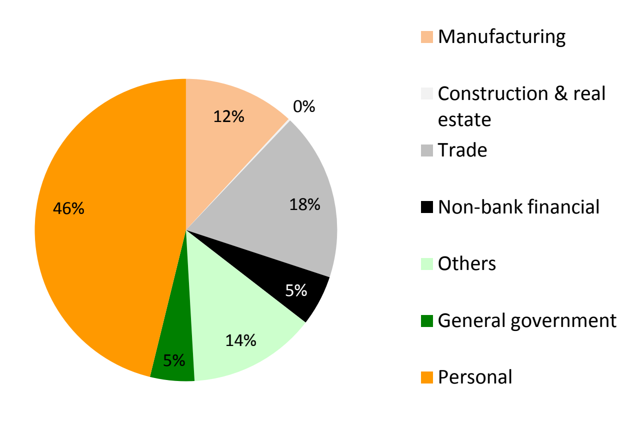
Following a period of political instability in the spring, Bahrain has witnessed a pronounced recovery in bank credit. Total bank loans reached BHD6.5bn in November, 12.7% up on BHD5.7bn a year earlier. This rebound makes the Kingdom one of the strongest markets in the region in terms of loan growth. The annual growth for the three-month period up to November was 10.4%. Credit to the private sector reached a total of BHD6.2bn in November, up 13.9% YoY. By contrast, public sector credit declined by an annual 14.3% to just over BHD0.2bn.

Bahrain bank credit, monthly changes (BHD bn)



Source: Central Bank of Bahrain

Sectoral breakdown of Bahraini bank credit 3Q11



Source: Central Bank of Bahrain

Equity markets: An elusive revival

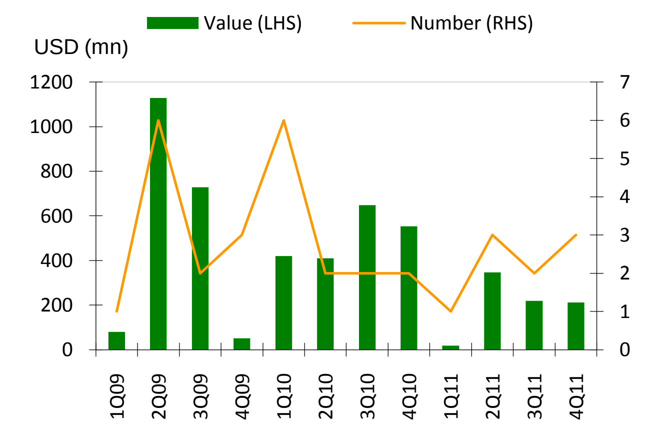
The closing three months of 2011 concluded a lackluster year for the GCC equity markets. Q4 saw a total of three GCC listings with an aggregate value of USD212.2mn. It was the best quarter of the year in terms of the number of issuances and second best in terms of issuance value. It marked a small decline on Q3 during which total issuance had fallen to USD218.9mn raise through two IPOs.

The quarter opened with the USD63.0bn offering of Oman's SMN Power Holding which had been launched already in September. Saudi Arabia saw two listings. The Enaya Cooperative Insurance Company has a total capital of SAR400mn, which 40%, the equivalent of USD42.7mn, was listed. Enaya is a new company which will focus its activities primarily on health insurance with an ambition to become a leading regional player. The company has been set up in consultant with the German reinsurer Munich Re. Enaya was the 32nd insurance company to list on Tadawul.

The Saudi United Electronics Company eXtra was a welcome example of a private sector success story. Originally established in Riyadh in 2003 with a total capital of SAR500,000, eXtra was transformed into a joint-stock company with a capital of SAR100mn in 2010. The capital was increased to SAR240mn by the end of the year. eXtra sell products of more than 12,000 brands. The IPO totaled SAR396mn (USD105.6mn) and involved the floating of 30% of the company's shares. It was 2.15 times oversubscribed.

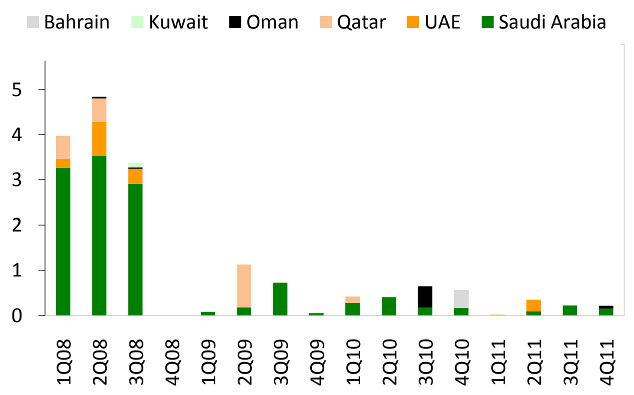
Q4 saw also two listed companies in Saudi Arabia turn to the market for additional capital. Alahli Takaful Co issued 6,666,667 new shares at SAR12 each to take the total to 16,666,667. Sahara Petrochemicals Co offered 146,265,000 new shares at SAR10 each in November. The company's capital rose from SAR2.9bn to SAR4.4bn. Sahara further secured a SAR1bn bank loan for its expansion plans.

GCC IPO activity



Source: Zawya

Geographic distribution of IPOs



Source: : Zawya

A year in review

The regional equity markets have been a relative weak link for the GCC capital markets throughout the year. The backdrop of global uncertainty, most notably the mounting Euro-zone crisis, meant that 2011 fell far short of the performance experienced in 2010. Whereas a 2010 saw a total of 12 IPO's with an aggregate value of USD2.2bn, the number of new listings fell to 9 in 2011. Their aggregate value fell by 60.8% from USD2.0bn to less than USD0.8bn, Saudi Arabia remained the leading regional market with a total of five IPOs with an aggregate value just short of SAR1.7bn (just under USD0.5bn). There were a total of three UAE listings with an aggregate value of USD271.3mn. Oman had one listing worth USD63.9mn. The largest 2011 IPO was the listing of Eshraq Properties in the UAE – a total value of USD229.1mn.

A more encouraging development was the decision by a number of Saudi companies to turn to the market for additional capital through public rights issues. Examples included the Jabal Omar Development Co, The Saudi Fisheries Co, Alahli Takaful Co, and Sahara Petrochemical Co.

The regional IPOs were generally successful with sometimes significant oversubscriptions. Inthe case of the UAE's National Takaful Co order reached seven times the floated shares. Also the Saudi Integrated Telecom Co was almost three times oversubscribed. The Saudi companies have been clearly the best performers in the secondary market, led by Saudi Integrated Telecom Co's 72% gain by the end of the year. Hail Cement gained just under 60% and eXtra just under 50%. All the UAE listings she value, led by National Takaful Co's 38% loss.

