



DUBAI

Smart money begins to move in

Legendary investor Mark Mobius is buying Dubai, and so are long-term players. The local market at these levels gives an opportunity to buy, most long-term players say. **Utpal Bhattacharya** argues that investors should look beyond Nakheel and continue to buy into the Dubai dream.

People are fickle, said legendary emerging market investor Mark Mobius, executive chairman of Templeton Asset Management.

Mobius was answering questions on the prospects of a recovery of confidence among international lenders to Dubai, and he was indicating that one good piece

of news can change everything. The emerging market investment guru not only surprised journalists by telling them the recovery of confidence among lenders could be quick, but also put all his weight behind Dubai, saying that the emirate would continue to lead the region in terms of transparency and governance and in

the area of financial services, where it has a first-mover advantage.

Like any another far-sighted investor, Mobius seemed quite pleased that Templeton was investing in Dubai stocks when the announcement came through that Dubai World was asking all of its creditors and those of its large-scale



developer Nakheel to stand still and extend debt maturities for six months until May 2010 for the purpose of debt restructuring.

A US\$3.5 billion Nakheel bond was due in December, and the announcement of extending debt maturities took the market by storm, taking the Dubai credit default swap (CDS) rates much beyond 600 points. However, once news came through of Abu Dhabi's support of US\$10 billion and the Dubai government's assurances of payment, the CDS rates dropped sharply below 500 points and continued to head south.

"We were buying the Dubai market during the crisis because we felt that there were great opportunities, which do not come often. We have been investing in property, diversified companies like ports and financial services," Mobius disclosed to journalists.

What's the problem then?

However, despite the opportunity that Mobius spoke of, there are short- to medium-term worries about the excesses that some of the Dubai entities like Nakheel got into. Mobius said: "Negative news will be there, like the concerns of

the debt ratings from rating agencies, who mostly provide a rear-view mirror picture." Beyond that, Dubai will have to address the leverage concerns of a number of entities in the emirate before continuing on with its ambitious projects.

Before proceeding any further, it is important to distinguish between independent commercial enterprises like Dubai World and the Dubai government, so as to put the debt story of the emirate into perspective. While the Dubai government generally does not guarantee debts issued by various entities under Dubai World and Dubai Holding, the sovereign guarantee is available for some selected loans issued by entities under Investment Corporation of Dubai (ICD), and obviously for the bonds issued directly by the Dubai government. Sandeep Raghuwanshi, vice president of Millennium Finance Corporation, says that these guarantees are comfortably spread out in maturity and adequately covered by the cash flows of the Dubai government¹.

Raghuwanshi also argues that while Dubai World, which is a state-backed holding company but an independent commercial enterprise, is indeed seeking to reschedule US\$22 billion of debt, this is not by any means a sovereign default of Dubai, as misconstrued by a section of international media.

However, as we go to print, there is a lot of speculation going on as to what debt is likely to be restructured and what, if any, assets will be sold. Of course, there will be much more clarity in the weeks ahead, but it looks likely that Dubai World will try to ring fence some of its good assets from the bad assets while it negotiates with the creditors on debt restructuring, including possibilities of a haircut, rolling or seeking an extension of payments.

The investment vehicles

Dubai, which has risen from being an extremely successful trading entrepot in the last century to becoming a modern tourism destination, as well as a hub for regional financial and service sectors, invested heavily in the new millennium to achieve its goals. Investments were made through a plethora of companies, but mainly through three holding companies: Dubai Holding, ICD and Dubai World.

The Jumeirah Group, TECOM Investments, Dubai Group, Dubai Properties Group, Tatweer, Sama Dubai, Dubai International Capital and others are under the umbrella of Dubai Holding. Some of the companies under the ICD umbrella are Dubai Aerospace, DEWA, Borse Dubai, a few other investments and partial ownership of Emaar. The Dubai World companies include Nakheel, Limitless, Istithmar, DP World, Dubai Dry Docks, Jebel Ali Free Zone, P&O Ferries and others.

Out of the above groups, only selected ICD entities have government guarantee. All others are mostly companies backed by the government, but not guaranteed.



Mark Mobius

Nakheel's trust certificates that matured last month were guaranteed by Dubai World, which is backed by the Dubai government. In other words, the sukuk did not have a Dubai government guarantee. The prospectus of the Nakheel's sukuk clearly says: "Investors should note, however, that the government of Dubai does not guarantee any indebtedness or any other liability of Dubai World." It also goes further to explicitly highlight risk for international investors. It reads: "Until the ports operating businesses currently owned by Ports, Customs and Free Zone Corporation (PCFC) are consolidated within

Dubai World, the majority of the assets of Dubai World are located within the UAE. As a result of the majority of the assets of Dubai World being located in the UAE, there may be insufficient assets of Dubai World located outside the UAE to satisfy in whole or part any judgment obtained from an English court relating to amounts owing in connection with the certificates."

Moreover, while Dubai World is guarantor, the Islamic sukuk has limited recourse to the underlying trust assets only and not a bond or a debt obligation of issuer. This is stated in very easy-to-understand language of the Limited Recourse paragraph, which says: "The certificates are not debt obligations of the issuer. In particular, the certificates do not represent bonds or notes issued by the issuer. The certificates attached represent entitlements solely to the trust assets."

Gross domestic product at basic current and constant prices - Emirate of Dubai* 2006 - 2008

Economic activity	Value in million AED											
	Growth rate			GDP 2008			GDP 2007			GDP 2006		
	Current prices 2007-2008	Current prices 2006-2007	Constant prices 2006-2007	Percentage contribution %	Current prices	Percentage contribution %	Constant prices	Percentage contribution %	Current prices	Percentage contribution %	Current prices	
Non-financial corporations sector	14.8%	19.2%	9.9%	92.81	279,899	92.18	224,906	92.32	243,882	91.61	204,600	
Agriculture, Live stock and Fishing	5.8%	5.1%	-2.5%	0.41	1,234	0.44	1,082	0.44	1,167	0.50	1,110	
Mining and Quarrying	6.2%	-16.0%	-24.0%	2.11	6,370	2.22	5,425	2.27	5,999	3.20	7,139	
Manufacturing	10.9%	10.2%	5.8%	14.12	42,582	15.12	36,880	14.54	38,400	15.61	34,855	
Electricity, Gas & Water	19.3%	-11.8%	14.0%	0.85	2,557	1.14	2,771	0.81	2,144	1.09	2,431	
Construction	20.4%	33.5%	16.2%	9.66	29,130	8.63	21,058	9.16	24,186	8.11	18,118	
Wholesale, Retail trade and Repairing services	18.1%	27.4%	14.8%	38.56	116,310	36.37	88,735	37.28	98,492	34.61	77,301	
Restaurants and Hotels	6.7%	9.1%	2.9%	2.50	7,532	2.73	6,657	2.67	7,056	2.90	6,468	
Transports, Storage and Communication	9.5%	16.5%	15.1%	8.44	25,445	9.41	22,948	8.80	23,234	8.93	19,937	
Real Estate and Business services	13.2%	15.6%	5.2%	14.73	44,419	14.64	35,721	14.85	39,228	15.20	33,944	
Social and Personal services	8.6%	20.6%	10.1%	1.43	4,319	1.49	3,629	1.51	3,976	1.48	3,297	
Financial Corporations sector	10.2%	8.8%	6.4%	8.25	24,879	9.05	22,070	8.54	22,571	9.29	20,743	
Government Services sector	2.9%	14.5%	8.3%	2.75	8,297	3.13	7,625	3.05	8,061	3.15	7,041	
Domestic services of households	-2.6%	9.9%	9.9%	0.41	1,249	0.53	1,283	0.49	1,282	0.52	1,167	
Less : Imputed Bank service	9.5%	13.9%	16.4%	(4.22)	(12,728)	(4.87)	(11,886)	(4.40)	(11,622)	(4.57)	(10,207)	
Gross domestic product	14.2%	18.3%	9.2%	100.00	301,596	100.00	243,998	100.00	264,174	100.00	223,344	

* Preliminary estimation. Source: Dubai Statistics Centre

The trust assets are a piece of land at the Dubai waterfront and recovering that asset by the lenders could also mean a very complex and lengthy legal process.