The performance of the 2011 IPOs since listing until the end of the year

Country	Issuer	Subscription Period	Size Offering USD M	Equity Offered	Over-Subscription	Price Change Since IPO
Saudi Arabia	Saudi Enaya Cooperative Company	19Dec11-25Dec11	42.66	40%		
Saudi Arabia	United Electronic Company	05Dec11-to11Dec11	105.59	30%	2.15x	+47.73%
Saudi Arabia	Hail Cement Company	20Sep11-to10Oct11	130.51	50%	1.30x	+58.50%
Saudi Arabia	United Wire Factories Company	01Aug11-to 07 Aug11	88.39	30%		+28.53%
Saudi Arabia	Saudi Integrated Telecom Company	02 May11-to 08 May11	93.33	35%	2.94x	+72%
Oman	SMN Power Holding	11Sep11-to 10 Oct11	63.88	35%	1.70x	
UAE	Eshraq Properties Company	01May11-to 11 May11	229.09	55%		-12%
UAE	National Takaful Company	18 Apr11-to 01May11	23.58	55%	7.00x	-38.10%
UAE	Insurance House	27 Feb11-to 09Mar 11	18.60	55%	1.00x	-13.04%

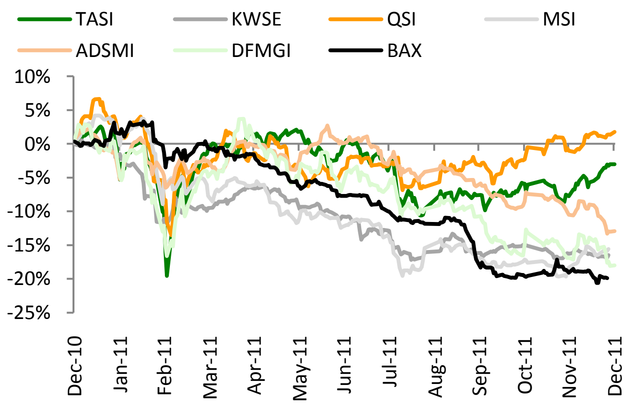
Source: Regional exchanges, Zawya

A broader market recovery gets underway

The regional secondary markets went through a rollercoaster ride during an eventful year. The spring saw sharp but temporary correction while much of the second half of the year was marked by a fairly steady downward pressure against the backdrop of the European crisis. The UAE and Qatar markets failed to receive an eagerly awaited fillip as the MSCI review declined to upgrade them to from frontier to emerging markets.

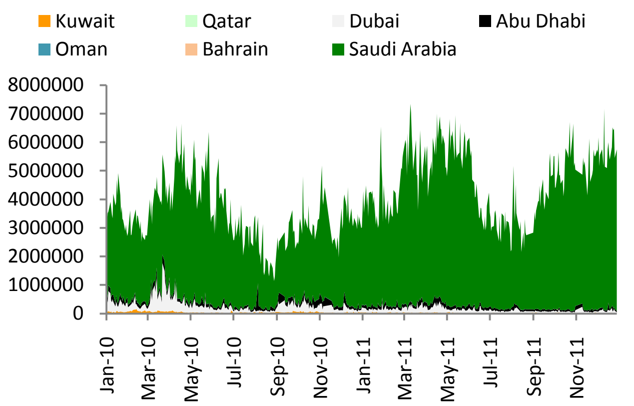
Nonetheless, the performance of the regional indices became increasingly differentiated in the closing months of the year. Qatar Exchange broke back into positive territory, ending with a 1.1% gain for the year while also Saudi Arabia's Tadawul regained most of the lost ground. It ultimately ended the year only 3.1% down, having gained 5.0% during Q4. The Bahrain market was the worst performer with a 20.4% loss during the year. The Dubai market shed 17.0%, Kuwait 16.4%, Oman 15.7%, and Abu Dhabi 11.7%. Trading volumes, by contrast, recovered fairly strongly during the closing months of the year.

The performance of the GCC benchmark indices



Source: Bloomberg, regional exchanges

Market turnover (USD '000)



Source: Bloomberg, regional exchanges

The pipeline still solid

The new year has seen its first new public offering in Saudi Arabia where the Takween Advanced Industries Co launched a 9mn share offering at SAR26 each in January. Etihad Atheeb Telecommuncation Co is due to launch a 117.5mn follow-up offering in February.

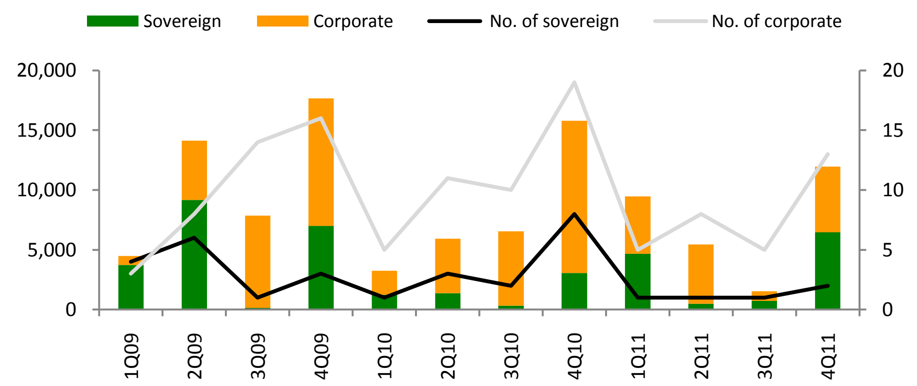
Saudia Catering is expected to float 30% of its equity capital. The company is currently 51% owned by Saudi Arabian Airlines and the planned IPO is part of the company's restructuring. National Air Services, the operator of Nas Airlines, is planning to raise SAR2.3bn through a 30% IPO.

The Omani Capital Market Authority has authorized a 25% IPO by Oman Arab Bank, although the law normally mandates a 40% free float. The Omani government is considering a plan to reduce the free float requirement to 25% as a way of encouraging more family-owned businesses to list.

Bonds: An end-of-year spurt

After an exceptionally subdued Q3, the closing three months of the year saw a clear revival in the GCC conventional bond markets, making this the best quarter of 2011 in terms of overall issuance volumes. There were a total of 14 issuances of more than a year during the quarter with a total value of USD11.9bn, up sharply on USD0.9bn in Q3 and in fact the best quarter of the year as a whole, clearly ahead of the USD9.5bn total seen in Q1. The positive momentum thus completed a rollercoaster year of exceptional volatility in a way that marked relative normalization but a revival whose sustainability still remain in question.

GCC conventional bond issuance (USD mn)



Source: Zawya, Bloomberg

Corporate issuance

In spite of some continued delays in planned issuances, some of the Abu Dhabi heavyweights returned to the bond market this quarter. The International Petroleum Investment Co placed USD 3.75 bn in three tranches at the end of October. The USD 1.5 bn 5-year tranche was priced at 3.74%, a comparable 10-year tranche at 5.5%, and a USD750mn 30-year tranche at 6.88%. IPIC's near-term spending plans include some USD6.5bn on two refineries to be built in the UAE and Oman. A USD3.5bn 200,000 bpd facility is being planned in Fujairah on the Indian Ocean Coast. A USD6bn, 230,000 mbd facility based in Duqm, Oman is also under consideration. Oman Oil Co is expected to contribute half the funds. IPIC is also construction a USD4bn pipeline to transport 1.5 mbd from Abu Dhabi's main onshore fields to Fujairah.