The issues relating to the Nakheel sukuk do create precedence in Dubai. However, with the assurance of payment now, investors can look forward to being paid. Still, it is very likely that lenders will be faced with some sort of haircut, depending on negotiations that are ongoing as we go to print.

There is still speculation about what will happen to debts given to entities other than Dubai World in Dubai. The concerns remain in the short term, but Dubai is expected to keep pushing for more transparency and better governance of companies in the future. The creation of insolvency laws on the Dubai International Financial Centre last month to handle any disputes with regard to the Dubai World debt is one such move, while another very important step taken was to create more accountability and transparency among government entities when it came to investing government monies in projects.

The big picture

While the Nakheel sukuk did provide a lot of gunpowder for headline news in the media late November and December last year, most writers did not question the risk management tools and techniques of lenders that lent to enterprises in Dubai like the one in question. Suffice to say, it is not uncommon to see enterprises go belly up because they bite off more than they can chew, especially during a downturn when liquidity becomes scarce. It is also not uncommon for lenders to get excited and lend much more than they should in boom times, when logic actually dictates lending to remain in the market. In fact, many banks have closed in the US and other parts of the world following the global downturn, and there are talks of consolidation of the industry in the region and in the UAE.

But what does all of this mean in the longer term for investors in Dubai? Probably not much, as these events do not alter the big picture



Abdul Majeed Al Fahim

or take away the vision or the infrastructure that the emirate has built.

Abdul Majeed Al Fahim, chairman of Pearl Dubai FZ LLC, a large property development project in Dubai, wonders why people fail to see that nothing can take away what Dubai has already created for itself.

"Dubai offers sophisticated services and great infrastructure. I would bet my chips on Dubai. In fact, what debt is the world talking about? Look at the fundamentals of the country. We have a large current account surplus and all debts can be paid off in three years if the oil price remains at the US\$70 per barrel level," he argues.

Al Fahim, who hails from Abu Dhabi, urges the world to look at the UAE as a country. He says the various emirates in the UAE are fiercely competitive, as in any other federation globally. And investors have to analyse their investments in Dubai from that perspective, he adds.

Al Fahim also says that Dubai's core was built around Jebel Ali and trading. Now that the whole infrastructure has developed around it, the emirate is poised for reaping the dividends. The global unwinding and rebalancing of assets will impact economies like Dubai in the short term, but once these difficult times are past and everything is adjusted to the new environment, there is nothing to deter the big picture and the ambition of the emirate's leadership, according to him.

The inherent strengths

The UAE as a federation has certain fundamentals that are unmatched in the region. While the underlying oil assets of Abu Dhabi give the country a strong platform, combined with Dubai's commercial expertise and a tolerant, cosmopolitan society, investing in the UAE becomes compelling for investors looking for regional assets.



Sandeep Raghuvanshi

"Unlike many other cities in the Middle East, Dubai has shown its willingness to accept expert advice from outside and it has been willing to put expatriates in positions of responsibility. And it has already become an international city in that sense," emphasises Mobius.

Al Fahim agrees, adding that the country has 204 nationalities working and living together.

In fact, many of Dubai's success stories have sustainable competitive advantages, and the fundamentals are largely unrelated to the construction and real estate sector.

According to Raghuvanshi, there are three areas where Dubai has sustainable global and regional leadership: Emirates Group, the Jebel Ali Free Zone and DP World and the financial and service hub for the region.

In fact, the well-known Emirates airline is only one division of a complete aviation business model comprising world-class airports, aircraft leasing and aviation-related services, duty free zones, cargo zones and a successful cargo airline, etc. Success of each piece rests on others and together they bring a formidable competitive advantage.

Raghuvanshi says that the success of Emirates is based less on the origin and destination traffic to and from Dubai and more on transfer passenger traffic as a global airline of choice for long-distance travel. It is against this backdrop that its strengths must be analysed. It is, arguably, the only major airline of global reach that can connect any two major cities on our planet with only one stop. This advantage comes from the fact that Dubai is located almost in the centre of the world, and from Japan to Brazil, no major agglomeration is further than 8000 nautical miles or one single flight away from Dubai, he adds.

Raghuvanshi also points out that the lack of strong competitors in Dubai's populous immediate neighbourhood of South Asia and the Middle East, as well as a dearth of potent flag carriers altogether

in geographies like Africa, makes Emirates the carrier of choice for the long-haul travellers of the entire region. Emirates also benefits from a low-cost home airport base, a young fleet and no legacy costs, while the final cherry comes from the excellent service, both on the ground and in the air.

Another similar success story that has little to do with the real estate construction industry is the cargo logistics infrastructure and services provided by the Jebel Ali Free Zone and DP World combined. Jebel Ali is one of the world's largest free zones situated next to one of the world's largest seaports and the upcoming world's largest cargo airport. This is a unique and formidable combination situated in the heart of the rapidly growing economies of South Asia, the Middle East and Africa, together comprising over two billion people.

Raghuwanshi argues that DP World's business is not just dependent on Dubai. It is one of the world's leading port operators managing almost 50 terminals spread across 31 countries, all the way from Australia to Argentina in the southern hemisphere and South Korea to Canada in the northern hemisphere. Part of its strength comes from the rapidly-growing economies of Asia, where the impact of the current financial crisis was very limited and industrial production levels are already higher than pre-crisis levels. For example, almost 40 per cent of India's container traffic is managed by DP World.

More recently, over the past decade or so, Dubai has invested time, money and effort to emerge as a financial and services hub for the region. Several factors play into the competitiveness of centres including business environment, market access, infrastructure and governance. According to the City of London's rankings, Dubai ranked 23rd globally as the most attractive financial hub in 2009, far ahead of any other GCC city (the next being 43rd). Given the nature of the financial industry, this lead might not be as sustainable as in other sectors, but Dubai does have inherent strengths and a first-mover advantage in several areas.

Notes Raghuwanshi: "First and foremost, Dubai is a truly global city – arguably more global than most international cities. It is uniquely tolerant and cosmopolitan, with almost every nationality represented. This, coupled with state-of-the-art infrastructure and very efficient public services, make it a city of choice for international professionals. On top of this, it has existing free-trade agreements with most of the developed and booming economies and a tax-free code. While some or all of these might be replicable, it may take several years to do so."

Mobius adds that although two financial centres can co-exist side by side, like Hong Kong and Singapore, more activity will be assured only in the freer city and in this case the former. He expects Dubai to play the same role as Hong Kong, given its cosmopolitan makeup, growing transparency and free exchange of ideas.

Raghuwanshi agrees, adding: "Post World War II, London emerged as a finance and services hub in Europe, largely on the back of its strategic location and its pre-war strengths. Later on, Frankfurt and Paris made strong efforts to replace London as the hub,