The Abu Dhabi National Energy Company TAQA in December sold USD1.5bn worth of five- and ten-year bonds, in equal tranches, mainly for debt refinancing purposes. The five-year paper was priced at 330 over US Treasuries and the ten-year issue at 390 bps. TAQA has a USD0.75bn bond maturing in October 2012. TAQA's total debt before the latest issuance was USD3.5bn in bonds and USD500mn in bank credit.

Mubadala Development Company placed a USD101.8mn seven-year bond in November at a 4.15% coupon. Also Abu Dhabi's Union National Bank in November completed a USD400mn bond issue, the first one since 2005. The coupon was set at 3.875% -- 287.5 bps over the Dollar five-year mid-swaps.

Two Kuwaiti financial services providers tapped the market in December. Commercial Facilities Company of Kuwait issued a four-year KWD50mn (USD180mn) bond priced at 1.4% above the CBK Discount Rate. CFC has over the past 34 years emerged as a leading consumer financing company and is now the largest non-bank consumer lender in the country. The investment house Kuwait Financial Center Markaz closed a five-year bond issuance which was 50% oversubscribed. The KWD22mn issuance had a rating of BBB by Capital Intelligence. The issuance was sold to ultra-high net worth and institutional clients of Gulf Bank. The bonds will pay a floating 2.5% over the CBK discount rate.

Smaller placements in the financial services sector included a USD26mnmn five-year issuance by Al Omaniya in October, a total of USD185mn in two five- and six-year tranches by HSBC Bank Middle East in October and December, a seven-year USD 129.9 mn by the Bank of Bahrain and Kuwait (BBK) in November, and a two-year USD193mn issue by Emirates NBD in October.

Sovereign issuance

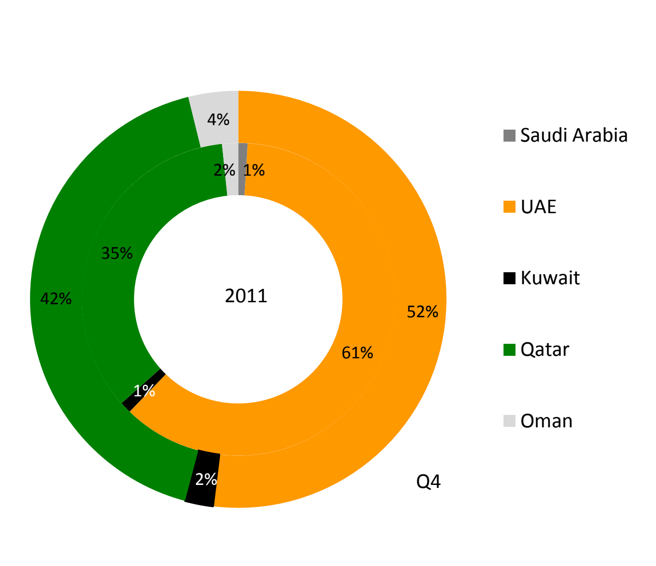
The landmark sovereign issue of the quarter – indeed of the whole year – was a USD5bn placement by the Government of Qatar via a tri-tranche conventional Euro-bond in November. The issuance was broken into tenors of five, ten, and 30 years with yields of 3.12%, 4.5%, and 5.75%, respectively. Highlighting Qatar's attractiveness, the issue was heavily oversubscribed with investor demand totaling USD9.5bn. Qatar has an AA rating from S&P and Aa2 from Moody's. Qatar last made a global issue in November 2009 – USD7bn. The Qatar bond is thought to be used in large part to finance the USD10.3bn Barzan gas field project. Total infrastructure spending over the coming five years is estimated by the government at USD150bn. The oil and gas services company Polarcus sold a Norwegian krone-denominated NOK230mn (USD42.5mn) two-year bond in November.

Oman in December sold its 39th development bond with a coupon of 3.25%. The OMR150mn (USD389.6mn) five-year issue attracted subscriptions of OMR189.1mn.

Both the Central Bank of Kuwait and the Central Bank of Bahrain came to the market for short-term issues of up to a year, primarily for liquidity management purposes. The CBK issued KWD215mn in three-month bills, KWD498.8mn in five three month CBK bond issuances, and a KWD99.4mn six-month issue. A total of KWD260mn was sold in three one-year Treasury bond issues. The CBB in December sold USD265.3mn worth of one-year paper.

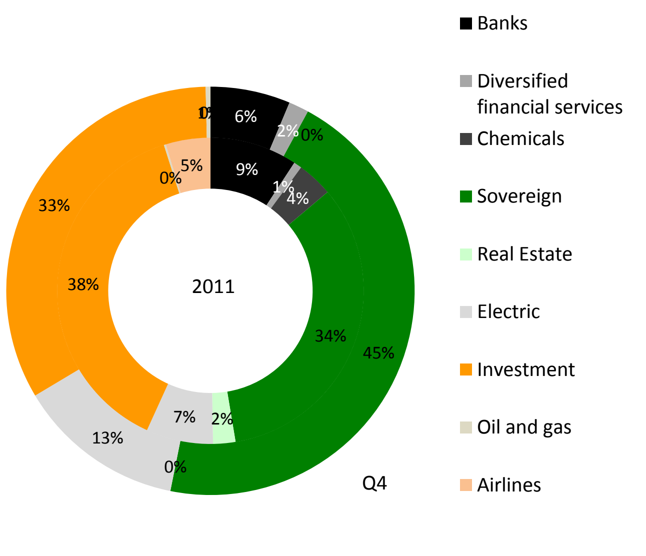
Another new market entrant, Qatar Central Bank currently issues T-bills with maturities of 3-9 months at the rate of QAR2bn (USD550mn) a month. Issuance began in May.

Geographic breakdown of GCC bonds, Q4 and 2011



Source: Zawya, Bloomberg

Sectoral breakdown of GCC bonds, Q4 and 2011



Source: Bloomberg

A year in review

2011 proved a much more uneven year for GCC conventional bonds than 2010, although the overall issuance activity remained remarkably constant. 2011 saw a total of USD USD28.4bn worth of issues with tenors in excess of one year. This was only marginally down on the total of USD USD31.5bn in 2010. The overall number of issuances fell from 59 to 36.

Corporate issuance has remained dominant in recent years. 2010 saw a total of 45 corporate issuances with maturities in excess of a year while there were eight sovereign issues. The aggregate value of the corporate bonds reached USD25.5bn while the sovereign paper totaled USD5.9bn. The number of corporate issuances fell to 31, worth a total of USD16.1bn. There were five sovereign issuances with an aggregate value of USD12.33bn

An ambitious pipeline for tough times

With the global economic situation remaining unusually risky, the outlook for bonds is uneven, potentially promising more of the kind of volatility that has characterized much of the past year. Probably the biggest single stress point for the region remains the position of the Dubai government and related entities, which have consistently had the highest credit default swap rates in the GCC.

Overall, the GCC countries have major redemptions pending in the coming year. The total volume bonds and sukuk maturing in 2012 is estimated by Standard & Poor's at USD25bn while the corresponding figure for 2013 is USD35bn. Among the largest near-term obligations of 'Dubai Inc.,' Jebel Ali Free Zone must redeem an AED7.5bn (USD2bn) sukuk in November. Dubai Holding Commercial Operations Group has a USD500mn bond due in February, while DIFC Investments must repay USD1.25bn on a bond in June. Dubai Holding and Drydocks World are currently in talks with creditors. Some have suggested that Dubai could use its sovereign wealth fund Investment Corporation of Dubai to make payments in the event of particular issuers encountering difficulties. ICD recently raised more than USD1.5bn from bilateral loans.

Fitch Ratings warned in December of new vulnerabilities for UAE banks due the uncertain global backdrop and reduced project spending in Abu Dhabi. UAE banks have an estimated total of USD3.5bn of bonds and sukuk due this year. The current market conditions may prompt them to refinance the bulk of this. UAE banks raised a total of USD2.3bn through bonds in 2011. The current pricing of publicly traded bonds and sukuk is in the range of 3-4%. UAE banks are also interested in turning to the market because of their declining deposit base and a recent gap between loans and deposits. Highlighting the pressures facing the Dubai sovereigns, some high-quality corporate names are now in greater demand with for instance Emirates airline yields falling below those of Dubai.

Some restructurings are happening also elsewhere in the region. Kuwait’s Global Investment House in December reached an agreement with its bondholders to delay a KWD45mn (USD163mn) repayment from April to June having last negotiated a delay in September. Global is understood to be seeking to renegotiate a USD1.7bn restructuring agreed in 2009.

The rapidly growing Al Omaniya Financial Services is due to return to the market in March after shareholder approved a plan for a OMR 10 bn five-year convertible bond issuance targeting existing shareholders in December. Renaissance Services of Oman in November similarly indicated plans for a bond issue.

International Bank of Qatar plans to issue up to USD 750 mn of bonds in late 2012. IBQ is 30% owned by the National Bank of Kuwait.

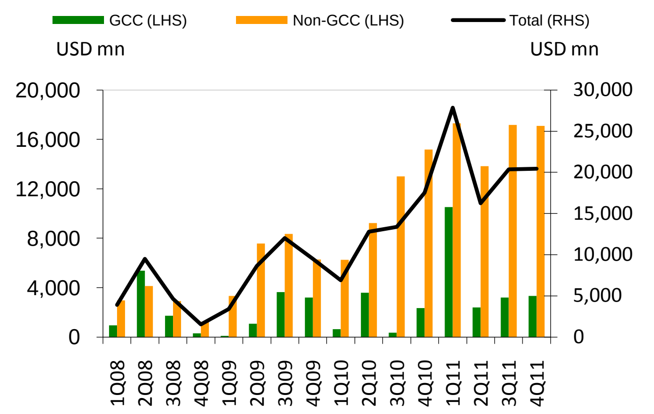
Saudi Arabian retailer Fawaz Abdulaziz Alhokair is planning to issue a bond to finance its acquisitions. In addition to the region, the company is considering the CIS and Agrica.

The sukuk rebound continues

2011 as a whole has been a landmark year for the global and regional sukuk markets. The positive trend continued throughout the closing months of the year and there are strong indications of a continued strong momentum into 2012 as sukuk are increasingly viewed as one of the main areas of resilience within the regional financial markets.

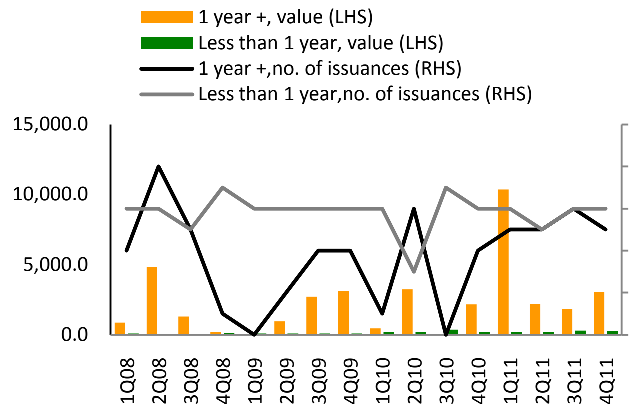
Among the key developments during the quarter globally, the Government of Indonesia issued a USD1bn seven-year sukuk in October while Bahrain placed a seven-year USD750mn issuance. Bank Negara Malaysia issued a MYR3bn (USD950mn) Government Investment issue. Also a number of leading corporate names tapped the market at a time when the global cost of sukuk fell from 5.4% in 2009 to 4.8% in 2010 and 3.9% in 2011.

A record year for global sukuk issuance



Source: Zawya, Bloomberg

GCC issuances have remained stable but strong



Source: Zawya

Corporate sukuk

The fourth quarter opened with the conclusion of a USD1.0bn project sukuk by the Saudi Aramco Total Refining and Petrochemical Co (SATORP) which will use the funds to finance its USD13bn refinery in Jubail. Highlighting the strong interest in the issuance, subscriptions totaled SAR3.7bn. The issuance was priced at the 6-month SAIBOR plus 95 bps. SATORP has to date raised total funding of USD8.5bn for its project. This is a potentially landmark development for a region with a massive pipeline of infrastructure projects and a growing desire to mobilize regional capital to drive the process.

Most of the issuance activity took place in the financial sector. Both Abu Dhabi Commercial Bank (ADCB) and Abu Dhabi Islamic Bank (ADIB) placed a USD500mn five-year sukuk each in November. The ADCB issue was priced at 4.0% (275 bps over midswaps) while the ADIB offering had a profit rate of 3.78% (a 245 bps margin). ADCB attracted subscriptions of USD1.4bn while the ADIB issuance was four times oversubscribed. Both banks raised funds in part for refinancing purposes. ADCB, interestingly, had a GBP500mn bond due in mid-

November while ADIB was looking to pay off a USD800mn five-year sukuk in December.

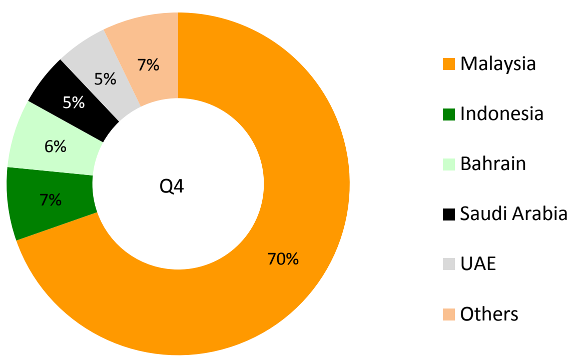
The Bahrain-domiciled but Saudi-owned Gulf International Bank raised a three-year USD300mn facility structured as *mudarabah*. The profit rate was set at the 6-month USD LIBOR+130 bps.

Sovereign sukuk

The landmark sovereign issue during the quarter was a USD750mn seven-year sukuk issued in October by the Kingdom of Bahrain. This replaced an original plan for a USD1bn conventional bond and will be used by the Central Bank to help create a yield curve. Offering a profit rate of 6.273%, the issuance attracted demand of USD1.8bn. 62% was allocated to Middle Eastern investors, 20% to Europeans, and 12% to Asians.