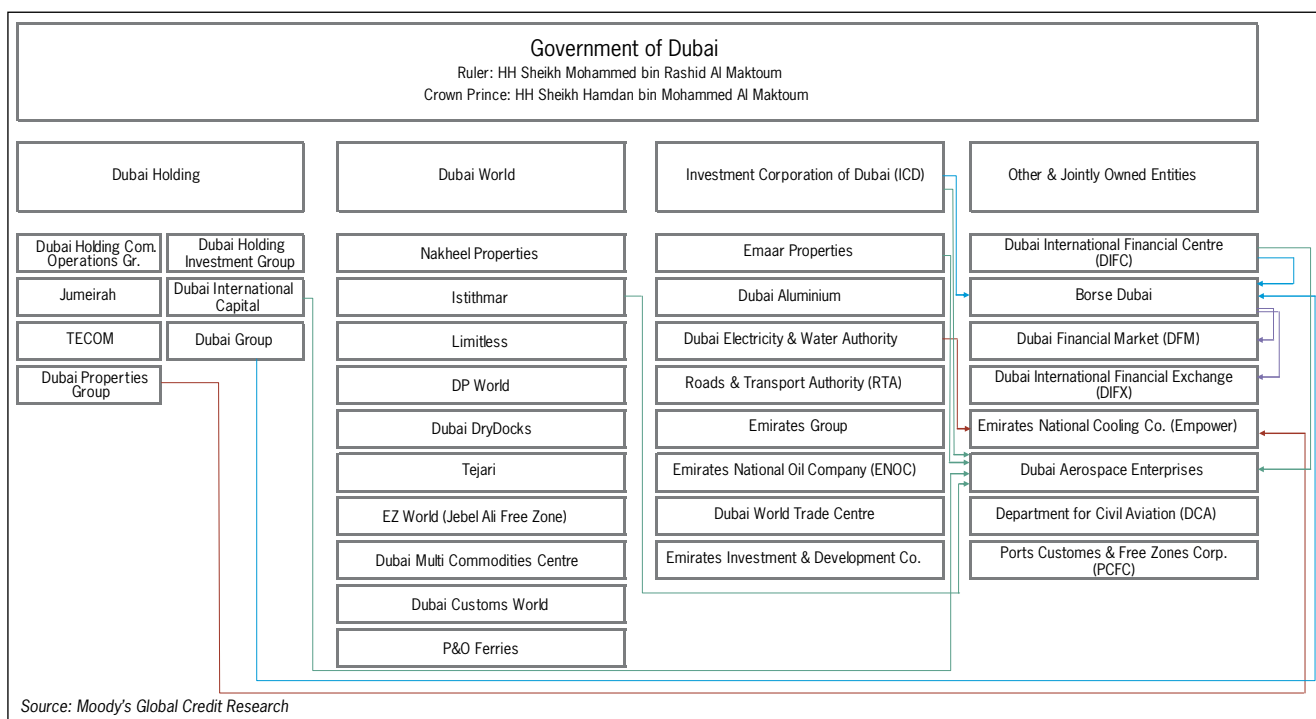
and at one point seemed to close the gap rather quickly. But in the long run, London not only managed to retain its leadership position, but even emerged much stronger."

The way forward

Dubai would never have had any problems of servicing its debt if it had taken long-term debt. And lenders would have happily lent long term, according to Al Fahim. It is also important to understand that major economies in the world were built on long-term debt, like the British funded the railways in the US with long-term debt, points out Mobius. And that's why a dynamic bond market would be very important for Dubai in the years to come, as the emirate will continue to build.

One of the other important areas to note is the over-concentration of the GDP in the real estate and construction sector, as Dubai had more than a quarter of its GDP coming from real estate and construction in the recent past. This will have its negative impact in the medium term, as the market will be hit by a supply glut, thus keeping the sector subdued until recovery happens beyond





2010. But on the other hand, Dubai's positioning as a healthcare destination, a media hub, home to technology companies, a centre of education and financial services and so on will continue to help the emirate diversify its economy from real estate in the months ahead.

But that does not mean that real estate is no longer a lucrative asset class in Dubai. Investors from the region have already started to move into Dubai's property market with a longer-term view. Besides, with an over US\$2 trillion-dollar surplus in China and with that country

already invested up to its ears in US Treasury and commodities, some of that liquidity could come into Dubai. Real estate is a very good asset, Mobius points out.

In the immediate future, however, it will be important for the government of Dubai to remain focused in ensuring that the debt crisis is contained within the four walls of Dubai World. In the medium to long term, the picture does not change much, as there is no shift in the long-term goals of Dubai. It is also expected that energy prices will remain strong with continued growth in the Asian economies, and this will also ensure strong liquidity flows into the region. Dubai is part of the region and will benefit from the high price of oil indirectly.

"We must remember that Dubai does not directly benefit from the liquidity coming from the energy market, as the emirate does not have much oil or gas. Hence, Dubai's focus would remain on developing an economy similar to that of Singapore or Hong Kong that leverages on all the growth happening around it and act as a gateway to the region," notes Raghuwanshi.



Footnotes

1 The viewpoints of Sandeep Raghuwanshi in this article are his own and not those of Millennium Finance Corporation.