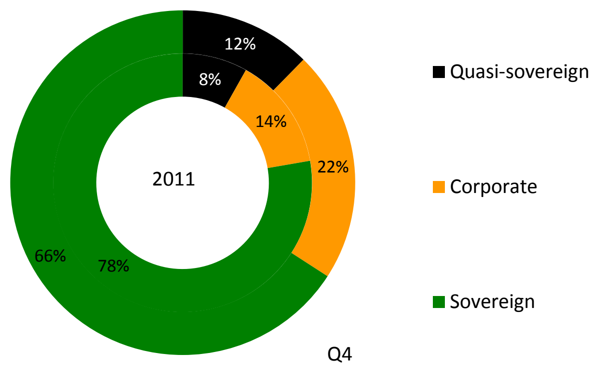
The Central Bank of Bahrain also continued its short-term issuance program with three *ijarah* and three *al salam* sukuk with a total value of USD275.5mn.

Geographic breakdown of sukuk, 2011Q4



Source: Zawya,

Sectoral breakdown of GCC and global sukuk



Source: Zawya

The year in review

The Year 2011 saw a dramatic rebound in the sukuk market, both globally and in the GCC region. Overall issuance in the Gulf nearly tripled in value from USD6.9bn in 2010 to USD19.4bn in 2011. At the same time, non-GCC issuance (including all maturities) rose from USD43.7bn to USD65.8bn. The number of issuances (including short-term paper with maturities of less than a year) rose from 33 to 44. The Government of Qatar was the leading issuer with a total of USD9.0bn worth of issuances and hence accounts for much of the increment year-to-year.

In spite of a clear positive momentum in recent months, corporate sukuk issuance has remained dominated by a small number of large deals. The GCC saw a total of 12 corporate sukuk with a total value of USD5.6bn. This was up from a total of seven corporate issuances in 2010. Their total value reached USD4.3bn. In spite of the positive momentum, it is clear that the GCC market – as indeed its Malaysian counterpart – remains critically linked to sovereign and quasi-sovereign issuances. Most of these remain short-term paper sold for liquidity management purposes, above all by the Central Bank of Bahrain.

Key regional sukuk issues in the course of 2011

Country	Issuer	Date of Issuance	Sukuk Structure	Issue Size Million ($)	Margin	Tenor
Bahrain	Gulf International Bank	07-Dec-11	Murabaha	300	6 Months LIBOR +130 bps	3 Years
UAE	Abu Dhabi Islamic Bank (Tranche 3)	22-Nov-11	Musharaka	500	3.78%	5 Years
Bahrain	CBB International Sukuk III	16-Nov-11	Ijarah	750	6.273%	7 Years
UAE	ADCB Sukuk	16-Nov-11	Wakala-Modaraba	500	4.071%	5 Years
Saudi Arabia	SATROP	10-Sep-11	Musharaka	999.9	6 Months-SIBOR +95 bps	14 Years
UAE	Nakheel Sukuk 4	25-Aug-11	Ijarah	1,034.6	10 %	5 Years
Kuwait	Gulf Investment Corporation	03-Aug-11	Al-Wakala-Bel-Isthmar	241.4	4.9%	5 Years
Qatar	Almana Group Sukuk II	28-Jul-11	Wakala	215	3 Months LIBOR +450 bps	5 Years
UAE	FGB Sukuk (Tranche1)	21-Jul-11	Wakala	650	3.797%	5 Years
Saudi Arabia	SBG Sukuk Limited	16-Jul-11	Murabaha	266.7	2.5%	1 Year
Saudi Arabia	Sipchem Sukuk	18-Jun-11	Modaraba	480	3 Months SIBOR+1 75 bps	5 Years
UAE	HBME Sukuk	02-Jun-11	Wakala-Modarabah	500	3.575%	5 Years
UAE	Sharjah Islamic Bank	25-May-11	Wakala	400	4.715%	5 Years
Saudi Arabia	Islamic Development Bank	12-May-11	Al-Wakala-Bel-Isthmar	750	2.35%	5 Years
Bahrain	Central Bank of Barhain	07-Apr-11	Ijarah	530.5	5.5%	5 Years
Saudi Arabia	Bank Al Jazeera Sukuk	29-Mar-11	Modarabah-Murabaha	266.7	6 Months SIBOR +170 bps	10 Years

Kuwait	First Investment Company	20-Feb-11	Wakala	329.7	-
Kuwait	Gulf Investment Corporation	16-Feb-11	Al-Wakala-Bel-Isthmar	196.9	5.25%
UAE	Emaar Sukuk Limited	03-Feb-11	Ijarah	500	8.5%
Qatar	Qatar Central Bank	17-Jan-11	Ijarah	9,061.5	5%

Source: Zawya, media

Strong issuance activity ahead

There is little in the current market conditions to suggest that the recent strong momentum in sukuk issuance will slow down in the near term. The resilience of the market benefits from a greater uniformity of structures, more robust regulations and practices, as well as product innovation which has made it possible to issue sukuk in areas such as project finance. At the same time, the demand on the part of Shariah-compliant asset managers appears to be strong and also some conventional institutions are seeking diversification opportunities.

Saudi Arabia. Sukuk issuance in the Kingdom is likely to continue to be led by the strong corporate names. The Capital Market Authority has approved an issuance of up to SAR5bn by the Saudi Basic Industries Co. This would be the fourth for the company. Also Saudi Aramco-affiliated companies are understood to be exploring the market as Saudi Aramco has refinery and petrochemical projects worth USD26bn in the pipeline. SATORP may issue a second sukuk after the success of its maiden issue. Saudi Aramco and Dow Chemical Co are understood to be planning to tap the markets to fund a USD20bn refinery in Jubail. Aramco further plans to dispose of its 65% stake in an IPO planned for late 2013. Rabigh Refining & Petrochemicals Co., a joint venture between Aramco and Sumimoto Chemical Co., plans to sell additional shares but will also raise debt. Similarly, Sadara Chemical Company is planning a sukuk.

In an eagerly awaited development, plans for a sovereign – or at least quasi-sovereign sukuk are thought to be well advanced now that the Kingdom's public debt to GDP ratio has fallen clearly below the previously announced 10% target. Government officials have described infrastructure projects, notably the country's ambitious airport developments as a potential opportunity thanks to their revenue-generating potential. Saudi Arabia's General Authority for Civil Aviation is expected to issue a sukuk in the first quarter to help finance the SAR27bn (USD7.2bn) Jeddah airport. The first tranche worth some SAR4.5bn is due to take place in 1Q12 and is expected to be followed by two more tranches in the subsequently months.

Also other Saudi corporates are thought to be considering sukuk as an option for their investment plans. For instances, Almarai is planning to invest SAR4bn (USD1.1bn) in the poultry sector and has obtained approval for a sukuk.

The UAE. New issuance in the UAE is likely to be dominated by the government-related corporates and the financial sector, much as has been the case this year. Abu Dhabi National Energy Company TAQA in October revealed plans for a MYR3.5bn sukuk program in Malaysia.

Emirates NBD, which issued USD500mn in conventional private placements during 2011, in understood to be actively considering its maiden sukuk in the form of a USD500mn five-year issue. Also Emirates Islamic Bank is January hired managers for a possible sukuk sale. Al Hilal Bank is looking at a program of USD1-3bn and has appointed banks for a USD500mn sukuk which is likely to reach the markets in 1Q12. The property lender Tamweel, which is 57.33% owned by Dubai Islamic Bank, is understood to be planning a USD300-400mn issuance.

The property developer Nakheel hopes to issue the second tranche of its sukuk in the next six months. The AED1bn issuance would settle the remaining claims of the contractors. Also the mall developer Majid al Futtaim was planning to raise USD350-500mn in a five-year sukuk by the end of November, although the plan was delayed.

Malaysia. Malaysia is looking at a record-breaking year for sukuk with overall issuance of up to MYR60bn this year. Projek Lebuhraya Utara-Selatan Berhad, a subsidiary of the PLUS Expressways inter-urban expressway operator, is expected to launch a MYR34.35bn sukuk program this month. PLUS Expressways was listed in 2002 and is one of the largest toll expressway operators globally. The company is issuing MYR23.4bn (USD7.3bn) in maturities of up to 25 years. PLUS Bhd is taking over PLUS Expressways Bhd in the first Shariah leveraged buyout. PLUS was set up by the Employee Provident Fund and the government-owned UEM Group Bhd to acquire the highway assets of PLUS Expressways after their MYR23bn acquisition of the company.

The International Islamic Liquidity Management Co is expected to come to the market soon, having previously delayed due to market conditions.

Malaysia's stature in the sukuk market is likely to grow also in the area of arrangers. CIMB Group Holdings Bhd is planning to expand its presence in the Gulf as a sukuk arranger.CIMB was the leading sukuk arranger globally in 2011 with a 20% market share. Foreign sukuk issuance in Malaysia itself is expected to rise by 25-30% this year. Malaysia currently accounts for some 63% of the USD179bn global sukuk market.

Indonesia. The Government of Indonesia is planning to return to the markets in March following the successful sale of its USD1bn, seven-year issuance at 4% in November. This was less than half the rate of its 2009 debut issuance, which was a five-year note with a 8.8.% profit rate. S&P in April raised Indonesia's foreign currency rating to BB+ and the country is expected to reach investment grade possibly as early as this year. The Indonesian issue attracted subscriptions of

USD6.5bn. Middle East and Islamic funds took up 30% of the issue, Asians 32%, and Europeans 18%.

Turkey. Turkey last year made changes to its tax law so as to equalize the treatment of sukuk with conventional debt. One of the country's four participation banks, Kuveyt Türk, in October issued the country's first asset-backed sukuk, a five-year USD350mn issue at a profit rate of 5.875%. The issuance was significantly oversubscribed. However, Albaraka Türk in December decided to once again postpone a sukuk issue saying that investors were demanding excessive yields due to the global crisis in spite of strong interest in the issuance. The bank wishes to raise USD200mn. S&P rated BB-. Also Bank Asya has mandated banks to issue an international USD300mn sukuk but delayed going to the market awaiting better conditions.

Other. A growing number of global financial sector institutions have shown interest in tapping the vibrant sukuk market. HSBC issued a USD500mn sukuk in May while Crédit Agricole has signaled interest in issuing. A recently unveiled USD2bn *murabaha* sukuk program by Goldman Sachs has engendered considerable controversy for allegedly contravening Shariah principles. Goldman Sachs launched the program in October with the Irish Stock Exchange.

Sukuk are increasingly being considered as an alternative to syndicated loans. Standard & Poor's estimates that syndicated loans in Europe, the Middle East, and Africa fell 31% QoQ to USD184.4bn while global sukuk issuance rose by 38% to USD7.2bn. Sukuk are also emerging as an important new instrument for aircraft finance following Emirates' USD550mn debut issuance in June 2005. Malaysian Airline System Bhd, AirAsia X Sdn, and Emirates are all understood to be planning sukuk issuances. Malaysian is seeking funding for MYR12bn (USD3.8bn) of aircraft to be delivered by the end of 2014. AirAsia is planning to triple the size of its fleet with 60 new orders. Emirate placed a USD18bn order with Boeing in November.

Also the geographic scope of the global sukuk market looks likely to continue to growth. The Japanese parliament is considering a sovereign *sukuk al ijarah*, although a minimum 60% will likely have to be sold to Japanese investors. UK-based Solum Assert Management is planning to launch the first investment sukuk. The planned GBP200mn (USD310mn) Student Accommodation Investment Sukuk will use equity to provide investors with an annual yield of 4-6% with tranches of 5-7 years. A GBP200mn UK Social Housing Investment Sukuk is due to be launched in 4Q12, followed by a GBP500mn-1bn Global Islamic Liquidity Investment Sukuk in 1Q13.

Also Libya under its new government is planning a sukuk law. Iran is planning to sell sukuk to fund the South Pars development. In Africa, Nigeria and Senegal have fairly advanced plans. National Australia Bank and Citilink Finance Australia are similarly looking at sukuk.

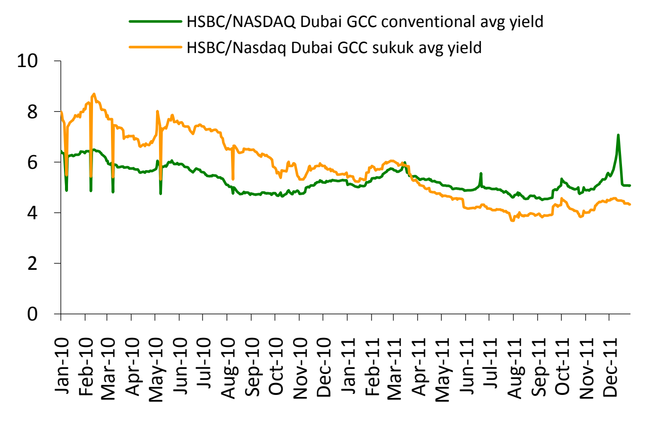
Secondary market lethargy

The regional secondary markets have stabilized significantly after the turbulence of the spring. Qatar, Saudi Arabia, and Abu Dhabi are generally recognized as the most stable markets. Even though credit default swaps and yields have declined across the region, markets such as Dubai and Bahrain remain more sensitive markets and tend to experience spikes during periods of market shocks, whether regional or international. In terms of asset classes, sukuk have continued to outperform conventional bonds and have been more stable in terms of their yields.

Dubai remains the most sensitive regional market, even if its resilience has increased markedly since Dubai World deal and the resumption of economic growth. Nonetheless, Dubai's main problem – a very high level of leverage – will require a long time to work through and will constitute a potentially major vulnerability in an uncertain economic environment. Dubai is deemed to have the highest credit risk in the Middle East after Egypt and Lebanon.

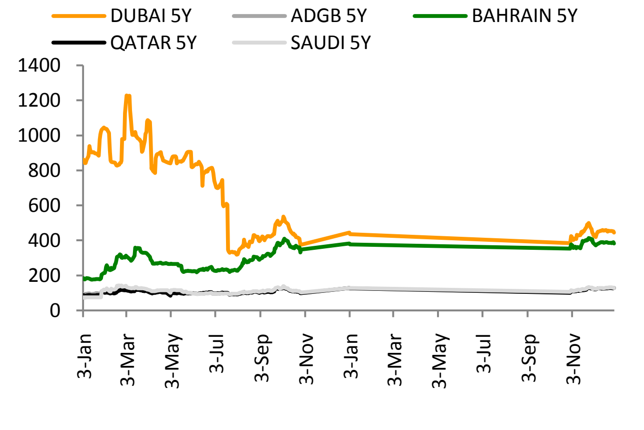
The Government of Dubai and related companies and organization are estimated to owe a total of up to USD129.3bn of which USD15.5bn is maturing this year. The Dubai authorities have repeatedly stressed their ability to service these debts without disruptions but tougher market conditions have repeatedly tested market confidence in these assertions. At the same time, the authorities have resumed their earlier program of fiscal consolidation with the Government of Dubai pledging to halve its 2012 budget deficit to AED1.8bn (USD0.5bn), or 0.6% of GDP, following a planned 4.2% cut in spending. Dana Gas caused market anxiety this month by failing to explain how it would repay its USD1.0bn sukuk due in October. Most of Dana Gas's output comes from Egypt and northern Iraq.

Average yields of sukuk and GCC conventional bond spreads



Source: HSBC/NASDAQ Dubai, Bloomberg

GCC Credit Default Swaps

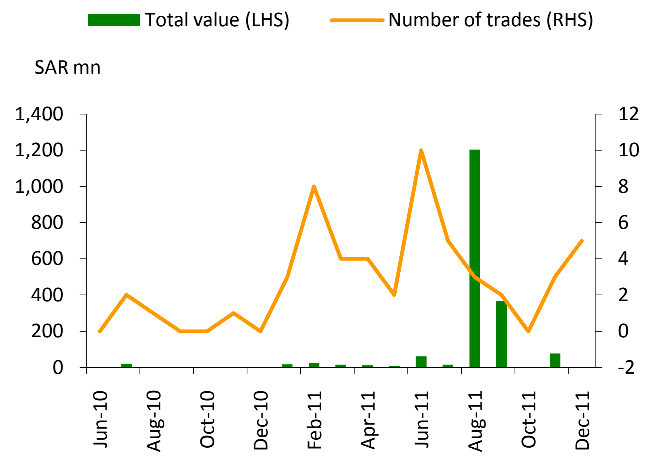


Source: Bloomberg

Secondary market trading on the organized platforms in the region has remained fairly modest. Tadawul's sukuk platform saw a total of only eight transactions during the quarter. Their total value reached SAR82.9mn. Activity on the Muscat market continued the pattern of recent months with considerable volatility.

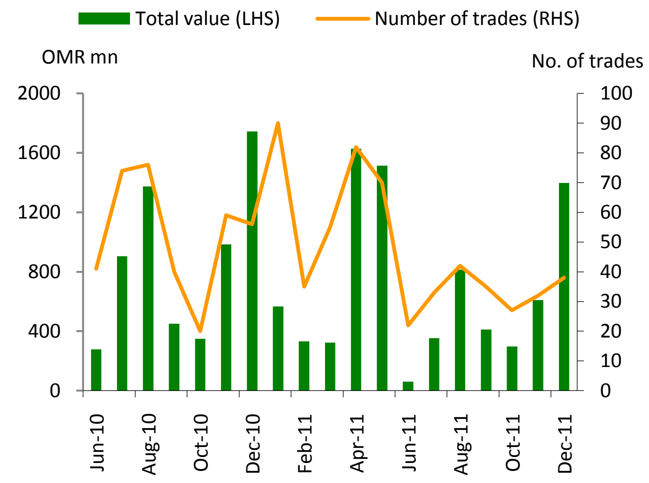
Qatar exchange in December listed the government's Treasury bills as the start of its secondary market for debt instruments.

Tadawul secondary sukuk market activity



Source: Tadawul

Muscat secondary bond market activity



Source: Muscat Securities Market

Alternative sources

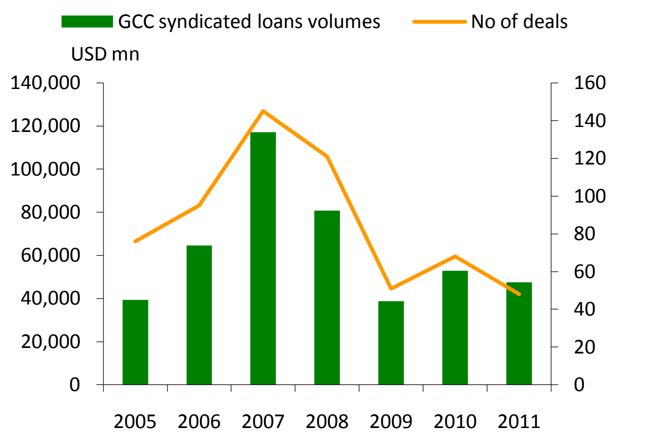
Loan syndications decline

2011 proved a challenging year for the regional syndicated loan market. The overall scale of the market contracted from USD 52.8 bn in 2010 to USD 47.0 bn, a 11% drop. This followed a significant slowdown in the deal flow in the second half of the year. The overall number of deals signed in 2011 was 32, down from 68 in 2010.

The number of deals shrank progressively during each quarter of the year. The overall number of deals in Q4 was eight, down on 10 in Q3 and as many as 30 in 1H2011. The aggregate value of deals nonetheless rebounded in the closing three months of the year, from USD5.1bn in Q3 to USD12.5bn in Q4. The final quarter saw four deals in the UAE, two in Saudi Arabia, and one each in Qatar and Oman. The single largest syndication was a USD6.73bn deal signed for the Barzan gas field with Exxon Mobil and Qatar Petroleum.

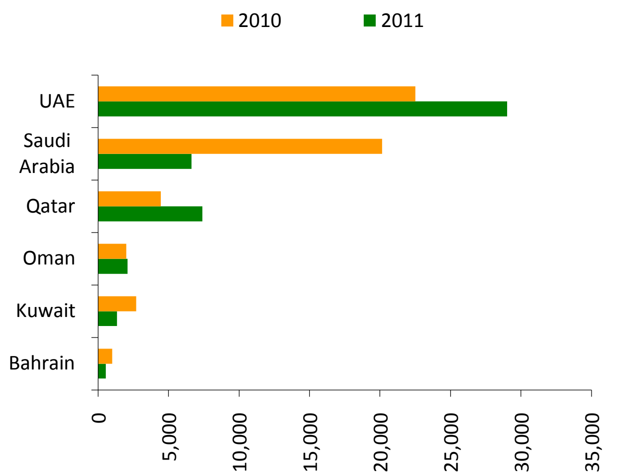
During the year as a whole, the UAE solidified its position as the largest regional syndication market, partly because of large refinancing deals. The total value of UAE syndications was USD 29.0 bn and it accounted for 61.7% of the regional total, up from 42.6% in 2010. Qatar was the largest regional syndication market last year, increasing its share from 8.4% in 2010 to 15.7% in 2011 – a total of USD 7.4 bn. The share of Saudi Arabia fell sharply from 38.1% to 14.1%, or a total of USD 6.6 bn.

GCC syndicated loan volumes



Source: Dealogic, Thomson Reuters, NCB estimates

Geographic breakdown of syndicated loans



Source: Dealogic, Thomson Reuters, NCB estimates

The syndication market has become significantly tougher due to the regulatory and market challenges faced by European banks, many of which have to varying degrees retreated from the region market. Some 50% of cross-border syndicated loans in the Middle East is estimated to have come from Europe in recent years. Especially French banks have retreated having previously played an important role in syndications. US banks typically remain reluctant to lend without prospects of fee-paying business which remains scarce. Although Asian banks are increasing their profile, this is a gradual process. Japanese lenders lack the necessary scale, while the Chinese tend to be still cautious. Local banks have been disadvantaged by their cost of Dollar funding but more expensive loans are now making them more competitive.

Private equity

The GCC private equity market remains depressed with only a handful of new deals, much in keeping with the experience of recent months and year. The region saw a total of half a dozen deals in Q4, although the value of only one of them was published, the USD130mn sale of the Eshraq Real Estate Co in the UAE in October. Given the lack of funding for M&A activity, no significant near-term pick-up in activity is seen as likely.

Recently reported GCC private equity deals

Date	Buy/Sell	Target company	Country	Sector	Industry	Size (USD mn)
Oct 2011	Sell	Eshraq Gulf Real Estate Holding Company	UAE	Real Estate	Landlords and Development	130
Oct 2011	Sell	Depa Limited	UAE	Construction	Specialty Contractors	-
2011	Buy	Kids First Group	UAE	education	-	-
2011	Sell	Ithmaar Bank	Bahrain	Financial Services	Islamic	-
2011	Buy	Alamar Foods	Saudi Arabia	Food & Beverages	Fast Food and Quick Services	-
2011	Sell	Thuraya Telecommunication Company	UAE	Telecommunications	Other Wireless Telecommunication Services	-

Source: Zawya, media

Government spending the key alternative

In spite of a strong revival in economic activity in much of the GCC region, the role of public sector investment in driving economic activity and access to capital remains pivotal. Recent government budgets, with the exception some renewed signs of relative consolidation in the UAE, suggest that government spending with remain critical also in the year ahead.

In Saudi Arabia, government spending in 2011 reached a total of SAR804bn, which was a hefty 38.6% above the original budget plan. Capital expenditures rose by 13.2% to SAR225bn. These trends look likely continue into 2012 with total projected government spending of SAR780bn, significantly ahead of the official budget target of SAR690bn. Capital spending is set to reach SAR265bn according to the budget. The government has sought to stimulate access to capital by allocating additional funds to the special credit institutions. These are projected to receive SAR86.1bn in 2012, a remarkable 85.3% increase on 2011.

Oman's 2012 budget foresees total expenditure of OMR10bn, an OMR800mn increase over the revised expenditure in 2011, a figure that was OMR1.9bn above the original budget plan. Investment expenditures are set to reach OMR2.7bn, of which OMR1.4bn are devoted to development projects and OMR1.3bn for the oil and gas sector.

Appendix

Sources of funding

Bank credit (USD bn):	**2009**	**2010**	**Nov-11**
- Saudi Arabia	196.5	206.8	237.7
- UAE*	261.2	264.9	271.8
- Kuwait	96.3	96.6	98.6
- Qatar	69.2	80.7	101.3
- Bahrain	15.7	15.1	17.1
- Oman**	25.1	27.4	30.7
IPO (USD bn):	**2010**	**1H2011**	**2H2011**
Saudi Arabia	1.02	0.093	0.212
UAE	0	0.253	0
Kuwait	0	0	0
Qatar	0.1	0	0
Bahrain	0.4	0	0
Oman	0.5	0	0.064
Bonds and sukuk (USD bn):	**2010**	**1H2011**	**2H2011**
Saudi Arabia	6.6	0.8	1.75
UAE	13.8	4.3	9.15
Kuwait	6.8	0	0.46
Qatar	10.2	0	5.22
Bahrain	5.3	0.7	1.64
Oman	0.8	0	0.415
Foreign direct investment inward (USD bn):	**2008**	**2009**	**2010**
Saudi Arabia	38.2	32.1	28.1
UAE	13.7	4	3.9
Kuwait	-0.1	1.1	0.81
Qatar	3.8	8.1	5.5
Bahrain	1.8	0.3	0.2
Oman	2.5	1.5	2
Private equity investments (USD mn):	**2010**	**2Q2011**	**3Q2011**
Saudi Arabia	154.4	0	0
UAE	128	0	336
Bahrain	25	0	0

Source: Bloomberg, Zawya, regional central banks
* Till September 2011 **Till October 2011

Key sukuk and conventional bonds issuance and IPO in 3Q2011

Issuer	Issue date	Tenor	Amount issued (USD mn)
Sovereign sukuk issuance			
Central Bank of Bahrain	26-Dec-11	91 Days	47.7
Central Bank of Bahrain	20-Dec-11	182 Days	26.5
Central Bank of Bahrain	28-Nov-11	91 Days	47.4
Central Bank of Bahrain	15-Nov-11	182 Days	53.1
Central Bank of Bahrain	24-Oc-11	91 Days	47.7
Central Bank of Bahrain	19-Oct-11	182 Days	53.1
Corporate sukuk issuance			
Gulf International Bank	7-Dec-11	3 Years	300
Abu Dhabi Islamic Bank	22-Nov-11	5 Years	500
Abu Dhabi Islamic Bank	16-Nov-11	5 Years	500
CBB International Sukuk Company	16-Nov-11	7 Years	750
SATROP	9-Oct-11	14 Years	999.9
Sovereign bond issuance	**Issue date**	**Maturity**	
State of Qatar	11/29/2011	1/20/2042	1000
State of Qatar	11/29/2011	1/20/2022	2000
State of Qatar	11/29/2011	1/20/2017	2000
Mubadala Development Company	11/15/2011	11/29/2018	108.316
Central Bank of Oman	7-Dec-11	5 Years	389.6
Corporate bond issuance			
Commercial Facilities Co.	12/14/2011	12/14/2015	180.148
HSBC Bank Middle East Ltd	12/14/2011	1/17/2017	85
Abu Dhabi National Energy Company	12/5/2011	3/13/2017	750
Abu Dhabi National Energy Company	12/5/2011	12/13/2021	750
Bank of Bahrain and Kuwait	11/30/2011	6/2/2018	129.86
Kuwait Financial Centre	19-Dec-11	5 Years	43.7
Union National Bank	11/2/2011	11/10/2016	400
IPIC	10/28/2011	3/1/2017	1500
IPIC	10/27/2011	11/1/2041	750
IPIC	10/27/2011	3/1/2022	1500
IPIC	10/27/2011	11/14/2014	42.5088
HSBC Bank Middle East Ltd	10/26/2011	11/14/2016	100

Emirates NBD	24-Oct-11	2 Years	193
Al Omaniya Financial Services	Oct-11	5 Years	26
IPO	**Subscription Period**		
Saudi Enaya Insurance Company	19-Dec-11	25-Dec-11	42.66
SMN Power Holding	11-Sep-11	10-Oct-11	63.88
United Electronic Company eXtra	5-Dec-11	11-Dec-11	105.59

Source: Bloomberg and Zawya